Middle Market Insights:

Sizing Up the Region's Hospital Consolidation Trends

By Ginger Stolzenthaler

The consolidation trend among hospitals and health systems continues. The question for most large players is not whether they will continue to make acquisitions but what types of companies will they target. Geographically adjacent healthcare systems, perhaps, or more specialized players to fill out their offering? Many small players wish to remain independent. The question is: how will they survive in an environment where size, scale and specialty capabilities matter more than ever?

There were 71 announced US M&A transactions involving hospitals and health systems in the first nine months of 2019. This is slightly ahead of 2018 when 68 deals were announced in the first three quarters, according to Kaufman Hall, a provider of management consulting services. There are no real signs of a slowdown. While these are national numbers, the drivers of consolidation in the Northeast are very much in line with the rest of the nation.

By getting bigger, health systems can employ highly trained specialty physicians in specific care segments like neurology, hematology/oncology, cardiology, etc. The systems can also improve their leverage with payers and negotiate better rates, bargain for better supply contracts, lower insurance liability costs, and improve efficiencies. For

Highlights

FOUR CONSOLIDATION DRIVERS AT A GLANCE

- Quality of care
- Improved efficiencies
- Leverage with payers
- Lower liability insurance costs

example, consolidating/ streamlining ACO relationships and directing specialized types of care (e.g., dialysis, MRI and ambulatory surgery) to lower-cost settings.

In one real-world example, Beth Israel Deaconess Medical Center and Lahey Health recently combined to form Beth Israel Lahey Health, the second-largest health system in Massachusetts. At the time of the merger, executives said that by combining, they could curtail the overuse of hospitals and academic medical centers, which drives up costs. They also pledged to use their combined purchasing power and expertise to lower costs.

For similar reasons South Shore Health in Massachusetts announced over the summer that it is in partnership discussions with Wellforce Health System. Executives there said they want to deliver healthcare in the community, control healthcare costs, and increase access to a larger provider network.

The consolidation trend in New England is hardly contained to Massachusetts. In New Hampshire, several mergers and acquisitions occurred in 2018 including Elliot Hospital in Manchester and Southern New Hampshire Medical Center in Nashua; a merger of equals among four small North Country hospitals; and the purchase of Wentworth-Douglass Hospital in Dover by Boston-area giant Massachusetts General Hospital/ Partners Healthcare. More recently in October of 2019, Dartmouth-Hitchcock Health and GraniteOne Health signed a formal agreement to combine forces, though they still must secure regulatory approval.

There is also some cross-border activity. Three hospitals serving Vermont and New Hampshire announced in the summer that they are considering merging their services. Two of these are Mt. Ascutney Hospital and Health Care in Windsor, Vermont and Valley Regional Hospital in Claremont, New Hampshire. The third, Springfield Hospital in Springfield Vermont, is going through Chapter 11 bankruptcy. The interim CEO has said its financial structure is unsustainable and its survival will be 'virtually impossible' unless it merges with other hospitals.

Meanwhile, Maine Governor Janet Mills signed legislation in April that will allow Mayo Regional Hospital in Dover-Foxcroft to move forward in merging with Northern Light Health, a statewide healthcare organization. Then, in June, two other Maine healthcare systems said they plan to merge, pending state and federal approvals: Brunswick-based Mid Coast-Parkview Health and Portland-based MaineHealth.

With the industry rapidly consolidating, smaller healthcare systems increasingly worry that they could be isolated and unable to compete. That is an understandable concern when you consider that Beth Israel Lahey Health operates 13 hospitals, and MaineHealth is potentially becoming a single nonprofit entity made up of seven hospitals in early 2020. However, there are also powerful interests pushing against this consolidation, or at least keeping it somewhat in check. The two biggest are regulatory concerns and the desire to maintain local autonomy. The primary regulatory concern involves antitrust considerations as the systems grow larger and dominate market share. Local autonomy issues are related to decisions as to who will lead the combined system, community needs, employee concerns and real estate duplication. Further, other concerns involve organizational stability, capital requirements and concerns with implementation risks.

For example, New Hampshire Governor Chris Sununu signed a bill in late July that will increase scrutiny of healthcare mergers. Under the new law, the director of the New Hampshire Charitable Trusts Unit has authority to ask merging health care organizations how the transaction will affect the community's "access to quality and affordable physical and mental health care services." It also increases the time the director has to review these proposed transactions and requires more than one public hearing on the proposals.

In Massachusetts, the potential South Shore Wellforce deal comes several years after the Commonwealth stopped Parters HealthCare from acquiring South Shore Health over concerns about cost increases. Meanwhile, Beth Israel Lahey Health had to agree to significant conditions from

the Commonwealth's attorney general to get its deal approved, including a seven-year price cap; participation in MassHealth, the state's combined Medicaid and Children's Health Insurance Program; and $71.6 million in investments supporting healthcare services for low-income and underserved communities in Massachusetts. Those kinds of conditions may become the norm, and could dissuade some would-be acquirers.

Besides these regulatory issues, there are often concerns around local autonomy. Local patients can certainly benefit when larger providers acquire their smaller healthcare systems. They could gain access to more healthcare options, including a wider array of specialists. However, local boards accustomed to making financing decisions as they see fit and operating the hospital according to local priorities often chaff at the sudden loss of control.

Thus, the local communities sometimes resist these deals. In June, for example, Massachusetts-based Partners HealthCare backed out of a hospital merger deal with Care New England (CNE) after Rhode Island's governor called for a more local solution. "Over the past several months I have increasingly heard from a number of stakeholders and understand the appeal of a locally-run, academic medical center based in Rhode Island," Governor Gina Raimondo stated.

At the end of the day, the real question needs to be: where are patients getting the highest quality of care? The answer is never simple and depends on a lot of factors.

As these recent examples illustrate, the region's healthcare industry is in a state of flux. Despite all the consolidation that has taken place, we at People's United Bank believe that more is in store for the Northeast.

While larger, serial acquirers have built-up internal know-how and a network of experts to help them with each new transaction, smaller healthcare systems, which are often the target of their interest, usually lack this expertise and network. Local boards may take justifiable pride in their independence and ability to manage through any circumstance, but when it comes to assessing a potential M&A deal, they should not try to go it alone. It is critical to seek out advice from lawyers, accountants and bankers to help identify the advantages and disadvantages of any potential deal and help weigh the tradeoffs. ■

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