Mergers and Acquisition in Hospital Sector: A Strategic Analysis of the Brazilian Market

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[Abstract] Brazil has become a globalized economy with development and professionalization of its business and market. Many sectors have attracted the interest of firms, competitors, and investors. One such sector consists of the hospitals in Brazil, which are facing challenges in improving efficiency and competitiveness. One of the strategies adopted by organizations in pursuit of growth is making mergers and acquisitions (M & A). This paper analyzes the M & A strategy focusing on Brazilian hospitals, describes the objectives, delineates the steps of the process, and lists its advantages and benefits. This paper also discusses obstacles, risks, and causes of success and failure.

[Keywords] merger and acquisition; hospital; health management; strategy

Introduction

For Brazil, the 19th century represented the start of a new economic era of development in which the country left behind a protected economy with low competitiveness (and being less prone to international partners) to become an open and globalized economy with development and professionalization of its businesses and its market, and with taxes and fiscal policies that allow better international competitiveness. In this context, many sectors have attracted the interest of firms, competitors, and investors. One of these is the hospital sector that remains as one of the open markets for business.

With the more open country, there was greater access to management technologies, raw materials, human capital, and especially the most modern and efficient equipment, which allowed increasing the competitiveness of most sectors of the Brazilian economy. In 2001, Goldman Sachs' chief economist, Jim O'Neill, proposed the term BRICs to designate a group of four countries that were the strongest and most important emerging economies: Brazil, Russia, India, and China. As a part of the BRICs, Brazil, today presents an attractive way for investors to increase their emerging-market exposure (Koch, 2011). An international setting with greater availability of capital for investors was prone to begin to see Brazil's great business opportunities. Thus, Brazilian companies, in various sectors, including health firms, have new challenges in the search for greater efficiency and competitiveness. Among the strategies being adopted by organizations around the world in pursuit of growth are mergers and acquisitions (M & A). Some factors that favor this phenomenon are the global economy, advanced technology, specific market forces, and government regulations (Schmidt, 2002).

There are two types of firm growth strategies: internal (organic) and external (M & A). Internal growth (organic growth) means that firm growth is realized through the firm's own strengths and resources and usually requires a long time; external growth (M & A) signifies a strategy that is achieved by buying another firm or business, which is usually perceived as a faster strategy than internal growth (Park & Jang, 2011). Even though much literature has constantly used the two words “mergers and acquisitions” together, they are not the same strategies and differ slightly from one another (Kongpichayanond, 2009). A merger can happen when two companies decide to combine into one entity. Acquisitions refer to an organization's purchase of or take-over of the operations of another (Schraeder & Self, 2003).

When merging, they join their available assets, liabilities and cultural values on a comparatively equal basis across different businesses and industries. In acquisitions, an organization acquires sufficient shares to increase the level of control, gain ownership of another organization, and maintains its identity

(Horwitz et al., 2002). In terms of this paper's purpose, M & A is an instrument for the growth of a company. Many sectors around the world use M & A strategies to grow. In recent years, many services companies around the world, such as banks (Barros et al., 2014), telecom (Soares & Mendonça, 2010), restaurants (Park & Jang, 2011) and airlines (Morrell & Merkert, 2012) underwent the major process of M & A. In spite of the acquiring strategy becoming progressively more active in developed economies, firms from emerging countries have served as targets rather than acquirers in cross-border acquisitions. However, a lack of market and knowledge-based resources at home also show a barrier to acquisitions by firms in emerging markets (Rabbiosi et al., 2012). In a recent report by Price Waterhouse Coopers, "Highlights of Brazil 2013-14," Brazil has, over the last four years, maintained robust levels of M&A activity. With an all-time record of 811 transactions announced in 2013, the 2010 to 2013 period had, on average, 783 announced deals. For 2014, it is expected to continue. The main sectors for investment will continue to be IT, retail, food and consumer goods, healthcare, education, general business services, energy, and finance. Hospitals, however, in spite of being a service sector and having some strategies that are challenging, such as a high-cost structure to operate, a large number of clients to attend to, and low profitability for each service provided, are few in the large-scale use of this M&A strategy.

