

After the Merger: A Strategic Framework for Integration

Signing the papers is only one in a series of events in a hospital merger. The actual operational and organizational integration of the merged parties can be as crucial to the ultimate success of the merger as is the structure of the transaction itself.

At a Glance

Three primary factors affect real post-merger integration:

- > Administrative and organizational rationalization
- > Service line integration
- > Clinical optimization

Hospital mergers, acquisitions, and closures have resulted in nearly 900 fewer hospitals in the United States today than in 1990 (American Hospital Association Statistics, 2007). And it appears that mergers and acquisitions (M&A) are on the upswing again. In 2006 alone, there were 57 M&A transactions involving 249 hospitals, up from 53 transactions involving 88 hospitals in 2005 (*The Health Care Acquisition Report*, 13th Edition, Irving Levin Associates Inc., 2007). Hospitals and health systems are affiliating for a variety of reasons, from increasing access to capital to reversing

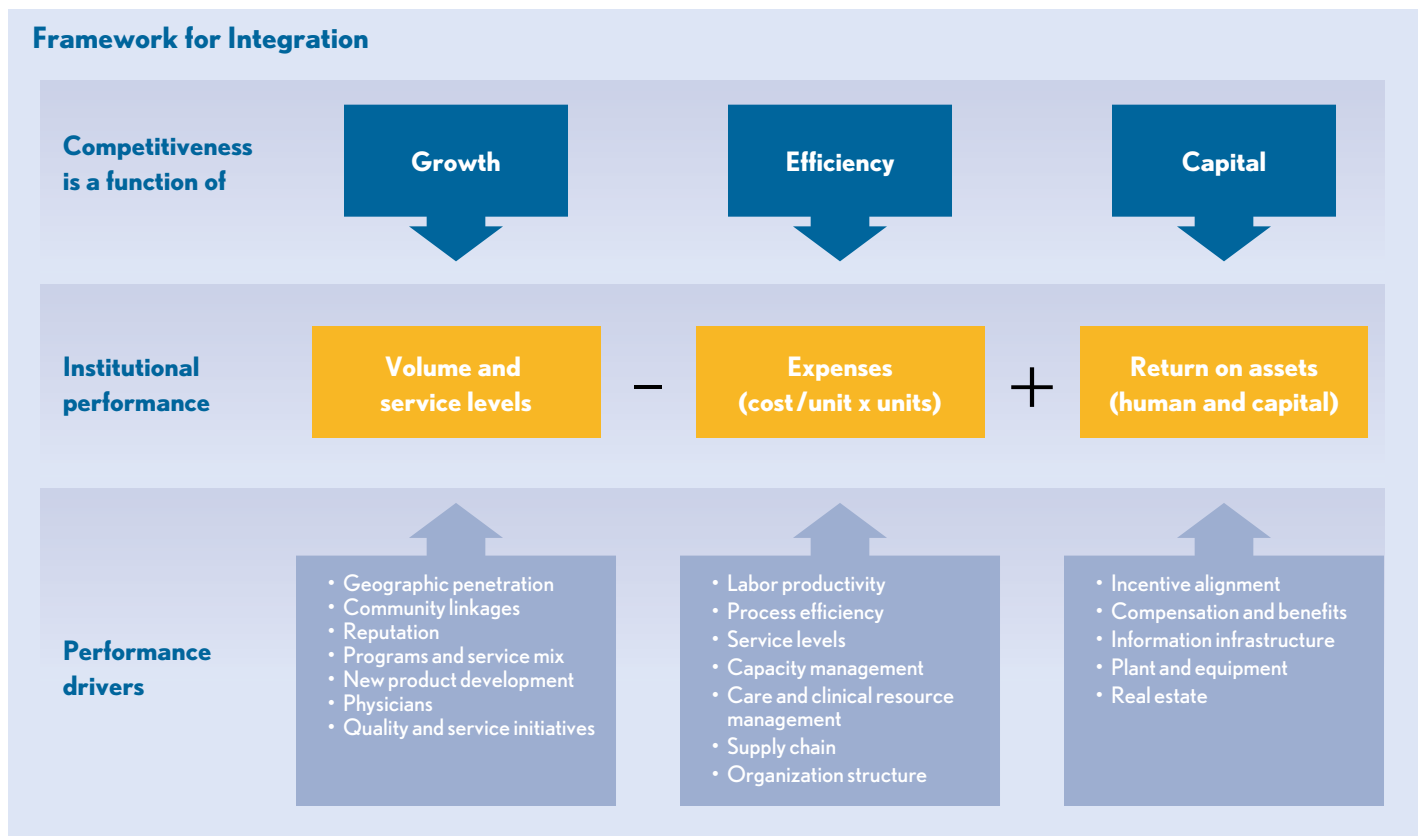
operating losses, to succumbing to public pressure to reduce costs, competition, and duplication of services.

