Amalgamation the Changing Face of General Practice Ownership
Your Presenters Today

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Session Objectives

Our objective today is to give you our insights as bankers and business advisors, and:

• Stimulate some fresh thinking about how to get the most out of your business

• Provide you with some useful insights into not only amalgamation, but managing change within your business.

• Work through some practical examples so that you feel more informed about the next steps if you are considering a change to your current business mode
Agenda

1. The current GP business environment
2. Trends in practice ownership
3. The Pro’s and Con’s of Amalgamation
4. Executing the strategy
5. Case Study
6. Recent Tax Issues
7. Conclusion / Questions
Key Drivers of the GP Business Environment

Macro Drivers

• Capitation has changed the business environment
• Increasing complexity of business management given significant increase in compliance and practice administration
• Highly fragmented sector with large concentration of small practices/businesses
• Scope of general practice services widening
• Many medical centres are constrained by size and functionality to provide wider services given small practice ownership and historically low levels of investment
Key Drivers of the GP Business Environment

Macro Drivers

• An aging and shrinking GP workforce creating future succession issues
• Accountability to deliver health outcomes under PHCS
• Higher volumes of illness and demographic trends creating ethical pressures
• Political pressure to create a more efficient health system given forecast public health expenditure – National Party Policy
Key Drivers of the GP Business Environment

Richard Tyler, GP and Chairman Capital PHO,

“The key to success is to focus on income not expenses. A lower percentage of expenses is not generated by lower costs but by greater income”

Revenue Drivers

• Capped revenue lines
• Wider clinical scope for nurses and additional revenue lines
• Price sensitivity
• “More buck for your bang”
• New remuneration models
• Shortage of qualified nurses and GP’s
• Patient retention
• Patient growth
Revenue Lines

- Immigration
- Diabetes
- CVD Screening
- Occupational Health
- Immunisation
- POAC
- Travel Health
- Corporate Health
- Worried well
- Training practices
Key Drivers of the GP Business Environment

Cost Drivers

• Shortage of qualified GP’s, nurses, and practice managers
• “Like most professionals I often try and work out my hourly rate after a month of 60 hour weeks and sometimes think I would be better off pouring pints.”. C. Barton – Westpac.
• More efficient use of lower fixed cost nursing staff to increase patient throughput and gross profit margin
• Major increase in compliance
• Accreditation
• Technology is an enabler
Future Threats and Challenges

• Potential dilution in subsidy value with the advent of wider revenue streams
• Continued price ceilings and dispute over fees policy
• Privatisation: ACC / secondary services / diabetes
• Higher compliance costs
• Competition from corporate or scale providers offering longer hours and wider services and higher salaries
• Burgeoning trend towards non profit ownership creating financial competition
• Private health insurance – cost minimisation strategies
• Potential development of PPP business
• Salary competition: Public, Private, Corporate
Sector Snapshot

The following observations are made from the 2006 IPAC GP Business Survey and the RNCGP 1997 and 2007 studies into NZ General Practices.

- 1135 practices
- 243 are partnerships with 3 partners on average or approx 20% of market
- Between 2005 and 2007 self employed GP’s fell from 56% to 45%
- Since 1998 sole practitioners have reduced by 67%
- Employed GP’s as a percentage of practice employees has doubled from 10% to 20% over 10 years
- 58% of GP’s have an ownership stake in their practice
- 45% owned their own premises
- GP owners spent more time in the practice compared to employees (1 FTE equivalent vs .50 FTE equivalent)
- 3 of 36 practices opened on the weekends
### Key Drivers of the GP Business Environment

**IPAC 2006 General Practice Business Study**

<table>
<thead>
<tr>
<th>Organisational Structure</th>
<th>N practices</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>GP(s) trade as individual sole traders, incur their own individual costs and employ all other staff</td>
<td>2</td>
<td>5.9%</td>
</tr>
<tr>
<td>GP(s) trade as individual sole traders but share practice costs and employ all other staff</td>
<td>3</td>
<td>8.8%</td>
</tr>
<tr>
<td>GP(s) trade through individually-owned limited liability companies, each employing their own nursing and administrative staff</td>
<td>2</td>
<td>5.9%</td>
</tr>
<tr>
<td>GP(s) trade through one jointly-owned limited liability company that employs all other staff</td>
<td>11</td>
<td>32.4%</td>
</tr>
<tr>
<td>GP(s) trade as partners in a legal partnership that jointly employs all other staff</td>
<td>6</td>
<td>17.6%</td>
</tr>
<tr>
<td>GP(s) and other staff are employed by the practice, which is owned by a community trust, DHB, or District Council</td>
<td>3</td>
<td>8.8%</td>
</tr>
<tr>
<td>GP(s) and other staff are employed by the practice, which is owned as a limited liability company by some combination of GPs, nurses, other health professionals, and administrative staff</td>
<td>2</td>
<td>5.9%</td>
</tr>
<tr>
<td>The practice operates under another business structure</td>
<td>5</td>
<td>14.7%</td>
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</tbody>
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Practice Ownership Trends

- New GP’s have different lifestyle and professional aspirations
- Practice ownership is decreasing given financial risk and burden of management
- Research indicates that small practice goodwill is deteriorating and return on investment is deteriorating for practice owners
- Focus on career variety and professional development
- Majority of new graduates are female and seek flexibility for family commitments
- Emerging corporate market looking to invest in highly fragmented market supported by changing philosophy of GP’s around ownership
Amalgamation – Moving to a Single Business Model

Definition

For the purposes of our presentation we assume amalgamation is the establishment of a single limited liability company which consolidates multiple GP businesses under the one trading entity via the transferral of practice goodwill and assets

Pro’s – Amalgamation

• Transfer’s risk to the practice
• Return on investment – Time / Equity
• Management
• Recruitment
• Governance
• Strategic Planning
• Succession Planning
Amalgamation – Moving to a Single Business Model

Pro’s – Amalgamation cont.