Mergers and Acquisitions (M & A) in Hospitals

One of the sectors that are beginning to receive the attention of investors is the healthcare industry. Researchers studying the United States of America healthcare strategies of consolidation suggest seven key forces are reshaping healthcare delivery and will continue to do so in the future: insurance industry consolidation, changing capital markets, expense increases that outpace reimbursement, workforce shortages, physician practice dynamics, large numbers of financially fragile providers, and healthcare reform (Zuckerman, 2011). Recently, some movements in the drugstores, pharmaceutical industry, labs, and healthcare companies were observed in Brazil, but there is much more in other countries (Zuckerman, 2011). Although still at the beginning, some acquisitions of hospitals by international groups are occurring, but they are still few. Only some hospitals groups, such as the Albert Einstein Hospital D`or Group and the United Health – Amil Group have acted with M & A. However, it could be a great strategic alternative over a wide financial and operational difficulty for the hospital sector. As is happening in other sectors, M & A among hospitals could increase competitiveness, optimize costs, and gain efficiency. Table 1 presents the main objectives to help decision makers to adopt M & A as a growth strategy:

Table 1

The Main Objectives of M & A in Hospitals

The main objectives of M & A in hospitals
The need for gains in production and services scales
Operations in other geographic regions
Entry into a new market segment
Increase market share
Elimination of a competitor
Emergence of new products and services
Seeking financial synergies, with probable cost reductions
Aggregation technologies with potential for innovation
Pursuit of operational synergies
Strengthen the brand

The hospital market in Brazil has some specifics characteristics. First, refer to the owner. Most of them belong to a family group, usually to a patriarch entrepreneur with subsequent generations of doctors. Other owners are groups of doctors which unite to create a hospital, public hospitals controlled by government, and religious hospitals created for philanthropic purposes. In fact, until today Brazil remains a traditional culture in which hospitals must serve the population and that have their rights recognized by the constitution of the country. Undoubtedly, if this fact is not a complete barrier, it at least needs to be considered by investors who think about investing in hospitals in Brazil.

Some scholars have studied the processes of M & A in Brazil. Some studies have analyzed the relevance of human factors and the cultural environment on success (Wagner & Hilal, 2014); the innovation strategies and their effect on successful process and product innovations (Goedhuys & Veugelers, 2012) or the comparison of M & A with others have grown strategies as joint ventures (Kayo, 2010). Researchers have shown that the processes end up gaining specific contours, filling their own style because of the striking features of local culture. Although 31% of the companies surveyed felt the study detailed business as the most important factor, successful operation of an M & A, 45.4% did not pass through due diligence and 48.3% said that there was no planning of the integration step (Tanure & Cançado, 2005). This, perhaps, shows a trace of the informal and less averse to the Brazilian culture processes, where at the same time executives know and attach importance to planning but do not practice it. They also concluded that the average of the trading stage is 3-12 months, the integration step is about two years, and almost half of the sample group does not perform planning.

If there are already fewer studies about M & A in Brazil, when it comes to the hospital sector we are practically in a dark zone, not knowing what really happens to the few cases in the country. It would be very important to know the numbers, the statistics, the financial impacts, and the synergy gains that will serve as a reference for other future cases.

Steps of the Process

The evaluation process of mergers and acquisitions is a field that involves knowledge and skills in several areas, not only finances or accounting. The diversity of topics covered during the evaluation process can be represented by the areas of knowledge that still involve legal departments, management strategies, administration, human resources, marketing, and sales, among others. The evaluation process involves the careful analysis of synergy and awards that are directly involved. Also, it involves some particular medical professional competitive aspects. Finally, it defines the financial resources to execute the negotiation. Many studies had been discussed about the evaluation process for the proposed acquisition of a company or asset (Kongpichayanond, 2009; Silva, 2013). Adapting various processes and proposing a better structure for the hospital sector, we propose the following steps:

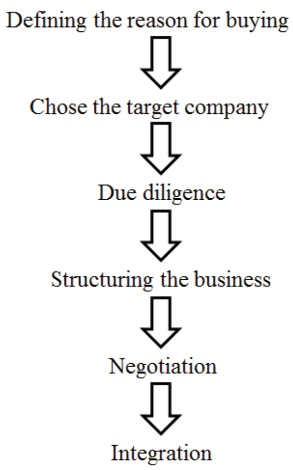

Figure 1. Proposed steps to M & A in hospital sector

Defining the reason for buying: 'reason for buying' refers to the existence of a reason, or motivation to carry out the business. In most of cases, the primary goal is to grow. With the actual competitive market, increasing the company only by using internal resources is slow and takes a long time. In addition, some market opportunities happening at a moment may quickly disappear. In the specific case of health, gaining operational and technological synergies is the main reason due to enormous pressure for cost reduction.

