



Howdy, **Partners**

Alternatives to M&A exist for groups open to considering creative approaches.

■ **By Kristofer Blohm, M.A., and Nora Kelly, M.B.A.**

An unprecedented “rush to scale” is occurring across health care, with leading players combining, acquiring assets, and transacting to develop new business models. Through acquisitions, large non-provider entities are moving rapidly into the provider space; through mergers, providers

are trying to build scale. In the background are tech giants making plans for a big entrance into health care. It’s clear that the modernization and digitization of health care offer avenues for new entrants and familiar players to succeed but will involve enormous financial and intellectual resources to do so effectively.



Industry pressures make it increasingly difficult for independent medical groups to simultaneously meet their strategic goals *and* achieve sustainable financial performance (see “Pressures”). The most common challenge is to balance the need for capital for practice growth with providing competitive, market-based compensation for group physicians.

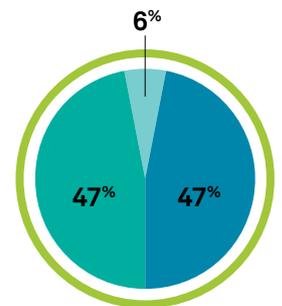
The number of physicians choosing to be employed by hospitals and integrated delivery systems continues to rise. According to a 2017 survey by the American Medical Association,¹ for the first time, more than half of physicians (53%) are employed, up about 6% from 2012. Crossing this threshold clearly signals increasing integration of caregivers and providers in an era of healthcare transformation.

Employment is not the sole option for physicians in independent practices. During the past few years, partnership opportunities for

high-quality independent groups have been strong. Many practices have a range of options to consider, often with attractive provisions. Overall, physician group transactions have increased, with an average of 70 transactions per year since 2010.²

Industry uncertainty is having an impact on the number and types of partnerships taking place, but opportunities remain for high-quality groups with both traditional partners and new entrants. The physician group’s decision does not have to be sell or go-it-alone. Partnering and structuring alternatives exist for groups open to investigating, discussing options, and considering creative approaches to meet their specific needs.

This article highlights motivations for various types of partnerships, the process used to explore and secure a partner, and innovative partnering options physician groups may wish to consider.



Distribution of Physicians by Ownership Status

- Owner
- Employee
- Independent Contractor

Source: American Medical Association

Pressures

- ▶ **Regulatory pressures from the Medicare Access and CHIP Reauthorization Act (MACRA) and other legislation**
- ▶ **Operating pressures from payment and pricing constraints**
- ▶ **Competitive pressures from health systems, nontraditional clinics, and telemedicine**
- ▶ **A tightening labor market for providers and staff**
- ▶ **Investment requirements for IT, geographic growth, new patient care facilities, and a care delivery model that will attract and retain today's healthcare consumers**

Source: Kaufman, Hall & Associates, LLC.

efforts, electronic health records (EHRs), and medical technology, as well as the lack of a ready pool of management and physician candidates, it is difficult for many physician groups to grow or even sustain current operations.

For some physician groups, the strategic or capital investment required to remain competitive in this challenging environment means assuming a greater level of business risk than has been historically tolerable. Other groups choose not to invest in “independent market leader” strategies in light of the high levels of risk and potential impact on physician compensation and shareholder equity value.

De-risking through partnership arrangements becomes more attractive to physician groups as it becomes increasingly difficult to maintain independent financial strength due to payment pressures, increasing competition, and growing capital requirements for IT, infrastructure, and growth, among other factors.

For a thorough understanding of a group's ability to continue to survive and thrive as an independent organization, an assessment by an objective third party with national experience may be helpful. Our company, Kaufman Hall, recently conducted this type of confidential, detailed assessment for a large, multispecialty medical group in the Northeast, looking closely at its financial capacity to support its strategic vision and care-delivery objectives while remaining independent.

What Drives Partnerships?

