Special Report

Medical Group Mergers:

Strategies for Success

Latham
Consulting Group
Make Decisions, Resolve Conflict, Move Forward

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Strategies for Success

Medical Group Consolidation

As the consolidation trend sweeps over the healthcare industry, many medical groups are considering strategic mergers with other groups in their region and/or specialty. In our experience, many physicians do not want their organizations to grow into larger entities (because of the increase in complexity, loss of autonomy, etc.). However, more and more groups recognize that in today's marketplace, bigger is often better in terms of providing cost-effective care and retaining autonomy.

Typically merger efforts begin with friendly and general discussions about shared interests and possibilities. Unfortunately, the merger effort often bogs down because either the groups do not know what to do next, or because of the lack of an organized effort.

In order to be successful, medical groups that embark on a merger effort should know the answers to the following questions:

- Why should we consider a merger?
- What are the costs and risks associated with merging?
- How does a merger process typically work?
- What are the key issues usually addressed in a merger process?
- Who participates in the merger process?
- How do we get started?

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The following pages present additional information on each of these issues.

Why Should We Consider a Merger?

Although the specific benefits of merging are different for each different specialty, location and group, the following are some of the typical reasons groups seek to merge:

- Maintain a higher level of autonomy than other options.
- Job security, income stabilization.
- Increased clout.
- Additional coverage, specialties or sub-specialties to strengthen competitive advantage.
- Develop critical mass to initiate new programs.
- Continue to have access to patients where such access is threatened.
- Survival of the group in light of physician retirements.
- Secure system referrals.
- Attract capital.
- Improve ability to compete.
- Economies of scale.

It is of key importance that all involved understand what the groups are trying to accomplish with the merger.

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What are the Costs and Risks of Merging?

While there are benefits to be gained, there are also costs/risks:

- Putting a merger together requires a significant amount of time from both the physicians and their administrative staff. Mergers often take six to twelve months to complete, and there are many issues to be discussed and decisions to be reached.
- Professional costs (attorneys, accountants, consultants) are not insignificant. While professionals will often provide "ballpark" estimates at the beginning of the process, these estimates can change depending on the ability of the merger participants to negotiate and reach conclusions.
- Many significant changes may be required by all involved. It is not feasible to merge and keep everything the way that it was. Some level of operational integration will be required and this requires compromise.
- It might not work. Anecdotal evidence indicates that 50% of all merger processes do not end in a merger. In some instances, this is a positive development as groups may not have the same long-term goals. In others, the lack of a disciplined effort to reach a decision often results in people becoming frustrated with the lack of progress and dropping out.
- External stakeholders might be uncomfortable with the merger. For example, hospital management may not be enthusiastic about a merger between hospital-based physicians.

Even with these costs and potential negatives, many groups believe that the benefits outweigh any risks and decide to move forward with a merger process.

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How Does A Merger Process Typically Work?

Merger processes involve a number of discrete yet inter-related steps. The general process is typically one of:

- Getting comfortable with each other.
- Understanding each other's philosophy of practice.
- Discussion and negotiation of key merger issues.
- Developing agreements in principle.
- Closing the merger.
- Implementing operational integration plans.

The specific steps of the merger effort are generally as follows:

1. ***Friendship and courtship:*** Prior to substantive discussions, the groups likely have made contact with each other via informal means.
2. ***Commitment to move forward:*** At some point, the groups agree that they should "get down to brass tacks" and look at the merger in a more formal manner.
3. ***Antitrust review***: Depending on the local market, a first step for many groups is to engage an attorney to conduct an antitrust review. While the details of such a review are beyond the scope of this document, the group should seek experienced legal counsel in this area if there are any concerns about creating significant market power.
4. ***Merger Committee appointment and empowerment:*** Unless the practices are very small, it wise to appoint a Merger Committee to do the bulk of the discussion and negotiation effort in the merger. It is desirable that the rest of the physicians empower this group to discuss and negotiate on the key merger issues. Typically this Committee includes one to three individuals from each of the groups.

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5. ***Confidentiality, non-competitive use, "no-shop" agreement:*** In order to protect their rights and the confidentiality of information, the groups should have their attorney draft an agreement in which each group agrees to:
    a. Keep the other group's information confidential.
    b. Use the information only for the purposes of merger negotiations.
    c. Not seek or negotiate offers with others for a period of time. While this last point is optional, it can be important if the groups are going to expend significant resources during their negotiations.
6. ***Initial data gathering***: In order to improve the efficiency and effectiveness of the merger discussions, a significant amount of information must be gathered from each group. Such information may include practice documents and financial information. In addition, it is typically appropriate to have each physician and administrator interviewed or surveyed to identify any merger concerns that they may have.
7. ***Merger Committee meetings/retreat to review data, discuss and resolve issues:*** Using the information gathered in step 6, the Merger Committee meets to discuss, negotiate and reach "agreements in principle" related to the key merger issues (discussed in next section below).

