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Building a Best-in-Class Hospital M&A Function

10 Tactics for Hardwiring M&A Excellence

Nicholas Bartz
Consultant
202-266-5686
bartzn@advisory.com

Yulan Egan
Senior Analyst
202-568-7079
yulane@advisory.com

Christopher Kerns
Managing Director
202-266-5600
kernsc@advisory.com

Thomas Cassels
Executive Director
202-266-5600
casselst@advisory.com

Executive Summary

Ten Tactics to Help Improve Your M&A Function

Hospitals, physician practices, and integrated health systems have seen periodic flurries of deal-making in the past, but rarely has the American health care provider sector experienced such sustained increases in mergers and acquisitions (M&A) activity as it has in recent years. This growth, driven largely by increasing pressure on hospital margins, heightened competition for physicians, and the growth of accountable care, is likely to continue. Interviews with hospital and health system executives, as well as our own analyses, suggest that robust hospital and health system M&A activity will continue apace in 2014.

In theory, M&A can generate significant benefits, but when executed poorly M&A can actually impede operational efficiency and reduce care quality. In extreme cases, mergers can collapse entirely, leading to costly divestitures and alienation of care partners. Research both inside and outside of the health care industry suggests that a well-organized and directed internal M&A function can help organizations make better decisions about which deals to pursue—preventing negative outcomes and increasing the amount of value that is unlocked through each deal.

Hospital and health system leaders looking to either improve the competency of their M&A function or establish a dedicated function should pursue three main goals. First, create an accountable leadership structure for M&A. Sourcing and deal-making can only proceed efficiently when responsibilities are clearly assigned and formal processes are hardwired. We’ve surfaced three tactics to help members achieve this goal:

1. Create a dedicated team and executive role with a clear mandate to drive the organization’s M&A strategy.
2. Appropriate the expertise of functional experts across each business unit of the organization when doing a deal
3. Establish an explicit reporting structure, both for the core M&A team, as well as those specialized M&A resources in other departments

Second, improve the discipline of the deal-making process and ensure that each step of the process is carried out as rigorously as possible. Four tactics can help members succeed here:

4. Institute a formal process to aggregate, monitor and efficiently allocate attention to potential leads
5. Build a consistent framework to screen deals that includes clear benchmarks for strategic relevance, financial return, and cultural fit as well as a limited set of intangible “nonnegotiables”
6. Conduct a robust risk assessment and scenario analysis when examining the business case for of each potential deal
7. Invest in clearly defined M&A approval processes, overseen by a small group of decision makers

Finally, hardwire a system for continuous improvement. Dedicated resources and hardwired processes can only take you so far. To ensure high performing deals each time, institutions must track and analyze their performance across deals, codifying lessons and insights. There are three key tactics here:

8. Ensure that M&A teams are tracking performance metrics that correspond to the specific strategic objectives outlined for each deal
9. Provide financial incentives to M&A team members based on the short term success of each deal and the long term success of corporate M&A strategy
10. Ensure that key lessons and insights from each deal are codified into an easily accessible knowledge asset to support performance improvement for existing staff and rapid training for new staff.

Source: Health Care Advisory Board interviews and analysis.

A Flurry of Consolidation

Surveys Suggest Even More Activity in 2014

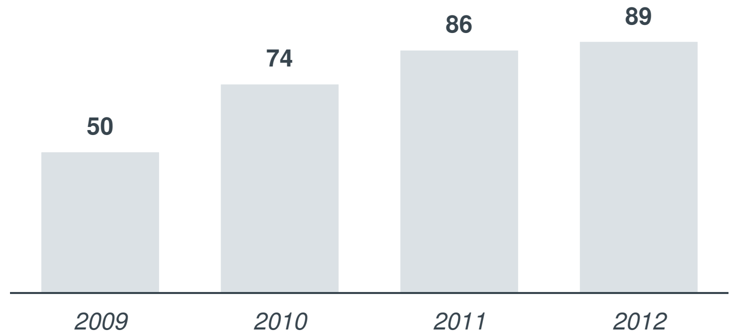
Over the past four years, the number of announced hospital and health system M&A transactions has almost doubled. Add this to massive increases in physician practice acquisition and employment, and the recent consolidation becomes even more remarkable.

The consolidation trend may be only just beginning. Interviews with hospital and health system executives suggest that the industry's M&A activity will continue to accelerate in 2014. These findings square with a recent GE Capital survey of provider executives: **88% plan to pursue a merger or acquisition within the next 12 months.**

The Advisory Board's research has identified five main forces driving this growth in merger and acquisition activity.

Number of Closed Hospital Transactions

2009-2012



Five Forces Impelling Hospital M&A

Favorable Market Environment

- Low interest rates ease access to capital
- Wide interest spreads give higher-rated organizations a debt advantage

Increased Margin Pressures

- Managing expense growth vital
- Reimbursement pressures from reform
- Worsening payer mix
- Managed care consolidation

New Capital Demands

- Recent capital spending freezes mean many updates necessary
- Many new non-accretive investments

Accountable Care

- Expanded scope of services across the care continuum
- New business model needed to reposition for cost, quality, and accountability

Competition for Physicians

- Increased resources to retain and recruit medical staff
- Stable practice models for continuity
- Strategies for integrating existing practices needed

Source: "Eighty-Eight Percent of Healthcare Services Execs Will Pursue M&A in the Next Year, Shows GE Capital Healthcare Survey," *Business Wire*, September 18th 2013, www.businesswire.com/; Health Care Advisory Board research and analysis.

Plenty to Gain from M&A, but Risks Abound

Range of Possible Outcomes from a Merger or Acquisition

The Good

In theory, M&A can generate significant benefits. Scale can allow organizations to improve cost structure. Expanding into a new parts of the continuum can increase opportunities to capture a larger share of total services spend. Moving into new geographies can also strengthen the reach of the clinical enterprise.

Administrative department consolidation into a centralized corporate office can also reduce staffing and office supply costs, and centralized office functions in finance, marketing, HR, and IS can lead to greater efficiencies.

On the clinical side, a merger or acquisition can result in principled service line consolidation, eliminating duplicative service offerings, while also achieving cost and quality improvements by standardizing evidence-based clinical protocols.

The motivation for consolidation goes beyond merely standardizing care and improving operational efficiency. Hospital consolidation has the potential to unite complementary assets to create a more seamless care continuum, improving patient outcomes and reducing overall costs.