Due to the factors cited in “Pressures,” groups often struggle to recruit and retain high-quality physicians and management talent. Physicians and managers in the Millennial generation are less entrepreneurial and more risk adverse than prior generations.³ They are less likely to assume the risk of starting or rapidly growing a private practice, often opting for employment to achieve stable income and work-life balance.

Additionally, Millennials are super-connected to technology. Providing the latest tools to deliver high-quality care efficiently is critical to recruiting and retaining this cohort.⁴ Given the personnel and capital needed to support marketing

The assessment indicated that executing the group's desired strategy on a standalone basis, while possible, would introduce a high level of financial risk. The group hesitated to assume this risk on its own. Practice leaders also recognized that, with external support from a partnering organization, the practice could enhance its already significant intellectual property in care and risk management and practice operations.

Following the strategic and operational assessment, “what's the practice worth?” is a key question often raised by medical groups interested in selling their practices. Valuation assessment, as described under “Worth,” is considered best practice in such instances as it provides foundational expectations for financial worth. However, physician groups will benefit from exploring more than valuation and options to sell their practice. Consideration of innovative partnering arrangements through an approach described next can yield major benefits.

Worth

Valuation assessment provides the foundation for financial worth and expectations for the physician group in the region in which it operates. A high-quality valuation combines traditional financial multipliers and quantification of practice value within and beyond traditional physician operations.

The standard valuation approach applies market-based multiples on historical revenue and cash flow and estimates the impact of expected growth using discounted cash flows. This approach is useful in determining a reference range of enterprise value for the group, but it often doesn't capture its intrinsic value—specifically, such factors as:

- ▶ **Strategic value to a potential partner**
- ▶ **Tangible asset value and brand strength**
- ▶ **The region's economic and healthcare environment**
- ▶ **Intangible assets and other factors that may impact the valuation**

Many recent arrangements have considered the value of pieces or components of physician clinics, which may in certain cases exceed the enterprise value of the clinical practices. Common components include ancillaries, covered lives, and intellectual property, including clinical protocols, utilization management tools, performance management tools, high-efficiency practice operating infrastructure, existing provider network, and current managed-care contracts and contracting capabilities.

Although valuing these assets may sometimes be subjective and difficult, the approach represents an opportunity to access capital through partnership alternatives without a complete sale.

Source: Kaufman, Hall & Associates, LLC.

Identify Options

Following assessment and valuation, most physician groups benefit from a thorough inside-and-outside-the-box exploration of partnership options. Determining which partner would be the best fit is based on a review of your group's specific needs; therefore, the process starts with articulating and confirming partnership goals, objectives, and future requirements.

Goals, objectives, and guiding principles.

Independent physician groups most often cite continuation of patient-centric care with excellent outcomes as their primary consideration for partnership, along with vision, strategy, and cultural alignment. Other criteria and objectives may include:

- ▶ Acceptable governance, operating, and management structure
- ▶ Support for provider recruitment and retention
- ▶ Physician leadership development
- ▶ Tools, analytics, and other resources designed to support enhanced quality performance and migration to value-based care models
- ▶ Access to capital, financial stability, and insulation from business risk

For example, one large, multispecialty clinic identified the following partnership objectives:

- ▶ Provide our physicians and staff with stability and a great place to work.
- ▶ Invest in programs to improve patient satisfaction, quality, and safety.
- ▶ Accelerate the transition to value-based care models.
- ▶ Gain access to capital for expansion of our geographic footprint.
- ▶ Obtain resources for infrastructure and physician leadership development.
- ▶ Preserve and enhance our culture.

