Coker Group is a national healthcare consulting firm with one mission: to help hospitals, physician groups and other healthcare companies reach an optimum level of productivity through proven, targeted solutions in four main service areas; Strategy and Operations, Finance, Technology, and Executive Search.

At Coker, our vision is to be a trusted partner to healthcare organizations as they navigate these uncertain, ever-changing times. We take ownership of your challenges, roll up our sleeves and get in the trenches with you to solve problems.

We have sat on both sides of the table, representing physician groups and hospitals for more than three decades.

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Transaction Strategies and Long-Term Value Creation: Do Deals Automatically Result in Success for Health Care Organizations?

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Doing deals isn’t like it used to be, at least not in the context of agreements among health care organizations. For hospitals, health systems, and other kinds of health care services organizations, deals among entities have been commonplace for many years. Transactions have been a frequently-pursued strategy to expand market value, geographic reach, and growth in the scope of services, all of which ultimately aim to achieve long-term value creation. And, while such strategies have varied considerably in size, scale, and structures, the pursuit of transactions among health care organizations has continued throughout a wide range of evolutionary market dynamics and policy landscape trends.

In many cases involving health care transactions over recent years, getting the deal to “close” was considered the most challenging aspect. Overcoming challenges or differences related to organizational culture, management styles, impact on personnel, and regulatory hurdles were among the common variables that made transactions more difficult. However, once the deal was closed, usually the problematic matters would be more likely to fall into place for the organizations involved. Eventually (and typically), the overarching result of the deal would achieve long-term value.

Fast-forward to today, and it’s safe to say that the equation that links transaction strategies to long-term value creation is not nearly as automatic. Further, in today’s health care marketplace, one cannot just assume that doing a deal—even one that appears to have considerable value on the surface—will automatically have a positive impact on the organization in the future.

Many factors have influenced the current landscape of health care transactions in today’s market dynamic. The financial crisis and economic downturn that the United States and global marketplace continues to work through have played a key role in the new trends faced by the health care industry today. Also, the progression of numerous major policy initiatives impacting health care organizations, such as the Patient Protection and Affordable Care Act and other related policy movements, have proven to be the chief drivers shaping market dynamics and guiding health care industry stakeholders.

But while there is no single culprit in the current health care market paradigm that is changing the deal landscape, it would behoove all parties involved with health care organizations considering transactions as a strategy for long-term value creation and growth to evaluate just how they intend to ensure achievement of value for their deals.

One overarching principle that has increasing validation in today’s marketplace is that the real work towards ensuring that a deal results in long-term value begins after the transaction is complete.

Even though there are still just as many, if not more, challenges in completing a transaction for health care organizations today, just getting a deal done does not mean the largest hurdles are removed. Indeed, the real challenging work is just beginning, and we can rest assured that it will continue for some time. Another aspect to this realization is that the sooner the main parties involved in a transaction start planning for the bulk of difficult tasks to come, the more likely they will be able to take the necessary steps towards the achievement of long-term value.

In the past, the primary questions around a transaction scenario typically related to aspects like valuation (i.e., what are we paying/receiving in this deal?) and financial metrics (e.g., debt retirement and absorption, etc.), as well as softer factors, such as community impact dynamic. And it was common to assume that the appropriate people throughout the combined organization(s)
could work out the kinks related to issues like operations, personnel, revenue cycle management, etc. after the deal closed.

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When doing health care deals today, however, management teams have to think about all of these factors and much more. If a deal is involving a hospital, one of the biggest issues will be ensuring strength and stability in the physician relations dynamic. Do the hospitals have joint ventures with physician groups? How do the market regions and service offerings compare and mesh? These questions can lead to identifying critical gaps in areas that ultimately can have a significant trickle-down effect on other aspects, including valuation (deal value and long-term value creation). This example is just one of many where leaders in health care organizations have to look before completing or even initiating a deal to (1) validate a deal's true value and viability and (2) identify key risk or gap areas that will be critical to the long-term value equation.

Curiously, as obvious as this might appear, getting ahead of the curve on upcoming or impending challenges is not always something management teams at health care organizations do best. As mentioned, part of this perception is the fact that in many cases in the past, the closing of the deal marked the completion of the difficult portion. As such, management teams just would not be confronted with major issues or questions working against the likelihood of success beyond a transaction's close.

Pursuing a transaction involving a health care services entity is unlike any other type of acquisition or investment deal process in many ways, even for other health care services organizations and especially for any party that is not already in that business. Just the nature of the parties involved can often result in a process that ends up creeping along at a snail's pace (or even slower), due to the many stakeholders and range of variables necessary to consider and include in a process involving these types of organizations. In addition, health care deals—especially when not-for-profit health systems and physician entities are involved—entail much greater legal and regulatory scrutiny that all of the parties must address, especially the buyer, to get a deal done.