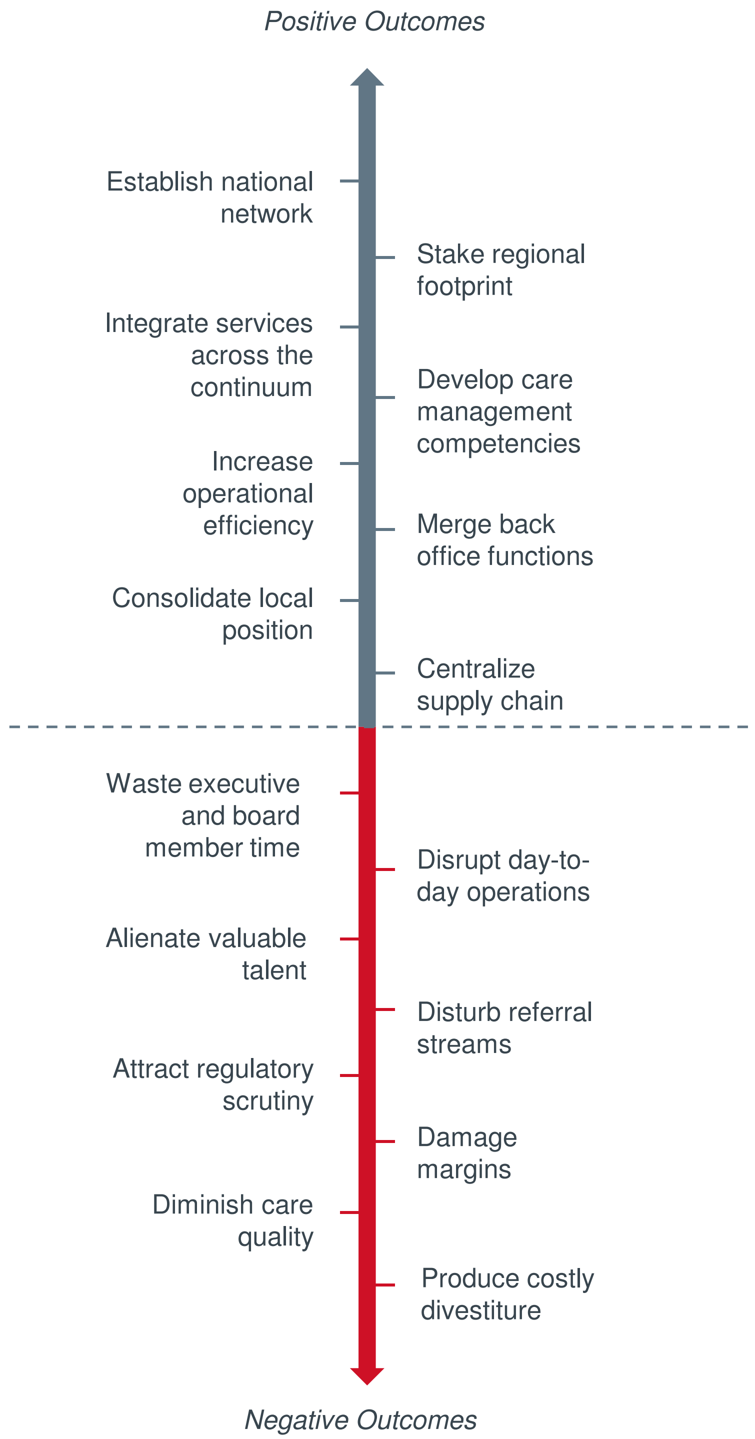
The Bad

When deals are executed poorly M&A can actually bring on additional administrative complexities and management responsibilities to existing resources and roles that may actually impede efficiency, ultimately hurting margins.

In some cases, consolidating clinical departments may result in tensions around leadership and ownership of highly profitable clinical services, with unresolved disagreements alienating valuable talent, and disrupting referral streams

The Ugly

And in some extreme cases, mergers collapse entirely. More often than not this results from soft assumptions behind the original theory of the deal or late recognition of cultural incompatibility.



Source: Health Care Advisory Board interviews and analysis.

Investing in M&A Function Pays Off

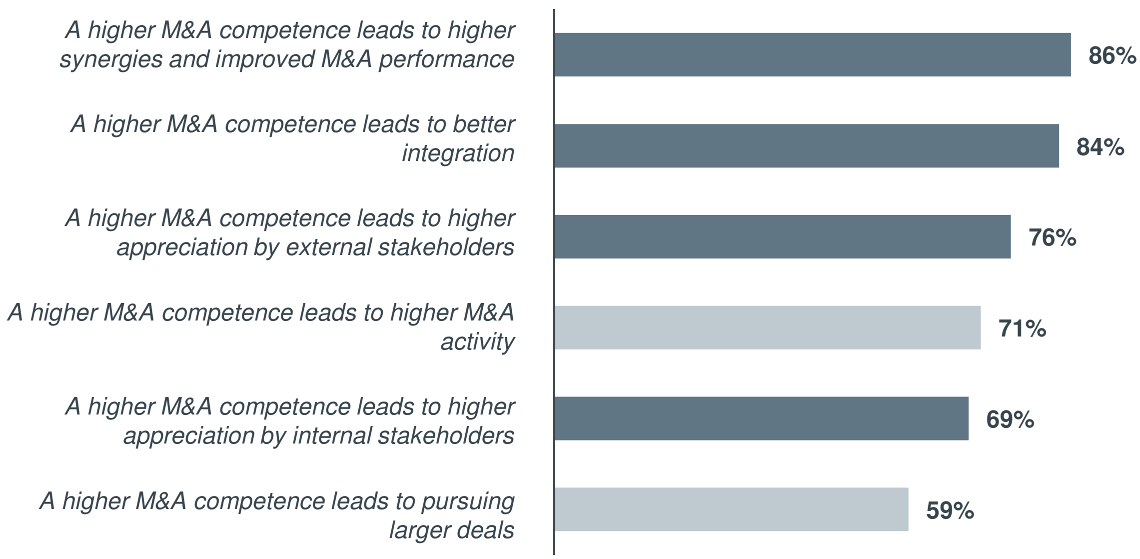
Evidence Suggests That an Investment in a Strong M&A Function Yields Advantage

Interviews with hospitals and health systems, as well as M&A professionals in other industries, suggest that a well-organized and directed internal M&A function can help organizations make better decisions about which deals to pursue, increase the amount of value that is unlocked when deals are executed, and mitigate execution risk during the integration phase. These results square with a recent cross-industry survey of M&A professionals conducted by Forrester consulting group.

To what extent do you agree with the following statements?

4 or 5 on a scale of 1 (strongly disagree) to 5 (strongly agree)

n=219 M&A professionals



A Strong M&A Function Means a Better Answer for Four Key Questions

It should come as no surprise that a high-performing internal M&A function leads to improved M&A performance. At its most fundamental level, the purpose of an internal M&A function is to answer the four questions most germane to any M&A deal. The more effectively your organization expends resources, talent, and experience against answering these questions precisely, the greater the likelihood of a successful deal.

1. **Partners**

   Which partners will make us more valuable to key stakeholders?

2. **Value Proposition**

   Why exactly does a particular partnership make us more valuable?

3. **Integration Strategy**

   How exactly will we unlock the value of this partnership?

4. **Scenario Planning**

   How can make sure the value of this deal is unlocked, even if markets change, or assumptions turn out to be incorrect?

Source: "Trends, Challenges, and Technology Use in a Changing M&A Environment," Forrester Consulting, May 2010; Health Care Advisory Board interviews and analysis.

