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HEALTH SYSTEM M&A: VALUE GENERATION IN A NEW ERA

Healthcare provider M&A is hotter than ever. But the average[1] US health system acquirer is leaving $30 million per year in untapped value, indicating that today's acquisition focus may not be leading us to a better future.

M&A IS TRANSFORMING THE INDUSTRY

Providers are in the throes of massive transformation in the US healthcare economy. Many are turning to consolidation to navigate industry-shaking changes like profit compression, talent shortages, new payer and customer dynamics and more. But the traditional M&A playbook no longer applies. Historically, in healthcare, M&A was solely about costs. Today, it is also about creating tangible and intangible synergies to weather disruption.

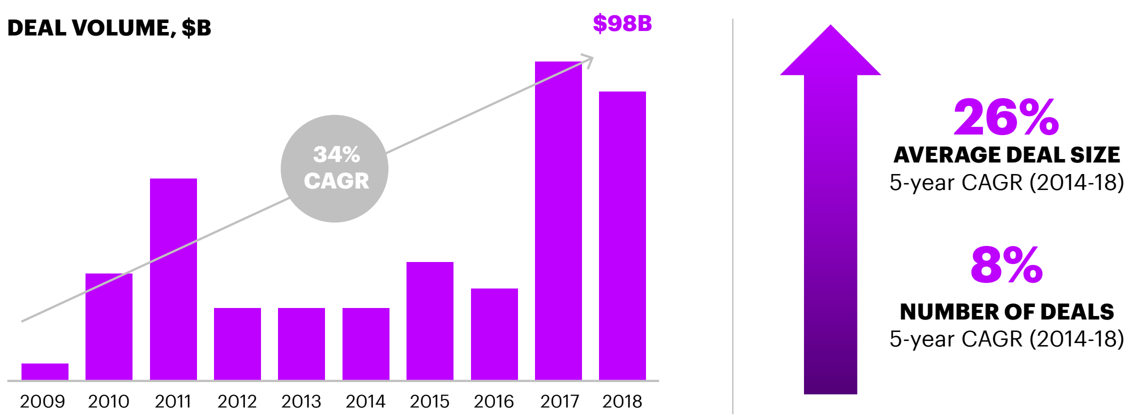
With synergy realization so important to navigating disruption, providers need a new M&A mindset. They can find it in comparable industries, having weathered similar macro forces, that are capturing more value post-merger by approaching M&A from a holistic perspective. This means abandoning the belief that healthcare is so unique that best practices from outside rarely apply. For providers, it is a choice between finally fulfilling the promise of M&A or continuing to leave value on the table, inviting margin erosion and market scrutiny.

[1] An average health system is defined as having 1,000 beds.

ACCELERATING TO NOWHERE

Accenture analysis finds that M&A transactions among providers are at a record high—reaching 34% CAGR over the last decade (See Figure 1).[2] Why the fervor around consolidation? Health systems have embraced it with high hopes to improve cost structure, gain market share, broaden the customer value proposition and sometimes even hedge for the future of healthcare.

Figure 1: M&A transactions among US health providers are at a record high



Sources: Accenture analysis and Thompson Eikon, 2018

Yet the outcomes of these deals have been underwhelming. Customers are losing in both their experiences and wallets. Accenture research shows the average Net Promoter Score® (NPS®)[3] for providers remains just 28 out of 100—more than 40 points lower than top retailers' scores. In fact, one in five customers switches providers because they do not receive good value for money.[4] Consider too how mergers have impacted prices. The average price of a hospital stay rose between 11 and 54% in the years following mergers.[5] Cost structures have not improved. There has been a surprising 18% post-merger jump in supply chain costs, a functional area that is typically low-hanging fruit for cost savings.[6] And providers are missing the opportunity to use post-merger integration as a catalytic moment to create a culture of performance and excellence in the new organization.

[2] Accenture analysis and Thompson Eikon, 2018

[3] Net Promoter, Net Promoter System, Net Promoter Score, NPS and the NPS-related emoticons are registered trademarks of Bain & Company, Inc., Fred Reichheld and Satmetrix Systems, Inc.

[4] Accenture 2018 National Patient Experience Provider Benchmark Study

[5] Kelly Gooch, "Hospital mergers often raise prices, analysis finds," November 14, 2018 at https://www.beckershospitalreview.com/finance/hospital-mergers-often-raise-patient-costs.html

[6] Rob Austin, "Consolidation is hurting hospitals' supply costs, not helping them," October 19, 2018 at https://www.statnews.com/2018/10/19/consolidation-hurting-hospital-supply-chain-costs/

LESSONS FROM THE OUTSIDE: THE NEW VALUE MINDSET

These disappointing outcomes are a stark contrast from what companies in other asset-heavy, service-oriented industries—such as telecommunications, financial services and hospitality—experience after consolidation. These industries have experienced M&A drivers and characteristics similar to what providers face today. Telecom had two decades of transactions driven by the need for vast networks, which fueled innovation and productivity. Financial services consolidated to pool resources to pursue high-risk product lines. More recently, hospitality players combined forces to compete with customer experience dynamos eating up market share.

