KPMG
cutting through complexity

HEALTHCARE

Taking the Pulse

A global study of mergers and acquisitions in Healthcare

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“Done right, M&A can be a valuable tool to drive sustainable clinical and financial outcomes. But it needs to be performed in a structured and professional way to reap real benefits, and this takes time. Proper pre-merger planning, robust clinical, cultural and financial due diligence and constant communication will pay off in the long-term.”

Roberta Carter
Partner
KPMG in the UK

Contents


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Foreword

Healthcare mergers are quite unlike those in any other industry. High emotion, political undertones, access concerns and stakeholder influences all play a significant role in deciding the outcome of mergers, particularly in the healthcare provider sector.

But in parts of the world, the pace of healthcare merger activity is booming: the US, the UK and Canada are all seeing rapidly changing marketplaces where mergers, consolidations and acquisitions are taking a lead role in creating value and driving down system costs.

Other areas of the globe seem on the cusp of major activity. Particularly in Europe, where growing budget deficits and aging populations are putting new strains on healthcare delivery, healthcare mergers are increasingly being considered as a possible solution to creating sustainable and patient-centric service models. The developing world is also seeing increasing levels of merger activity in healthcare, primarily instigated by foreign investment, but also to gain cost efficiencies and scale.

Against this varied backdrop, the common perception is that individual merger situations are far too unique to be able to share any significant lessons.

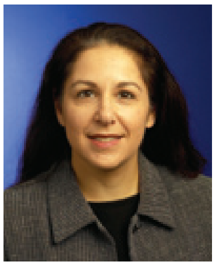
This study clearly shows otherwise. Around the world and across different social, political and economic environments, there are a number of key lessons that are cited by healthcare executives over and over again: focus on value, work with stakeholders, pay attention to planning, and plan for long-term success.

And while – on the surface – many of these findings seem true to all merger activity, there are mitigating factors and challenges that face healthcare providers more than peers in other industries.

To gain greater insight into the successes and failures of mergers in the global healthcare sector, KPMG commissioned the Manchester Business School in the UK to interview senior executives from 29 healthcare organizations around the world, all of whom had been involved in at least one integration.

We believe that the findings provide a clear set of lessons and considerations for healthcare executives, system managers, government policy makers and private investors who are approaching a merger in this sector.

We would like to thank all the executives who gave their valuable time to participate in the study.



Roberta Carter
Partner
KPMG in the UK

Mark Britnell
Chairman
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Chairman's Introduction

In the last decade, mergers and acquisitions (M&As) among healthcare organizations have become much more commonplace. In many countries the scale and pace of clinical sub-specialization, economies of scale, financial pressures and payer demands have combined in a heady mix to drive restructuring and organization consolidation.

Of course, the history of organizational mergers is not covered in glory with some academics suggesting that up to 70 percent of transactions fail to add value when measured in human, financial and organization terms. While this may be true in part, it does not follow that future M&As should share the same fate. Health research has tended to ignore the pre-conditions for successful M&As, and there are plenty of examples in the corporate world where good due-diligence, pre-merger integration analysis and high quality execution have added great value. But while M&A horror stories have been the focus of the press in some parts of the world, some healthcare organizations have quietly – but successfully – merged, and it is worth exploring the most important characteristics of success that materialize over a long timescale – often between two and ten years.

Relatively few healthcare mergers are analogous to the kind of M&A activity seen in other industrial sectors where functioning markets and competitive pressures predominate. For one, the attention given to pre-merger planning and due diligence is often highly variable in healthcare M&As. In part, this is because a substantial proportion of mergers are politically mandated rather than being organically initiated by the merging organizations and, as a result, pre-merger decision making is telescoped into post-merger implementation. Insufficient pre-merger integration planning is a key factor in failure and a key ingredient for success if clinical, financial and infrastructure synergy are to be achieved.

A striking feature of mergers over the past 15 years is that many executives have only ever been involved in the one merger they were managing and many were learning on the job – a high risk strategy when so much is at stake. Across the board, capability will need to be built and lessons can be learned from M&A successes in parts of the UK, the US, the Netherlands, Germany, Canada, New Zealand, and Singapore to name but a few.

Strategic leadership of the highest order is required to keep alive and constantly communicate the compelling purpose and clinical vision for any given merger or acquisition. Critically, that leadership needs to come from clinicians working alongside managers, cascading the messages through to the people on the ground that will ultimately be expected to turn high level objectives into robust plans, and drive through changes.

The truism that 'culture eats strategy for breakfast' is often ignored and not properly analyzed pre-merger. Cultural assessments addressing issues such as organizational values, leadership style, clinical prowess, conflict and decision making processes, methods of work monitoring and accountability regimes can expose potential risks, and strategies can be developed to mitigate such risks.

Finally, M&A activity should be seen as a serious strategic endeavor – owned and delivered by resolute clinicians and managers. There are no short cuts, and – as this study and our firms' experience – demonstrate successful M&As get seven fundamental things right over the course of time:

1. **Select new leaders and let them lead** – By identifying and publicizing the new leadership team, the merged entity can effectively cut links with past loyalties, provide a neutral platform and clarify lines of reporting.
2. **Create and communicate a strong, clear vision** – From the start, all staff should be informed of the rationale behind the merger, the transition process and the expected changes, and encouraged to engage in two-way feedback to increase the sense of involvement.
3. **Place an emphasis on planning** – Having a robust and long-term post-merger integration plan is essential to overcoming fragmented ways of working, legacy structures and cultural issues.
4. **Do the due diligence** – Giving proper consideration to short verses long-term benefits, and carrying out robust due diligence will help the organization set their sights on opportunities at an early stage, and incorporate anticipated issues into post-merger integration plans.
5. **Win over key stakeholders** – Clinicians are the people that make services happen, so it is vital to overcome their natural resistance to change. 'Change champions' should be chosen at an early stage, and given the responsibility and authority to influence and motivate their colleagues.
6. **Develop both the structure and the people** – Make sure that the new organization has the resources and the skills to manage the transition process by instituting structural and procedural changes such as mixed work schedules and cross-site working that can encourage collaboration and generate a new culture.
7. **Have patience to achieve long-term objectives** – Mergers are highly challenging and integration is unlikely to happen quickly; to succeed every level of the organization requires dedicated resources, experienced people, and strong pre- and post-merger planning, all of which take time to develop and deploy.

By considering these seven essential steps, we believe that healthcare executives can not only increase the likelihood of success, but also deliver better patient outcomes through an effective and efficient merger or acquisition process.

Dr Mark Britnell

Chairman
Global Health Practice
KPMG in the UK

Executive Summary

Healthcare mergers are not easy. They require executives and system managers to overcome multiple challenges and a constantly-evolving environment to drive through very complex changes.

On one level, there are socio-political impacts to healthcare that vary from country to country and are often integral to the very fabric of communities and – indeed – nations. One only need witness the highly-public debates continuing to unfold in the US and the UK to see how healthcare can polarize voters and politicians alike.

And yet, regardless of the socio-political landscape, our study has found that the roadmap for successful healthcare mergers is largely dependent on three key characteristics that are outside of the individual organization's control:

- the extent to which the merger is mandated by a 'higher power'
- the ownership structure of the organizations involved (i.e. private, public, not-for-profit, or a mix)
- whether the region in which the organizations operate are seen as 'developing' or 'mature'

"These are key market and organizational characteristics that have a significant influence on the progress, pace and success of healthcare mergers," noted Mark Britnell, Chairman of KPMG's Global Health Practice. "Understanding how these characteristics will impact a merger, and being able to mitigate and respond to them are critically important if healthcare mergers are to achieve their full potential."

Our study also found that there are a number of specific challenges that are common to healthcare mergers around the world and that are wholly within the control of the managers and executives that will plan and execute the merger.