Three Goals for Improving M&A Performance

Hardwiring a Better Answer to the Four Key Questions

Hospitals and health systems looking to improve the performance of their M&A function, or put in place a function should pursue three main goals. First, create an organizational support structure for M&A. Sourcing and deal-making can only proceed efficiently when responsibilities are clearly assigned, and formal processes are hardwired. Second, improve the discipline of the deal-making process, ensuring that each step of the process is carried out as rigorously as possible. Finally, hardwire a system for continuous improvement. Dedicated resources and hardwired processes can only take you so far. In order to ensure high performing deals each time, institutions must track and analyze their performance across deals, codifying lessons and insights.

Goal #1: Create Accountable Leadership Structure for M&A

Tactic #1: Staff Dedicated M&A Team

Tactic #2: Cultivate Functional M&A Experts in Key Business Units

Tactic #3: Outline Clear Reporting Structure

Goal #2: Improve Transactional Discipline

Tactic #4: Continuously Monitor Discrete Sourcing Pathways

Tactic #5: Leverage Simple and Consistent Screening Framework

Tactic #6: Conduct Comprehensive Scenario Analysis

Tactic #7: Delineate Explicit Decision-Making Structure

Goal #3: Hardwire System for Continuous Improvement

Tactic #8: Tie Deal Performance Metrics to Core Strategic Objectives

Tactic #9: Financially Incentivize M&A Team

Tactic #10: Codify Experience into Knowledge Asset

Source: Health Care Advisory Board interviews and analysis.

Ad Hoc Approach to M&A Management Insufficient

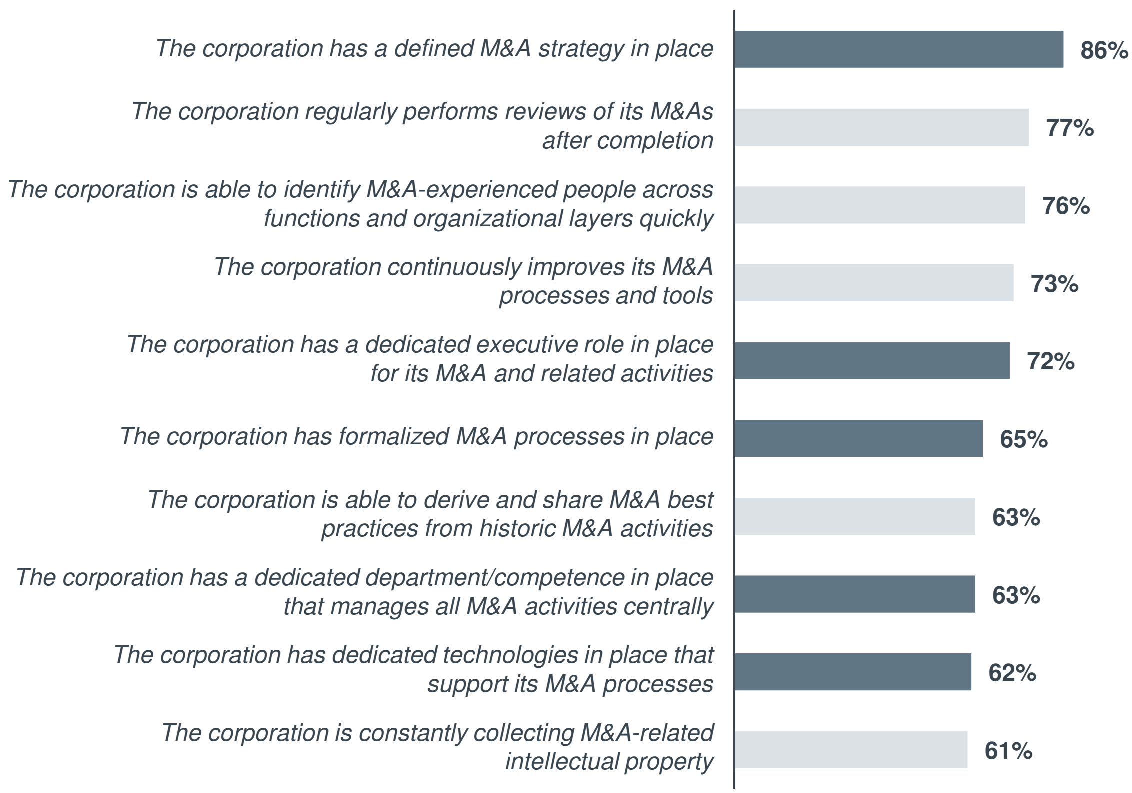
Surveys Suggest M&A Function Needs Dedicated Governance and Structure

Given the inherent complexity of M&A strategy development and variety in deal life cycles, it should come as no surprise that most growth-focused organizations, both inside and outside of health care, believe that dedicating resources specifically to M&A is critical. A majority of M&A professionals believe that organizations not only need a well-defined M&A strategy, but also a dedicated team, dedicated executive position, and formalized M&A processes.

How Critical are the Following Criteria for Successful Corporate M&A?

4 or 5 on a scale of 1 [not at all critical] to 5 [very critical]

n=219 M&A professionals



Three Key Tactics to Strengthen Governance and Structure of M&A Function

While the first tactic of this section will describe the need to establish a dedicated M&A team, the next two tactics will focus on the need to cultivate functional experts within other business lines and the importance of developing an overarching governance structure to coordinate M&A resources across the enterprise.

Tactic #1:
Staff Dedicated Mergers and Acquisitions Team

Tactic #2:
Cultivate Functional M&A Experts in Key Business Units

Tactic #3:
Outline Clear Reporting Structure

Source: "Trends, Challenges, and Technology Use in a Changing M&A Environment," Forrester Consulting, May 2010; Health Care Advisory Board interviews and analysis.

Dedicated Team Critical for M&A Success

Allocating Responsibilities Across Existing Roles not Effective

According to surveys of M&A professionals across all industries, a dedicated M&A department and executive role is critical for M&A success. A dedicated function and role must be created with a clear mandate and be empowered to drive the organization's M&A strategy. Members of the M&A team must take responsibility for overall M&A strategy, managing individual deals, and supporting M&A performance improvement, as outlined in the table below.

Responsibilities of the M&A Team

Core Responsibilities	Target search and identification
	Assisting with corporate strategy development
	Valuation and analytics
	Leading negotiations
Management Responsibilities	Selecting and allocating appropriate resources to various deals and tasks within deals
	Tracking tasks and progress across teams
	Managing communication, collaboration between internal and external teams
	Managing the internal approval process
	Reporting real-time picture of progress to senior leadership and M&A staff
Support Functions	Measurement of M&A performance
	Collection of M&A best practices
	Training M&A support staff across institution

Breaking Down Responsibility Across Three Core Roles

To efficiently allocate responsibilities across available resources, many progressive organizations choose to create three core roles on the M&A team: an M&A executive to oversee the direction of the M&A function and liaise with senior leadership, individual managers to oversee each deal, and M&A analysts to conduct market research, build business cases, and conduct valuation and risk analyses.

