WEB FEATURE

EARLY EDITION November 2016

hfm

healthcare financial management association hfma.org

Scott Boyd

hospital M&A activity

a window of opportunity to tackle the talent conundrum

A period of M&A activity can be the optimal time for healthcare organizations to examine and update employee benefits.

AT A GLANCE

M&A activity offers healthcare organizations an opportunity to update and streamline their employee benefit offerings and, thereby, accomplish several objectives:
> Attract and retain talent
> Prepare workers for retirement
> Manage pension risk

Fueled by the desire to form new business models, achieve economies of scale, and broaden service reach, mergers and acquisitions (M&A) present significant opportunities for the hospital sector, but they also pose challenges for management. In 2015, more than 100 transactions involving hospitals were announced, with deal volume being the highest it has been over the past decade and many transactions exceeding $500 million. It is anticipated that by year end, 2016 could set another record in terms of transaction volume, according to a recent report from PwC.[a]

The success of these transactions will depend, of course, on how well the organizations manage their financials. But success does not depend on this factor alone. Many healthcare finance executives and administrators underestimate the talent management challenges that these transactions can present and do not understand how meeting these challenges can help their institutions achieve a sustainable competitive advantage. For example, a hospital could use its retirement plan to achieve strategic talent objectives as part of M&A and, in the process, reap financial benefits. Hospital finance leaders should closely contemplate such options.

a. PwC, *U.S. Health Services Deals Insights: Analysis and Trends in U.S. Health Services Activity 2015 and 2016 Outlook*, February 2016.

A Window of Opportunity

Although M&A activity may help hospitals achieve their strategic business objectives, it also creates challenges as management implements new business models and builds new organizational structures. One such challenge is effectively managing talent while achieving cost synergies.

No matter how effectively M&A transactions are executed, the employees affected often undergo a period of uncertainty that can prompt them to consider their career options. Retirement benefit plans can provide an effective means for addressing this concern. Simply put, a hospital can increase retention of essential personnel during an M&A process by ensuring its retirement benefit plans are competitive with those offered across the industry.

M&A transactions, for example, can result in a web of legacy defined-contribution and defined-benefit retirement plans in which employees in a given segment receive a much more favorable benefit from one plan than they would from another. In addition to sending confusing messages to employees, the combined legacy plans often are fraught with hidden costs because having multiple plans creates additional complexity and administrative burden and can lead to staff turnover as targeted employees become dissatisfied with their plan options.

Streamlining and redesigning these plans could help hospitals accomplish a number of objectives, including retaining and attracting employees, preparing employees to retire when they wish, and lowering pension plan risk—possibly without even adding costs. Using data analytics and actuarial expertise also provides a potential means for hospitals to optimize the retirement plan offering.

The Talent Conundrum

In the hospital sector, talent management challenges encountered during the implementation phase of an M&A transaction may have financial as well as workforce management implications. The most common talent management issues that arise as a result of an M&A process are

> Attracting and retaining talent
> Preparing employees to retire when they wish
> Managing pension risk

Attracting and retaining talent. Hospitals have unique talent management challenges: The workforce is highly skilled and specialized; performance is of critical importance; and it requires many years of education to become a physician, nurse, technician, or surgeon, which makes it a slower process to bring new ones on board. Moreover, an aging workforce is leaving hospitals with staff shortages. One in three practicing U.S. physicians is over the age of 65. By 2025, demand for physicians will exceed supply by a range of 46,000 to 90,000, according to the Association of American Medical Colleges.[b] The talent shortage also is being driven by increased medical needs of the aging baby boomers and a significant number of newly insured people entering the system as a result of the Affordable Care Act.[c]

The recent M&A boom is making talent retention and attraction an even bigger challenge, as employees rethink their career options. Due to the proliferation of outpatient facilities, hospitals and health systems are competing fiercely for the same talent pool in a given geographic region. Sixty-one percent of respondent to a recent *Economist Intelligence Unit* (EUI) survey of hospital executives say strategic talent management will be key to staying competitive, and 74 percent say their organization needs to pay more attention to retaining and attracting the best talent.[d]