Choose the target company: choosing the best company to be a partner is a difficult option. Not always is the best company the ideal company. A company will be considered the right target if it is capable of providing benefits to the other. However, for various reasons, the target company is that will best adapt to the difficult process of mergers and acquisitions, reducing barriers to the fullest. In the hospital sector, the choice should be based primarily on technical evaluation, ignoring emotional, cultural and competitiveness among medical personnel aspects.

Due diligence: the central step in the evaluation process of an acquisition, this step is to investigate and audit the information provided by companies. The business valuation involves detailed strategic analysis studies, a competitor's analysis, strategic alignment, economic assessment from point of view of the buyer and the target company, and the valuation of synergies identified in the business proposition. Investing with strong due diligence facilitates the rest of the process and increases the likelihood of the transaction creating value.

Structuring the business: this step helps define the influence that a target company has influence of the target company on tax consequences of the transaction. This step, like the first two steps of the process must occur in parallel with the evaluation stage of the business.

Negotiation: this phase will define the final parameters and how the negotiation will be completed. Most of the time, this may be long and exhausting, so it is essential that the professionals involved in the process are determined and persevering. This can occur with money (or debt equity) or shares of the acquiring company. Negotiation should be transparent and objective in order to provide the necessary support to reduce risks and improve the success of the operation. In health sectors, maybe this is the most difficult phase because it involves money, power, and professional aspects.

Integration: the post-acquisition is the final stage of the procurement review process. It is at this stage that management will seek the fulfillment and implementation of synergies and awards identified and quantified in the evaluation phase of the business. The team that promotes post-merger integration should be comprised of people from both companies who have credible know-how and autonomy to act. This integration phase is often overlooked by buyers, which can raise the risk of a project's success.

As the M & A process is evolutionary and continuous, it is suggest that mergers are partly overlapping so that the continuity of the process does not get hampered. The overlap allows for greater integration between each phase. Thus, all the information obtained in each step can more easily be passed to the next stage, retaining all aligned and consistent process. All the process needs to be validated by the top management of the company and be built by all participants involved.

Advantages and Benefits

A successful M & A results in increasing market share, gaining an organization's core capabilities, and gaining more capital, knowledge, expertise, and talent at lower cost (Kongpichayanond, 2009). It is a good way by which organizations can better compete in a changing business environment and strengthen their competitive advantage (Hitt & Pisano, 2004). An M & A could bring a lot of advantages for both companies. The most important strategy point is to obtain synergies by integrating specific resources. In hospitals, these synergies can be obtained through many different aspects (Zuckerman, 2011). For example: 1) improvement in quality of care – refers to the gains acquired through sharing of clinical experiences regarding the care protocols, clinical procedures, processes aimed at quality; 2) human resources – the gains are achieved by improving the standard of quality and productivity of labor, the choice and optimization of the best employees who are better adapted to higher demands; 3) cost reduction – the greatest goal of the whole process of M & A is achieved by reducing the number of employees, greater bargaining power with suppliers and economies of scale in operational processes; 4) optimization of resources – the rule is to optimize workforce managers and directors, legal and accounting department, training and development of employees, and marketing actions; 5) greater competitive force in the market – represented by strengthening the brand that gains greater credibility, greater bargaining power with health insurance companies, and medical organizations and increased barriers to new market entrants; 6) technology ladder – a way to optimize resources but analyzed here separately due to its enormous importance. The cost of technology and equipment is very high in the healthcare industry. The possibility of expanding the maximum use of technology and maximizing the operation of equipment, if possible working 24 hours, is a great competitive advantage; 7) expansion of services – is the provision of a greater mix of services to market, complementing previous shortcomings and expanding source of profitability; 8) financial gain – the final objective to be achieved will be the final result of all the benefits mentioned above with a good cash flow generation and good profitability.

Obstacles and Risks

M & A is much more complex than simply joining another company. In the Brazilian case, the major problem we encountered on several occasions is the difficulty of Brazilian businessmen knowing how to structure the business, including such issues as knowing which alternatives to adopt, what types of operations to use, how to prepare a project and its phases, and, especially, what is the value of the company for a potential transaction of sale or purchase. Another important point is to know the obstacles and risks pre- and post-process.

