Coker GROUP

Business Advisors for the Healthcare Industry

The Revival of Management Services Organizations as a Growth Strategy

January 2022

About the Authors

MAX REIBOLDT, CPA

PRESIDENT/CEO
MREIBOLDT@COKERGROUP.COM
678.832.2000

Max Reiboldt, CPA, is the president/CEO of Coker Group. His 45 years of work has provided invaluable experience, working in business and industry, primarily involving healthcare providers. He handles strategic, tactical, financial, and management issues that health systems, physicians, and other healthcare entities and/or investors face in today's evolving marketplace.

ANDY SOBCZYK, FACMPE

SENIOR MANAGER
ASOBCZYK@COKERGROUP.COM
678.832.2000

Andy Sobczyk is a senior manager for Coker Group's physician services and finance, operations, and strategy divisions. Andy joined the Coker team in August 2018 to partner with clients in the ambulatory enterprise arena to deliver value in the areas of operational efficiency, organizational structure, physician alignment strategy/due diligence, financial stability, revenue cycle management, and leadership coaching and development. He also supports compensation valuation work, compensation plan redesign, and strategic business planning. He has a passion for collaborating with healthcare leadership, providers, and staff to identify improvement opportunities and convert strategy into meaningful action and results.

Contents

Introduction

Management services organizations (MSOs), entities that provide various administrative support services to physician groups, have grown significantly. While this trend is primarily linked to the influx of private equity (PE) activity in healthcare, many independent physician practices are considering their own MSO strategy. MSOs can be valuable vehicles through which PE firms or independent physician groups acquire or partner with multiple practices, scale services, and achieve operational efficiency for members.

Despite previous iterations of MSO-like companies failing in healthcare (i.e., physician practice management companies in the 1990s), the current wave of MSO activity may be in a better position for success. The shifting landscape of value-based reimbursement, the increased need to leverage technology to achieve efficiency, and the expansion of consumerism in healthcare all provide opportunities for MSOs to thrive in the current environment if properly executed.

This paper details the drivers that are leading to the recent MSO revival. Next, we outline the characteristics, structures, and strategies that define many MSOs in healthcare today. Finally, we explore unique MSO growth strategies for the current healthcare landscape.

MSOs 101: The Basics

MSO

An organization that provides practice management and administrative support services to individual physicians, private practices, or medical groups. Other services may emanate or ensue from it.

The primary purpose of the MSO is to alleviate pressures for independent providers. MSOs can also capitalize on economies of scale for those supported by their services. Physicians, medical groups, other operators, or private equity entities can own MSOs. Their geographic footprint can be local, regional, or national, and they can comprise practices from a single specialty or multiple specialties[1].

Traditional MSO services may include but are not limited to the following:

- Senior executive support such as business development, contracting, and related executive functions necessary for the practice operation.
- IT support services (e.g., project management, managed services, etc.) may be provided by a third party or developed internally.
- Financial services (accounting, payroll, reporting, etc.).
- Billing and revenue cycle management (RCM).
- Business and strategic planning (e.g., assessment of opportunities, business development, and other analyses).
- Administration of utilization and quality management systems
- Maintenance of corporate compliance programs and auditing.
- Maintaining records related to business operations.
- General administrative and clerical services (i.e., front office functions).

Common MSO Fee Structures

There are three common MSO fee structures: the cost-plus method, the fixed-fee method, and the percentage of revenue method.

Cost-Plus Method

In the MSO cost-plus method, the MSO charges the practice for all expected costs plus a reasonable profit margin. The costs are essentially a *pass-through* and then, an appropriate mark-up is applied. The key is aligning actual with agreed-upon cost totals or, if not, an overrun will not be reimbursed and thus is offset by the mark-up, lowering the effective profit margin. This method somewhat insulates the MSO from losses, assuming the MSO manages costs.

Fixed-Fee Method

In the fixed-fee method, the MSO charges the practice a fixed fee each year. Different fees may be accrued for the services selected (i.e., Revenue Cycle, HR, IT, etc.). This fee reflects an agreed-upon budgeted total with caveats. Those caveats may include an allowance for adjustments (i.e., increases) as warranted. For example, increases in the client's number of providers, additional services provided, or other similar scenarios would trigger a review and likely a change (addition) to the fixed fee total. This arrangement may be modified to have fixed fees per provider or another reasonable metric, such as the number of locations, ancillaries, etc. This method is, without an allowance for adjustments, the riskiest for the MSO to realize an acceptable profit margin, unless the fixed fee can be adjusted whenever necessary.

Percentage of Revenue Method

The MSO charges the practice a percentage of net patient revenues for specific services in the percentage of revenue method. These charges may be separated into various service areas (i.e., 4% for Revenue Cycle, 2% for HR, etc.) The percentage of revenue method is one of the most common and readily accepted methods among participating practices. Further, often this rate will be tiered so that when certain levels of revenue are attained, the fee percentage may decrease slightly.

MSOs can also leverage *hybrid* fee structures where a portion of the charges are fixed with other services based upon more variable metrics. Fee structures selected will likely be market-specific. Additionally, the MSO's leadership must understand local and regional regulations to ensure fee structures are compliant. For example, percentage of revenue structures are not permitted in New York and other states with similar restrictions.

