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Exit Strategies for Physician Groups

By Dan Gaffney
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Whether you're a physician with a small or large group, you're likely concerned about the future of your practice. You've dedicated a great deal of time and energy to building your practice and taking care of patients. Perhaps your clinic is thinking of combining forces with a hospital to better cope with the wealth-shrinking impact of last year's financial meltdown or to deal with the anticipated consequences of health care reform or to help with long-range planning issues surrounding recruiting, retention, and succession. Or perhaps it was your plan all along to retire in the next few years. By whatever path you took to get here, you're now approaching a crossroads: a milestone that affects your practice, your family, your wealth, and your future.

The crossroads is the transition of your practice. When the time comes for transition—whatever your reason—you want to make sure your practice and your patients will be left in good hands. In a perfect world you'd find someone who'll pay you precisely what you believe your practice is worth and at the same time provide the same level of care to your patients that you did.

Any final ownership transition plan needs to take into consideration your retirement goals and your needs. It must contain a price and terms to provide sufficient cash flow to fund your retirement and maintain your lifestyle while being economically feasible for the new owners to sustain the practice. But successful ownership transition really begins with identifying potential successors, which may include new physicians, other clinics, or hospitals.

Physicians must evaluate many factors before transitioning their practice. A few of the key areas of focus that are integral to a successful transition plan are:

- Entity structure. Business entities structured years ago may not have been designed with succession in mind and may create adverse tax consequences to the seller or purchaser. The original entity structure must be evaluated to determine whether any further restructuring is needed to facilitate any potential future transaction. Entity structuring is a key area to address well in advance of any potential business transition in order to ensure that the physician group is positioned to maximize its return.
- Assessing your ownership transition choices. Who are your buyers? There are different issues associated with each of your options. If you're

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LETTERS TO THE EDITOR

If you have questions or suggestions regarding the News and its contents, please reply to dpeel@cahcnews.com.

Letter from the Publisher and Editor

Dear Reader,

Now that healthcare reform has become law, many organizations are developing plans for it's successful implementation and administration.

Our current times remind me of 1996. That was the year the Health Insurance Portability and Accountability Act (HIPAA) was enacted. HIPAA was intended to combat fraud, abuse, and waste and make the system more efficient. The federal government's initial estimate of the cost of complying with HIPAA was $3.8 billion. This was much lower than industry estimates as the American Hospital Association alone estimated the hospital industry's cost of compliance at $22.5 billion. Although hard to find, many companies used external resources like attorneys, accountants and consultants to successfully implement HIPAA.

The new law is much more expensive and complicated than HIPAA and you will again need external resources. Fortunately, unlike 1996, you can quickly and easily find attorneys, accountants and consultants by visiting the Consultant Marketplace page of the California Healthcare News web site at cahcnews.com/consultant. Until next month,

David Peel, Publisher and Editor

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transitioning to younger physicians, your ability to attract quality candidates will be critical, since younger physicians are often not interested in their own practice but rather attracted to the stability of a hospital. If you're looking at selling to a larger clinic or a hospital, then you have many issues to consider, ranging from outright sale of the practice to a joint venture. Regardless of your transition strategy, the changing economic and regulatory environment requires even greater cooperation between physicians and hospitals, and any transition plan must take this into consideration.

- Managing the tax impact. Tax is always a major component of any transaction, and appropriate steps must be taken to manage this cost when planning, negotiating, and structuring a deal. However, federal income tax, both corporate and personal, isn't the only component to be thinking about. State and local sales tax, use tax, business tax, and any personal property or real estate excise taxes must also be factored into the transaction, since these costs are often overlooked until the end—creating an unpleasant surprise.

Ownership transition is the process by which you transfer ownership to both maximize value and fulfill your financial goals. It provides an orderly exit for you while enhancing your practice's value. Once you've established your personal and financial needs, determined the value of your practice, developed cash flow models, and identified potential management succession issues, you can evaluate the various options for transferring ownership and choose the most advantageous one.

It's important to remember that your situation is unique. Every physician and every practice has a different financial scenario, personal circumstances, operations, management, knowledge and education, motivations, and hopes. A meaningful ownership transition plan will lead to increases in cash flow, greater transferable value, long-term practice continuity and success, and continuous high-quality care for your patients.

This is a very difficult and demanding time to be a physician running a practice. Because of all of the challenges facing you today, from the changing regulatory environment to capital constraints to recruiting and retention of top talent to the economy, now is a great time to evaluate your options.

