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Does your integration playbook tackle tomorrow's M&A challenges?

Health care

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Delivering growth with end-to-end patient care

The health care sector is actively experimenting with increasingly integrated care delivery models. Rather than remaining a loosely linked set of health care services, the sector is realigning and restructuring itself strategically to deliver seamless end-to-end patient care.

The pieces in this end-to-end model include outpatient clinics and urgent care centers, primary and subspecialty care clinics, hospitals, rehabilitation facilities, home health care, and hospice services. All of these provider systems are increasingly linked more closely with payors and retail (e.g., pharmacies). But, even as hospital networks, payors and others providing health care services battle to expand and integrate, successful new business models will continue to evolve over the next several years.

An aging population, the evolution of patients into consumers, reimbursement pressures, a flood of new data and medical inflation are all disrupting the US health care model and pushing US health care businesses toward consolidation and convergence. They are looking to capture economies of scale and to deliver more coordinated care in order to drive improved outcomes and increased health care value.

With annual health spending projected to hit US$5.7 trillion by 2026, up from US$3.5 trillion in 2017[1] — and health's share of GDP expected to reach 19.7% by 2026[2] — substantive shifts in dollars could have a significant impact on the broader economy.

1 *National Health Expenditure Projections 2017–2026*, Centers for Medicare & Medicaid, U.S. Department of Health and Human Services, 2018.

2 Ibid.

Consolidation has been relatively common over the last decade, allowing providers to expand their range of treatments, deepen expertise available at closer-to-home centers of excellence, enhance coverage of patients within a geography, and gain market scale that impacts contract negotiation and the distribution of revenue centers. However, efficiencies gained through these transactions have not been able to keep pace with the rising costs of care, nor to meet the demand for new and differentiated care

About this report

This report is part of the EY *Buy & Integrate* series of sector-specific reports that encourage CFOs, CDOs and transaction leaders to take a fresh look at how they identify and capture synergies during M&A. In the reports we suggest leading strategies to improve your M&A and integration playbook.

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models. Convergence is also now emerging as the new paradigm in the health care merger life cycle, as payors buy providers and vice versa, to gain access to new patients or markets, with the goal of delivering high-value, lower-cost, patient-centered medical care.

Still, the basic requirements of localized care delivery along with regulatory frameworks, physician employment models, cultural differences and unique community needs have limited the benefits of scale. Payors and providers are now starting to evaluate an expanded set of value drivers when thinking about M&A and integration priorities, to uncover new revenue and cost synergy opportunities, and new combinations of value in order to be sustainable in this evolving environment.

What does this mean for the future of health care, and how can companies develop integration structures to create the most value?

Focus on end-to-end continuum of care

The emerging business models are being developed to provide continuity of care across a range of services within the same network, distributing medical risk and offering a fee-for-value model of care, based on a more dynamic relationship between patients, providers and payors. Below are some suggestions on how to do this right:

- **Pursue authentic integration, not conglomeration.** To deliver the right care to the right place at the right time and at the right cost across the entire health care spectrum, providers have to pursue authentic integration, not simple asset acquisition and conglomeration. This means thinking about the relationship between the outpatient, inpatient and post-acute environments. To shift the way care is delivered, these combined systems must use information in new ways to push beyond back-office integration, and change the processes and behaviors of those actually coordinating and delivering care.
- **Don't be afraid to experiment with the model.** The time is ripe for experimentation with new combinations: have a hospital think about its outpatient locations relative to urgent care or retail health locations; use electronic health record data to identify how patients are referred throughout the system; benchmark fixed and variable costs per unit of service at the sites of care to improve efficiency. Explore different collaboration models to identify the value and determine how they might fit within a more integrated delivery system.
- **Create a more targeted, data-driven care delivery model.** Real value in coordinated care delivery stems from data that is more representative of the entire patient experience. Understanding the handoffs and needs of a patient throughout the continuum of care will help guide organizations in thinking about care delivery through new technologies delivered at lower-cost sites, including in the home.
- **Build a clear integration plan that shows how you want to function as an expanded network.** Work with clinical and non-clinical stakeholders to develop and test scenarios based on data analytics and, potentially, examples from other industries. This will inform the process, from the roles people will play to the future-state structures adopted by an integrated organization. People working in the combined system need to be shown the vision of how they can do better with the new system. Align management structures and incentives, as well as possible economic implications of the new operating model.

