M&A Due Diligence:

7 Things the C-Suite Should Know About IT

Until recently, many mergers and acquisitions (M&A) took the form of a "holding company" approach as it pertained to information technology (IT) assets and services. That is, acquisitions would largely function independently with their own IT organizations and only integrate where needed. This holding company model of IT integration for acquired entities is inadequate to meet the demands of today's market.

Today, numerous market demands and internal enterprise requirements for IT—including digital health and IT's role in advancing strategic imperatives and cost containment—often require integrating the entity's IT platform more closely with the acquiring institution. As a result, it is more critical than ever to consider IT in early stages of M&A due diligence. IT leadership should be involved in the broader partnership strategy discussions and business case development from beginning to end of the deal lifecycle—not off to the side and handled solely by the acquirer's and acquiree's IT teams. Assessing the IT landscape and costs is a key step in getting the deal's financial model right and setting the course not only for a successful integration and post-Day One transition but importantly, for value capture.

Will the Partnership Enable or Hinder Your Digital Health Strategy?

The past 2 years have been a catalyst for digital transformation and have forced health systems to reevaluate and redesign partnership portfolios and growth strategies to better align with the new healthcare delivery environment and evolving consumer expectations. The exponential growth of the data-driven, digital environment is bringing together personal tech, consumer goods, retail, and other industries once considered completely distinct from healthcare. Along with core business and clinical operations, M&A activities must consider—from the earliest days of planning—both alignment of their technology platform and IT services with their overall digital strategy and the potential impact of digital health service disruption. Acquiring organizations must integrate (and, wherever possible, standardize) IT services because the traditional holding company approach of acquired organizations maintaining their respective IT platforms won't meet digital health demands. ROI-driven digital health use cases (such as digital front door; sustainable, virtual, on-demand access models; patient engagement and service center of the future; and hospital at home) would be handcuffed without a flexible, scalable digital architecture.

Will IT Accelerate or Slow Down Your Strategic Imperatives?

Health systems face high-stakes expectations to realize the full benefits of integration, and IT's impact on the success of an acquisition is significant. This impact will continue to increase. IT is a force multiplier to enable the value creation intended by the partnership. Partnering to increase scale is no longer a sufficient case for consolidation by itself, and increased regulatory scrutiny requires a compelling partnership case. While partnership objectives will continue to include market expansion, clinical service line growth, access to capital, and the addition of new payer networks, health systems are expanding and accelerating their partnership focus to quality, value-based care, and health disparities. While IT typically accounts for less than 5% of a health system's operating expense, **it is not unusual for more than 75% of an organization's strategic initiatives to have direct IT requirements**. Advanced digital capabilities and a solid platform of core systems like an integrated electronic health record (EHR) and cloud-based enterprise

resource planning (ERP) are critical in order to achieve the intended benefits of the transaction and position the combined enterprise for true value creation—whether driving growth; catalyzing clinical integration and high-reliability care; improving affordability, access, and equity; or advancing marquee programs. Operations and IT must work side by side, beginning in the earliest phases of a merger or acquisition, to put in the right governance structure and portfolio management approach, identify target benefits, and map out the organizational readiness plan to achieve them.

Will IT Help Contain Costs or Bloat the Budget?

Health systems are doubling down on execution as a competitive advantage for inorganic growth, resulting in a shift in focus to integration and value capture. In addition to the value capture imperatives already noted, achieving cost efficiencies remains important. We have found that developing an IT cost model and associated IT budget early in the acquisition process is critical to understanding the total cost of the acquisition and can materially impact the value and success of the deal.

Some partnerships have been abandoned as the time and cost required to integrate information systems such as EHR and ERP solutions were found to outweigh the potential synergies. Some acquirers have been forced to make unplanned expenditures, such as mitigating longstanding technology and infrastructure or cybersecurity deficiencies. Divestitures involve added complexity as an acquirer must fully understand the cost implications of continuing to pay for IT support from the divestor during the post-close IT transition period. In addition to the overarching transition services agreement (TSA), it is critical to define and negotiate the terms of an IT-specific TSA during due diligence to avoid undue costs or missed expectations in service delivery during the transition period. Outside of payer contracts, this is one of the larger risk-mitigating efforts in an asset transfer.

