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Mitigating Financial Risk through MSO Investment

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Amid the shifting economics of health care, management services organizations (MSOs) can be an attractive alignment option for both physicians and hospitals. MSOs have long been seen as a mechanism for a hospital or health system to acquire the operating assets of a physician practice when regulations prohibit direct ownership. But at their core, MSOs provide administrative and management services to physician practices and can be beneficial to hospitals and physicians alike.

Here's why they're growing in popularity.

Practice Perspective: A Question of Independence

In the U.S. today, more physicians are choosing employment over independence. It's easy to understand why; being employed by a hospital or a hospital-owned practice often gives providers a sense of income security, predictable work hours, and relief from administrative burden. Market conditions brought on by the pandemic also prompted some physicians to consider selling their practices to hospital systems or larger corporations.

But health system employment isn't for everyone. Being small and independent has its advantages, such as increased autonomy, quicker decision making, and smoother change implementation—all of which can be valuable in evolving markets. Still, running an independent practice incurs overhead costs related to revenue cycle management, regulatory compliance, human resources management, technology upgrades, and more.

For practices that want to remain independent but need practice management and administrative support services, an MSO can be an appealing option. Providers rely on MSOs to handle certain nonmedical functions, allowing physicians to focus on the clinical components of care—all while gaining efficiencies, cutting costs, and retaining practice control. Some practice operators will create MSOs to benefit from economies of scale by offering the same services to other independent practices in the marketplace.

Health System Perspective: If You Can't Buy Them, Join Them

Health systems make good partners for existing MSOs given their deep experience in managing the business aspects of health care, including payer contract negotiation, compliance management, human resources and recruitment support, financial reporting, access to group purchasing discounts, billing, information technology, and care management. For health systems, buying an ownership interest in a physician-owned MSO can be an attractive alternative to a practice acquisition, especially when a practice wants to remain independent. Partnering with MSOs that have relationships with other independent practices or creating an MSO for the purpose of forming a relationship with the practice can be an avenue for health systems to improve care coordination, build brand presence within the community, and earn revenue for providing administrative services. Further, because the physicians still own their clinical practice, they are incentivized to maintain and improve its financial performance, thus alleviating some financial risk for the health system. In addition, there is less risk of the physician competing after an MSO partnership is formed since the physicians have an ownership interest.

Flexibility for Physicians and Hospitals

MSOs allow for more flexible and unique transaction terms when compared to purchasing a direct interest in a practice.

- Some transactions are structured such that part of the purchase price is contingent on a certain amount of growth. As growth is based on obtaining new contracts with the MSO and not provider volume, there is less regulatory risk.
- In some instances, the management fee will have an incentive piece and the full amount is not paid unless certain financial metrics are achieved. The metrics for MSOs are often tied to profitability but are sometimes linked to quality. This further reduces the financial risk on the health system, as it puts more responsibility on the MSO operators to run an efficient operation, and the health system is a partial owner in that operation.

Memorializing the Agreement

Because of complex regulations, it is imperative that agreements with a physician-owned MSO are tightly structured with solid contract language that memorializes the goals and objectives of the parties. Key factors in the formation process include the following:

- ***Fair Market Value (FMV) and Commercial Reasonableness (CR) of MSO Services:*** Both parties should ensure there will be no violations of the federal Anti-Kickback Statute if they enter into a partnership.
- ***FMV of Purchase Price and MSO Arrangement:*** Health systems and MSOs can seek the opinion of a qualified third-party valuation expert to determine a FMV purchase price for the subject interest and that the management services fee is FMV.
- ***Review of Transaction Terms:*** It is important that the terms of the transaction are thoroughly vetted, and that the valuation firm takes these into account, given terms can impact the value of an MSO interest to a minority or controlling partner.

When full acquisition or the formation of a joint venture with a practice isn't a viable option, entering a relationship through an MSO can be a good solution. For hospitals and physician practices alike, MSOs are poised to be a more favorable, less risky strategic option for the foreseeable future.

About the Authors

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