Respondents to our global survey consistently cited four main challenges that – in some form or other – affected their ability to drive change and create value:

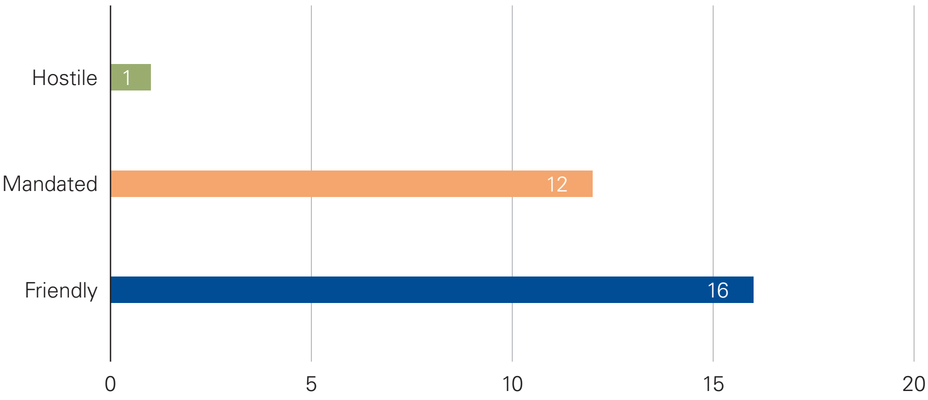
- Defining and enhancing value
- Managing stakeholder relationships
- Insufficient planning and due diligence
- Difficulties maintaining momentum

"It is telling that the majority of respondents reported that – in hindsight – they had been unprepared for the complexities and challenges that they would face through the merger process," added Bill Baker, a partner with KPMG in the US. "This report aims to cut through some of that complexity and provide valuable insights for healthcare executives, system managers and their funders."

> "How healthcare managers approach these challenges will dictate how successful their merger will be in the long-term,"
>
> – Roberta Carter, KPMG in the UK

Mandated or not

Was the merger mandated, friendly or hostile?

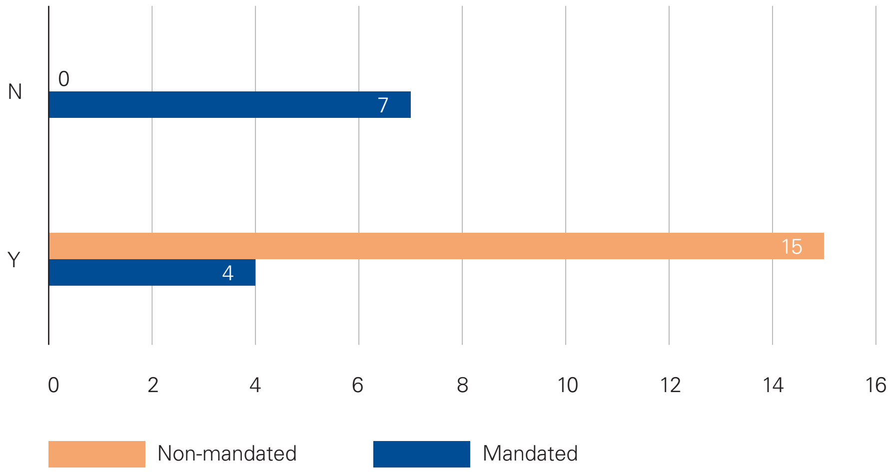


Note: Number may vary as not all respondents answered each question.
Taking the Pulse, KPMG International, 2011

Healthcare mergers – particularly those in the public sector and within publicly funded systems – are often perceived as being 'mandated' or non-competitive. According to our research, 44 percent of the mergers in the study were effectively chosen by government, regulators, healthcare funders or other influential stakeholders.

"When governments or large payers are working within the system to bring together hospitals and healthcare providers, they are often focused on delivering better services to patients and finding cost reductions," said Georgina Black, National Healthcare Industry Leader, KPMG in Canada. "Unfortunately, this often leads to the perception that the activity is mandated by a higher power, which can have a significant impact on motivating key players to support the merger."

Was due diligence undertaken?



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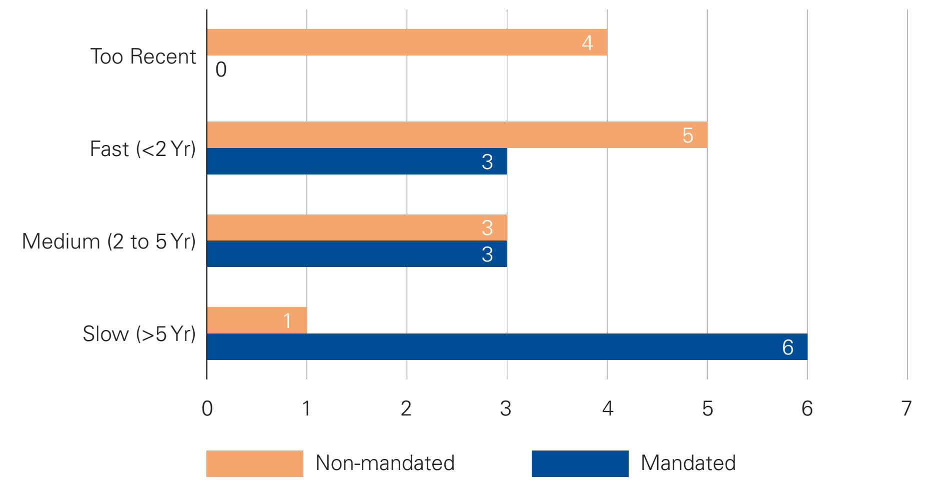
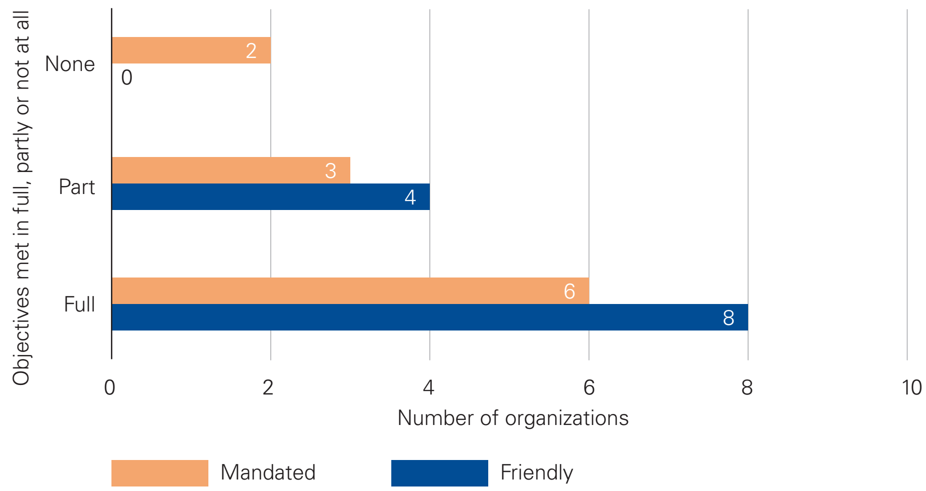
Taking the Pulse, KPMG International, 2011

Pace of post-merger change



Note: Number may vary as not all respondents answered each question.
Taking the Pulse, KPMG International, 2011

Success of merger versus a mandated or friendly merger



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Taking the Pulse, KPMG International, 2011

Two thirds of the mergers examined were also essentially non-competitive, with respondents citing no real or potential alternative merger partner and, in most cases, no process for considering competing offers or proposals.

"Our (mandated) merger didn't make sense – in the private sector you would look for more commercial reasons, for a good fit. Contested mergers like this one, with strong cultural differences, bring hostility," conceded one respondent.