MSOs offer value propositions for private equity owners, physician owners, participating practices, and hospitals and health systems.

MSO Value Proposition for Owners and Participating Practices

PE Owners

The MSO provides a vehicle for a PE firm to acquire and roll-up multiple practices to achieve the desired scale. This proposition offers an opportunity to leverage efficiencies and scale to improve income and the potential sale price.

Physician Owners

Physician owners can have new revenue and income opportunities, the potential to grow an MSO and sell it to a PE firm, health system, insurer, etc.; and the ability to consolidate practices and be proactively prepared for healthcare reform requirements plus payer contracting strategies.

Participating Practices

MSOs can alleviate the administrative burden of managing a practice. They also provide an opportunity to leverage the strength of the MSO network to achieve efficiencies or reimbursement upside via payer negotiation and the potential for operational performance improvement.

Hospitals and Health Systems

Lastly, MSOs offer hospitals and health systems affiliation opportunities with physician-led MSOs. They may also enhance the system's physician enterprise by improving infrastructure for practice management.

Recent MSO Trends

As previously stated, the recent influx of MSO activity can be linked directly to the rise of PE physician services transactions. This link exists because many PE transactions require the formation or presence of an MSO to meet the corporate practice of medicine (CPOM) requirements. CPOM laws prevent a PE firm from directly purchasing medical practices in most states. Therefore, in these situations, an MSO is formed as a separate entity from the practice to encompass all administrative and back-office operations while the practice maintains clinical functions[2].

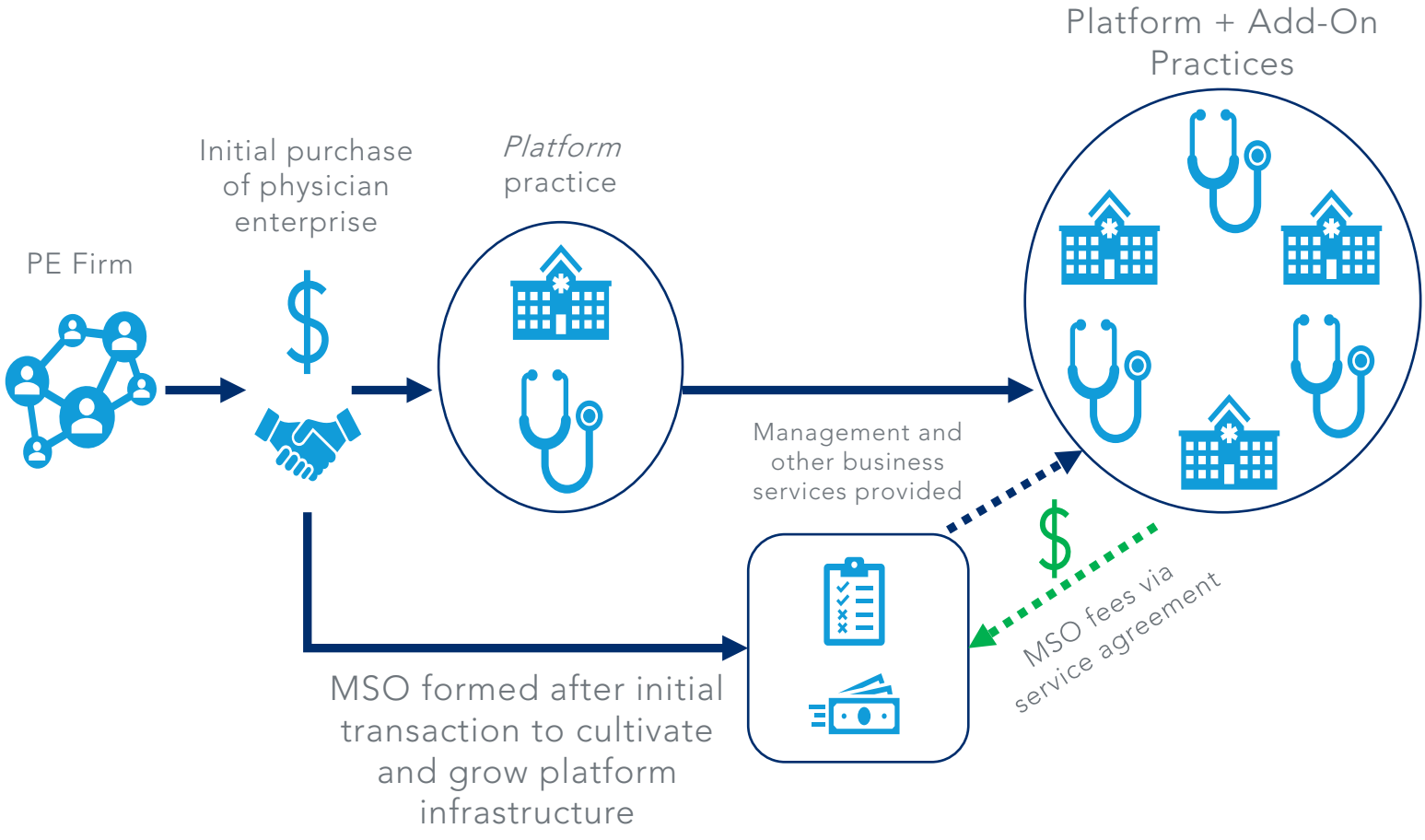
Physician services PE transactions have risen considerably in recent years. In the twelve months preceding 11/15/21, there were 400+ physician services PE transactions, representing a 119% increase over 2020. By comparison, average deal volume per year from 2017 – 2019 was only 200-250[3].

