2014 HFMA Spring Institute
Thinking Beyond the Practice Acquisition

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Agenda

This presentation addresses key considerations in achieving a successful acquisition and transitioning to a sustainable model for the physician enterprise.

- Framing the Situation
- Essential Elements
- Integrating the Physician Practice
- Key Takeaways
Key Learning Objectives

• Understand the essential elements of a successful physician practice acquisition.
• Gain an appreciation for the importance of non-transactional aspects of integrating the physician practice.
• Understand the range of physician governance and management structures in employed/integrated physician practices.
Framing the Situation
## Framing the Situation

### Healthcare Market Trends

*The healthcare market is being influenced by a number of factors.*

<table>
<thead>
<tr>
<th>Factor</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Delivery and Payment Reform</td>
<td>Healthcare reform will require organizations to redesign how they provide clinical care.</td>
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<tr>
<td>Economic Pressures</td>
<td>Recent economic challenges have restricted healthcare spending as federal and state budgets are strained and unemployment remains high.</td>
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<tr>
<td>Insurance Exchanges</td>
<td>The expansion of insurance coverage will likely lead to increased patient volume across many specialties, primary care in particular.</td>
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<tr>
<td>Move to Integration</td>
<td>In response to healthcare reform, many provider organizations are seeking to establish integrated delivery networks in order to provide more efficient and cost-effective care.</td>
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<tr>
<td>Primary Care Delivery Model</td>
<td>The transition to value-based delivery will place a premium on developing alternative delivery models (e.g., PCMH) for primary care services.</td>
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<tr>
<td>Physician Recruitment</td>
<td>Physician shortages are creating increased competition for the most sought-after specialties.</td>
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<tr>
<td>Payor Innovation</td>
<td>Health plans are implementing products that shift financial risk and/or reward providers that can demonstrate better cost and performance.</td>
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Framing the Situation
Consolidation and Organization of Physicians Is Old News

The increase in health system-employed physicians is significant, as physicians are seeking to join larger, more leveraged organizations.

- From 1965 to 1998, the number of physicians in groups grew from 28,000 to 207,000 (three times the growth of the physician population).
- From 1998 to 2008, the number of physicians in groups grew to 600,000.
- Younger physicians are more interested in joining medical groups because of the stability, access to capital, and competitive advantage.
- Medical groups, whether independent or hospital-affiliated, are investing in the systems required for performance accountability, which is beginning to be linked to reimbursement.
Framing the Situation
Forces Driving Affiliation

While acquisitions may be either defensive (preserve what you have) or offensive (get more of what you want), today there are five common themes to a health system’s rationale for alignment.

**Community Need**
Employing physicians can be the most effective way to attract providers and thereby meet patient access needs.

**Market Share**
Maintaining/protecting market share often leads to employing physicians who may otherwise close their practices, become employed by a competing organization, or ultimately leave the community.

**Service Expansion**
Expanding the scope of services within the community is often achieved by employing physicians with specialty expertise not readily available in the market.

**Population Management**
Employing physicians is often the most direct way to build a value-based delivery network in fragmented markets.

**Care Integration**
Employing physicians can be viewed as the preferred option to align physicians with the hospital’s interests to reduce care variation to improve quality and reduce costs.
Framing the Situation

The Goal of Physician Employment

Healthcare providers’ success in the future will be measured on the ability to drive quality and service in an efficient manner.

- Focus on operating spending.
- Expectations of lower reimbursements.
- Pressure to create efficiencies.
- Higher expectations from consumers.
- Incentive for innovation through pilot initiatives.
- Pressure to meet community needs,
- Recruitment and retention of skilled healthcare professionals, all while keeping costs down.

The Institute for Healthcare Improvement (IHI) Triple Aim provides a framework to accomplish healthcare reform’s key objectives.
Framing the Situation

Physician Network Evolution

As physician networks evolve over time, the ability to manage populations should become a larger focus of development.

Four Phases of Physician Network Evolution

- Phase I – Recruitment
- Phase II – Growth
- Phase III – Service Expansion
- Phase IV – Value-Based Network

Without a cohesive and proactive physician employment strategy, organizations are far less likely to evolve into a mature network and may squander a valuable strategic asset.
Essential Elements
Essential Elements
Start With the Planning Process

Ideally, acquisition planning involves a balance between the mechanics of getting the deal done and the equally important discussions of how the integrated entity will function post-acquisition.

