The Coalition for Behavioral Health

Business Recovery Initiative

Using Mergers, Acquisitions & Affiliations To Address 'Urgent' Cashflow Needs

The Coalition for Behavioral Health's Business Recovery Initiative

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OPEN MINDS

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Agenda: Using Mergers, Acquisitions & Affiliations To Address ‘Urgent’ Cashflow Needs

1. Context
2. Is a business combination the right choice for my organization?
3. How do I find the right partner?
4. What steps are involved in a merger?
5. What key factors lead to successful combinations?
6. Is a crisis the right time for a merger, acquisition, or affiliation?

1. Context

Market Drivers Of Consolidation

Focus On Care Coordination & Service Integration	Increase In Selective Contracting & Narrow Networks	Movement To Value-Based Reimbursement Models	Consolidation Of Payers & Large Provider Organizations	Economic Recession & Extended Uncertainty Related to COVID-19
• ACOs • Health homes • New roles for provider organizations – comprehensive versus specialist	• Preferred provider status • Centers of Excellence • Statewide and multi-state contracting	• New technical capabilities • Population health management • Data-driven outcomes strategies	• Increased vertical integration • Economies of scale—minimize geographic barriers and increase access to technology	• Increased costs for staffing and safety • Extended projection of impact drives need to assess long-term sustainability

Economic Recession & Extended Uncertainty Related To COVID-19

Rising Deficits Will Drive Reductions In Social Spending

- Medicaid budgets will be reduced
- Budgets for other social determinants will be reduced

Health Care Costs Will Increase

- More uninsured due to unemployment
- Focus on cost containment through managed care and VBR

Economic Bust Will Be Extended

- The Congressional Budget Office has projected that it may take 10 years for economic growth to reach pre-2020 levels

Organizations with weak balance sheets and low profit margins need to consider significant long-term sustainability strategies to preserve their mission.

Business Combinations: Mergers, Acquisitions & Affiliations

Financial incentives drive M&A in for-profit organizations. However, it is often financial challenges and long-term sustainability that motivate non-profit leadership to consider new organizational structures.

“When sustainability is viewed as being a matter of survival for your business, I believe you can create massive change."

- Cameron Sinclair

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The For-Profit Sector

- Key drivers in health care mergers focus on implementing new technologies, consumerism, and competitive positioning.
- Market expansion with a focus on the bottom-line and cash flow are key considerations.
- Private equity firms are seeking value-based care models and consolidation of “fragmented” markets.
- Key health care market subsector focus has been on long-term care, intellectual and developmental disabilities, and autism services.
- The average margin of acquiring companies was 12.8%.

The Non-Profit Sector

- There are 1.5 million non-profit organizations in the U.S., with total revenue of $428 billion.
- Almost 9 out of 10 non-profits spend less than $500,000 annually, with 80% of revenue from government grants, contracts and fees for services.
- In a recent study of non-profit mergers, 88% of participating organizations reported that they were better off after the merger.

2. Is A Business Combination The Right Choice For My Organization?

Factors That Create Economic Value In An Organization

- A history of strong revenue growth with adequate cash and a strong balance sheet
- A key player in your market (however consumers and payers define it)
- Significant barriers for competitors entering your market
- Strong talent in executive and management teams
- Diversified revenue
  - Services provided
  - Consumers served
  - Payer sources
  - Geographic footprint
- Stage in the innovation cycle and market demand for current services
- Potential for technological substitution

These factors are important to both “buyers” and “sellers”

How does your organization look to interested parties?

Lexicon Of Business Combination Terms

- **Merger** – a combination of two organizations into one structure where the legal structure of one, or both, organization does not continue
- **Acquisition** – a combination of two organizations where one organization purchases the assets or stock of another organization
- **Affiliation** – an agreement where two organizations with separate legal structures work together with varying combinations of governance, leadership, and asset sharing
- **Joint Venture** – a commercial enterprise of two or more organizations that retain their separate legal structures
- **Stock Purchase** – an acquisition of an organization by purchasing stock (including organizational identity and potential liabilities)
- **Asset Purchase** – an acquisition of specific assets of another organization, but not the corporate identity

Impact Of Business Combination Types

Joint Venture → Affiliation → Merger → Acquisition

- Collaborative
- Lower Risk
- Greater Autonomy
- Less ROI

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- Efficient
- Higher Risk
- Less Autonomy
- Greater ROI

Urgent business combinations increase risk and ROI

Why Pursue M&A As A Strategy?