The perceived mandated nature of mergers has a direct and significant impact on the full life-cycle of merger activity. For example, respondents that had participated in a mandated merger were almost half as likely to have

Respondents that had participated in a mandated merger were almost 50 percent less likely to have conducted due diligence before the merger conducted due diligence before the merger, whereas those participating in non-mandated mergers unanimously followed this critical pre-merger step.

Mandated mergers also tended to be slower to achieve their objectives than non-mandated ones, with more than half of mandated merger respondents suggesting that significant change took over five years to achieve, whereas non-mandated mergers tended to see success in two years or less. "We have noted that, for those mergers that are widely seen as mandated, momentum and engagement is often a key challenge," said Roberta Carter, a partner with KPMG in the UK.

The mandated nature of a merger also seems to have an impact on the overall success of the merger activity. Just over half (55 percent) of respondents that had undertaken mandated mergers claimed to have achieved full success, versus two thirds (66 percent) in non-mandated mergers.

"Managers implementing mandated mergers tend to have a more difficult time identifying and quantifying the indicators of success," said Wah Yeow Tan, partner and National Head of Healthcare, KPMG in Singapore. "For non-mandated mergers, the objectives tend to be fairly clear, which in turn allows healthcare managers to focus their attention on achieving their key indicators and executing a highly-strategic plan."

"For those mergers that are widely seen as mandated, momentum and engagement is often a key challenge."

– Roberta Carter, KPMG in the UK

KPMG Viewpoint:

Healthcare mergers that are widely seen as having been mandated are often plagued with challenges. As the data shows, planning, momentum and success are all influenced by the mandated nature of a merger, but so too are stakeholder relationships and the organizational culture, both of which play a key role in achieving merger objectives.

"To navigate these challenges, healthcare managers will need to take an external perspective on the merger activity and try to look at the situation through the eyes of a private investor." said Volker Penter, a partner and National Head of Healthcare with KPMG in Germany. "This includes everything from conducting proper due diligence in order to understand where synergies and value lie, through to communicating with key stakeholders as if they were all equity-holding investors."

For mandated healthcare mergers, success will often depend on the ability of managers to articulate a clear vision and achievable objectives which provide a strong roadmap for enhancing value to patients, employees and funders.

CASE STUDY

UK

University Hospital Birmingham gets it right

The story of the new University Hospital Birmingham NHS Foundation Trust started in 1996 when five separate hospitals were merged to create the new University Hospital in Birmingham, the UK's second largest city. The merger was born out of financial crisis and the growing realization by politicians, clinicians and managers that the existing health model was both clinically and financially unsustainable.

The early stages of merger were marked by conflict and competing clinical priorities. Early due diligence was heavily centered on the need to make large efficiency savings, and a large number of redundancies followed, setting a negative tone for the new organization in its early days.

However, with the appointment of Sir Jonathan Michael, a senior physician, in 1997, the hospital saw the beginning of a new clinical vision for integrated and consolidated tertiary clinical services. Following the publication of a new strategic outline case in 1998, a lot of the lessons of successful mergers were put in place: new leaders were chosen, a strong vision was created, plans were detailed, stakeholders informed and a 10 year plan mapped out.

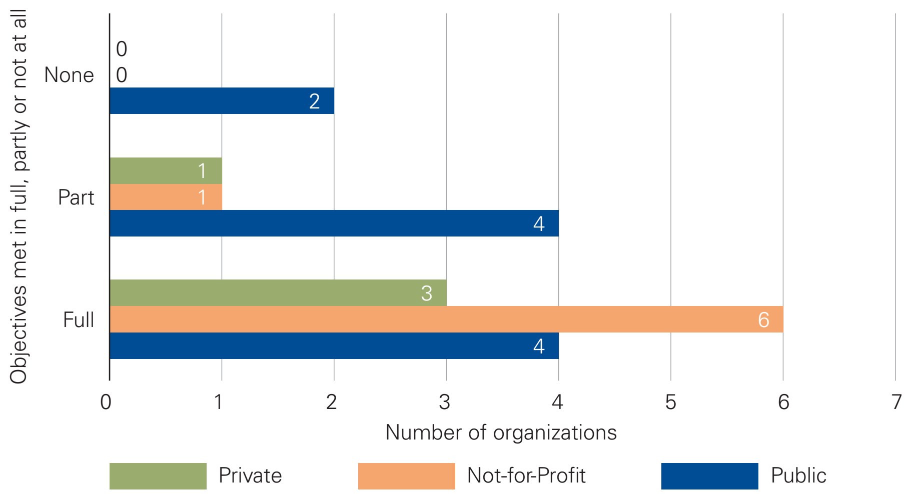
Most importantly, new organization structures were created, new people (including Chairman John Charlton) were recruited and managerial teams were grouped around the new care pathways which would be present in the new, unified hospital facility. The unfaltering determination and perseverance of the managerial teams helped to implement clinical changes and prepare all 6,500 staff for their new roles.

The project reached outline business case approval in 2001 and contract signature for building in 2006. A new CEO (former Chief Operating Officer Julie Moore) was appointed to take clinical services into the new facility between 2010 and 2012.

Since 2000, University Hospital Birmingham has been one of the highest performing in the NHS and successfully transferred clinical services on time and cost to the new facilities. As a result of the merger, the organization has also dramatically improved the quality and safety of clinical services in the region.

Public or Private

Success of merger versus organization ownership: Private, not-for-profit, or public



Note: Number may vary as not all respondents answered each question.
Taking the Pulse, KPMG International, 2011

While most public mergers fall into the 'mandated' category, respondents reported a number of distinct differences between public sector mergers and private sector mergers that influenced success beyond those associated with their mandated nature.

"Private sector mergers are almost always evaluated in terms of shareholder value, which makes the measurement of success relatively straightforward," notes Martin Munro, a Partner with KPMG in the UK. "But because public – and to a large degree not-for-profit – healthcare facilities are often measured by their quality of care, staff satisfaction levels and patient wait-times, success can sometimes be much more difficult to fully achieve for public sector healthcare providers."

Public sector and not-for-profit respondents to our survey also tended to report more complicated stakeholder management issues as a result of their ownership and funding structures.

"Governments and charitable foundations may be the primary funders of some public healthcare providers, but often the community, employees and regulators also play a more commanding role than in most other sectors," noted Georgina Black from KPMG in Canada. "In our firms' experience, public sector healthcare mergers tend to take longer to achieve their objectives because many of the difficult integration issues carry a degree of political or stakeholder risk that managers are loath to take on."

Both private and public sector mergers are often influenced by political factors such as a change in government policy or fiscal austerity measures. "Healthcare merger activity is likely to pick up dramatically in Spain after the general election scheduled for next year," said Javier San Miguel Garcia, a director in KPMG's Healthcare team in Spain. "The makeup of the new government will likely decide the direction that healthcare funding will take in the future."

"Uncertainty related to policy change or unclear lines of leadership can create unnecessary complexity and easily derail the merger process."

– Martin Munro, KPMG in the UK

Of course, many respondents from the private sector also noted the impact of political and social factors on the success of their mergers. And, while these pressures were often reported to be less acute than in the public sector, many private sector managers seemed surprised at the level of influence these factors had on their long-term success.

KPMG Viewpoint:

Healthcare mergers – both public and private – will always be conducted under more acute pressures than similar activity in other industries. But for the public sector, the influence of stakeholders and policy development cannot be understated.

"Healthcare mergers are fundamentally transformative endeavors and can't be switched on and off in mid-stream to suit changing policy or sudden stakeholder demands," notes Wouter Bos, partner and National Head of Healthcare with KPMG in the Netherlands and former Dutch Finance Minister. "It takes a long-term outlook and a value-driven mindset that goes beyond policy objectives and individual stakeholder demands."

System managers and government healthcare authorities will need to work with hospital management to ensure that the merger planning and objectives reflect the long-term needs of the system or facility, and improve the quality of patient care, rather than short-term goals that may achieve quick wins but will erode benefits later in the process.