Transactional Elements
(The Deal)
- Financial analysis.
- Valuation.
- Compensation.
- Due diligence.
- Document preparation.
- Legal transaction.
- Lease/contract assignment.
- “Day 1” operational considerations.

Non-Transactional Elements
(The Relationship)
- Vision.
- Decision making.
- Management.
- Communication.
- Culture.
- Expectations.
- Governance.
- Medical staff relationships.
- Joint strategic planning.

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Essential Elements
Strategic Considerations for Acquisitions

The acquisition opportunity should be critically examined from a variety of perspectives, both in terms of “fit” and long-term benefit to the organization.

Clinical Services
- Service offering.
- Clinical coverage.

Competitive Advantage
- Competition.
- Geography.
- Unique benefit.

Feasibility
- Timeline.
- Alternatives.

Healthcare Reform
- Clinical integration.
- Cost containment.
- Payment reform.

Cultural Fit
- Political impact.
- Reputation.
- Practice patterns.

The acquisition opportunity should be critically examined from a variety of perspectives, both in terms of “fit” and long-term benefit to the organization.
Health systems should carefully assess the direct and indirect financial impact of the group. In short, will this be a sustainable business relationship?

**Group Operations**
- Financial performance.
- Financial improvement opportunity.

**Long-Term Impact**
- Risk.
- Investment required.
- Expansion opportunity.

**Contribution to System**
- Care strategies.
- Downstream impact.
- Value-based contracts.

**Essential Elements**

**Financial Considerations for Acquisitions**

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In reality, the acquisition process is not linear, and the lines between components are often blurred.

Essential Elements
Getting From “Here” to “There”

With a rigorous assessment of the strategic and financial opportunities complete, the acquisition process begins in earnest.

Typical Acquisition Process

Component I
- Partnership Planning
  - Develop and agree upon strategic direction.
  - Select affiliation partner.
  - Assemble transaction team.

Component II
- Transaction Development
  - Execute nondisclosure/exclusivity agreements.
  - Develop and exchange preliminary data requests.
  - Negotiate key terms, including deal structure, legal/ownership structure, governance, physician employment terms, etc.
  - Prepare term sheet.

Component III
- Transaction Execution and Due Diligence
  - Conduct detailed due diligence.
  - Negotiate and finalize definitive agreements.
  - Secure stakeholder approvals.

Component IV
- Integration
  - Assemble resources/work groups to execute integration.
  - Develop integration blueprints.
  - Execute integration plans to conduct business as a combined entity.

In reality, the acquisition process is not linear, and the lines between components are often blurred.
Essential Elements
Drafting the Right Players

Based on your defined purpose and objectives for acquiring practices, it is important to assess the cultural and behavioral fit of the physicians and practice.

Poor Cultural Fit

Positive Cultural Fit

Having a cohesive, aligned partner is vital to the long-term success of the physician acquisition.
Essential Elements
Maximizing Reward and Mitigating Risk

Organizations considering a practice acquisition need to demonstrate discipline, focus, and an integrated capability to execute across the deal life cycle – the underlying goal should be to minimize the organization’s risk in this process.
Essential Elements

Assemble Transaction Teams and Planning Committee

It is generally advisable for the parties to assemble a single committee with representatives from each organization to guide the planning process.

Transaction Team (Group)
- Five or Six Committee Members Per Group
  - Lead Physicians (two or three)
  - Business/Tax Advisers
  - Legal Counsel

Transaction Team (Hospital)

Planning Committee
- Planning committee includes individuals who are empowered to lead the discussions and represent their organization.
- Members of the committee report back to their respective constituencies at critical stages in the process.
- Membership can vary but often includes a mix of lead physicians, hospital leadership, and external advisers.
Essential Elements

Execute Nondisclosure/Exclusivity Agreements

Nondisclosure/exclusivity agreements between the two parties are crucial, even if the parties have a strong, long-standing professional relationship.

Benefits

- Ensure information is kept confidential.
- Limit the use of information to merger negotiations only.
- Prohibit the group from discussing partnership offers with another organization for a period of time (typically for the duration of negotiations).
  - This is particularly relevant if the parties expect to expend significant resources during their negotiations.
Essential Elements

Exchange Preliminary Data

With confidentiality agreements in place, the parties begin exchanging information in order to build a thorough fact base regarding the other party.

Data Exchanged

• Overview of medical group.
• Strategic plan.
• Organizational structure.
• Physician and employee roster.
• Compensation and benefits plan description (physicians and staff).
• Services offered.
• Market area served.
• Facilities and major equipment.
• Historical financial information, including operating statistics.