M&A Executive

- Collaborates with senior leadership to determine overall M&A strategy
- Serves as conduit between senior leadership and M&A team

Transaction Managers

- Manage deal pipeline
- Coordinate communication between external and internal resources

M&A Analysts

- Support M&A strategy development and target identification with in-depth research
- Conduct valuation and analytics for deals

Source: Health Care Advisory Board interviews and analysis.

Always a Need for Expert Guidance

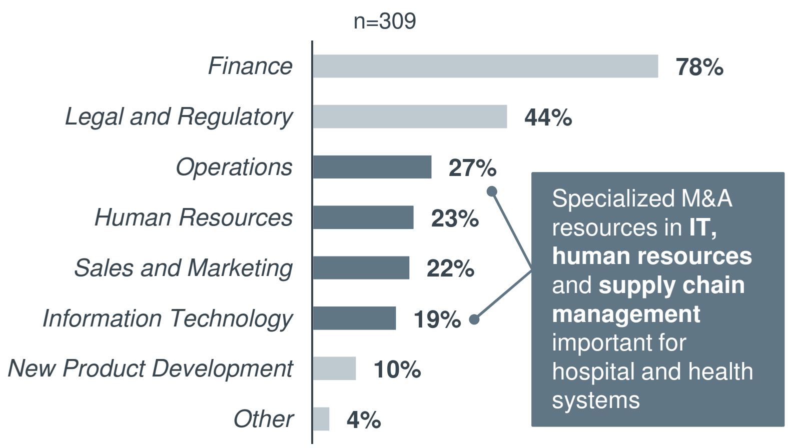
Centralized M&A Team Not the Only Source of Deal Insight

Though M&A staff may have significant deal-making experience, it is unrealistic to assume that they will have adequate expertise across all key business lines to build a truly comprehensive business case and conduct sufficiently rigorous due diligence on another organization. To enhance the quality of forecasting, improve the amount of value captured in integration, and increase the accuracy of valuation and risk-assessment, the deal team should appropriate the expertise of functional experts across each business unit of the organization when doing a deal.

Almost all organizations rely on dedicated M&A resources within the finance department, but depending on the number of deals pursued each year, organizations should consider cultivating dedicated resources in operations, HR, and IS. Given the relative importance of cultural integration in the success of any merger, resources in HR with M&A experience could be the difference between success or failure. Given the potential synergies involved in hospital supply chain consolidation, and the costs involved in integrating disparate health care information systems, functional expertise is crucial.

Percentage of Organizations with Specialized M&A Resources in Each Business Function

Deloitte Corporate Development Survey 2012



Ideal Qualities of Functional Experts
Strong relationship-building skills
Ability to remain calm when challenged
Strong ability to communicate effectively at all levels
Deep knowledge and interest in organizational culture
Significant comfort with uncertainty and change
Previous experience with M&A
Significant tenure with the organization

Big Picture Training Necessary to Unlock Value of Specialized M&A Resources

It is the responsibility of M&A management to make sure that all functional experts have the right combination of skills and training to effectively contribute to M&A planning and execution. Consequently, the same functional experts must be used across each deal-cycle, ensuring that M&A experience from prior deals enhances future deal-making.

In many cases, functional experts may lack an understanding of the broader corporate strategy of their organization, leading to a narrow focus on specifics and diminishing the quality of insight they are able to deliver. For example, at Rupert[1]Health System, the M&A management team ameliorates this problem by regularly by bringing together functional M&A experts across all business functions to discuss broader organizational M&A strategy, and providing insight into the wider process of conducting an M&A deal.

Rupert[1] Health System M&A Training Sessions

- Semiannual training sessions bring together M&A leaders with embedded experts across business units
- Walk through health system's overall corporate strategy, discuss M&A teams role in deal-pipeline

1) Pseudonym.

Source: "Corporate Development 2012 Leveraging the Power of Relationships in M&A," Deloitte, 2012, http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/FAS_ForensicCenter_us_fas-us_dfc/us_ma_Corporate%20Development%20Survey%202012_052212.pdf; Health Care Advisory Board interviews and analysis.

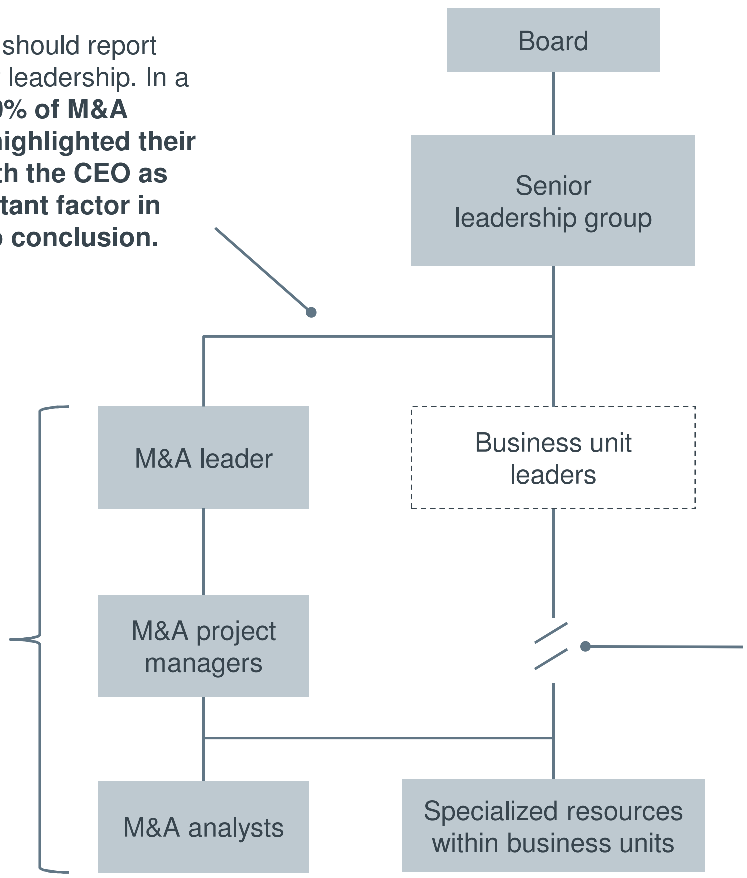
Lack of Clear Reporting Structure Hampers Efficiency

Overarching Structure Key to Collaboration and Effective Allocation of Resources

To ensure that resources are allocated efficiently across all projects and deals, labor is not unnecessarily duplicated, and there is clear decision-making authority, organizations must put in place an explicit reporting structure, both for the core M&A team, and those specialized M&A resources in other departments. Each organization's reporting structure will differ according to individual responsibilities, executive purview into M&A, and decision-making pathways; one common structure is outlined below. Our research has unearthed three key insights to keep in mind when developing the M&A reporting structure, regardless of the reporting structure used.

