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Structuring Management of the Post-Merger Integration Phase in the Buy-and-Build Model: The Case of a Private Network of Integrated Healthcare Entities

Abstract

Objectives: In recent years, researchers have indicated a significant rising trend in the number of serial transactions carried out in the Buy-and-Build model. Simultaneously, managing the Post-Merger Integration (PMI) phase has not yet found much reflection in the investigations of researchers. The chosen subject of the research is related to activity which is focused on exploring the issue of proper management of the PMI phase in M&A projects. The article reviews the literature on the subject, supplementing it with a practical description of structuring the management of the PMI in the B&B model on the German market.

Research Design & Methods: Information included in this article is mainly based on the analysis of the literature on the subject of PMI management, verified on the basis of publicly available data on the consolidation of the healthcare sector on Western European markets, supplemented with knowledge from the implementation of the PMI project on the German market. The conducted research was not verified on the basis of the realities of the Polish market and is not based on Polish literature of the subject.

Findings: Structuring management of the PMI phase in the B&B model is unique and requires an individualised approach. Generic assumptions for the integration process are formulated and steering based on feedback mechanism from information provided by line managers responsible for a particular PMI. Observations coming from the practical case study show that there could be four generic stages in structuring the integration phase in the healthcare industry: (i) market context analysis; (ii) formulating the strategy including business planning and developing long-term financial projections; and (iii) developing the guidelines for the analysis of the entity subjected to acquisition and integration. Furthermore, proper management of the PMI phase should close within a strictly defined timeframe that is not longer than 120 days in order to avoid the degradation of the value resulting from acquisition.

Implications / Recommendations: The perspective of private investors in the healthcare sector should be recognised by public managers. Investors from the private sector in Western countries, identifying the ineffectiveness of the public healthcare system, make attempts to recreate the architecture of the public healthcare system based on general and specialist clinics by acquiring private clinics and including them in a mutually-connected network. The upside from the investor's perspective that allows for generating a high rate of return on acquisition results from the effective management of the PMI phase due to, *inter alia*, building an IT infrastructure enabling the digitisation of patient's contact with medical institutions and building a product offer for companies providing access to private healthcare as an employee benefit.

Contribution / Value Added: The main contribution of this paper is a practical description of structuring the management of the PMI in the B&B model on the foreign market of Western Europe based on the example of a serial acquisition of healthcare entities by a private equity investor. Furthermore, following recommendations by public managers operating in the healthcare sector – in particular those relating the need of digitalised contact between the patients, doctors, and clinics – could limit the negative impact for society, resulting from the extended time of access to medical care.

Keywords: Post-Merger Integration, PMI, Buy-and-Build, B&B, Private Equity, Private Healthcare

Article classification: research article

JEL classification: G24, G34, G32, I11

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Introduction

According to a report provided by the international legal advisor company Allen & Overy (2022), the global value of M&A transactions reached a record level of over $5.8 trillion in 2021, which is an increase of 64% compared to 2020 and by 48% more than in 2018, i.e. the previous record year (p. 1).

Furthermore, the Boston Consulting Group (Brigl et al., 2016) indicated a significant rising trend in the number of serial transactions carried out in the buy-and-build model, pointing out that B&B deals outperform standalone private equity deals generating an average IRR of 31.6% from entry to exit compared with IRR of 23.1% for standalone deals (p. 3).

Despite sufficient returns generated by B&B deals, this transaction model has not yet found much reflection in the interest of scientific researchers, unlike other well-researched private equity transactions, such as leveraged buyout (Axelson et al., 2013, p. 2225). Another research, one conducted by Hoffmann (2008) on German buyout market, based on 21 buy-and-build transactions, indicates that, on average, the B&B model created a significant value, especially by capturing synergy between the different companies involved. It can be assumed that the majority (ca. 75%) of the analysed B&B transactions at least fulfilled the minimum expected IRR of approximately 25% (Hoffmann, 2008, p. 184).

The main contribution of this paper is a practical description of structuring the management of the PMI in the buy-and-build model on the foreign market of Western Europe, based on the example of a serial acquisition of healthcare entities by a private equity investor. The case study presented in the article does not provide a universal determinant of well-managed integrations, but, rather, provides guidance as to which areas of PMI are worth addressing and how a door-to-door process of serial integration could be organised.

