The Consolidation Question

By James R. Brennan

Merger and acquisition activity in the IT industry bodes well for EHR adoption.

James R. Brennan

The health information technology industry is undergoing an unprecedented wave of consolidation. According to industry reports, there were 471 merger and acquisition deals in the sector in 2006, compared with 443 deals in 2005. Early market indicators suggest that the overall number of deals is likely to be even higher in 2007.

Some critics suggest that industry consolidation should be prevented because it will slow the pace of health IT adoption by physicians and hospitals. The rationale behind this argument is that fewer vendors mean less price competition. In addition, some argue that small physician groups, which have the lowest rate of electronic health record adoption, need unique technologies. These critics argue that when the vendors that cater to small practices are acquired by companies that primarily sell to large organizations, the new owners will standardize their applications and absorb the smaller vendors' unique features.

But consolidation is a natural, positive development in most new, fast-growing industries. In the early 20th century, for example, there was rapid growth and later consolidation in the railroad, automobile and aviation industries. In almost every case, consolidation brought large-scale production and lower prices for consumers, while industry innovation continued at a rapid rate.

The same progression will occur in the health IT sector, leading eventually to bigger companies and lower prices for end users.

More Vendors, Less Adoption?

Let's take a quick look at the industry today. The 2007 HIMSS conference in New Orleans boasted a record 915 vendors. Looking more narrowly at clinical information system, health information system and EHR vendors, the 2007 *Healthcare Informatics* Resource Guide lists 180 companies in these categories alone.

Many industry analysts agree that in the long term, the U.S. market cannot support so many vendors. In the last year, more than a dozen, small health IT vendors quietly went out of business. For other emerging companies, especially those with limited capital resources, survival will require acquisition by a larger company.

The effect of consolidation on physician and hospital IT adoption will almost certainly be positive. Here's why:

The current glut of health IT vendors has not produced widespread adoption. In fact, the array of operating systems and features makes comparison difficult and interoperability often impossible.

According to *CIO* magazine, fewer than 25 percent of physicians are now using EHRs, and most of those are only using a rudimentary or nonintegrated system. To stimulate wider physician adoption, the federal government created the Certification Commission for Healthcare Information Technology. CCHIT developed minimum standards for EHR functionality and has certified 80 EHR products so far.

While one of the goals of the certification effort was to create a level playing field among large and small IT vendors, it may actually lead to further consolidation as many small companies struggle to pay the review fees: a $28,000 registration fee and up to $40,000 in additional fees for updates and new products.

A separate government action designed to further adoption of EHRs also may make competition tougher for small companies. The IRS in May ruled that not-for-profit hospitals can provide health IT to physicians at subsidized prices. Many experts believe this will prompt hospitals to offer their EHRs to physicians.

Hybrid Deals Benefit All

These developments will only increase the pressures for industry consolidation. Many health IT users fear that when a large company acquires a small vendor, the latter's technology is likely to disappear. But that is no longer the case. Now, more and more acquisitions are structured as "hybrid" or equity participation agreements.

In a hybrid M&A deal, a large public corporation takes a stake (typically 10 percent to 50 percent) in a smaller public or private company. Generally, this equity infusion comes with a right to purchase the entire company at a later date if certain conditions are met.

One of the leaders of the hybrid M&A model has been Cisco Systems, which began using it more than a decade ago. Between 1993 and 2007, Cisco made 119 acquisitions, many of which were start-ups or small companies with limited track records.

Larger companies use hybrid acquisitions to gain access to new technologies at minimal cost. In most cases, their intention is to add the new technologies to their current product lineup.

A hybrid acquisition holds unique benefits for the seller. For the smaller company, it provides welcome capital, access to new markets and, in many cases, enables the company founders to maintain a high degree of control.

Competition Still Thrives

What will the health IT marketplace look like in the year 2020? Will the industry have consolidated down to just a handful of large companies?

This is unlikely. The industry is extremely competitive, and small companies can obtain market dominance quickly.

If the marketplace is allowed to create similar innovation and technology standardization in health care, EHR systems could eventually become as affordable and easy-to-use as current desktop programs for word processing, photo editing and e-mail. And that would be a welcome development.

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