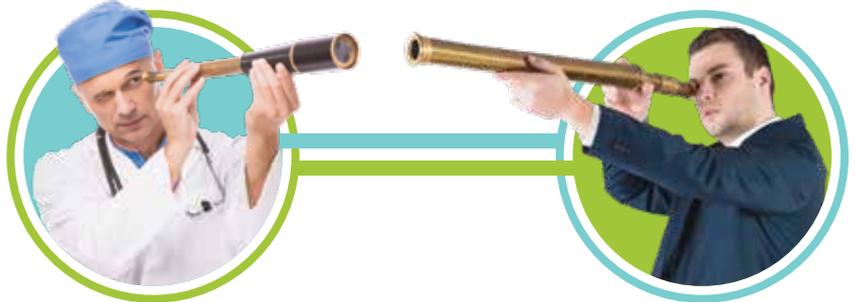
Synthesize your goals and objectives into a defined set of guiding principles from which a set of criteria is developed to facilitate decision-making related to strategic options. Additionally, using this information ensures that preferred relationship models are consistent with your group's objectives, mission, and vision. Meeting your group's objectives typically requires finding a balance between operating control, strategic growth, and economic consideration. Priorities often evolve during the processes. The information also is used to communicate the decision-making process and partnership benefits to key constituents such as physicians or community leaders.

The same large, multispecialty clinic approved guiding principles (see "Guiding Principles").

Guiding Principles

- ▶ **We are seeking a partner that will insulate our organization from business risk so that we may focus on patient care.**
- ▶ **We will select the partner that is best positioned to help us achieve our strategic objectives while honoring our culture.**
- ▶ **Our chosen partner will share our commitment to quality, safety, and value.**
- ▶ **We are committed to remaining a great place to work for physicians and staff.**
- ▶ **We are open to shared governance, but will ensure that we maintain sufficient control of clinical and operational decision-making and a strong voice in strategic direction.**

Source: Kaufman, Hall & Associates, LLC.



Identify candidates. Identifying potential partners requires a tailored approach that leverages the strengths of your group and each prospective partner. The universe of potential partners will vary based on your objectives and profile. Group characteristics that may influence the universe of potential partners include, but are not limited to, for-profit/non-profit status, geographic location, financial performance, payer mix, specialty mix, and experience with value-based care. Therefore, a deep understanding of your group, the industry, potential partners, and the multiple ways you can create value for potential partners is required.

Evaluate potential partners based on their alignment with your group's partnership objectives and guiding principles. For example, a group seeking access to significant capital for geographic growth should focus on parties with a strong financial position that have significant access to capital themselves. A group seeking to accelerate the transition to value-based care models would be well served by a partner that has significant prior experience in this area or existing strategic relationships that can provide access to new contracting approaches.

The appropriate number of potential partners will vary and should be determined based on individual circumstances. Not every medical group wants to use or should use the broadest "auction

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Successful, sustainable partnership models create value for all sides—and often require concessions from all sides as well.

- process” for considering potential partners.
- ▶ An *exclusive negotiation* with a single partner is appropriate when your group has a highly preferred partner that is best positioned to meet your objectives.
 - ▶ A *controlled competitive process*, which involves contact and negotiation with a defined number of potential partners (from a few to many), is appropriate when you want to “test the market” to determine the best-available option.
 - ▶ A *public auction*, which allows any credible party to participate, typically is used for public entities, in situations of financial distress, or to satisfy specific legal requirements.

Although not a hard-and-fast rule, small practices often focus on a single or small number of potential partners that already have a presence in their geographic market. Large practices frequently use controlled competitive processes to identify the right partner. These practices often include parties from both inside and outside their market to understand the broad range of options available.

Examples of organizations your group may partner with include:

- ▶ Health plans
- ▶ Health systems (non-profit and for-profit)
- ▶ For-profit physician and/or management services companies
- ▶ Private equity firms

Once you have identified a universe of potential partners, the formal steps in getting to the best-fit partner include:

- ▶ Contacting potential partners
- ▶ Obtaining nondisclosure agreements to assure confidentiality
- ▶ Releasing confidential marketing materials describing the medical practice and its partnership-exploration process
- ▶ The receipt, evaluation, and negotiation of proposals

