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Do M&A Deals Really Result in Long-Term Value Creation?

Increasing Your Odds of Success

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Consolidation among healthcare providers, including hospitals and physician-owned entities, continues to skyrocket each year, exceeding the prior year's transactions. However, the structures and strategies have changed dramatically.

Hospitals have been engaging in various mergers and acquisitions (M&A) deals throughout the various cycles that began in the 1980s. Emerging in the 1990s were deals between physicians and hospitals, where these two unique market players pursued mergers and other joint ventures. The majority of these deals unraveled, proving to be negative experience from both sides. The baggage left behind continues to impact the dynamic between hospitals and physicians today.

We are again witnessing the coming together of hospitals and physician-owned entities through a variety of joint ventures and alignment structures, driven largely by the broader industry trends around healthcare reform and value shifts in the economic model associated with the healthcare delivery process. Meanwhile, consolidation among hospitals and health systems also continues to increase through traditional M&A, as well as alternative deal strategies and structures that allow these organizations to achieve their objectives of strength in numbers, shift from volume to value, or whatever the primary strategy behind a partnership may be for the parties involved.

One thing that lingers for any discussion around consolidation through deal strategies and partnerships is how the parties involved achieve their value targets under a proposed transaction. After the deal is struck, how do partners involved in a transaction achieve success?

For over ten years, I have focused on completing strategic deals between two healthcare provider organizations where I am representing the buyer. Buying a healthcare entity is unlike any other type of acquisition or investment transaction process in many ways. The parties involved usually move at a snail's pace, due to the many stakeholders and range of variables that must be considered and included in a process involving these types of organizations. Also, healthcare deals--especially when not-for-profit health systems and physician entities are involved--entail extensive legal and regulatory scrutiny that all of the parties, but especially the buyer, must address to reach an agreement.

The financial drivers involved in deals between healthcare provider organizations, regardless of size, are also unique. First, the process of determining and negotiating a deal's valuation and economic terms differs from most deals, because they must adhere to specific fair market value guidelines. As a result, deals involving such organizations often have very little range of movement in terms of the financial consideration, especially pertaining to comparables and market multiples compared to other markets and industries.

Perhaps one of the least-defined pieces of healthcare M&A deals over the years and throughout market ups and downs is the value the purchaser, particularly for the not-for-profit system, hopes to achieve from a deal where they're spending hundreds of millions of dollars.

Nevertheless, many hospital deals in the past entail the parties getting together and having an idea that teaming up through a merger or one party selling to the other would ultimately result in great things for the organizations, their patients, and the communities as a whole. Putting any real numbers specifically on where that value would ultimately come about was unlikely. In such cases, simple hope was essentially the key driver behind these deals.

Fortunately, some deals that entailed less than optimal value drivers and other key strategies turned out okay in the long run and benefitted most stakeholders. However, the result of many deals among healthcare organizations was failure and/or significant hardship for the organizations left behind post-transaction. Market dynamics or the lack of effective planning ultimately resulted in deals that failed to deliver the intended or anticipated value long-term, leaving observers and participants in a state of shock.

Today, value is more elusive than ever, and achieving value from consolidation efforts is becoming more difficult for all stakeholders involved. Just defining a value target for a deal can be challenging. Even if you can peg specific value targets and strategic objectives that are tied to defined growth and financial projections post-transaction, setting targets and achieving them in a way that results in long-term growth and value creation for the organization is an entirely different matter.

Then what's missing in between setting these targets and seeing them through to reality? Is it the lack of a plan or "roadmap?" Are the expectations going into a deal and driving the value targets unrealistic or improperly influenced and misunderstood? Perhaps there were external market variables that negatively impacted the targets, but which could not be foreseen, and this ultimately resulted in missing those targets or other unintended consequences on the long-term value justification. All of these are likely reasons why deals in today's marketplace fail to deliver long-term value or even a combination of these and other reasons.

Identify the Value Targets

So how does an organization pursuing a transaction work to limit the risk of failure or missing its value targets? First, identify the value targets. If you are unable to do that, then step back and make sure to address and define this and other fundamental pieces. Both buyers and sellers should be able to articulate the value targets.

Develop a Planning Process

The planning process most often ignored by organizations engaging in a transaction is to establish a "roadmap" that walks your organization(s) down the road. Within this over-arching strategic roadmap that spans from the very beginning to years following a deal's completion, there also will be smaller pieces of the larger map that assist in implementing key segments of the overall process. Mergers and collaborations have many moving parts, large and small, yet critical to the over-arching picture. The key to the strategic roadmap is ensuring that each of these parts are implemented effectively, and just as important, that they are managed in a way that allows for value to be delivered and transferred in a streamlined, seamless manner throughout the entire process.

Execute the Plan

Once a roadmap is in place, the rest is execution. Execution entails uncertainty and the potential for confusion and pitfalls. You must be prepared to negotiate such obstacles, primarily through the planning process. However, some challenges will call for outside expertise.

Know When to Get Help

When the range of problems is beyond an organization's technical or professional expertise, outside advisors can add specific skills and knowledge. The best advice will come from a combination of deep domain expertise in relevant areas (i.e., healthcare finance, valuation metrics, quantitative analytics, market research, etc.) and from those who have been involved in executing deals that have been successful elsewhere in the marketplace.

Engage the Right Advisor

Using an advisor to help navigate the deal process is not a requirement or absolute necessity. However, the use of a quality outside experts to help an organization through a process that is highly specialized and nuanced is a common characteristic of successful ventures. Moreover, one of the greatest value components of using an advisor during the complex value creation strategy process is to enable management to focus on their primary job responsibilities. This freedom, in turn, contributes to an organization's overall strategic value, operational efficiency, and growth.

What Kind of Advice Do We Need?

Advisors can help through a transaction process in many areas. Investment bankers specializing in M&A advisory, transaction services advisory, and advisors for specific and technical expertise (i.e., experts in valuations, HR due diligence and payroll consolidation, IT/IS systems and infrastructure integration, executive compensation, and an organization's employed physician network and related strategies).

Regardless of the qualifications and the soundness of the advice, no level of experience and/or domain expertise within a specific, technical area will deliver value from a deal, if such efforts are not delivered in conjunction with intentional and proactive strategic planning on behalf of the organization.

More to Follow

Coker will be releasing an in-depth paper and related market study to take readers and audiences through this assessment evaluating successful healthcare provider deals versus those that failed to achieve long-term valuation creation or those that were not able to achieve their strategic targets. This study will look at the key characteristics that played critical roles in the determination as to whether a deal was successful or not, and how certain strategies, leadership steps, and other resources ultimately led to deals delivering successful results as opposed to failing, even when market and other competitive dynamics were more challenging than previous, friendlier market periods. Stay tuned for discussion of these important questions that will be critical for any organization, leader, and senior stakeholder to understand before pursuing deal strategies in today's marketplace.

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