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The Dating Game

HOW TO CHOOSE A STRATEGIC PARTNER

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Consolidation in the health care industry continues at a rapid pace. Solo practitioners and small medical groups are joining larger medical groups, IPAs are acquiring one another, and physicians are entering into long-term management agreements with hospital-based management services organizations (MSOs) and physician practice management companies (PPMCs).

Choosing a strategic partner is obviously a crucial decision for any physician or group. Choose the wrong partner, and the union is likely to fail. Unfortunately, many physicians and groups have only a limited understanding of how to evaluate a potential strategic partner. Physicians should consider the following key points when evaluating a potential partner.

HAVE COMPATIBLE GOALS

Before you can evaluate whether a potential partner is the right one, you need to understand and articulate your own goals, as well as those of a partner. Both parties' goals should meet four tests. First, they should be substantial and not readily achievable without partnering. For example, could your goals be accomplished through a looser affiliation or contractual relationship and without a formal merger?

Second, the goals must be realistic. For example, are you hoping to establish a national presence, when a strong position in the local market is what is obtainable at best?

Third, each party's goals must be understood by the other. Frequently, potential partners do not truly listen to each other. Finally, you and your potential partner must agree on the goals. The goals do not have to be identical, but they certainly must be compatible.

CHOOSE AN EXPERIENCED AND FINANCIALLY VIABLE PARTNER

The prospective partner should have actual experience in the areas where you need help, such as experience in medical practice management and in managed care. Have they organized and operated an integrated delivery system before, and has it been a success?

Regarding financial viability, does a prospective partner have substantial equity, or is it thinly capitalized and highly leveraged? Does it have sizeable reserves, an established line of credit, or other access to capital? If the partner is a medical group or IPA, look for significant liabilities, such as long-term debt, unpaid specialists, or insufficient reserves for incurred but not reported claims. You should review financial statements with the assistance of an accountant, practice consultant, or health care attorney, and check references by interviewing others who currently do business with your potential

partner as well as those who have decided not to do so. A thorough "due diligence" background check is absolutely essential.

DEVELOP A STRATEGIC BUSINESS PLAN

Not having a business or strategic plan may show a lack of sophistication, organization, or commitment. If the potential partner does have a business plan, is it realistic and compatible with your goals? Among other things, a business plan should: describe the current business; set forth its goals; discuss local market conditions and competition; delineate the plan for obtaining managed care contracts, expanding enrollment, and meeting other strategic objectives; and project revenue, expenses, and capital requirements.

OBTAIN A SUFFICIENT FINANCIAL COMMITMENT

Are you and your partner prepared to invest the necessary funds to carry out your strategic plans and demonstrate a serious commitment to each other? If one party is not willing to contribute any significant cash or tangible assets, it might indicate that it has limited capital or commitment. PPMCs, particularly those that are publicly traded or hope to be, might agree to pay for physician practices only with their stock or a promissory note. They may then use the cash flow from a long-term management agreement with the physicians to create earnings that can be capitalized and multiplied many times in selling their stock. If physicians are to receive money or anything else of value from a partner they must ensure that it will be in compliance with federal and California fraud-and-abuse, anti-kickback, and self-referral laws, such as the federal "Stark" and state "Speier" laws.

CHOOSE A CULTURALLY COMPATIBLE PARTNER

Every organization and group of individuals has its own style. Your culture and that of a potential partner need to be compatible. Physicians who want to focus on practicing medicine may not mix well with "corporate types." Will a not-for-profit hospital culture be compatible with a smaller medical-group style? Does the partner have a reputation for fairness and flexibility, or does it insist on doing everything its way? How will decisions be made? Will there be an autocratic, top-down approach or will it be bottom-up and democratic? Will decisions be made locally or by an out-of-state corporate home office? Can decisions be made quickly, or is there a large corporate bureaucracy requiring approvals at many levels? Is one group looking for short-term gain either in the form of a buyout payment or by going public, while the other has a long-term focus?

ASSESS PHYSICIAN INVOLVEMENT

Physicians are still the key players in any strategic alliance. If you plan to join with other physicians in a larger group, IPA or integrated delivery system, ideally your prospective physician partners will share the same commitment to and enthusiasm about the venture and not be suspicious and resistant to being part of a larger organization. Are the physicians interested in the long term rather than a cash payment and early retirement? Is the group you plan to join well managed, or is it a financial basket case? What are the reputations of the physicians among their colleagues? Are they

well positioned in the local market? Do the physicians have prior experience in working together either in a group, an IPA, or on the same medical staff? Do the physicians have "quality" practices? Will sufficient numbers of primary care physicians be involved?