Literature review

Characteristics of the buy-and-build model

Buy and Build (B&B) is a Mergers and Acquisitions (M&A) strategy in which a private equity (PE) fund acquires a portfolio company as a platform for the so-called add-on acquisitions (Hammer et al., 2017, p. 2).

According to Smit (2001), these ‘add-on’ acquisitions are done to consolidate the targeted industry (and capturing the advantages of economics of scale) and to eliminate the small firm premium. The strategy involves buying ‘platform’ assets and building the scale and scope through subsequent M&As as a primary source of business growth. The economic rationale of the B&B model rests on economies of scale and efficiency improvements between the platform and add-on companies (Smit, 2001, pp. 79–82).

Moreover, Cumming and Johan (2010) indicate that add-ons come with additional monitoring and integration costs, distract focus from organic growth, and cause the portfolio firm to grow in size and complexity (p. 229).

On the other hand, some researchers indicated that due to the high level of complexity of transactions in the B&B model, there is a risk of increased costs related to post-acquisition issues. Costs incurred due to information asymmetries and coordination are very important during the B&B, because they refer to the intended return and investment horizon (Hammer et al., 2017).

According to the Boston Consulting Group, there is one simple reason for implementing the B&B model: it outperforms standalone PE deals. B&B transactions are not only a way to generate superior performance, but they also provide an opportunity for operational improvements and the furthering of a credible narrative about future growth and margin expansion owing to value generated from traditional synergy levers such as the economy of scale effects as well as from improved sales forcing effectiveness and pricing (Brigl et al., 2016, p. 5).

Ghosh (2001) disagreed with the above thesis; in his studies of the post-exit operating performance of a buy-and-build firm, he finds no evidence of improvements in post-acquisition operating performance.

The team under the supervision of MacArthur from the Bain Company observed that the B&B model has never been as popular as it is today. The researchers concluded that the reason is simple, namely that buy-and-build can offer a clear path to value at a time when deal multiples are at record levels and GPs are under heavy pressure to find strategies that do not rely on traditional tailwinds, such as falling interest rates and stable GDP growth (MacArthur et al., 2019, p. 37). Furthermore, they pointed out that the most effective B&B models target sectors with predictable secular growth and a low risk of disruption as well as fragmented industries with sufficient acquisition targets of the right size (MacArthur et al., 2019, p. 41).

Fragmented industry such as the target market was also indicated by Hoffman (2008), who pointed out that the B&B model typically happened in at least relatively fragmented markets characterised by a combined market share of below 50% for the top 5 companies (p. 185).

Hoffman's another conclusion contributing to the literature on the subject is that the quality of the management team was clearly the most important success factor in buy-and-build strategies. Moreover, the sophistication of the financial controlling/reporting system which represents a prerequisite for effective monitoring of the managers by the private equity firms was also identified by Hoffman as a partly relevant success factor (Hoffmann, 2008, p. 185).

The issue of the PMI of entities implementing serial acquisitions interested Kengelbach et al. (2012) from the Boston Consulting Group and Sperling at the Leipzig Graduate School of Management. The researchers were inspired by the following theses: 1) that multiple acquirers have a considerable potential to learn, but usually fail to exploit it (Hayward, 2002, p. 21); 2) that experience effects may range from positive to negative, because subsequent deals are usually rather heterogeneous, thus making inferencing often inappropriate (Haleblian & Finkelstein, 1999, p. 30). The researchers verified above theses using a global sample of 20,975 of the M&A transaction and came to the conclusion that serial acquirers' short-term transaction performance is equal to that of single acquirers. The conclusions drawn from research by the Boston Consulting Group and Sperling at the Leipzig Graduate School of Management are not unequivocal, although they indicate that serial acquirers have relative competitive advantages owing to the positive learning curve in (i) public target acquisitions and (ii) small to middle-sized deals; it is, therefore, worth to subsequently investigate M&A learning and PMI problems in the remainder of the study (Kengelbach et al., 2012, p. 16).

Companies with superior operational performance are more likely to be part of a buy-and-build model as a platform. Results are more ambiguous with regard to follow-ons, although there is some evidence to suggest that companies with lower operational performance have a higher probability to be acquired as a follow-on (Abrahams, 2018, p. 3).