"Once policy decision makers and system managers have made the decision to merge facilities, they need to appoint a leadership team and then step back and let them lead," added Martin Munro, KPMG in the UK. "Uncertainty related to policy change or unclear lines of leadership can create unnecessary complexity and easily derail the merger process."

"Healthcare mergers are fundamentally transformative endeavors and can't be switched on and off in mid-stream to suit changing policy or sudden stakeholder demands."

– Wouter Bos, KPMG in the Netherlands

Emerging market or mature

Unsurprisingly, the healthcare needs of emerging economies differ dramatically from those of the more mature markets of Europe and North America.

Whereas the majority of the respondents from the mature markets cited consolidation – both financial and clinical – as key objectives for their merger activity, emerging markets tend to be much more focused on financial investment and growth.

"The Chinese government would like to greatly expand the hospital system over the course of their current ten year plan," said Mei Dong, a partner with KPMG in China. "They have also been investing heavily in a national electronic records platform to speed up patient care and improve access to services."

Private sector investment is also increasing in other high growth markets such as Singapore, Korea and parts of Africa.

"In Africa, healthcare mergers are driven by the need to simultaneously achieve economies of scale, skill, and scope in order to deliver more sustainable healthcare," noted Sandile Hlophe, National Head of Healthcare, KPMG in South Africa.

Private equity (PE) firms have been particularly active in many of these regions in recent years. "In some cases PEs are simply focused on finding good investments with long-term returns, but in other cases they are looking at growing out existing hospital systems to gain a greater market share and enhance their investment," said Min Shik Cho, partner and National Head of Healthcare, KPMG in Korea.

And as household incomes begin to climb in many developing countries, this is often accompanied by a notable increase in public expectations and demand on the healthcare system. As a result, fast-growing countries such as China and India plan to increase healthcare spending substantially over the next few years.

"In mature markets, health systems are under pressure from four main sources: aging facilities, shifting demographics, rising healthcare costs and – in the US in particular – regulation," noted Bill Baker, KPMG in the US. "And now many governments are facing looming deficits and are feeling enormous pressure to contain costs and redirect investments."

Having built up substantial healthcare agencies, many mature markets are now seeking reforms. These include alternative financing arrangements for capital projects and equipment, and the introduction of private providers into the system. They are also coordinating and sharing resources across providers or health economies and de-listing medically insured services.

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KPMG Viewpoint:

There are significant opportunities for healthcare organizations in both emerging and mature markets. But even with increased investment in healthcare, neither market is going to be able to maintain funding without pursuing sustainable cost-efficiency measures such as clinical integration and consolidation of certain services and facilities.

"A growing number of foreign investors are looking at the emerging markets with interest, seeing them as a potential high-growth investment opportunity," said Wah Yeow Tan, KPMG in Singapore.

Defining and enhancing value

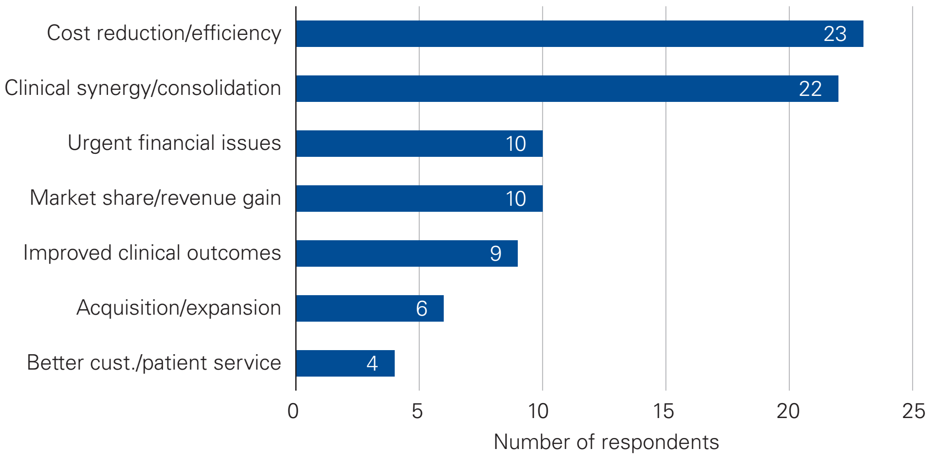
While the characteristics of each market and merger situation will dictate many of the conditions under which healthcare mergers must occur, there are also a number of challenges that are shared across jurisdictions and market characteristics.

"These challenges are within the direct control of healthcare executives, system managers and Boards of Directors," noted Martin Munro, KPMG in the UK. "Issues such as defining organizational value and conducting proper planning and due diligence will make or break a merger and determine whether value will be created or destroyed in the long-term."

In the context of healthcare, 'value' can mean different things to different stakeholders. In responding to our survey, healthcare executives tended to focus on two dominant objectives for their mergers: cost efficiency and clinical reconfiguration. Both are clearly measures focused on driving greater efficiency and value throughout the organization.

65 percent of respondents claim that the merger met its objectives

Objectives of merger or acquisition



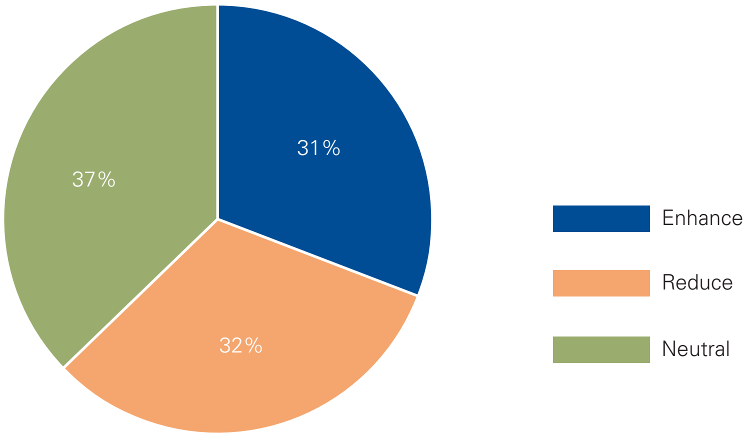
Note: Number may vary as not all respondents answered each question.
Taking the Pulse, KPMG International, 2011

One respondent cited his organization's merger objectives as "shortening the waiting times for access to specialists, and improved patient and comfort for in-patient care," both of which are measurable. Another respondent spoke of economies of scale achieved by consolidating two hospitals that were situated too close together. Yet another said that the merger: "introduced a more systematic approach to performance assessment, based on benchmarks and utilization review for acute in-patient care, mental health care, and continuing care and rehabilitation."

"The primary outcome of clinical realignment is often more efficient delivery of services, which ultimately leads to cost savings and improved clinical outcomes," noted Bill Baker with KPMG in the US. "But clinical realignment tends to take some time, whereas cost savings objectives are usually in response to an urgent need, so there is often conflicting pressure on healthcare executives."

81 percent of executives in the study believe the benefits of mergers outweigh the costs

Private sector mergers: was value created?



Note: Number may vary as not all respondents answered each question.
Data collected for A new dawn: good deals in challenging times, June 2011, KPMG International

A number of respondents to our survey cited improvements in back-office functions such as IT, finance and human resources as opportunities to achieve 'quick wins' in cost efficiency and to achieve productivity gains.

"In many of the emerging markets, the value generated from back-office consolidations and integrations are often one of the key drivers for merger activity in the healthcare sector," noted Jon Parker, a partner with KPMG in China. "As hospital groups expand in these regions, they start to take advantage of group procurement and shared service models to drive greater value from their network."

Interestingly, when asked to rate the success of their own merger experiences in terms of whether value was created, reduced or remained neutral, two thirds (65 percent) of respondents claimed that their deal added value. "This appears to be a surprisingly optimistic response," notes Roberta Carter, KPMG in the UK, "given that existing research by KPMG[1] on mergers in the private sector – across multiple industries – shows that only 30 percent of all mergers meet their financial expectations in terms of share price or shareholder value."

