WHITE PAPER

Physician Practice Merger Considerations

With the ever-evolving reform of the U.S. healthcare industry, comes much uncertainty for private practice physicians. While some practices are content with no organizational changes and some have decided to be acquired by hospitals, others have gone the route (or are pondering) of merging with another private practice (either same specialty or different specialty). For those that are considering merging with another private practice entity, there are many things to strategize about vice just assuming there will be a windfall of benefits by consummating a merger.

Physician owners must have a clear rationale for a transaction or truly understand a deal's impact on their practice's long-term financial future. Too often, however, there's a misguided sense of why the merger should take place at all, and there's far too little time spent defining how the merger enables them to beat competitors and increase organizational value. For a merger to be successful, it is critical in the pre-deal phase to carefully identify, capture, and price the potential cost and revenue synergies. While valuing synergy requires assumptions about future cash flows and growth, the lack of exactness in the process should not be a deterrent. With due diligence, it is possible to obtain an unbiased estimate of value. Moreover, when assessing a deal's assigned value (market value plus the premium) it is important to understand that pricing should be set based on the impacts that are both operational (e.g. cost savings and economies of scale) and financial (e.g. lower cost of capital, higher return on investment potential, and potential for a lengthier growth period from increased competitive advantages).

It is also important to understand synergies and valuation, because there is a potential for reducing the cost of operations in many mergers. In general, it is much easier to cut costs than to attempt to increase the revenue of a practice on its own. When similar practices merge, they are presented with an opportunity to improve savings through expense reduction strategies like optimizing operations and lowering redundancies. Skillful cost cutting measures and combining redundant departments can reduce training and turnover expenses while also helping to promote employee loyalty. Arguably the biggest error in planning mergers is overconfidence in projected revenue synergies. It is difficult to project revenue synergies because in most cases they are matters of speculation, and manifest themselves in so many different ways. Ideally, the merger should help improve market reach and better negotiations with payers. The new practice now encompasses a larger catchment area, where revenue increases can be realized by increased patient volume, which in turn can boost provider productivity in the long run.

Despite these benefits, projected synergies must be carefully considered and priced before any transaction, as overly rosy visions of the combined practices' future can lead both physician owners and managers astray. To be sure, there will always be uncertainty surrounding future synergies. However, qualified healthcare consultants should attempt to make the best estimate of how much value cost and revenue synergies will be created in any merger before advising the parties to proceed.

Performing this synergy valuation is significant even though doing so requires the consultant and practice owners to make assumptions about an uncertain future. Failure to perform the lengthy due diligence will result in mergers that are dead on arrival, no matter how they are managed after the deal is complete. Realizing these future synergies requires significant management actions, and thus the core driver of a merger must be a marriage of sound management philosophy and the implementation of projected synergies. Without both, there is no foundation for the merger.

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