Losing valuable talent not only is detrimental to service delivery, but also comes with a high price, costing about 100 to 300 percent of the base

b. Association of American Medical Colleges, "Physician Supply and Demand Through 2025: Key Findings," 2015.
c. Maurer, R., "Managing the Talent Gap in Health Care Staffing," The Society for Human Resource Management, May 7, 2015.
d. EIU, *Tipping Point: Hospital Resilience in a Perfect Storm*, 2016.

salary of the employee being replaced, and that assumes the talent is available.[e]

Preparing employees to retire when they wish. Employers need to strike a balance of retaining talent and helping employees retire when they wish. A recent survey found that 57 percent of finance executive respondents anticipate that a significant portion of their employees will have to delay retirement due to inadequate retirement savings.[f] Among respondent to the previously cited EIU survey, 65 percent of hospital executives see an aging workforce presenting a problem in the long term. Yet legacy defined-contribution plans in an M&A transaction may not be effective at improving employees' retirement readiness.

Delayed retirements often create financial stress, a lack of engagement, and lower productivity from employees who want to retire, as well as higher turnover among younger employees due to the lack of advancement opportunities. Delayed retirements also can reduce an employer's ability to hire new employees, reducing the inflow of new ideas and talent.

Although the relationship between the age of a workforce and its cost is complex, with qualitative factors also playing a role, delayed retirements typically result in higher costs for employers. These costs manifest as increased compensation, defined-benefit and defined-contribution retirement plan costs, and group benefits costs. According to the University of Connecticut Goldenson Center for Actuarial Research, a one-year delay in retirement is estimated to increase incremental workforce costs by 1 to 1.5 percent annually, not including the qualitative costs, such as lost productivity and financial stress on employees.[g] This additional cost may be especially significant for a healthcare institution's bottom line, because payroll costs represent about two-thirds of a typical healthcare provider's costs.[h]

Managing pension risk. Although many employers have shifted from defined-benefit to defined-contribution plans, many hospitals have legacy defined-benefit plans. Pension plans can contribute to significant long-term business risk when combined with asset/liability mismatch, escalating longevity, unpredictable funding requirements, and ongoing market volatility. Pension plan funding status has fallen over 35 percent twice since 2000 during significant market downturns.[i] Among senior finance leaders responding to a recent survey, 43 percent believe their defined-benefit plan have placed a constraint on their companies' cash flow, while 50 percent acknowledge an impact on earnings due to volatility of plan funded status, and 36 percent indicated an impact on their ability to invest in growth opportunities.[j]

Tackling the Conundrum Through Retirement Plans

Hospital finance executives should be prepared to address the most common talent challenges that emerge during an M&A initiative. Optimizing retirement plans during such an effort is an option that may be the key to retaining and attracting top-level talent, creating better retirement outcomes for employees, and managing pension risks—all while saving the hospital money.

Hospitals seeking to leverage their retirement plans to retain and attract talent should start by setting talent objectives, assessing the current talent, and benchmarking their retirement plans against those of other, comparable organizations. Equipped with this knowledge, hospitals may design their defined-contribution plans to help achieve the new objectives, using data analytics

e. Inventive Talent Consulting, "Measuring and Mitigating the Cost of Employee Turnover," webcast, The Society for Human Resource Management, July 17, 2012.

f. CFO Research Services and Prudential Financial, Inc., *Helping Employees Achieve Secure—and Timely—Retirements*, 2015.

g. Research by University of Connecticut Goldenson Center for Actuarial Research sponsored by Prudential Financial, Inc., 2015-16.

h. Kaplan, R., and Hass, D., "How Not to Cut Health Care Costs," *Harvard Business Review*, November 2014.

i. Prudential Financial, Inc., *Shifting Longevity Risk (Back) to Insurers*, October 2012.

j. CFO Research Services and Prudential Financial, Inc., *Managing Financial Risk in Retirement and Benefits Programs,* June 2014.

and actuarial expertise to model different design alternatives and their outcomes.

