MERRITT HEALTHCARE ADVISORS

WHITE PAPER

Consolidation in specialty health care practices

Top challenges of balancing needed growth and desired autonomy

Merritt Healthcare Advisors
INVESTMENT BANKING

Opportunities are accelerating for surgical specialists and specialty practices to access private practice alternatives and move away from large hospital systems and academia. A sea change in the delivery of specialized care is opening up new opportunities and revenue streams for practitioners who can also reclaim their much-desired autonomy and lead more physician-driven and physician-centric businesses. In turn, this move toward independence in specialty care is driving a wave of mergers, acquisitions and consolidations in specialty care practices as the need for size and scale leads practitioners to seek the capital and resources necessary for growth.

With the opportunity of acquisitive growth comes risks for doctors who fiercely value and guard their independence and control over their practices. For investors and advisers, recognizing and addressing these nonpecuniary concerns when discussing possible deals is critical to successful transactions.

> One of the key challenges of acquisitions of specialty physician practices is moving physicians from a siloed approach to defining success on a broader continuum. Specialists usually want to maintain some degree of self-governance and autonomy.[1]

Changing regulatory, reimbursement landscape drives consolidation

A key driver in the growth of independent specialty practices is the change to regulatory and reimbursement policies that allow practitioners to perform Centers for Medicare & Medicaid Services-approved procedures in ambulatory surgery centers rather than on an inpatient hospital basis. This creates a significant pathway for practitioners to take advantage of a new revenue stream for cases that they're already doing and grow their practices. Before these changes, certain specialists were almost entirely hospital-driven because there was no practical or viable mechanism for physician-driven, physician-centric businesses to thrive.

It isn't just new revenue streams driving specialists in this direction, however. In private practice, specialists can be more autonomous than they would be in a large hospital system. They can make their voices heard, govern themselves internally, have more control over patient care and monetize services to improve their compensation.

[1] https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4221756/

But in the absence of size, controlling sites of service, and having robust data collection and data management, it can be difficult for small practices to grow and be consistently profitable. This is especially the case with alternative payment models and in light of increasing consolidation of health systems, payers, and primary care, and other referral sources.

Organic versus acquisitive growth

Specialty practices can grow in two ways: organically and acquisitively. The former can involve bringing on new practitioners/shareholders or expanding ancillary services, both of which require an initial investment of time and money. This involves doctors coming off-line from seeing patients because they need to put on their business hats, crunch the numbers and do the analytics, and then decide whether they want to make that investment. This can make organic growth impracticable or unattractive.

That's why the market for acquisitive growth in the specialty practice ecosystem — through mergers, acquisitions and consolidations, in particular — is so robust. Structural pressures, whether regulatory or economic, are pushing toward consolidation in a highly fragmented industry that has many fixed costs. The amount of private equity investment in specialty practices has increased significantly over the last 12 years. In turn, deal count and deal value have increased substantially since 2020, breaking records for consolidations, with no signs of slowing down.

BY THE NUMBERS: PHYSICIAN MEDICAL GROUPS ACQUIRED BY PRIVATE EQUITY GROUPS, 2013-2016[2]

		Year of Acquisition			
Group	**Total**	**2013**	**2014**	**2015**	**2016**
Practices	355	59	72	88	136
Sites	1426	216	308	386	516
Physicians	5714	843	1413	1576	1882

[2] *https://jamanetwork.com/journals/jama/article-abstract/2761076*

What makes specialty practices attractive investments?

Investors and other players who seek opportunities in the specialty practice market consider several factors when evaluating practices and determining whether they're an attractive investment platform. These include size, the type of ancillaries the practices have and how those ancillaries are doing, and what aspects of their practices the physicians/ owners have consolidated.

Investors are attracted to providers who have a history of success and understand the demonstrated best practices of executing upon that success. The regulatory and payer environment where a practice operates also plays a role.

Beyond the dollars and cents, investors seek practitioners who share their vision for growth and a fully integrated national platform. When they find a practice where vision and values are in sync, investors will want to lean into the doctors' strategic vision for their practice, bring their strengths to bear in support of executing that strategy, and add resources — whether capital, analytics or staffing — to help drive growth. In the end, it's about how much investment is required to create the infrastructure necessary for expansion.

It's about more than dollars and cents

Investors and practitioners share a desire for growth and increased revenue. But doctors approach prospective deals with a distinct set of concerns about consolidation and acquisition, as essential as such transactions may be for viability and growth. Evaluating opportunities involves much more than considering financial terms.

Specifically, the challenge for doctors in private practice is how to balance their desire for autonomy with the ability to access capital or take advantage of scale so they have a level playing field. A practitioner who's obtained independence and control over his or her practice will be understandably reluctant to work for a hospital system or a big medical group. After being an owner, the physician won't want to become an employee.

Practitioners may be able to address these concerns by choosing partners they're comfortable with and those that align with their goals. In turn, investors must be cognizant of the tension practitioners feel between necessary growth and desired autonomy and its role in their decision-making process. Failing to acknowledge and address these concerns during negotiations could quickly sour a practice owner on the potential benefits of a proposed transaction.

Similarly, the medical practice advisers who find opportunities, connect potential partners and facilitate deals for practice owners also need to recognize and consider how emotional these transactions can be for practitioners who live and breathe the business they've built for themselves.

Advisers want all parties to see the opportunity as a win-win. The adviser's role is to provide sound, objective data to help guide doctors through the process and make them feel good about what they're doing.

Unique focus. Proven results.

Merritt Healthcare Advisors focuses exclusively on representing owners of surgical facilities and health care practices that are considering strategic options, whether selling an interest in their organizations, creating new partnerships or growing through acquisitions.

As the industry's leading mergers and acquisitions firm, our proven process and extensive buyer network enable us to help our clients realize the absolute best financial and nonfinancial outcomes. We're unique in that we're the only firm that combines an investment banking background with actual "owners" experience that comes from developing and managing our own health care facilities. We've used this experience to successfully complete more than $4 billion in transactions on behalf of our clients.

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