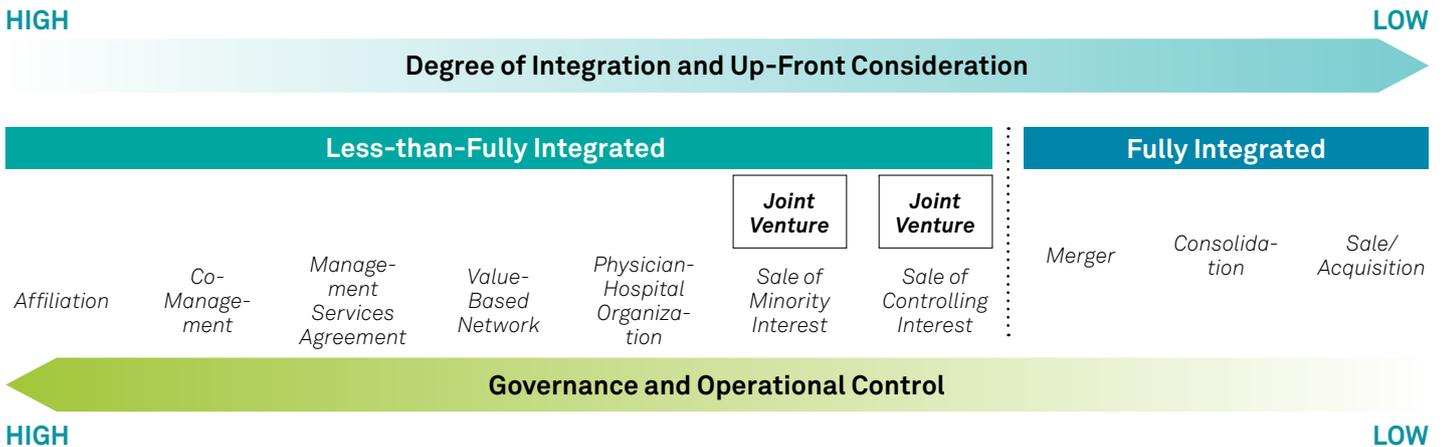
Ultimately, you will reach the point of a go/no-go decision on whether to advance to the transaction implementation phase, which includes partnership agreement negotiation and closing. The process for identifying and implementing the right partnership is often time- and labor-intensive. Outside resources, including legal and financial advisors, may help to ensure an optimal outcome while minimizing disruption of the practice’s business.

Develop the Preferred Partnership Structure

Successful, sustainable partnership models create value for all sides—and often require concessions from all sides as well. As mentioned above, each practice has unique goals and objectives. Tailor the optimal structure to meet these needs. Trade-offs between economic considerations, retained governance and operational control, and other factors should be balanced.

Although the partnership spectrum is broad, many independent physicians and physician practices choose to sell their practices using traditional *sale/acquisition*, *fully integrated models* at the far right of the spectrum (see Figure 1).

Figure 1
Spectrum of Partnership Options



Source: Kaufman, Hall & Associates, LLC.

Table 1

Rationale for Various Partnership Structures

	Percentage of Equity Sold			
	100%	Majority	Minority	0%
What do we get?	<ul style="list-style-type: none"> ▶ Economic consideration ▶ Possible future guarantees (e.g., capital, compensation) 	<ul style="list-style-type: none"> ▶ Economic consideration and future value from retained equity ▶ Possible future guarantees (e.g., capital, compensation) 	<ul style="list-style-type: none"> ▶ Some economic value ▶ Partial alignment with a strategic partner 	<ul style="list-style-type: none"> ▶ Specific benefits as defined in the partnership (e.g., fee income, intellectual property, resources, services)
What do we give up?	<ul style="list-style-type: none"> ▶ Governance control ▶ Equity ownership 	<ul style="list-style-type: none"> ▶ Governance control ▶ Majority equity ownership 	<ul style="list-style-type: none"> ▶ Some governance representation ▶ May limit ability to sell additional equity without partner's approval 	<ul style="list-style-type: none"> ▶ Resources, bandwidth, and/or capital
What are the risks?	<ul style="list-style-type: none"> ▶ Impact of loss of control on culture and physician engagement ▶ Strategic and operational integration risk 	<ul style="list-style-type: none"> ▶ Impact of loss of control on culture ▶ Strategic and operational integration risk 	<ul style="list-style-type: none"> ▶ Partner's financial return expectations ▶ May limit future partnership options 	<ul style="list-style-type: none"> ▶ All business risk is retained by the physicians ▶ May limit future partnership options
Why would we do this?	<ul style="list-style-type: none"> ▶ Independence is not a viable option or requires more risk than we are willing to accept ▶ We do not believe that retained equity provides meaningful value 	<ul style="list-style-type: none"> ▶ Independence is not a viable option or requires more risk than we are willing to accept ▶ We believe there is value in retained equity (e.g., economic value, physician engagement) 	<ul style="list-style-type: none"> ▶ A specific strategy requires funding ▶ Desire a partnership that does not require giving up control 	<ul style="list-style-type: none"> ▶ Desire to remain independent ▶ We have a discrete strategic or operational need ▶ The timing isn't right

