

Deal Mania –All the Rage Perhaps Some Folly!

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A bridge is bad if it is shorter than the width of the stream.

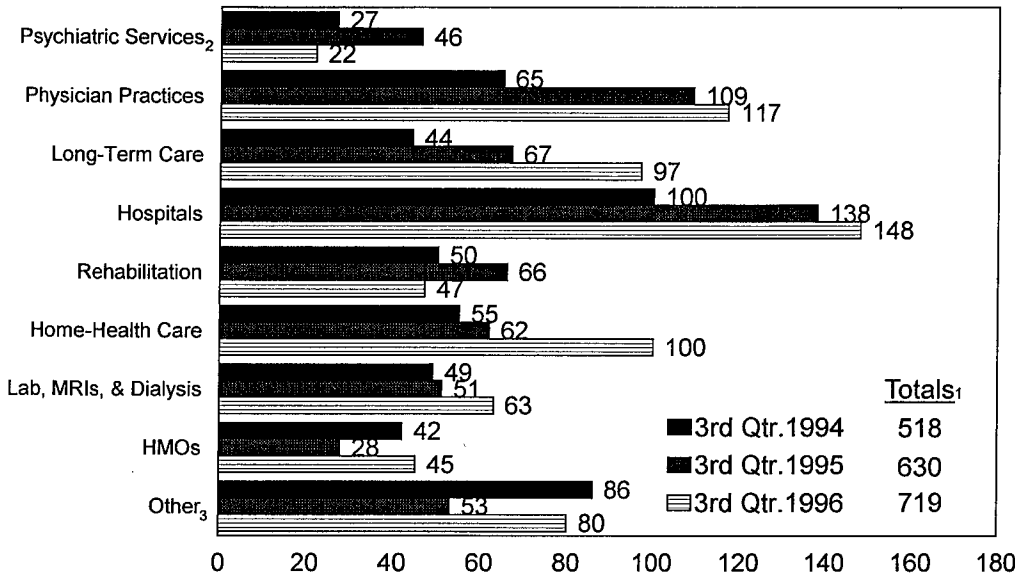
— German Proverb

1996 has seen acceleration in healthcare mergers and acquisitions, similar to the trend occurring in other industries. The end of the year was punctuated by Boeing's \$13.3 billion dollar offer for McDonnell Douglas. As of December 17, 1996 the "deals done" in 1996 came to almost \$630 billion, surpassing the record of \$518 billion set in 1995.¹ Additionally, Wall Street set debt and equity records in 1996. Initial public offerings raised \$50 billion, twice as much as was raised in 1995, and 20% more than the previous record of \$41.5 billion, set in 1993. The number of initial public offerings in 1996, 866 through December 20, was also a record.² Venture funds were active as well. They invested an estimated \$10 billion in small businesses in 1996. However, that money was invested in only a small fraction of the 700,000 new businesses that were incorporated during the year. Most of the money went to high-tech or health-care companies that have fast-growth potential.³

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Focusing specifically on the health care industry, reports indicate that there were 271 "deals" in the 3rd quarter of 1996 — a 14.8% increase over the previous quarter and 50.5% more than the third quarter of 1995 (Figure 1). In specific, hospital mergers and acquisitions during the 3rd quarter of 1996 were approximately 44% higher than the same period a year earlier with more transactions occurring in the Northeast than had been seen in the past (Figure 2). In the not-for-profit arena the "deals" were fueled by discussions of "strategic fit" and "negotiating advantage" and the need for "integrated delivery systems." In the investor-owned world, a strong investor response to announced deals spurred more mergers and CEOs saw deals being rewarded in the marketplace.⁴ A trend toward global markets made some feel that they would be left out if they didn't get bigger. Indeed, the standard business response to uncertainty appears to be "bigger is better." Never mind that the efficiencies and productivities of the mergers are yet to be recognized or that there is a tremendous challenge in blending the cultures of different businesses even in situations of strategic fit (e.g. hospitals and medical professional practices may fit, but they are certainly different businesses with different cultures and different management requirements). In fact, the business world is replete with examples of megadeals that don't always create the best shareholder value. Mercer Management, which is performing research on this subject is finding that

Figure 1. Total Mergers and Acquisitions



1. Transactions are tracked by date of announcement, rather than by date of completion. 2. Includes substance-abuse facilities, managed behavioral-health businesses, and psychiatric hospitals. 3. Includes such health-care businesses as outpatient-surgery services, ambulance and disease-management services, hospices, institutional pharmacies, and pain-treatment companies.

Source: *The Health Care M&A Report, Third Quarter, 1996* and *The Health Care M&A Report, Fourth Quarter, 1995* Irving Levin Associates. Medical Economics, November 11, 1996.

