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MERGERS AND ACQUISITIONS IN HEALTH & HUMAN SERVICES:

Good Business or Risky Business?

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Merger and acquisition (M&A) activity has been, and no doubt will continue to be, a fact of life in the health and human services (HHS) world. Organizations across the industry continue to pursue M&A opportunities at a record-setting rate. However, the odds of success have not typically been high when it comes to these initiatives and achieving a smooth transition has become even more difficult since the pandemic.

The Fred C. Church team has worked side by side with numerous nonprofit and human services organizations as they've progressed through an M&A process, so we would like to share essential insights and advice on the opportunities, risks, and challenges of mergers and acquisitions in your industry. If your organization is looking to acquire another health and human services provider or seeking to be acquired, this information may provide you with a deeper understanding of the HHS M&A environment you are about to venture into.

The Typical Drivers of Merger and Acquisition Activity in Health & Human Services

The following are three situations that tend to influence whether an HHS firm is open to either being acquired or acquiring other firms. While there could be many other reasons an organization might pursue a merger or acquisition, this list highlights the major factors that have contributed to this ongoing trend in the industry.

1. ***Across New England, a significant number of CEOs and other senior executives at a variety of HHS companies are quickly approaching retirement age.***

   Some of these leaders may have even accelerated their retirement plans due to the increased workplace health risks that COVID-19 posed for older employees. As these CEOs strategize for their inevitable transition to retirement, they want to ensure the ongoing strength of the organization they've helped build by putting an experienced leadership team at the helm. Plus, many aren't ready to close this chapter of their life completely. Instead, they want to find a way to remain actively involved in the industry for as long as possible, often beyond the qualifying age for Social Security. To extend their careers, many of these CEOs look to have their firm acquired by another organization that has strong leaders in place. This generally allows a former CEO who is still passionate about what they do and who they serve to slowly pull back on their responsibilities, while continuing to be a resource for their constituents.

2. ***Increased competition and economies of scale have made survival for smaller organizations challenging.***

   The majority of HHS providers rely heavily on state and federal reimbursement of services rendered to ensure the survival of their programs. However, access to government funding sources and social services contracts has always been relatively scarce, resulting in a very competitive landscape. The pandemic only served to exacerbate funding shortages, with traditional sources quickly drying up and the costs of taking care of people escalating. When competition for resources and contracts is this intense, it is the larger, more established organizations that will generally outlast all others. In addition, given the infrastructure it takes to run an organization today, larger HHS firms have a distinct advantage as they spread IT, finance, and human resources costs across a larger group of employees and clients. Small companies often struggle to gain similar economies of scale in this type of environment, unless they can find a bigger fish in the industry to help them out.

The Typical Drivers of Merger and Acquisition Activity in Health & Human Services

3 ***To achieve more financial stability, organizations are striving to serve clients throughout their life.***

In the past, a key ingredient of success for an HHS provider was to have a focus or specialization. Today, this same trait has turned into a limiting factor to an HHS organization's revenue stream. For instance, if an organization's programs are designed to serve clients only until they reach the age of 22, participants who reach that maximum age are no longer eligible and must go to another program. If several people age out at the same time, an organization may lose critical funding that it was getting for services provided to these clients. This is one of the main reasons why many HHS organizations are merging with or acquiring new businesses—they want the ability to provide care throughout their clients' entire life. As an example, in the day services sector, we have seen organizations increasingly branch out and merge with other HHS companies that have residential offerings, with the goal of building out a full continuum of services.

The pandemic reinforced the wisdom of providers' attempts to diversify their programs. During the national shutdown, many HHS organizations adopted telemedicine and other remote services so they could continue to support their participants. The use of these technologies has now become routine for several reasons, including that many participants and their families are reluctant to go back inside facilities for programs, especially because many clients have underlying health risks that make them more vulnerable to getting ill. In addition, HHS leaders have a persistent concern that day programs may never return to the pre-pandemic standard model or could potentially be shut down again due to another similar situation. All these factors have led to an emerging thought in the industry that traditional day programs may not be the most efficient or financially feasible way to do business in the long run. As a result, many organizations are seeking merger and acquisition deals to help them prepare for a very different-looking industry in the future.

