Health Care Consolidation

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Fast Facts

- There were 1,299 mergers and acquisitions in the health care sector in 2014 at a value of $387 billion, both record highs.[1]
- Health care mergers and acquisitions were up 26 percent from 2013 to 2014, and the value of those deals rose 137 percent. The pharmaceutical sector, which accounted for 55 percent of spending and 14 percent of deal volume, drove much of the increase.[2]
- Activity in the provider sector slowed, although it picked up toward the end of 2014. Altogether for the year, there were 79 hospital mergers, down from 94 in 2012, and 58 physician practice groups merged or were purchased, down from 65 in 2013.[3]
- The estimated national market share for the five largest insurers in 2014 was 83 percent, up from 79 percent in 2010 and 74 percent in 2006.[4] Proposed mergers would combine the "Big 5" into three firms.

2014 brought a flurry of consolidation in the health care industry, and congressional oversight committees and federal regulators began to pay close attention with the prospect of the "Big 5" insurance companies becoming three in the near future.

In 2014, there were a total of 1,299 mergers and acquisitions in the health care sector, up from 1,035 in 2013 – a record number, according to Irvin Levin Associates, a Norwalk, Conn. publisher of financial data on the health care industry.[5] While activity slowed among hospitals and physician groups, it picked up in the insurance sector. The largest increase, though, was among pharmaceutical companies (the value of transactions totaled $213 billion in 2014), and companies providing long-term care (the value of transactions totaled a record $26 billion).[6] The number of health IT mergers also increased, to 219 in 2014 from 165 in 2013.[7]

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Consolidation in the pharmaceutical industry has spiked recently – the first half of 2015 saw $221 billion in deals, which is three times the value of transactions during the first half of 2014. Increasingly, smaller companies and spun-off subsidiaries are shuffling between larger firms. Investor pressure and projections of increased interest rates are driving the rising rate of pharmaceutical consolidation.[8]

Though pharmaceutical and technology mergers are receiving growing attention, this toolkit focuses primarily on provider and health plan consolidation.

Through the first half of 2015, the number of consolidation deals continued to decrease for hospitals compared to the first half of 2014, while increasing for physician groups.[9 10 11]

In the 1990s, there was a wave of health care mergers as stakeholders grappled with ways to contain health care costs. Those health care marriages waned in the early part of the 2000s, and then accelerated again in the later part of the decade as the industry anticipated passage of the Patient Protection and Affordable Care Act (ACA) in 2010.[12 13]

Enactment of the ACA has added financial pressure on hospitals, doctors and insurers in a variety of ways, including less in Medicare payments to hospitals, Medicare reimbursements that are pegged to quality standards, limits on administration costs for insurers under medical loss ratio rules that require 80 to 85 percent of premium dollars to be spent on care, and new payment models that emphasize coordination and management of patient care.[14 15]

While there has been considerable criticism of provider and insurer consolidation, with opponents citing harmful implications for consumers, including higher costs, others point to the merits and say that some amount of activity is necessary to reshape the health care industry in positive ways.

Indeed, insurers argue that some activity is necessary as the health care sector shifts from a fee-for-service model towards value-based payments. In addition to the expected benefits of consolidation generally, such as reducing administrative costs, acquiring complementary capabilities and acting on new synergies, they maintain that the acceleration of this shift, as well as the capability to move towards a more consumer-driven marketplace, has a positive effect on the health care system as a whole.[16]

Some experts maintain that there is a contradiction in advocating for the policies that have driven provider consolidation but then condemning the mergers. Health care costs are rising at a historically low rate, and it is possible that policies that would reduce provider concentration could raise health care costs, they say.[17]

Hospital and Physician Consolidation

Hospitals responded to ACA changes by joining forces. From 2009 to 2011, the number of annual hospital deals increased steadily.[18]