MSOs will continue to expand their footprint in the physician services space as expectations are that this trend will not slow soon.

The Role of MSOs in Private Equity Transactions

In PE transactions, MSOs play a specific role, as follows:

- After the PE firm purchases the initial physician enterprise or practice, an MSO is formed, owns all non-clinical assets, and provides business services to the practice for a fee.
- The PE firm has majority ownership of the MSO, and physician owners involved in the transaction may receive MSO equity as part of the deal.
- Physicians may retain ownership of practice/clinical entity (i.e., in the corporate practice of medicine states), or the firm retains majority ownership.
- Additional practices and facilities are brought on to the *platform* with the MSO providing services to all, growing its revenue and enhancing efficiencies of practices.
- All entities (MSO and platform + add-on practices) can be sold, providing value for both the PE firm and physician equity holders.



Despite most MSOs being linked to PE transactions recently, independent physician groups can also benefit from leveraging their own MSO strategy. In our experience, independent groups are pursuing creating their own MSO or partnering with others for the following reasons:

- Reducing the administrative burden of owning a practice while maintaining independence.
- Achieving economies of scale and operational efficiency.
- Leveraging *strength in numbers* to pursue more favorable reimbursement rates or value-based care contracts.
- Creating additional revenue opportunities for physician owners through recurring distributions of MSO profit or income from the sale of an MSO entity.

Several factors have recently converged to create a more favorable environment for the utilization of MSOs in healthcare, generating renewed interest from private equity and independent practices alike. The following trends make it more difficult for physicians to remain independent and drive them to seek a partner or potential buyer to alleviate financial and administrative pressures, assuming they otherwise do not desire health system employment.

- Declining fee-for-service reimbursement along with increased regulatory pressure to adopt quality initiatives and value-based care models.

- Rapid consolidation among health systems and physician enterprises for greater negotiating leverage and clinical integration.

- Technological improvements that allow organizations to scale, integrate, maximize reimbursement, engage patients, and report outcomes more efficiently than ever. Capital required to purchase, implement, and manage such systems may be cost-prohibitive for many independent practices alone.

MSO Development and Organizational Structure

Before creating an MSO, physician owners or PE firms should complete a detailed evaluation of the operational and strategic current state of the potential participating practices. Understanding the landscape in this manner will guide stakeholders in identifying core services to develop. Additionally, there will need to be careful consideration of the IT and organizational infrastructure required to deliver the services specified.

Assessment Phase example:

1. Complete an overall assessment of the current organizational/operational structure and foundation
2. Identify gaps in current vs. proposed business structure
3. Consider MSO services to include, but not be limited to, staffing, IT, collection and billing processes, scheduling, equipment, management, etc.
4. Develop a draft of overall revenue projections and a ramp-up plan for adding practices, practitioners, and staff in the future (e.g., scalability).
5. Review current IT needs of the MSO related to clinical integration, group purchasing, and billing activities.
6. Create a timeline for the formation of the MSO and the addition of practices, including developing a marketing plan

---

Implementation Phase example:

1. Develop a business plan with identified deliverables and timelines to be initiated; define services and functions.
2. Construct a pro forma financial projection that includes adding practitioners, staffing policies, recruitment plans, revenue projections, and ROI.
3. Develop a framework with recommendations for IT infrastructure.
4. Launch core services and other hosted IT systems; leverage the same services across all managed entities.
5. Provide centralized financial, IT, and revenue cycle departments to support managed entities.
6. Allow physicians to be involved in advisory policymaking.

Organizational and Governance Structure

MSO organizational structures can vary depending on the services offered, geographic footprint, and roles and responsibilities of team members. However, many MSOs leverage operational structures much like those seen in large group practices or health systems. These structures include executive leadership oversight (i.e., a C-suite), service lines separated into front-line teams that are supervised by directors or managers, and various support departments that may report to members of the executive team (e.g., HR, Legal/Compliance, internal IT).

In addition to this operational structure, Coker often recommends MSOs deploy a governance structure comprised of executive leadership, equity ownership, and physicians. See the example below.