1

M&A leadership should report directly to senior leadership. In a recent survey **60% of M&A professionals highlighted their relationship with the CEO as the most important factor in driving deals to conclusion.**



2

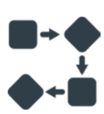
Reporting relationships within core M&A team should be defined during the deal-cycle as well as during general target identification and corporate strategy development to ensure all resources are used efficiently during off-cycle periods

3

Reporting relationships and accountability for performance should be explicitly delineated for specialized support staff pulled into M&A deals from other business units

Benefits of Explicit Reporting Structure

Easier to manage and deploy resources across multiple projects



Less potential for duplication of labor

Easier to measure performance, manage accountability

Clear decision-making authority

Source: Health Care Advisory Board interviews and analysis.

Facing Challenges Across Each Stage of the Deal-Cycle

It is not enough to establish a dedicated team and support structure for the M&A function. A highly competent M&A function should also have a disciplined deal-making process. During the course of our research, we surfaced five core challenges associated with each stage of the deal-making process: managing informal lead generation, adjudicating between numerous potential leads, managing forecast accuracy, steering decision-making processes, and comprehensive integration planning. To support members with the first four challenges, we've collected four tactics commonly used by high performing organizations. To support the final challenge, we have published a dedicated white paper on best-in-class integration planning.

Process Step	Core Challenge	Supporting Tactics
Source Deals	Managing informal lead generation	**Tactic #4:** Continuously Monitor Discrete Sourcing Pathways
Screen Potential Acquisitions	Efficiently differentiating between potential acquisitions	**Tactic #5:** Leverage Simple and Consistent Screening Framework
Conduct Due Diligence	Managing forecast accuracy	**Tactic #6:** Conduct Comprehensive Scenario Analysis
Negotiate and Execute Transactions	Steering decision making processes	**Tactic #7:** Delineate Explicit Decision-Making Structure
Integrate Organizations	Comprehensive planning for integration	: **Best-in-Class Integration Planning**: Health Care Advisory Board white paper, available at advisory.com

Source: Health Care Advisory Board interviews and analysis.

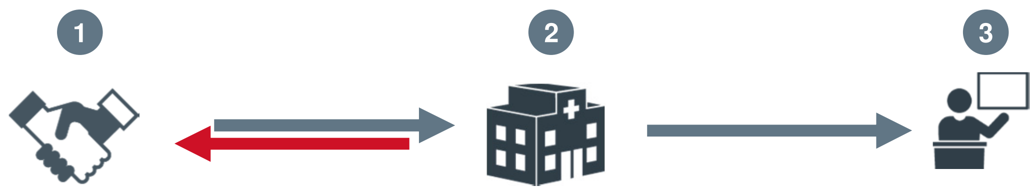
Bringing Structure to an Informal Sourcing Process

Aggregating, Prioritizing and Ensuring Consistent Communication

Organizations traditionally rely on informal relationships crafted by executives and board members to produce M&A leads. But while the deals themselves may spring from informal relationships, the deal-sourcing pipeline cannot afford to remain informal. Without a formal process to aggregate, monitor, and efficiently allocate attention to potential leads, organizations may lose track of leads, accidentally send mixed messages to potential partners, or become overwhelmed while trying to manage too many leads at once.

Laud[1] Health System's Deal Aggregation Pipeline

At Laud Health System, members of the M&A team are responsible for collecting potential leads, prioritizing them according to strategic fit and urgency and making sure that all executives across the organization are kept up to speed with the status of each deal, ensuring potential partners gets a consistent message. Their three-step process is outline below.



- Regional hospital leaders discover potential leads by cultivating relationships with local organizations
- Pass along potential leads to system M&A team

- System M&A team conducts initial market research on lead,
- Sends local leader research packet to help them assess and, if appropriate, cultivate lead further

- System M&A team aggregates all leads in pipeline, prioritizes according to fit and urgency
- Presents regularly to senior health system leadership on state of all potential leads

Unlocking the Value of Social Media in Deal Sourcing

Organizations that are proactively looking for potential M&A targets, or who are not seeing much yield from informal relationships, may consider leveraging social media, or online deal networks such as SecondMarket and Axial, to increase deal flow. These methods are not intended to replace offline relationship building, but rather to complement it. Building an active presence on social media and in M&A networks can multiply the effectiveness of other deal-sourcing tactics, ensuring that your organization is top-of-mind with executives at other health systems when they are looking to partner.

Social Media

Informal relationships form the basis of most deals, but relationships are increasingly moving online. Social media can help create new relationships or re-kindle old relationships, and help articulate your hospital or health system's strategy and operational expertise.

Deal Networks

Deal networks such as SecondMarket or Axial focus on helping buying organizations connect with sellers of companies. They give buyers the ability to manage an online presence that ensures that they're visible to organizations researching and preparing to engage prospective buyers.

1) Pseudonym.

Source: "Corporate Development 2012 Leveraging the Power of Relationships in M&A," Deloitte, 2013, http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/FAS_ForensicCenter_us_fas-us_dfc/us_ma_Corporate%20Development%20Survey%202012_052212.pdf; Health Care Advisory Board interviews and analysis.

Cutting Through the Noise

Differentiating Between Several Options with Limited Resources

For many hospitals and health systems, the question will not be how to increase deal flow, but how to adjudicate between a range of opportunities. Even with a large internal M&A team, an organization may not be possible to conduct an in-depth analysis of each potential lead. One simple yet disciplined approach to separate worthy opportunities from distractions is to build a screening framework. The framework should include clear benchmarks for strategic relevance, financial return, and cultural fit, as well as a limited set of intangible “non negotiables” that automatically kill any deal. Outlined below are five areas where the framework should give clear, fact-based guidance as to whether a potential acquisition is worth further scrutiny.

It is important that the framework is made transparent and widely available across the enterprise. Not only will this help increase the quality of leads passed from within the organization, but it will also allow external parties to asses their potential fit before reaching out.

Key Questions for the Deal Framework

1. What is an acceptable strategic business case for acquiring an organization?
2. What financial benchmarks does an organization need to meet to be a potential acquisition?
3. What cultural compatibility benchmarks does a potential acquisition need to meet?
4. What are acceptable versus non-acceptable regulatory hurdles for acquiring an organization?
5. What are the immediate deal-breakers that would make a deal a no-go?

Key Qualities of the Vetting Framework

Objective, fact-based

Transparent, widely available

Continuously updated as corporate strategy evolves

Benefits of Consistent Deal Framework

A consistent screening framework can help speed the process of vetting potential deals and also help focus due diligence efforts further down the line, diminishing the need to build a business case from scratch for each acquisition. Going further, an impartial framework can help prevent personal biases and egos from clouding decision making.

Allows objective appraisal of potential deals

Avoids time wasted conducting individual research

Provides framework for due diligence

Source: Health Care Advisory Board interviews and analysis.

Learning from the M&A Veterans

M&A vetting frameworks don't necessarily have to be complicated, or quantitatively rigorous, so long as they help to differentiate between potential acquisitions. Cisco Systems is an organization that has relied on rapid M&A activity to fuel growth for over 30 years, and its M&A team has had to efficiently differentiate between worthwhile targets and those that were not worth attention. To do this, they have developed five simple criteria for assessing whether or not a deal is worth further analysis.