Cut costs now or later?

Based on an EY study of notable closed health care deals in the past seven years, cost synergies continue to play an important role, but achievement requires disciplined execution. On average, announced cost synergies as a percentage of target revenue in health care deals came in at about 4%, with a median of about 2% in the period from 2010 to 2017, according to EY research, while cost synergy as a percentage of combined sales, general and administrative (SG&A) expenses averaged about 12%, with a median of 4%.

As cost synergies are always a sensitive topic when restructuring the clinical environment to improve efficiency and patient care, the question remains: where is the intersection point of lowest cost and highest quality?

M&A is a change event that can allow for a hard look at cost synergies, where regulations allow:

- **Look at enabling IT systems improvements.** Even as you align an integration on the front end, take the M&A event as a chance to do the hard work of combining and updating IT systems to create a more integrated platform that enables more powerful sharing of information and analytics potential.
- **Leverage leading clinical practice across a broader set of providers.** It may cause short-term investment and force some difficult decisions, but can lead to lower cost and higher quality down the road. Clinical expenses are the biggest cost driver on the P&L and can move the needle on financial performance if part of a focused effort.
- **Share services.** If part of the acquisition rationale is to achieve greater scale, then those efficiencies can be achieved by designing a new operating model and combining back-office functions.
- **Leverage new business model synergy potential.** With no gold standard template to guide cost-reduction efforts, there is room for creativity on how the back office will support the new

business model. Outsourcing is often embraced by the larger payor organizations but shunned by care delivery ones. Also, think about how more services can be provided through fewer sites based on emerging technology, an overlap in patient population or a new coverage model. This efficiency can enable further geographic expansion.

Consider more convergence deals

Convergence between payors and providers is a major lever for aligning the incentives and information needed to build an optimal care-delivery model. In a traditional model, payors take on much of the health care cost risks but depend on others to deliver that care. Therefore, it is always a tug-of-war between the payor and the provider for the level of care provided. In addition to that, both payors and providers are seeking more data and interaction with patients beyond the individual acute episodes of care.

Convergence deals offer more visibility to the "holistic health" of an individual while giving organizations access to a more comprehensive data set that represents both sides of the transaction in caring for the patient or member. They allow for revenue synergies as well, if there are overlaps in membership, due to a more standardized approach to care.

Where should payors and providers look for convergence opportunities?

- **Care delivery revenue potential.** Instead of focusing exclusively on cost synergies to build a business case for a deal, explore potential revenue synergies. In convergence deals, revenue synergies tied to patient-facing activity can often be where you will see a significant potential value. Quantifying revenue synergies in convergence deals is tricky — many haven't yet been realized, making some convergence deals a leap of faith. But taking the time to evaluate the options and develop a detailed understanding of those revenue synergies will pay off in the long run.
- **Enhanced data gathering and analytics capabilities to get the most out of patient data.** To influence health outcomes, you need to coordinate care across the spectrum. But to do so requires access to more detailed patient data from a variety of health care sources. Health plan data offers the broadest representation of a patient's needs and care consumption; the plans identify what's driving them to seek care, what works and what doesn't, and what's expensive and what's not. Health plan and care delivery patient data aggregated via convergence deals can produce a more complete view of supply and demand.
- **Potential for disruption in a market or subsector.** New combinations are surfacing weekly in the health care world. With health care business valuations having been at

Case study: improving outcomes while leveraging synergies

Challenge

A leading US health payor was seeking to acquire a leading national post-acute care provider. The post-acute reimbursement structure was undergoing evaluation by the government during the evaluation process while other competitors were beginning to consolidate, further increasing competition. The payor was looking to improve outcomes for its patients while lowering the cost of care by providing proactive in-home care that leverages existing and new technology to minimize emergency department visits, inpatient admissions and readmissions.