> It is mission critical for the full executive suite to know the key IT areas during due diligence to dramatically reduce integration costs, risks, and time to completion. This means integrating IT leadership into the broader partnership strategy discussions and business case development. Following these 7 leading practices can ensure IT helps create and maximize the strategic value of your partnership portfolio.

1. PLAN FOR RAPID TRANSITION TO A COMMON, INTEGRATED IT SERVICES PLATFORM.

Set expectations and lay the strategic groundwork with key stakeholders from both entities during due diligence to convert to a standard set of IT tools and services to maximize integration benefits and value capture. This usually requires a small IT team to review IT expectations, major system upgrades and replacements, and leadership commitment to supplement IT staffing to quickly transition. A long-standing "workaround" or issue unresolved can be a financial burden and major risk.

The team should conduct an application and infrastructure review and create a high-level roadmap with a consolidated approach and budget. The platforms that need to be consolidated/integrated Day One or shortly thereafter must be identified. This usually includes human resources, finance, supply chain, provisioning, email, facilities and systems access, and executive reporting. Clinical and revenue cycle system transitions represent an even more complex undertaking and lengthy timeline, typically requiring 6 to 12 months post-close to integrate. Remaining platforms should be transitioned (or decommissioned) by Year Two. For example, Chartis recently supported IT integration in an acquisition that reduced the acquired entity's IT operational costs by 40% within 2 years.

A rapid IT transition usually requires considerable workforce retraining, so the team is operationally ready for the change. By "bundling" this training with the transition's other organizational readiness and training efforts, it is far more effective (as well as less expensive and disruptive) than a delayed IT transition.

You can measure the value of a rapid transition by improved end-user satisfaction, increased workflow standardization and staffing, more comprehensive and accurate analytics, and improved support for future business transactions. It is the fastest and most effective way to provide a unified "digital front door" for digital health services and realize strategic benefits from the transaction, including cost containment.

2. KNOW THE DATA PART OF THE DEAL.

You may assume that information pertaining to patients, insurers, physicians, and general operations are part of the transaction, which may be true if you are acquiring an independent entity. However, if you are acquiring an organization that is a divestiture from another organization, the target's parent company may think you will receive only what is mandated by legal statute.

The data is one of the most valuable assets you will obtain. It is critical to assess what information exists, where it is kept, what the quality is, and what is needed to collect and transform the data. Before you move beyond due diligence, ensure that key questions like these are answered:

- What happens with the original data? Do you get a subset of the information? Does it remain shared with the target's parent company, or should it be destroyed?
- How will co-mingled data be addressed and migrated?
- Is this data secure?
- Is it kept in the cloud or on site?
- What are the legal, financial, quality-of-care, and overall customer service implications?

Answering these questions effectively requires close collaboration between IT and operations teams during diligence. Be sure to include expectations on data availability and acquisition in the definitive agreement.

3. UNDERSTAND IT STAFFING AND THE CONTRACTUAL OBLIGATIONS, AND MODEL A PRO FORMA ALONGSIDE THE REST OF THE DEAL.

Staffing accounts for the largest cost driver in IT, typically accounting for more than 40% of IT operating costs. The organizational structure, IT staffing, remote/hybrid staffing models, and shadow IT costs are important to understanding the overall IT portfolio investment and go-forward potential implications.

Similarly, properly assessing IT contract obligations in due diligence can reduce your near-term IT cost exposure by 20% or more. Contracts are usually the second largest IT operating expense after salaries and are difficult to analyze. Also, IT contracts are often managed by the IT department instead of purchasing. As a result, they are often overlooked in traditional due diligence purchasing-led reviews. Establishing educated positions on major IT contracts early—with a focus on terminations—can lead to substantial savings. While it may not be possible to get full access to the contracts in due diligence, it is possible to obtain a blinded assessment with key considerations like length and termination clauses. Most major IT vendor contracts require at least 6 months cancellation notification, so early reviews can help right-size coverage and minimize termination penalties. With presumed public anonymity during due diligence, you are probably in the strongest negotiating position with vendors before a deal becomes public.