But while private sector mergers can always be evaluated in terms of shareholder value, it is often more complex to quantify successful healthcare integration. Improved clinical outcomes and better patient service, for example, are often a result of the work of multiple departments and functions working together to achieve specific objectives.

"Clinical realignment tends to take some time, whereas cost savings objectives are usually in response to an urgent need, so there is often conflicting pressure on healthcare executives."

– Bill Baker, KPMG in the US

1 *A new dawn: good deals in challenging times,* June 2011, KPMG International

KPMG Viewpoint:

While the case for mergers in healthcare is usually focused on securing optimal clinical configuration and cost efficiencies, many are driven politically and are frequently associated with financial crisis. Often, there is a long-standing strategic rationale for a merger which, paradoxically, only proceeds when exacerbating factors – such as a financial crisis – enable it to be progressed.

"Ironically, too much political direction coupled with financial instability often results in short term attitudes which drive out the original long term value of strategic consolidation," said Mark Britnell, Chairman of KPMG's Global Health Practice. "In these cases, mergers never get beyond the conflict stage and present persistent signs of serial failure."

However, mergers undertaken in such a constrained and difficult financial context are inevitably problematic and challenging. "Many sustainable and transformative cost efficiency measures require an initial investment in time and resources, which is often difficult to secure when financial strain has already set in," said Roberta Carter, KPMG in the UK. "A fair number of healthcare mergers are never really given a fighting chance because – at the front end – the project lacked the proper support in terms of investment."

Managing stakeholder relationships

According to respondents – and borne out by our firms' own experience in the field – managing stakeholder relationships can be one of the hardest components of a healthcare merger to plan and execute. Managed badly or inconsistently, it can be a leading cause of destroyed value and lost momentum.

"It's critical to get stakeholders like senior clinicians and local communities to work with you, and to be certain beforehand that the politicians are going to support the process," noted Wouter Bos, partner and National Head of Healthcare with KPMG in the Netherlands and former Dutch Finance Minister.

And while some of the key constituents and stakeholders are familiar to healthcare managers (such as government system managers in public sector mergers, or equity shareholders in private sector mergers), respondents cited considerable challenges as a result of wavering or non-existent support from other key stakeholders.

"Time and time again, we see healthcare mergers taking a long time to achieve their objectives because clinician support was not properly secured at the start of the process," said Volker Penter, a partner and National Head of Healthcare, KPMG in Germany. "This is the greatest lesson for healthcare executives and one that – in hindsight – is widely recognized as the cause of many merger challenges."

Gaining clinician support and buy-in for such transformations is often a long journey that starts in the early stages of merger planning and continues long after the transaction is completed. As one respondent noted, "...to secure clinical service reconfiguration you have to take the clinicians with you."

A number of respondents spoke of the pre- and post-merger period as being filled with anxiety and confusion for key internal stakeholders, with a feeling that there were winners and losers in the new entity. Staff, patients and community groups were often skeptical and – at worst – actively hostile to the merger.

Indeed, a strong focus on creating a common culture is critical. Over the last 10 years, KPMG's global research of M&A in the private sector has shown culture and communication rank consistently as the most difficult (but most important) areas to get right for successful deal implementation. In our most recent global survey[2], 20 percent of respondents cited culture as a top issue, but only 19 percent used diagnostic tools to examine cultural issues.

"There is a need for clear agendas, clear objectives and transparency from the merger project team in all its dealings with key stakeholders (in order to reduce and manage anxiety). It's also essential to keep the boards of the two organizations fully informed," advised one respondent when looking back at their stakeholder relationship experience.

> "...to secure clinical service reconfiguration you have to take the clinicians with you."
>
> – Respondent

> "Ten years on, we still don't have a single culture."
>
> – Respondent

2 *A new dawn: good deals in challenging times*, June 2011, KPMG International

KPMG Viewpoint:

"The importance of gaining buy-in and active support of senior clinicians should not be underestimated." said Alberto de Negri, partner and National Head of Healthcare, KPMG in Italy. "Clinicians are the people that make services happen, so it's vital to overcome cultural differences and any resistance to change."

'Change champions' should be chosen at an early stage, with the responsibility and authority to influence and motivate their colleagues. Our research shows that organizations that did not meet their objectives all reported poor communication between stakeholders.

Healthcare mergers require strategic leadership of the highest order, and that leadership needs to come from clinicians working alongside managers, cascading the messages through to the people on the ground that will ultimately be expected to turn high level objectives into robust plans, and drive through changes.

"If you can communicate the merger objectives in terms of patient outcomes, clinical quality and service levels, it becomes very difficult for stakeholders to oppose," noted Wouter Bos, KPMG in the Netherlands.

Establishing and communicating a clear, consistent and convincing narrative that explains the purpose of the merger and commands the support of internal and external stakeholders is essential. It is also important to face up to and tackle the trauma that change could produce and the cultural changes it often demands.

"Culture is often seen as a 'soft and wooly' area but it is important to manage cultural clashes effectively, as this is an inevitable part of the merger process. Carrying out a cultural assessment or similar diagnosis on all the organizations involved is a start. But it doesn't stop there. A long-term 'one culture' development program, based on business objectives, needs to be developed and implemented if deep-seated cultures are ever going to really change." Roberta Carter, Partner, KPMG in the UK

CASE STUDY

New Zealand

Southern District Health Board: merging two very different cultures

Culture clashes create significant challenges for merging healthcare organizations. So when two rival district health boards in New Zealand merged to form the Southern District Health Board, the CEO knew he had to put a strong focus on culture.

"It is important not to ignore cultures and micro-cultures within organizations," said Brian Rousseau, Regional CEO of the Southern District Health Board. "I instituted a program of vision, values and behavior that was common and acceptable to both organizations, and this is an ongoing piece of work today."

And while the two entities had enjoyed a long history of working collaboratively (characterized by Rousseau as "years of courting before getting married"), there was a conscious decision to deal specifically with the cultures and micro-cultures within the two organizations. This involved identifying a set of common acceptable behaviors applicable to both organizations, which is an ongoing task.

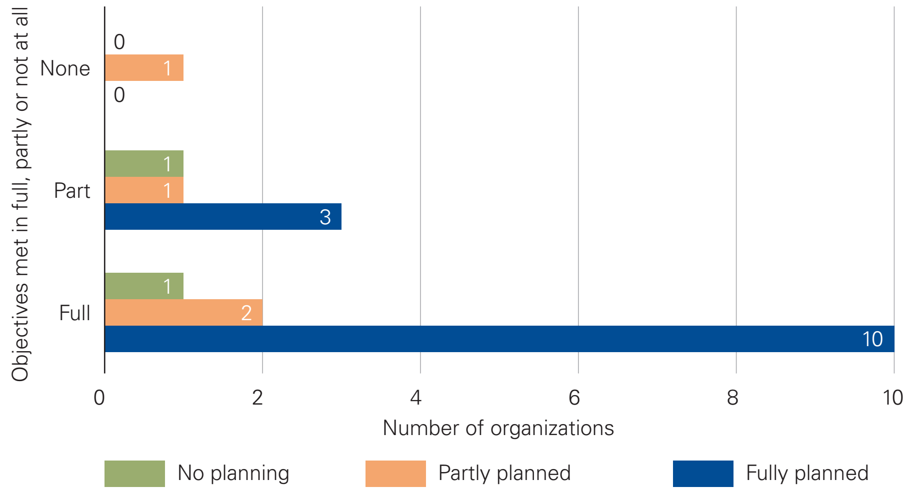
Rousseau and his management team focused on communicating one common philosophy: to protect and develop clinical services. However, even though the merger was largely friendly and non-competitive, it still met with some resistance from a small number clinicians and board members.

