Establishing Strong Governance Structures for Mergers of Equals

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Healthcare is experiencing a rise in partnerships among larger hospitals and health systems that are coming together in "mergers of equals" to strengthen their positioning in the face of rapid industry disruption.

Organizations seeking such partnerships share common goals of building economies of scale, ensuring financial stability and strategic flexibility, and establishing a framework for organizational transformation and innovation. An effective merger, however, requires effective leadership—and mergers of equals pose a unique set of challenges when it comes to combining board governance.

Many of these challenges center on the fact that the term "mergers of equals" is a misnomer. Each organization is unique, with its own history and set of strengths and weaknesses. Whether it is a discrepancy in revenue, EBITDA margin, market share, or some other factor, no two organizations truly qualify as "equal."

Healthcare leaders considering partnerships with like-sized organizations should come to terms with this fact, and take the long view—focusing on how the combined organization could benefit the communities served over time. As unique entities, legacy organizations often include deeply entrenched governance structures, cultures, and traditions that can make decisions such as identifying the new board chair particularly difficult. Overcoming these challenges requires creativity, collaboration, and in many cases, concessions.

Merging organizations should approach decisions related to the design of their boards with a clean slate. They should not be tethered to the legacy structures of the partnering organizations, but rather focused on creating the optimal governance structure for the new organization.

A New Approach to Governance

The number of large-system transactions—involving organizations with annual revenues of $1 billion or more—fluctuated between five to six announced deals between 2011 and 2016, and jumped to a high of eight in 2017. Three such transactions were announced in the first half of 2018.[1]

These mergers are creating a whole new level of scale in healthcare. The joining of Catholic Health Initiatives (CHI) and Dignity Health, for example, will create the nation's largest health system, with combined revenues of $28 billion, and 140 hospitals and more than 700 care sites spanning 28 states.[2] The April 2018 merger of Advocate Health Care and Aurora Health Care brought together two systems with about $11 billion in combined annual revenue and 27 hospitals serving approximately three million patients per year.[3]

Several of these recent partnerships have taken a 50-50 approach to governance. The joint board for Advocate Aurora Health, for example, includes an equal number of directors from Advocate and Aurora,[4] and the new governing board for the combined Dignity Health and CHI will include six members from each legacy board and both organizations' chief executive officers.[5] For the merger of Bon Secours Health System and Mercy Health—which is expected to close this fall—Bon Secours' current board chairman will lead the new board while Mercy Health's board chair will be vice chair.[6]

Yet reaching agreement on equal governance is rarely easy. Historically, most hospital and health system mergers have involved the integration of smaller entities into larger organizations. Structural governance changes were minimal, as the smaller entity came under the umbrella of the larger organization's existing board.

With mergers of similarly sized organizations, however, both entities have significant scale and resources, and well-established legacy governance structures. In many cases, leaders from one or both organizations have a somewhat biased view of the strengths that their hospital or health system bring to the table. Disagreements over the appropriate distribution of governance responsibilities often arise as a result.

For example, leaders from a $5 billion organization may argue for a 60-40 split in governance in its partnership with a $3 billion organization, but leaders from the $3 billion organization may press for 50-50 representation, arguing the value of its established health plan. Similar debates have scuttled numerous deals, even those with the strongest business cases.

Focusing on the Future

Healthcare leaders who find themselves in similar situations should try to step

Key Board Takeaways

Mergers of equals are creating a new level of scale in healthcare as large, multi-billion-dollar health systems partner, posing unique challenges in combining board governance structures. Keys to overcoming these challenges include:

- Approach governance design with a clean slate.
- Build on existing strengths with a firm future focus.
- Weigh debates over equal board representation against the long-term potential of the future organization.
- Avoid drawing lines in the sand over disputes about organizational merits that have the potential to disproportionately negatively affect the outcome of an otherwise promising deal.

1 Kaufman Hall proprietary research.
2 Dignity Health, "Dignity Health and Catholic Health Initiatives to Combine to Form New Catholic Health System Focused on Creating Healthier Communities" (press release), December 7, 2017.
3 Lisa Schencker, "Advocate Health Care Finalizes Merger with Wisconsin Hospital System," *The Chicago Tribune*, April 2, 2018.
4 Guy Boulton, "Aurora Health Care and Advocate Health Care to Merge," *Milwaukee Journal Sentinel*, December 4, 2017.
5 Dignity Health, 2017.
6 Philip Betbeze, "Bon Secours, Mercy Pick Post-Merger Name, CEO," *HealthLeaders*, July 23, 2018.

back from the politics and emotions affiliated with the legacy organizations and their histories. The key is to look at the potential of the *future* organization, and what it will mean in terms of improving and strengthening healthcare for generations to come. Differences between two organizations likely are not so significant that they warrant drawing a line in the sand and terminating that potential.

To be successful, the leaders from one or both partnering entities must be willing to make concessions. For example, perhaps the leaders of the previously mentioned $5 billion organization agree to 50-50 governance, even if they continue to disagree with the other party on the weight of the health plan. While such decisions may be difficult, they are worthwhile if they help solidify the partnership and enable both organizations to move forward with building a better, combined health system.

The governance success of similarly sized merging entities really relies on building on the past with a firm focus on the future. Leaders should thoroughly assess cultural commonalities between the two partners, and the strengths that each bring to the new health system board. They should clearly define the mission and governance goals of the new organization, and determine how best to achieve those by leveraging and expanding existing strengths.

For instance, one health system's existing board may have strong clinician representation, while the other's board may have strong representation of progressive business leaders. Both are valuable characteristics, and should be integrated into the structure and processes of the new board of directors.

Mergers of like-sized organizations can be some of the most difficult partnerships to execute. Healthcare leaders involved in similar negotiations should remember that establishing a new organization is an opportunity for a fresh start. The key is focusing on building optimal governance for the future organization.

Hotly debated issues now—such as board leadership and board representation—often become moot within a matter of a few years, as the new organization becomes increasingly integrated and legacy leaders are replaced or evolve over time to a mindset focused on one common mission for the new, combined organization.

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