WHAT YOU SHOULD KNOW ABOUT MERGING YOUR PRACTICE

One night at dinner with his friend and colleague John, Bruce looks at him and says, “we are both successful, good friends, cover for each other and trust each other. Why do we have two offices, two billing systems, two complete staffs, we each need another provider but not full time and we each pay a different accountant to do the same thing. Is there something here that would make more sense”.

“Mergers and Acquisitions”. That was the hot phrase we read about in the 80’s and 90’s. It was supposed to mean that by combining two businesses the resulting new business will have a larger market share, less expenses and be more profitable. Sometimes it was an accurate description.

Until the mid 80’s it was not necessary for medical practitioners to seriously consider merging their practices to capture a larger patient base. Until then, practitioners could bill and expect to receive eighty percent (80%) of charges based on UCR (usual, customary and reasonable) from the insurance company and twenty percent (20%) of the charge from the patient. (Imagine, getting paid what you charged!)

Today practitioners can still charge what they want, but if they are “par” (participate) with the payers, they receive a reimbursement based on the payers’ fee schedule and the remaining amount is adjusted or written off. As a result, practitioners are looking for ways to maintain their income in the face of decreasing reimbursements and increasing expenses. One approach to maintain income and create security for the owner(s) of a practice is growing their practice by merging with other practitioners.

What results should you expect as a result of merging your practice?

Too many times practitioners have unrealistic expectations or fantasies of what the results of merging their practices will have on them.

Here are some **INCORRECT ASSUMPTIONS** of what a merger will accomplish.

- More profit
- More time off
- Negotiate with payers*
- Less expenses
- Less time spent on administration**
- Bigger is better

* depending on your size
** A merged practice may be able to hire professional management

Here are some **CORRECT ASSUMPTIONS** of what a merger will accomplish

- More, less or the same number of offices
- More owners or partners
- More security for the partners
- Better chance for increasing your quality of life
- One tax identification number that you bill under
- Usually one practice management system
- One retirement plan
- One fee schedule
- One set of governance documents
- A new accountant and attorney(usually)- for the practice

Merging does not necessarily mean you have to change

- Vacations, holidays call schedule
- Compensation and bonus formulas
- The way you practice
- Your office
- Your office and hospital schedule
- Clinical protocols
- Relationships with referring sources
- Office staff

TYPES OF MERGERS

Operational Merger

An operational merger is the type of merger you are probably used to hearing about. For this article we'll use Dr. Able's practice which has 1 doctor and Dr. Smith and Jones's practice with 2 doctors. Both practices are in the same town about two miles apart. The doctors are all in their forties. They each earn different amounts. ($160k, 190k and 245k). They have different practice management systems (PMS), different schedules and only one operates at the hospital. They've known each other for ten years, trust each other and are comfortable with each other's level of clinical competency. These evaluations are the first and most important steps in their due diligence process.

In an operational merger two or more offices are consolidated into one or fewer offices. The new office can be one of the existing offices or as is usually the case, a new, larger office is acquired.

Ideally, a committee made up of one doctor and one staff member from each office is charged with listing what an ideal office will look like, working from the doctors' "wish list". After the list is created they determine the approximate square feet needed. A realtor is contacted to find the space in a location within a reasonable radius from each of the previous offices. (Loyal patients will travel to see you, but not a great distance.) When the space is found, the same committee determines the configuration based on their ideal office and incorporates the changes based on the amount the doctors want to spend. The new office should have *at least one more exam room* than they planned for in addition to enough chairs for the patients of four (not three- plan ahead) doctors, a larger business area, separate area for billing and collecting, enough parking or close to transportation and a staff break area.

In an operational merger each staff will lobby their doctor to keep their PMS, super bill, schedule and other components that they feel are "better" than what the other practice has. While that reaction is to be expected it may not be best for the new entity. $17,000 is the cost to expand Dr. Able's practice management system. Expanding Smith and Jones's practice management system would cost less than $6000. While both systems are different, both are capable of performing all the tasks necessary to run a practice. Regardless of the cost differential, Dr. Able's staff` lobbied for the new entity to use their system.