How can management ensure that the necessary motivation exists for the merged organizations to achieve the economies, efficiencies, and improved service that they promise?

A Model for Post-Merger Integration

To understand any complex system or guide any strategy, a clearly understood framework is desirable. It is no different with planning for post-merger integration. We have found that a simple model reflecting the three key drivers of competitiveness—growth, efficiency, and capital adequacy—is a useful tool for developing an integration strategy (see the exhibit below.)

Growth. The first element of the integration framework, which should be addressed immediately, is growth to meet community needs. Growth is a function of the scope



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and mix of services provided and their associated volumes—the revenue-generating activities of the parties to the merger. Typical performance drivers of institutional growth include elements such as geographic service penetration, linkages with other community resources, and organizational reputation. These, in turn, are influenced by the capabilities of the organization, expressed in terms of its scope and mix of services; product and service synergies between the merging parties; business development activities; physician reputation, skill and specialty mix, and customer service and quality initiatives.

The growth element forms the *strategic* component of the integration plan and answers such questions as:

- > What are current levels of demand and how are they likely to change?
- > What capacity do we need to meet this future demand?
- > Where can we consolidate clinical services to achieve immediate efficiencies?
- > What should be our longer term plan for clinical care capacity?
- > Are there new programs or services that could be a growth engine for us?

Efficiency. The second element of the framework is improving the efficiency and effectiveness of the organization. Efficiency is a function of the number of resources being applied to the organization (such as labor, supplies, drugs, and equipment) and the unit cost of those resources.

There are a large number of drivers of performance related to efficiency and the interrelationships among them can be complex. Consider the question of labor productivity. Not only does one need to address the number and skill mix of staff, but also the work processes (which are likely to vary considerably between the parties), differences in labor practices (including the impact of collective bargaining agreements), and service level expectations.

A rapid move to streamline executive positions, eliminate redundant managers, and redesign the new organizational structure will yield demonstrable cost savings; it will also signal that a new and different entity is emerging, one that is more than the mere sum of its parts.

Capacity management practices also have a substantial bearing on organizational efficiency. Modeling the impact of service reconfiguration scenarios can result in improved utilization of beds and key clinical services, such as the emergency department and surgery.

Of particular importance and impact are the care management and clinical resource utilization practices of each organization. This can be a knotty problem to the extent that the medical staffs do not overlap and have been competitive, or when there are particular differences in care delivery models, such as a hospitalist program at one organization and a community physician attending model at the other. On the other hand, care management practices are primary drivers of efficiency and cost and should be a key component of the integration strategy.

Purchased services, including drugs and supplies, may represent opportunities for consolidation efficiencies, though with the limited number of group purchasing organizations and highly competitive item pricing between them, these opportunities may be limited. Other purchased services, such as service and management contracts, can be candidates for consolidation or elimination, yielding substantial year-over-year savings. Finally, one only needs to look at the organizational structures of many hospitals to see that mergers offer a wealth of opportu-

nity for reducing redundant positions, restructuring reporting relationships and spans of control, and realigning the organization for improved effectiveness.

The efficiency element is the first of two *tactical* components of the integration plan and addresses such questions as:

- > What organizational structure changes should be made?
- > What staffing plans should be implemented?
- > Where can we consolidate administrative and business functions to achieve immediate efficiencies?
- > What longer term opportunities do we have to achieve further efficiencies?
- > What operational or management contracts may provide opportunities for cost reduction?

