

FOR EXECUTIVES SEEKING TO BUY, SELL, OR RECAPITALIZE BUSINESSES

Practice M&A: The Devil Is In The Details

Pitfalls To Watch For In Professional Practice Mergers & Acquisitions

Empirical evidence suggests that many small to midsized professional practices are increasingly disintegrating into solo practices or getting merged into or acquired by larger professional practices. The factors driving this trend are: retiring baby boomer practice owners, burned out owners, increased cost of regulation, pervasion of web-based services, and ever increasing infrastructure costs.

In these uncertain times, middle market practice owners concerned about their financial security need to make some careful choices in deciding which way to go forward. This is especially true for the owners who are close to their retirement. Fortunately, most mid market practice owners have several options: sell the practice, merge with another practice, grow through acquisitions, or continue on the current path and let the chips fall where they may. The latter option is clearly not recommended for practitioners who seek financial security and have the need or desire to feather their nest egg.

If the practitioner is forced by personal issues, familial issues, or does not have the energy or drive to run the practice, a sale of the practice may be the only option. However, merging, reorganizing, or growing through M&A can be desirable paths if the practice ownership has the energy, skills, and sophistication. For the purpose of this article we will refer to the process of merging, reorganizing, or acquiring a practice as a "merger".

For most practice owners, the biggest benefit of a merger is the size of the combined practice. Increased size can result in several advantages:

- **Resources:** The resources of the combined organization may allow the practice ownership to attain previously unattainable personal and professional goals or attain them sooner than otherwise would be possible.
- **Better Lifestyle:** Larger practices afford less administrative overhead for the practitioners while simultaneously providing better coverage for each other with less adverse impact on customer support and retention. A larger practice can help practitioners provide better coverage for the customer without sacrificing personal time-off.
- **Customer Leverage:** The combined practice can increase the effectiveness of the marketing programs, improve ability to reach customers, expand the range of services that can be offered, and increase the number of touch points to the customer.

- **Supplier Leverage:** Larger practices typically have more leverage with suppliers resulting in better prices and terms. A larger revenue stream may also enable the practice to attract suppliers unattainable prior to the merger.
- **Cost Reduction:** Consolidation, with proper planning, leads to more efficient and streamlined use of staff, space, systems, and equipment resulting in lower administrative costs. These cost savings fall to the bottom line and make the practice more profitable and valuable.
- **Increased Market Share:** Combining practices increases the market share and this by itself can become a virtuous cycle and further propel the practice to newer heights.
- **Built-in Exit Strategy:** The terms of the combined practice can be written in such a way that there is an automatic exit strategy for an individual practitioner within the group in the event of disability, death or other agreed upon event. If planned well, the outcome for the owner or owner's estate can be significantly better than what is possible in a smaller practice.
- **Increased Valuation:** Practice valuations for mid-market practices vary widely depending on the size, transferability and strategic value of the practice. Transferable, larger practices routinely command [EBITDA](#) multiples dramatically higher than smaller practices without a proper management structure.

While these benefits make the M&A path very attractive to practice owners, there are several disadvantages of taking the M&A path and several pitfalls to watch for to arrive at a successful outcome. Here are some concerns and pitfalls and the approaches that can be taken to overcome them.

- **Loss of Control:** The biggest disadvantage to practice merger is the loss of control and autonomy, real and perceived, by the parties. While the loss of some control is a reality in most mergers, the problems arise when the perceived loss is more acute than expected or when the perceived benefits of the merger are less than expected. In order to minimize the chances of this outcome, ensure that you have a clearly defined buy-sell agreement and an agreement defining roles and responsibilities of the parties post merger. Both these agreements will be of great benefit should the merger not materialize as planned.
- **Owner Satisfaction:** While successful practice mergers are aplenty, it is not uncommon for owners to be disenchanted with the merged practice. To increase harmony and streamline integration, the goals of the merged practice should be extremely clear and well understood by all parties. What is the purpose of the merger and what is the strategic direction? More services? Broader market? Practitioner coverage? Going after a different customer base? Whatever the reasons are, if the expectations are clear, the satisfaction of the practitioners and the probability of success of the merged practice is enhanced.
- **Capital Structure and Voting Stock:** One of the sore aspects of a merger involves lack of agreement on capital structure and control of the practice. A retiring practitioner may care little about control but a lot about the finances. On the other hand, the partner looking to grow may have stronger feelings about control. To avoid this, efforts should be made early on to separate the capital structure from voting rights structure. The financial and governance needs of key management members and the ownership should be addressed and codified. A good set of Bylaws along with delineation between

what needs to be approved by board vs. shareholders vs. officers of the company should be well documented.

- **Compensation Structure:** Compensation structure and division of income for the owners, and key staff members must be developed with an eye toward tax impact as well as fraud and abuse considerations.
- **Benefit Plans:** A substantial discrepancy between the benefit plans of the merged corporations is another potential problem area in practice mergers. Benefit plans of the merging entities and key individuals must be reviewed carefully and adjusted as needed to ensure there are no post close surprises.
- **Compatibility between Practitioners:** Practitioner incompatibility is another disadvantage of practice merger/acquisition. This problem can be especially acute if the practice includes several specialty areas and the needs of the specialists are not compatible with the needs of the organization as a whole. Consider this aspect of the merger carefully and put plans in place before the merger to head off any issues.
- **Offices & Personnel:** Offices & Personnel is another area of friction in practice mergers. Care must be taken to ensure which of the office locations and personnel will continue with the combined practice after the merger. If resolution of this issue is expected to occur post close, bylaws and governance rules can be created to ensure the process for resolution is agreeable to both parties.
- **Liability, Fraud & Abuse:** Liability, fraud and abuse issues should be addressed to make sure that the combined organization and the key individual needs are adequately addressed. Merging parties typically would indemnify one another from liabilities that predate the merger.
- **Supplier & Customer Contracts:** Ensure the supplier/customer contracts are reviewed carefully and any differences between two different contracts with the same supplier or customer are reconciled to the advantage of the joint organization (costs, reimbursements, etc.).

Practice mergers can be of great benefit to mid market practice owners. However, practice owners need to be cognizant that practice M&A can be complex and the results can be adverse unless considerable amount of preparation and deal making occur prior to the finalization of the agreement. Extreme care should be taken to ensure that issues such as the ones mentioned above are carefully considered and addressed prior to close. To adequately address these and other complex issues, practice M&A can take an extended period of time. Six to eighteen months of preparation/negotiating from signing of the LOI to the close is common.

The time and money spent upfront to avoid typical merger pitfalls and achieve a common understanding of the deal can go a long way in ensuring the personal and financial goals of the M&A process are realized as planned.

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