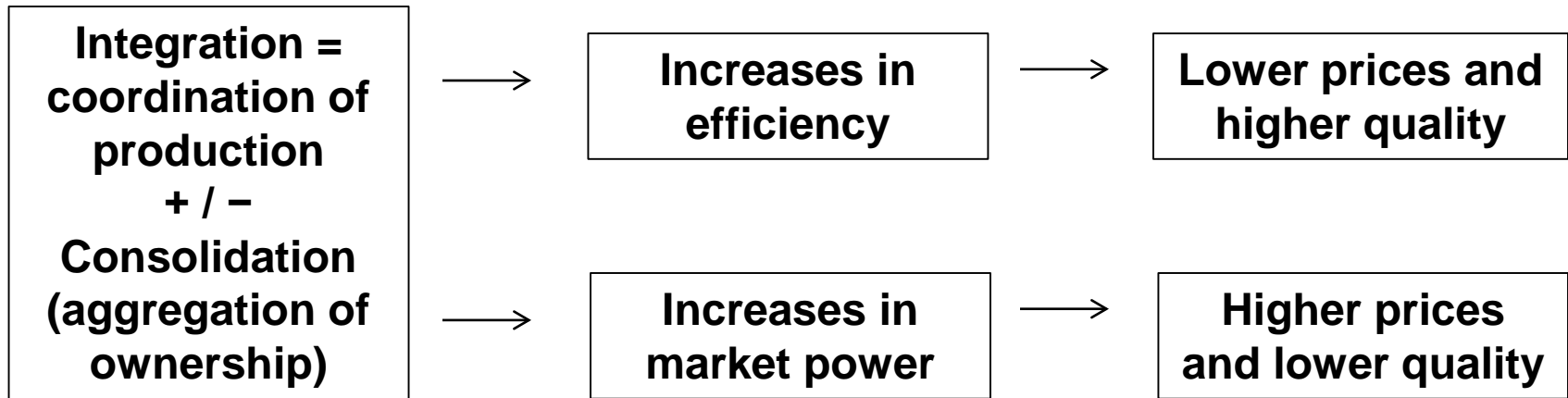

Drivers, Trends, and Emerging Patterns Of Health Care Industry Consolidation

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Consolidation Versus Integration



Questions for today

- When do social benefits of coordination of production outweigh social costs of aggregation of ownership?
- When is consolidation necessary to achieve integration?
 - Can benefits of ACOs be obtained by contracts among participants instead of joint ownership?

Integration Takes One Of Two Forms

- “Vertical” Integration
 - Traditionally defined as between firms at *different stages* of the production process, but better defined as between firms that produce *complements*.
 - Examples: joint ownership of hospitals and physician practices, or of specialist and primary-care physicians; ACOs; CVS/Aetna and Cigna/Express Scripts mergers.
- “Horizontal” Integration
 - Traditionally defined as between firms at *the same stage* of the production process, but better defined as between firms that produce *substitutes*.
 - Examples: joint ownership of hospitals, or of same-specialty physicians.

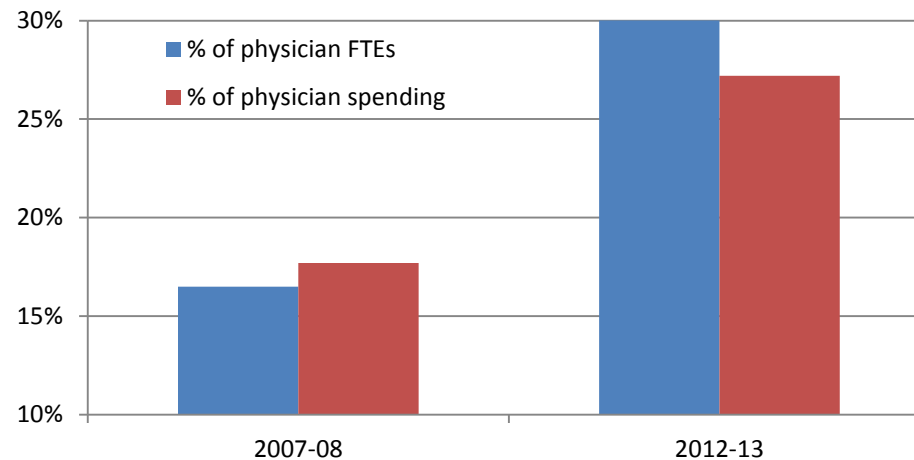
Vertical Integration May Have Both Social Benefits And Social Costs

- Benefits: more coordination of care, economies of scale and scope
- Costs: less competition, higher prices or lower quality
 - More bargaining power for integrating hospitals or physicians
 - Less bargaining power for remaining competitors through foreclosure
 - Exploitation of payment rules (billing a facility fee for services generally delivered in physician offices)

Although vertical integration in most industries is viewed as benign or socially beneficial, health care is different because one integrating party often controls referrals to the other.

Vertical Integration Is Increasing

Percentage of Physician FTEs and Physician Spending In Hospital-Owned Practices



Sources: FTEs from [1], Spending from [2].

Empirical Evidence On Vertical Integration

- Benefits of vertical integration have been modest [3]
 - Medicare ACOs: nominal benefits
 - Private ACOs and high-risk patient groups: potentially greater benefits
- Costs of vertical integration have been significant: “vertical integration poses a threat to affordability” [4]
 - Hospital ownership of physicians → higher prices for and spending on hospitals [5,6] and physicians [2,7]
 - Multispecialty physician practice → higher prices for both generalist and specialist physicians in concentrated markets [8]

Vertical Integration In Markets For Health Services Is An Important Policy Problem

- Need to reconsider antitrust policy toward physician/hospital integration, multispecialty physician practice, and non-traditional vertical mergers in light of new empirical evidence.
- Social costs due to both reductions in competition and exploitation of payment rules.
- Future work should explore how social benefits of vertical integration might be achieved without social costs.
 - Integration through (limited) contract rather than ownership?

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