
MERGERS AND ACQUISITIONS:
ARE THEY A SUCCESSFUL STRATEGY AND IF NOT, WHY?

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CORPORATE AND EXECUTIVE EDUCATION
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Mergers and Acquisitions: Are They a Successful Strategy and If Not, Why?
A case study discussion on the potential and realized cost savings from hospital mergers.

Executive Summary

Motivation for Merging

Mergers are the buying, selling and/or combining of different companies as a corporate strategy to promote goals of the firm. These goals may include cost savings, growth of the organization, acquiring new product lines, increased market share and/or taking a technological advantage to another company. Whatever the reason may be for the merge, firms have to do an initial assessment of the pros and cons of merging or not merging with another firm. Before a decision to merge is made consider the following questions. If you decide to merge, you will not know what would have happened if you did not merge. If the merger is successful, was it because of the merger or would it have happened anyway? If the merger was unsuccessful, were your initial assessments wrong?

Case Study: Hospital Mergers

Research in academic journals comparing hospitals that merge to hospitals that do not merge for a cost saving strategy indicates that there is not much of a difference in cost savings for either case. Are the merging hospitals not realizing the expected cost savings? Were the merging hospitals' initial assessments wrong or were the potential cost savings just not realized?

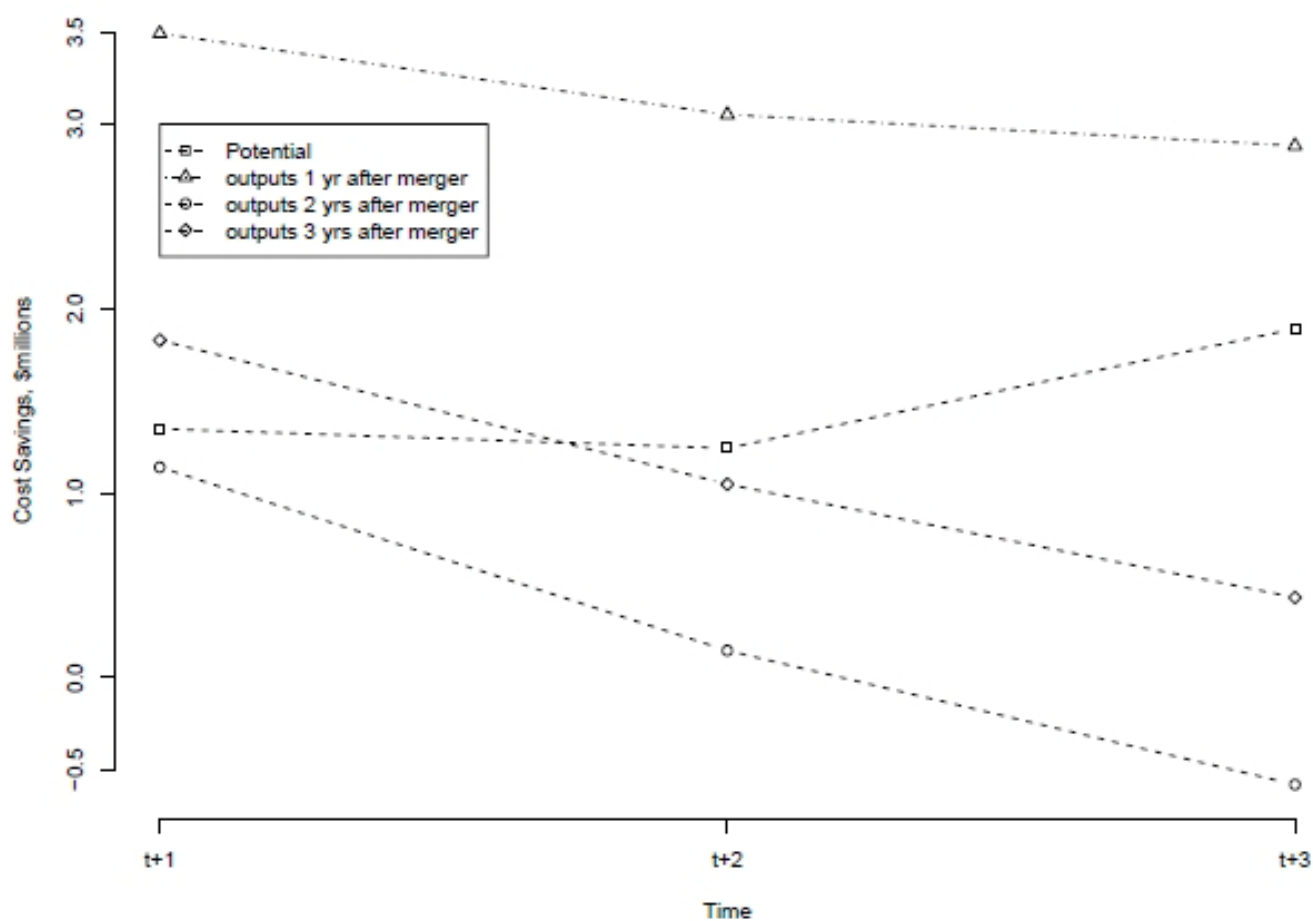
Does economy of scale (cost advantages businesses obtain due to expansion) exist pre-merger and were the potential cost savings capitalized realized post-merger? Teresa Harrison developed a technique that can be applied to any industry to differentiate between potential and realized cost reductions. Hospital mergers provide a good sample to study potential post-merger cost reductions.

