The Governance Institute's E-Briefings

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Welcome to The Governance Institute's E-Briefings!

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Whole-Hospital Joint Ventures between Non-Profit and For-Profit Companies

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Boards and managements of non-profit hospital companies are experiencing pressure to consider business combination transactions in light of the need for real consolidation of the industry. A whole-hospital joint venture is an alternative approach to ownership change that falls between the more conventional options available to non-profits (e.g., combining with a non-profit partner or an outright sale to a for-profit company). This article focuses on whole hospital joint ventures between for-profit and non-profit hospitals/health systems and seeks to provide an understanding of their basic structure, the reasons for entering into these arrangements, the types of non-profits that have entered into them, and the outcomes that have been experienced.

Whole-Hospital Joint Ventures

By entering into a whole-hospital joint venture (WHJV), a non-profit organization is selling a majority position in its hospital system to a for-profit partner, and retaining both an equity stake and a role in the future governance of the "new company." Most often, these have involved ventures between non-profit and for-profit companies; there have also been a small number of WHJVs created by two non-profit companies. These have not, however, involved the payment of cash to the non-profit and do not represent a meaningful alternative to more traditional transactions. Also, the structure reviewed in this article should not to be confused with joint ventures involving specialized services (e.g., surgery centers). As a result, we will focus exclusively on WHJVs entered into by non-profits with for-profit partners.

Transaction Structure

As part of the negotiation of a change-of-control transaction, a WHJV is created by a non-profit hospital or hospital system (the "NP Hospital") and a for-profit hospital company (the "FP Partner") as they form a jointly owned for-profit company. The NP Hospital contributes one or all of its hospitals and the FP Partner contributes cash. This cash contribution, effectively, is used to purchase its majority ownership position in the WHJV and to fund its share of future capital needs. The NP Hospital contributes its "business" (i.e., the facilities, equipment, operations, and working capital) to the WHJV in exchange for cash and a minority ownership share in the WHJV. The amount of cash received by the NP Hospital is reduced by its share of the future capital requirements of the WHJV. As with an outright sale, the cash distribution received by the NP Hospital is typically used to retire its liabilities, and a foundation is created with the net proceeds. NP Hospitals that enter into these arrangements usually seek contractual protection against unforeseen change. In this regard, put and call options and rights-of-first-refusal have been commonly granted to the NP Hospital.

Governance

As with non-profit systems, WHJVs typically have two boards, one at the WHJV level and one at the hospital level. The WHJV board usually has parent-company authority regarding major strategic decisions and the hospital board's responsibilities consist primarily of day-to-day operating decisions. Until recently, WHJVs were structured so that board representation matched the equity position held by each party. However, more recent WHJVs have been structured so that the NP Hospital has 50–50 board representation, so long as it maintains an ownership position of at least 20 percent; this means that representatives of the former NP Hospital have the right to nominate 50 percent of the WHJV board. This is significantly more governance authority than would have been realized had they become part of a large non-profit system.

Operations

Once established, the WHJV is typically managed by an affiliate of the FP Partner under a management services agreement. These agreements last approximately five years, are renewable, and often compensate the manager on the basis of some percentage of the WHJV's net revenues. As majority-owner, the FP Partner typically consolidates the WHJV's results on its financial statements. Unlike a non-profit hospital system, WHJVs are able to make capital distributions; however, should there be additional capital needs, these distributions may be suspended. Future capital investment in the WHJV is derived from the initial capital contribution, loans from the FP Partner, and pro-rata contributions from the partners.

Non-Profit Participants

A wide variety of non-profits have chosen the WHJV structure, including community and religious sponsored, local government-owned, and academic hospitals. Most WHJVs resulted from the conveyance of the entire non-profit system. However, there have been several situations in which large non-profit systems (e.g., Ascension, Texas Health Resources) elected to build a new hospital via a WHJV with a for-profit partner. Since their first development in the early 1990s, approximately 30 WHJVs have been completed; they represent a small but meaningful minority of all change-of-control transactions. These WHJVs now contain 59 former non-profit hospitals, or approximately two hospitals per transaction. They have most often been entered into by non-profits with rich traditions, significant market reputations, and heavily committed boards of directors. The average size of the non-profits that entered into WHJVs was approximately 50 percent larger than the average size of all non-profits participating in business combination transactions with for-profit acquirers over the same time period.

Consistent with the hybrid nature of WHJVs, non-profit hospitals have had several motivations for selecting this approach. These include benefits generally associated with conversions (sale to a for-profit) and benefits unique to this structure. Conversions hold several common benefits, including creation of a foundation, improved access to capital, and transfer of management to an experienced and broad-based group. The benefits associated with the WHJV structure itself relate primarily to the local accountability that results from the governance construct, and the investment opportunity inherent in maintaining an ownership stake in the hospital system. In our view, governance authority has been the most important objective sought by non-profits in choosing the WHJV structure. In comparison to an outright sale, the WHJV structure involves a significant trade-off between foregone cash proceeds (i.e., from the minority stake which is not sold) versus the significant governance authority that results. In order for the WHJV structure to be compelling, the non-profit must have a board that places enormous value on local accountability and a debt level that allows this option to be financially feasible.

For-Profit Participants

Six different for-profit companies act as the FP Partner in the 30 WHJVs. One particular management group, and their career progression, accounts for the presence of three of these companies. In considering partners for prospective WHJVs, the major for-profit companies fall into three groups: most are somewhat ambivalent and willing to consider, but do not seek, such structures; several are not willing to enter into them; and one is very focused on creating WHJVs.

Outcomes

In practice, WHJVs have been very successful and nearly all those that have been created remain in place today. Only one non-profit has exercised its put option, and this was due to a church-related refocus of mission, not displeasure with the WHJV. One FP Partner was recently bought out by the NP Hospital; this resulted from the sale of the original for-profit sponsor to another for-profit company.

Future Application

WHJVs have represented an attractive alternative to outright sale or merger and have performed well in practice. Juniper considers these to be highly evolved and proven structures. As non-profit boards consider business combination transactions, WHJVs are often a viable alternative, particularly in circumstances in which boards place great importance on local governance. In our view, non-profits are going to commonly consider business combination transactions on a proactive basis in the near future. This is in contrast to defensive motivations, which dominated transactions during the past decade. As a result, WHJVs will often represent an attractive alternative that warrants serious consideration.

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