These staffing costs and IT contractual obligations and costs are a critical component of the acquisition integration's total IT capital and operating expenses, and they are a key input to modeling a realistic pro forma along with the rest of the deal.

4. SOLIDIFY IT TRANSITION TERMS AS PART OF THE OVERALL AGREEMENT FOR DIVESTITURES.

Most transactions that involve acquiring an entity from a larger parent company will require material IT transition assistance and continued access to the target's IT services for a year or more post-close. Many health systems underestimate the effort required from the divesting entity after Day One and make the mistake of addressing IT transition support only after the overall agreement is reached. By then, the divesting parent entity is far more focused on its core IT constituents and presumes your organization will fund all necessary support costs post-Day One—at whatever service level they can provide.

One client avoided $10 million in unforeseen IT transition costs by creating a strong IT TSA in due diligence.

In divestiture deals, create a formal IT TSA that outlines the divesting entity's responsibilities for providing appropriate IT services pre- and post-close and the costs for those services. Insist on defined service levels (with financial penalties if not met), and include all vendor expenses and key transition commitments. These are very different from other organizational-focused TSAs, so include legal counsel with IT- and operations-specific experience and IT team members in the TSA development and negotiation in the due diligence phase.

5. REVIEW RECENT CYBERSECURITY AUDIT FINDINGS, AND INSIST ON A FOLLOW-UP THIRD-PARTY AUDIT JUST BEFORE DEAL CLOSING.

There is no shortage of headlines and data highlighting the impact of cyberthreats. The fact that many healthcare acquisition targets are financially distressed also means they are likely to have underinvested in IT and preventive cybersecurity measures.

Review cybersecurity audits to identify compromised—and thus devalued—IT assets included in the deal and the remediation/preventive maintenance programs in place to guard against future attacks. To mitigate the risks you uncover, adjust the acquisition value and/or include cybersecurity remediation requirements in the definitive agreement. Another important and related safeguard is to insist on a follow-up third-party audit just before deal closing.

> Uncovering cybersecurity vulnerabilities early is key to at least containing, if not reducing, acquisition risks. The findings may have a material impact on the overall deal valuation.

6. UNDERSTAND YOUR FACILITY IT.

Creating a common patient and employee experience and brand across the integrated organizations requires common “smart” building technology, such as building access, digital signage, wayfinding kiosks, and smart patient rooms. If you expect employees to work across merged facilities, then integrated building access, timecard devices, and security monitoring becomes critical.

Ensure joint IT/facility teams conduct site/physical plant assessments and answer key questions like:

- Is the physical communication network sufficient? (If not, it can take over 6 months to upgrade a hospital at a cost of more than $200/device.)
- Can the facility equipment “talk” to one another?
- Can employees utilize badges across facilities, or is an investment needed to standardize?
- Is asset tracking in place to avoid equipment “disappearing” on Day One?

A new ambulatory facility can cost $100-120/square foot for IT. What expenses are hiding in your newly acquired facilities? Knowing that information up front will be an important decision point as you evaluate the deal and will inform realistic integration planning.

7. SET THE STAGE FOR SUCCESS WITH IT AND OPERATIONS WORKING SIDE BY SIDE.

It is never too early to set the stage for integration success, even during due diligence. Operations and IT must be in lockstep to ensure the due diligence accurately reflects the operational and IT implications to valuation and the organization realizes the intended organizational and community benefit from the deal. It is also helpful to set the stage for successful integration if the deal proceeds.

Clinical and operational leadership will set the overall system strategic vision and operational and clinical direction. Operations and IT must work together to determine the risk, high-level operational transition timelines and the IT implications and constraints—and, importantly, plan for how to ready the organization for the changes.

Are IT and operations working in lockstep or in separate parallel paths? Critical decision points during due diligence and the resultant integration success depends on their working side by side—to ultimately support digital health demands, strategic imperatives, and cost containment.

Moving Forward

Market demands ranging from digital health to cost containment are all making IT a critical component of any early-stage M&A efforts. Focusing on these 7 key areas with IT leadership as part of the due diligence process will prepare your organization to make a more informed business decision on partnership strategy and deal structure. It will also help your organization reduce IT costs associated with integration and accelerate value creation.

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