Purpose

• Identify the topics/areas that will require the most time, resources, analysis, etc., to negotiate.
• Determine whether there are any immediate issues that would prevent the parties from combining operations.

This initial data exchange is still part of the orientation process. A more comprehensive review of each party’s operational performance is conducted during the due diligence phase.
Essential Elements

Negotiate Key Deal Terms

Assuming there are no immediate barriers that would prohibit the acquisition from occurring, the parties will seek to reach consensus on the major terms of the partnership.

Common Questions Addressed During Negotiations

• What assets will be acquired, for how much, and on what terms?
• How will the physician organization be governed?
• What will be the organizational/management structure for the physician organization?
• Will practice locations be consolidated?
• How will physicians be paid?
• What about retirement and benefits plans?
• How will malpractice insurance coverage be handled?
• What happens if a physician becomes disabled, wants to retire, or wants to leave?

For most questions, there is no predetermined “right answer,” provided the deal terms support the underlying goals/objectives of the partnership.
The negotiation process itself is iterative rather than linear, because the terms of the transaction are closely interrelated. The figure below depicts the planning process and supporting analyses.

- **Financial Analyses**
  - Practice valuation.
  - Creditworthiness.
  - Debt capacity.
  - Operational implications.

- **Deal Structure**

- **Management Structure**

- **Corporate Structure**

- **Governance Structure**

**Operating Assumptions**
Prepare Term Sheet

Once the parties agree to the major deal terms, the commitments are codified in a term sheet.

Description

- The term sheet includes a reasonably detailed, layman’s description of the major terms and commitments made by each party involved in the partnership.
- It also serves as the blueprint for the development of definitive agreements.
- Thus, the more detail that can be provided in the term sheet, the more efficiently definitive agreements can be prepared.

Term Sheet

- Summary of deal structure.
- Capital contributions/payment terms.
- Ownership considerations.
- Legal and governance structure.
- Physician employment terms (compensation, benefits, etc.).
- Employee commitments.
- Service/facility commitments.
- Other terms.
- Closing target date and conditions to close.
- Operation of group prior to close.
Essential Elements

*Develop Definitive Agreements*

Once due diligence is substantially under way, the parties will begin work to draft and finalize the definitive agreements.

- These are the legally binding documents that provide the terms of the partnership to ensure that previously established commitments and actions are fulfilled.
- In general, this process is led by special counsel retained by each party, with significant input from each party’s merger committee members.
- Once definitive agreements are fully negotiated, each group’s stakeholders (board and/or shareholders) will meet to vote on the transaction, as defined by the legal documents.

**Definitive Agreements**

- Articles of Incorporation (new or amended).
- Corporate Bylaws (new or amended).
- Asset Purchase Agreement.
- Merger and/or Consolidation Agreement.
- Shareholder Agreement.
- Physician Employment Agreements.
- Others, as necessary.

Ultimately, the number and type of definitive agreements that are necessary is dependent on the deal structure.
Essential Elements

Obtain Stakeholder Approvals

As the definitive agreements are being developed, each organization must undertake the process of securing internal approvals from its leadership.

Process

• Solicit input from stakeholders (board/governing body and every physician shareholder).
• Document all other relevant terms and open items for active resolution through research, analysis, discussions, and negotiations.
• Schedule meetings with stakeholders, and document all communications for future reference.

Critical Success Factors

• Know the requirements for approval (e.g., documents, education, timing, approval threshold).
• Thoroughly communicate the impending changes to physician shareholders (employment terms, governance, compensation and benefits, financial terms, etc.).
Integrating the Physician Practice
A key question to be answered is what level you plan to integrate the acquired physicians with existing employed physicians.

**Looser Integration**

- Compensation will be tailored to each specialty and/or physician.
- Separate governing groups will be formed by specialty or service line.
- Each specialty and/or service line will have distinct management accountability reporting.
- Each specialty or practice will develop its own support services.
- There will be more physician autonomy to direct patient care and limited or no coordination regarding outcomes reporting.

**Integration**

- Compensation Plan
- Governance Structure
- Management
- Infrastructure
- Clinical Coordination and Reporting

**Tighter Integration**

- All physicians will participate in a single compensation plan/approach.
- One governing body will oversee all specialties.
- A shared management model with a physician/executive team will oversee all administrative services.
- Support services will be centralized (e.g., billing, contracting, IT).
- There will be a streamlined patient experience across group specialties, a common EHR, and standard outcomes reporting.
Integrating the Physician Practice

Why Is Physician Compensation Important?