Board of Directors

- Oversee all MSO business affairs
- Final approval of policies and procedures
- Create committees
- Membership decisions (new members, fees, transfers, etc.)
- Profit distribution methodology
- Hiring and firing of executive team (CEO, COO, CFO, CIO)

Executive Council

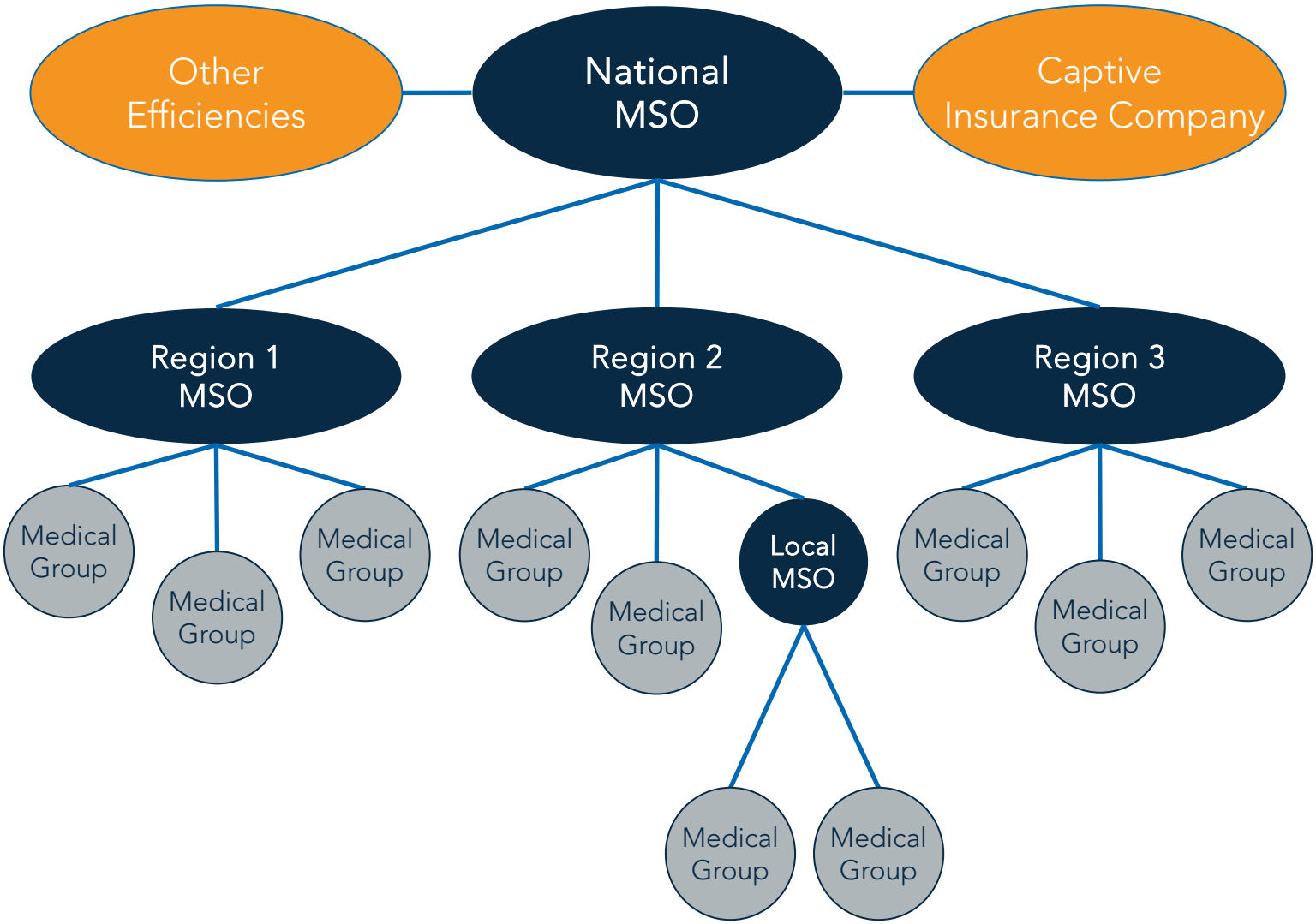
- Executive council typically composed of Board officers
- Delegated authority to act on matters in between Board meetings that do not require a board vote
- Decisions can range from MSO expenditures, strategy, human resources, etc.
- Council may also oversee certain activities of committees

Committees of the Board

- Board can form Committees to accomplish specific organizational objectives or oversee components of operations
- Consider committees for operations, finance, business development, and IT
- Each committee should have a specific purpose (charter) and be required to accomplish objectives on behalf of the Board

Achieving Value at Scale: Example of National MSO

An MSO's growth and development does not have to be limited to one area or region. They allow for the ability of the organization to scale its services, negotiate with payers via clinical integration, and offer value to clinical organizations across regions that provide significant opportunities. Also, IT infrastructure and integration are critical to achieve MSO value at a regional or even national level.



Equity Ownership and Capitalization Considerations

Equity Ownership Structure Introduction

There are no absolute *right* or *wrong* ways to structure ownership equity. Therefore, the following traits should serve as guiding principles as to the structure for the new MSO/BSO. It should be simple and manageable, equitable with all parties included in the formation, reasonable and legally compliant, attractive to new members, scalable, transitional, and organized for meeting business plan goals and objectives.

Objectives to Address in Defining Equity Ownership

Primary objectives to address in defining equity ownership include clarifying which parties should own units of equity in the MSO, designating classes of equity to distinguish Founders from Non-Founders, etc. Additional objectives include defining equity owners' rights through unit allocations and distributions, specifying future equity holders' buy-in terms, and addressing buyout terms upon exiting.