The empirical results of a study into a deal sample comprising 964 buy-and-build deals and 1,401 traditional LBOs that have taken place in the UK between 2008 and 2016 suggest that buy-and-build models are more likely to appear in industries that are more fragmented and have a higher amount of exit and follow-on opportunities compared to industries that have not seen any buy-and-build activity (Abrahams, 2018, p. 3).

Furthermore, Bansraj and Smit (2017) determined that the B&B model works the best in specific predefined conditions divided into three main pillars: (i) financing, (ii) industry, and (iii) company conditions (p. 3).

Smit (2001) argues that buy-and-build is an acquisition-driven strategy with the purpose to consolidate a certain industry. The first step in the buy-and-build model is to acquire a target company that fits into the role of a platform. The platform company is a well-established industry player with a sustainable competitive advantage over other industry players through noticeable capabilities and unique resources (Smit, 2001, pp. 82–89).

Borell and Heger (2013) empirically address the sources of value creation of the buy-and-build model and state that private equity combine platform companies with follow-on companies with the purpose of allocating resources more efficiently (p. 5).

Nikoskelainen and Wright (2007) put forward an indirectly contradictory thesis that the B&B model would positively influence the performance of buyouts (p. 512).

An analysis conducted by BCG Consultants of buy-and-build deals executed in the period from 1998 to 2012 found that the approach is the most successful when the portfolio company: is small or medium sized; has a PE sponsor with operational and buy-and-build experience; offers an operationally-efficient and scalable platforms; is in a low-growth, low-profitability, highly-fragmented industry; does only one or two add-on acquisitions; targets add-ons in its core industry; and uses acquisition to expand internationally (Brigl et al., 2016).

The business case for building a vertically-integrated healthcare entity in the buy-and-build model

The literature identifies a wide variety of organisational structures and approaches to integrating the healthcare business across private providers. The main conclusion from the Healthcare Intelligence Report, which briefly describes several vertically-integrated healthcare businesses, is that health systems must find a way to evolve beyond their fragmented legacy care delivery models. This will involve partnering with untraditional allies to create regional hubs which bring value to consumers and build patient loyalty using M&As (Hanys, 2019).

Schuhmacher's analysis has shown that the buy-and-build model, which is key to private equity firms in the healthcare sector, is possible and by standard anticipated in facilities' agreements documenting leveraged buyouts (2021, p. 114).

The advantages of building a network of medical facilities in the buy-and -build model are confirmed by business practice, identifying several advantages of building an integrated network of healthcare entities benefiting from the economy of scale and, therefore, generating a number of synergy effects, e.g. increasing medical and visual standard; building a large purchasing group that gives a better negotiating position in the supply of materials; or implementing wider digitisation, which is profitable only after building an appropriate business scale (medical application enabling contact on the patient–facility–doctor line, better utilisation of medical specialist, integration of marketing and sales activities, the possibility of creating a dedicated shared service centres, cooperation with companies from the insurance sector and businesses that provide private care for their employees as part of cafeteria programmes, etc.)

Therefore, in Central Europe, for example on the Polish market, several networks of vertically-integrated healthcare entities were built in the buy-and-build model, such as CenterMed, Enel-Med, Lux-Med, Medicover, or Polmed, operating in a similar business model to that of their counterparts in Western Europe and the USA.

Generic management scheme for the integration phase in the buy-and-build model

A considerable challenge related to building a management model for serial acquisition involves structuration of the post-merge integration phase in a way that: (i) allows standardisation; (ii) correlates with the process of preselection of particular healthcare entities subject to acquisition; (iii) is coherent with an overall strategy of building vertically-integrated healthcare capital group; and (iv) allows the maximisation of the generic added value associated with the add-on acquisition while simultaneously leaving adequate space for own initiative implemented by operational managers responsible for particular integrations.

The projected structure of the integration process is highly influenced by information appearing during the implementation of individual integrations (output signals). Therefore, information coming from a particular integration manager has a fundamental impact on the structuring of the integration phase management methodology.

