Coming on the heels of the recession, hospital merger/acquisition activity began to accelerate. Hospitals began acquiring other hospitals and hiring medical staff in an effort to provide the leadership needed to reform a siloed health care system that nearly everyone from Institute of Medicine to the Medicare Payment Advisory Commission (MedPAC) has singled out as one of the main culprits in higher cost, lower quality health care.

Both government and the private sector are creating incentives that are driving hospitals toward one another and toward their medical staffs with new global and fixed payments; new incentives for meeting quality, efficiency, and patient satisfaction goals (and penalties for failing to do so); and rescinding payments for certain readmissions.

Meeting these myriad challenges requires building a continuum of care that includes healthier, leaner hospitals and closely aligned medical staff.

To achieve these worthy goals, mergers may be the only recourse, as decades old regulatory barriers can keep hospitals and doctors from working closely together to improve care and reduce costs unless they are under the same ownership umbrella. Gainsharing demonstration projects in New Jersey, for example, show care and cost improvements from closer collaboration, yet the barriers remain.

Both Moody’s and Standard & Poor’s report a negative financial outlook for hospitals, attributable in large part, to the fact that “[t]he healthcare industry is undergoing a period of fundamental transformation in which the very model of healthcare delivery is being questioned and changed.”

—Moody’s Outlook 2012

“[H]ospitals that successfully improve operating efficiencies, engage in growth strategies, and align more closely with physicians will be better poised to adapt to ongoing challenges.”

—Moody’s Special Comment 2012

“[I]t appears that consolidation has resulted in the possession and exercise of health insurer monopoly power ... instead of passing any benefits of consolidation such as lower premiums from efficiency gains on to consumers ... [T]he majority of health insurance markets in the United States are highly concentrated.”

—Competition in Health Insurance 2012

“Payers have consolidated over the past several years ... providing greater negotiating leverage for the payer.”

“In most markets dominated by large payers, hospital commercial reimbursement rates are lower than average.”

—Moody’s 2012

Some payers tend to blame hospital mergers for high insurance premiums. Two economic consulting firms examined charges that hospital mergers in the 1990s drove up prices. They said:

“There is no valid empirical basis for [that] conclusion.”


That is still true today.

—Continued
Hospitals: Consumer Preference Matters

Like firms in every other sector of our economy, hospitals are not all the same. Some hospitals with high-level or more costly services, like burn or high-level trauma units or other highly specialized care, have higher costs and may charge higher prices. These may also be the very hospitals that consumers most want to go to when they are seriously ill or badly injured.

Pundits often confuse such consumer preferences with market power – they are wrong to do so.

“Even the FTC acknowledges that for hospitals, different prices are “neither necessary nor sufficient to demonstrate … market power.”

—FTC Working Paper 2009

Hospitals compete to be the best and invest the resources needed to maintain consumer trust and loyalty.

—Compass Lexecon 2010

In a radio interview, small business owners in California said they were willing to pay more for the hospitals their employees believed were the best.

—KQED, November 20, 2010

Hospitals: Price Growth is at Historic Lows

Despite renewed merger activity, the growth in spending on hospital care is at historic lows.

—Altarum 2012

It is not hospital prices that are driving the rise in insurance premiums. The growth in insurance costs from 2010 to 2011 was more than double that of the underlying health care costs, including hospitals. From 2011 to 2012, premiums began to reflect the lower spending growth, but still outpaced it by nearly 14%.

Percent Change in Premium Levels vs. National Spending on Health Care, 2010 to 2011 and 2011 to 2012

<table>
<thead>
<tr>
<th>Change in Premiums</th>
<th>Change in Spending on Health Care</th>
</tr>
</thead>
<tbody>
<tr>
<td>9.5%</td>
<td>4.5% 4.4% 3.7%</td>
</tr>
</tbody>
</table>


Growth in Medicare spending per beneficiary hit historic lows during the 2010 to 2012 period.

—HHS Issue Brief 2013

Insurance companies are expected to drive hospital rate increases even lower, according to Moody’s, “continuing a multi-year trend.”

“[T]he opportunities to gain leverage and higher rates from commercial payors are quickly dissipating….”

—Moody’s New Forces 2012

“We expect commercial payers to remain highly aggressive in negotiating lower reimbursement rates with hospitals in 2012.”

—Moody’s 2012

Unlike other health care sectors, study after study has shown that hospital prices are directly related to the cost of caring for patients. Funds needed to hire and retain doctors, nurses and other medical and support staff with the right qualifications and training are the single largest cost for hospitals – they account for two-thirds of total expenses.

About two-thirds of hospital costs go to the wages and benefits of caregivers and other staff.

Percent of Hospital Costs by Type of Expense, 4Q09

<table>
<thead>
<tr>
<th>Type of Expense</th>
<th>Percent of Hospital Costs</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wages and Benefits</td>
<td>59.5%</td>
<td>IHS Global Insight, Quarterly Index Levels in the CMS Prospective Payment System (IPPS) Hospital Input Price Index, 2009 Q3.</td>
</tr>
<tr>
<td>Other Products (e.g., Food, Medical Instruments)</td>
<td>14.2%</td>
<td></td>
</tr>
<tr>
<td>Prescription Drugs</td>
<td>5.9%</td>
<td></td>
</tr>
<tr>
<td>Other Services Non-Labor Intensive</td>
<td>16.9%</td>
<td></td>
</tr>
<tr>
<td>Other Services, Labor Intensive</td>
<td>3.8%</td>
<td></td>
</tr>
</tbody>
</table>

—Continued
**Hospitals: Investing in Technology and Upgraded Facilities**

Other significant outlays for hospitals involve IT. Every hospital is expected to meet new standards for having and using electronic medical records for its patients or face penalties in 2015. Meeting that requirement safely will cost as much as $50 million for a midsize hospital.

---

**Hospitals: Essential Capital is in Short Supply**

There is no doubt that limited access to capital for IT and other investments essential to providing high-quality care at lower costs is driving mergers.

“Access to the capital markets has become more difficult for smaller and lower-rated hospitals, driving the need for many to seek a partner.”

---

**Hospitals: Need to be Healthy to Provide the Most Value**

This transformation will require time, patience and capital investment to build a continuum of care that accommodates 21st century technology and standards of medical care. When mergers are needed to help financially, geographically or otherwise challenged hospitals avoid “closure, bankruptcy, or payment default,” or to become stronger and more efficient to meet current challenges and fulfill community needs, that should be a welcome development.

References available at [www.aha.org](http://www.aha.org), updated 12/12

© April 2013 American Hospital Association