

BAIN & COMPANY

Using
Mergers and
Acquisitions
to Secure
Strategic
Position and
Profitable
Growth

Health Care Viewpoint

Number 11



Bain health care expertise

As the year 2000 approaches, the health care industry is still turbulent. Customer requirements and competitive dynamics continue to evolve. The industry is seeing more deals, more alliances, more investment, and more experiments than ever before. It's not always clear whether a new approach is a fad or a real basis for leadership in the marketplace. Health care organizations are rethinking every element of their strategies, structures, and business practices to find the path to sustainable results.

Bain & Company helps health care companies navigate a course to outstanding results. We work closely with motivated management teams to create a clear map, a goal and direction for achieving not incremental improvements, but full potential returns.

Bain's global health care practice combines expertise, an industry network and years of experience accumulated across all parts of the health care industry. Bain helps health care companies, including product suppliers, distributors, providers, and payers worldwide, select a strategic course and create a practical migration path to the goal.

securing strategic position

Only 33% of all health care M&A activity creates sustainable, improved shareholder and strategic value. However, as Boston Scientific, Johnson & Johnson, and others have demonstrated, M&A activity can be an integral part of a company's strategy to build profitable growth and capability. After a short decline in 1991 and 1992, created by the uncertainty around U.S. health care reform, M&A volume and prices again have increased. While global health care dynamics have increased the potential payoff of M&A as a strategic lever, increased acquisition premiums have made it more important than ever to emulate the process followed by successful M&A value creators:

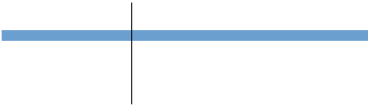
- 1) Assess the target company's strategic fit and fundamental attractiveness,
- 2) Negotiate deal price and structuring (to minimize real cost), and
- 3) Ensure excellence in post-merger integration (to realize the value).

Successful M&A value creators:

Three Key Steps

1] Select the Best Target: Assess Strategic Fit and Fundamental Attractiveness

Global health care market dynamics are changing the fundamental structural requirements for success. Innovation continues to be driven by creativity and entrepreneurial energy, not scale. However, development, manufacturing, sales and marketing, and distribution are increasingly



dependent on scale. Also, new ways of competing—including services, channel strategies and new technologies—require access to external capabilities. Carefully targeted acquisitions can provide access to capabilities, scale, and attractive new growth opportunities.

2 Structure the Right Deal: Minimize the Real Cost

Target selection addresses the value creation potential. Price, however, drives the effective premium over the stand-alone operating value, and, therefore, the net value creation potential. At the right price, any acquisition can create value. While the negotiated price is the most visible component of the deal, many additional side items (i.e., working capital adjustments, existing contract transfers, potential liability transfers); accounting and tax treatment structuring; price and payment linkage to major performance variables; and the currency used to pay for the acquisition all drive the effective price paid. Using a highly valued stock as a currency can allow companies to pay a high price for a company while increasing earnings per share in the first year. Given the valuation cycles for industry sectors and individual companies, having a multi-year time horizon is also a critical variable.

3 Realize the value:

Excellence in Post-merger Integration

The intensity of accomplishing the deal usually leaves both management teams looking to catch their breath, but post-merger integration is when the real work begins. Experience indicates that there are five critical requirements for successful integration:

- 1) The creation and communication of a clear and compelling strategic vision of how the combined entity creates new value;
- 2) The utilization of tightly planned and coordinated transition and integration teams sponsored by senior management and staffed with high potential individuals focused on the key joint value creation opportunities;
- 3) The development and utilization of clear merger principles—designed to select the best from each organization’s culture, people, and practices—based on an objective process with the most knowledgeable individuals assessing trade-offs and making decisions;
- 4) Monitoring critical operating levers to avoid the downward cycle of financial shortfalls, customer losses, and employee defection during integration; and
- 5) Execution of a comprehensive communication plan, including the strategic vision, merger principles, and on-going decisions required to avoid paralysis and to gain support for new initiatives.

summary

While mergers and acquisitions are not a replacement for a competitive, differentiated market strategy, they can help turbo-charge the strategy. But, like all strategic investments, they, too, require rigorous evaluation, careful prioritization, and superb execution.



Bain is one of the world's leading global business consulting firms. Its 2,400 professionals serve major multinationals and other organizations through an integrated network of 26 offices in 18 countries. Its fact-based, "outside-in" approach is unique, and its immense experience base, developed over 26 years, covers a complete range of critical business in every economic sector. Bain's entire approach is based on two guiding principles: 1) working in true collaboration with clients to craft and implement practical, customized strategies that yield significant, measurable, and sustainable results, and 2) developing processes that strengthen a client's organization and create lasting competitive advantage. The firm gauges its success solely by its clients' achievements.

BAIN & COMPANY

BAIN & COMPANY, INC.

Two Copley Place
Boston, Massachusetts 02116
Tel: (617) 572 2000
Fax: (617) 572 2427

Atlanta • Beijing • Boston • Brussels/Amsterdam • Chicago
Dallas • Hong Kong • Johannesburg • London • Los Angeles
Madrid • Mexico City • Milan • Munich • New York • Paris
Rome • San Francisco • São Paulo • Seoul • Singapore
Stockholm • Sydney • Tokyo • Toronto • Zurich