A tapering off in deal volume followed from 2012 to 2014. In 2014, there were 79 hospital mergers, down from 94 in 2012, and 58 physician practice groups merged or were purchased, down from 65 in 2013.[19] Hospital consolidation continued to moderate through the first half of 2015, when hospital mergers and acquisitions were down 6 percent from the first half of 2014.[20 21] However, during the same time period, physician medical group deals increased 50 percent.[22]

Across the health care industry, but most notably in hospitals, organizations are also engaging in non-binding agreements rather than outright mergers, which are the only deals counted in this publication's statistics. Non-binding arrangements include partnerships, collaborations and joint ventures.[23]

There is also a new trend regarding the focus of hospital acquisitions. Merger activity has moved away from dominant health systems acquiring weaker ones and towards health systems acquiring community hospitals to provide guaranteed referrals.[24]

Doctors, for their part, have been increasingly interested in becoming salaried employees of hospitals because it provides payment security at a time of uncertain reimbursement rates, and a better work-life balance.[25] Further, hospitals can help doctors offset the high cost of adopting an electronic health records system and eliminate the headache of having to find younger doctors to maintain business and handling the administrative and billing side of the business in house.[26 27]

This activity has prompted a debate about the advantages and disadvantages of provider consolidation. In addition to more commonlycited reasons for mergers, hospital executives who have acquired a physician group in the last year cited "increased market-share" as one of the five major motives for acquiring medical practices, in addition to expanding service capabilities, insurance-related purposes, meeting community need and increasing efficiency and alignment.[28]

Some critics of provider mergers argue that this activity is resulting in increased prices. A 2015 *Journal of the American Medical Association* (*JAMA*) study found that physician-hospital integration was associated with increased outpatient costs. The most integrated areas saw a 3.1 percent annual increase in outpatient spending per enrollee and that the increase was driven almost entirely by an increase in prices.[29] A 2014 JAMA study found that, in California, local hospital-owned physician groups' expenditures were 10.3 percent greater, and multihospital system-owned physician groups' expenditures were 19.8 percent greater than physician-owned groups.[30] A 2015 *Health Affairs* article additionally found that prices for common, high-cost medical procedures in counties with the highest average physician concentration were 8 percent to 26 percent greater than those in the lowest counties.[31]

Some experts counter that there are merits to consolidation. Hospitals say there is still plenty of competition and that most mergers have improved health care quality and provided benefit to the community. Though many recent transactions involve health systems acquiring community hospitals, which would assure referrals,[32] the first wave of post-ACA transactions primarily involved one institution buying another that was struggling financially, or needed more capital or specialized expertise, according to an April 2013 report commissioned by the American Hospital Association.[33]

Additionally, some proponents argue that provider consolidation may be necessary to achieve the care coordination and efficiency goals of policymakers. They point to the Mayo Clinic, Kaiser Permanente and Intermountain Healthcare as some of the best examples of integrated health systems successfully providing high value care while holding strong market positions.[34]

Driven in part by the emphasis on high-value care and population health, inpatient hospitalizations have decreased over the last 10 years, a trend that is projected to continue at least through 2021. That draws into question how much capacity is required.[35]

Former Medicare and Medicaid administrator Bruce Vladeck, in a 2014 *Health Affairs* letter to the editor, argued that there are "too many hospitals, too many inpatient hospital beds, too much underused diagnostic equipment, too many neonatal intensive care units and cardiac surgery programs, and too many marginal hospitals that survive by permitting too many inadequately skilled doctors to admit patients to them." That, he said, benefits neither patients nor payers. The challenge, he continued, is in consolidating "in a way that improves quality, protects payers and maintains access to care for those who need it most."[36]

Insurer Consolidation

Insurer consolidation has more recently been in the news because of recent activity among the "Big 5" health plans. Nationally, the market share of the "Big 5" insurers has grown from 74 percent in 2006 to 83 percent in 2014, and proposed mergers between Anthem and Cigna and between Aetna and Humana would reduce the "Big 5" to a "Big 3," with United being the third firm.[37] In local markets, the median Herfindahl–Hirschman Index (HHI), a measure of market concentration, increased from 1,716 in 2001 to 2,973 in 2012, well above the 2,500 Department of Justice and Federal Trade Commission-set cut-off to qualify as "highly concentrated."[38]