And although well planned and executed, reconfiguration of clinical services was delayed due to lack of a clear roadmap. Service integration was also initially trialed to develop trust and bring key stakeholders onside ahead of a full roll-out.

Rousseau notes many key lessons from his experience. For one, it takes tough decisions made over time to lay the foundation for a successful merger. Rousseau also noted that slowing the pace of the integration allowed his team to build trust and engagement from stakeholders.

Planning and due diligence

Success of merger versus quality of planning



Note: Number may vary as not all respondents answered each question.
Taking the Pulse, KPMG International, 2011

Less than half of respondents felt that their organization was fully prepared for the merger or acquisition.

According to our research, less than half of respondents felt that their organization was fully prepared for the merger or acquisition. Most of the senior healthcare executives involved in this study reported that effective planning and preparation – both pre- and post-merger – was crucial to measuring value and achieving success.

"The survey results show a close correlation between a professional, leading practice approach and the perceived success of the merger," said Volker Penter, KPMG in Germany. "Due diligence and robust integration planning are critical in any industry, but even more so for healthcare executives who need to extract both clinical and financial value at the same time."

However, many respondents report a significant lack of experience when it comes to healthcare mergers. Half of all respondents in this study said their organization had never previously undergone a merger. Of the remainder, most had only been involved in one merger in the past.

"The level of experience and competencies within most healthcare institutions isn't very high with respect to complex mergers, so most are unaware of the importance of planning and how they need to approach it," commented Wouter Bos, KPMG in the Netherlands. "It takes a careful process of developing quality standards and setting metrics by which to measure them, and then using that data to create a plan that focuses on value."

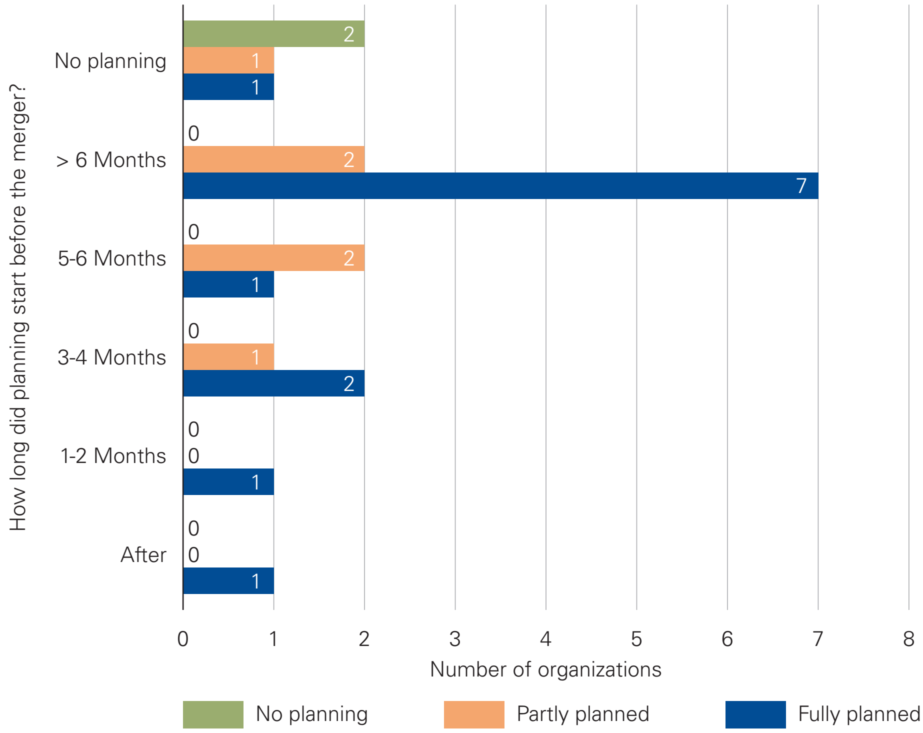
The vast majority (77 percent) of those organizations with good merger planning and a clear merger strategy reported that they were able to achieve all their objectives. The outcome is even more decisive when it comes to due diligence: 90 percent of those who carried out due diligence met all their goals, compared to a success rate of just 42 percent for those who carried out no due diligence at all.

One executive noted that: "You can't underestimate the benefits of a formal approach driven by and underpinned by clinical/service experience, developed within the context of a clear strategic plan for service change and development."

"Due diligence and robust integration planning are critical in any industry, but even more so for healthcare executives who need to extract both clinical and financial value at the same time."

–Volker Penter, KPMG in Germany

Success of merger versus quality of planning



Note: Number may vary as not all respondents answered each question.
Taking the Pulse, KPMG International, 2011

90 percent of those that carried out due diligence met all their goals, versus a success rate of just 42 percent for those that carried out no due diligence at all.

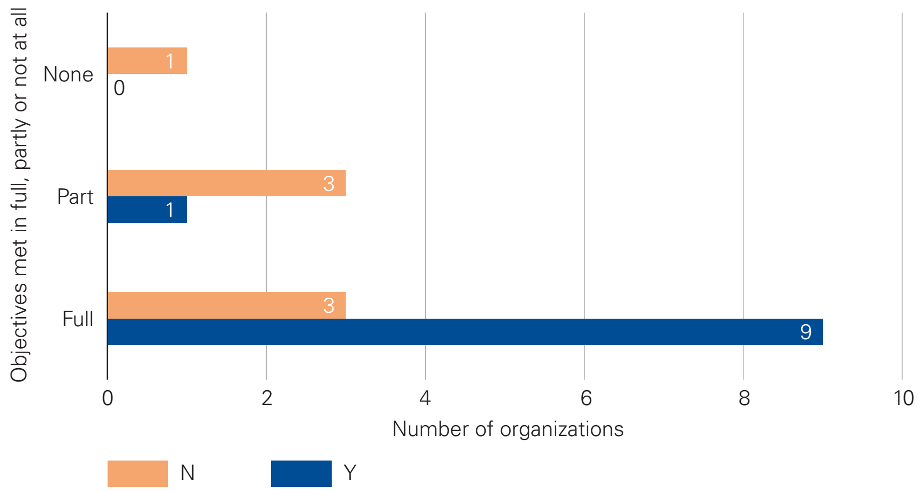
"Those who carry out robust due diligence are able to set their sights on opportunities at an early stage, and can incorporate anticipated issues into post-merger integration plans throughout the process," adds Bill Baker, KPMG in the US. "Many healthcare executives know that they need to conduct financial due diligence, but they often overlook the clinical due diligence that is so important when designing the post-merger integration plans."

The level of attention given to pre-merger planning and due diligence is also highly variable. In part, this is because a substantial proportion of mergers are politically mandated rather than being organically initiated by the merging organizations and, as a result, pre-merger decision making is telescoped towards post-merger implementation. But the degree of planning also varied between different hospitals, with some beginning months and even years before the eventual merger, and others taking a less structured approach in the run-up to the event.

"There was no clear strategy for the merger – even the financial case was worked up in great haste to get the budget through. All of the issues were left to be resolved post-merger and

50 percent of the executives said their organization had never previously undergone a merger

Success of merger versus due diligence undertaken (Y/N)



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Taking the Pulse, KPMG International, 2011

efficiency savings were not based on any analysis of what was possible or likely," reported one respondent to our study.

The findings also suggest that pre-merger planning is more commonly associated with non-mandated mergers, which could explain why only 44 percent of organizations in the study said they were completely ready at the time of merger.

"By ignoring the pre-merger preparation, the board is effectively acknowledging that the transaction is a 'done deal.' Having not been responsible for the initial decision, it may feel that it has less accountability and can therefore be less thorough in its approach," added Paul Venhoeven, a partner with KPMG in the Netherlands.