Note: The examples of equity ownership to follow are only those of a typical make-up. Each situation should be carefully evaluated with expert consultative and/or legal counsel and customized to meet the goals/objectives of each MSO.

Equity Ownership Considerations

Equity ownership considerations encompass ownership criteria, effects of new members, administrative (non-provider) ownership, and the legal entity. The ownership criteria should prioritize the recognition and separation of Founding vs. Non-Founding owners.

New Members

Regarding the effects of new members, they may be eligible to enter under non-founding classes of ownership units; as authorized by the Board; units would be diluted as the ownership group grows. The MSO will require new member investment in equity with the possible exception of administrative management, which may be awarded equity based upon their contribution to the MSO's success.

Administrative (Non-Provider) Ownership

Administrative leadership will be critical to the growth and success of the MSO. We recommend the Board award such members equity based upon their contribution to the MSO's development and success. In addition, some (not all) within this group may be eligible for recurring profit distributions, at the Board's discretion. Others within this group will only receive distributions upon the MSO's sale. Likely, this will entail a limited number of individuals/positions.

Legal Entity

Recommendations are for organizing the MSO as an LLC as it allows the most flexibility regarding overall organizational and equity ownership structures.

Ownership Criteria

- Recognition of critical MSO leadership, either via equity or compensation
- Status of non-physician and administrative owners, i.e., eligibility; criteria for equity
- Ownership classes and rights
- Voting rights within ownership classes
- Eligibility for Board or committee participation and profit distribution

Equity Ownership Structure Example*

Class A

- Preferred ownership rights; eligible for Board and Committees.
- Voting rights, profit distributions, distributions upon sale; controlling interest (i.e., maintain 51% control)
- Founding members

Class B

- Non-Founding owners (join after launch)
- Board eligibility at discretion of Board; Committee-eligible
- Limited to practices that join moving forward, based on vote of current owners
- Similar rights to Class A though shares could be diluted further

Suggested Allocations

70-80% of total units

Class C

- Class C to encompass other potential owners
- Other Investors
  - Buy-in required; potentially limited only to providers or administrative leaders in participating practices. May open to external stakeholders at discretion of Board
  - Participate in distributions, though likely at lower rate
  - Committee eligibility and voting determined by Board
  - Eligible for proceeds of sale
- Awarded Equity
  - Equity awarded by Board for service contributions via compensation bonuses or other means
  - Eligible for proceeds of sale based on equity awarded.
  - Mostly non-voting; committee eligibility and voting rights determined by Board

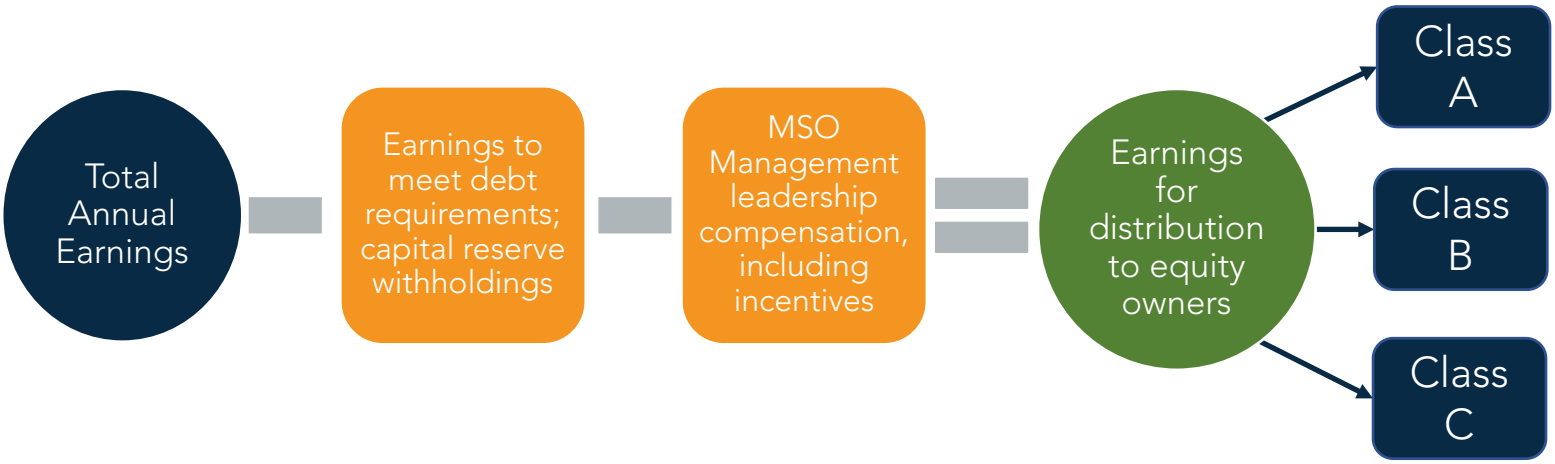
20-30% of total units

*This structure only represents one viable example. Each MSO should be customized as to the structural options that best fit the needs of the organization.