The feedback mechanism occurs in many processes that require self-regulation, including in automation, computer science, biology, but also, which is confirmed by the described case study, in the discipline of management sciences. Feedback is the influence, direct or indirect, of changes at the outputs of a given system on the state of its inputs. The idea behind the feedback action is to adjust the successive responses of the system based on information about the effects of its own actions (Kowal, 2018, p. 7). The error signal, which is the difference between the input signal and the feedback signal (which may be a function of the output signal), is fed to the control system so as to minimise the error and bring the output signal to a given value (Figure 1). From the above definitions it can be concluded that in the feedback mechanism, the effect of a given action is, *de facto*, the beginning for another action (Gitlow, 2009, p. 14).

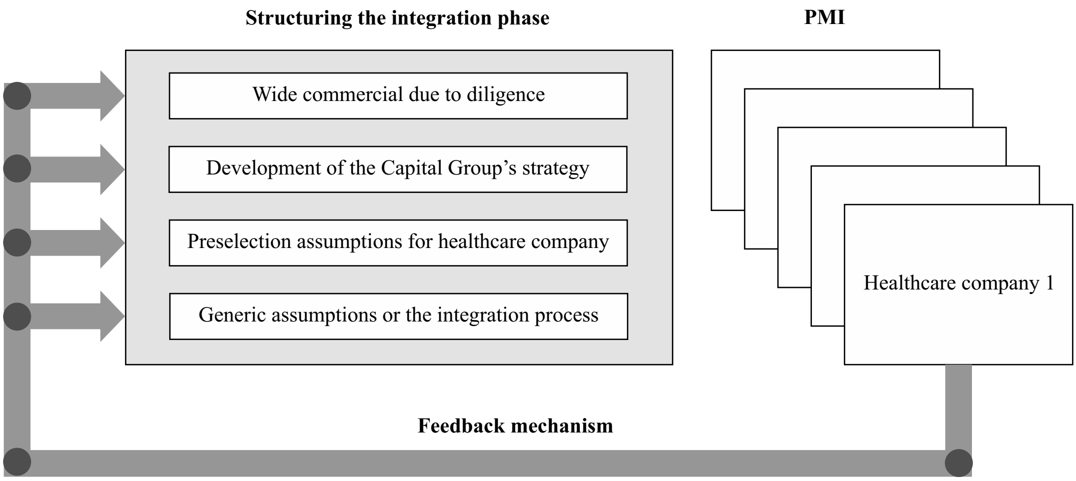

Figure 1. Generic management scheme for the integration phase in the buy-and-build model

Source: own elaboration.

The feedback mechanism in integration management comes down to addressing the relevant questions to line managers responsible for a particular PMI in order to obtain relevant information about how generic assumptions for PMI are reflected in practice. It is especially important to find out how key personnel of a healthcare entity responds to changes, what the key customers' findings or any possible disruptions in supply chains are, etc. The conclusion based on the collected data from at least several medical facilities within at least 8 months after the Day-0 starting integration may point to corrective actions not only for the generic assumptions for the integration process, but also for the preselection assumptions or even the Capital Group's strategy.

Research method

The chosen subject of the research is related to the researchers' activity focused on exploring the issue of proper management of the PMI phase in M&A projects. Namely, the authors of this article noticed a gap in the literature on the subject concerning techniques and tools that, if applied, could support PMI managers in carrying it out correctly, thus reducing the risk of failure.

The dataset included in this article is mainly based on the analysis of the literature on the subject of PMI management, verified on the basis of publicly available data on the consolidation of the healthcare sector on Western European markets, supported by knowledge from the implementation of the PMI project on the German market. The conducted research was not verified through the prism of the reality of the Polish market. The researchers did not use Polish-language literature.

Observations drawn from the implementation described in this article's case study confirm the proposed hypothesis that every particular post-merger integration reflects its unique specificity even in PMI projects that relate to a very similar asset class, such as healthcare entities. The differences in the described case study result mainly from the human factor, including different levels of resistance to stress of key personnel, related to participation in the M&A project as well as attachment to the previously existing customer service model, which changes after the integration.

Structuring the integration phase – preparatory stage

Structuring the management of the post-integration phase in a case study from the healthcare sector had a cascading character and was divided into four interrelated stages (described in Figure 2 below). All of the generic stages were considered from the perspective of PMI as a key activity in building an integrated Capital Group in the healthcare sector.