Dr. Able's challenge is to point out to his staff that it would be ideal to keep their present system. But because all three doctors will share equally the start up costs, it is in his best interest to agree to expand Dr. Smith and Jones's PMS. Dr. Able, recognizing his staff's anxiety about learning a new system, takes one of his staff members to Dr. Smith and Jones's practice to spend a day using their system. Dr. Smith and Jones's staff is aware of Dr. Able's staff feelings about a new system and has prepared themselves to demonstrate that their system will work fine **without** saying that it’s a better system than Dr. Able’s.

STAFF

Sometimes the fear of change clouds minds from seeing the objective. Your support staff may let it be known that they don’t think a merger is a good idea when what they mean is that they are uncomfortable with the perceived changes. Your staff are probably very good and loyal, however, be alert to when their concern is change and not what is best for the new practice. Work with them to show that they felt the same way before their previous practice management system was replaced by the current system, or the time the office moved or a new manager or provider was hired. Working with your staff to alleiviate their concerns will make them strong advocates of what you want to accomplish.

Be aware at the beginning of the process that your staff may feel some of them may be fired as a result of the consolidation. Our recommendation has always been to let the staff know early on that no one will be let go as a result of the merger. Yes, you may have more staff at the beginning of the merger, but you will have the opportunity to reduce staff by attrition and not by firing staff.

The staffs of both practices then prepare a list of their vendors and what supplies they purchase from each. They each create a binder with all the forms and assorted paper that they use in the office – from the patient information sheet, fax cover sheet, referral forms, hand outs, super bill, receipts, forms that are in the chart.. A sample chart with the labels used on the outside (purge year, last letters from the patient’s name, labels to indicate special conditions, billing arrangements…) is also placed in the binder.

The staffs then compare the binders and examine which form and format they all feel would work best in the new office. Or they could use this time to design an improved form. When the move into the new office takes place, the charts from each practice are moved into the chart area of the new office, but kept separate. As the patients come into the new office for their appointment, the chart is then filed in the new merged chart area with any new changes placed in and on the chart. This saves the enormous amount of time trying to combine the charts before seeing the patients. This also helps purge the charts of patients who have left the practice. Keep a list of all patients from each practice.

The staff meets and presents to each other, their doctor’s office hours and hospital OR time. The staff presents to the doctors their recommendations on what a new combined schedule for all three doctors might look like.

The staff next should list all the participating payers for each practice. Find out (where possible) how long it will take to get a new provider number and address approved by the payers with a new tax identification number.

The doctors should view the staffs' recommendations seriously but should allow themselves the final decision which may differ from their staff's recommendations.

FINANCING

There are two ways to finance the new practice during the start up and for the first few months.

Line of Credit

Shop around for a line of credit from a bank. The banks should know that they are in a competitive situation and have to bid for your business by submitting a term sheet. Each doctor signs for an equal share of a line of credit from the bank. The new practice will bill for services performed after the merger date and those funds go into the new practice's bank account. The line of credit will pay for staff salaries, and the operational costs until cash flow meets expenses. The staff will also continue to work the accounts receivable (A/R) from the previous practices. As those funds come in (A/R), they are deposited into the previous practice's bank account. The doctors will draw down those funds for their salaries. After a few months there will be enough funds coming in for services after the merge date to pay for all expenses and begin to pay back the line of credit.

Accounts Receivable (A/R)

The second way is to have the collections from services performed before the merger used to pay for start up and operational needs. (There should still be a line of credit – just smaller). As all three doctors will be equal partners, they should each contribute the same amount to the new entity (This is explained by the group's new accountant). Track the collections from each doctor for services performed before the merger that are put into the new practice's bank account. If they are not equal after an appropriate time, discuss with your consultant, accountant or attorney options that are available to equalize the initial start up contribution (capitalization).

Ownership

The partners should be equal owners in the new practice.

Compensation

The easiest way to determine compensation is to have each partner receive the same compensation. That naive assumption will immediately end any discussion of a merger between these three doctors. In our example there were three different compensations paid to the doctors in their previous practices, $160k, $190k and $245k (W-2). Here are two examples of how their new compensation formula may look.

