

The Due Diligence Imperative

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National Association of Certified Valuators and Analysts

August 8, 2018

Competition (Part Four of a Six-Part Series)

The first part of this six-part series provided an overview of the due diligence imperative for valuation professionals, in the context of the *Four Pillars of Healthcare Value*, i.e., Reimbursement, Regulatory, Technological, and Competitive environments. The second and third installments reviewed the due diligence process related to the reimbursement and regulatory environments, respectively. This fourth installment will review the due diligence process as it relates to competition in the healthcare industry.



Resources:

[Healthcare Industry—Trends, Analysis, and its Impact on Valuations](#)

[Trending Matters in Business Valuation and Healthcare Valuation](#)

[The Imperative of Considering the Concept of Highest and Best Use in Healthcare Valuation](#)

The first part[1] of this six-part series provided an overview of the due diligence imperative for valuation professionals, in the context of the *Four Pillars of Healthcare Value*, i.e., Reimbursement, Regulation, Technology, and Competition.[2] The second and third installments reviewed the due diligence process related to the reimbursement and regulatory environments, respectively. This fourth installment will review the due diligence process as it relates to competition in the healthcare industry.

Professor Michael Porter, MBA, PhD, of Harvard University,^[3] the author of nineteen books and over 125 published articles, is one of the world's leading authorities on competitive strategy and international competitiveness. In his book, *"On Competition,"* Dr. Porter discusses the need to analyze the competitive environment within the framework of the "Five Competitive Forces that Shape Strategy," which asserts that all businesses operate within a competitive marketplace defined by an underlying structure comprised of the following five competitive forces:

1. Threat of new market entrants
2. Bargaining power of suppliers
3. Threat of substitute products or services
4. Bargaining power of buyers
5. Rivalry among existing firms^[4]

Heated debate has persisted related to the potential benefits and costs of free market competition within the healthcare industry. While proponents of free market competition claim that competition can reduce costs, increase quality, improve efficiency, and provide an incentive to innovate,^[5] opponents argue that there are unique differences between the healthcare provider and payor markets and the markets for other industry sectors; therefore, generally applied economic models cannot be adequately utilized to draw conclusions related to outcomes within the U.S. healthcare delivery system.^[6]

The various regulations that govern competition in the U.S. healthcare industry also differentiate it from the other industries. For example, state Certificate of Need (CON) programs are aimed at restraining healthcare facility costs and facilitating coordinated planning of new services and facility construction.^[7] These CON laws act as barriers to entry in the healthcare industry, restraining competition.

Some of the valuation techniques for which the general research is useful are: (1) financial ratio benchmarking; and (2) a determination of the specific competitors in the market service area of the subject interest.

In order to compare the subject interest's financial performance to others in the industry, the analyst may utilize industry normative benchmarking survey data, as well as the financial data of publicly traded firms, depending on the type of subject interest being appraised.

To determine the competitors in the market service area of the subject interest^[8] the analyst may consider factors such as: geographic location; types of services provided; the size of the entity; the ownership structure of the entity; and the socio-economic demography of the relevant market service area. Upon constructing a list of competitors, the analyst may collect information pertaining to these competitors, such as: financial information, size, services provided, and type of facility.

The data requested of, and obtained from, the subject interest to determine the pertinent competitors should include information that may be used to define the market service area, as well as financial information, and strategies used by the subject interest to differentiate itself

from its competitors. The information and documents to be requested from the subject interest may include, but are not limited to:

1. Patient location zip code distribution report
2. Marketing plans and marketing materials
3. Any market service area analysis for the subject interest, including any documents and information which may address the origin (e.g., zip codes) of the subject interest's patients
4. Any utilization or demand forecast prepared by or for the subject interest
5. Strategic plans of the subject interest, including documents or information which relate to any increased expansion into new geographic areas or service lines
6. Copies of all licenses, certifications, accreditations, permits, and other regulatory approvals, including (if applicable) CONs

As this research is client and project specific, the documents and the information required may change depending on the facts and circumstances of the engagement.

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[1] For more information, see the first installment of this six-part series: "The Due Diligence Imperative—For the Valuation of Healthcare Enterprises, Assets, and Services" *The Value Examiner*, NACVA (November/December 2017).

[2] "*Healthcare Valuation: The Financial Appraisal of Enterprises, Assets, and Services*" By Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA, Volume 1, Hoboken, NJ: John Wiley & Sons, Inc., 2014, p. 2.

[3] Michael Porter is also the director of the Harvard business school's Institute for Strategy and Competitiveness.

[4] "*On Competition*" By Michael E. Porter, Boston, MA: Harvard Business School Publishing, 2008, p. 4.

[5] "*Healthcare Valuation: The Financial Appraisal of Enterprises, Assets, and Services*" By Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA, Volume 1, Hoboken, NJ: John Wiley & Sons, Inc., 2014, pp. 465–466.

[6] *Ibid*, p. 466.

[7] "CON-Certificate of Need State Laws" National Conference of State Legislatures, <http://www.ncsl.org/research/health/con-certificate-of-need-state-laws.aspx#Program> (Accessed 11/21/17).

[8] The market service area may be determined based on the areas that the current and historical patients come from; or the analyst may use the metropolitan service area that the subject interest is situated in.

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