(1) **Market context analysis for the strategy of building an integrated capital group in the healthcare sector:** an in-depth analysis of the formal, legal, regulatory, and business environment, enabling the construction of a strategy for an equity investor, whose aim is to build a vertically-integrated network of healthcare entities based on a serial acquisitions and the integration of the existing healthcare companies, as well as, after that, raising their standard (both medical and visual, e.g. interior design), and then generating a number of synergy effects coming from: (i) building a large purchasing group that gives a better negotiating position in the supply of materials; (ii) introducing a wider digitisation, which is profitable only after building an appropriate business scale (medical application enabling contact on the patient–facility–doctor line); (iii) a better optimisation of medical workers' calendars owing to the exchange of patients; (iv) the integration of marketing and sales activities;

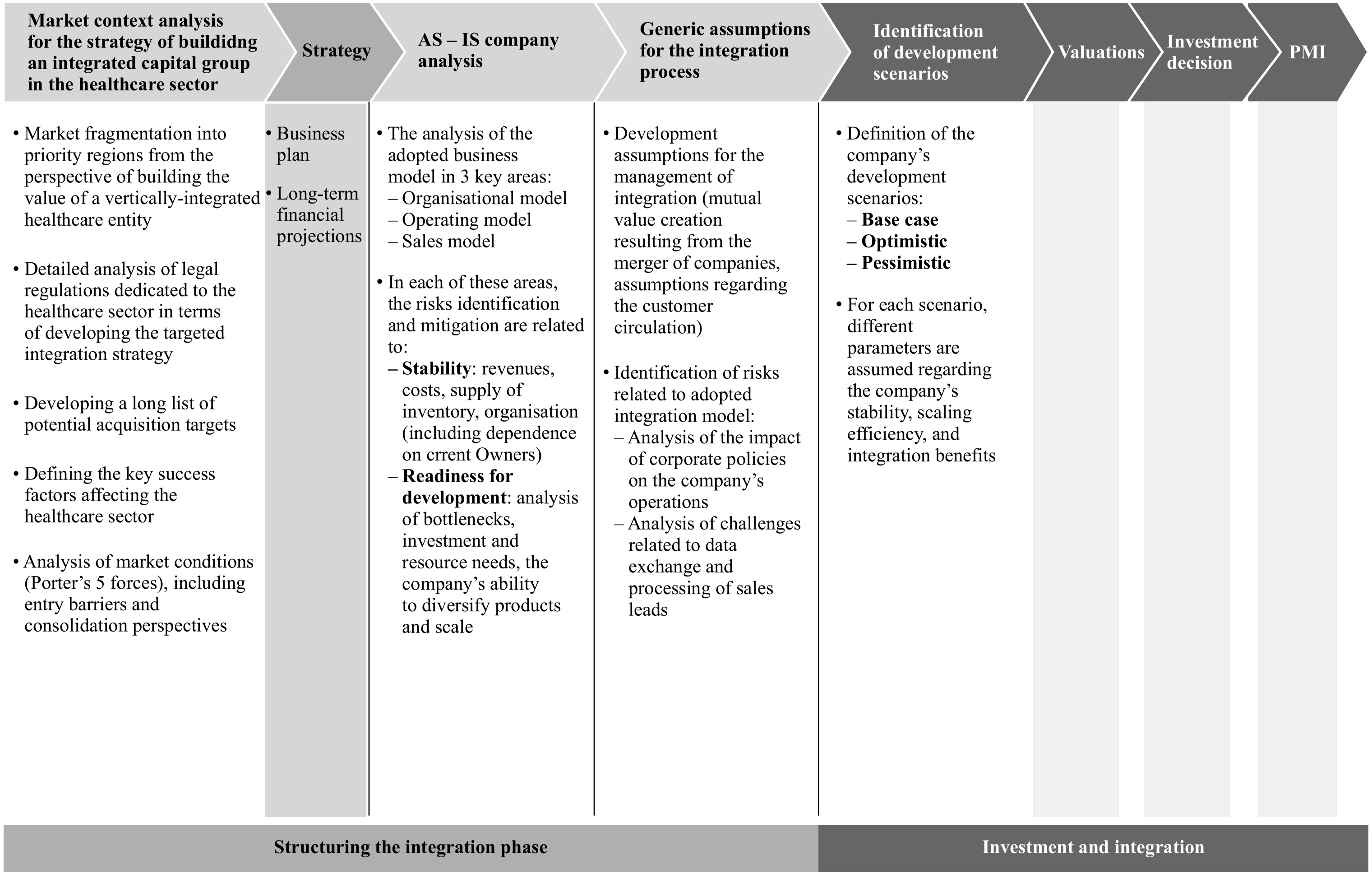

Figure 2. Diagram presenting stages of structuring the integration phase

Source: own elaboration.