According to The Commonwealth Fund, 97 percent of markets in U.S. counties were found to lack significant competition in the Medicare Advantage (MA) program, through which nearly one-third of Medicare beneficiaries receive private coverage, mostly through HMOs and PPOs. While MA enrollees can choose from an average of 18 plans, some of those plans may be offered by the same insurer.[39] [40]

Doctors also blame increased costs on insurance companies. Physicians say the result of insurer mergers and acquisitions has been higher premiums and less generous benefits to consumers.[41]

The emergence of provider-sponsored health plans may also play a role in the rate of new entrants and competition in the health insurance industry. Thirteen percent of U.S. health systems currently offer a health plan in one or more markets, and as market power on the insurer side grows, offering their own plan may become an increasingly viable option for providers to avert reduced reimbursement rates while maintaining a steady volume of patients.[42]

Regulation

Antitrust officials have been following the consolidation trend closely, and the Federal Trade Commission has blocked several health care mergers.[43] In February 2013, the Supreme Court confirmed the agency's authority to challenge the merger of two hospitals in Georgia. In March 2013, the FTC filed a lawsuit to block an Idaho hospital chain's purchase of the largest multi-specialty independent physicians' practice. In 2012, the agency also stopped the purchase of a surgical center by a hospital in Pennsylvania, and in 2011, it challenged a hospital merger in Ohio.

The U.S. Department of Justice is currently reviewing proposed mergers between Anthem and Cigna, as well as Aetna and Humana.[44] The mergers would reduce the five firms with the greatest national market share to three.[45] Aetna and Humana shareholders have approved the merger, while Anthem and Cigna have shareholder meetings scheduled for later in the year to vote on the deal.[46] [47]

During fiscal year 2014, the Federal Trade Commission challenged 17 mergers or acquisitions, and the Department of Justice challenged 16 of the 1,663 transactions reported under the Hart-Scott-Rodino Antitrust Improvements Act.[48]

In response to potential antitrust complaints, some health systems negotiate with state attorneys general. These negotiations can involve such concessions as limiting rate increases. However, despite deals between merging entities and state governments, courts sometimes reject them or federal agencies file complaints on the grounds that the negative effects of mergers will occur once the deals expire, or that the deals are not sufficient to assuage antitrust concerns.[49] [50]

One possible model for regulating mergers and acquisitions is the Certificate of Public Advantage, or COPA. Though rare, one authorized by a 1993 statute in North Carolina has operated for nearly two decades. Entering into a COPA protects merged entities from antitrust enforcement, but subjects them to conditions imposed by this quasi-regulatory body. Conditions can affect profit margins, patient costs and employment rates. COPAs can also adjust conditions over time.[51]

The latest merger discussions have raised questions about the appropriate role and scope of federal antitrust oversight.[52] Congressional committees have held at least four hearings in 2015 on consolidation or competition in health care.[53] [54] [55] [56]

Resources

General

Building a Strategy: Mergers & Acquisitions in Healthcare
Benton, B. (March 17, 2015) Dixon Hughes Goodman LLP
http://goo.gl/FZhMgJ
This article addresses the movement away from stronger, dominant health systems taking over smaller or financially weaker organizations to large systems joining with community hospitals to assure referrals. It also addresses the impact of the movement toward value-based payments.

Medical Cost Trends: Behind The Numbers 2016
(June 2015) PricewaterhouseCoopers Health Research Institute
http://goo.gl/MHYuZc
This paper examines the variety of factors that impact medical costs, including purchases of physician practices and hospital mergers and acquisitions.

US health services deals insights: Analysis and trends in US health services activity 2014 and 2015 Outlook
(February 2015) PricewaterhouseCoopers Deals practice
http://goo.gl/ol0yDX
This report summarizes the current state of health care merger and acquisition activity as a whole and within six subgroups. It finds that both the number and value of deals in 2014, driven almost entirely by the first and fourth quarters, significantly exceeded that of 2013. The last ten years of data on the volume and value of deals are presented.

