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Rural Focus

Strategic M&A for Rural Hospitals: From Barely Surviving to Clinically Thriving

By **Hector Torres**, Managing Director, and
Amit Payan, Vice President, *FocalPoint Partners, LLC*

COVID-19 catalyzed positive, albeit disruptive, changes in what has been a historically "slow to embrace change" U.S. healthcare industry. The pandemic also shed light on many aspects of the domestic healthcare delivery model that reflected antiquated practices that desperately needed to evolve. The digital revolution happening all around us finally manifested itself in healthcare through telemedicine and other virtual means aimed at expanding patient access to care. Hospitals in urban areas with ample resources and infrastructure benefited during this period by being better equipped to adapt to what were systematic shifts in the delivery of healthcare services across the U.S. Yet, these innovations did not manifest equally across all acute care providers; hospitals in rural settings found themselves lacking the resources required to adapt both clinically and technologically.

Rural hospitals have historically faced steeper challenges than their urban hospital counterparts, stemming in part from having to provide care for nearly 20 percent of the U.S. population with only a small fraction of the financial, technological, and human capital resources urban hospitals and health systems have benefited from.[1] In many ways, COVID-19 exacerbated this dynamic, further compounded by the fact that rural hospitals have historically faced declining patient populations, worsening economic conditions, and persistent shortages of clinicians.[2] Many rural hospitals were unable to fully deploy and subsequently benefit from the shift to telehealth relative to non-rural hospitals during the height of the COVID-19 pandemic due to insufficient funding to build and/or upgrade the key infrastructure critical to deployment of virtual care. While today many rural hospitals face declining

1 American Hospital Association, "Fast Facts on U.S. Hospitals, 2021."

2 George H. Pink, et al., "Geographic Variation in the 2016 Profitability of Urban and Rural Hospitals," Findings Brief: NC Rural Health Research Program, March 2018.

performance and an unsustainable care delivery model, a small but growing cohort of these rural players have utilized M&A as a strategy to achieve long-term sustainability overall.

M&A As a Strategic Alternative for Rural Hospitals

It is well known that M&A can improve rural hospital financial performance; however, a long unanswered question has been how, if at all, are care quality and patient outcomes impacted by M&A as a strategic alternative for rural hospitals?

→ Key Board Takeaways

As boards of rural hospitals further explore the viability of M&A as a potential strategic alternative to ensure long-term clinical and financial sustainability, they should consider the following:

- What challenges are we currently facing that could potentially be solved by a merger or acquisition? Rural hospitals have typically faced much stronger headwinds and operational challenges than their urban counterparts, with the COVID-19 pandemic serving to amplify this historical dynamic.
- Could pursuing a merger or acquisition lead to improved care and outcomes for our community? M&A can certainly support improved financial performance for rural hospitals joining larger urban hospitals and/or health systems, but a recent study now provides for substantive empirical support that mergers and acquisitions of rural hospitals are also associated with better mortality outcomes for certain conditions as compared to rural hospitals that remained independent.
- Can we successfully serve patients well into the future without partnering? While not a one-size-fits-all solution set, the pursuit and consummation of a merger or acquisition between a rural hospital and a larger, more well-capitalized hospital or health system can provide for long-term sustainability through enhanced scale, streamlined clinical services, improved patient outcomes, increased access to capital, implementation of technology infrastructure and related best practices, and even access to higher-margin value-based care programs and related initiatives.

Understandably, many rural hospitals have long been hesitant to explore M&A, in large part due to the desire of not wanting to potentially risk diminishing the quality of care provided to their communities.

A recent article published in *JAMA Network Open* discusses an analysis of quality of care for patients at rural hospitals that merged compared to those that remained independent.[3] The study compared 172 rural hospitals that underwent a merger or acquisition against 266 rural hospitals that remained independent. After controlling for factors relating to the characteristics of the patients, hospitals, and communities, the researchers found a "significantly greater" reduction in inpatient mortality for several conditions—including acute myocardial infarction, heart failure, stroke, and pneumonia—among patients admitted to the merged and acquired hospitals as compared to the independent hospitals. Improvements in mortality rates for acute myocardial infarction were the greatest in the first four years after the transaction, which could be a result of a transfer of technology and expertise from the larger "acquirer" system.[4] Improvements in mortality rates for heart failure, stroke, and pneumonia typically occurred three to five years after the transaction, which the authors indicated was consistent with research regarding complexities in adopting quality improvement approaches. The study's findings concluded that mergers and acquisitions of rural hospitals are associated with better mortality outcomes for certain conditions as compared to rural hospitals that remained independent. This is important evidence of the value that mergers between rural hospitals and acquisitions of rural hospitals by larger systems can bring to patients in those communities.[5] The study further concludes that M&A resulted in enhanced rural healthcare, as the participants were able to close the gap between disparities in the quality of care between rural and urban settings across key clinical areas.