Earnings Distribution Methodology

In general, earnings should be distributed annually only after the MSO is profitable, the necessary debt obligations are met, and capital reserves are secured as determined by the Board. As the MSO grows, the need to consider capital reserves will be critical and may take priority over earnings distributions.

The parties should be eligible for distributions in proportion to their investment (buy-in) and corresponding membership units; members awarded equity by the Board without buy-in requirements may receive *distributions* in the form of compensation bonuses, etc., but should not share in recurring profit distributions. All classes should be eligible for distributions based on unit ownership upon full or partial sale of the MSO. Additionally, the Board may determine if units become *fully vested* after a certain timeframe. Owners should receive all or a portion of their distributions based on when the sale is completed.



Note: Notwithstanding the above, some participating equity holders may be limited (or even restricted) in annual earnings distribution with their source of ROI tied to when MSO sells or to annual bonuses via employee compensation terms.

- Distributed based on units of equity owned by each party
- Class C owners with *awarded equity* may have distributions from other means (i.e., bonus payments)

Capitalization Considerations

Early-stage MSOs should develop comprehensive business plans based on priorities and initiatives identified during the development phase and investment from owners determined under the equity ownership structure. Pro forma financial analyses should follow, evaluating strategic and operational needs, to determine capitalization requirements. Additionally, the following capitalization options and approaches may be considered based on how they fit the organization's needs.

1. Equal Sharing of Costs/Capital from Members

Costs are shared equally among all members via capital call

- May include direct capital contributions from owners or may include value of assets
- Should entail earnings distributions only to cover individual equity holders' tax liability; remaining earnings plowed back into MSO to fund growth

2. Debt Financing

Various avenues for debt financing:

- Securing a line of credit
- Bank loan
- Peer-to-peer loan, etc.

- May involve MSO procuring debt for remaining capital needs

3. Third-Party Investor*

Venture capitalist

Insurer

Professional organization or network, etc.

*Will have to dilute equity

4. Hybrid Model

Myriad arrangements possible

E.g.: 50% of costs funded via Option 1 with remaining 50% funded via Option 2

Note: Most MSOs are not adequately capitalized and thus are limited in their growth and operational capabilities.

Evaluating Capitalization Approaches

1. Equal Sharing of Costs/Capital from Members

Pros: Simple structure to administer

Cons: May deter some members from agreeing to participate

Cons: Lack of earnings distribution due to capitalization needs

2. Debt Financing

Pros: Quick and simple vehicle for obtaining capital

Cons: May increase risk, especially if profitability timeline is uncertain

3. Third-Party Investor

Pros: Likely to have various interested parties

Cons: Ownership structure may require changes to incorporate new partner

4. Hybrid Model

Pros: Many alternatives possible with no right or wrong answer

Cons: Agreeing on exact hybrid model may be challenging

> Would you tell me, please, which way I ought to go from here?
>
> That depends a good deal on where you want to get to.
>
> *- Alice in Wonderland*

Contemporary Growth Strategies

Additional value, over and above MSO service fee revenue, can be attained through new ventures. If pursuing such initiatives, we recommend creating a Business Services Organization (BSO) as a parent company to oversee multiple entities as they are developed. Like an MSO in structure and organization, a BSO emphasizes broader services beyond traditional practice management. It also diversifies revenue streams and expands the pool of prospective investors/partners. A BSO also accommodates diversification of equity holders (i.e., not all may be owners of each legal entity under the corporate BSO umbrella).

Enhanced Services Offerings to Grow from MSO to *BSO*

Growing from an MSO to a BSO can encompass an investment in analytics/business intelligence (BI) platforms to support more efficient finance and strategic offerings and move away from manual processes.

Further, expanded RCM capabilities in areas of contract negotiation and value-based care revenue management.

Expansion of technology services, including general IS services (not outsourced); EHR and/or practice management systems; and new technology innovation.

Greater presence in research, encompassing clinical trial participation and management and data collection and reporting.

Growing strategic planning/consulting services in areas of CIN development, which may be spun off as a separate entity from the MSO/BSO; group purchasing development and management; center of excellence planning, development, and implementation; employment or PSA contract negotiations; and real estate ventures.

Expanding innovation initiatives; device inventions; monitoring services; and savings of supply costs.

Clinical integration and the ability to support value-based care can be overlooked as strategic priorities for MSOs[4]:

- MSOs can bridge organizations seeking to integrate clinically but lack the necessary infrastructure.
- The organization can deploy capital to provide critical IT, practice management, and business intelligence capabilities.

Such infrastructure supports providers in sharing goals and improving quality. MSOs can also support IPAs, PHOs, and ACOs in broader value-based care initiatives. Delivering this infrastructure can make MSOs even more attractive to potential investors. A recent example is BCBS of Michigan acquired an MSO to improve operations and expand its ability to deliver value-based care.[5]

Potential Exit Scenarios

What are the strategic goals of the MSO?

Early-stage MSOs should have a clear understanding of their strategic goals and the organization's overall purpose. Part of that answer may involve considering the following potential *exit* scenarios.

