How to Make the Strategic Partnering Decision
What We’ve Learned from Recent Merger, Acquisition, and Affiliation Activities

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Introduction

Mergers, acquisitions, and joint ventures are increasing rapidly in the healthcare industry, as hospitals, health systems, and other providers secure partners to gain the competencies and scale needed to succeed in the emerging care delivery and payment environment.

Under the value-based business model, which is expected to replace the volume-based business model during the next decade, hospitals, health systems, and other organizations will be responsible for providing services with the best-possible quality and outcomes at the lowest-possible cost, while managing the health of a specific patient population along the continuum of care needs. New expertise and significant capital resources, often beyond the reach of independent hospitals and even small health systems, will be required.

Given these circumstances, regional systems looking to expand their scope, market reach, and clinical, financial, and strategic capabilities have been particularly active on the acquisition and joint-venture fronts. Additionally, new and different competitive entities are entering the healthcare space, with innovative partnerships announced nearly daily. Private equity firms are investing directly in hospitals and other providers. Insurers are buying providers or entering the care delivery market directly. Not-for-profit organizations are forming for-profit ventures; and for-profits and not-for-profits are taking steps to exert control over public-hospital ownership. The provider landscape is changing significantly, and consolidation is a reality.

Since early 2009, Kaufman Hall has been collaborating closely with senior management teams and boards of hospitals and health systems nationwide to identify and evaluate their strategic options in the rapidly changing healthcare environment and, if appropriate, to structure and execute partnership arrangements. Since that time, we’ve worked with all types of organizations on both sides of the table: small and large; independent hospitals and multi-hospital systems; regional and national systems; and academic medical centers, public hospitals, and children’s hospitals.

As a result of this experience, we offer here eight lessons that can help healthcare boards and executive teams make the best-possible strategic partnership decision.

1. Set Clear Objectives

Conducted by the board and senior management team, this is likely the most important component of the strategic partnership process. Objectives define the business goals the prospective partners want to accomplish. They also provide the framework for all other steps in the partnership process, including the evaluation of potential partners and the selection of the partnership structure. Objectives need to be as specific as possible so that prospective partners can be evaluated on their ability to meet identified needs.

The nine topics related to objectives that the board and senior management should cover when initiating the strategic partnership process are outlined in the Sidebar on the next page.

2. Carefully Manage Expectations

To increase the likelihood that a partnership will progress smoothly and achieve beneficial results for both parties, objectives should not only be as concrete and specific as possible, they also should be realistic. Hospitals and other providers cannot expect to structure an arrangement that allows them to continue operating exactly as they have in the past. Their boards and executive teams must be willing to give up a certain degree of control involving some aspects of operations, whether it be strategic planning and direction, operating and capital budgets, or service continuation and enhancement. Leadership teams should decide ahead of time what they are—and are not—willing to cede. Distinguishing between negotiable and non-negotiable factors is essential, as is the active management of expectations throughout the partnering process.

For example, a community hospital in the Northeast hoped that a prospective partner would commit to building a new patient tower, but it was realistic about the fact that an unconditional commitment to build the tower was unlikely. The patient tower became the cornerstone of partnership discussions, but ultimately, a new partner agreed to support a short-term facility project that satisfied the community hospital’s immediate facility needs. The partner also agreed to build a new patient tower if the community hospital met certain thresholds. By setting expectations appropriately, the community hospital avoided stipulating a “deal-breaking” expectation that might have been difficult for a partnering organization.
Sidebar 1. Topics to Be Covered in Partnership Goals and Objectives

1. **Mission, vision, and values**: What are the critical elements and is there alignment between potential partners?

2. **Strategic plans**: What are the critical elements and do the initiatives mesh well together?

3. **Clinical programs and services, quality and outcomes, and costs**: What are the goals and how will partners collaborate to achieve these? How will a partnership govern the delivery of existing programs and services, develop new services, enhance major service lines, expand geographic reach, and increase the quality of care while reducing its costs?

4. **Facilities, information technology, and other capital commitments**: How will a partnership set priorities for capital commitments and timelines for capital projects?

5. **Physician relationships and commitments**: What are the goals and timing expectations related to physician employment, recruitment, contracting, and governance?

6. **Employees**: How will a partnership handle workforce issues, including the retention of executives, managers, and employees?

7. **Governance considerations**: What are the expectations and the desired degree of local-level involvement? How will a partnership involve trustees in setting strategic direction and strategic plans, create operational and capital budgets, and make decisions about the range and scope of health services?

