Healthcare Trends – More Consolidations – This Time Health Insurers - ObamaCare's Oligopoly Wave – presented by Foxboro Consulting Group, Inc.

Bigger insurance, bigger medicine, and a health consolidation frenzy.

The five largest commercial health insurers in the U.S. have contracted merger fever, or maybe typhoid. UnitedHealth is chasing Cigna and even Aetna ; Humana has put itself on the block; and Anthem is trying to pair off with Cigna, which is thinking about buying Humana. If the logic of ObamaCare prevails, this exercise will conclude with all five fusing into one monster conglomerate.

This multibillion-dollar M&A boom is notable even amid the current corporate-financial deal-making binge, yet insurance is only the latest health-care industry to be swept by consolidation. The danger is that ObamaCare is creating oligopolies, with the predictable results of higher costs, lower quality and less innovation.

The business case for the insurance tie-ups among the big five commercial payers, which will likely leave merely three, is straightforward. Credit is historically cheap, and the insurers have built franchises in different areas that could be complementary. As for antitrust, selling coverage to employers doesn't overlap with, say, managing Medicaid for states. (Expect some of the Blue CrossBlue Shield nonprofits to hang for-sale signs soon for the same reasons.)

Opinion Journal Video

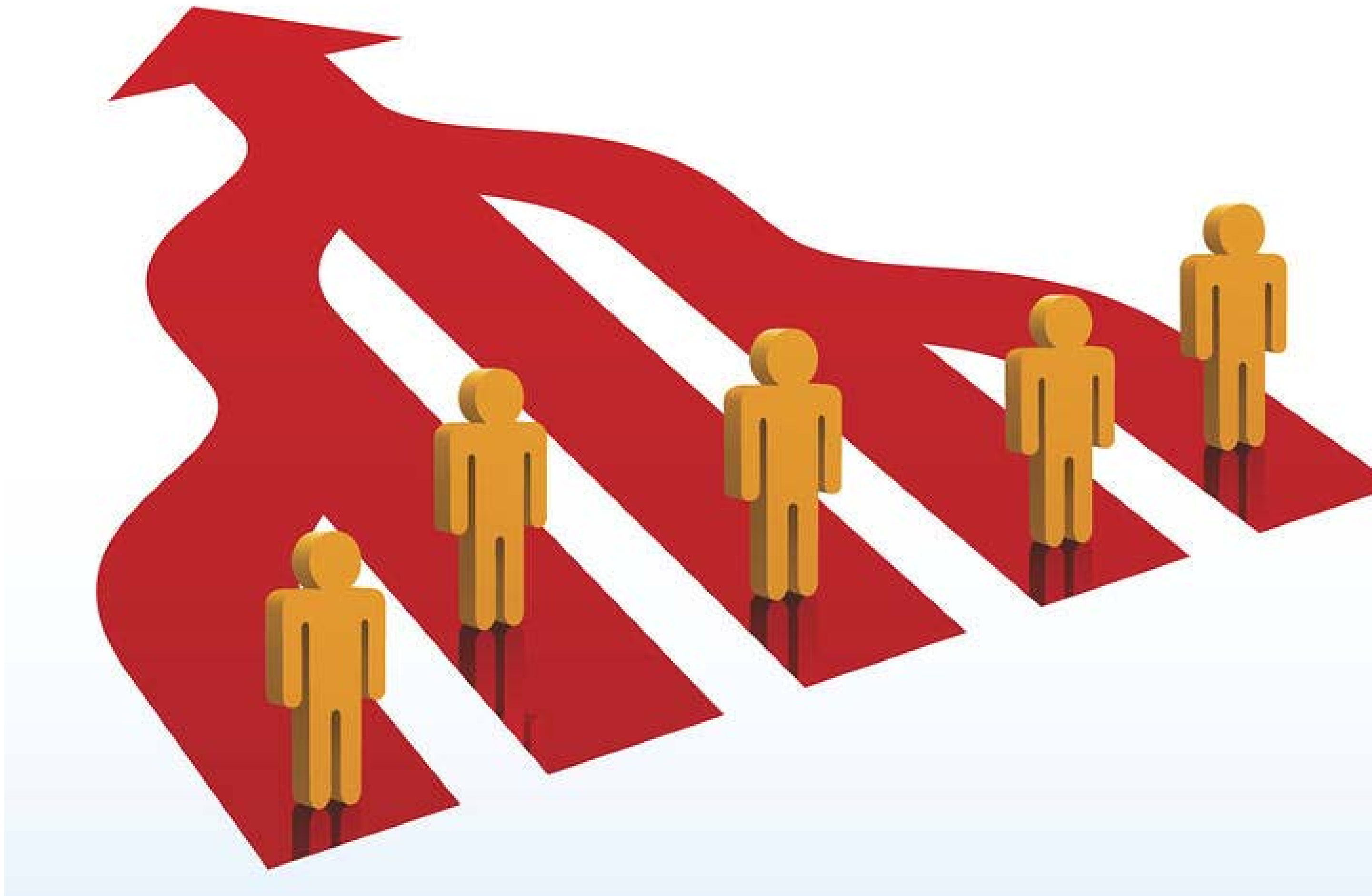
Editorial Board Member Joe Rago on how President Obama's signature healthcare law has encouraged consolidation among insurers—and the implications for consumers. Photo credit: Getty Images.