One of the main reasons why many HHS organizations are merging with or acquiring new businesses is because they want to build out a full continuum of services that will enable them to provide care throughout a client's entire life.

The Two Biggest Problem Areas That Can Hold Up a Merger or Acquisition

While a merger or acquisition can bring positive outcomes and help organizations capitalize on opportunities and trends, a wide variety of studies show that between 70% and 90% of these initiatives fail. From relatively small deals to large transactions, we have seen many mergers and acquisitions, forged with the best intentions, ultimately break down.

The following are two of the most common reasons some HHS mergers and acquisitions do not end up meeting expectations or goals:

1. ***General cultural differences exist between the two companies.***

   Within an HHS organization, culture is a huge part of the company's identity. Both positive and negative aspects of this culture build up over time and become engrained into the very fabric of the firm. Assimilating two such entrenched cultures, especially if they are contrasting, can be a significant challenge when organizations come together under the tent of a single logo. In the world of private corporations, the culture of the larger company tends to dominate and impose its will upon the smaller one. But in the health and human services world, organizations are more likely to be led by people who herald inclusiveness and want to honor everyone's culture. However, it is very difficult for both organizations in a merger or acquisition to remain "equal" throughout the process. If one cultural identity is not established for the newly formed company, all employees may be left questioning the organization's philosophy on many critical issues, from participant care to community involvement.

2. ***Risk management process differences exist between the two companies.***

   Some HHS organizations are very proactive when it comes to safety concerns, taking a more strategic approach to identifying, assessing, and addressing risks. Other firms are more reactive; their approach may assume that risks are simply part of the landscape, and that the best tactic is to buy insurance as cheaply as possible and deal with the consequences should an event occur. If these two types of organizations merge, they can expect a clash of risk management approaches and some very negative outcomes. Typically, in these situations, firms that have best-in-class practices—for example, being proactive and taking a strategic approach—find that their safety culture and claims experience suffer, while the more reactive organizations may see a slight improvement in these areas. Even organizations that think they have a well-thought-out emergency plan for a disaster may realize, only in hindsight, that their plan never included how to react to a pandemic or similar national crisis. As uncertainty continues to permeate the HHS workplace, paying detailed attention to the risk management approaches of two cultures that are coming together is more important than ever.

Many HHS organizations are missing the opportunity to sort out these and other differences well ahead of the final merger day. Even if an issue is brought up, it's typically not until the final 60 to 90 days of the process. Then, if an issue is a big sticking point, it may prevent negotiations from moving forward in a timely manner or even lead one party to walk away. It is always better to know earlier than later—before a lot of time, effort, and money are invested—that an issue is not resolvable.

The Main Risks and Challenges to Consider Before a Merger or Acquisition

Almost every initiative undertaken in an organization comes with some risk factors. The key to a successful outcome is to ensure these risks are properly recognized, accounted for, and managed. Some of the risks and challenges that we ask our clients to consider up front in a merger or acquisition initiative include:

- **Increasing Board of Directors liability.**

  These volunteers generally look at a merger or acquisition in the HHS industry as a coming together of two organizations for the good of the people. They see the initiative as building stability and helping each organization to better serve its constituents. However, it's important that the directors also understand that, as board members, they are at greater risk for lawsuits during and after this process, especially if it can be proved that they have not done sufficient financial due diligence in making their decision. For example, there is currently no clear indication whose social services contracts and funding will be continued by the state. It's critical that board members carefully consider the potential bottom-line impact of this type of scenario, along with many others, before they conclude that a merger or acquisition is a sound financial decision.

