VIEWPOINT

# "One is a Lonely Number: Uptick in Mergers"

BY EDWARD A. KAZEMEK

NOTWITHSTANDING THE slowdown caused by the frozen credit markets, it appears that the pendulum will swing again in the direction of more industry consolidation. Financial and competitive pressures are causing both strong and weak stand-alone hospitals and smaller hospital systems to consider merging, acquiring or collaborating with other health care providers for mutual benefit.

As in the past, these deals are being driven by the belief that getting bigger or being part of something bigger will help reduce costs, increase quality, and ensure enhanced access to health care services in the community. A more basic motivation for many board and executive leaders is to increase the likelihood that their institutions will survive in one form or another.

### Failure is Common, But ...

Many attempts at creating stronger health systems through mergers and acquisitions fail in spectacular fashion. The recent breakup of Cincinnati's Health Alliance and the implosion of Pennsylvania's Alleghany Health Education Research Foundation come to mind. Many others simply fail to achieve all of the benefits that were promised—such as cost savings, new services, job creation and improved quality—when the deals were being sold to the boards and the communities.

On the other hand, the large number of highly successful national and regional health systems with strong balance sheets, financial reserves and reputations for clinical quality suggests that getting big or being part of something big offers benefits that far outweigh the struggle to create such organizations.

### The Board's Role

The health care industry now has at least 30 years of experience in designing and executing merger and other collaborative arrangements. A deep bench of health industry lawyers, accountants and other consultants has developed to ensure that the business dimensions of doing a deal are addressed adequately. However, the role and level of involvement on the part of boards during a merger or collaboration transaction are not as perfected, and this often leads to confusion, decision-making delays, and lost opportunities. As a facilitator of numerous collaborative arrangements, this author views the constructive involvement of the board as a critical ingredient in the long-term success of a collaborative arrangement among hospitals and between hospitals and physicians.

Most board members are acutely aware that any major transaction that has the potential for their organization to either gain or cede control over assets requires the highest level of performance of their fiduciary duties of loyalty, care and obedience to the purpose or charitable mission of the organization. Board members know that they must act in good faith and use their authority in the best interests of the organization they govern, which includes avoiding conflicts of interest and maintaining confidentiality throughout collaborative discussions with other parties. They also know that decisions concerning change of control must be based on solid information with all of the board members being knowledgeable on all aspects of the transaction. And, most board members know that their fiduciary duties are owed to the corporation itself and no one else.

### Board's Involvement

However, while heightened performance of fiduciary duties is a prerequisite for effective board oversight of a major collaborative transaction, it is only one dimension of the board's involvement. Board members often feel frustrated that they are on the periphery of major deals being structured by management and a small group of board leaders and wonder what else they should or could be doing to contribute to a successful outcome for their institution. Above and beyond performing their fiduciary duties, below are some other aspects of a merger, acquisition or collaboration transaction in which board members should participate in a meaningful way. These are areas for board involvement that transcend the usual strategic and financial planning aspects of doing a deal.

***Process Design.*** An organized approach for pursuing a merger or collaborative relationship with another organization must be established early in the process. As a key first step, the board should agree upon who would serve on a steering committee to guide and negotiate the deal, determine what type of outside assistance will be required and how it will be funded, approve a detailed schedule for meetings of the steering committee and the board, and identify methods for involving key stakeholders in the process. These are just some of the decisions that board members can participate in at the outset of pursuing a merger or collaboration transaction. These discussions provide all of the board members with a sense that they are involved and have some influence over the process, even though the detailed work will be handled by a smaller group.



ILLUSTRATION BY CHRISTOPH HITZ

***Readiness, Culture Compatibility.*** An area where board members can be helpful early in the transaction process is to insist that an assessment be done to clarify the potential benefits of the transaction and that the cultural norms, beliefs and values of the collaborating organizations be examined to determine cultural compatibility and to answer the critical question of whether or not the desired arrangement is worth the effort. This assessment also includes ensuring that the parties to the transaction have a unified vision for the long-term evolution of the new organization.

A recent two-hospital merger project in which the author was involved illustrates the importance of this issue. The board of one of the hospitals was concerned that the other hospital's culture did not value striving to have strong, collegial relationships with all facets of the active medical staff. To address its concern, the board insisted that a "culture compatibility assessment" be done by an external consultant. The consultant's report confirmed the board's concern that this would likely spark dissension and mistrust among the medical staffs that could prevent successful implementation of the merger. As a result, the merger exploration process was terminated, without a lot of time and money wasted.

***Determining Governance Structures.*** Appropriate governance structures (number of boards, reserved powers, and committees), policies and procedures that address the political and fiduciary requirements of the collaborating parties are critical ingredients in the long-term success of a merger/collaborative arrangement. This is largely board work with the full board providing leadership for this dimension of the negotiations between the parties. The governance committees of the collaborating boards should be engaged to provide their ideas on all matters related to governance of the collaborative enterprise and retain the services of an expert governance consultant to assist them, if necessary.

***Implementation Plans.*** Once the ink is dry, the real work begins in earnest—making the deal successful for all parties. A merger or comprehensive collaborative arrangements are not discrete, short-lived projects. These transactions are ongoing organizational change processes that must be led and managed from initial discussions through a period of two to three years after the papers are signed. The fiduciary board for the collaborative or merged entity should require management to develop a long-range implementation plan that includes benchmarks to be met at various times, measurable results to be achieved (cost savings, service line consolidation and/or expansion, information technology integration, human resource policy reconciliation) and rigorously monitor implementation of those plans.

***Communications.*** The boards involved in a merger or collaborative arrangement should agree up front to a consistent, united flow of information to the community at large, employees, medical staffs, volunteers and the news media. Board members should insist that an agreed upon communications plan be developed and adhered to fully. The issue of confidentiality and when information will be shared must be spelled out in great detail to make sure that information flow is controlled and does not turn into wild rumors circulating throughout the organization and community.

For example, the boards of an emerging health system in the Midwest recently discussed the possibility of converting one of their existing hospitals into an outpatient facility. The information "leaked" out of the boardrooms and the local newspaper's front page story the next day reported that the hospital in question would be closed if the two hospitals were to merge into one organization. The merger process was set back months with board leaders and management spending huge amounts of time responding to the rumor and rebuilding trust with the medical staff, employees and the community at large.

## Benefits of an Engaged Board

Too often, the majority of board members are excluded from playing an active role in a merger or collaborative arrangement process under the mistaken belief that it is better to keep most of the board members in the dark until there is a need for them to make a decision. In effect, some board members end up being denied the opportunity to provide the leadership that board members are expected to provide. The biggest danger in following this approach is that the board will be unable to perform its fiduciary duty of care properly or make an informed decision in a timely manner.

Engaging the full board throughout a major transaction utilizes the talents of all board members, eliminates the possibility that the transaction will be rejected because a majority of the board is miffed over being excluded from the process and helps to beat the odds against a merger or collaborative arrangement failure. **T**

EDWARD A. KAZEMEK *is chairman and CEO of **ACCORD** LIMITED, a Chicago-based firm specializing in health care governance, strategy and management. He can be reached at (312) 988-7000 or at ekazemek@accordlimited.com.*