How Board Members Can Support Successful Hospital Mergers and Acquisitions

BY JOSEPH J. FIFER, FHFMA, CPA, HEALTHCARE FINANCIAL MANAGEMENT ASSOCIATION

Riding the wave of excitement that hospital merger discussions can generate, it's easy to gloss over issues and tools that are critical to a merger's success. These include understanding and thoroughly assessing a merger's value drivers, paying attention to cultural alignment, and employing rigorous analytical and planning tools. This article looks at each of these areas and the ultimate goal of coming together to provide improved value and high-quality care.

Key Board Takeaways

Amid the activity and excitement of merger discussions, the board should focus on understanding and thoroughly assessing a merger's value drivers, paying attention to cultural alignment, and employing rigorous analytical and planning tools. This includes taking the following into consideration:

- Mergers that improve value delivered to patients and other care purchasers have the best prospects of success. That knowledge should guide the board in its evaluation process.
- Cultural alignment at the board level is too important to be left to chance; it must be closely and carefully managed.
- The board should expect to review both an operating model and integration plan for the merger.

Be Clear on the Value Drivers

Acquiring organizations may pursue a merger for a variety of reasons: to achieve cost efficiencies through economies of scale, improve market share, expand the physician network, or access a population large enough to make population health management feasible.[1] Board members need to have a clear understanding of the value drivers associated with a proposed merger. These potential value drivers should be reality-tested before a decision about the merger is made. Mergers that improve value delivered to patients and other care purchasers have the best prospects of being well received in the marketplace and succeeding in the long term. That knowledge should guide the board in its evaluation process. For example, if a merger is driven by achieving cost efficiencies, the board will want to give careful consideration to whether there are opportunities to improve care affordability.

Make Culture Alignment Job One

Culture alignment starts with the board. To work smoothly and effectively together, the merged board must blend two separate and distinct board cultures, each with its own established work styles, norms, and traditions. The merged board will be charged with creating a merged mission statement, developing a unified strategy for the organization, establishing a process for financial oversight, and making and communicating crystal clear decisions about lines of authority for major decisions—and that's just for starters. With a to-do list like that, it's apparent that cultural alignment at the board level is too important to be left to chance; it must be closely and carefully managed.

At the enterprise level, cultural alignment is also a key success factor, and one that tends to be undervalued. The overarching goal of any merger is to create a combined entity that is more valuable than either one alone. To accomplish that, the organizational culture should support employees and physicians in their efforts to navigate through the disruption inherent in mergers, build solid working relationships with new colleagues, and understand their role in and value to the merged organization.

Research conducted by the Healthcare Financial Management Association (HFMA) and the Deloitte Center for Health Solutions in 2017 found that organizations that addressed the challenge of combining cultures more adroitly focused on internal and external communications, beginning in the early stages of a transaction.[2] These conversations can help each party gain insights into the other's culture, identify cultural "red lines" that may become problematic, and test assumptions about cultural compatibility.

Follow Best Practices of High-Value Mergers

The HFMA/Deloitte Center for Health Solutions study also found that only about 29 percent of chief financial officers in hospitals involved in mergers between 2008 and 2014 achieved more than half of the cost structure efficiencies projected from the deal.[3]

Researchers identified a group of "high-value" mergers that reported quality improvements and realized more than half of projected cost efficiencies as a result of a deal. The high-value group represented approximately 19 percent of transactions in the study.

Acquirers in high-value transactions are more likely to use rigorous analytical and planning tools. Specifically, they are more likely to have developed a clearly defined, board-approved operating model for the transaction along with a board-approved integration plan that flows from it. Board support throughout the execution of the agreed-upon operating model is a key success factor.

Developing an Operating Model

An operating model includes a statement of strategic vision for the combined entity; identified/validated areas for value capture from the transaction; a plan to realize revenue growth and cost-reduction opportunities; and a description of organization-specific key enablers.

The first step in developing an operating model (early in the pre-merger process) is creating hypotheses about potential value drivers available from a given transaction. This helps ensure that difficult questions are addressed and answered. It will also enable the new entity to differentiate itself in the market.

The second step, which should occur during the early stages of due diligence, is rigorously testing the hypothesized value drivers by creating a tangible list of activities the organization must complete to realize the desired outcomes. This step serves

1 HFMA, *Acquisition and Affiliation Strategies,* 2014.
2 HFMA and Deloitte Center for Health Solutions, "Hospital M&A: Margin and Quality Improvements Take Effort, Time," October 2017.
3 HFMA and Deloitte Center for Health Solutions, October 2017.

as a way of pressure-testing assumptions and a potential merger's ultimate ability to create value. The process also reveals relationships and dependencies that should be evaluated during due diligence and defines outcome metrics that can be used during the integration process. The results can form the foundation of an integration plan tied to the deal's value drivers.

The board should review and approve the operating model to ensure that it supports taking the steps necessary for the deal to achieve value.

Translating the Operating Model to an Integration Plan

Establishing clear lines of decision-making authority is an essential prerequisite for translating priorities to reality. A board-approved plan to guide the integration of the merging organizations can help ensure successful execution. The operating model for the merger that was developed and validated during the early phases of a deal should be adapted to an integration plan. Board approval of the plan empowers the management team to make difficult decisions related to staffing and service distribution in a timely way. Delaying such decisions is a common barrier to achieving results. Having an integration plan also elevates accountability for achieving results to the highest level of the organization.

The integration plan should front-load activities that support the organization's ability to drive value for the merged organization. For example, if the primary goal of the merger is to reduce cost structure by increasing economies of scale, the initial focus should be on business areas that are likely to yield the greatest savings or economies of scale, such as quality, safety, finance, supply chain, human resources, risk management, and managed care contracting. In contrast, if the merger's primary goal is to improve care coordination in support of a provider-sponsored health plan or other risk-based contract, the initial focus should be on clinical alignment strategies such as integrating clinical IT systems enterprise-wide or enrolling acquired physicians into all of the acquiring system's risk-based contracts.

The Value Improvement Imperative

Value is created when the patient or other care purchaser experiences an improvement in the relationship between the quality and the cost of care. Mergers that seek only to increase market power are less likely to succeed than those where the acquirer is seeking to produce the cost efficiencies, gains in clinical quality, and access that patients and other care purchasers need and expect. By taking the latter approach, healthcare organizations will be best positioned to compete in their markets and win market share by offering patients, employers, and other care purchasers a superior value proposition, no matter what the payment models.

Price is an important element of the equation; mergers that increase prices without concomitant improvements in quality will not be viewed favorably in the marketplace. This presents a potential conflict for the board. From the merged entity's standpoint, it may make sense to raise prices post-merger; in some cases, the rationale is to improve payer contracts that have terms that are unreasonable. But if prices increase out of proportion to value, the community does not benefit. Mergers will ultimately be judged by their impact on the total cost of care to patients and other care purchasers. Healthcare consolidation is only a vehicle. Value improvement is the destination.

The Governance Institute thanks Joseph J. Fifer, FHFMA, CPA, President and CEO of the Healthcare Financial Management Association, for contributing this article. He can be reached at jfifer@hfma.org.