EVALUATE A PROSPECTIVE PARTNER'S PRACTICE MANAGEMENT EXPERTISE

Many physicians feel they need to have a partner to gain access to "professional" management, an area in which hospitals and PPMCs often claim to have superior expertise. Sometimes this is true, but in too many cases it is not. Hospitals, in particular, often fail to realize that the business of running an acute care hospital is very different from managing a medical practice.

After a so-called practice management professional takes over practice costs sometimes increase, and collections and profits decrease. Physicians need to carefully examine their prospective partner's actual practice management record and not rely on promises. Management service agreements should include performance guarantees relating to overhead and profitability.

IDENTIFY A PARTNER'S MANAGED CARE EXPERTISE

In addition to practice management expertise, a prospective partner should be evaluated for its experience in managed care. Many physician groups might be surprised to find that they have considerably more managed care experience than their much larger hospital or PPMC potential partners. Can the prospective partner increase your patient enrollment with existing health plans, gain access to new health-plan contracts, and increase your capitation rates and share of risk-pool distributions? Has the potential partner successfully managed the complex relationships among primary care and specialty physicians, the hospital, ancillary service providers, health plans, and patients so that enrollment has increased, the specialists have been paid, and there is a surplus in the risk pool to distribute? Do health plans view your prospective partner as desirable? Does your partner have sufficient numbers of geographically well-situated primary care physicians and specialists? Does it have a significant degree of penetration in the local market? Will you have direct contracts with the health plans or be in a subcontracting role?

DEVELOP A PLAN FOR SHARING CONTROL AND DOLLARS

Is your prospective partner's proposal for sharing money and control fair? Does it insist on retaining voting control? How will profits be shared? Will you end up repaying an initial buyout amount in the form of your partner's taking, for example, 15 to 20 percent of all future profits you generate?

Physicians should note that control and money do not need to be shared in the same way. For example, subject to legal compliance, one party might own all or a majority of the "Class A" stock, with the "Class B," nonvoting, equity-only stock shared equally.

EXAMINE OPPORTUNITIES FOR EQUITY BUILDUP

Many physicians hope to get an equity stake in a venture that will eventually sell out to a well-heeled purchaser or go public. In the 1990s, there were certainly cases where this happened. But more often, a prospective partner will dangle the potential to get rich quick in front of physicians to entice them into the venture, avoid paying cash for the physicians' practices, or persuade them to give up control or a fair share of the profits. Unrealistic expectations or promises can distort the whole structure of the relationship. In most cases, physicians should strive to ensure that they will get a fair share of the profits year in and year out. Although physicians should try to maximize their equity position, generally, they should not do so at the expense of ongoing control and profits.

BE INFORMED ABOUT EXCLUSIVITY OR RESTRICTIVE COVENANTS

Will the potential partner expect you to agree to an exclusive arrangement? Will it be exclusive to you in return? Hospitals and PPMCs sometimes seek a one-way exclusive, while reserving the right to manage other potentially competing groups. Similarly, if things do not work out and you split up, the partner might prevent you from partnering with someone else, from re-establishing your practice within a certain geographic area for a specified number of years, or limit you in soliciting former patients. Will you have the right, or the obligation, to buy back practice assets and, if so, at what price?

UNDERSTAND THE RELATIONSHIP'S LENGTH

Will your potential partner be willing to enter into an arrangement that either party can terminate, on reasonable notice, if it is unhappy, or will you be expected to make a 30-to-40-year lifetime commitment? If the proposed term is too long, it may cause physicians to balk at entering the relationship in the first place. On the other hand, if it is too easy to end the relationship, the parties might not make a sufficient commitment to its success. Among the alternatives to a long-term, no-cut contract, are: a shorter-term contract, such as three to five years; providing for an opt out or buy back during the first one to two years; or establishing performance standards tied to profitability, managed care enrollment, and other factors. If the standards are not met, physicians would have the right to terminate the relationship.

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By asking, and getting answers to the right questions, physicians can greatly increase their chances of identifying and avoiding unsuitable candidates, and choosing the right partner for their practice.

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