Capital. The third element of the integration framework addresses capital adequacy to fund future programs and services. The focus of managing capital is improving return on assets, both human resources and capital, and flows directly from the organization's strategic priorities. Accordingly, human capital tactical plans regarding compensation, benefits, and incentive systems need to be evaluated and realigned for consistency and strategic fit across the merged organization. New ways of delivering care may necessitate innovations in traditional human resource policies, particularly if staff will rotate between organizational entities. Of course, there must be an explicit linkage between the new organization's strategic goals and objectives and executive and manager performance management and incentive compensation systems.

A further complex challenge in capital management concerns the organization's information infrastructure and how and to what extent financial, clinical, and management information systems will be integrated. In most cases, such integration will be important to the organization's ability to

achieve its goals and objectives and may be a linchpin to realizing clinical and operational consolidation opportunities. Finally, the integration plan must address how best to utilize plant, equipment, and real property.

Capital adequacy addresses such questions as:

- > How consistent should our human resource practices be between entities?
- > How should compensation reward performance?
- > What are the key information needs critical to our success?
- > To what extent do we have the information systems and technologies we need to guide us into the future?
- > Is our physical plant infrastructure sufficient for future growth?
- > Can we accommodate future volume without excessive capital spending?

Developing the Integration Road Map

The model described above provides a basic framework for integration, answering the question of *what* should be addressed in planning. However, a second step is necessary to identify and define *how* the integration should be accomplished. The analysis and assessment that occurs

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in this step is critical for ensuring that the promises made during courtship are fulfilled during the marriage.

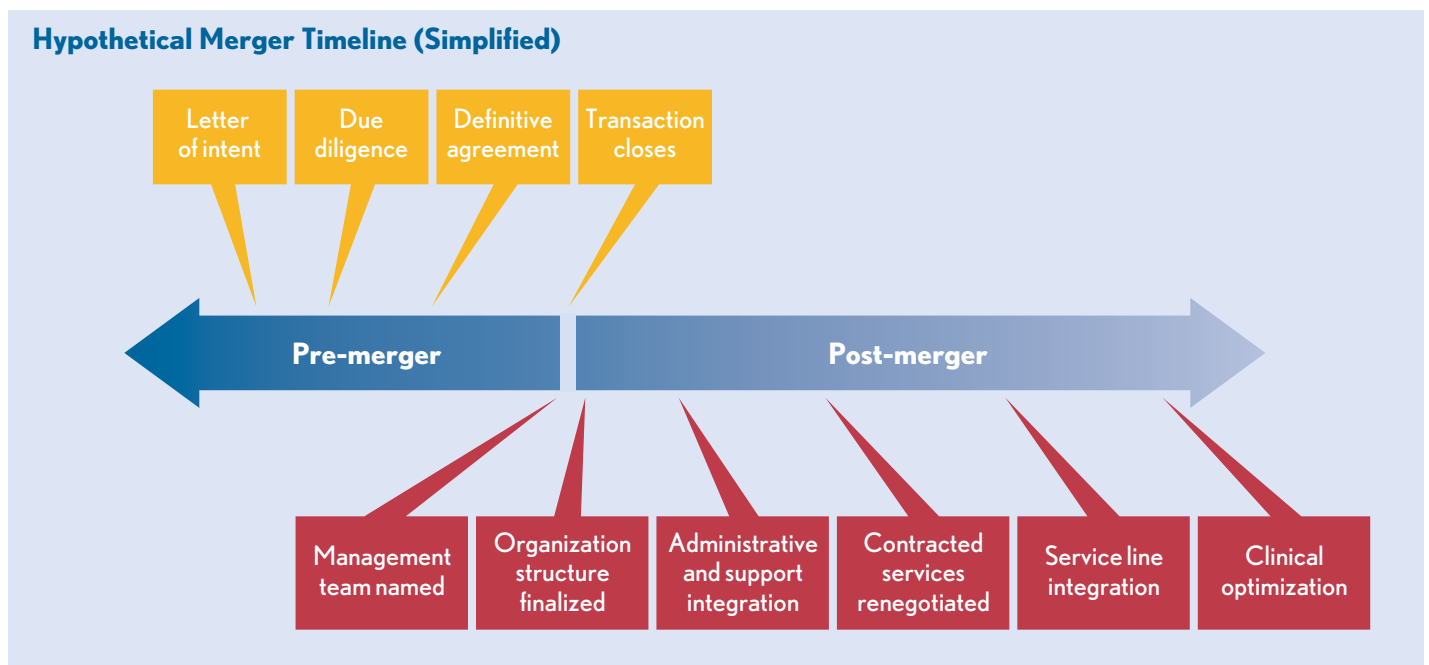
For those mergers undergoing anti-trust review, a key concern of the government is to what extent the planned efficiencies could be accomplished without a merger, and the motivation of management to actually enact the planned changes. There is hard evidence to support the contention that most merger efficiencies that are proposed are never actually realized (Joint FTC/DOJ Hearings on Health Care and Competition Law and Policy, April 2003).