Cisco M&A Screening Criteria

1. Does the other institution share a similar institutional vision?
2. Will the deal provide quick wins for shareholders?
3. Will the deal provide long term wins for all four constituencies:
   - Shareholders
   - Employees
   - Customers
   - Business partners
4. Is there sufficient chemistry between organizations?
5. **For large acquisitions:** Are the two organizations geographically close enough?

Such a framework could easily be adapted as the basis of a hospital or health system deal framework, as seen below:

Example Hospital or Health System M&A Criteria				
1	**2**	**3**	**4**	**5**
Does the other organization share a vision of where the health care industry is going?	Are there sufficient short-term cost or revenue synergies to demonstrate quick wins?	Will the deal create value in the long term for health care purchasers: • Health plans • Self-insured employers • Patients	Is there sufficient cultural compatibility between the two organizations?	*For large acquisitions:* Do the two organizations have geographically complementary service areas?

Source: Rifkin G, "Growth by Acquisition: The Case of Cisco Systems," *Strategy and Business*, Booz Allen Hamilton, New York, 1997; Health Care Advisory Board interviews and analysis.

Don’t Aim for False Precision

Accepting the Limits of Business Case Forecasting

Short-and long-term financial forecasts are essential components of the overall business case for each deal; they support decision making, improve valuation fairness, and can assist with deal-structuring. Yet according to a majority of cross-industry M&A professionals, forecasts are often highly inaccurate. In a recent Deloitte survey of M&A professionals, only 20% of respondents thought that forecasts were consistently accurate.

Observed Pattern Of Accuracy In Forecasts

Deloitte Corporate Development Survey 2013

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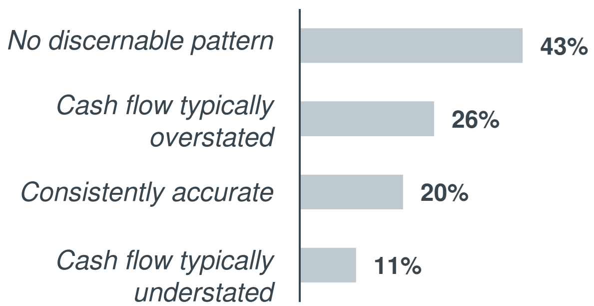

Most Difficult Elements to Forecast

Deloitte Corporate Development Survey 2013

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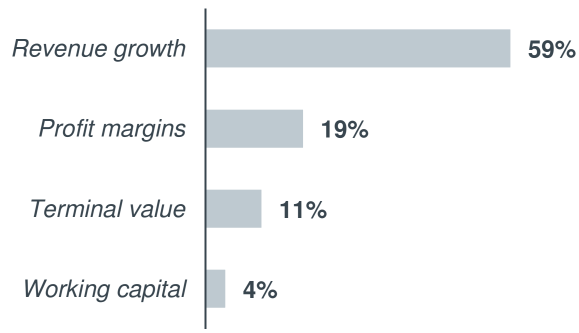

Progressive Organizations Embracing Uncertainty

Rather than doubling down on the elusive goal of improving accuracy, progressive organizations are focusing on more comprehensive risk assessments. Instead of trying to come up with one right answer, M&A teams at these organizations are providing as much information as possible on the various scenarios that could play out after the deal is signed, their potential impact on the success of the deal, and the likelihood of each scenario. Armed with this information, executives and board members at these organizations can make more educated decisions.

Methods of Demonstrating Uncertainty in M&A Business Case Forecasts

Sensitivity Analysis
Vary one assumption at a time

Scenario Analysis
Vary several assumptions at a time

Heat Map
Visual representation of probability versus impact of each potential scenario

Monte Carlo Simulation
Probabilistic risk model

Most Common Action Taken to Mitigate Business Case Uncertainty

Deloitte Corporate Development Survey 2013[1]

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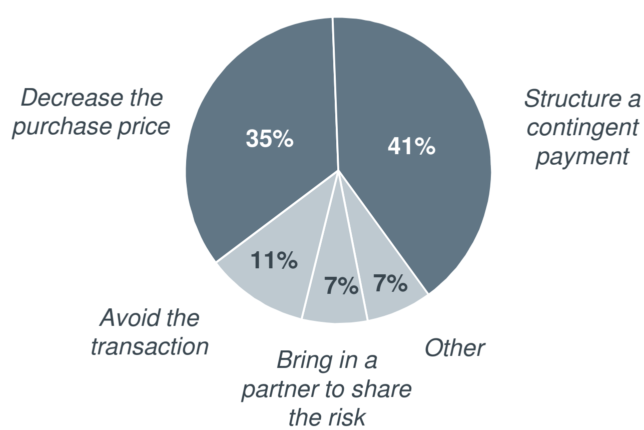


1) Totals may not add up to 100% due to rounding.

Source: “Corporate Development 2013: Pushing Boundaries in M&A,” Deloitte, 2013, https://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/FinancialAdvisoryServices_FAS/us_fas_Corporate-Development-Survey-Report_2013.pdf; Health Care Advisory Board interviews and analysis.

Charting a Path Toward Consensus

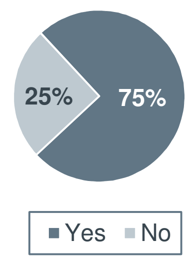
Moving Quickly: a Clear Virtue in Deal-Making

To ensure that organizations can move quickly while also vetting each acquisition with sufficient, fact-based, rigor, they must delineate an explicit path toward decision making.

Most organizations outside of the provider industry have invested in clearly defined M&A approval processes, overseen by a small group of decision makers. Yet in interviews with large health systems, we found that decision making was often ad hoc, resulting in often repetitious, back-and-forth communications between executives and board members.

