The allure of technology in hospital acquisitions

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Not all hospital technology is created equal, and hospitals on the lookout for acquisition targets must establish exactly what a target's technology might bring to the table.

Between 1985 and 2000, mergers and acquisitions (M&As) increased significantly in the U.S. hospital industry. The health-care industry was under pressure to become more efficient, due in no small part to the rise of managed care.

Hospitals usually merge to improve economic efficiency and increase their market power, though doubts remain as to whether hospital consolidation actually yields significant cost savings.

Technology has risen to the forefront as a way for hospitals to improve quality and, thus, improve differentiation among hospitals in a highly competitive field.

It has also become clear that costs related to technological change make up nearly half of all medical care costs.

Clearly, technology isn't just a great asset; it is strategically crucial to mergers and acquisitions.

But what role does technology play in the process of health-care consolidation?

This is the subject of a working paper by IESE's Núria Mas and Giovanni Valentini, "The Importance of Technology in the Consolidation of Hospital Markets: The Case of the United

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States."

The added value of technology in health care

Hospitals with robust technological assets often make desirable targets for M&As. Indeed, M&A initiators closely analyze targets' technology holdings to make their selection decisions.

It's worth noting that medical technology encompasses much more than computers and software; it includes procedures, devices and hospital-specific infrastructure.

A hospital that performs open-heart surgery, for example, may be seen as more technologically competitive than one that does not.

In this paper, 13 types of technology were taken into account, including PET, MRI, CT-scanner, ultrasound and X-ray therapy.

An assessment of the 222 M&As that occurred in the United States between 1985 and 2000 reveals three key factors that need to be considered when evaluating a target's technology: absence of overlap, complexity and profitability.

Absence of overlap

A target whose technology does not overlap with the acquirer's technology is more likely to be selected.

When an acquirer gains access to new and different technology, the resulting organization becomes more of a one-stop-shop hospital that can attract more patients and become more adept at dealing with managed care organizations.

As a result, a wider variety of procedures can be offered at a standardized level of quality.

Another reason why overlapping technology could be unappealing is that antitrust agencies may take issue with the potential of the newly merged entity to hold a monopoly on a specific technology.

Complexity

Companies on the lookout for acquisitions are generally more likely to target hospitals with complex technology.

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Technology itself isn't the only valuable element; the knowledge and skills that accompany it are crucial as well.

An acquirer can't always replicate knowledge and skills simply by hiring specialists. Indeed, much knowledge is hospital-specific. So, if a target has complex technology to which an acquirer can gain full access, that target becomes more attractive.

Complexity can be measured by evaluating the resources a technology requires and measuring cost per patient, among other methods.

Profitability

Finally, the profitability of a target's technology is most likely a prerequisite for any acquirer.

A robust cost/benefit ratio is critical in a health maintenance organization's decision to include a hospital in its network, so a target that can strengthen that ratio for the acquirer is particularly appealing.

Close analysis of data from the American Hospital Association (AHA) Annual Survey, which provides details about M&As, confirms that technology plays an active role in hospital acquisition strategies.

That said, analyzing target selection isn't quite so neat and simple, and a few variables must be controlled for.

For example, not-for-profit hospitals often merge with hospitals of the same type, since post-merger market power is less of a consideration.

Secondary factors

Length of patient stay, capacity utilization and profitability must also be accounted for in target hospitals, as must the potential market share resulting from a merger.

Analysis of two additional factors strengthens the claim that technology plays a major role in M&As.

The first is the restrictiveness of a particular state's Certificate of Need (CON), which is required before facility expansions or creations can be executed.

If the CON is very strict, purchasing new technology may be difficult. Therefore, hospitals in

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states with strict CON requirements may pursue mergers as a way of obtaining technological assets.

In these cases, the acquirer may be less concerned with technology overlap.

The second additional factor is the level of managed care enrollment in certain areas. Where enrollment is high, hospitals will feel greater pressure to be more efficient, and they will then have greater reason to seek targets with technology that has a favorable cost/benefit ratio.

Bolstering public policy

In sum, the authors' paper reveals that prime M&A targets in the hospital-care sector tend to have non-overlapping technology that is complex and profitable, giving the acquirer the opportunity to become a one-stop-shop hospital.

Such findings are significant when it comes to considering public policy around both patient welfare and hospital innovation. Future R&D efforts, for example, can be bolstered when a merger occurs between institutions with complementary technology.

There are plenty of opportunities for further research, in particular into the effects of technology-driven mergers on consumers and on post-merger technology development.

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