

# Don't Lose Sight of the Strategic Value of Due Diligence

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Performing due diligence can seem like a “check the boxes” exercise as organizations verify material facts, gain a clear view of the risks involved, and more. But there is strategic value in due diligence, especially in identifying the impact of the transaction on existing partnerships and relationships. Such insight empowers post-transaction planning and sets the stage for successful integration.

A “strategic” approach to due diligence seeks to develop a strong understanding of the relationships, market dynamics, competitive forces, and other factors that could affect the success and viability of the transaction. For example, organizations that elevate due diligence from a required exercise to a strategic opportunity:

- Evaluate the “What if?” scenarios of competitors’ response to the transaction
- Assess the potential impact of the transaction on physician alignment
- Consider whether and how the transaction will affect partnerships with competitors

There are three standard areas of due diligence that, when strategically leveraged, play a critical role in preparing for integration.

## **AFFILIATIONS AND VENTURES**

Standard due diligence includes review of an organization’s existing affiliations and business relationships (e.g., joint ventures, clinical affiliations, contracted services). Strategic due diligence goes beyond understanding the terms and legal considerations associated with these arrangements and seeks to understand the following:



**Competitive and marketplace implications:** Take the time to assess the potential impact of a competitor's response to the transaction on the organization's existing relationships. For example, one health system sought to acquire a community hospital whose primary competitor was a health system that was similar in size to the organization that wished to purchase the hospital. All of the hospital's gastrointestinal and orthopedic physicians were employed by the competitor. Additionally, the hospital had entered into a joint venture with the competitor to operate a cancer center.

During strategic due diligence, health system leaders:

- Considered how to respond if the hospital's physician competitors chose not to provide care at the hospital
- Established plans to align independent orthopedic practices in the area
- Assessed the potential to pull out of existing joint venture relationships and partnerships
- Evaluated the near-term integration priorities for the hospital and health system

**Potential sources of future redundancy:** For example, if a potential partner has a strong cancer program or a cancer center, the acquiring organization should consider how this program will fit within its existing service line.

**Implications for accountable care organizations (ACOs) and clinically integrated networks (CINs).** This is especially important in transactions that involve hospitals or health systems with multisystem physician networks.

## PHYSICIAN SERVICES AND ALIGNMENT

Standard due diligence will include a review of medical staff, physician/clinical relationships, medical staff composition (e.g., employed vs. independent, affiliations with competitors, age), and coverage arrangements. Strategic due diligence goes a step further, taking into consideration:

**Gaps in medical staff/physician coverage:** In addition to identifying current gaps in physician services, consider potential gaps in service that could arise in response to the transaction, such as changes in patient flow between facilities. Early identification of areas where stop-gap coverage may be needed ensures continued service delivery.

**Impact on referral patterns:** Consider the competitive dynamics that could influence post-transaction operations, including clinical referral patterns.

**Implications for executive leadership.** When reviewing contracts, keep an eye out for change-of-control provisions in place for the organization's executive leaders. For example, if an executive leader has a change-of-control clause that states the leader may leave voluntarily after the transaction is complete and receive severance and full benefits for a specified period of time, this could present relevant financial risk.

## MANAGEMENT AND ADMINISTRATIVE SERVICES

Standard due diligence includes a review of management contracts with third-parties and contracts for outsourced services, such as IT, billing, coding, and food services. Strategic due diligence seeks to strike a balance between the desire to eliminate expensive outsourced contracts and the need to retain on-the-ground insight and organizational knowledge that will be critical during integration.

For example, while it may be tempting to cut the expense of outsourced IT functions and contracted management and leadership by terminating contracts, look deeper. Is the hospital's EHR homegrown? If so, you'll need to keep outsourced IT staff onboard, at least in the near term, to maintain on-the-ground support and knowledge of the system during integration.

Effectively managing employees' response to change also is important. Consider how employees might react if the entire leadership team of the acquired organization were to leave once the transaction is final. Absorbing some of the costs related to leadership retention may be necessary to ensure a smooth transition.

## A FRAMEWORK FOR POST-TRANSACTION SUCCESS

Elevating the role of due diligence provides a foundation for effective post-transaction planning and supports prioritization of near- and long-term planning and integration efforts. Look for opportunities to strategically leverage the insight gained at each stage of the due diligence process—and position the organization for post-transaction success. ●