Another key piece is the valuation metrics in use. These metrics can be different for health care organizations when looking at a transaction's value versus the "downstream" or "synergistic" value potential for the organization over a longer-term period. The financial drivers involved in a deal between health care provider organizations are unique, regardless of their size. First, the process of determining and negotiating a deal's valuation and economic terms differs from most deals because of the need to adhere to specific fair market value guidelines. As a result, deals involving such organizations often have limited range of movement in terms of the financial consideration. Guys like me often talk about deal comparables and market multiples; however, the truth is these valuation parameters have a relatively minimum range and often even less movement compared to other markets and industries.

Another key point when considering the financial impact is the value driver that ultimately makes a buyer interested in doing a deal. This aspect is perhaps one of the least-defined pieces of health care merger and acquisition (M&A) deals, and it has been this way over the years and throughout market ups and downs. Most people would think that a health system would be able to tell you relatively quickly the value they hope to achieve from a deal where they’re spending hundreds of millions of dollars. This expectation particularly applies to a not-for-profit system with a role as a major community or market stakeholder.

Unfortunately, this is not always the case, and I would even venture to say that this scenario is most likely more common than the alternative case, where such answers are clearly defined and understood by all of the relevant stakeholders. The truth is, for many hospital deals in the past, they mostly would entail the parties getting together and having an idea that teaming up through a merger or one party selling to the other would result in significant benefits for the organizations, their patients, and their communities as a whole. However, putting any real numbers specifically on where that value would ultimately come about was unlikely. And for some deals, even coming to that general hypothesis of “one good plus one good equaled one great” was a question; in such cases, simple hope essentially was the key driver behind these deals.

Due to the nature of some health care organizations and the particular market dynamics in which they operate, some deals that entailed less than optimal value drivers and other key strategies ultimately turned out okay in the long run. Many of the organizations or partnerships that emerged out of such deal scenarios grew and achieved marked success going forward. For some organizations and during certain periods of growth within the health care industry, value still could be attained, despite the unintended issues that would challenge most consolidation strategies. Whether it was timing and specific market dynamics or the good luck of what turned out to be the right deal at the right time, success that emerged out of some periods of consolidation among health care industries was almost an inevitable result that would benefit most stakeholders, regardless of their shortcomings and poor planning efforts.

However, we know that such luck and inevitable success despite contrarian efforts is not the norm and rarely continues for long periods. In many (or most) cases, the result of the deals among health care organizations was failure and/or significant hardship for the organizations left behind post-transaction. Even in the deal scenarios where great effort was placed on ensuring success, the market dynamics or the lack of adequate planning ultimately resulted in deals that failed to deliver the intended or anticipated long-term value. Many people within the industry
are shocked and surprised that such deals were not as successful as they anticipated or hoped they would be.

In today’s health care marketplace and the current wave of consolidation among all kinds of organizations, regardless of size, scope, or financial investment involved, value is more elusive than ever. Further, achieving value from such deals is only becoming more difficult for all stakeholders involved. Just defining a value target for a deal can be challenging enough for many health care organizations, particularly those larger health systems that tend to grasp tightly to the traditional deal dynamics that were in past cycles. Even if one can peg specific value targets of a deal and the 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 a different matter.

What then is missing in between setting these targets and seeing them through to reality? Is it the lack of a plan or a “roadmap?” Are the expectations when entering an agreement and driving the value targets unrealistic or improperly influenced and misunderstood? Perhaps there were external market variables that impacted our targets negatively that were not foreseeable, which resulted in missing those targets? Or, were there other unintended consequences on the long-term value justification? The answer is “yes” to all of these questions. All of these variables (or a combination of them) are likely reasons why deals in today’s marketplace fail to deliver long-term value.

So, how can an organization that is pursuing a transaction work to limit the risk of failure or missing its value targets? First, identify the value targets. If the organization is unable to do that, then it should take a step back in the process so that it can address and clearly define the value targets and perhaps other fundamental pieces. Otherwise, how can the organization expect a complex investment or M&A transaction to deliver the value that it envisions if none of the parties, both the buyers and sellers, can articulate these core points?

So, how can an organization that is pursuing a transaction work to limit the risk of failure or missing its value targets?

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Second, there is the planning process. While this may seem like a rather obvious piece, it is the component that is most often ignored or overlooked by organizations engaging in some transaction. Ideally, this planning initiative will produce a “roadmap” that walks your organization(s) from today’s status where the parties are two separate entities, through five or so years down the road (or however long a particular deal will span). The outcome will demonstrate a clear value that has been achieved from the deal strategy and how the organizations continue to build that value model together into the future.