Hospital and Physician Consolidation

Paradigm Lost: Provider Concentration And The Failure Of Market Theory
Vladeck, B. (June 2014) *Health Affairs*
http://goo.gl/51JGUu
This article responds to the claims that classic market theory dictates provider concentration is to blame for high health care prices. The author suggests that reducing provider consolidation could lead to an increase in health care costs, and that policy solutions should be less representative of economic theory and have a stronger focus on practicality.

Hospital Consolidation Isn't the Key to Lowering Costs and Raising Quality
Frakt, A. (January 27, 2015) *JAMA*
http://goo.gl/6d8t3A
This article, written by a Boston University associate professor in the JAMA Forum, describes why competition, not consolidation, is the key to reducing costs and improving the quality of care. He concludes that "hospital consolidation is neither sufficient nor necessary to lower costs and raise quality."

Total Expenditures per Patient in Hospital-Owned and Physician-Owned Physician Organizations in California
Robinson, J.C. and Miller, K. (October 22/29, 2014) *JAMA*
http://goo.gl/HoORTH
This article describes the differences in health expenditures across physician groups in California based on their ownership. It finds that groups owned by physicians have the lowest expenditures, followed by groups owned by local hospitals, and then those owned by multihospital systems incur the greatest costs.

Association of Financial Integration Between Physicians and Hospitals With Commercial Health Care Prices
Neprash, H.T., et al. (October 19, 2015) *JAMA*
http://goo.gl/2DiOl5
This article describes a correlational study of 240 metropolitan statistical areas and finds that increases in physician-hospital integration were associated with increases in outpatient spending, driven almost entirely by increases in prices.

Synthesis Project Update: The Impact of Hospital Consolidation
Gaynor, M and Town, R (June 9, 2012) The Robert Wood Johnson Foundation
http://goo.gl/Lbml7h
This update six years after the first report on hospital pricing again concluded that increases in hospital market concentration lead to increases in the price of hospital care. This report found that the average price increase can be "dramatic," often exceeding 20 percent. The update also concluded that mergers may threaten the quality of care.

How Hospital Mergers and Acquisitions Benefit Communities
(June 3, 2013) American Hospital Association and the Center for Healthcare Economics and Policy, http://goo.gl/2KD0dS
The AHA-commissioned report says that much that has been written about hospital consolidation is misleading and that mergers in the past 6 years have been among the strategies used to respond to private sector and government incentives to improve quality and more efficient care. Further, the association notes that all the transactions underwent tough antitrust scrutiny.

Hospital Mergers Can Lower Costs and Improve Medical Care
Davis, K. (September 15, 2014) *The Wall Street Journal*
http://goo.gl/0h8CpA
This article, an op-ed by the president and CEO of Mount Sinai Health System, describes the increased costs hospitals face in the wake of health care reform, and argues that hospital consolidation can mitigate those costs as well as improve the quality and coordination of care.

Less Physician Practice Competition Is Associated With Higher Prices Paid For Common Procedures
Austin, D.R. and Baker, L.C. (October 2015)
Health Affairs
http://goo.gl/Pr3SEL
This study describes the relationship between levels of physician practice competition and prices for 15 high-cost, common health care procedures. It found that decreased competition lead to increased costs for 12 of 15 procedures, and that the counties with the lowest levels of competition had prices 8-26 percent higher than those with the highest levels of competition.

Health Insurer Consolidation

Paying a Premium on Your Premium? Consolidation in the US Health Insurance Industry
Dafny, L., Duggan, M., Ramanarayanan, S. (April 2012) *American Economic Review*
http://goo.gl/DDUUD9
This paper is a quantitative analysis of a major health insurance merger. It reviews the 1999 merger of Aetna and Prudential Healthcare and finds that the consolidation led to an increase in premiums and reduced health care employment.