- **Integrating two workforces.**

  There are many implications for human resource departments when two organizations merge, not the least of which is getting to know each employee and their history and identifying any potential conflicts. Imagine you are an acquiring organization. In reviewing the employees now in your workforce after a merger, you find that there is at least one worker whom you have terminated for cause in the past. Let's take this one step further: What if you are the manager who originally fired the problem employee, and you are now, in the new structure, assigned to oversee this person's performance improvement plan? A scenario like this could expose your new organization to an employment practices lawsuit for discrimination, harassment, hostile workplace environment, and more. These situations are actually quite common occurrences in HHS mergers, because there is such a limited number of HHS agencies, not to mention applicants, in any given area.

- **Coordinating employee benefit plans.**

  Some firms offer plans with benefits that are much broader than those offered by others. To resolve the disparity between two companies' benefits programs, the newly merged company may want to consider rolling out a new plan or selecting the program that contains the best benefits and offering it to all employees. One scenario that typically backfires very badly is continuing to offer parallel plans long after a merger or acquisition deal is consummated. This not only may result in resentment and confusion among employees but also may prevent the newly formed company from taking advantage of cost savings and possible alternative funding options that a consolidated plan would provide.

The Main Risks and Challenges to Consider Before a Merger or Acquisition

- **Communicating policies and procedures.**

  The policies and procedures of both companies must be carefully examined and revised, expanded, or clarified as needed. Then, they should be clearly communicated to employees. From properly using company credit cards to understanding evacuation and active assailant response plans and running employee background checks, the company will need to reeducate each staff member on the newly formed entity's updated policies and procedures.

- **Ensuring adequate insurance coverage.**

  The acquiring entity is, essentially, considered the new organization and, as such, should have all of its insurance coverages reviewed and then updated if necessary. The organization being acquired should review key coverage areas such as Executive Liability, which includes Directors and Officers, Employment Practices Liability, and Fiduciary coverage. In addition, the acquired entity may need specialized coverage to safeguard against claims that may occur during or after a merger. Of course, it's beneficial to utilize an insurance broker who has broad experience assisting HHS organizations with the M&A process. In today's environment, though, it's also critical to work with a broker that has demonstrated their skill and capabilities not just during times of stability in the industry, but periods of turbulence as well.

  Finally, insurance policy underwriting is continuing to evolve because of the pandemic; we are now seeing insurers explicitly excluding communicable diseases from coverage where there had not been specific language like this before. The only way for companies to stay on top of the constantly changing insurance marketplace and keep their finger on the pulse of the HHS industry is to work closely with their insurance brokers throughout the merger and acquisition process.

The Many Risks and Challenges of a Merger or Acquisition Should Be Given Careful Consideration and Analysis Long Before a Transition Actually Occurs

A thorough risk identification and assessment process may not only uncover issues that need to be addressed but also illuminate reasons to not move forward at all. Working with an experienced insurance broker and risk resource, like Fred C. Church, that has been through this process with many HHS companies is the best way to ensure that all the potential positive and negative outcomes of a possible new, larger entity are properly evaluated.

About the Author

Tom Rogers joined the Fred C. Church family in 2004. Prior to becoming an insurance broker, Tom spent 12 years working for insurance carriers in a variety of roles, including underwriting, risk management, and marketing. Tom's specialties include health and human services, developmental and disability service providers, and community action programs. Tom loves the outdoors and is a member of the Brookline Conservation Commission, where he is an active promoter of using the trail system. When Tom is not out on the trails, he is hanging out with his wife, Stephanie, and daughter, Lauren. He resides in Brookline, New Hampshire.

About Fred C. Church

Fred C. Church Insurance is one of the largest firms in the Northeast and one of the top 100 full-service brokerages in the United States. We offer property & casualty and employee benefits solutions, risk management consulting services, and private client asset protection. With over 155 years of industry experience, multiple locations throughout New England and Colorado, and 165 full-time insurance professionals, risk consultants, and claims advocates, we deliver a superior customer experience. Through our hands-on approach, strategically developed to identify, assess, and address risk, we provide personal and business clients of any size and specialty with the advice and guidance they need to make informed decisions about their insurance.

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