



What's in a Name?

Valuation of Healthcare Brands



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INTRODUCTION

The Cleveland Clinic, Mayo Clinic, MD Anderson and Duke Health – each is a familiar brand name that signals high-quality patient care and outcomes. Over the years, these brands have seen extended reach outside of their immediate communities, not just in other cities within the United States, but across the world. Large health systems and smaller community hospitals have sought alliances with these healthcare giants not only to leverage their expertise in patient care protocols and physician professional services, but also to signal to their local patient population that they now have the expertise and reliability that are hallmarks of these names.

Similarly, regional healthcare organizations with strong brands also are exploring ways to monetize their brands, while many smaller providers are looking for opportunities to affiliate with larger organizations with greater resources. For example, at a more local level, smaller community hospitals have been seen to affiliate with academic medical centers (AMCs) and larger, more established health systems within their state or immediate geography, for specific service lines. Having invested heavily in providing desired messaging around quality and expertise, these more established brands are now seeing increased potential for leveraging their brands in return for economic benefits.

An important first step in forming such affiliations intended to capitalize on brand strength is to evaluate the brand's value, including the anticipated incremental value that it will bring to the joint venture or other business arrangement. Such valuations require a thorough analysis of multiple factors such as each party's brand strength, competition for services, the margins achievable through the new venture, and ultimately, the anticipated impact of branding on cash flows.

WHAT IS BRAND?

Brand means more than logos, slogans, and trademarks; it includes tangible and intangible qualities that create value.

In healthcare, brand typically is tied to factors such as an organization's reputation for quality of care, patient satisfaction, and outcomes.

In introducing the new brand image for Emory Healthcare, former CEO John Fox offered a succinct definition of healthcare brand:

“This is not just a new logo, signage, or new ads. This is about who we are; how we are able to reduce costs while continuously improve quality, and where we are going as an organization...¹”

BENEFITS OF A STRONG BRAND

A strong brand is typically a competitive advantage resulting in loyal customers, growth in market share, and often higher levels of profitability. In healthcare, a strong brand can influence purchasers of such care to select one provider over another in an otherwise intensely competitive market. Strong reputations and brands also help attract top-quality physicians. With the Association of American Medical Colleges predicting a national shortage of up to 95,000 physicians by 2025, attracting and retaining top-quality clinicians is a top priority for many hospital organizations.²

Brands help in a world where commoditization is feared. Apart from certain cutting-edge treatment options, patients can choose from a number of providers for the services they need, and a known brand creates top-of-mind awareness, reduces perceived risks of seeing an unknown provider, and simplifies the decision-making process.

¹ http://news.emory.edu/stories/2013/09/emory_healthcare_launches_new_brand/campus.html.

² https://www.aamc.org/newsroom/newsreleases/458074/2016_workforce_projections_04052016.html.

EVALUATING BRAND STRENGTH

A hospital's brand strength can be influenced by a number of factors, such as the following:

1. Reputation
2. Competition
3. Physicians associated with the hospital
4. Patient awareness and loyalty
5. National rankings



REPUTATION

A wide range of factors influences the public's perception of a health system, including its historical role in the community. For example, AMCs often must battle the “providers of last resort” reputation, given their roles in the communities they serve as safety net hospitals, ensuring care is available for the uninsured. Many AMCs have devoted significant resources – and also relied on the passage of time – to ensure the markets they serve are also aware of the research, medical advancements, and high level of specialized care they provide.

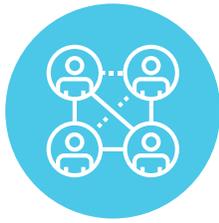
Both a hospital's clinical accomplishments and its historical financial performance also influence its reputation. Factors such as reports of bad outcomes, medical malpractice lawsuits, or the public release of data showing above-average infection rates can tarnish a hospital's hard-earned reputation. With regard to the latter, defense of reputation has become one of the key motivators behind concentrated efforts to reduce hospital-acquired conditions (HACs). Dramatic improvements have been realized—the U.S. Department of Health and Human Services reported that an estimated 87,000 fewer patients died in hospitals and approximately \$19.8 billion in costs were saved by reductions in HACs from 2010 to 2014.³



COMPETITION

In urban areas, patients typically have multiple options for their medical needs. Therefore, for healthcare organizations operating in highly competitive urban markets, brand recognition is a key factor as a means of differentiation in quality and breadth of services. In smaller communities, local healthcare providers often affiliate with larger organizations as a way to remain competitive and bring higher-quality services to the local market. While lack of specific services can be a driver, outmigration of healthcare services is influenced significantly by local perception regarding quality of care and accessibility.