Economies Of Scale/Reduced Costs Per Unit	Expansion Of Services	Expansion Of Geographic Reach
Opportunity To Rebrand	Enhanced Collaboration / Population Health Opportunities	Increased Internal Talent
Increased Opportunities For Innovation	Better Infrastructure & Technology	Enhanced Opportunities For Payer Contracting

Is Economic Scale Enough For Success?

1. Economic scale can make larger organizations more efficient as costs are spread over more services—resulting in a lower unit cost.
2. Size alone doesn't matter—it needs to be combined with strategy, efficient operations, quality systems, and key performance factors.
3. Organizations need to be careful to not lose focus on innovation and nimble leadership as they grow larger.
4. Informed strategy, targeted synergies, clear performance outcomes, and effective execution are key success factors.
5. Many large organizations don't achieve the efficiencies of scale because they have too many different programs that prevent leverage of their infrastructure.
6. A key goal of scale is increasing your "talent" ratio.

Synergy – the concept that the combined organization has greater potential than the original organizations alone

Revenue Synergy – an opportunity where two combined organizations are able to earn more revenue than as separate organizations

Expense Synergy – an opportunity where two combined organizations are able to reduce expenses

Strategies For Sustainability & Growth

- Organic Growth (Build) – takes longer to build scale (how critical is speed to market for new services?):
  - Service line development expertise
  - Capital and talent for geographic expansion
  - Capital for technology investments
  - Talent acquisition capital and strategies
- Inorganic Growth (Buy) – can be implemented faster, but carries potential risks and post-implementation
  - Merger
  - Acquisition
- External Growth/Impact (Partner)
  - Strategic alliance
  - Joint venture
  - Franchise / Licensing

In the ever changing market, every organization needs a plan for innovation, growth and sustainability. The big question is:
Do you build, buy, or partner?

Examples Of Provider Business Combinations

Questions to consider in determining the best business combination for your organization:

- What type of combination works best for your strategy?
- Will you plan to continue to be a specialist?
- What path will enable you to provide integrated services?
- If you are being acquired, what structure best supports your mission?

Merger – Two Non-Profit Providers	Merger – Non-Profit Specialty & Primary Care Providers	Acquisition – For-Profit Of For-Profit Provider	Acquisition – Non-Profit Of For-Profit Provider
Joint Venture – Two Or More Non-Profit Providers	Affiliation – Two Or More Non-Profit Providers	Administrative Service Organization – Multiple Providers	Acquisition – Non-Profit Health System Of Specialty Provider

Key Question To Consider – Acquiring Organizations

1. What are your goals for the acquisition?
2. What is your organizational culture, and how will you assess the cultural fit of the other organization?
3. What talent do you want to bring into your organization?
4. How will you identify potential organizations to acquire, and how will you confirm they align with strategic market objectives?
5. Who will you choose as your external implementation team?
6. How will the acquisition be funded?
7. How will I bring my board, executive team, managers, donors, and other stakeholders into the process, and when?
8. Who will drive the post-merger integration?

Key Question To Consider – Organizations Looking To Be Acquired

1. What are your goals for being acquired?
2. What is your organizational culture, and how will you assess the cultural fit of the other organization?
3. What talent do you want to ensure continues in the organization?
4. What role do you want in the new organization?
5. How will being acquired impact board and stakeholders, and what communications will be needed?
6. How will you identify potential organizations, and how will you confirm they align with goals for being acquired?

3. How Do I Find The Right Partner?

Finding A Partner

Formal Strategy – merger is an active strategy

1. Define criteria for a merger partner
2. Engage a merger “facilitator” to identify potential partners that meet your criteria for the target list
3. Reach out in a “blind” offer, or open communication
4. Vet the potential partner
5. Proceed with the merger process for those potential partners that appear to be fit
6. This strategy can be used for finding partners seeking both strategic and “urgent” mergers

Opportunity Knocks – merger is a goal, but no process is in place until an opportunity presents itself

1. Another organization reaches out to you
2. Awareness of struggling provider organizations
3. CEO retirements in potential partner organizations
4. Economic or market changes that challenge the sustainability of previously successful organizations

Considerations For Assessing Partner Fit

1. What are your goals for pursuing the merger?
   - Provide new service lines
   - Expand geographic footprint
   - Acquire needed talent and expertise
   - Create greater impact – contract negotiations, licenses, branding
2. Identify organizations that meet the target criteria
   - Mine local contacts
   - Use the services of a “matchmaker”
3. Initial outreach and discussions
   - “Blind” offer letter
   - Non-disclosure agreement
   - Exclusivity agreement
   - Determine of “Go/No Go”

Eyes Of The Buyer (EOTB)

Steps by both organizations to “clean house”

1. Identify and address issues that will be of concern to the other party
2. Prepare and recast financial statements and forecasts – by service line, geography, and payer mix
3. Address employee issues that have been overlooked
4. Address any current or potential legal issues
5. Summarize contracts and grants
6. Review policies, procedures, and documentation that will be needed to address questions of the other party

Questions to consider:

- Seller: How do we add value to the new organization?
- Buyer: How do we meet their goals for selling?