Does Your Company Have a Clearly Defined M&A Approval Process

Cross-Industry M&A Professionals
n=435



Number of Decision Makers in M&A Approval Process

Cross-Industry M&A Professionals
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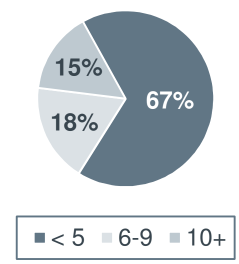
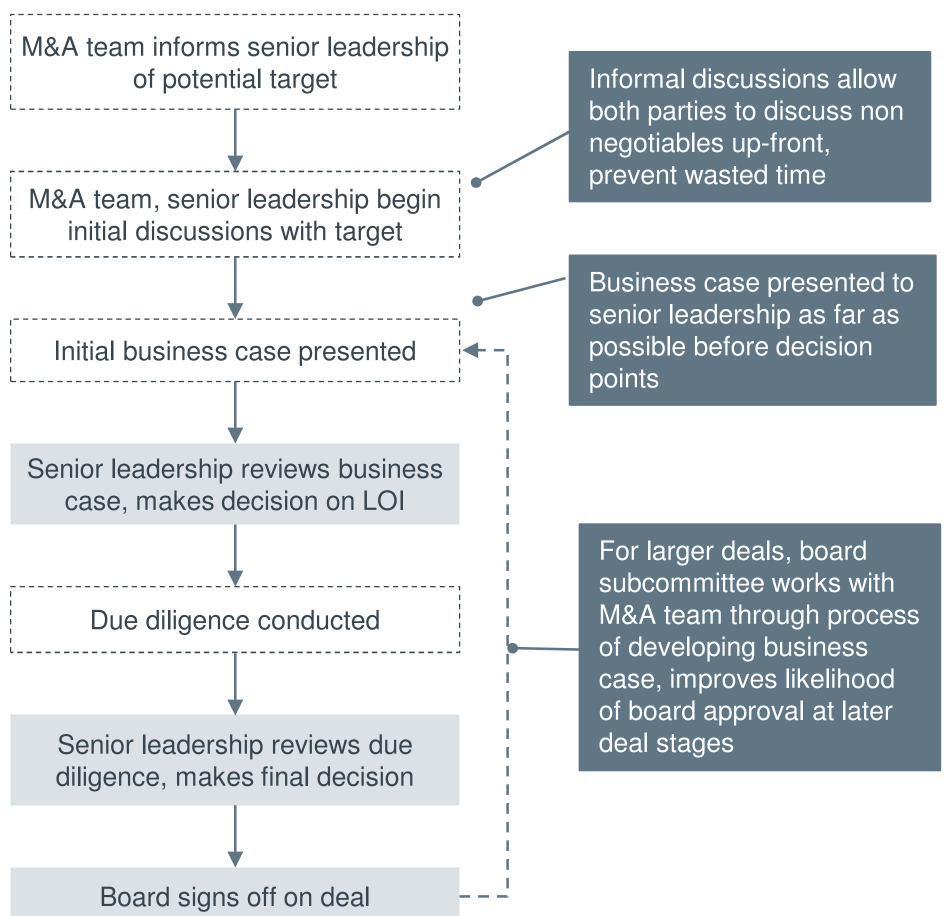


Case Study: Edgehill[1] Health System Decision-Making Pathway

At Edgehill Health System, formal decision-making is required at only two points: senior leadership weighs in before a letter of intent(LOI) is issued, and before the deal is signed, and the board signs off only on the final decision.

To encourage expedient deliberations, the M&A team makes sure to provide decision makers with a fully researched business case for each deal as far as possible before decisions are made. This ensures that there are no surprises when decision makers gather.

For larger deals, where the board may be inclined to weigh in more actively, Edgehill will actually designate a subcommittee to act as a liaison to the M&A deal team, ensuring that both the board, the M&A team, and senior leadership are on the same page when it is time to make the final decision.



1) Pseudonym.

Source: "Corporate Development 2013: Pushing Boundaries in M&A," Deloitte, 2013, https://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/FinancialAdvisoryServices_FAS/us_fas_Corporate-Development-Survey-Report_2013.pdf; Health Care Advisory Board interviews and analysis.

Experience Proving No Guarantee of Success

Codification of Key Lessons and Insights from Previous Deals Necessary to Improve

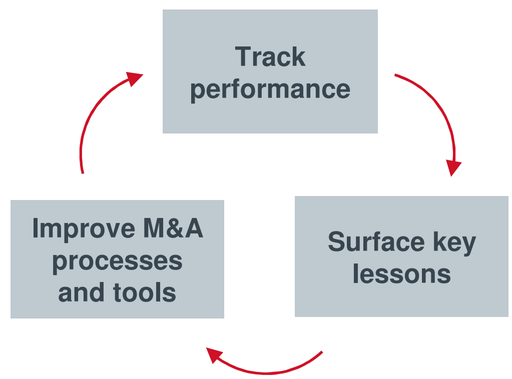
Though experience in multiple deal cycles may give M&A teams insight into the process of deal making, it does not automatically translate into improved M&A performance. Cross-industry evidence actually suggests that a little experience can actually lead to overconfidence and reduced performance. Actually extracting lessons and insights from a single deal can be problematic for a number a number of reasons:

- Multiple, often conflicting variables for determining success
- Difficult to separate impact of deal from outside factors, market changes
- Lessons learned from one deal may not apply to deals different in kind
- Organizational bias toward overstating benefits of deal

Importance of Continuous Learning

To ensure that lessons and insights from deals translate into improved performance in the long run, progressive organizations often hardwire a system for continuous learning.

Such a system should ensure that a range of appropriate performance metrics are tracked for each deal, that data is then analyzed to discern key lessons and that those lessons are used to improve existing M&A processes and tools.



Three Tactics to Support Continuous Learning

To help support continuous M&A performance improvement, we have surfaced three tactics. First, to ensure that organizations have a clear measure of success for each deal, M&A teams must ensure that they are tracking performance metrics that correspond to specific strategic objectives for each deal. Second, provide financial incentives to M&A team members based on both the short-term success of each deal and the long-term success of corporate M&A strategy. Finally, organizations should also ensure that key lessons and insights from each deal are codified into an easily accessible knowledge asset to support performance improvement for existing staff and rapid training for new staff.

Tactic #8:
Tie Deal Performance Metrics to Core Strategic Objectives

Tactic #9:
Financially Incentivize M&A Team

Tactic #10:
Codify Experience into Knowledge Asset

Source: Health Care Advisory Board interviews and analysis.

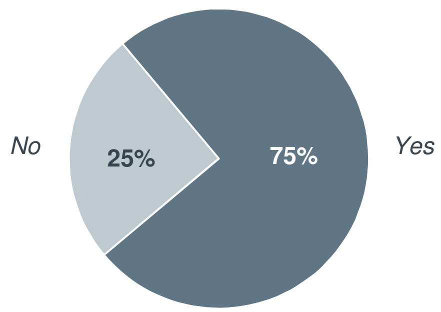
Outlining Clear Performance Expectations

Few organizations will proceed with a deal without outlining specific objectives and goals. However, research has shown that most organizations actually fail to set quantifiable metrics to track the performance of each deal against these goals. This is an essential way to determine if a deal is underperforming and needs course correction, but it is also the only reliable way to assess where the M&A function can be improved. Furthermore, data has shown that those organizations rating their deals as successful tend to measure performance more frequently.