8. **Community goals**: How will a partnership assure service access and patient satisfaction, handle charity care, as well as promote and deliver health services to meet emerging demographic and market needs?

9. **Philanthropic and foundation considerations**: What are the specific goals? If a new community foundation is to be established, what are the expectations related to its funding?

*Source: Kaufman, Hall & Associates, Inc.*

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### 3. Bring the Right People to the Table

A small group of key decision makers will speed and facilitate the partnership-exploration and transaction processes and maintain the required confidentiality along the way. This team typically includes senior management, financial and legal advisers, and a small task force of board members. The advisers and senior management team typically manage the day-to-day details, while the task force measures and tracks performance against relationship objectives, provides critical advice on the development of the transaction, and reports to the full board at critical stages in the process.

The team for Prince William Health System (PWHS), for example, a not-for-profit health system in northern Virginia, included the executive committee of the board—the chair, vice chair, president of the medical staff, and chairs of the finance and strategic planning committees—and the CEO, CFO, and the director of strategic development in a support role. The team conducted ongoing project oversight, informed and made recommendations to the full board, and served as an information conduit to stakeholders.

### 4. Identify and Assess Best-Fit Partners

A hospital or health system that is contemplating a new business relationship should have clear criteria for potential candidates. Building on the objectives for pursuing a partnership (discussed in Lesson 1), the organization’s board members and senior management establish parameters for identifying and evaluating the suitability of each candidate. Parameters include any direct experience with, or knowledge about, a potential partner, its financial position and ability to access capital, geographic proximity, market strength, physician platform, branding, and corporate infrastructure, among other items.

For example, PWHS identified 20 potential not-for-profit and for-profit partners. A well-defined process winnowed the universe of prospective partners to two organizations that could best achieve PWHS’s 11 defined partnership objectives. Based on the core objectives, PWHS chose North Carolina–based Novant Health as its best-fit partner. Novant was willing to:
• Pledge more than $240 million to PWHS to enhance services and meet the needs of a quickly growing population in northern Virginia
• Assist in recruiting 50 additional physician specialists so that PWHS could fill gaps in primary and specialty physician coverage
• Upgrade PWHS’s 170-bed flagship hospital and build an additional hospital to bring inpatient care closer to a nearby community

The merger of PWHS and Novant was completed in July 2009, at a time which represented the beginning of a significant uptick in healthcare consolidation activity.

An unwillingness to develop a mutually beneficial partnership or inflexibility over the partnership structure can eliminate a prospective partner. For example, a community hospital interested in joining a health system to broaden its market reach and attain specific clinical program goals and specialist recruitment targets initiated a partnership-exploration process. One of the identified health system partners proposed in general language the ways in which it would recruit physicians and build clinical programs without specifying where activities would occur. Moreover, the system did not address the community hospital’s specific and stated strategic imperative of recruiting and retaining neurosurgeons and cardiovascular surgeons. As a result, the community hospital believed that the system would likely retain its historical hub-and-spoke system of care, with market growth achieved by the system, rather than the community hospital.

A shared vision and a mutually agreed-upon commitment to mission-based healthcare, operational discipline, and effective clinical programs were critical to the partnership between NorthEast Medical Center (NEMC) and Carolinas HealthCare System (CHS).

Although the 450-bed NEMC had an 82 percent market share in the North Carolina county it served, the nearby Charlotte community was growing rapidly, and its healthcare environment was becoming highly competitive. Charlotte-based CHS already had 24 owned, leased, and managed hospitals in North and South Carolina. The partnership between NEMC and CHS expanded the breadth and depth of services in the larger community. For NEMC, the partnership expanded tertiary services, added to its network of affiliated physicians, and improved access to capital to meet strategic needs. For CHS, the merger solidified the health system’s tertiary presence in its market area and provided improved access to specialized care.

5. Test Cultural Compatibility

While the business case for a partnership must be solid, more qualitative considerations involving mission, vision, values, and corporate culture should not be overlooked. A successful partnership rests not only on financial and operational underpinnings, it also relies on compatible corporate cultures, management and decision-making styles, governance, and values.

During a partnership process, cultural compatibility can be assessed by means of interaction with potential partners. A well-designed process allows for interaction—at appropriate times and with required confidentiality—with key constituents, including boards, management, physicians, and community leaders.

For example, the partnership process for 176-bed Martha Jefferson Hospital (MJH) in Charlottesville, Virginia, began at the conclusion of an update to the hospital’s strategic and financial plan. Although MJH had stress-tested its five-year plan for ensuring services to its community, the executive team and board wanted to evaluate partnership scenarios that could enhance, accelerate, or widen the scope and nature of available services and enhance the quality and safety of operations. MJH had extensive experience with numerous partnerships in the past.