If You Pay Physicians Correctly

• You will have the chance to form a sustainable business.
• You will align incentives between your enterprise and physicians.
• Physicians will feel appropriately rewarded for their efforts.
• Physicians will not feel torn when “doing the right thing” costs them money.
• The group culture will be maintained.
• You will field competitive offers to ideal candidates.
• You will eliminate physician candidates who are not an appropriate fit with your situation.

What a Compensation Plan Will Not Do for You

• Overcome the natural limitations of your environment.
• Guarantee physician happiness.
• Guarantee successful recruitment.
• Guarantee patient care coverage, retention, medical staff peace of mind, or administrator job security.

Failure to align incentives with physicians was the most important factor in causing major financial losses during the physician employment era of the 1990s.
Integrating the Physician Practice Compensation Design – Key Considerations

The right compensation model balances the needs of the physicians with those of the health system and any service line programs.

- A key question is whether the compensation will be based on a group pool\(^1\) or individually allocated.
  - In the case of pooled compensation, the methodology used to create the pool is often different than the methodology used to distribute compensation to individual physicians.
- The physicians’ current compensation methodology is important to take into account when designing the new compensation distribution methodology.
- For practices that heavily utilize midlevel providers, consider how their productivity and expense will affect physician compensation.
- Nonclinical duties, such as the following, need to be taken into account:
  - Practice management responsibilities.
  - Outreach staffing.
  - Medical directorships and other leadership responsibilities.
  - Relocation and operational changes associated with on-boarding.

\(^1\) Subject to all applicable Stark law exemptions.

Healthcare organizations will need to simultaneously invest in operational infrastructure to support value-based compensation models.
Integrating the Physician Practice Governance – Importance of Shared Decision Making

Challenges of Sharing Governance

• Natural reluctance to relinquish control to physicians.
• Risk aversion and discomfort with physicians’ style of decision making.
• Failure to recognize that physicians are needed to influence other physicians.

Benefits of Sharing Governance

• Takes advantage of physicians’ considerable skills and knowledge.
• Facilitates accountability and engagement for physician leaders.
• Enables changes in behavior that lead to quality improvements.
• Promotes physician satisfaction and unity.
• Leverages the strength of both clinical and administrative leadership.

A common mistake for organizations is to fail to tap into physicians’ knowledge and expertise and instead treat them as rank-and-file employees.

Involve the existing physician leadership early in pre-acquisition discussions and communicate.
Often, organizations may begin the development of their employed physician network as a federated model but evolve to a multispecialty group over time.
Integrating the Physician Practice Management – Physician Engagement

With many groups, the opportunity to play an active role in management and governance is just as important as compensation. The three key opportunities for physician involvement are illustrated below.

<table>
<thead>
<tr>
<th>Medical Group</th>
<th>Physician Division</th>
<th>Service Line</th>
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</thead>
<tbody>
<tr>
<td><strong>Scope of Responsibility</strong></td>
<td><strong>Scope of Responsibility</strong></td>
<td><strong>Scope of Responsibility</strong></td>
</tr>
<tr>
<td>• Clinic capital/operating budgets.</td>
<td>• Mission and values.</td>
<td>• Service line strategy and business development.</td>
</tr>
<tr>
<td>• Clinic operations (e.g., scheduling).</td>
<td>• Organizational strategy, business development, and operating/capital budgeting.</td>
<td>• Service line capital and operating budgets.</td>
</tr>
<tr>
<td>• Physician recruitment.</td>
<td>• IT resource deployment.</td>
<td>• Service line and quality oversight.</td>
</tr>
<tr>
<td>• Provider income distribution methodology.</td>
<td>• Physician division policies/procedures.</td>
<td></td>
</tr>
<tr>
<td>• Human resources.</td>
<td>• Physician division financial performance.</td>
<td></td>
</tr>
<tr>
<td>• Clinic financial performance.</td>
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</table>
To facilitate integration, dyad models, which pair administrative and physician leaders to comanage service areas, have demonstrated meaningful results in improving organizational performance.
## Integrating the Physician Practice Management – Transition Planning

While there are numerous functions that foster the success of the physician network, it is arguably more important to recognize that successful organizations evolve these functions as their physician networks grow.

