Washington Healthcare News®
wahcnews.com
Articles, Interviews and Statistics for the Healthcare Executive

To Merge or Not to Merge: How to Prepare for this Decision

By Harman Wales, CFA
Managing Director
Moss Adams Capital LLC

By Roberta Hurst
Vice President
Moss Adams Capital LLC

Health care reform has placed an increased focus on accountability for quality outcomes and, at the same time, low-cost care. Health care leaders should evaluate the degree to which hospital mergers or affiliations will offer improved quality of care and lower costs in their own facility.

As pressure to improve quality and reduce costs mounts, and capital requirements grow for new investment, stand-alone hospitals will become less common in the health care ecosystem. Independent hospitals and midsize systems are facing increasing pressure as larger health organizations combine, consolidate, and merge. Should your independent hospital join the movement and sell to a larger system or hospital? Are you prepared and ready to consider this important decision?

There are many options available for most small to midsize hospitals, including remaining independent. Hospitals considering a merger or affiliation can increase their chances of achieving desired outcomes by evaluating all the options well ahead of time. When thoughtful consideration is given to the broad and complex topics involved, the hospital's management team is most likely to make a strategic choice that meets its identified needs. Preparation in advance will create value and improve the outcome.

Consolidation is underway

Many independent hospitals face growing economic uncertainty. Reforms will bring lower revenue and higher administrative costs. Hospitals require funding to invest in IT and prepare for reform. Many smaller organizations aren't performing as well as in the past, so access to capital is scarce. Traditional financing is much harder to achieve. Rather than going it alone, the leaders of small and midsize health care organizations are giving a close look to consolidation with a larger system.

The pace of consolidation is accelerating. Larger systems will enjoy multiple advantages that the smaller hospitals will struggle to obtain. Among them:

- Better access to capital
- Greater efficiency thanks to large economies of scale
- Improved pricing leverage with vendors and insurance companies
- Upgraded IT systems that meet interoperability needs

While smaller hospital systems give thought to selling, other larger systems are emerging as consolidators. Larger health care systems see an opportunity to buy independent hospitals and quickly improve profitability by placing them on a bigger platform. Private equity funds are moving into this area as well, providing capital to support consolidation and investment. The buyers are plentiful for a well-run but challenged independent.

A Viable Strategy for Long-Term Growth

The sale of a hospital can be a compelling strategy for its leadership team. Faced with an increased regulatory burden, declining patient counts, and challenges with physician employment, an increasing number of hospitals are concluding that a merger or acquisition makes good strategic sense. Selling to a larger system means protecting the long-term viability of the facility and making many of the vexing challenges disappear.

For buyers, an acquisition is a compelling opportunity to add new services and enter new geographic regions. Diversifying the patient base and the payer mix can be equally important to the buyer seeking acquisitions.

Evaluating Strategic Alternatives

Hospital leaders should be open to the full range of alternatives that can address the coming changes to healthcare. There are multiple options on the table. Before pursuing a specific solution, it's vital that leaders clearly understand the full range of alternatives as well as the implications of each. Of course, remaining independent is always an option and should be considered alongside a consolidation or merger. The best decisions often result from careful consideration of all alternatives.

One of the first steps is clarifying the rationale for consolidation or merger. Leaders must identify what the organization can accomplish once combined that it cannot achieve on a stand-alone basis. They must understand the expected organizational and community benefits, the enhanced services and clinical capabilities, the quality of care, and the financial benefits, including access to capital and economies of scale. Clarifying and ranking these criteria will provide the decision-making framework for evaluating each strategic alternative. After reviewing all the options, leaders can select a strategy and a partner that's the best fit based on its ability to meet the hospital's identified needs.

It's important to note that a sale is not the only alternative. A hospital can partner with a physician group, a clinical practice, or a capital partner without undergoing a complete sale. These alternatives should be examined alongside any potential sale. The key is to know the objectives before commencing the transaction process and to continually check to see that the objectives will be achieved when the deal gets closed.

It Pays to Be Prepared

Evaluating strategic alternatives is a complex and intense process. Managing the transaction process is also a challenging undertaking. It's worth considering an experienced advisor who can guide your leadership team through the process and provide objective advice along the way. It's not a time for on-the-job training.

Many organizations wait to contemplate their future until they've lost a great deal of leverage and available options have faded away. Early planning will help you control your own future and drive your options to the very best outcome possible. Readiness can create value.

Are you prepared?

Harman Wales is a Managing Director in Moss Adams Capital LLC, the investment banking affiliate of Moss Adams LLP. He leads teams that perform strategic advisory, financing, and merger/acquisition services to health care companies. He can be reached at (206) 302-6770 or jet.wales@mossadams.com.

Roberta Hurst is a Vice President in Moss Adams Capital LLC, the investment banking affiliate of Moss Adams LLP. She provides strategic advisory, financing, and merger/acquisition services to health care companies. She can be reached at (206) 302-6700 or roberta.hurst@mossadams.com.