MJH used a structured process to identify and assess the full range of potential partners, defining and applying identical evaluation criteria to each organization. A number of the criteria focused on strategic and cultural fit and the ability to influence the execution of MJH’s strategic plan.

Sentara Healthcare, a not-for-profit health system, based in Norfolk, Virginia, was one of the potential partners participating in the screening and evaluation process. MJH had had a long-standing, collaborative relationship with Sentara, so the board and executive team wanted to be particularly careful to evaluate Sentara in the same manner as the other organizations. Their collaborative history involved the divestiture of one of MJH’s non-acute care business units to Sentara more...
than five years prior to the new partnership-exploration process. In the years following the divestiture, Sentara was an important resource to MJH in advising on the execution of its IT, quality, and patient-safety efforts. This interaction not only afforded opportunities for individuals in the two organizations to build working relationships, it also validated Sentara’s commitment to the highest quality care.

At the end of the rigorous evaluation process, Sentara emerged as the optimal partner. The merger of the two organizations was completed in June 2011.

6. Select the Right Partnership Structure

The transaction structure for a partnership is critically important to achieving expected partnership benefits. Structures range from loosely integrated to fully integrated arrangements (Figure 1):

- Fully integrated structures include acquisitions (of assets or by lease) and mergers (with a hospital or a parent corporation) to consolidation (forming a new entity with a change of corporate membership).

- Less fully integrated structures include joint ventures (involving the sale of a minority or a controlling interest or a joint operating agreement), affiliations, and management services agreements.

Choosing the most appropriate transaction structure depends on the objectives of the partnership. If a principal objective is to obtain a large amount of capital for infrastructure and development, the most likely transaction structure would be merger with a large organization. If a major objective is to enhance surgical service lines, less highly integrated transaction structures, such as a joint venture or clinical affiliation, may be more appropriate.

The MJH management and board began its study of transaction structures for a partnership with an evaluation of loosely integrated, joint venture–type structures. This is often an appropriate starting point for organizations with the ability to remain independent. Over time, and through a thorough evaluation of its aims, MJH deemed that a more integrated structure offering the full, committed support of a partner would better enable MJH to achieve its strategic objectives, fully realize the organizational mission, and meet the needs of its community going forward. The transaction structure approved by both organizations involved the integration of MJH into the Sentara organization through a corporate member substitution.

7. Ensure Stakeholder Buy-in

The success of a partnership relies on the acceptance and participation of stakeholders, including the community, hospital staff, and employed and independent physicians. Stakeholders need to understand the reasons for pursuing a partnership, as well as the ways in which a partnership assures the viability and growth of healthcare delivery in the community going forward.

A thoughtful consensus-building process brings stakeholders on board. This process typically is implemented through a communications plan that is focused on, and engages with, each constituent group at appropriate times during the partnership process. Many organizations use advisers who are experienced in developing communications for partnership arrangements.
Finally, stakeholder buy-in can be driven by a well-structured governance process, as executed by board members. As stewards of the community asset, board representatives who have a firm grasp of community needs are often the best advocates for ensuring that a partnership addresses not only organizational needs, but also key stakeholder concerns.

8. Recognize When Not to Partner

Partnerships should be pursued to provide value to the community, to reposition for the changing healthcare business model, and to ensure viability into the future. Partnerships are forward-looking and strategic. But, if an organization’s leaders have not clearly thought through the goals of partnering, the characteristics of a best-fit partner, or the ramifications of various partnership structures, they may not be ready to make a partnership decision.

There are times when a partnership is not the right strategic move, and the organization’s leadership should reconsider its options. Hospitals and health systems, particularly market leaders/innovators, should walk away from a transaction if strategic conditions change, the prospective partnership fails to meet objectives, if expectations are unrealistic, if stakeholders are not on board, if negotiations languish, or if the proposed partnership plan fails to meet timeline deadlines. For example, a community hospital in the Northeast went through a comprehensive partnership-exploration process with the two major providers in its market. Both providers appeared to have many of the characteristics that the community hospital was seeking. However, following a thorough evaluation of the proposals from both organizations, the community hospital determined that neither potential partner was willing to make the necessary commitments for the community hospital to be successful in the long term. The community hospital decided to decline further partnership discussions.