Example 1

Add the three salaries together

$160,000, + $190,000 + $245,000 = $595,000

Determine what the percent of each salary is to the total

160/595 = 26.9%
190/595 = 31.9%
245/595 = 41.2%
100%

As long as all three partners' schedules are the same after the merger as they were before the merger, the profits (salaries) are divided as above.
If the profits are greater than $595,000 at the end of the year, those profits are split equally. If the profits are less than $595,000, the salaries are reduced based on the percentages above.

Example 2

Take 75% of the lowest paid partner's W-2 from the previous year and use that as the base salary for each partner. On a monthly basis, after expenses are paid distribute the remaining profits based on productivity.

NOTE

When using a formula similar to example 2, it is important that each partner keeps his own patients that follow him to the new practice. New patients are then divided equally between the partners.

STRATEGIC MERGER

Due to the growth of suburbs and the ability of the population to travel, strategic mergers are more common now than in the past. In this type of merger, two or more offices might be anywhere from one to thirty or more miles apart. But because the practices may be in different towns, or because of the lack of space or other factors, each office will stay in their present location.

In this form of merger, the partners will manage their practices, now referred to as profit centers. They will make all the decisions regarding hiring, firing, salaries hours of operation and bonuses for staff **as they did before.** All their expenses will be paid out of their profit center's collections. Other than a new PMS, a central billing office, changes in forms and the process for payables, there really are not many changes to your practice in a strategic merger.

All profit centers will have to convert to one PMS and one tax ID number similar to an operational merger. There is usually one central business area that pays all bills, calls in payroll and does the billing and collections.

When we merge practices, we request the partners attend a meeting at least every other week during the first year. Each month the partners receive a detailed financial report on their profit center's collections, expenses and profits and for the entire practice.

BENEFITS

- In either type of merger there are now partners who will cover for you when you go on vacation or are sick.

- There is a formula or an already determined amount you or your estate will receive in case of death, disability or retirement. This eliminates the nightmare of trying to agree on an amount when something happens.

- In a strategic merger, if your profit center can use another physician but does not need one full time, you can split the cost with your partners and use the new physician at other profit centers in addition to yours.

- If there is an underserved area, you and your partners, rather than you alone can share the costs associated with opening a new office.

- If there is a new piece of technology to treat patients with, the new practice can purchase it and spread it across a larger patient base.

- If you merge and control a **very significant** amount of the services in your area, it may allow you to discuss your concerns with payers on a level field.

- In any merger there are economies to be recognized as a result of purchasing in larger amounts.

GOVERNANCE

There are three basic documents required if you are a corporation, two if you are an LLC. If you are a corporation you will need a shareholders agreement, employment agreement and a deferred compensation agreement. These agreements are worked out BEFORE the effective date of the merger. Working through the issues these agreements identify will help you decide if you can get along with your partners.

When we merge practices we do it in 3 phases and anyone can drop out at anytime. An important component of the documents and one that allows participants to feel more comfortable is a “Bailout” provision. It allows any partner, within 12 months of merging to leave the new entity and revert to his/her previous practice. They must pay for whatever costs they incur.

- Phase 1 - Write up governance documents – at the same time begin the operational assessment and determine costs (PMS, moving and construction if an operational merger, PMS only if a strategic merger)

- Phase 2 - With costs identified, present the model of the practice to the partners

- Phase 3 – “Go live”. Monitor and adjust during the next 24 months

The ***shareholders agreement*** explains how you acquire shares, how you lose shares and what type of vote is needed for specific situations.

The ***employment contract*** explains how you get paid, your benefits, vacations, holidays, and how you can be terminated among other details.

The ***deferred compensation agreement*** explains what you or your estate receives if you die, become disabled or retire. To insure the viability of the practice, there is usually a time limit required to work for the new practice in order to receive 100% of your retirement benefit. To eliminate any financial strain on the practice there is also a cap put on the amount that can be paid out in any one year for any reason. If the amount to be paid out exceeds the cap, the cap stays and the time period of the payout is increased.

CAUTION

Merging requires a great deal of communication and time for meetings. Do not try to merge without taking it very seriously and without planning ahead.