Why Independence Assessments Still Matter

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More than 60 percent of the nation's community hospitals are now part of health systems. In this environment, leadership at independent hospitals and smaller health systems are well advised to conduct a thorough assessment of the potential for remaining independent.

Some independent hospitals will benefit from mergers or acquisitions, and others may not achieve significant benefits. Merging, as a process, has significant short-term costs and disadvantages and should not be undertaken unless it is clear that the benefits will exceed those costs and disadvantages.

The three frequently cited benefits of hospital mergers are the following:

- Economies of scale/purchasing power
- A better bond rating and improved access to capital
- An improved negotiating position

Many—but not all—hospitals that merge or are acquired will obtain one or more of these benefits. The impact on any one hospital is highly individual.

ECONOMIES OF SCALE

A recent study by the American Hospital Association (AHA) found that hospital mergers reduced operating expense per admission by 2.5 percent at acquired hospitals. That's significant—but it's also low enough that the average almost certainly includes some hospitals with no reduction, or a small increase, in operating expenses.

To achieve a good portion of potential savings, there may need to be layoffs, and hospitals and health systems, being socially oriented, tend to resist laying people off. Non-personnel costs, such as supplies and equipment, typically represent 30 to 40 percent of a hospital's expenses, which can be targeted for savings through the larger scale of a health system (see Butcher, L. "Sizing Up Economies of Scale," Leadership, Oct. 31, 2012). But for any one hospital to determine its likelihood of realizing non-personnel savings in a merger, the organization must conduct a full review of its numbers as well as those of potential partners and group purchasing organizations the hospital might join.

BOND RATINGS

Moody's Investors Service considers organizational size, as measured by total revenues, in assigning bond ratings. Forty-five percent of the agency's scoring is based on market position, and a quarter of that—about 11 percent of the total score—is based on total revenues. It's a significant piece, but other positive factors can outweigh it.

In contrast, Standard & Poor's does not consider organizational size, per se, as part of market position rating; rather, it appears to place more emphasis on concentrated local or regional presence and market share. An independent hospital or small health system may well have these attributes, resulting in a favorable credit position.

NEGOTIATING POSITION

Independent hospitals in highly competitive urban markets may be at a disadvantage when negotiating with commercial health plans, and could realize benefits from becoming part of a health system with better leverage. On the other hand, if they do not merge, lower payment rates may make them an attractive component of a narrow network.

Rural hospitals or hospitals in a single provider market with limited or distant competition are in a different position; combining with other providers may not produce a significant impact on negotiating position.

The actual benefit to any independent hospital will depend on the hospital's individual situation and goals. Some goals, such as improving quality or being better positioned to manage population health, may be achievable through various forms of affiliation. A hospital's situation should be carefully assessed before concluding that a merger or acquisition is the best choice.

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