Closing Comments

Exploring partnership options is perhaps the most important activity in which a hospital or health system’s board and management team will engage. Partnership may be an imperative for fulfilling fiduciary and management responsibilities into the future. Healthcare’s new value-based business model will be transformative for most hospitals and health systems. Many organizations will need to secure strategic partners in order to access required expertise and capital resources. The time to consider whether or not to partner is while the organization maintains a solid market and strategic/financial positions and while there are multiple attractive options. We urge healthcare boards and executive teams nationwide to carefully consider partnership opportunities, and in so doing, take stock of the eight lessons described here.

As always, we are prepared to assist you in any way you’d find helpful. We can be reached at 847.441.8780 or mgrube@kaufmanhall.com and mfinnerty@kaufmanhall.com.

Kaufman Hall expresses sincere thanks to executives at the profiled organizations, whose permission to use the material cited in this or other Kaufman Hall publications, has allowed us to provide relevant examples of best-practice partnering processes.
About the Authors

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Mark has more than 25 years of experience in the healthcare industry, as a consultant and as a planning executive with one of the nation’s largest healthcare systems. He has worked extensively with a broad range of healthcare providers, including community hospitals, specialty hospitals, regional and national health systems, and academic medical centers.

Mark received an M.B.A. from the University of Chicago Graduate School of Business and a B.S., *magna cum laude*, in Economics from Bradley University.

**Michael J. Finnerty** is a Senior Vice President of Kaufman Hall and a member of the firm’s mergers and acquisitions group. Mike advises on all facets of the merger and acquisition (M&A) process, debt-related financial advisory services, valuations, and joint venture execution, working with a variety of clients, including not-for-profit hospitals and health systems, managed care plans, and other for-profit and not-for-profit entities.

Mike also has extensive experience in the managed care sector, where he has completed many transactions representing both provider-sponsored and for-profit health plans. During his career, he has been involved in more than 100 merger and acquisition advisory engagements in the healthcare sector.

Prior to joining Kaufman Hall, Mike was an investment banker with Shattuck Hammond Partners, where his responsibilities focused on M&A advisory and capital raising services related to or for hospitals, imaging, managed care, and healthcare information technology.

Mike has an M.B.A. in Finance and Healthcare Management from the Wharton School of the University of Pennsylvania and a B.A. from Middlebury College.

About Kaufman Hall

Founded in 1985, Kaufman, Hall & Associates, Inc. is among the country’s most respected independent strategic financial and capital consultants, working with healthcare organizations of all types and sizes.

The firm provides strategic advisory services; physician advisory services; financial advisory services to debt transactions; strategic, financial, and capital planning services; capital allocation design and implementation services; and merger, acquisition, joint venture, real estate, and divestiture advisory services. The goal is to help hospitals and health systems achieve tangible, measurable, and improved strategic-financial results.

In addition, Kaufman Hall developed and markets the ENUFF Software Suite® of strategic and financial management products. Kaufman Hall serves its clients from offices in Chicago, Atlanta, Boston, Los Angeles, and New York.
New Era Readiness and Repositioning

How well positioned is your organization to respond to industry changes? As U.S. healthcare transitions to a value-based business model, new organizational competencies are required of providers:

- Physician/hospital integration
- Care coordination/management capability
- Information systems sophistication
- Service distribution system effectiveness
- Cost management
- Scale and market essentiality
- Brand identification
- Payer relationships/contracts
- Financial strength/capital capacity

Kaufman Hall’s New Era Readiness and Repositioning Services are designed to help you gain a broader and deeper understanding of significant strategic issues, identify areas of improvement to become more competitive and differentiate on value, and build consensus on priorities and develop action plans for achieving your desired position.

For more information, contact Mark Grube or Brian Fuller at 847.441.8780, or mgrube@kaufmanhall.com or bfuller@kaufmanhall.com.

Strategic Options

The competitive landscape of healthcare is changing as players realign to “regionalize” local markets and secure the intellectual and financial capacity necessary to be successful into the future. How might your community’s healthcare needs best be met? What are the available paths that might help you fulfill your organization’s mission?

Our Strategic Options Advisory Services focus on helping a hospital’s board and management team address four key areas that are vital to determining the best path forward:

- Identifying relevant industry and market-specific trends
- Building a shared understanding of the hospital’s current market position
- Assessing the hospital’s strategic and financial direction
- Examining the implications and available strategic options

The discussion is analytically grounded to provide a solid information base to facilitate organizational decision making and action.

For more information, contact Kit Kamholz or Mark Grube at 847.441.8780, or kkamholz@kaufmanhall.com or mgrube@kaufmanhall.com.

