

February 2026

Why healthcare strategic partnerships fail: lessons from the deal table



Partnerships, like all relationships, are *de facto* collaborative. Certain success factors are well known, including the importance of cultural alignment, constant communication and effective post-closing integration. Based on our collective experience assisting health systems with the negotiation of strategic partnerships, we share other lessons learned that are important considerations. These are tangible steps that require intentional focus and may require hard choices during the partnership development process but are important for ensuring long-term success. We hope these “inside baseball” lessons and case studies are useful for organizations when negotiating their next strategic partnership.



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Lesson 1: Develop a credible business case early in the partnership process

The development of a credible business case early in the partnership process before definitive agreements are executed greatly improves the likelihood of success. This enables partners to articulate and quantify value creation and avoids time and expense spent pursuing deals that do not enhance mutual value. A thoughtful business case can serve as the foundation for an effective communication strategy that clearly articulates the benefits of the partnership to key stakeholders, both internal and external. Given the high level of scrutiny placed on healthcare partnerships, it is critical to demonstrate tangible benefits to patients and the community.

For two health systems coming together, early business planning demonstrated the potential for significant value creation as highlighted in the case example below. Had the parties not proven the value of the partnership prior to negotiating the letter of intent, the partnership would have likely failed. Negotiating governance terms in any large-scale partnership is complex. A credible business plan that shows significant value creation helps prevent gridlock and enables partnerships to go forward.

Key benefits of a well-developed business case

The partnership business case

1. Generates buy-in and enthusiasm for partnership
2. Improves board confidence
3. Helps the parties negotiate contentious deal points (i.e., partnership governance, new management structure, etc.)
4. Serves as blueprint for integration plans and contains:
 - Synergy and dis-synergy estimates
 - Costs of integration and capital requirements incorporated into a set of combined projections along with implementation tactics
 - Reasonable expectations and clear identification of resource requirements, contingencies and key areas of risk
 - Operational and clinical leadership involvement to improve feasibility of the plan

Figure 1. Early business planning case example

Partnership Example	
Overview	<ul style="list-style-type: none"> • \$3.0 billion revenue regional health system with a \$1.5 billion revenue academic health system
Situation	<ul style="list-style-type: none"> • The parties performed business planning while negotiating a letter of intent (LOI) • A key sticking point during business planning / LOI negotiations: <ul style="list-style-type: none"> – AMC required equal governance representation in the newly formed system – Regional health system insisted that governance should be determined by relative fair market values contributed • Board members for both organizations were prominent leaders in their respective communities; however, the regional health system Board composition included members with significant experience negotiating for-profit business combinations (which are typically based on fair market value contributions)
Outcome	<ul style="list-style-type: none"> • Ultimately the parties settled on equal board representation with the new CEO being appointed by the regional health system; the parties were able to break through the impasse in part due to clarity around the significant economic benefits of the partnership and the motivation that created to find a mutually acceptable pathway to realize those impacts for the benefit of patients and the community

Lesson 2: Safeguard against misaligned incentives in definitive agreements

At the onset of a joint venture and other less than fully integrated relationships, parties may overlook potential alignment concerns (and not incorporate appropriate safeguards into definitive agreements) due to a reliance on pre-existing relationships or strong desire to complete the

deal. Without safeguards, however, entering joint ventures and other less than fully integrated relationships where the parties have misaligned incentives strains the relationship and will may potentially cause the partnership to fail.

A case example that illustrates this concept is provided below. The joint venture failed and resulted in dissolution, because partnership interests were fundamentally misaligned.

Figure 2. Competition and misalignment case example

Partnership Example	Outcome
<p>Background</p> <ul style="list-style-type: none"> • \$1 billion+ regional health system (“HS”) entered into a joint venture with a large group of primary care physicians (the “PCP Group”). The HS contributed a small community hospital (the “Hospital”) on the fringes of its service area to the joint venture 	<ul style="list-style-type: none"> • As time passed, the PCP Group recruited additional Hospital specialists and redirected higher acuity referrals to the Hospital that were historically admitted to the HS’s tertiary hospital. These actions strained the relationship and the PCP Group threatened the HS it would redirect referrals to competitor hospitals • As a result of the leverage the PC Group had over the HS, the PC Group was also able to implement various related party outsourcing agreements (e.g., revenue cycle) <ul style="list-style-type: none"> – Related party revenue cycle and other outsourcing arrangements were implemented at the Hospital and increased costs (and became a significant profit center for the PCP Group) • HS leadership changed, and new administration commenced legal action against the PCP Group primarily due to these related party outsourcing contracts • The joint venture ended with the HS divesting its ownership interest
<p>Situation Overview</p> <ul style="list-style-type: none"> • The HS operated a tertiary hospital, the Hospital and other community hospitals. The PCP Group was an important referral source to the HS • The PCP Group desired ownership in the Hospital <ul style="list-style-type: none"> – The PCP Group threatened to align with a competitor if the HS did not comply • The HS relinquished control of the Hospital through the joint venture with the PCP Group owning a majority interest • The HS expectation was that PCP Group would continue historical referral patterns 	

Lesson 3: Create durable partnership structures that support integration

The greater the ability to terminate or unwind a partnership, the less integration may be achieved. Unwind provisions tied to time or financial metrics often create uncertainty and discourage investments in operational integration, limiting the synergies available through partnership. In less than fully integrated partnerships, it is customary and appropriate to include reasonable unwind provisions. However, in practice easy unwind often correlates with a lack of commitment to the partnership, making it challenging to optimize the relationship to achieve its full potential.

Partnerships, like all relationships, are *de facto* collaborative. While certain success factors are well known, other lessons are based on experience.