Experience suggests that there are three primary categories of activity for effecting

real post-merger integration: administrative and organizational rationalization, service line integration, and clinical optimization. See the exhibit below.

Administrative and organizational rationalization. The most obvious and easiest goal to achieve is rationalizing the merged organization's administrative and organizational structure. A rapid move to streamline executive positions, eliminate redundant managers, and redesign the new organizational structure will yield demonstrable cost savings; it will also signal to the rest of the organization and the community that a new and different entity is emerging, one that is more than the mere sum of its parts.

Associated with the organizational realignment is consolidation and integration of administrative and support functions. Though physical consolidation is not always feasible or desirable, most merged organizations find that centralizing the business office (i.e., finance, patient accounts) and logistics management enables them to perform more efficiently and eliminate duplication; it also allows them to identify further opportunities for



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improvements in such areas as renegotiating supply contracts, centralizing drug formulary management, and rationalizing contract services (e.g., food service, maintenance, environmental services). Finally, administrative consolidation simplifies the pursuit of revenue and cash management improvement initiatives.

Service line integration. Integration of service lines is the next logical step in developing the integration road map, and necessarily follows organizational realignment. Although indicated as a point in time in the exhibit on page 20, service line integration actually may require months or years to accomplish, depending on a wide variety of factors, such as the nature and scope of services provided, cultural and political realities, and physical infrastructure. Nevertheless, for organizations to truly achieve merger economies, this is a critical activity requiring substantial forethought and planning.

Service line integration addresses such questions as:

- > Can we consolidate certain services at location X?
- > What effects would this have on referrals?
- > Should we have a complete duplication of services at each entity, or should one entity specialize?
- > Is the idea of organizing core- and-satellite services (e.g., for pharmacy or laboratory) feasible?

Clinical optimization. Implementing best clinical and operational practices enabled by information technologies, represents the third and most ambitious category of

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activities on the integration road map. It requires having a uniform IT platform and advanced clinical applications across the entire enterprise, as well as standardizing clinical and business processes. The benefits of clinical optimization are typically measured in terms of improvements in quality, patient safety, and physician and staff satisfaction. Although these are longer term benefits of post-merger integration, they should be explicitly identified and defined in pre-merger objective setting.

The Role of Culture

Left out of the discussion thus far has been the role of culture in integrating previously separate organizations. All successful mergers create a new organizational culture; in fact, the strategy set by the governing board will dictate many of the elements of the emerging culture. To a large extent, the integration road map will shape that culture, as well as partially reflect the cultures of the legacy organizations. The ultimate success of the merger will depend not only on how well planned the integration strategy is, but on how engaged and committed leadership is to building a supportive culture to achieve the new organization's strategic objectives.

A merger integration strategy is a thoughtful and comprehensive approach to identifying and deploying the right tactics to achieve organizational and administrative integration, service line integration, and clinical optimization. An effective integration plan must balance growth, efficiency, and capital requirements through a systematic and critical analysis of organizationwide performance drivers. The result can be used as a road map to guide management toward a successful organizational integration. ☞

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