Capital Access, Structure, and Risk

Volatility and uncertainty in the capital markets, as experienced in recent years by borrowers and investors, continue to affect all hospitals and health systems. Although access to capital for creditworthy hospital borrowers in the municipal markets has been generally adequate, concerns remain about costs, terms, and risk.

Amid today’s capital market volatility, healthcare borrowers need strategies to establish and defend an appropriate level of risk in the capital markets, given their available resources, risk tolerance, and credit position. How appropriate is your capital structure moving forward?

A well-developed and implemented enterprise risk management approach to balance sheet management and specific treasury practices can mitigate potential capital structure stress in the future. Kaufman Hall’s Capital Access, Structure, and Risk Advisory Services can help you define a “Global Capital Strategy” that enables your management team to:

- Effectively manage risk
- Build an optimal capital structure
- Proactively address organizational and market change

For more information, contact Jim Blake or Eric Jordahl at 847.441.8780, or jblake@kaufmanhall.com or ejordahl@kaufmanhall.com.

Service Distribution Optimization

Is your service distribution system optimized across your markets? Whether your organization is a multi-hospital system with facilities in one or more states or a small system with numerous facilities in one region, creating a rational service distribution system that has accessible primary care and easy access across the care continuum has become a major priority for healthcare providers.

Kaufman Hall’s Service Distribution Optimization Advisory process studies demand patterns and patient

continued on page 8
requirements across your network and competitive environment to arrive at an efficient and effective care delivery system that ensures:

- The ability to drive quality and outcomes through specialization and volume/repetition
- Improved care management and outcomes
- Reduced unnecessary/duplicative clinical services and technology
- Optimized ambulatory and hospital facilities and geographic footprint
- Best possible use of scarce capital and human resources
- “Rationalized” capital and operating expenditures

For more information, contact Mark Grube or Walter Morrissey, M.D., at 847.441.8780, or mgrube@kaufmanhall.com or wmorrissey@kaufmanhall.com.

Strategic Cost Management
The need for rigorous cost management is clear. Unsustainable growth in national healthcare costs, reform, and the emerging value-based business model will push hospitals and health systems to improve quality, access, and outcomes, while reducing expenses. Is your organization positioned to meet the expense-reduction challenges of the coming years?

Kaufman Hall’s Strategic Cost Management Advisory Services assist clients in converting cost management initiatives into improved, sustainable financial performance. The service focuses on:

- Readiness Evaluation: Do you have the systems, practices, and management controls in place to produce needed financial improvements?
- Opportunity Assessment: What is the magnitude of achievable cost reduction and what is the composition of that opportunity?
- Benefit Realization: Are staffing and other cost targets aligned with financial and strategic plans?
- System Cost Rationalization: How might your organization better rationalize/consolidate administrative, support, or clinical services across facilities and functions?

For more information, contact Brian Channon or Jason Sussman at 847.441.8780, or bchannon@kaufmanhall.com or jsussman@kaufmanhall.com.

Clinical Integration
Whichever models emerge for care delivery, hospitals and health systems can make significant advances—in quality, cost management, and physician integration—by moving forward in an incremental manner with Clinical Integration programs. Is your organization taking the right steps toward value-based care?

Kaufman Hall is committed to supporting hospitals and health system in building the capability for Clinical Integration. Our Clinical Integration Advisory Services assist clients with a Clinical Integration program that includes:

- Definition of the physician, hospital, and market value proposition and communications models
- Capital and operational cost modeling
- Physician selection and participation criteria
- Technology requirements
- Estimated utilization, quality, and reimbursement opportunities
- Clinical and financial reporting requirements
- Patient and physician satisfaction measurement
- Physician payment and incentive models
- Payer contracting analysis

For more information, contact Jim Pizzo or Scott Cullen, M.D., at 847.441.8780, or jpizzo@kaufmanhall.com or scullen@kaufmanhall.com.

Strategic Partnering
Many organizations are looking closely at new ways to grow their operation and/or secure the capital resources and expertise needed to stay competitive in the changing provider landscape. For some, the best way forward is to partner with or acquire an organization that offers strategic, operational, and financial strength. Is your organization sized for success moving forward?

Kaufman Hall delivers a uniquely comprehensive view to help hospitals and health systems make the right long-term move for their organization and community. Our Strategic Partnering Advisory Services integrate strategy, financial planning, and financing, with experience across a broad range of transaction structures, to assist you from early analysis of potential partners to close of a new partnership.

For more information, contact Kit Kamholz or Mike Finnerty, at 847.441.8780, or kkamholz@kaufmanhall.com or mfinnerty@kaufmanhall.com.
Financial Strategies for Healthcare