KPMG Viewpoint:

Thorough due diligence right from the start should help uncover any challenging issues and help to avoid unwanted surprises along the way. Giving proper consideration to short-term verses long-term benefits, identifying areas for further investigation and analysis early on will pay off and save time in the long run.

"Pre-merger integration work, although difficult and time consuming, is not nearly as tricky as making it up as you go along following a shot-gun wedding," commented Mark Britnell, Chairman of KPMG's Global Health Practice. "In our firms' experience, having a robust and long-term post-merger integration plan is essential to overcoming the fragmented ways of working, organizational structures and cultural issues that are pervasive in healthcare mergers."

Particularly in the case of mergers resulting from political decisions (which typically entail little or no engagement with the board), the planning process is often given a lower priority. And while in these circumstances much of the effort focuses purely on implementation, the lack of a robust plan can seriously reduce the chance of gaining clinical, financial and infrastructure synergies.

"Many healthcare organizations start to lose track of the benefits that were outlined in their business plan which makes measuring success and value difficult," added Wouter Bos, KPMG in the Netherlands. "Healthcare leaders need to make sure they keep a clear view on those benefits throughout the implementation process to ensure that they are achieving the goals they set out at the start."

CASE STUDY

US

Lifepoint: a proven model of M&A success

With 48 hospitals across North America, Lifepoint is keenly focused on consolidating its position as a key player in the US healthcare market. In the past decade alone, the organization has undertaken 30 transactions and has created a tried and tested approach to conducting mergers.

Lifepoint's most recent transaction has been with Sumner Regional System, a 270-bed facility with 1,300 staff members. By leveraging their extensive merger experience, the company developed a three-part model to help manage the acquisition and tracked performance against their objectives over the next ten years.

"There was a clear merger strategy set out from the start, along with a robust planning phase. A five year model projection and a one year transition period allowed for the right mistakes to be made by taking a long-term view," said Paul Hannah, Lead Negotiator for Lifepoint Hospitals.

Lifepoint's model focuses on a number of key functions that support the merger process and help executives guide success. These include:

- **Team continuity:** the same team that undertakes due diligence manages the transition, building a shared learning of critical success factors
- **Portfolio management:** Lifepoint gains a clear, objective assessment of the relative position of any new hospital within its portfolio, while carefully selecting the appropriate integration strategy to suit the organization
- **Transition management:** by allowing a year for transition activity, the team creates strong data reporting processes and gives scope to learn from mistakes
- **Stakeholder management:** including a formal communication plan involving local community groups. This helps to engage those loyal to their local provider and communicate the rationale for the change
- **Robust due diligence:** in the Sumner merger, Lifepoint had 20 teams looking at various aspects of due diligence, focused on all the main functions

While Lifepoint continues to learn from experience and build up a body of knowledge, they also acknowledge that each merger is unique. That is why they use a common framework and philosophy that puts transition planning at the heart of every integration. This helps the team make the right decisions at organizational, functional and leadership levels to create a high-performance healthcare culture.

Maintaining momentum

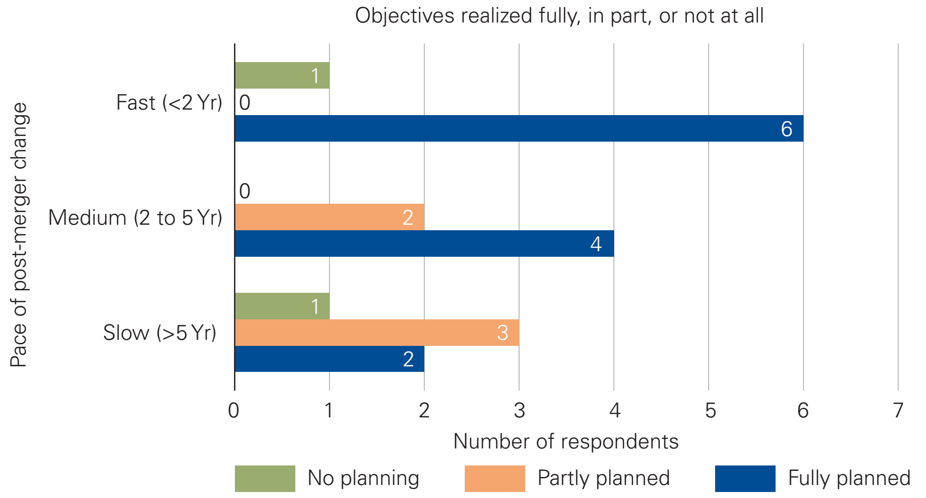
Although almost 65 percent of respondents suggested that they had achieved all of their planned objectives, many reported that progress took far longer than expected. In a number of cases, full success was only achieved after almost ten years of ongoing post-merger integration.

"Clinical improvements in particular may not be seen for several years due to the lengthy planning and implementation process, and because many of the real benefits involve major capital investment," noted Alberto de Negri, KPMG in Italy.

Indeed, healthcare mergers are highly challenging and integration is unlikely to happen quickly. "Mergers are not a 'quick fix' and new ways of working have to be embedded, and that takes time. Loyalties to old ways of working are sometimes very hard to shift," commented one respondent. "Even though we've merged, there is still a degree of organizational protectionism in the system," admitted another respondent.

> "Mergers are not a 'quick fix' and new ways of working have to be embedded, and that takes time."
>
> – Respondent

Pace of post-merger change versus success of merger



Note: Number may vary as not all respondents answered each question.
Taking the Pulse, KPMG International, 2011

Many respondents pointed to the need for strong leadership, along with consistent and clear communications, to ensure that successful change can be accomplished. "You cannot achieve a merger from solely a top-down approach; there needs to be someone to paint the vision," noted a respondent.

Where the merger involved a private sector acquisition, however, many respondents reported that there was usually a pragmatic attitude to communication where management recognized the importance of keeping key internal and external stakeholders fully informed in order to expedite the process. Three quarters of those respondents that praised their organization for good communications practices through the merger process also reported that they had achieved all of their objectives.

For example, when the Birmingham Heartlands Hospital (a UK NHS facility) was mandated to merge with the smaller and financially troubled Solihull Hospital, management chose to face the challenges head on. "Cost reductions and clinical changes were radical and fast, tough decisions were made quickly. Changes and closures were communicated on day one, and then followed through," said Sir Robert Naylor, former CEO, Birmingham Heartlands Hospital, UK.

> "Changes and closures were communicated on day one, and then followed through,"
>
> – Sir Robert Naylor, former CEO, Birmingham Heartlands Hospital, UK

Success versus quality of communication (good/poor)

Note: Number may vary as not all respondents answered each question.
Taking the Pulse, KPMG International, 2011

"Strong communications and the ability to articulate and maintain a vision for the merger are critically important to keeping the organization engaged and moving towards a goal," said Martin Munro, KPMG in the UK. "The importance of regular communication is often underestimated but leaders who do not clearly communicate their vision for the merger – be that financial, clinical or otherwise – are rarely able to maintain momentum or gain buy-in."

Several of the executives taking part in the study said their organization had failed to either create or sustain a message that commanded support across the merged organization – particularly from senior clinicians. "The merger did not really achieve joint working and service reconfiguration – change happened slowly and the resistance to this was led by clinicians," confided another respondent.

KPMG Viewpoint:

While a lack of a clear vision may not directly correlate to failure, the qualitative feedback is that vision matters in terms of buy-in. From the start, all staff should be informed of the rationale behind the merger, the transition process and the expected changes. A comprehensive communications program should articulate and repeat these messages, with two-way feedback to increase the sense of involvement.

"Achieving a long-term vision takes time and lots of patience, not just for senior management, but also for the stakeholders impacted by the change," warned Georgina Black, KPMG in Canada. "It isn't enough to simply reorganize a few senior managers or replace a Board of Directors; every level of the organization requires dedicated resources, experienced people and strong pre- and post-merger planning."