Specifically in the case of health, we could say that the main obstacles are 1) Synergy of power: in other words, who will own and who will be the "boss"? This occurs more in merger cases because, at acquisition, the acquiring company makes the rules. 2) Lack of vision of business management, particularly in strategy. Healthcare companies in Brazil are normally managed by doctors with little or no training in healthcare management. 3) Difficulties in defining the real value of each company – this risk can be minimized if there is a good due diligence. 4) Financial difficulties of the sector – as hospitals are still controlled by forces and must survive in a competitive and low-profitability market, financial supports is difficult and uncommon. 5) Risk of personal incompatibility of professionals (doctors, nurses, physiotherapists, and others), which because of the historical rivalry between the companies and professional groups, may remain conflicted personal relationship. 6) Difficulty in incorporating new work philosophy – health professionals from other areas are often resistant to change. 7) Fear of unemployment – another common obstacle related with human management. This fear is most real because one of the main reasons for M & A is cost reduction and synergy of the workforce. 8) Legal Limitations –liabilities are unresolved, as in the case of labor liabilities, with huge legal commitments can greatly decrease the value of the company. In the hospital sector, it is not infrequent that labor relations are punishable by legal liability. This happens because the various form of existing professional relationships in the industry. In some cases, hospitals use external and temporary workers, as in the case of doctors who are not part of the clinical staff but often perform procedures on the premises. In other cases, outsourcing is prevalent, both for doctors and many other health professionals, such as physiotherapists, occupational therapists, nutritional experts, as well as feeding, laundry, security, information technology, etc. Finally, the whole employment relationship between hospital and medical professionals is subject to litigation.

Success or Failure

Actually there is a broad expert consensus that the post -acquisition integration process represents the most crucial and important determinant of acquisition performance (Heimericks et al., 2012). To explain M&A success and failure in the integration of acquired or merging firms, studies have focused on strategic and financial factors beyond an emergent field sociocultural and human resources (Stahl et al., 2013). In spite that in many cases of M&A success occur (Aggarval-gupta et al., 2012; Barros & Dommquez, 2013), on the other hand, high rates of failure and dissatisfaction with M&A performance were reported in the literature (Knapp, Gart, & Becher, 2005; Schoenberg, 2006; Tuch & O'Sullivan, 2007; Banal-Estanõl & Seldeslachts, 2011; Weber & Tarba, 2012) suggest there are inherent complexities in merger process management that are yet to be fully understood. According to Sherman and Hart (2006), at least "three out of five M & A deals result in ineffective integration" (p. 234). Human resources, the corporate cultures, the operating and management information systems, the accounting methods and financial practices, and related matters are often the most difficult parts of completing a merger or acquisition Sherman & Hart, 2006, p. 234). Here list a few issues that are obviously known.

1) Culture shock – A major challenge in this operation is directly linked to culture shock. Uniting people from different companies with their own work methods, private retention policies, motivation and career processes, into a hierarchical and power relations environment is a difficult task for leaders. Some failing , some the stress, anxiety, and fear of the unknown could be present. Many companies go together officially, legally, and strategically but cannot join oil and water." In some cases, the mix of cultures to generate a single entity becomes impossible to achieve without harmful results to the company.

2) Human Factors –The human factor is clearly paramount to success or failure. Some topics, such as resistance to change, uncertainty, employees' expectations and commitment, stress, employee turnover and retention, need to be considered. The perception that workers have about the pre-conditions of work, the importance that the new union will be strategic in the future, the way the process is managed by leaders, the communication strategy adopted, and the clarity on future policies that value employees can be determinants of success (Wagner & Hilal, 2014).

3) Synergy processes –Another important challenge is to unify the business processes of the company. Employees are accustomed to previous processes and adapt to a new way of working requires training, effort and dedication of all. Higher complementary features between merging firms, such as in R&D, lead to less failures (Banal-Estanõl & Seldeslachts, 2011).

4) Income or financial loss – Financial risk exists when mistakes occur during evaluation of the value of target enterprise or brought by financing activity of the firms. To control these variables, carefully select and check all the financial of the enterprise, confirming the strength and position and reasonably evaluate the real value. Adopt various financing measures and a mode of mixed payment, and establish a financial alarm management system (Liu, 2010).

Final Considerations and Implications

The present study focuses on a comprehensive analysis of the M & A process applied to the hospital sector, offering good contributions to the better understanding of this methodology in this particular emerging area; yet, the process has been little studied. This study also boosts the adoption by hospital managers when they are faced with the challenge of expanding their businesses, helping to make better strategic decisions. Although still incipient in the hospital sector, the M & A strategy can be considered a possibility for growth, noting its advantages, obstacles, challenges, and risks. Another aspect of this study is to provide to international and Brazilian investors more specific vision of the culture of the hospital sector in Brazil, both in relation to their occurrences regarding the business culture and the nuances of the medical culture. Knowing the intrinsic interests, the struggle for power, and the professional competitiveness of the medical profession is a challenge for investors. Finally, this study leaves open the possibility of conducting specific academic studies in hospitals.

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