Approach

The business case for the acquisition was built on a detailed and broad portfolio of synergies to support the value proposition. To develop the synergy portfolio, EY completed a national market evaluation that examined the overlap between the health plan members and the post-acute sites of service. This included how far in-home providers could reasonably travel to care for patients. It also considered resulting medical cost reduction implications that increased post-acute utilization could have on eliminating inpatient hospital admissions. Other value drivers included reduction in medical costs due to improved STAR ratings, plus new markets for both the post-acute and payor. Longer term, the ability to provide more services in the home was considered, along with back-office consolidation between aspects of the utilization management infrastructures of both organizations.

EY worked with the buyer's corporate development, clinical analytics and in-market operational teams to develop these value drivers in the form of a broad top-down synergy portfolio. EY combined publicly available sources of information with EY proprietary benchmarks, other third-party sources and client claims data to analyze the various geographies revenue and medical cost savings. These opportunities were incorporated into the incentives and risk mitigation considerations that ended up in the joint operating agreement between all parties involved.

The CEO, CFO, chief strategy officer, VP of corporate development, business unit presidents and other advisors and partners were actively engaged in the iteration of cost and synergy estimates by EY that ended up being a critical input to the final value proposition endorsed by the board.

Result

The process positioned the client to feel confident in its decision and have an approach framed around its preferred set of value drivers. It also created a new model for how the organization viewed the utilization of different levels of health care services to improve quality and reduce cost. To facilitate a more streamlined process for future acquisition targets, EY also assembled a convergence integration playbook that documented a step-by-step approach to managing a pre-sign-to-sign and sign-to-close process for future convergence transactions.

historically high levels, identifying a new combination may offer first mover advantage. Synthesizing all of the above can help you identify targets that may have tremendous unrealized value that can be unlocked through a new business model.

Identify the risks early

The transition to true value-based models of care is still in its infancy. Proper planning — framed around value, analytics and data, as well as desired outcomes — will be important to achieving the vision for these deals. What are the risks, and what can businesses do to mitigate their impact?

- **Understand what you are trying to build.** Some businesses are amassing assets before they know how to use them differently to execute a platform-based, end-to-end care-delivery model. Eventually, the need to deliver an integrated organization will appear. Think about how each acquisition fits into the business model you are trying to build.
- **Anticipate longer antitrust reviews.** Aetna's agreement to buy Humana for US$34.1b and Anthem's attempt to acquire Cigna for US$54b were both blocked on competition grounds. Regulatory hurdles may be less frequent in convergence deals, but the US Government, for example, is now looking more closely at mergers in which companies are not direct competitors. The ability to demonstrate a value proposition that puts the member or patient first can help mitigate concerns.
- **Evolve the not-for-profit mindset to include a sharp focus on value creation.** Health care providers have not traditionally been focused on best-in-class efficiency and value due to their focus on mission. Building a coordinated care delivery model can reframe the discussion, emphasizing improved patient care as well as cost containment and economic strength, while still putting an organization on a path to growth. This will be vital as disruptive competition increases from for-profit care delivery organizations. For example, CVS Health Corp.'s US$69b announced acquisition of health insurer Aetna Inc. can enhance the move to turn retail locations into MinuteClinic walk-in clinics. CVS-Aetna can establish these in prime commercial locations based on market analysis, while traditional not-for-profits search out hard-to-find prime, central locations and raise funds to build.

Conclusion

The drive to develop more ownership of patients and members across the continuum of care means that health care companies are acquiring assets outside of their comfort zone. Understanding those assets through a thorough diligence and planning process, plus leveraging the data that they provide, are key to achieving the maximum value from the transaction through thoughtful integration.

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