What do these industries do in M&A that providers should be doing too, to realize value? In addition to aligning the operating model, it comes down to having a value mindset. In these other industries, Wall Street is watching. Facing scrutiny from shareholders, analysts, regulators—and their own performance-focused boards—these newly-formed companies have no choice but to double-down on value. They apply stringent approaches and clever techniques to lock-in new value in the near-term and sustained value over time.

Such an entrenched value focus is alien to most providers. They do not have this external ownership imperative demanding value delivery. However, they can begin to infuse a value mindset into their M&A strategies by applying three keys to success from these other industries:

01 Win the customer

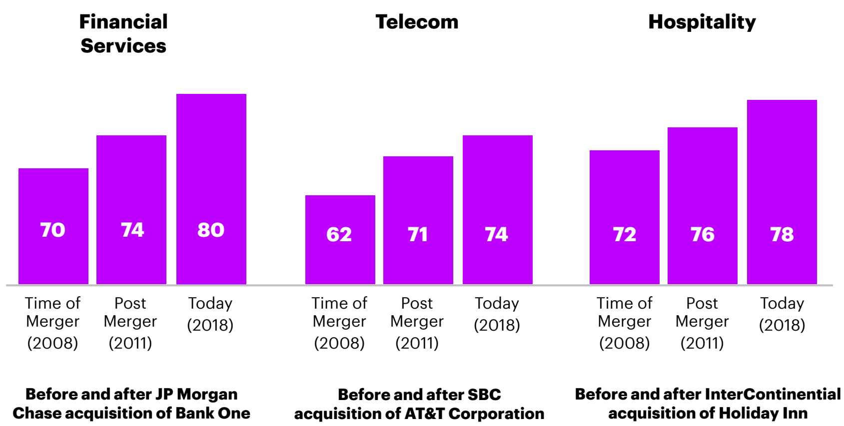
Customer experience drives hard value—the lifetime value for an individual healthcare customer is around $1.4 million.[7] While mergers create opportunity for providers to multiply this value, they are not taking advantage of it. They focus on patients and the past, rather than on customers and the future. In other industries, the customer is the center of the M&A universe. Companies work to understand customers and use what they learn to map out the new future, and they have results to show. Recent research shows that with key mega deals in the last fifteen years, customer satisfaction materially improved in the three years post-merger (See Figure 2).[8] Case in point: A telecommunications company focused on what would keep the future customer loyal, thinking beyond typical core voice and data services. This insight defined the future operating model.

[7] Brian Wynne, "The Real Reason Loyalty Lacks in Healthcare," May 2, 2018 at https://www.beckershospitalreview.com/population-health/the-real-reason-loyalty-lacks-in-healthcare.html

[8] Accenture analysis of the American Customer Satisfaction Index at https://www.theacsi.org/

Figure 2: Industry peers using M&A as trigger to elevate customer satisfaction

Improvement in customer satisfaction of key mega deals, post-merger (ACSI scores)



Average customer satisfaction improved 3% from peak of M&A activity to today, across all companies in financial services, telecom, & hospitality.

Source: Accenture analysis of The American Customer Satisfaction Index (ACSI)

An approach like this is about creating the *"should be"* customer experience given the resources, reach and audience of the new company. Before transaction close, merging entities in other industries often appoint a customer "maestro" to anticipate people's concerns and orchestrate the new customer dynamic. The telecommunications company did just that, creating a new role to identify tactics and promotions to maintain (and keep) customer satisfaction.

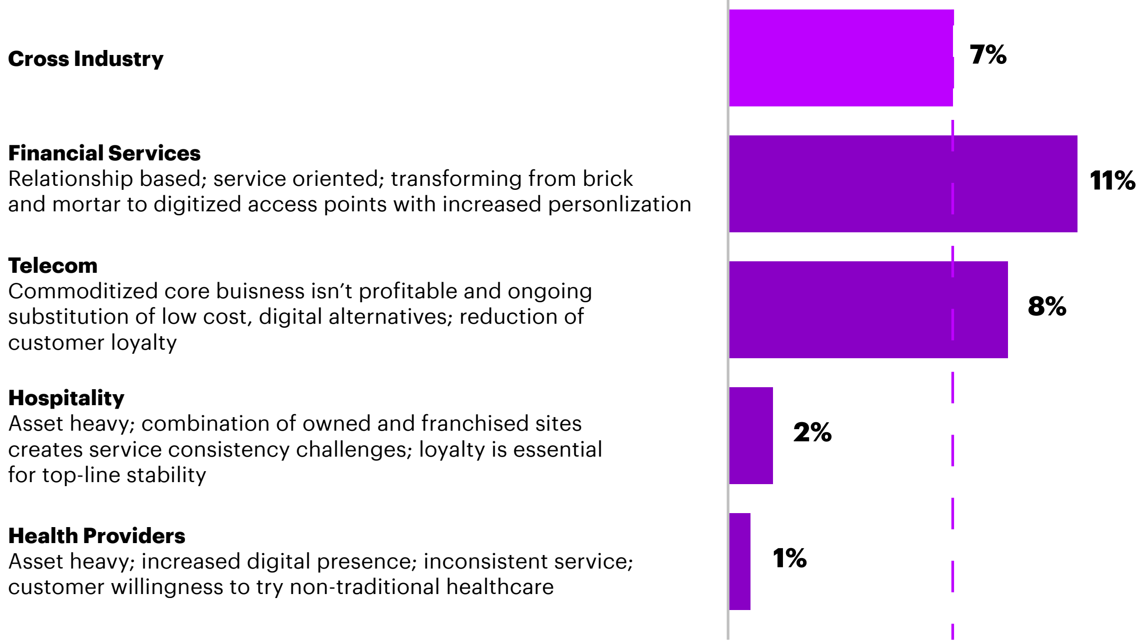
In healthcare, M&A is a way for providers to address the customer access challenges that have plagued the industry and completely redefine customer experiences. While it can be difficult to define near-term direct value, customer-centric strategies for experience and loyalty are key to sustain any value realized.