• Larger infrastructure can create more revenue opportunities
  • “We now have more consulting room’s and can offer our patients access to specialist clinics, as well as better facilities for nurse consultations”.

• Patient retention / attraction

• Patient mix
  • “One of our goals was to enrol more patients in the 25-44 year old age bracket, which we achieved largely because of the wider services and convenience of the new facility”. Dale Sheppherd, Pakuranga Medical Centre.
Amalgamation – Moving to a Single Business Model

Cons – Amalgamation

• Long term capital investment
• Short term dilution in earnings
• Personal investment – Anecdotally we have seen a large gestation period for establishing amalgamated practices and it involves a lot of preparation, consultation and consensus to move forward. Think years not months!
  • “The first 12 months were hectic and all of us worked harder than we had in years, but despite the stress we achieved significant growth in patient numbers, financially we are better off, and environmentally it’s a great place to work.”
Amalgamation – Moving to a Single Business Model

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- Transition / Business Disruption
  - “We were much busier than we thought we would be, when we first opened a huge number of local people turned up to have a look around – both existing and new patients mushroomed so we quickly employed a 4th receptionist”.
- Complexity – Higher reliance on management team increases staff cost however should be offset by scale economies
Amalgamation – Moving to a Single Business Model

Cons – Amalgamation

• Shareholder / Practitioner conflict
• Cost / Barriers to Exit
• Governance
• Lack of control / independence
• Commerce Commission restrictions
• Devolution of decision making
• Technology
The Amalgamation Journey
Amalgamation

Where do you start?

The amalgamation of practices into a “super” practice is a complex task and requires detailed planning, expert advice and a common interest in the project from all stakeholders.

Key questions?

• Where do you want your practice to go?  Objectives
• How are you going to get it there?  Tactics
• How much is it going to cost?  Financial
Amalgamation – considerations

- GP’s aspirations – financial and clinical
- Shareholder ideologies

Financial
- Profit – what is the best remuneration model for the group?
- Succession – what are shareholders exit strategy?
- Valuation – what is the most appropriate way to value the practice?
- Transfer of assets?
“We had been looking at amalgamation for 8 – 9 years and the major handbrake was finding the right property for relocation. We must have looked at 8-9 sites and combined with resource and building consent issues it took a long time to bring to fruition.”

Pakuranga Medical Centre
Amalgamation – The Sum of Many Parts

Stage One
Strategic Review

• Agree on guiding principles and business plan
• Appoint advisors
• Agree on basic principals of shareholders agreement
• Prepare financial projections and amalgamation costs
• Consider valuation of practices
• Property considerations
• Structuring
Stage Two
Operational Considerations

- Agree on governance and management structure
- Identify and rationalise business practices eg payroll, accounting, debtor and creditor management.
- Prepare IT and telecommunication implementation plan and engage contractors
- Review and rationalise staffing requirements and remuneration levels
- Develop and implement transition plan – physical relocation
- Agree on employee transition plan eg new employment contracts with business owners to pay out staff leave entitlements or novate existing contract’s?
Amalgamation – The Sum of Many Parts

Stage Three: Execution

• Implement communication strategy e.g. announcement, branding, logo, website, stationary, signage, PR etc
• Establish / Implement marketing strategy
• Official staff launch
• Official public launch / opening
• Complete risk management plans
• Rationalise supplier contracts
• Formalise ongoing HR policies eg training, recruitment, performance management etc
Amalgamation – Key Issues

• Structuring the right entity

• Shareholders agreement – consider all of the what if’s?

• Remuneration
  • % of revenue, per consult weighted to patient segmentation, top dollar salary, low base with high incentive, sessional with profit share, eat what you kill and share of practice capitation?

• Profit share
  • Proportionate by consult time, revenue generated, sessions worked, % of NPAT etc
Amalgamation
A KEY SUCCESS FACTOR

• Professional advisors: Get the right advice!

  • Appointing an experienced consultant such as Peak Healthcare or specialist advisors such as BDO Spicers Corporate Services

  • Don’t be cheap! It’s a major transaction so invest in good advice.

  • Don’t appoint one of your patients, or your partner’s mate who is an entrepreneur or a property developer or a bush accountant unless they have the right credentials
Amalgamation – Lessons from past experiences

• Talking to similar business owners and practice managers who have amalgamated

  Pakuranga Medical Centre identified the following:

  • Pre qualify all your relocation obligations with the council and your property advisers
  • Identify a realistic opening date and stick to it!
  • Involve staff from day 1 and keep them regularly informed and involved in business planning
    • “Keep them valued and involved – they are just as important as your patients” – Dale Shepherd, Practice Managers, Pakuranga Medical Centre
  • Get the gender balance right
  • Pay the dollars to maximise consulting and storage space on site
Case Study
Case Study Key Issues

• Revenue increase (Co-payments) from amalgamation?

• Shareholders remuneration

• Valuation Issues

• Shareholder exit?
Tax Issues

• Penny v CIR; Hooper v CIR

  • Salary for services performed taxed at personal tax rates (38%)
  • Profits taxable at company tax rate (30%) or trust rates (33%)

• What does this case result mean?

• Tax Planning options for GPs?

• Important that there is commercial rationale for amalgamation rather than just tax mitigation
Summary of Session

• Macro factors are making amalgamations a sound option

• There is increased corporate interest in GP businesses

• A successful amalgamation requires good planning and advice

• It is important to set up the amalgamated entity well from the start to minimize future issues.