Hospital Merger Cost Savings Research

In 1981 there were 7,166 hospitals in the United States. In 2009, there are approximately 5,815 hospitals. This decrease was due to changes in technology and healthcare insurance reimbursement which caused many hospital closures in the 1980s and resulted in hospital mergers and acquisitions in the 1990s. The development of the Diagnosis-Related Groups (DRGs), a patient classification system that groups patients by treatments is used to determine how much Medicare/Medicaid will reimburse the hospital for patient services. Hospitals are not reimbursed on actual costs, but only on average costs within each treatment category. The DRGs system incentivizes hospitals to reduce their costs.

Results from Average Cost Savings for Approximately 200 Hospital Mergers 1984-1997

The graph below represents the cost savings outputs after the hospitals merged.



One year after the merger, cost savings were realized. Three years after the merger, there were less cost savings; which may have been caused by other factors, such as recession or new technologies. Or the lack of managerial effectiveness or other organizational structure issues could have an impact on cost savings.

Decisions made in one year after the merger were better than decisions made three years after the merger. Why? Teresa Harrison's research takes into account national trends and local trends in inflation. There was not enough research to know if change in management affected the merger outcome. Benefit of this research is that there were cost savings to be had, but they were not realized.

Feedback from the Roundtable Discussions

The audience at the January 20th CFO Alliance Roundtable were presented with the following questions:

Merger Paradox

In theory, mergers are never good; not enough cost savings, prices go up and firms do not do well. So why do mergers continue?

Stages of Mergers

1. Pre-deal stage and identifying good targets
2. Early analysis of the deal and what information do you need
3. Action plan to achieve goals and how will the goals be implemented
4. Contingency planning and weighing in on the best and worst case scenarios
5. Implementing plans after consummation and how do you put action plan in effect. What is role of the CFO?
6. Integrate corporate cultures between the two merging firms
7. How to continue monitoring the success of the merger
8. Lessons learned from the post-merger

Questions

- 1) In your experience what have been the main motivating factors to engage in a merger?
- 2) Were the goals of the merger clearly defined prior to negotiation and consummation of the merger?
- 3) Did the merger accomplish those goals and if not, why
- 4) As a CFO what role should you play in ensuring the success of the merger?

Table Comments

1. Compare strategic plans
Consult 3rd party for an objective opinion
Some companies want to grow to grow; grow to survive
Makes sense culturally
2. Financial analysis is result of thinking behind it
Skill sets of other company acquiring talent
Savings
IT systems
Changes to internal culture
Branding/marketing/promotion
Relationships with vendors/clients

The results for hospitals discussed here are drawn from Teresa Harrison's paper "Do Mergers Really Reduce Costs? Evidence from Hospitals," forthcoming in *Economic Inquiry*. A full draft of the paper is available at <http://faculty.lebow.drexel.edu/harrison/workingpapers/mergercostsavings.pdf>. Any reference to this research should therefore cite this publication accordingly

3. Brainstorm to anticipate problems
Assign integration teams to address all unit
Identify clear financial and non-financial metrics
Act quickly-time is critical; create and use timeline
Use 3rd party expertise
Themes = don't identify everything
4. Pre closing: Legal and how pricing can affect higher or lower cost savings
Post closing: What do you do if merger is not successful? Unmerge?
5. Integrate all functions of both companies
Define commonalities
Regular reporting and review of sub-groups
Identifying champions
6. Understand the merger and integrated or separate operations
Values, achievement, compensation
Develop/adopt standard materials, policies and procedures
Compensation package
What type of acquisition
Identify who the key leaders are in both organizations for their involvement pre and post merger
Management welcome new company and employees
7. Create a playbook
Identify a champion
Consequences for results
Do not set expectations that cannot be met
Follow the money - who's spending what, when and where
Compare cost savings pre and post merger
What is the ultimate customer satisfaction?
8. Benchmark against original assumptions
Use lessons learned proactively
Keep eye on target; recognize there may be other outcomes than original goal



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