Competition Among Medicare's Private Health Plans: Does it Really Exist?
Biles, B., Casillas, G., Guterman, S. (August 25, 2015) The Commonwealth Fund
http://goo.gl/hKFy2y
This issue brief from The Commonwealth Fund evaluates the levels of competition in Medicare Advantage markets throughout the country. It finds that 97 percent of markets in U.S. counties can be considered highly concentrated, according to a standard measurement of market competition. It also found that, in the 100 counties with the greatest numbers of Medicare beneficiaries, 81 did not have competitive MA markets.

Medicare Advantage: 2015 National Snapshot
Carpenter, E. (July 24, 2015) Avalere Health
http://goo.gl/qKgPDC
This analysis examines the health plan choices available to Medicare beneficiaries. It finds that there are sufficient choices available, with 94 percent of beneficiaries having five or more plans from which to choose, and a total average of 18 plans from which to choose.

Competition and Choice in the Health Insurance Marketplaces, 2014-2015: Impact on Premiums
Sheingold, S., Nguyen, N. Chappel, A. (July 30, 2015) Office of the Assistant Secretary for Planning and Evaluation, U.S. Department of Health and Human Services
http://goo.gl/AodpYO
This brief describes levels of competition and choice in health insurance marketplaces, which were created by the Affordable Care Act for individuals and small businesses seeking health insurance. It found that competition increased in most areas between 2014 and 2015, and that competition between insurers had a significant impact on premium growth; counties that experienced a net gain in insurer saw a premium 8.4 percent lower than others for the second-least expensive silver plan.

Examining Implications Of Health Insurance Mergers
Greaney, T. (July 16, 2015) Health Affairs Blog
http://goo.gl/waTVeI
This blog post from a Saint Louis University School of Law professor gives an overview of the effects of previous insurance mergers as well as potential competition and policy concerns, mainly around the potential Aetna/Humana and Anthem/Cigna mergers.

A Healthy Side of Insurer Mega-Mergers
Fuchs, V. and Lee, P (August 26, 2015) *The Wall Street Journal*
http://goo.gl/Fbu5pL
This op-ed, by an emeritus professor of health economics at Stanford University and the executive director of Covered California, describes the potential benefits of consolidation between large insurers, mainly that a reclamation of market power from providers has the potential to lower costs for consumers and that they have the potential to improve the quality and efficiency of care.

Provider-led health plans: The next frontier- or the 1990s all over again?
Khanna, G., Smith, E., Sutaria, S. (January 2015) McKinsey & Company Healthcare Systems and Services Practice
http://goo.gl/eu5iSV
This report describes the emergence of provider-sponsored health plans and how the current health care landscape provides a more positive outlook that of the 1990s. They also consider the potential risk and benefits for providers who are considering entering this market.

Antitrust Activity

Aetna-Humana merger will face tough antitrust review
Schencker, B. (July 9, 2015) *Modern Healthcare*
http://goo.gl/pdOUXi
This article gives an overview of the potential Aetna/Humana and Anthem/Cigna mergers, as well as a smaller, less scrutinized consolidation of Centene and Health Net, and describes the antitrust process they are currently facing. It also quotes experts on the likely outcome, which they predict will be a series of required divestitures that ultimately result in the approval of the mergers.

Hospital Consolidation, the Bad the Good and the Ugly
Ohlhausen, M (March 13, 2013) Federal Trade Commission
http://goo.gl/Frru05
In this speech at America's Health Insurance Plans' 2013 National Policy Forum, FTC Commissioner Maureen Ohlhausen outlines and defends the Obama administration's antitrust efforts with regard to health care industry consolidation.

Selected Experts

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Catalyst for Payment
Reform www.catalyzepaymentreform.org

Federation of American Hospitals
www.fah.org

Heritage Foundation
www.heritage.org

Irving Levin Associates,
Inc. www.levinassociates.com

Kaiser Family Foundation
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www.mathematica-mpr.org

Urban Institute
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Endnotes

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