<table>
<thead>
<tr>
<th>Key Functions</th>
<th>Phase I – Recruitment</th>
<th>Phase II – Growth</th>
<th>Phase III – Service Expansion</th>
<th>Phase IV – Value-Based Network</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management Focus</td>
<td>Basic Support Functions (Primarily Back Office)</td>
<td>On-Boarding; Infrastructure Development</td>
<td>Evolution of the Organizational and Leadership Structure</td>
<td>Modify Practice Patterns; Control Costs and Improve Quality</td>
</tr>
<tr>
<td>IT Emphasis</td>
<td>EHR Adoption</td>
<td>Connection/Integration of Physicians</td>
<td>Quality Reporting; Practice Optimization</td>
<td>Manage Risk; Demonstrate Value</td>
</tr>
<tr>
<td>Physician Leadership</td>
<td>Identify Recruits</td>
<td>Cultivate Physician Trust and Partnerships</td>
<td>Encourage Integration</td>
<td>Embrace Pilot Programs (PCMH); Adopt Protocols or Clinical Guidelines</td>
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Integrating the Physician Practice
Infrastructure – To Centralize or Decentralize

As organizations increase the size and scope of their employed physician networks, the organization of practice management infrastructure must be scaled appropriately.

**Infrastructure Domains**

<table>
<thead>
<tr>
<th>Business Operations</th>
<th>Financial Management</th>
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<tr>
<td>Human Resources</td>
<td>Information Management</td>
</tr>
<tr>
<td>Organizational Governance</td>
<td>Patient Care Systems</td>
</tr>
<tr>
<td>Quality Management</td>
<td>Risk Management</td>
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</table>

**Key Decisions**

- How will the organization bill and collect for physician services?
- Will all practices use the same EHR and practice management system?
- Will each practice have the same compensation and benefit structure for nonclinical staff?
- To whom should nonclinical staff report?
- How will the organization provide professional liability insurance?
Integrating the Physician Practice Infrastructure – Improving Access

To meet patient demand for affordable and accessible care, health systems are innovating their delivery models to improve capacity and throughput.

The creation of an efficient delivery model requires that an appropriate support structure be developed to maximize physician time.

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Employed providers will play an expanding role in driving specific initiatives that will increase the value of healthcare services.

**Support Disease Management Programs**
Help chronic care patients who account for 75% of total healthcare dollars manage their conditions and get the care they need.

**Coordinate and Integrate Care**
Give support to providers to put in place care management programs and encourage team care through medical home-type models.

**Utilize Comparative Effectiveness**
Establish an independent institute to guide reviews and research on the comparative effectiveness of new technologies and medical procedures.

**Improve Quality While Reducing Costs**

**Require Transparency Regarding Quality and Costs**
Require providers to collect and publicly report measures of healthcare costs and quality.

**Promote Patient Safety**
Require providers to report preventable medical errors.

**Align Incentives for Excellence**
Accelerate efforts to develop and disseminate best practices, as well as align reimbursement with the provision of high-quality healthcare.
Key Takeaways

In order to successfully evolve into a mature network focused on population health, hospitals need to identify and integrate the right physicians into their organizations.

- Outcomes are important, and identifying the right partners is critical to a successful outcome.
- It is essential to develop a long-term strategy to evolving the physician network in order to achieve key facets of clinical integration and population health management.
- Integration takes time, and it is necessary to work with physicians to ensure it is actually occurring.
- Integrating physicians into the fabric of the organization is key, and an understanding of the behavior and cultural fit of the physicians is important.
- Although compensation methods, governance and management structures, and infrastructure needs will evolve over time, it is wise to proactively plan for and adjust to the future.
Questions & Answers

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Presenter Biographies

• **Ms. Jennifer Maher, Vice President Finance, Business Analytics and Decision Support, MedStar Health**
  – Jen is responsible for providing financial leadership in the areas of business analytics, business intelligence and decision support. Additionally, Jen leads due diligence efforts and transition with major business development activity and provides oversight of financial analysis and valuations.
  – Jen may be reached at Jennifer.m.maher@medstar.net.

• **Mr. Sean T. Hartzell, Senior Manager, ECG Management Consultant**
  – Sean is the co-leader of the firm’s transaction advisory service line, which focuses on developing and disseminating the firm’s thought leadership in the areas of transaction planning, facilitation, and implementation, and he has published thought leadership pieces and spoken nationally on these topics.
  – He received a master of business administration degree from the Darden Graduate School of Business at the University of Virginia and a bachelor of science degree in operations research and industrial engineering from Cornell University.
  – Sean can be reached at (703) 522-8450 or shartzell@ecgmc.com.