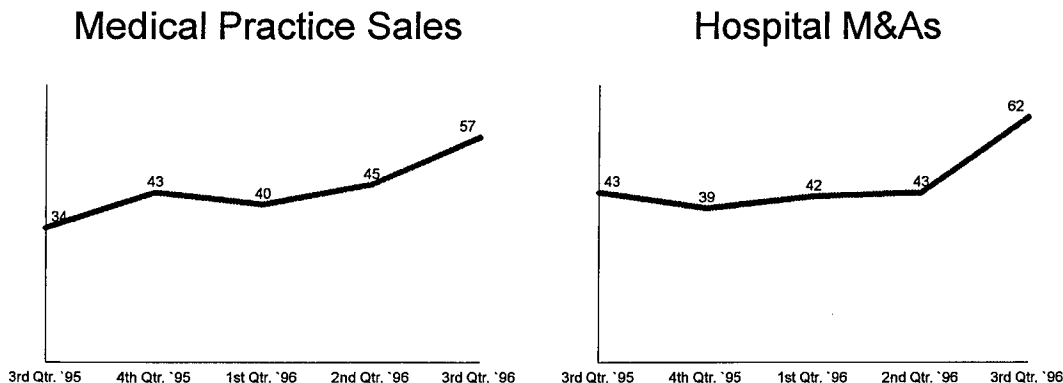
after 3 years only 25% of the big deals created returns for shareholders that beat industry averages.⁵

With the above in mind and whatever the deal before you as a practitioner, clinic, department or health system, and no matter who is involved, it is probably reasonable to consider these basic tenets.

1. Don't do any deal you don't fully understand. There is an old adage that frequently holds true: "the big print giveth and the small print

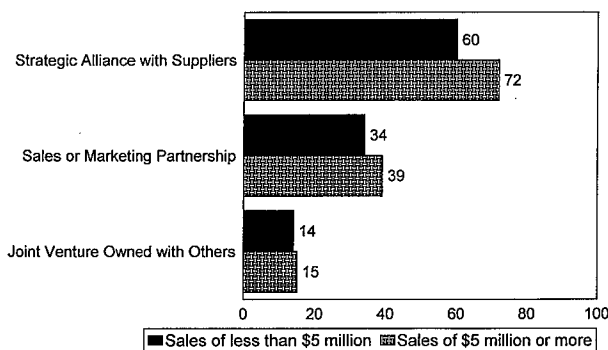
taketh away." You will need expert help in deciphering contracts and strategies and shouldn't hesitate in requesting your advisors to assist in assessing the situation. It is critically important to know exactly what are your responsibilities and what are the responsibilities of the other party. What rights belong to whom and the duration of the contracts and control/ownership issues. The more complex the arrangements, the more the likelihood for misunderstanding if you don't analyze the situation carefully.

Figure 2. Medical Practices and Hospitals



Source: *The Health Care M&A Report, Third Quarter, 1996* and *The Health Care M&A Report, Fourth Quarter, 1995* Irving Levin Associates. Medical Economics, November 11, 1996.

A survey of 437 fastest-growing companies shows that half collaborated with outside partners to create products or services, generating 23% more new offerings than those that went at it alone.



Source: Coopers & Lybrand

Figure 3. Alliances — Partnering Payoffs

2. Be suspicious of deals requiring significant amounts of money up front. Possession remains 90% of the law. Whether you are bargaining services, your practice, rights granted or anything exchanged, one needs to be aware that you are intensively involved in a give and take situation. It is preferable to stage exchanges over time, thereby avoiding giving up important issues and items at once.

3. Be wary of a deal you are urged to do in a hurry. Shot gun marriages do not have a high success rate. Long-term deals take courting and careful deliberation on both sides. The ploy of pushing for a rapid decision often is aimed at not letting you think about options carefully. There are always options.

4. Avoid doing deals with people, organizations or companies you do not know well or do not share your values or long-term view. This is really a very important point. It is at the heart of successful long-term relationships. Take time to review the management team. Who are they? What are their backgrounds? How long have they been in healthcare? Do they understand your business and practice? (N.B. much of the funds from venture capitalists entering the healthcare field have been in businesses felt to be able to provide a quick return. Traditional medical practice is a low margin, long-term undertaking). What has happened to those businesses or practices they have managed or operated previously? The success of mergers and various deals are very often the result of how the merger or deal is managed. In real estate and retail it may be location, location, location, but in a service business like healthcare, our experience would suggest it is

more management, management, management and *people, people, people!*

5. Be suspicious of the flattering “make you feel good” smooze or manipulation. While it is quite possible for an old competitor or adversary to become a reasonable partner in a new relationship, be aware that as the saying goes “cats don’t change their stripes readily.” Culture and personalities are ingrained over years of experiences.

6. Avoid the deal that sounds too good to be true — it probably is. Remember that successful undertakings are a careful blend of hard work, sacrifice, attention to detail, skill, talent and sometimes a good dose of luck. Healthcare, by its very nature entails long-term relationships.

Finally, it may be very reasonable to give careful thought to ways of leveraging your practice or medical business without necessarily having to undergo a merger or acquisition. There is much to be said for strategic alliances and networks and creative partnerships. The business world has learned these lessons and appreciates the fact that it may not be necessary to own it all (Figure 3). If one does pursue the partnering or alliance approach keep the following points in mind:

A) Partner with major players who have developed a good reputation and experience base.

B) Commit to high quality and accountability.

C) Attempt to form partnerships that compliment your activities. A partnership of two weak entities does not necessarily make a strong entity.

D) Standardize processes that eliminate cost and waste.

E) Be pragmatic about your market and the community or segment of the community you serve.

F) Commit to a pragmatic view of what it is you provide. In general, healthcare delivery and the business functions associated with it should take a long-term approach that benefits the ultimate customer — the patients and those who seek our help.

Cui bono?

Who stands to gain?

- Cicero

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