Source: Kaufman, Hall & Associates, LLC.

In some cases, their rationale includes declining financial performance and inability to sustain competitive market compensation or meet operating and capital investment requirements. In other cases, practices with good financial performance choose to sell from a position of strength to meet future strategic objectives and benefit from favorable partnership valuations. For these practices, partnership objectives often:

- ▶ Reduce exposure to business risk.
- ▶ Secure compensation guarantees and recruitment support.
- ▶ Access capital for growth.
- ▶ Increase access to operating resources (e.g., EHR, data/analytics, risk management/managed care contracting).
- ▶ Fulfill desire for a liquidity event.

In *change-of-control* models, the strategic partner may acquire 100% of your practice's equity through a sale or acquisition or may acquire a majority of the equity (*sale of controlling interest*), with the physicians retaining the balance. Retained equity provides your group and the partner with comfort that following the closing, individual physician interests will continue to be aligned. Additionally, physicians often value this equity as a mechanism for engagement and retention. In cases where the partnership drives significant practice growth, the future value of the retained equity may be a substantial financial incentive.

In some cases, a *minority investment* from a strategic partner may be appropriate. This arrangement provides access to capital while preserving majority governance control for your

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group. The partner generally receives governance representation in proportion to its investment and may request additional rights. The proceeds from the transaction may be used for strategic growth, operating requirements, or shareholder liquidity and will need to be agreed to with the partner. A minority investment can test the waters by building a relationship with a strategic partner that could expand in the future. If objectives are not met, minority-investment relationships also are easier to unwind than a majority sale.

There is no “one size fits all” partnership structure. Objectives and considerations leading to various structures include:

- ▶ Desire to preserve governance control
- ▶ Willingness to retain some or all business risk
- ▶ Ability to identify specific and discrete strategic, operating, or capital needs
- ▶ Interest in an expanded relationship with a strategic partner without constraining future strategic options
- ▶ Lack of compelling change-of-control partnership opportunities in the relevant region

The amount of capital required often helps to define which structures are possible.

Simple schemas that *identify* the options available to the medical group and their rationales can help. For example, Table 1 presents four options identified by one medical group—ranging from a 100% equity sale to remaining independent and entering into creative strategic relationships—and the medical group’s answers to four standard questions.

Make the Decision

Each partnership decision-making process is unique. Following are brief descriptions of the process used by two physician groups.

Example 1

A nationally recognized physician group completed a merger with a leading independent medical group in 2015. Kaufman Hall identified and evaluated a broad range of partnership options, received and analyzed proposals, coordinated potential partner presentations, drafted and negotiated terms sheets, and assisted in negotiating the agreement. Toward the end of the partnership evaluation process, proposals fell into two primary categories: strategic affiliations and change-of-control partnerships.

Helping Hands

Partnership structures range widely across the market. Exploring creative options for partnership in lieu of selling equity is an option many medical groups consider and use. Options may include:



Clinically integrated networks. The medical group and the partner jointly develop a clinically integrated network to manage value- and risk-based contracts. The partners negotiate their respective contributions, which may include capital, access to payer contracts, access to provider networks, and management services infrastructure.