02 Embrace a zero base

Providers typically follow traditional cost reduction techniques based on standard benchmarks that plan to what is normal, not to what is possible after consolidation. Accenture analysis shows that on average, other comparable industries realize a 7% reduction in OPEX compared to just 1% in OPEX reduction for providers post-merger. This means that the average health system is missing upward of $30 million in direct cost savings per M&A transaction per year (See Figure 3).

Figure 3: Health providers lag comparable industries in cost savings from M&A transactions

Post-merger operating expense reduction



$30M **Annual non-labor savings a health system may leave on the table, by not merging like organizations in other industries**

Source: Accenture analysis

Yes, the clinical side of healthcare is unique. But this is an analysis of non-labor operating costs, which are common across industries. Starting with a defined, aligned operating model, other industry acquirers capture cost synergies from a zero base to realize value from Day One. They target big bets like third-party spend, IT and supply chain costs. Again, Wall Street expects nothing less than bold cost-savings ambition. No “sacred cows” allowed.

While strict boundaries need to be retained before regulatory approval and close, providers can institute “clean rooms” to begin value target analyses to identify opportunities to reduce costs. Take third-party spend. With intense review of vendor contracts, combined with next-generation benchmarking and forecasting, companies can have a targeted plan as soon as the ink dries. These clean rooms not only support a zero-based mindset and rigorous cost discipline, they can also expose biases early in the impending merger.

03 Rally around culture

Culture is not always a priority for providers in M&A. Leaders often think that culture is just about how engaged people are in the office environment, and that the culture of the new company will organically fall into place. They just assume that the relationship-driven cultures common among providers will naturally mesh well. This assumption is risky. Cultural misalignment can wreak havoc on a merger—between 70 and 90% of deals across industries fail to achieve stated goals such as merger-driven cost reduction or quality improvement,[9] and cultural differences and poor fit can be contributing factors.

Companies in other industries leverage integration more intentionally as an opportunity to multiply value by taking the best aspects of the two cultures and setting a new standard that elevates the combined culture. They understand culture as a source of competitive advantage that is infused in and reflective of all aspects of the business on a day-to-day basis. As such, these companies make it a priority to assess the strengths and weakness of the cultures of the two organizations, pulling from the strengths to create a common purpose that grounds the organization and sets it apart from the competition.

By tackling culture head on and early on and assessing how the cultures of the organizations best fit together for strategic advantage, these organizations can cultivate a new working environment and value system that keeps the workforce satisfied and productive, which is essential to win the war for talent and sustain enterprise value. This is just what one financial services company is doing. Instead of trying to do the impossible and change cultures, the new company is laser-focused on a common purpose and empowering people to make decisions that align with it.

FULFILLING THE PROMISE

Higher prices, higher costs and mediocre customer experiences are not what providers want from mergers. Far from it. Health systems that throw away yesterday's M&A playbook—and take a page from other industries' approaches—can fulfill the promise of consolidation. They can create synergies that improve the core business and jumpstart new customer propositions. If the providers do this well, future industries undergoing consolidation may look to healthcare as a model for driving value.

[9] Clayton M. Christensen et al., "The Big Idea: The New M&A Playbook," March 2011 at https://hbr.org/2011/03/the-big-idea-the-new-ma-playbook

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METHODOLOGY

Accenture analyzed the untapped post-merger cost savings opportunity for US health systems by comparing typical cost savings realized in provider deals (based on publicly available post-transaction data and Accenture experiences) to typical cost savings realized from major M&A transactions in telecom, financial services and hospitality industries (based on publicly available post-transaction data and Accenture experiences). The percent difference was then applied to an average health system's (defined as having 1,000 beds) overhead to derive the estimated cost savings left on the table. The analysis assumes the acquisition of an average health system.

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