

Are You Ready for the Next Wave of Healthcare Provider Consolidation?

Alan M. Zuckerman, FACHE, FAAHC, for HealthLeaders Media, March 20, 2008

A second wave of healthcare provider consolidation is on the horizon, rivaling what occurred in the 1990s and is guaranteed to bring a new round of challenges and opportunities for providers across the country. Although the number of mergers and acquisitions has been modest for the past five years, six key environmental forces are converging to create a new tidal wave of consolidation.

Insurance industry consolidation. Consolidation in the health insurance industry is creating fewer, larger companies and an increasing imbalance of power between these large companies and the fragmented providers with whom they negotiate contracts.

Tightening capital markets. While the capital needs of providers are growing rapidly, the worsening of the overall industry balance sheet and poor national credit situation, such as the subprime crisis, bond insurer poor financial performance, means that capital access will tighten and be less available to many.

Expense increases outpace reimbursement. Continuing inflation and flattening public and private payor reimbursement, combined with escalating uncompensated and undercompensated care, will undermine the financial situation of vulnerable organizations.

Workforce shortages. Growing workforce shortages combined with the changing recruitment markets, favor larger, well-heeled organizations that can compete for personnel in a broader market.

Physician practice dynamics. Physician shortages and the fact that physicians entering practice want employment, either by hospitals, systems, or large medical groups, also favor the larger organizations that can support such structures and put smaller hospitals at a substantial disadvantage.

Large number of financially fragile providers. The growing gaps between the financially strong and weak will widen with a disproportionate impact on small, inner-city and rural organizations. The inevitable consequence is that failures and consolidations will escalate.

In this more volatile environment, some leaders can position their organizations as consolidators, while many others must be realistic about their likelihood of survival if they go it alone.

Most health systems have flourished for the past several years, benefiting from a generally healthy economy, both inside and outside of healthcare, and a return to sound business fundamentals. Marginal operations have been pruned, focus has returned to core businesses, and a number of years of solid performance have strengthened these organizations.

In the next few years, many will have the opportunity to become a consolidator--either locally or nationally.

Can or should your organization be a consolidator?

Part of the answer lies in the impact of market forces in your community and region. How consolidated are and will be the insurance companies? How able is your organization to manage the capital access situation? What is the underlying financial strength of your hospital or system?

The nature of the opportunities available will be another important variable. Perhaps of greatest importance when deciding whether to be a consolidator is your ability to scrutinize each deal to see if it brings clear, significant revenue growth and expense reduction benefits. Unlike the last wave of consolidation in the 1990s, speculative, hypothetical benefits or the lack of vigorous pre-merger planning and post-merger implementation could lead to failure rather than just underperformance.

For organizations unable to take on the consolidator role, the issue will be one of survival and, if so, in what form. Healthcare organizations tend to avoid giving up their independence and autonomy until the organization is bankrupt or nearly so. Under these circumstances, attracting a partner can be grueling and reversing the organization's downward spiral, even if a partner exists, can be nearly impossible.

Weaker organizations must seek partners while they still have value. Nonprofit hospitals should emphasize continued service to their communities--not autonomy or protecting individual facilities. Continuation of mission is the essence of responsible governance. By recognizing when to come in from the cold, providers maintain some negotiating leverage in merger and acquisition situations and their missions are much more likely to survive in a reasonable form.

As systems grow and expand over the next five to 10 years, the industry must manage this change in a more business-like manner than the previous wave of consolidation. To maximize the chances for success, providers should drive toward six main categories of benefits:

- Capital rationalization and access
- Cost reduction
- Access to scarce personnel and expensive technologies
- Revenue enhancement
- Quality improvement
- Improved care for the vulnerable

Ensuring that management processes are in place to secure these benefits, post-merger and acquisition, means that this next surge of consolidation, while disruptive and unsettling, could ultimately lead to stronger, healthier, sustainable healthcare organizations that are better suited for meeting community needs.

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