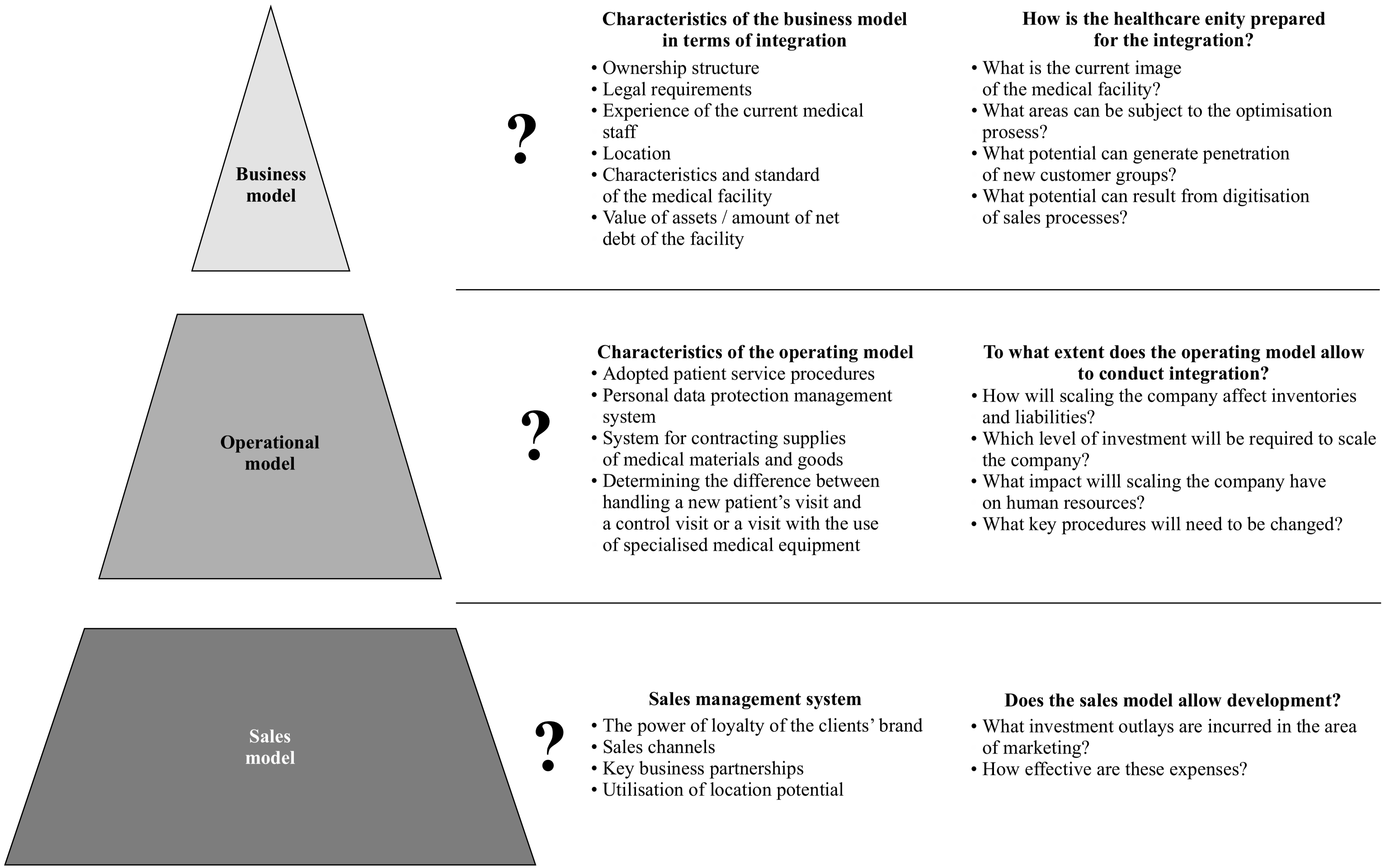

Figure 3. Scheme of guidelines for the analysis of the company that is the subject of the acquisition and integration (analysis of the AS-IS company)

Source: own elaboration.