Rural Hospital M&A's Criticisms Revisited

Hospital M&A has historically faced criticism from payers, regulators, and others who allege that acute hospital consolidation results in higher prices and lower quality of

3 H. Joanna Jiang, et al., "Quality of Care Before and After Mergers and Acquisitions of Rural Hospitals," *JAMA Network Open*, September 2021.
4 *Ibid.*, p. 3.
5 *Ibid.*

care. Many of these historical claims are not applicable to the rural acute care setting. For example, given that most rural hospitals are typically the only acute care facility in their community, the pursuit of a merger with a larger clinical enterprise would not necessarily lead to greater market consolidation. Further, a merger or acquisition is oftentimes the only available lifeline for an independent rural hospital that provides critical services for its community. From an upside perspective, potential benefits of M&A for rural hospitals include access to much-needed financial resources (e.g., growth and working capital), clinical expertise (e.g., specialized services), and new technologies (e.g., electronic health records).[6]

An analysis of the study cited above, combined with the historically proven benefits derived from enhanced clinical integration, size, and overall operational scale collectively reinforce the merits of M&A as a potential solution set for rural hospital sustainability. As such, the following five potential attributes should be carefully considered by rural hospital boards and leadership teams when contemplating M&A as a potentially viable pathway, each of which are stratified across both clinical and financial benefits to the rural hospital joining a larger acute care health system enterprise:

1. **Enhanced overall organizational scale**:
   - *Rural hospital clinical impact:* Access to enhanced and/or higher quality clinical services, capabilities, clinical providers, and medical supplies and/or infrastructure.
   - *Rural hospital financial impact:* Opportunities for revenue synergies via access to new acute care and/or ancillary clinical services, while simultaneously realizing operating expense synergies through group purchasing, lower overall cost of capital, and enhanced overall organizational bargaining power.
2. **Streamlined and/or consolidated clinical service lines**:
   - *Rural hospital clinical impact:* Targeted focus on enhancement of key local-level clinical service line capabilities, with ability to access enhanced clinical services, capabilities, and overall clinical outcomes through redirection of patients towards alternate sites for specialized, higher-acuity clinical care.

6 David M. Cutler and Fiona Scott Morton, "Hospitals, Market Share, and Consolidation, *JAMA*, November 2013; pp.1964–1970.

- *Rural hospital financial impact:* Streamlined clinical service footprint at the local rural hospital level will rationalize spend on higher-acuity clinical cases and/or providers, thus enhancing financial performance overall.

3. **Increased access to working capital:**
    - *Rural hospital clinical impact:* Better clinical equipment, resources, and related infrastructure, along with the ability to recruit and retain top clinical provider talent.
    - *Rural hospital financial impact:* Flexibility, financial support, and continued reinvestment in people, processes, and the physical plant to adequately weather short-term financial fluctuations, while creating for a more durable and sustainable financial position overall.
4. **Shared new technologies and associated infrastructure:**
    - *Rural hospital clinical impact:* Increased patient access to clinical care and enhanced overall throughput via access to best-in-class technology infrastructure, telemedicine, and related capabilities.
    - *Rural hospital financial impact:* IT implementation cost savings realized through economies of scale, as well as improved overall financial performance via cost-sharing and/or subsidization of "high ticket" purchase elements such as EMR, telemedicine, and related infrastructure elements.
5. **Access to alternative reimbursement models:**
    - *Rural hospital clinical impact:* Ability to improve clinical outcomes, while reducing overall cost of care through participation in value-based care programs.
    - *Rural hospital financial impact:* Bolstered financial performance through participation in higher margin value-based care incentive programs that both enhance profitability and reduce organizational waste.

Conclusion

Unlike much of the merger and acquisition activity that took place over a decade ago, in which financial outcomes were perhaps the only measure of post-transaction success, recent activity and investor sentiment reflects recognition of the critical interdependence between both clinical and financial outcomes as it relates to the acute care setting. Optimized outcomes for acute care providers of all sizes and types can be realized when both hospital and health system leadership and providers are working collaboratively to advance the quality of care and clinical outcomes, while simultaneously striving toward financial sustainability in parallel. Given the nuances, challenges, and unique dynamics of rural healthcare, it is even more critical for rural hospital boards and leadership to consider how a strategic partnership, affiliation, and/or M&A transaction may advance their organization's mission, while simultaneously ensuring the long-term sustainability of the essential healthcare services being delivered to the community at large.

The Governance Institute thanks Hector Torres, J.D., M.B.A., Managing Director, Healthcare Investment Banking, and Amit Payan, CPA/ABV, Vice President, Healthcare Investment Banking, FocalPoint Partners, LLC, for contributing this article. They can be reached at htorres@focalpointllc.com and apayan@focalpointllc.com.