Designing plans that allow matching contributions to be tailored to the needs of different employee segments according to need, for example, can enable a hospital to get the most for its matching dollars. It may even allow the hospital to implement automatic enrollment or escalation features without increasing costs. Employer-matching contributions, and potentially nonelective and profit-sharing contributions, can vary based on a number of factors, allowing a hospital to allocate contributions to its employees to meet desired outcomes and other important requirements, such as discrimination testing.

Using this approach, hospitals also may explore other benefit plan levers to retain talent, and M&A activity can provide the impetus to do so. Sixty-five percent of finance executives responding to a 2016 survey by CFO Research Services, the sponsored research arm of CFO Publishing, say employee benefits are critical to attracting and retaining employees.[k] For example, streamlining disability and absence management functions can help control costs, reduce absence, and improve productivity. A healthcare organization also may consider adding new benefits, such as student loan repayment, that target young employees. Hospitals also may consider expanding their benefits lineup with voluntary benefits, whereby employees customize their benefits coverage and bear all, or part, of the cost.

The same customized approach to plan design can be deployed to help selected employee segments achieve retirement readiness. In addition, employers may offer guaranteed lifetime income products to help reduce the level of defined-contribution plan savings that employees need to generate their desired level of retirement income. In fact, recent research suggests incorporating guaranteed lifetime income products into a defined-contribution plan reduces the level of assets required for a typical participant to retire at age 65 by about 36 percent.[l]

As part of efforts to ready employees for retirement, healthcare organizations should provide saving and investment education to help employees proactively make informed financial decisions, including ways to optimize their retirement plans (e.g., contributing at a rate that allows them to take full advantage of an employer's matching contribution). One in four employees does not save enough to receive their full employer match, with the result that the nation's employees may be leaving an estimated $24 billion on the table each year.[m] Planning tools may help employees set and gauge progress against retirement income planning objectives.

Along with education and planning tools, protection products may boost employee financial wellness and improve retirement outcomes. Without adequate protection, a disability, critical illness, or accident may precipitate the need for an employee to halt defined-contribution plan contributions or even withdraw retirement savings, potentially leading to financial stress in the workplace and delayed retirements. Providing employees with adequate coverage is key to helping hospitals protect the investment they have made through their institution's match in their employees' retirement readiness. Among finance executives responding to the previously cited 2016 study by CFO Research Services, 82 percent say they believe that their companies benefit from having workforces that are financially secure, and 78 percent say that employers should assist employees in achieving financial wellness during their working years. Solutions to managing pension risk, such as through the use of liability-driven investing or pension risk transfer transactions, may help employers reduce both balance sheet liabilities and funded status volatility.

k. CFO Research Services and Prudential Financial, Inc., *The Value of Employees' Financial Wellness*, 2016.

l. Marcks, C.C., and Kalamarides, J.J., *What Employers Lose in the Shift From Defined Benefit to Defined Contribution Plans...and How to Get It Back*, Prudential Financial, Inc., 2015.

m. Jurs, M., "American Employees: Are You Leaving Money on the Table?" Financial Engines, May 12, 2015.

Bio

An Key Component to Employee Retention

Hospitals and health systems should view M&A transactions as opportunities not only to implement new business models and increase scale, but also to strategically strengthen their workforce management capabilities in a way that reduces overall costs. Retirement plans can be the underpinnings of a successful workforce strategy that supports management's objectives, while also providing an ROI. In addition to any direct cost savings resulting from retirement plan redesign, a hospital's ROI may include implicit savings from lower turnover costs due to improved employee attraction and retention, lower workforce costs achieved by minimizing delayed retirements, and a lower risk profile as a result of reducing risk in defined-benefit plans. Such a redesign is one key piece of the employee retention puzzle, particularly in times where M&A activity is prevalent. ■

About the authors

Scott Boyd, MBA,
is senior vice president and head of healthcare solutions, Prudential Retirement, Hartford, Conn. (scott.boyd@prudential.com).