³ <http://www.ahrq.gov/professionals/quality-patient-safety/pfp/interimhacrate2014.html#Summary>.

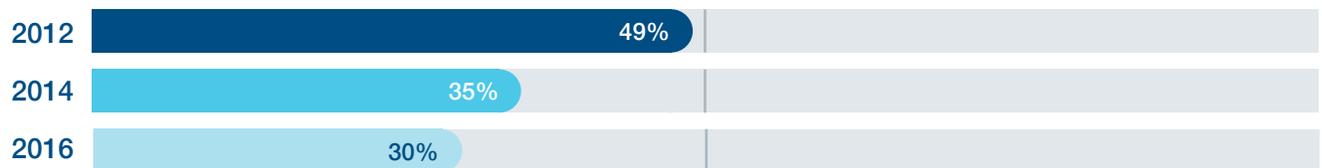


PHYSICIAN REFERRAL NETWORKS

The importance of physician referral networks cannot be overstated. Patients rely on their primary care providers to direct them to the right facility for surgery, imaging, and other services. In an effort to capture these referrals, health systems have been affiliating with, or acquiring, physician practices at an increasing rate over the last several years. A 2016 Physician Foundation survey found that only 30% of doctors described themselves as independent, down from 35% in 2014 and 49% in 2012.⁴

Many hospitals also are utilizing non-acquisition strategies to affiliate with physician practices, such as co-management arrangements, joint ventures, and clinically integrated networks. Early results show these alignment strategies can be very effective in supporting physician loyalty, as well as improving hospital financial and clinical performance.

Declining Percentage of Independent Doctors



- 2016 Physician Foundation Survey



PATIENT AWARENESS AND LOYALTY

Evaluating brand recognition is a significant component of assessing brand strength. In the brand awareness continuum, potential patients first may become knowledgeable of a healthcare provider's existence by viewing an advertisement, hearing reports from family and friends, or seeing the provider's physical location. Through reinforcement, they move from "recognition" to a level of "familiarity" resulting in top-of-mind awareness

Moving patients from brand familiarity to "loyalty" is the end goal of a healthcare marketing plan. However, the ultimate measure of the marketing plan's success is the use and promotion of the provider's services.

Customer loyalty commonly is evaluated and measured by an organization's Net Promoter Score⁵ (NPS), which is a metric developed from customer responses to just one or a few questions (e.g., "How likely would the individual recommend the [subject organization] to a friend or relative?"). Survey responses subsequently are compared to actual behavior over time, such as repeat business and referral activity, and then scored on a scale of 0 to 10. A comparison of NPS metrics among competitors also can be an effective way of evaluating brand strength.



⁴ http://www.physiciansfoundation.org/uploads/default/Biennial_Physician_Survey_2016.pdf.

⁵ <http://www.medallia.com/net-promoter-score/>. See also Reichheld, Frederick F. (December 2003). "One Number You Need to Grow." Harvard Business Review.



NATIONAL RANKINGS

Obtaining high marks from national ranking organizations is an important goal for many hospitals. There are multiple organizations that rank hospitals on a regular basis, such as *U.S. News & World Report*, The Leapfrog Group, and Healthgrades. The *U.S. News & World Report*'s annual "Best Hospital" rankings are highly coveted by many hospital executives seeking to distinguish their hospital's services from competitors. The Baldrige Award also recognizes top-performing businesses, including healthcare companies and systems, across a wide range of performance measures.

The Centers for Medicare & Medicaid Services' (CMS) *Hospital Compare* website is another resource for individuals to evaluate their options for healthcare services. *Hospital Compare* has expanded to include hospital rankings on readmission rates, quality scores, efficiency measures, hospital-acquired conditions, and "never events" (e.g., surgery on the wrong limb). Most recently, CMS released the Hospital Consumer Assessment of Healthcare Providers and Systems' star ratings for patient experiences, using a one-to-five-star rating system, from a total of 3,507 general and specialty hospitals.⁶ The level of transparency and the ease with which consumers can access this information will continue to increase in the near future.