    There are two primary alternatives in how this process may be conducted:

    - For groups who have already had significant discussion or are very knowledgeable about each other, a Merger Retreat (typically 2 to 2 ½ days) can be used to finalize agreements in principle.
    - For groups who have the need for more in-depth discussion and negotiation, a series of meetings are held during which agreements in principle are made.

    During this effort other professionals (such as accountants, attorneys, benefits consultants, etc.) are involved as needed.
8. ***Reach agreement in principle and execute Letter of Intent:*** Once most of the key decisions have been made, the groups execute a Letter of Intent under which they agree to merge under agreed upon terms unless certain events occur. This authorizes the groups to move forward with step 9.

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9. ***Create merger documents:*** Once the Letter of Intent has been signed, the attorneys will draft several documents, including:
    a. Merger Agreement (the primary purpose of this document is to require each group to make full disclosure about its activities).
    b. New Entity Corporate Documents.
    c. New Entity Shareholder Agreement (Buy-sell).
    d. New Entity Physician Employment Agreements.
    e. Other needed documents.

    At the same time, the accountants will be developing the financial information needed to close the merger.
10. ***Perform due diligence:*** During this effort, the attorneys and accountants review a number of practice-related documents to identify any issue that might impact the merger from a legal perspective.
11. ***Develop post-closing operational integration plan:*** The work we have discussed up to this point is focused primarily on the organizational and legal aspects of the merger. Once the groups are on track to merge, an operational integration plan must be developed.
12. ***Merge:*** The merger occurs when all papers are signed and all are committed to move forward.
13. ***Implement post-closing integration plan:*** The operational integration plan is implemented.

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What Key Issues are Usually Addressed in a Merger?

A key goal of the merger process is for the parties involved to:

- Gain a better understanding of the other group.
- Discuss key merger issues.
- Negotiate on areas where there are differences.
- Reach agreement in principle on the key issues.

Naturally the key merger issues are different for any particular merger. However, typical key issues include:

- Overall Practice Philosophies
- Governance
- Physician Compensation System
- Retirement Plans, Benefits
- Physician Contract Issues
- Buy-in/Buy-out Issues
- Personality Issues
- Value of Capital Contribution/Ownership
- Call/Workload
- Administrative Management
- Personnel
- Combined Practice Name
- Relationships with Professional Service Providers (lawyers, accountants, etc.)
- Operational Infrastructure

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Who Participates in the Merger Process?

The following constituents are typically involved in the merger process:

Merger Committee:
- Small practices: typically all physicians.
- Larger practices: typically 1 to 3 participants from each group.
- Empowered to speak for the group.

Group Physicians:
- Interviewed individually to identify concerns and key issues.
- Attend full group meeting.
- Approve final agreements.

Administrative Management:
- Heavy involvement in data-gathering.
- Often involved in negotiations.
- Very involved in operational integration plan.

Merger Facilitator:
- Organizes process and keeps effort on track.
- Sets format and process for analyzing and deciding on issues.
- Facilitates meetings.

Attorneys:
- Heavily involved once substantive agreements in principle have been reached.
- Will advise you on aspects of the merger, help with structural issues to combine the two organizations and provide guidance on legal issues.
- If necessary, use for antitrust review.

Accountants:
- Facilitate analysis of groups to forecast correctly the financial implications of the merger.
- Provide guidance on tax and accounting issues.
- Prepare financial information needed to close merger.

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Third Party Appraisers:

- Rarely used - use depends on the method chosen to value fixed assets or real estate.

Why Should We Consider a Merger Facilitator?

When groups attempt to merge, they face several key obstacles:

- They may not be sure how to work their way through the myriad of merger issues and processes.
- There may be sensitive issues that are difficult for the merging groups to address.
- The groups may have no one to coordinate the merger negotiations.
- Other professionals (such as attorneys and accountants) are so busy representing the interests of the existing practices that they are not able to help the merging groups reach the compromises necessary to form a combined group.

To assist in overcoming these obstacles, many groups use a Merger Facilitator to serve in the following role:

- As an ***objective and impartial outsider*** who can “represent” the interests of the combined group and help the merging groups reach reasonable compromises on issues.
- As a ***guide*** through the various merger issues and processes.
- As an ***advisor*** who can offer insight into how other groups have solved merger problems or optimized their position through mergers.
- As an ***organizer and facilitator*** to help keep the merger effort on track and moving forward.

How Do We Get Started?

If your group has been discussing a merger for some time, we would suggest the following as first steps in the process:

1. Make a decision as to whether or not you are willing to commit the time and money required to consider merging.
2. Establish a Merger Committee.
3. Decide how you will be guided through the process. Will you do it with internal resources, or use a merger facilitator?
4. Begin the data-gathering and analysis effort.

As you might expect, our knowledge in this area is based on the fact that Latham Consulting Group has provided **Merger Support Services** to many medical groups. If we can provide assistance or answer any questions you might have, please contact us at 704/365-8889.

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