Dan Gaffney is a Partner with Moss Adams LLP and a leader and steering committee member for the firm's Wealth Services Group. He specializes in serving physicians and medical groups with tax issues, strategic and operational business planning, estate planning, retirement planning, and business succession planning. He can be reached at 425-303-3195 or dan.gaffney@mossadams.com.

To learn more about Moss Adams LLP visit their web site at www.mossadams.com.

Physician Integration - California Style

By Tom Kumura, FHFMA
President
Kumura & Associates, Inc.

According to an Association of American Medical Colleges and AMA survey of physicians under the age of 50, time for family/personal life is very important. (Edward Salsberg, Association of American Medical Colleges, *National Physician Workforce Trends*, April 22, 2009)

The aging physician population and family friendly work attitudes of younger physicians are the major limiting factors on physician supply. In some cases, it may take two younger physicians to replace one older physician who has been working 75+ hours a week.

In addition, as a response to unreasonably low reimbursement from governmental payors and the increased administrative headaches associated with third party insurance companies, some physicians have begun practicing concierge medicine. These physicians limit their practice to a small number of patients who pay an annual "access fee" which affords them quicker office visits that are not hurried.

Other physicians have become more hospital-based. These include hospitalists, intensivists, neurointensivists, orthointensivists, pediatric intensivists, laborists, and nocturnists. Combining this trend with the increased demand for healthcare services due to population growth, aging of the population and advances in medical technology will only result in additional physician shortages.

Physician integration strategies are increasing as hospitals attempt to secure a stable base of physicians to work with. These strategies include:

- Medical Directorships
- Emergency Room On-call
- Co-management Arrangements
- Joint Ventures
- Employment

Medical Directorships

Medical directorships are used by some hospitals to secure the administrative services of physicians with specific clinical experience. The duties of these medical leadership positions are typically documented in written agreements, which also state the average number of hours required per month and the fair market value of hourly compensation.

Emergency Room On-call

Hospitals are deciding whether to pay fair market stipends for ER on-call or to have their ER go on divert status. In certain specialties, like neurosurgery or orthopedic surgery, it is not unheard of for hospitals to pay a stipend of $1,000 a day.

Co-management Arrangements

Under a Co-management service agreement, a hospital works with a management company formed and jointly operated with individual solo practicing physicians and physicians from medical groups to co-manage a clinical department or specific service line. The management agreement is typically from one to three years and provides fixed and incentive compensation.

The incentive portion of the compensation is based on achieving specific targets focused on operational improvements, patient satisfaction and/or improved outcomes. The fixed portion of the management service agreement is paid monthly and used primarily to pay operating expenses and physicians for their time served on management boards and committees. A fair market analysis may be used to support hourly rates paid. In addition, the rate paid to other healthcare management providers may be reviewed to justify any percentage of revenue co-management fees paid. Depending on the

specific duties and performance incentives, co-management fees of 2 to 6% of net revenues are not unusual.

Joint Ventures

Hospital and physicians may decide to work together on a health care joint venture that generates technical revenues. Joint ventures are much more complicated and take significant time and resources to develop. Investors frequently earn a return based upon their ownership percentage.

Should a joint-venture involve an established business such as an ambulatory surgery center, it should be purchased at fair market value to avoid ruling afoul of Stark regulations and anti-kickback statutes.

Employment

California has a corporate practice of medicine doctrine which prohibits business corporations from employing physicians. Accordingly, hospitals have contracted with physicians to provide their professional expertise. In most cases, the hospital produces a technical bill with the physician producing a separate professional bill.

Some hospitals have developed medical foundations, which hire physicians in medical groups through a professional service agreement. The medical foundation may be a subsidiary of the hospital but has its own medical foundation board.

The medical foundation oversees the day to day operations, assets and research/community education, while the medical group is responsible for distribution of compensation, quality of care/patient satisfaction and other physician employment duties. The medical foundation needs at least 40 physicians in 10 different specialties.

Conclusion

Some hospitals may attempt alternatives such as employing physicians to staff hospital clinics/outpatient departments. Others may attempt to use a "Friendly Professional Corporation" where a professional service agreement is secured with a physician corporation.

As hospitals and medical groups struggle to cope with decreased reimbursement and the limited supply of physicians, other physician integration strategies may evolve, with the market determining who the winners will be.

Tom Kumura is the President of Kumura & Associates, Inc., a nationally recognized healthcare consulting firm. His firm specializes in fair market valuations, market analysis and other services. He can be reached at 760-310-8882.

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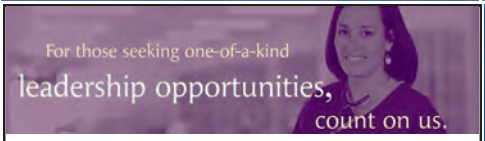

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