4. What Steps Are Involved In A Merger?

Key Considerations For The Merger Plan

1. The size, service lines, and location of the ideal merger partner
2. The source of funds and budget for the merger plan
3. The method for locating potential merger partners
4. The desired outcomes of the merger – service expansion, integration, revenue expansion, talent acquisition, profit margin
5. The communication plan for each stakeholder – executive team, managers, board, donors, community
    - Caution: A key factor in some failed mergers is not informing and involving key stakeholders in the process (too early, or too late)
6. The acquisition team
7. Marketing plan to address the perceptions of consumers and the community

Assembling The Merger Team

A successful merger needs an experienced team with the necessary expertise to keep the process merger, reduce risk, and maximize the final value:

- Merger Facilitator – may play a number of roles in the process; market intelligence and strategy, identification of potential organizations, recommended business combination, facilitator of communication
- Legal Counsel – ensures that both parties understand all legal ramifications to make informed decisions, ensures compliance with all regulations, reduces risk by providing legal counsel, prepares all formal documents
- Financial Counsel – prepares and/or reviews financial reports, advises on regulatory, reporting any tax issues, and may be involved in estate planning or compensation structuring in for-profit acquisitions

Letter Of Intent

1. The legal document that moves the parties from consideration of a merger to an agreement to work together on the merger framework – it moves the parties from concept to commitment.
2. The agreement will contain binding and non-binding terms.
3. Identifies the type of business combination to be implemented.
4. Sets the expectation of confidentiality on the part of both organizations.
5. Identifies an overall schedule for moving the merger along – timeline, access to records, due diligence schedule, internal and external communications.
6. For urgent mergers, this is an opportunity to ensure that the need for full disclosure is documented and that the timeline is sufficient, but no longer than necessary.

Due Diligence

- The process of looking carefully at the documentation of the organization to ensure that the strengths, weaknesses, risks, and opportunities agree to expectations.
- Full disclosure is necessary for due diligence – an atmosphere of trust and accountability most be provided by both organizations.
- Checklists of key areas of operation drive the process:

1. Legal documents
2. Financial statements for analysis
3. Billing, collections and revenue cycle management
4. Human resources policies, procedures and key productivity measures
5. Organization chart and talent management
6. Contracts and grants with payers
7. Property titles and documentation
8. Operating and quality management

- The goal of due diligence is to ensure that all risks have been identified and the plan for a successful merger can be implemented.

Post-Merger Integration

1. Have an integration plan developed by the time you close the deal
2. Align performance expectations around the reason for the merger—set quantifiable performance goals for the consolidated information and track them
3. Commit to one culture
4. Resolve power and people issues quickly—pick the team with enthusiasm for the new vision
5. Develop detailed implementation plans for every aspect of the business operation—with realistic expectations of the pace of each change (finance, tech, branding, web site, marketing, service line definitions, HR, physical plant decisions, etc.)
6. Have a designated integration project manager to coordinate the many moving parts (this is parallel to the project manager for a new tech implementation) —and pick a select group of executive sponsors for the integration team
7. Employ change management best practices to win “hearts and mind” of the staff on both sides—communicate a consistent vision
8. If you plan to do more mergers, develop a "repeatable" implementation model

5. What Factors Lead To Successful Combinations?

Combination Success Factors

1. Insight for planning business combinations as a strategic element of growth and sustainability, instead of a reaction to financial or leadership problems
2. Knowledge about business combinations and how to approach, plan, and implement them
3. Clear insight into the ideal merger partner, and a process for identifying and assessing potential partners
4. Adequate funds for partner selection, due diligence, and post-merger integration
5. Assembly of a knowledgeable, experience merger implementation teams (external and internal)

Factors That Contribute To Merger Failure

1. Allowing personalities and emotional issues to derail the process—don't underestimate the importance of organizational history, name, and brand to some stakeholders
2. Failing to get "buy-in" from key stakeholders—board, executive team, management team, donors, community partners
3. Talent needed for success in the new organization is missing
4. The two previous cultures are not aligned
5. Significant organizational risks and challenges missed during the due diligence process
6. Inability to execute post-merger activities and achieve the potential synergies

Key Emotional Issues That Can Derail A Merger

- Who will be the chief executive officer of the merged organization?
- What will the be the name of the merged organization?
- What will be the board composition of the merged organization?