More important, the economics of ObamaCare reward scale over competition. Benefits are standardized and premiums are de facto price-controlled. With margins compressed to commodity levels, buying more consumers via mergers is simpler than appealing to them with better products, to the extent the latter is still legal. Synergies across insurer combinations to reduce administrative overhead and other expenses also look better for shareholders.

The mergers reflect the reality that government—Medicaid managed care, Medicare Advantage and the ObamaCare exchanges—is now the artery of insurance profits, not the private economy. The feds "happen to be, for most of us now, our largest customer," Aetna CEO Mark Bertolini said this month at a Goldman Sachs conference.

Foxboro Consulting Group, Inc. – Business Valuation & Financial Advisory Services
P.O. Box 141, Foxboro, MA 02035
Contact: Ronald J. Adams, CPA, CVA, ABV, CBA, CFF, FVS, BCA, CGMA at: Office (774) 719-2236 or Mobile : (508) 878-8390, or email at: adams.r@foxboro-consulting.com

Mr. Bertolini added: “So there is a relationship you need to figure out there if you’re going to have a sustained positive relationship with your biggest customer. And we can all take our own political point of view of whether it’s right or wrong, but in the end-analysis, they’re paying us a lot of money and they have a right to give us some insight into how they think we should run our business.” Such domestication is part of ObamaCare’s goal of political control, and it may well be that only fewer, larger and more centralized insurers can survive financially.



One irony is that insurance consolidation is intended to offset another ObamaCare side effect, which is the consolidation of medical providers. Hospitals, doctors and other providers like rehab and skilled nursing are also uniting en masse. Irving Levin Associates reports that health services M&A deals rose 18% in 2014 after a record 2013.

Hospital mergers have climbed every year since 2009, and in 2014 the number of deals that closed was 50% higher than the number in 2009, which was the year before the health law passed. Three of five hospitals now belong to a system. Hospitals are also absorbing physician groups, with the estimated share of doctors who are salaried workers at hospitals ranging from one-seventh (the American Hospital Association) to two-thirds (Credit Suisse).

Foxboro Consulting Group, Inc. – Business Valuation & Financial Advisory Services
P.O. Box 141, Foxboro, MA 02035
Contact: Ronald J. Adams, CPA, CVA, ABV, CBA, CFF, FVS, BCA, CGMA at: Office (774) 719-2236 or Mobile : (508) 878-8390, or email at: adams.r@foxboro-consulting.com

The danger is that when insurers negotiate private reimbursement rates, larger providers usually extract higher mark-ups. At least until the arrival of telemedicine and virtual care, most people will continue to consume medicine where they live, and the side with more market leverage extracts higher rents. Insurers can exclude hospitals from their networks, but not if there are few local alternatives.

ObamaCare encourages doctor and hospital consolidation to promote clinical integration, with large institutions in theory better able to administer speculative new cost-control programs and coordinate best practices. Yet these goals can be achieved short of ownership, such as joint ventures, affiliations and contracting. Sure enough, a growing economic literature suggests that today's hospital concentration is more about revenue maximization than efficiency.

One troubling trend is the rise of cross-market mergers to create regional hospital mega-systems. These providers use their dominance in one metro area (like the San Francisco Bay Area) to demand "all or nothing" offers everywhere else (like the Central Valley). In a 2014 paper, Matthew Lewis of Clemson and Kevin Pflum of the University of Alabama found that these mergers increase net reimbursement in the out-of-market system by 14% to 18%, which can't be explained by better quality outcomes, the patient case mix or the general spending trend.

Health care has been consolidating since the 1990s, but ObamaCare has accelerated the trend. Insurer and especially hospital transactions will come under increasing regulatory scrutiny, but the antitrust cops are irrelevant when government's overwhelming priority is to create and entrench cartels.

A healthier market would have many new competitive entrants given the transformative pace of technological and biomedical discovery. Health-care finance and delivery ought to be evolving along with these innovations, but the only disruptive force under ObamaCare is government. So five years into the glories of "health-care reform," the same antiquated incumbents dominate as they did before, only with less accountability to patients. Cartels don't care about quality, safety or costs to consumers.

Insurance and hospital-chain stocks are on a fabulous run, but investors should beware corporations that bet their future on leviathan rather than challenging the status quo. Sooner or later you run out of things to buy, and if America does converge into a single monster "insurer" or "health system," it will be the federal government [Wall Street Journal – Review & Outlook - June 20, 2015]

Foxboro Consulting Group, Inc. – Business Valuation & Financial Advisory Services
P.O. Box 141, Foxboro, MA 02035
Contact: Ronald J. Adams, CPA, CVA, ABV, CBA, CFF, FVS, BCA, CGMA at: Office (774) 719-2236 or
Mobile : (508) 878-8390, or email at: adams.r@foxboro-consulting.com