Within this overarching strategic roadmap that spans from the very beginning to years following a deal’s completion, there will also be smaller pieces of the larger map that assist in implementing key segments of the overall process. For instance, there is the deal itself, which is a crucial but still relatively small piece of the overarching picture. Then, there is integration, which again is one of the most critical pieces, but unfortunately, is often missed entirely. The key, however, to the strategic roadmap is ensuring the effective implementation of each of these parts, and just as necessary, ensuring that the management of those parts allows for value to be delivered and transferred in a streamlined, seamless manner throughout the entire process. Think of the roadmap strategy as ultimately guiding the organization to an elusive and well-guarded treasure. However, to eventually arrive at the final “X” that marks the spot, an organization and its leaders first will have to complete a series of distinct tasks and challenges along the way. Only when they reach the top of one hill will they ultimately be able to proceed to the next mountain ahead.

Once a sufficient and comprehensive roadmap plan is in place, the rest is execution.

Though the implementation may seem relatively straightforward on the surface, it entails a lot of uncertainty and potential for confusion. Pitfalls, landmines, and traps are inevitable. The organization must be prepared to negotiate the obstacles, some of which will emerge in the planning process. However, some challenges will arise that are outside an organization’s or team’s range of expertise.

A good time to seek the support of outside advisors is when problems occur. It is important to bring in the necessary technical skills and knowledge of people with experience in specific areas at crucial points or throughout the deal process as a whole. This support typically will come from a combination of deep domain expertise in relevant areas (i.e., health care finance, valuation metrics, quantitative analytics, market research, etc.) and skill in executing such deals that have been successful (and perhaps failures that result in sometimes even more valuable lessons) elsewhere in the marketplace.

This author’s intent here is not to promote consulting services or suggest that success from transactions will only come if an organization hires the right advisor. Using an advisor to help navigate through the deal process is not a requirement or absolute necessity. However, it has been our experience that one of the key characteristics of successful deals is the use of quality outside advisors to help an organization through a process that is highly specialized and nuanced, and in which most management team members do not have specialized experience. Moreover, one of the greatest value components related to using an advisor on a transaction is that depending on an advisor to guide an organization through a deal and the overall value creation strategy process ultimately allows management to focus on their primary job responsibilities. In turn, this freedom contributes to an organization’s overall strategic value, operational efficiency, and growth.
An advisor can help the transaction process in many ways. Investment bankers specializing in M&A advisory are often valuable resources for an M&A transaction; however, their role will typically be limited to the parts that specifically focus on structuring and executing the deal and perhaps arranging financial products, such as credit facilities and other instruments that are implemented in the deal. Bankers are typically restricted to advising on financial or valuation components of a deal, as well as coordinating the various deal process steps. Such high level coordination, however, does not usually involve getting into the details of an organization’s strategic targets, value measurements, and other critical pieces that come into play when trying to achieve long-term value from a specific deal strategy.

A transaction services advisory group can serve as the overall coordinator of the deal process and typically will play a weighty role in the due diligence phase of this process. Due diligence is a critical function, particularly when looking at deals as the buyer. In the health care industry, being the buyer can take shape in different ways; for example, by purchasing an equity stake in a joint venture (JV) enterprise or acquiring another by absorbing debt and/or making capital commitments. Constructing the financial model for such a transaction will entail various inputs for the distinct types of structures. However, the overall process essentially remains the same across all deal efforts. It boils down to one party investing to join another party in a strategy with another entity. Afterward, the newly joined entities or the joined efforts in this particular venture will continue forward under a combined strategy with unique value and growth targets over some defined period.

Other types of advisors that can be of value throughout the transaction process and an organization’s overall strategic effort are those who can get involved in specific pieces of the process. Typically, these advisors will be engaged to provide specific and often technical expertise within a defined component of a deal. Areas can include a valuation advisor who assists an organization on the financial modeling and calculations of a deal or organization’s value. There are also consultants who will provide specialized technical analysis and advice in specific areas of due diligence and/or the integration process. Other specialized consultants may be engaged to provide assistance in key functional areas, such as HR due diligence and payroll consolidation or IT/IS systems and infrastructure integration. Some consultants may be engaged to offer answers on executive compensation or conduct analysis on an organization’s employed physician network and related strategies.

Many different types of advisors are available to provide assistance to an organization throughout the strategic deal process, such as Coker Group, and there are various structures under which consultants can be engaged in this type of scenario. It is critical to understand, however, that no consultant, lawyer, or other “magic bullet” will be able to automatically deliver a result of success by merely engaging them and paying their fees. There is no level of experience and/or domain expertise within a particular technical area that will deliver value from a deal if the efforts are not in conjunction with intentional and proactive strategic planning on behalf of the organization driving the transaction strategy and overall effort.

The real work towards ensuring that a deal yields long-term value begins after the transaction is complete. So how can an organization’s board members, management team, and key stakeholders make certain their deal targets will result in long-term value creation? It is true that even the best plans, roadmaps, outside experts, and financial resources can sometimes miss the projected targets for that deal strategy, but we can learn a lot by looking at some of the trends from various deals that have taken place in the current marketplace and by assessing the significant characteristics that resulted in success versus failure.