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Merger Considerations for Rural Hospitals

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While mergers and acquisitions are not new in the hospital sector, including for rural and community hospitals, the nature of the transactions and the factors surrounding them have undoubtedly changed in recent years. Moreover, the various considerations that rural organizations must evaluate and address with transactions have unique characteristics. Even when considering these factors, rural health facilities often face distinct challenges in generating long-term value from engaging in deals. But regardless of the complexities of pursuing transactions, significant opportunities can emerge from these strategies, which can ultimately result in substantial benefit to the organizations involved and the communities they serve.

When looking at transactions, whether a merger, acquisition, or another type of partnership between two or more organizations, there are multiple perspectives to consider. An organization could be looking at a deal from the "buy-side," or it could be in need of another organization to come in as a buyer, whether full or partial, which is the "sell-side." Alternatively, the situation may not entail an outright merger or acquisition; instead, an organization might seek a transaction that is a partnership structure. Many different arrangements are available with transactions. However, for a rural health facility or community hospital, the viewpoint of a potential transaction is often through the buy-side or sell-side lenses.

The Buy-side Options

For rural hospitals, the buy-side perspective is often relatively straightforward in terms of options,

Key Board Takeaways

Mergers and acquisitions are a viable option for many rural hospitals. However, simply "doing a deal" does not automatically result in value creation. Boards of rural hospitals that are working towards these transactions should:

- Have a strategic vision for the transaction that all parties subscribe to, and incorporate a detailed roadmap for value creation long after the deal is done.
- Carefully think through their options. There are many different types of transaction alternatives available to rural hospitals, besides traditional mergers.
- If on the buy-side, consider what scenario would work best for your organization. Scenarios involving rural hospitals often entail hospitals targeting other rural health facilities outside their primary market area but within an overarching region, or hospitals acquiring ancillary, outpatient, and ambulatory services within their primary market area.
- If on the sell-side, consider what is driving the transaction. Rural hospitals pursuing a sale are often driven by either financial challenges where there is a need for capital, or pursuit of a partner that can deliver a "strength in numbers" element to that entity. Whatever the scenario, this will heavily influence the direction of the deal.

though the alternatives are not simple and they rarely are easy initiatives to pursue. However, when considering the nature of the markets in which independent rural hospitals operate, there typically is not a cross-town competitor that they pursue as an acquisition target. Then, what are the buy-side options?

The most common two scenarios we see in the current marketplace are:

1. Rural hospitals seeking acquisition targets in communities near their current market
2. Acquisition of ambulatory and/or ancillary services entities, such as physician groups, surgery centers, etc.

Regarding targeting hospitals in nearby or adjacent market areas, the idea is relatively direct in that a hospital will seek to expand its existing market reach to new markets, and, typically, there is an additional market opportunity available by providing supplemental services into areas between the two primary market areas. While we may not see these types of transactions every day, they do happen and are often quite successful for the parties involved. Indeed, this strategy is how independent rural hospitals that were once relatively small have grown into large regional health systems.

We also frequently see cases where rural hospitals will target and make deals with smaller, allied health service entities, such as ancillary services, ambulatory care, and physician groups. These arrangements are increasing and are occurring on a daily basis. Just as larger metropolitan or urban-based health systems have pursued physician alignment transactions for many years, rural health facilities are also seeking growth through such deal opportunities. Many transactions are proceeding between rural hospitals and physicians, as well as other healthcare services organizations. Primarily, these types of facilities are engaging in physician employment arrangements where a buyout of the legacy practice occurs, as well as alternative structures, such as professional services agreements, clinical co-management agreements, and hybrid agreements. Additionally, a significant amount of activity is happening where rural health facilities are pursuing joint venture equity arrangements with physicians and other healthcare companies involving ancillary services, such as surgery centers, surgical hospitals (in some states), ancillary services centers, and others. Many of these transactions have proven fruitful in that they can facilitate stronger partnerships between a hospital and the physician community as well as capture revenue from outpatient, ancillary, and ambulatory services.

The Sell-side Scenario

Now let’s consider the sell-side scenario in terms of transactions involving rural health facilities. From a general, high-level perspective, there are typically a couple of reasons why a rural hospital would pursue either a full or partial sale. The first is financial distress. Unfortunately, in recent years, rural hospitals are being acquired because they need it. Beginning with the market crash of 2008 and afterward, many healthcare marketplaces are significantly more challenging to maintain both economic viability and a high quality of diverse healthcare services, especially for rural health facilities. Although some of the smaller, more rural markets have bounced back, many continue to struggle while they attempt to maintain independence.

The second reason why rural hospitals are in pursuit of a sales deal is lack of operating capital. The credit crunch and limited access to capital have intensified the challenge for many organizations to maintain solvency. While the financial markets have loosened up somewhat since the bleak days of the financial crisis, access to capital is still a tricky equation for many rural hospitals. As a result, they need to pursue a sale, which can include being acquired by another regional community health system, aligning with a regional metropolitan or urban-based acute care hospital system, or seeking financial assistance from national groups, such as for-profit health systems and others in that space.

The reality of these deals is that some end up working very well, while others have proven to be nearly as flawed as if the hospital had attempted to push through on its own. However, each deal opportunity and the potential long-term value proposition will depend on the individual parties involved in that transaction and the circumstances of the situation. This means that while these types of deals often present great potential, it is critical that the parties strive to ensure everything is done right during the transaction to achieve long-term value for *all* stakeholders.

Not all sell-side situations are necessarily from the standpoint of need or survival. Many transactions involving rural hospitals in today's marketplace are centered more on growth strategies, as opposed to last-resort options, and many of these cases have proven to be both highly successful and encouraging for other organizations seeking similar opportunities. These transactions often entail a rural health facility seeking a partner-type arrangement through an agreement that will result in a relationship that delivers additional value. This relationship can be accretive to the existing assets and worth that both organizations involved in the deal have already built independently. Perhaps the need is capital aimed at expanding market reach or scope of services, which can then expand value opportunity for both organizations' respective market bases. This type of deal can offer a way for two or more rural health organizations to expand their existing scope of services that they can then deploy in a larger combined marketplace. There are many scenarios where this has taken place, where "strength in numbers" is an appropriate strategy.

Achieving the Strategic Vision of the Transaction

As with any deal scenario, it is critical to validate the strategic vision of the transaction, and the validation should include long-term value propositions for all parties involved. Also, equally as vital to success as the vision is the need for a clear roadmap to ensure the ultimate achievement of the value targeted in the deal's strategic vision. Doing deals is challenging even in competitive marketplaces where the capital access equation and volume drivers are explicit. Further, some might argue that when it comes to achieving long-term value through mergers or other transactions, the cards are against you, even in situations where the barriers appear relatively minor. However, when you consider the additional hurdles that rural healthcare organizations must overcome, the margin of error for making deals work over an extended period and for all stakeholders involved is significantly smaller. Therefore, it is essential to make that extra effort to ensure not only the deal transpires correctly but that the resources and leadership are in place to increase the probability of success long after the agreement is complete.[1]

The Governance Institute thanks Mark Reiboldt, Senior Vice President, Coker Group, for contributing this article. For questions or assistance, he can be reached at (678) 832-2021.

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[1] For more information on merger and acquisition considerations, see Mark Reiboldt, *Long-Term Value Creation through Effective Post-Merger Integration*, Coker Group, December 2017 (available at http://cokergroup.com/wp-content/uploads/2015/07/Long-Term-Value-Creation-Through-Effective-Post-Merger-Integration_December-2017.pdf).