Hospitals now are more aggressively advertising their quality rankings and patient satisfaction scores in an effort to differentiate themselves in competitive markets.⁷ Many hospitals pay to brand their websites or collateral marketing materials with rankings, awards, and scores, often at a significant cost.⁸

BRAND'S IMPACT ON PROVIDER AFFILIATIONS

In the face of rapid changes in healthcare, many providers look to clinical affiliations to provide stability and position them for success. While there are numerous structural permutations for a branding arrangement, some involve the transfer of ownership, control rights, or preferred returns to the licensor rather than compensation through a traditional royalty arrangement. Several examples of healthcare companies that have successfully capitalized on their brand's value are summarized in the following section.

DUKE LIFEPOINT

Duke LifePoint Healthcare (Duke LifePoint), was formed in 2011 with the purpose of collaborating with hospitals, physicians, and patients to bring quality and innovative healthcare services to communities.⁹ This collaboration started almost 10 years ago when LifePoint Hospitals Inc. (LifePoint) approached Duke University Health System (Duke) to obtain assistance around evaluating and improving a cardiovascular service line in an area hospital run by LifePoint. LifePoint saw clear benefits from leveraging Duke's clinical and operational expertise and invested in a partnership that now helps bring about tangible improvements to an increasing number of facilities.¹⁰ Duke LifePoint pursues acquisitions and shared ownership and governance of community hospitals seeking to participate in a stable, quality-outcomes-focused, well-funded system.

Within that system, the functional roles of Duke and LifePoint clearly are delineated. Duke offers community hospitals clinical and quality guidance, as well as access to highly specialized medical services. LifePoint provides financial

⁶ http://hcahpsonline.org/Files/October%202016_Star%20Ratings_Stars%20Distributions.pdf.

⁷ Healthcare Leadership Forum, Athena Health. "Why Brand Matters in Healthcare." June 6, 2013.

⁸ KatieBo Williams. "How much does using the U.S. News 'Best Hospitals' branding cost providers?" July 30, 2014, as accessed at <http://www.healthcarediver.com>.

⁹ http://www.dukelifepointhealthcare.com/about_us.aspx.

¹⁰ <https://www.advisory.com/daily-briefing/2016/05/17/lessons-from-the-c-suite>.

and operational resources, including access to capital for ongoing investments in new technology and facility renovations.

As consideration for the use of its well-known brand, Duke received a 3% equity interest in Duke LifePoint, while a subsidiary of LifePoint owns the remaining 97%. According to its 2012 audited financial statements, Duke is not obligated to contribute additional funds to Duke LifePoint.¹¹

MAYO CLINIC CARE NETWORK

In 2011, Mayo Clinic launched the Mayo Clinic Care Network (MCCN), a network of provider organizations, domestically and abroad, that will benefit from having access to Mayo's expertise and physicians. This is part of Mayo's initiative to create, connect, and apply integrated medical knowledge to deliver the best healthcare, health guidance, and health information to people everywhere.

The MCCN presently includes 40 hospitals and health systems located throughout the United States, each of which proudly proclaims its Mayo Clinic affiliation in its marketing materials. Details of such relationships are controlled closely, and no terms or financial arrangements for affiliates were disclosed publicly or in the public filings of Mayo Clinic or any of the affiliates.¹²

CLEVELAND CLINIC

Since 1994, Cleveland Clinic's Heart and Vascular Institute has formed affiliations with cardiothoracic surgery and cardiovascular medicine programs in Ohio and across the country, aiming to leverage its brand, as well as its research and clinical expertise, with other cardiac programs. Physicians and nurses from affiliate programs participate in training, conferences, and educational programs provided by Cleveland Clinic's leading heart

program. The affiliate physicians collaborate on a regular basis with their colleagues in Cleveland Clinic's Heart and Vascular Institute and have access to the latest technology and procedures under evaluation. Details of such relationships are controlled closely, and details on the terms of these financial arrangements were not available from public sources.