1. **Internal *organic* growth** includes continued quarterly dividends to equity holders while accruing cash for further purchases.
2. **External investment.** Equity investment by an outside party for additional growth and a subsequent liquidity event to equity holders; adding other partners.
3. **Initial Public Offering (IPO).** This option is much less common and unlikely.
4. **Sale and Exit.** This sale is likely to PE, an insurer, or a health system.
5. Another exit scenario is a **hybrid of the previous options.** An example is a partial sale.

Final Thoughts

The recent surge of private equity investment in physician services has made MSOs more relevant and widespread in healthcare. Industry trends, such as technological innovation, reimbursement shifts from fee-for-service to value-based care, and continued provider consolidation have created an environment where MSO services are in high demand. The value proposition is stronger than ever.

PE firms may be among the most common MSO owners, but private practice physicians and health systems can also benefit from creating their own MSOs or leveraging MSO services. Before pursuing an MSO strategy, stakeholders should carefully evaluate the structures, strategies, and organizational considerations outlined in this paper to execute their vision effectively. In addition, beyond the traditional MSO services and structures described, more contemporary growth strategies (i.e., BSO development, clinical integration, etc.) can further enhance the organization's value. The opportunities in this space continue to grow, and the trend of healthcare MSO utilization is unlikely to slow any time soon.

Appendix

MSO/BSO Key Steps to Formation

Organizational Assessment

Evaluate the current infrastructure supporting the services selected.

- Can it be scaled to add new clients?
- Are new investments required?
  - IT, business intelligence, staff, facilities
- Determine the name of the organization and obtain proper registration(s).

Review organizational structure needs to launch and manage services.

Determine appropriate legal structure(s) for the MSO using qualified counsel.

- Determine possible equity partners.
  - Practice physicians, private equity, health systems
- Consider equity ownership structure with emphasis on founding versus non-founding members and various classes of equity owners
- Evaluate governance structure and composition of Board and committees

Develop a checklist of matters to address relative to MSO formation and execution of operations.

Develop a checklist for MSO policies and procedures; determine current policies (if applicable) that need to be revised and which need to be created.

Services Assessment

Consider MSO services to offer.

- Determine market demand within primary and secondary geography and targeted specialties; evaluate expertise internally and consider outsourcing to qualified experts.
- Evaluate alternatives
  - Practices performing services on their own, other MSOs and their capabilities, vendors
- Assess the timing and roll-out of services

Review current capabilities and value proposition for prospective clients and practices.

- Can certain services be better performed or at lower cost than others?
- Consider benchmarking analyses of key performance indicators or review market data to understand performance expectations for new services
- Is there adequate access to vendors or contractors that can?

Business Planning

Develop MSO goals.

- What does the MSO want to be? Will it grow beyond local geography? Will it serve multiple specialties? Will the MSO eventually want to sell to a health system or PE?
- Evaluate the potential to develop MSO into a BSO in the future. This initiative would involve adding competencies and infrastructure beyond traditional practice management services.

Review potential fee structures for services offered. Determine which structures align with market dynamics and local/regional regulatory considerations. Develop revenue projections based on potential client base and growth scenarios.

- Cost-plus method
- Fixed fee method
- Percentage of revenue method

Develop pro forma financial analyses to include anticipated revenues, expenses, and growth scenarios.

Evaluate capital expenditure needs and other start-up investments.

- Equipment, facilities, software

Create business and strategic plans based on assessments and financial analyses.

Update business and strategic plan as needed, no less than every other year.

The Business Plan

Consider options for capitalization based on needs identified in financial analyses.

- Sharing of costs from members and equity holders
- Debt financing
- Third-party investor
- Hybrid of previous options

We recommend starting with the following sections:

- Section I: Scope of the Assignment
- Section II: Situational Overview
- Section III: Service Offering Identification (Competencies)
- Section IV: Structural Formation
- Section V: Financial Pro Forma
- Section VI: Strategic Marketing Plan
- Section VII: SWOT Analysis
- Section VIII: Action Plan and Next Steps
- Section IX: Execution Summary

Implementation

Pursue the capital and infrastructure investments identified.

Create and deploy marketing and business development plans.

- ✓ Prospective client outreach, focusing on physician stakeholders

Hire key executive leadership, if not currently in place.

Form Board and governance committees as outlined in the legal structure.

Hire additional staff, as necessary, to meet the service demands of initial clients.

Complete a thorough review of policies, procedures, and compliance programs to ensure operations and services meet regulatory standards.

Launch initial services for clients.

Marketing and Business Development

Create materials for prospective clients or investors (i.e., pitches) that outline business and strategic plans and emphasize MSO competencies and value proposition; when needed, develop promotional materials and brochures.

Develop a list of prospective clients or investors.

3 - 5 Year Goals and Objectives to Maximize Value

Identify ways to remain focused upon an updated mid-to-long-term strategy and business plan.