Risk businesses. The medical group and partner jointly develop a global risk-bearing entity. Each partner transfers capitated contracts, with the parties negotiating the allocation of upside and downside risk. The parties negotiate their respective additional contributions, which may include capital, care/utilization management services, and risk management services.



Management services arrangements (MSAs). Through an MSA, the group either provides services to the physicians practicing in the partnering entity or purchases management services from the partner entity. Services may include care management, practice management, managed care services, and others.



Joint network development. The medical group and partner jointly develop primary and/or specialty care networks in new or existing markets. The partners negotiate their respective contributions, which may include capital, professional services, provider recruitment/retention, facilities development, and other management services.

Strategic affiliations encompassed structures that achieved a meaningful strategic and/or operating relationship with a partner without a transfer of equity ownership or governance control. The partnerships were intended to be meaningful relationships with more “glue” than a contractual relationship, such as a service line professional services agreement. Candidates included both health systems and insurers, with options to do one or more of the following:

- ▶ Create a jointly owned clinically integrated network and/or independent practice association.
- ▶ Provide management services to providers in the partner’s existing network.
- ▶ Develop a joint venture to collaborate on geographic growth in both existing and new markets.
- ▶ Purchase a minority ownership stake. High-level considerations included:
 - ▶ The required amount of liquidity for shareholders
 - ▶ Capital offered for growth
 - ▶ Meaningful retained governance and operational independence
 - ▶ Level of future business risk

Change-of-control partnerships involve the sale of a majority equity stake and transfer of governance control to the partner. The arrangements did not necessarily require the group to cede all strategic, operational, and clinical decision-making. Decision-making could be shared, and future influence would be negotiated. Strategic alignment with the partner was *the* critical factor.

Several strong candidates emerged for this type of partnership, including health systems, other types of providers, and management services organizations. Key considerations included:

- ▶ A majority acquisition arrangement offering significant liquidity for shareholders
- ▶ Capital for growth, particularly in the ambulatory arena
- ▶ A physician bonus pool
- ▶ Retention by the group’s physicians of appropriate influence over clinical decisions

The final decision of the group was to merge with an independent, non-acute provider organization, which supported the group’s goal to grow its influence in regional ambulatory care as it moves toward a value-based care model.

Example 2

A multispecialty physician group with more than 20 clinical locations pursued a “controlled process.” Parties involved included for-profit and not-for-profit healthcare providers and health plans, which were invited to respond to a request for proposal. Based on the information received, the group evaluated each party’s ability to help the group achieve its strategic and financial objectives; the potential strategic and business rationale; geographical synergies/commitment to the region; size and scale; financial health; and execution issues.

The physician group selected the for-profit health services company; a partnership with this company allowed the group to be locally operated and serve patients under its existing brand name. The partnership was the company’s first venture in the region. The company offered its services, including technology and a network, at all the group’s locations. This strategic partnership bolstered the group’s ability to grow and expand, modernize its clinical facilities, access advance data analytics capabilities, and attract top medical talent.

Customized Partnerships

Most medical groups have partnership options that will allow them to simultaneously meet their strategic goals, access capital for practice growth, provide market-based compensation for physicians in the group, and achieve sustainable financial performance. Partnering and structuring alternatives exist for groups open to considering both traditional and creative approaches to meet their specific needs. [GRJ](#)

Kristofer Blohm, M.A., is a senior vice president at Kaufman Hall and a member of the firm’s mergers and acquisitions (M&A) practice. In this capacity, Mr. Blohm advises clients on a broad range of strategic transactions, including mergers, acquisitions, divestitures, and joint ventures as well as partnerships. **Nora Kelly, M.B.A.**, is a senior vice president in Kaufman Hall’s West Coast practice. Ms. Kelly is responsible for strategic financial planning, capital allocation, debt-related financial advisory, and mergers and acquisitions for physician groups, community hospitals, and healthcare systems.

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