Organizations Defining Post-merger Objectives

2010

n=120



Organizations Quantifying and Monitoring Objectives

2010

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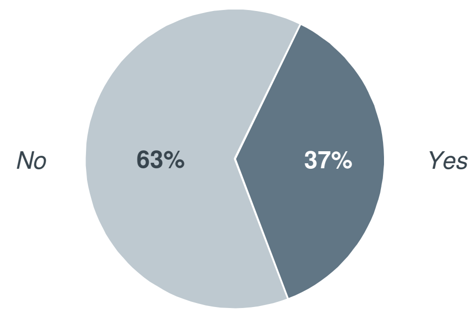


Example Performance Metrics for Typical Deal Objectives

Objectives	Metrics
Improve financial performance	Revenue growth
	Cost savings due to integration
	Transaction return on investment
Improve clinical quality	PQRS scores
	HCAHPS scores
	Length of Stay
Merge back office functions	SG&A expenses as part of revenue
	Vendor service costs as part of revenue
Stake regional footprint	Regional market share
Establish national network	National market share
Integrate services across the continuum	Per member per month costs
Increase operational efficiency	Headcount reduction
Consolidate local position	Local market share
Centralize supply chain	Reduction in supply costs

Source: "Putting the Pieces Together: Post Merger Integration Survey 2010," PwC, 2010, http://www.pwc.in/en_IN/in/assets/pdfs/publications-2011/Post_Merger_Integration_Survey_Report.pdf; Health Care Advisory Board interviews and analysis.

Encouraging the High Performance M&A Team

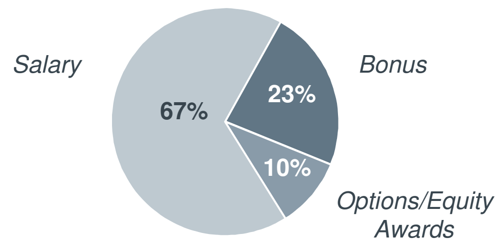
Prioritizing Incentives to Promote Success in the Short- and Long Term

To encourage continuous performance improvement, organizations must tie deal performance, both in the short and long term, to the financial compensation of members of the M&A team. Evidence from outside of the health care industry suggests that, on average, 23% of the total compensation of M&A executives and team members is tied to performance.

Average Components Of Compensation for Industry-wide Corporate Development Teams

Deloitte Corporate Development Survey 2012

n=309



Important to Incentivize the Right Mix of Metrics

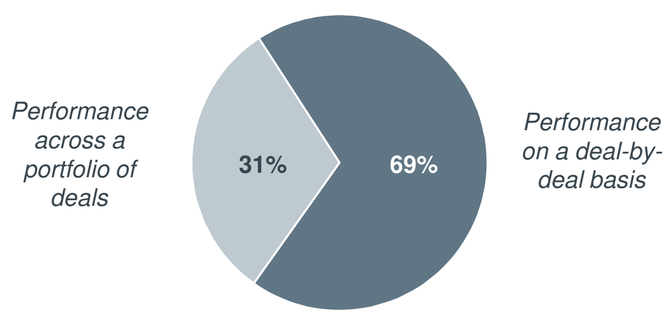
It is important to strike the right balance between incentivizing the short-term success of individual deals and the long-term success of the M&A team as a whole. Focusing too much on short- term performance may encourage deals that create quick financial gains in the short term but unlock little long-term value. In contrast, too much of a long-term focus can disengage M&A professionals and encourage riskier long-term gambles. Surveys of M&A professionals and CEOs outside the healthcare industry suggest a preference for short-term incentives, as shown in the accompanying pie chart. However, the right mix will likely depend on the specific goals of each hospital or health system.

The table below contains the metrics most often tied to M&A compensation found during the course of our research.

Relative Importance in Evaluating Corporate Development Group Effectiveness

Deloitte Corporate Development Survey 2011

n=325



Sample Metrics for Tracking M&A Team Performance	
Value accretion of acquired companies on a deal-by-deal basis	Actual performance of deals versus business plan post-closing
Financial performance of acquired companies post-closing	Relative value of deals closed compared to some standard/benchmark
Number of deals closed	Speed of closing deals
Strategic benefits of deals	Costs incurred per deal
Value accretion of acquired companies across a portfolio of deal	Performance against established process timeframes
Earnings accretion of acquired companies	Work hours incurred in closing deal

Source: "Corporate Development 2011: Scanning the M&A Horizon, Deloitte, 2011, http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/FAS_ForensicCenter_us_fas-us_dfc/us_fas_ma_CorporateDevelopment_2011_061411.pdf "Corporate Development 2012 Leveraging the Power of Relationships in M&A," Deloitte, 2012, http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/FAS_ForensicCenter_us_fas-us_dfc/us_ma_Corporate%20Development%20Survey%202012_052212.pdf; Health Care Advisory Board interviews and analysis.

Investing in a Permanent M&A Competency

Informal Methods of Knowledge Transmission Insufficient

Experience enhances performance only when it is accompanied by a codification of the lessons and insights gathered from previous deals. This codification should begin with a formal, evidence-based analysis of past deals and end with either the creation of knowledge assets or the improvement of hardwired processes. Codifying lessons and insights garnered from previous deals into a single knowledge asset allows lessons and insights to be shared across units and managers, thus promoting real organizational learning.

Cromwell[1] Health System's Consolidated Knowledge Asset

One progressive institution has taken a comprehensive approach to preserving and codifying lessons from past deals is Cromwell Health System. At Cromwell, lessons and insights are collected, both during a deal and retrospectively, into a single, widely available knowledge asset that is then consulted for advice and training for new and existing M&A team members in preparation for future rounds of deal making.

Learning Before

M&A team seeks to acquire lessons, success factors and potential obstacles from previous mergers, acquisitions, and divestments

Learning During

One team member assigned to document lessons, practices, key insights that emerge as the M&A progresses

Learning After

Interviews conducted with team members to determine success factors to repeat, and hazards to avoid

Knowledge Asset

Output from learning during and after process packaged into knowledge asset, preferably an easily accessible web-based compendium, or wiki that that allows for future re-use

1) Pseudonym.

Source: Health Care Advisory Board interviews and analysis.

Get a Blueprint for Corporate Strategy

Executing intentional corporate strategy is a marathon, not a sprint. Whether you are beginning to consider your options or working on integration, the Health Care Advisory Board has the resources to help both buyers and sellers develop an intentional and intelligent corporate strategy, proactively source suitable acquisition targets or buyers, and manage a successful and value-creating integration. See these resources and more at **advisory.com/corporatestrategy**.

Executive Strategy Workout

Onsite Intensive

Outline clear goals for your organization and internal communication strategy in multi-part, one-on-one CEO working sessions.

Best-in-Class Integration Planning

Executive Briefing

Capture returns on your investment with an action plan that begins at the outset of formal discussions and extends through the first 12-24 months post-merger or acquisition.

Building a Best-in-Class Hospital M&A Function

Executive Briefing

View profiles of successful approaches from inside and outside the health care industry. Get an inside look at decision-making structures, operational span of control, and sourcing strategies.

Key Determinants of Cultural Affinity Checklist

Decision Guide

Find out if your potential partner is a "true fit" before you commit. Measure cultural affinities and differences with our interview guides, key stakeholder mapping, and crosswalks.

Partnerships & Affiliations Diagnostic

Decision Guide

Arm your executive team, Board members and physician leaders with a clear framework and tools to weigh different alignment models along a spectrum from affiliation to M&A.

For additional research and information on ways we can support the development and execution of your own intentional corporate strategy, please visit our website: **advisory.com/corporatestrategy.**