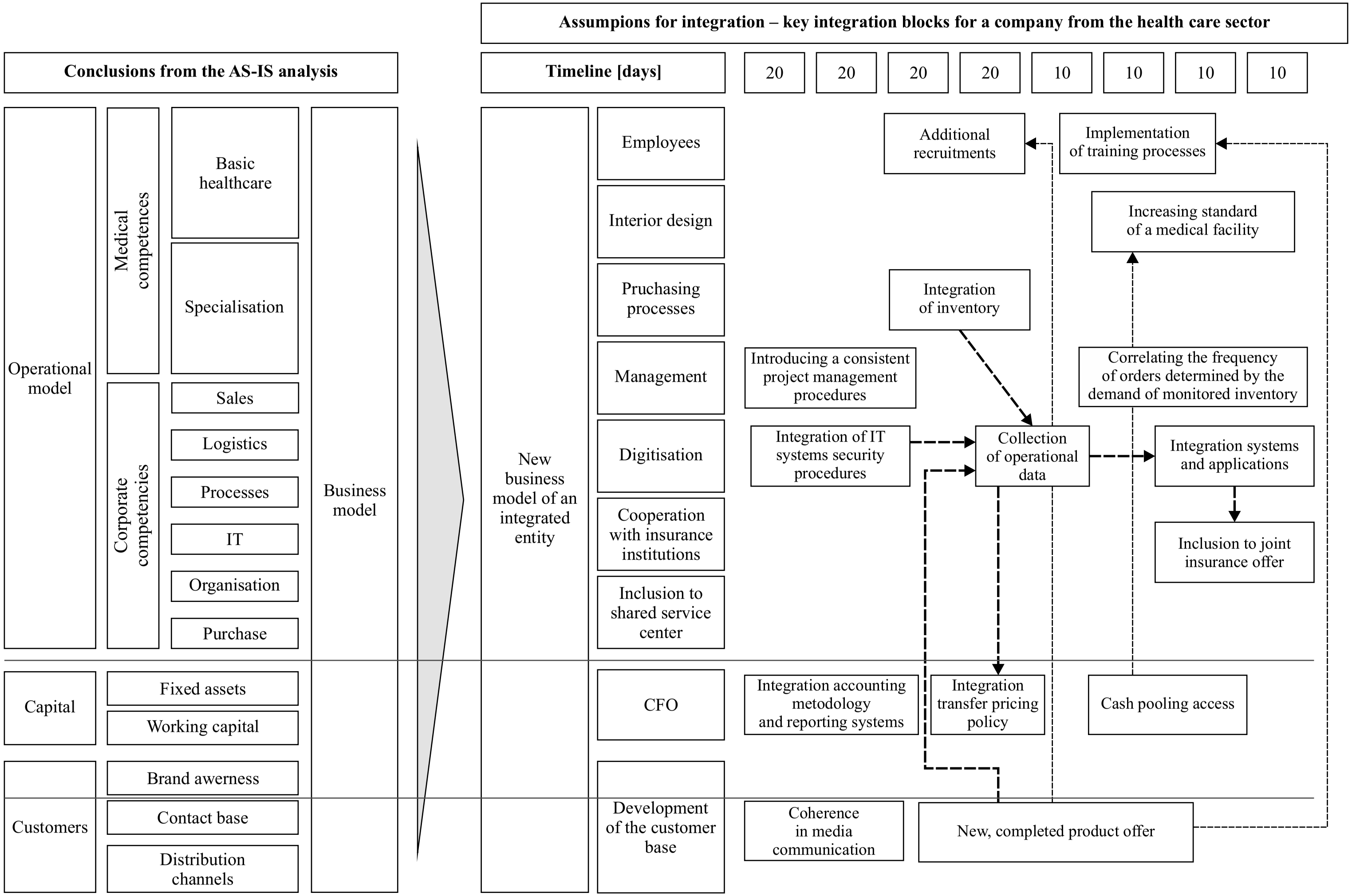

Figure 4. Scheme of key integration blocks

Source: own elaboration.