CASE STUDY

Netherlands

Talant: taking the longer view

Talant, a Dutch healthcare organization, was born from mergers. In 2002, two mental disability care organizations merged to bring together their home-based and residential care services. In 2008, the company then merged with two other care providers to extend their services into age-care. As of 2009, the company operated in three regions in the Netherlands, serving 3,600 clients at over 400 locations.

While the 2008 merger was largely driven by budgetary concerns and as a response to legislation, all three organizations involved were also focused on enhancing the primary process of care to their patients.

By bringing together three like-minded organizations, the merger was largely a multi-lateral decision that focused on shared values and common business sense. But Talant recognized that planning such a complex integration would take a dynamic approach and lots of patience.

"Talant has been learning post-merger lessons for eight years. It takes between five and ten years to really start to achieve objectives. Most mergers are judged far too early," said Erik Kuik, CEO, Talant, Netherlands.

As a result, planning for the merger started well in advance and Talent recognized that there was "not just one way". A staged approach was taken to post-merger planning and different plans were initiated at different stages.

As a starting step, the successful transition phase introduced fresh governance and management, as well as a shared corporate language, to communicate the new values and priorities to all staff.

And while the merger enjoyed a favorable legislative environment, a long-standing collaborative culture and a history of working alliances, the Talant leadership did not expect instant results. Recognizing that a merger is "a process not an event," the success of the merger will not be evaluated for at least five years by Talant – with a 'thermometer reading' after two to three years.

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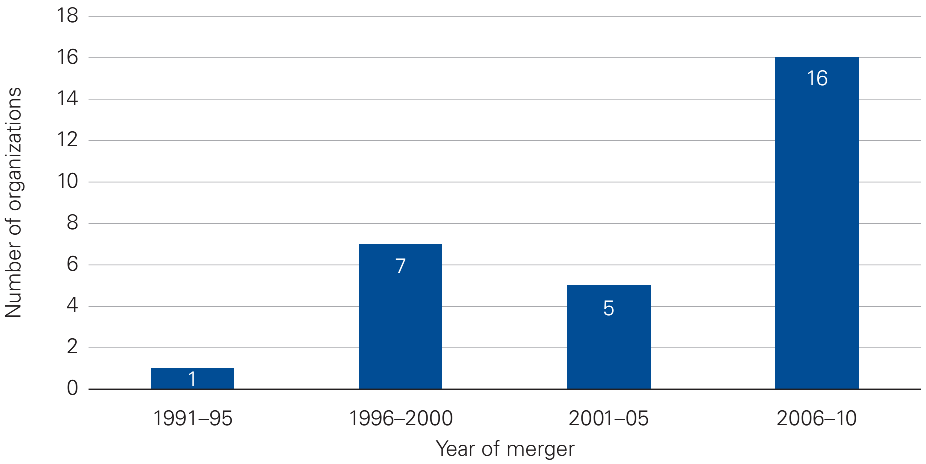
KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We operate in 146 countries and have 140,000 people working in member firms around the world.

About the research

From late 2010 to early 2011, the Manchester Business School's Healthcare and Public Sector Management team carried out 29 in-depth interviews with senior executives from private and public healthcare providers in 12 countries across the globe. The respondents and their organizations had all been involved in a merger and the discussions focused on their experiences before, during and post-integration.

All but one of the mergers took place between 1996 and 2010 and included government, not-for-profit and for-profit healthcare organizations. Most of the mergers studied were conducted between acute-care organizations (hospitals or groups of hospitals), although some also featured mental health, community and learning disability service providers.

Mergers studied by year



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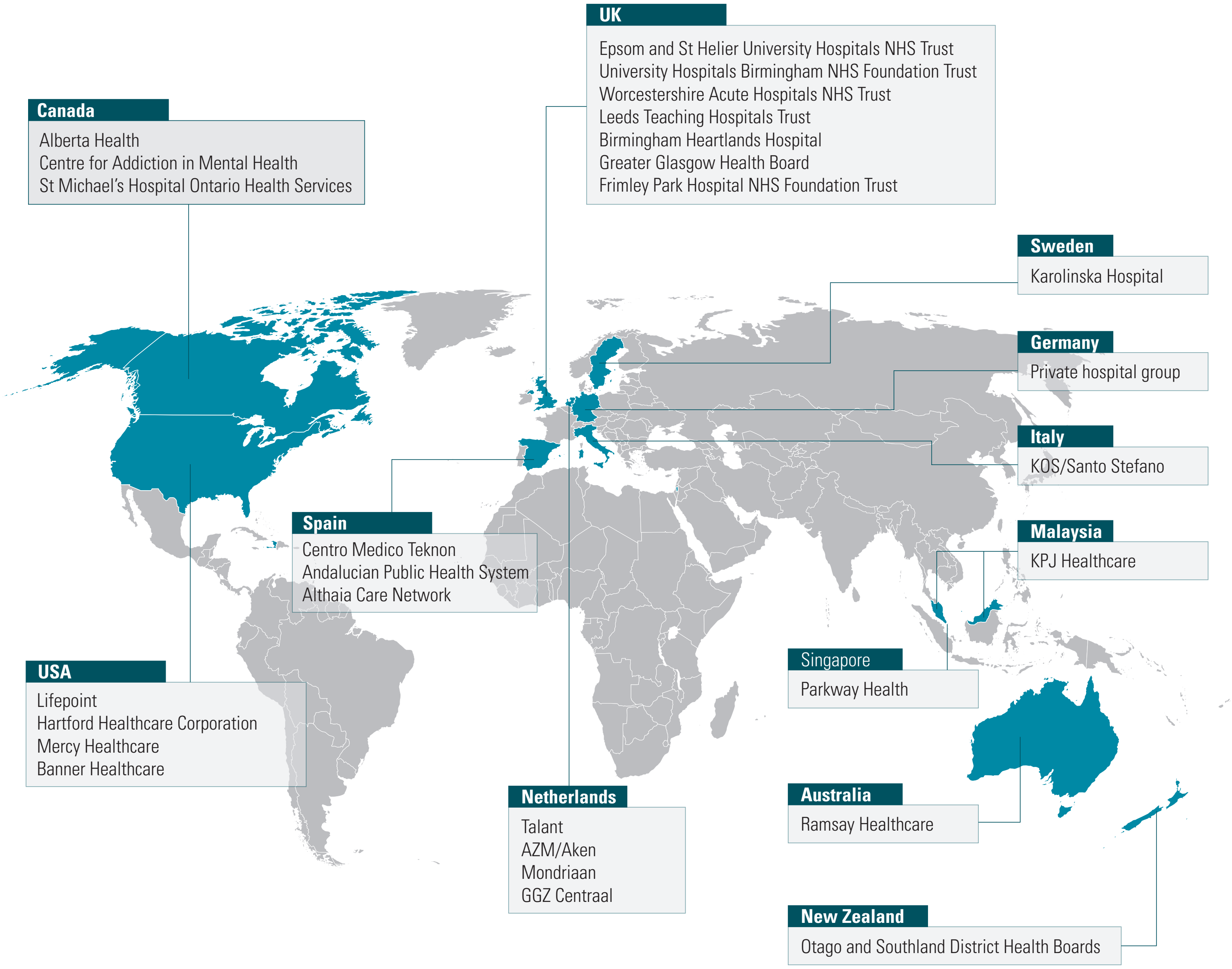
Taking the Pulse, KPMG International, 2011

Scope of research



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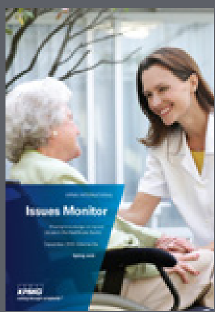

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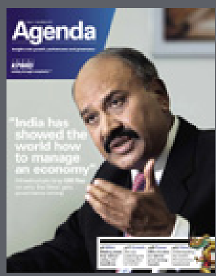

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