6. Is A Crisis The Right Time For A Merger, Acquisition, Or Affiliation?

Mergers To Address ‘Urgent’ Cash Needs

1. During a weak economy, some combinations are driven more by survival than by growth.
2. A merger can be a path to financial solvency brought on by the crisis, and preserves the mission and services to consumers and creates a sustainable profit margin.
3. Careful consideration of the best legal structure is crucial to limit potential liabilities.
4. The due diligence process cannot be rushed even if the organization being acquired has urgent cash needs.
5. Projected financial balance sheets and income statements of the combined organizations with obtainable assumptions are necessary.
6. Emotional topics and potential “deal breakers” need to be identified and addressed even though there are urgent cash needs.

Opportunities For 'Acquiring' Organizations With Urgent Cash Needs

- A "failing" organization that may not be able to continue services long-term
- An organization seeking to be acquired
- A competitor organization with talent, reputation, and a strong culture where there have been ongoing discussions about a potential merger
- A competitor organization whose chief executive officer is retiring
- A primary care or other specialty provider organization that has been negatively impacted by the current crisis, but can complement your current services

Questions to consider:

1. Are the cash issues related to outdated contracts, culture, poor leadership, or lack of economic scale?
2. Will the acquisition have a positive impact on organizational mission?
3. Is there sufficient time for a thorough due diligence process?
4. What will the balance sheet look like after the merger?
5. Does the cost structure and related unit costs support sustainability and profitability after the merger?
6. What is the best type of combination to maximize opportunity and minimize risk (i.e., merger, stock purchase to create for-profit subsidiary, assess purchase)?

Opportunities For ‘Selling’ Organizations Because Of Urgent Cash Needs

- There is sufficient cash for a short-term crisis, but not to weather a sustained recession.
- The organization has talent and effective services, but lacks the capital to grow.
- Leadership is burning out because of the growing complexity of operations and market changes.
- The long-term chief executive officer is preparing to retire and the organization lacks the resources to hire leadership talent for the increasingly complex market.

Questions to consider:

1. Can the mission to the community continue to be served in the new organizational structure?
2. Does the culture of the acquiring organization align with the current organization?
3. Is there a place in the new organization for current talent?
4. Are there merger options that can continue the organizational name, brand, or relationship in the community (i.e., program, subsidiary, affiliation, etc.)?
5. Does the impact of the crisis remove obstacles (board members, donors, stakeholders) that prevented past merger discussion?

Steps To Assess ‘Urgent’ Mergers

1. Create an implementation plan with a systematic process
2. Use experienced talent – market intelligence, “match maker”, finance, and legal
3. Confirm the motivations of each party
4. Perform adequate due diligence
5. Engage stakeholders at the right time for their input and buy-in

The *OPEN MINDS* Approach To Assessing Collaborations

1. Determine the organizational goals and a collaboration model based on organizational needs
2. Review and assess the organizational diversity of revenue sources, service lines, profitability, debt ratio, and cash
3. Assess the current market trends and funding patterns
4. Create a "Go Forward" plan with the structure for the ideal organizational collaboration
   - Collaboration types with pros, cons and strategic considerations
   - Ideal structure and needed elements for success
5. Identify potential collaboration partners

Questions From Our Clients

1. How can our organization consider a merger when we are so focused on managing the current crisis?
2. Is it a good idea for a non-profit service organization to own a for-profit subsidiary? What issues does this create?
3. We are a behavioral health organization. What are the "best" opportunities for merging with, or acquiring an organization?
4. What role should the board play in the merger process?
5. When is the best time to involve the executive team in merger discussions, and how do we manage the risk of talent "jumping ship"?
6. Isn't it risky to move ahead with a merger with the uncertainty of a potential recession?

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RESOURCES

- *Private LinkedIn Discussion Group:*
  - https://www.linkedin.com/groups/12422327/

- *Toll-Free Phone for Technical Assistance*
  - 833-888-0219
    - *Pro-bono, one-hour consultations available for Coalition and ASAP members*

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