(v) the creation of a dedicated shared service centre; and (vii) cooperating with companies from the insurance sector and businesses that provide private care for their employees as part of cafeteria programmes.

(2) Development of an integrated strategy of the Capital Group: here, a business plan is developed containing key assumptions concerning, *inter alia*, (i) investment budget; (ii) management structure, including a business development department (a team actively looking for new acquisition targets), a team dealing with the transaction phase, and a team responsible for integration; (iii) identifying and agreeing the terms of key business partnerships; and (iv) defining the number of investment goals assigned to particular years; and many others. The second important document developed during those stages is a long-term financial projection with reflected income and cost assumptions resulting from the previously developed business plan.

(3) Development guidelines for an analysis of the entity subjected to acquisition and integration, otherwise known as AS-IS company analysis (described in Figure 3): the scope of the analyses determined by the specificity of the healthcare industry as the organisational model of healthcare entities is usually a hybrid of internal forces and external partnerships, thus combining business flexibility with control over the quality of the provided services, described exactly on the basis of market analyses carried out as part of the previous stage and focused on three main areas: sales management, operations, and managing the organisation of partners and employees. In each of these areas, the aim of the analysis is to address key questions which are strategically important from the integration perspective.

(4) Development of generic assumptions for the integration process (described in Figure 4): the last stage of structuring of the integration phase, reflecting, *de facto*, the key conclusions from the other three stages. It is also the most important stage from the perspective of building the Capital Group and achieving the assumed business goals. In addition, as part of the process of structuring the integration phase, it is also the stage that should be influenced most strongly by information from line managers responsible for the operational conduct of individual integrations combining medical facilities into the Capital Group.

Concluding remarks and discussion

Developing business by a serial acquisitions of other businesses and implementing vertical integration known as buy-and-build is a growth model observed in practice for companies from the healthcare sector. Structuring management of the post-integration phase in the buy-and-build transaction model is unique and requires an individualised approach. PMI integration is a set of activities aimed at achieving the assumed synergies between the merging companies. It is important to properly plan the integration process before finalising the transaction, as well as create extensive plans for the first 120 days after the transaction closing with a detailed breakdown of decision-making and competence centres, including the determination of resources and planned effects.

Observations coming from the practical case study show that there could be four generic stages in structuring the integration phase in the healthcare industry, namely: (i) market context analysis for the strategy of building an integrated capital group in the healthcare sector; (ii) formulating the strategy including business planning and developing long-term financial projections; and (iii) developing guidelines for the analysis of the entity subjected to acquisition and integration. Based on the previous three stages, the generic assumptions for the integration process are formulated and steering based on feedback mechanism from information provided by line managers responsible for a particular PMI.

The described case study is the beginning of further research in the field of post-merger integration management.

Research limitations

Conducting research on the key factors of structuring management of the PMI phase is severely limited due to the specific approach of various entities to the faced challenges as well as varying business goals, the generation of which may lead to erroneous conclusions.

Additionally, due to the competitive environment in which most companies operate, they do not make information on managing the PMI phase publicly available.

Generalising the approach to PMI management may lead to statements of conclusions whose practical application may not bring the desired effect related to improving the management of the PMI phase.

Policy recommendations

Identifying the ineffectiveness of the public health care system, investors from the private sector in Western countries make attempts to recreate the architecture of the public healthcare system based on general and specialist clinics by acquiring private clinics and including them in a mutually-connected network.

The upside from the investor's perspective that allows for generating a high rate of return on acquisition results from the effective management of the PMI phase due to, *inter alia*, building an IT infrastructure enabling the digitisation of patients' contact with medical institutions as well as building a product offer for Corporations providing access to private healthcare medical benefits as an employee benefit.

The insights of the private sector should be noticed by decision-makers from the public health sector, which, through proper management, owing to having a large network of treatment facilities, would be able to significantly improve its efficiency.

In particular, an important factor in the development of the public health service is the digitisation (e.g. by creating an interactive application) of contact between the patients, doctors, and clinic. It will make it possible to reduce social losses resulting from the extended time of access to medical care.

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