Hospital Mergers and Acquisitions – Overview and Critical Success Factors

by Surabhi Swaroop, MBA

Due to industry and economic pressures, many acute care hospitals are deciding to form an affiliation or merge with another entity rather than continuing to operate as a stand-alone entity. Although each transaction is unique, hospitals generally experience five phases in the process: assessment, partnership planning, transaction development, transaction execution/due diligence, and integration. The transaction process is not linear, and the activities within each phase may overlap with the activities of another phase. The transaction process is typically complex; it can distract from core operations, and associated details can extend the process and increase costs. The following provides an overview on the various phases and critical success factors (“CSFs”) to increase the likelihood of a successful transaction:

Assessment. In this phase, an organization assesses their current situation with respect to market position, physician alignment, utilization trends, cost position, quality indicators, financial performance, readiness and response to healthcare reform, and information technology (“IT”) resources. It then identifies the needs and resource requirements to move from the current position to the desired position. After taking inventory of available resources, if there is a shortage of resources, and unlikely ability to incur additional debt, partnership opportunities are usually considered.

- **CSF:** Be objective in analyzing existing capabilities and the potential for acquiring needed resources internally. Deciding to partner or remaining a stand-alone entity can be emotional as senior leaders, medical staff, and board members are invested in their organization. Maintaining objectivity will help keep a realistic perspective.

Partnership Planning. Once the decision to partner is reached, activities within the partnership planning phase occur. This phase includes educating management and the board of the partnership process and potential structures, developing partnership goals and objectives, identifying and evaluating the potential candidates, and selecting the appropriate partnership process (e.g., exclusive negotiation process vs. a competitive process).

- **CSF:** Focus on development of the strategic and financial goals and objectives of the partnership since this establishes the foundation from which the organization will negotiate. The organization’s mission, vision, and values should be considered, along with operational considerations such as service line development (e.g., growth of the cardiovascular line or the addition of a high-end imaging facility or, on the other hand,
consolidation of clinical services), capital and facilities commitments, employee commitments, governance considerations, and the transaction structure.

Transaction Development. Activities included under this phase include preparing a descriptive memorandum or request for proposal (“RFP”), evaluating RFP responses (if necessary), selecting the preferred partner, conducting the valuation, negotiating key terms, and preparing and executing the letter of intent (“LOI”).

- **CSF:** Take an analytical approach to assess the strategic and financial position fit. Key questions include: What are the benefits of a transaction with this partner? What are the risks? How does this partner compare to the other potential partners on the table? Go back to the organization’s mission, vision, and values along with operational considerations, and evaluate the compatibility with the potential partner.

- **CSF:** Adjust the valuation to reflect the incremental impact (both positive and negative) from the partnership. Examples of specific factors impacting the valuation may include building in a time lag of realizing gains in contracted rates due to the contract renegotiation process and building in synergies gained from sharing resources such as billing, payroll, human resources, etc.

Transaction Execution/Due Diligence. During this phase, typical activities include conducting transactional due diligence, negotiating and finalizing definitive agreements, and securing regulatory approvals. In this phase, it is common to obtain outside assistance, particularly in the financial and legal arenas.

- **CSF:** Follow a thorough, unbiased due diligence process. A “We must buy this” perspective will take away from the integrity of the process and possibly skew findings that may result in an unsuccessful transaction.

- **CSF:** Ensure that regulatory issues that may arise as a result of a partnership are resolved. Regulatory considerations are critical and every effort should be made to ensure that the transaction is sound from a regulatory/legal perspective. Obtain outside guidance, if necessary.

Integration. The integration phase includes activities both pre- and post-merger. Pre-merger activities include: confirming expectations related to the degree of integration on “day 1” after the merger, assembling the resources and structure to execute integration, and developing integration blueprints. The most significant post-merger activity is the execution of integration plans to conduct business as a combined entity.

- **CSF:** Implement rapidly and effectively. Ensure rapid and effective implementation of decisions that were fundamental to the strategic financial assessment. Implement operational changes in a timely manner to realize the cost savings and/or increased revenue reflected in the valuation (e.g., streamlining shared resources or renegotiating more favorable payer contracts.

For more information on successful hospital mergers and acquisitions, please contact Ms. Swaroop at 310.320.3990, x 3962 or sswaroop@thecamdengroup.com.