8 Reasons

Why Mergers and Acquisitions Fail in Healthcare (and Elsewhere)

ZEPHYR Healthcare Advisors

ORGANIZATIONS THAT TRACK MERGER AND ACQUISITION ACTIVITY OFTEN REPORT THAT APPROXIMATELY 50% OF TRANSACTIONS END UP ULTIMATELY FAILING. Some may be surprised that so many deals end unsuccessfully, but trying to integrate two separate entities, often with disparate cultures and "personalities," is a complex and risky proposition. Reasons for doing a deal must make sense (i.e., are properly vetted), and a thorough examination of the ability of combined entities to adapt and "change stripes" can be critical. Too often, important considerations are deferred ("we'll look at that later") versus a proactive attempt to identify barriers that need to be overcome for a combination to be successful.

Having witnessed some successful mergers as well as being part of two failed acquisitions, my take on key reasons for failure is outlined below.

1 Doing a Deal for the Wrong Reasons

This is sometimes a failure of a Board of Directors and/or executive leadership to perform adequate due diligence or gauge the ability to remain independent. Admittedly, evaluating the length in months/years of the "financial runway" for an organization can be challenging and unpredictable. In some instances, selling or merging is necessary, and it's more a function of picking the right partner. However, there are other instances where decisions to acquire or sell are poorly conceived (e.g., executive ego gone amok), or the pot is too sweet to say "no." Reasons for pursuing an acquisition or sale should be identified and clearly vetted. Sometimes an objective third-party is needed to help guide an organization through this process and help ensure a vigorous evaluation, sound decision-making, and greater likelihood of a successful transaction.

2 Inadequate/Poor Due Diligence

One of the most frequent reasons some deals fail is bad due diligence. A thorough review of key elements including risk factors, financials (balance sheet and income statements), contracts, workforce/key personnel including retention plan, compensation including benefits/

pensions, and other vital items must be thoroughly reviewed. This is basically Deal Making 101 and has been articulated countless times by business advisors.

3 Misrepresenting "The Fit and Flexibility" of Bringing a New Entity on Board

Executives and business development teams sometimes grossly misrepresent or exaggerate the ability and practicality of bringing a new business in and properly being able to "fit" it into the new environment. Statements like "You can decide how you do it" or "We are very flexible" can turn out to be false (i.e., sales tactics). This is a common complaint in failed transactions in my experience.

4 Cultural Misalignment

This is one of the more difficult areas to gauge in evaluating a deal, even with sound due diligence. There are cultural elements of organizations that can make them unique and vital to their functionality and success. These can be embodied in formal organizational "value statements," HR protocols/guidelines, employment contracts, or in many unofficial ways an organization runs itself on a day-to-day basis. Sometimes these are a reflection of a leader(s) based on their personal style and unwritten "rules of the road." In the world of hospital systems and hospitals, there can be significant differences across domains such as for-profit/not-for-profit, faith-based or secular, urban versus rural, and community versus academic/teaching. There can be fundamental elements of culture rooted in organizations that are critical to a successful business combination. Large companies typically operate very differently than smaller ones, which can pose many challenges in terms of cultural fit. Further complications can be presented when taking into account the nuances of various constituents of an organization. For example, in hospitals, you must contend with Boards, senior management, department management, physicians, nurses, and other labor. Medical staff misalignment is a major landmine.

5 Poorly Designed Performance Metrics/Incentive Compensation for Senior Leadership

"Business as usual" can spell doom for mergers. To help foster necessary paradigm shifts, leaders must be expected and clearly instructed to drive organizational performance in the desired direction. This requires clear goal setting and communication (e.g., individual and group performance plans and targets) and compensation plans that align goal achievement/outcomes with how much senior managers get paid. Adequate bonus dollars need to be put in place to incent performance and the achievement of core organizational goals, some of which must be geared toward fostering successful organizational change and integration. In this unstable labor market, employee retention for all levels of an organization is more critical than ever, and incentives, both metrics and dollars, must be carefully developed. Bad mergers almost always have a high employee turnover rate which can be a significant reason for failure.

6 Inability to Bridge the Silos

This is a commonly reported problem for many mergers. Sometimes this is a function of a poor leadership structure (or having the wrong leaders in place). The persistence of silos is anathema to business combinations and leads to poor coordination, suboptimal communication, employee frustration, inefficiencies, and missed opportunities. Successful mergers can bridge the silos by creating optimal structures, reporting relationships, and employee wellbeing/mentoring programs to catalyze future success.

7 Inability or Unwillingness to Tackle "Sacred Cows"

Mergers require give and take from both sides, and there needs to be a realistic expectation for this to occur. As such, there will be positions, programs, and ways of doing things that need to change. Insisting that "we've always done it this way" is dangerous and stifling when adapting an organizational culture. To the extent that "sacred cows" can be detected and vetted before consummating a transaction, it is very helpful in identifying changes

that will need to occur to help level the playing field and avoid jamming the acquired entity into an inflexible model with no give and take.

8 Didn't Detect the "Secret Sauce"

Most successful businesses have some sort of "secret sauce." It could be related to the chemistry or relationships on a team (e.g., strong loyalty and support system). It could be the value proposition the organization conveys to the market in areas such as pricing, turnaround times, "high touch" customer service, and/or ways of doing things. Changes related to specific client contacts, communications, billing practices, and other protocols can have a material impact on customer relationships. Moving, for example, from a high-touch model to a low-touch, high-tech model can be disastrous for customer satisfaction and retention. It is surprising how many deals get done without the "secret sauce" being identified, and that can be the kiss of death for a business combination.

Author**, Eric Themm, is the President of Zephyr Healthcare Advisors**, and has over 30 years of experience advising hospitals, physician organizations and other healthcare entities. His areas of expertise include strategy, physician network development/ workforce needs, physician compensation, facility planning, transaction assistance, community needs assessment, and Board planning/facilitation.

Zephyr Healthcare Advisors, a healthcare management consulting firm, works with organizations to help determine if a business combination makes sense, identify proper processes and criteria for evaluation, and avoid the pitfalls identified above in pursuing a transaction.

For more information, contact Eric Themm to discuss your organizational needs. He can be reached at (949) 433-4697 or ericthemm@zephyrhcadvisors.com.

www.zephyrhcadvisors.com