MSO should be mindful of potential exit scenarios. While short-term priorities should include growth and development of services, clients, owners, and investors, long-term considerations may include:

- Sale of MSO to private equity, insurer, health system, or other physician enterprises
- Initial public offering (*less common*)
- Merge with another MSO or BSO
- Hybrid of previous options (i.e., partial sale or merger)

MSO/BSO Key Steps to Operations

Performance Management

Optimize MSO competencies and core services. Consider additional or complementary services as the MSO grows (via organic growth or acquisition). Outsource when necessary, especially at the outset.

Determine key performance indicators (KPIs) to monitor for each service.

- Develop standard reports or dashboards for MSO and client use.
- Set targets that emphasize value and performance improvement for clients.

Evaluate the financial performance of services during the initial growth phase.

- Compare revenue and expense performance to initial financial proformas, and determine if adjustments are necessary while still providing value for clients.

Engage client physician stakeholders to develop mechanisms and provide input to the MSO (e.g., committees, governance).

Consider options for re-investing MSO profits during initial years.

- Forgoing owner distributions during this time may be prudent to ensure needs to the business and growth strategies can be adequately funded

Services or Competencies

- Billing and collection services
- Practice management
- Managed care services
- Staffing
- Schedule management
- IT services
- Group purchasing
- Human resources
- Compliance
- Financial services

Ongoing Strategic Planning and Business Development

Initiate ongoing strategic planning process to evaluate current services versus market needs to identify gaps and opportunities.

- Consider various growth strategies beyond initial core services.
  - Expanding geographic footprint of practices and clients
  - Development of clinically integrated networks with member organizations or strategic partners; pursue opportunities in value-based care
  - Evaluate alternative lines of business or revenue sources (e.g., real estate, technology, group purchasing)

Accommodate new owners and investors as the equity ownership structure allows.

- Ensure new owners and investors align with the goals of the MSO.

Consider potential to acquire or develop new entities. If pursued, this strategy may warrant the development of a BSO to serve as a parent company.

- MSO formation steps will mostly apply to the development of the separate organization, though not all entities under the BSO may have equity ownership.

MSO/BSO Key Steps to Transactions

Strategy and Planning

The initial phase for any contemplated MSO transactions.

Objectives

- Identify transaction target(s)
- Establish an overall deal strategy
- Create deal plan

Create the following analyses and planning documents.

- Market analysis
- Financial targets and valuation parameters
- Preferred structure and terms
- Strategic Roadmap for the MSO/BSO (near, mid, and long-term)

Transactions can assume varied forms and functions from MSO/BSO sale to bringing in joint venture partners to contractual deals with consultants and other vendor suppliers of services on behalf of the MSO/BSO.

Go-to-Market Services

Begins with initial discussions and negotiations.

General objectives include initiating negotiations and agreeing on general deal terms.

Key considerations and activities

- NDA terms
- Initial discussions
- Board/Management meetings
- Exclusive negotiations
- Process, timeline, targets
- Establish roles/parties
- Draft letter of intent

Due Diligence and Definitive Agreement

The transaction process has been initiated at this point.

Objectives include completing due diligence, finalizing deal documents, and submitting regulatory filings (as applicable).

Process steps include, but are not limited to:

- Finalize terms and valuation
- Mark-up definitive agreement(s)
- Data request
- Set up Working Groups
- Business and Risk analysis
- Valuation, Q/E, debt, etc.

Due diligence typically involves a myriad of areas of review to approval by purchaser. Specific outlines for such should be developed.

Integration Management

Deal agreement has been reached at this point. Closing and post-transaction integration are key focus areas. Execution and implementation plans completed.

Plan and preparation for Day 1 is critical in this phase.

Transaction team should develop project plans and roadmaps for integration.

Additional considerations and components of this phase include:

- Development of teams and roles
- Services defined, fine-tuned
- Financial impact analysis
- Threat and issue resolution
- Roadmap implementation
- Ongoing capital projects
- Training, change mgmt.
- Personnel integration; staff alignment completed

Sources

1. Anthony, Thomas D. Frost Brown Todd, LLC. "Management Services Organizations: Best Practices and Major Obstacles." Presentation to American Health Lawyers Association. May 18, 2016.
2. Pitchbook Data, Inc. "Understanding US Private Equity Healthcare Provider Transactions". https://files.pitchbook.com/website/files/pdf/PitchBook_Analyst_Note_Understanding_US_Private_Equity_Healthcare_Provider_Transactions.pdf. October 19, 2021.
3. Health Services: Deals 2022 Outlook. PwC US. https://www.pwc.com/us/en/industries/health-industries/library/health-services-deals-insights.html.
4. Anderson, Gregory. Grey, Emily. "The MSO's Prognosis After the ACA: A Viable Integration Tool?". Physicians and Physician Organizations Law Institute (Feb. 11-12, 2013). 54-57.
5. Blue Cross Blue Shield of Michigan Expands Physician Support with Acquisition of Management Services Organization. MI Blues Perspectives. August 10, 2021. https://www.mibluesperspectives.com/news/blue-cross-blue-shield-of-michigan-expands-physician-support-with-acquisition-of-management-services-organization/.

Coker GROUP

Business Advisors for the Healthcare Industry

For further information about Coker Group, and how we could be of assistance, please call 1.800.345.5829 or visit cokergroup.com