The case example below illustrates how unwind provisions resulted in unintended consequences leading to an us versus them mentality that ultimately inhibited meaningful integration.

Figure 3. Durable structures case example

Partnership Example	
Background	<ul style="list-style-type: none"> • \$2 billion revenue academic health system (“AMS”) entered into a fully integrated (i.e., member substitution) partnership with a \$500 million revenue regional health system
Situation Overview	<ul style="list-style-type: none"> • As part of negotiations, the regional health system negotiated an ability to unwind the partnership if certain liquidity (e.g., days cash on hand) and profitability metrics (e.g., EBIDA margins) were not met during a four-year post-closing period • Because of the inherent uncertainty, despite identifying significant potential synergies, no significant integration occurred for the first several years after closing • Regional health system governance resisted integration efforts citing the potential for terminating the partnership
Outcome	<ul style="list-style-type: none"> • Ultimately, due to financial pressures, the AMS negotiated a termination of the unwind provisions and commenced a full integration plan, including consolidation of back-office functions and implementation of the same EMR platform

Lesson 4: Enter into partnerships with eyes wide open

Relying on past success stories, reputation or leadership representations without investing the time to independently validate expected capabilities that are a significant component of the partnership’s value proposition can backfire. While health systems typically conduct adequate confirmatory due diligence reviews such as quality of earnings, coding and legal reviews to assess risk and provide a historical perspective, promises of exported capabilities (such as value-based analytics) and other factors that are the basis of the partnership’s true potential aren’t always vetted sufficiently by the

organization relinquishing control. Confirming the benefits objectively can avoid unintended consequences and surprises.

The case example below highlights the outcome of a health system that relied on collateral materials and leadership representations regarding the effectiveness of key capabilities. These key capabilities were the primary deal currency used to convince the organization to cede control and enter a fully integrated partnership (i.e., change of corporate member transaction) with the larger health system. Execution matters; the failure to realize expected benefits ultimately caused the partnership to rupture.

Figure 4. Thorough due diligence case example

Partnership Example		Outcome
Background	<ul style="list-style-type: none"> • \$5 billion regional health system partnering with a \$1 billion health system 	<ul style="list-style-type: none"> • Once the partnership closed and integration activities commenced, it became clear that the highly touted clinical capabilities were not able to generate the expected synergies • Specific performance covenants were negotiated as part of the definitive agreements (including the realization of synergies) along with indemnification agreements rights • Due to a lack of tangible benefits from the partnership in addition to other factors, the smaller health system initiated a lawsuit claiming the larger health system did not fulfill the terms of the partnership agreement • The parties ultimately settled and unwound the partnership
Situation Overview	<ul style="list-style-type: none"> • The primary partnership goal for the smaller health system included implementation of the larger health system’s clinical capabilities, including (1) Proprietary inpatient care management protocols that standardized the delivery of care for acute cases to reduce cost (e.g., ALOS) and improve quality outcomes and (2) An advanced primary care medical home model that utilized a proprietary data-driven system for chronic disease management • These capabilities were highly regarded and pre-due diligence synergies were estimated to be over ~\$40M annually • Clinical due diligence by the smaller health system was never performed to vet these opportunities <ul style="list-style-type: none"> – The smaller health system leadership largely relied on marketing materials and leadership presentations to avoid damaging the developing relationship and delaying the partnership process 	

Lesson 5: Be thoughtful about highly structured partnerships, which often fail

The highly regulated nature of the healthcare industry sometimes necessitates complex partnership structures to achieve shared objectives. To reach mutual agreement on difficult issues, parties may seek to implement highly structured features into definitive agreements such as “springing” governance powers based on financial performance. There are some cases where complexity is appropriate, as often is the case with physician relationships and value-based care joint ventures, for example. However, a degree of complexity beyond what is necessary to effectuate a given model can be counterproductive. Definitive

agreements that are over-engineered to find a workaround for gating issues often lead to failure and should be avoided. Instead, enhancing other areas of partnership consideration (e.g. capital commitments) and striving to reach agreement with simpler agreements that directly address the issue(s) in question should be the preferred path forward.

The below example illustrates how highly structured governance terms ultimately led to dissolution of the partnership. A traditional merger structure was burdened by complex governance-related provisions to break through a negotiation hurdle. While this allowed the parties to reach agreement in the short term, the long term the success of the relationship was compromised.

Figure 5. Highly structured partnerships case example

Partnership Example	Outcome
<p>Background</p> <ul style="list-style-type: none"> • \$1 billion regional health system partnered with a \$5 billion regional health system • The smaller health system was financially strong with an “A” credit rating • One of the primary goals of the smaller health system was to retain significant local control after closing 	<ul style="list-style-type: none"> • By implementing these “springing” reserved powers, the parties were never able to integrate as one system <ul style="list-style-type: none"> – The smaller health system had control over operating and capital budgets which inhibited integration and perpetuated an “us” versus “them” mentality – Ultimately, the smaller health system became increasingly frustrated with the larger health system and wanted to regain its independence • The parties ultimately unwound the partnership
<p>Situation Overview</p> <ul style="list-style-type: none"> • Since the smaller health system was financially strong with a capable management team, the larger health system agreed to forgo certain customary reserved powers such as approval rights over operating and capital budgets, subject to the smaller health system complying with certain financial covenants 	

Conclusion

Partnerships don’t fail because of bad intent; they often fail because of avoidable missteps early in the partnership process, often in moments of optimism and goodwill. These observations aren’t necessarily new or novel, but they highlight important steps that can be taken during the

partnership process requiring time, resources, hard choices, and purposeful intention and confer real impact on the success of the partnership. As senior leaders evaluate future partnership opportunities, heeding these lessons will be invaluable for building successful partnerships that endure.

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