MD ANDERSON CANCER NETWORK™

MD Anderson Cancer Network™ is a program of The University of Texas MD Anderson Cancer Center. The network has "certified members," "specialty members," and "partner members." Each level of membership offers different benefits, including access to MD Anderson's faculty expertise, education, and training opportunities, such as quality protocols and best practices, treatment regimens, and multidisciplinary treatment planning conferences. Specialty members and partner members are able to co-brand with the MD Anderson brand name, and both programs offer physician integration, education and training, and access to clinical trials and research collaborations. Cancer centers interested in the affiliation go through a rigorous review process which typically takes six months and includes site visits and quality assessments by MD Anderson representatives. The review process also includes full assessments of potential candidates' surgical, radiation, diagnostic imaging, and oncology departments. The implication is clear: only those organizations with the capability of maintaining, or advancing, the MD Anderson brand are admitted to the program. The cost of brand erosion through poor performance is too high. As is common with any well-established brand, co-branding hospitals need to adhere to specific guidelines regarding use of the brand name.

¹¹ Duke University Health System, Inc. Audited Financials, Note 1, 2012.

¹² <http://www.mayoclinic.org/about-mayo-clinic/care-network>.



WHY VALUE AN ENTITY'S BRAND?

Brand power can have a significant impact on joint ventures and other similar affiliation arrangements. When several entities come together to form an affiliation, and one entity's brand becomes the face of the new alliance, quantifying its brand value to ensure fair compensation can be challenging. The usual measure of a brand's worth – the ability to charge consumers premium prices – has limited relevance in healthcare, given that most healthcare is paid for at set rates by governmental and commercial payers. However, proceeding with the alliances without a clear idea of brand value can mean leaving money on the table for many health systems. Additionally, even in the absence of a potential alliance or transaction, knowing the value of one's brand is important in the management of brand architecture, marketing strategy, and marketing budget allocation. Finally, brand valuations are important for larger systems that have disclosure requirements under generally accepted accounting principles for financial reporting purposes.

If a measurement matters at all, it is because it must have some conceivable effect on decisions and behavior. If we can't identify a decision that could be affected by a proposed measurement and how it could change those decisions, then the measurement simply has no value.

**Douglas W. Hubbard,
How to Measure Anything:
Finding the Value of
"Intangibles" in Business**

VALUING BRANDS OF HEALTHCARE ORGANIZATIONS

Although valuation based on premium pricing is not applicable, there are well-recognized trade name and brand valuation methodologies, which other industries employ, that have relevance in healthcare brand valuations. The appropriateness of utilizing one or more valuation methodologies will depend upon specific facts and circumstances. As a general rule, multiple methodologies should be utilized to the extent possible, and the results reconciled and/or weighted for purposes of determining the final conclusion of value.

RELIEF-FROM-ROYALTY METHOD

The relief-from-royalty (RFR) method provides an indication of value based on the estimated royalty fees that could be avoided through ownership of the underlying asset, rather than licensing it from an outside party. To apply the RFR method, an appropriate royalty rate (or range of royalty rates) is identified based on evaluating certain quantitative and qualitative factors relevant to the subject brand. This royalty rate is a proxy for the rate that a licensor and a licensee would negotiate for use of that brand if both had reasonably and voluntarily attempted to reach such an agreement.

Royalty rates from actual licensing agreements for hospital names, however, do not exist apart from limited royalty rates identified in legal settlements. As a result, the search for data most likely will need to be extended to comparable industries, and additional corroborative approaches may help in creating "bookends" to the analysis.

The percentage-of-profit or "rule-of-thumb" analysis is one such corroborative approach. A 1950s study by Robert Goldscheider found that royalty rates were approximately 25% of the licensee's profits on the products embodying the value-adding intellectual property (IP). The theory underlying the analysis is that the licensor and licensee



should share in the profitability of the products embodying the IP. The rule of thumb also requires the profitability of the licensee to be considered (not that of the licensor) as the IP derives its value from the use to which it will be put.¹³

PERCENT-OF-PURCHASE CONSIDERATION

Pursuant to the Financial Accounting Standards Board's Accounting Standards Codification Topic 805 - *Business Combinations* (ASC 805) (and equivalent guidance for not-for-profit entities), acquirers must determine the fair value of acquired tangible and intangible assets. Based on PYA's research, there is limited data showing the percent-of-purchase consideration allocated to acquired trade names within the Securities and Exchange Commission filings for larger acute care facilities.

