Mergers and Real Competition

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It's easy to get swept up in merger mania. Many industry observers see rapid consolidation with no end in sight. In fact, a recent report by one major consulting firm posited that only about half of the current health systems will be left standing in 10 years.

This conclusion was supported by analyses from other industries—finance, retail, and airlines—over the past two decades. These comparisons ignore a critical factor in health care: the physician. Neither the banking vice president, nor the merchandising manager, nor the pilot enjoys the control or the influence that the physician has in the delivery of health care.

In many markets, savvy physicians have realized the value in their relationships with their patients and have independently entered into value-based arrangements with payers (e.g., patient-centered medical homes, physician-sponsored accountable care organizations, bundled payments).

In focusing on each other, hospitals and health systems in these markets may have failed to consider the potential power of physician groups. Fierce competitors, these groups have the ability and motivation to drive down hospital utilization and shift referrals to cooperative, lower-priced hospitals.

In theory, this potential shift to lower-priced hospitals could favor consolidation, as scale may decrease operating costs under the right circumstances. However, many studies point out that consolidation often increases hospital prices. Creating the leverage to negotiate higher prices, a tried and true strategy of the past, may be counterproductive if physicians (or patients with high cost sharing in their health coverage) steer clear of high-priced hospitals.

At the same time, the Federal Trade Commission (FTC) may fight hospital mergers with increasing vigor to maintain competition. Although the FTC currently is challenging only a handful of deals, it stands to reason that more will come under scrutiny as increasing numbers of mergers cause antitrust concerns to grow. There is likely to be a balancing point at which market competition remains sufficient for lower-priced hospitals to gain advantage, while merger strategies based on higher prices may fail.

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As hospitals enter the era of true price competition, simply aggregating higher-priced hospitals will not yield competitive advantage. That kind of merger may increase market presence, but it also raises the risk of being outmaneuvered by other providers that are managing costs effectively.

The right strategy for any given hospital or health system will be one that delivers real value, whether through population health management, lower operating costs, improved quality, or a combination of all three. Health systems ignore this reality at their peril. It is critically important to consider any potential merger in the light of its ability to deliver this kind of value.

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