Applied to the overall business enterprise value of the healthcare facility, the percent-of-purchase consideration approach can provide some corroborative evidence of the brand value of a potential joint venture. However, it is important to note that both the identification and valuation of trade names for financial reporting purposes entail a discussion around the typical market participant's intended use of the trade name, which often is transaction-specific. Hence, the information can provide directional guidance but should not be used as the sole methodology.

RESIDUAL VALUE CALCULATION

Another corroborative approach, the residual value calculation, evaluates the overall value of a hospital or healthcare system (which, in itself, can be an extensive exercise) and assesses if there is sufficient value to be allocated to intangible assets after the appropriate value is allocated to the real and personal property. Given the capital intensive nature of healthcare, this approach offers a quantitative sense of how much value remains to be allocated to intangible assets, including brand name.

INCREMENTAL BENEFITS CALCULATION

A provider deciding whether to affiliate with the likes of Mayo Clinic or MD Anderson must determine whether it will realize a positive return on its investment. This analysis is an example of the incremental benefits

calculation, commonly known as the "with-and-without scenario" calculation. The partnering hospital will first assess the present value of future cash flows of its operations on an "as-is" basis and compare this business enterprise value to what would result from its affiliation with a national brand.

Such analyses are not pure financial calculations and can be complicated as the affiliation also may involve management and professional services. To comply with Stark and Anti-Kickback regulations, these agreements first should all be established at fair market value before the eventual incremental benefit calculation is performed.

COST BUILD-UP METHOD

Building a brand "from scratch" can involve significant costs. When licensing or acquiring a brand name is not an option, building a brand name is the alternative, and the cost build-up method can serve as the floor value for such a brand name analysis. Even long-standing brands sometimes need to change for various reasons. For example, after 18 years of operations as NorthShore LIJ Health System, in September 2015, the hospital officially changed its name to Northwell Health at an estimated cost of approximately \$15.0 million. Similarly, in 2014, Fletcher Allen Health Care in Vermont changed its name to The University of Vermont Medical Center at a cost of approximately \$5.7 million. When Shands Jacksonville, the AMC for University of Florida Health, evaluated changing its name in 2013 to create greater alignment with the university and its research and education programs, it was indicated that the research related to changing the name cost \$350,000, and that even a small change to the employee name tags, for example, cost another \$75,000.

In all, the cost of creating a brand asset can be substantial in the healthcare arena. Evaluating the costs of branding or rebranding and focusing on actual costs that would be incurred in making the transition are helpful considerations in estimating the floor value for a brand name. As indicated above, the cost build-up method often serves as a floor value for brands and generally is better suited for new or developing brands as opposed to long-standing and well-developed brands.

¹³ Robert Goldscheider et. al., "Use of the 25 percent rule in valuing IP," December 2002.

CONCLUSION

Building a strong brand and maintaining its relevance in the market involves sustained investment and strategic positioning. While payers and consumers may not be willing to pay more to be treated at a healthcare facility with a distinguished brand, the choice of *where* patients would seek care is affected by the perception of quality embedded within the entity's brand. Hence, in an environment where there is significant competition for medical services, strategic investments that improve brand awareness are critical to ensure continued relevance of health systems within their community.

Healthcare systems recognize this reality and are working to improve safety scores, quality ratings, patient perception, and awareness. Affiliating with strong local or national brand names is an increasingly common strategy which brings along with it access to clinical protocols and best practices. Brand valuations can help contracting entities understand what should be paid or received for these affiliations to ensure continued success of these strategies.

How PYA Can Help

PYA's Valuation Team can help health systems, AMCs, and other healthcare organizations with understanding the value of their brands and can assist with developing strategies for capitalizing on such value in connection with various types of affiliations, joint ventures, and other transactions. From AMCs applying their name and expertise to improve community cancer programs to orthopedic physician groups with a strong brand value due to long-standing relationships with major sports teams, we can help during affiliation formation by utilizing our experience and expertise. Myriad factors influence a health system's value proposition, and the PYA team is experienced in understanding and accounting for the interdependence of these factors and their influence on branding and brand value.



To learn more about our experience, valuation services, and how we can support you, visit pyapc.com

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