



Healthcare Consulting | Valuation

Partner Insight Series:

*Big Business Threatens the  
Traditional Provider*

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# *How Should Traditional Providers Respond to the Threat of Megacorporations?*

In today's world, the emergence of large corporations is having a drastic impact on small business in almost every industry. Healthcare is no different. Although historically it seems that the industry has fared well, new threats are quickly discouraging traditional providers. In recent years, big business has taken advantage of economies of scale leading to lower prices and increased service offerings – something that private practices often cannot compete with.

To understand the current threats, one must first understand how large corporations gain an advantage. Vertical and horizontal integration strategies are helpful in efforts to lower costs, gain a competitive edge, and increase efficiency.

## *Vertical Integration*

Vertical integration refers to the combination of two or more stages of production normally operated by separate companies.

The desire in vertical integration is to gain a competitive stronghold in multiple levels along the value chain. For example, a retailer may acquire a manufacturer and a distributor to eliminate compounding costs as products exchange hands through the value chain. This helps to lower costs and expand market share in an industry.



## *Horizontal Integration*

Horizontal integration occurs when a company acquires another firm that offers similar products or services.
















Those who implement a horizontal integration strategy seek to increase market share and gain a significant edge on competition. For example, a retailer may buy out other retailers in the same or similar industries. This consolidation increases their influence over the market.



## Integration Trends in Healthcare

We are currently seeing both vertical and horizontal integration strategies employed in the healthcare industry. Payers were early adopters of integration by engaging in frequent and creative large and small acquisitions. The first wave of those reflected horizontal integration strategies with the Aetna-Humana and Anthem-Cigna mergers. Although these were broken up in 2017 on the grounds of anti-trust infringement, payers have more recently implemented vertical integration strategies rather than directly partnering with each other. The large commercial payers have acquired Pharmacy Benefit Managers (PBMs), specialty pharmacies, and some provider services to gain a broader footprint in healthcare by participating at many levels of the patient care continuum. Further, expanded service offerings are attractive to payers because while most health insurance companies are required to utilize at least 80% of premium income on claims (leaving only 20% for administration, marketing, and profit), the margin on other services is not capped.

The table below outlines how payers are currently operating in the healthcare industry.<sup>1</sup>

Vertical Integration Within Large Payers				
<b>Insurer</b>				
<b>PBM</b>				
<b>Pharmacy</b>				
<b>Provider</b>				

Another disruptive trend within the healthcare industry is the entrance of large retailers. Amazon, Walmart, and CVS Health are leveraging their existing infrastructure and resources to aggressively move into the healthcare industry. Recently, both corporations have demonstrated their interest in healthcare by launching pharmacies, virtual platforms, and even “brick and mortar” primary care clinics. Their presence in the market will bring about change in how patients receive care by offering a wider range of services not likely to be replicated by traditional community doctors’ offices.

<sup>1</sup> Derived from information presented in “After the Breakups: Big Payers Find Vertical Love in New Faces.” Poulin, John N. and Johnson, David W. 4sightHealth. 29 January 2019. <https://www.4sighthealth.com/after-the-breakups-big-payers-find-vertical-love-in-new-faces/>

## *Effects on Traditional Providers*

Traditional healthcare providers operate in a fragmented manner for the most part. Consolidations have occurred over the past few decades; however, healthcare provision is still generally a local affair between provider and patient. This relationship will continue, but these other healthcare players will influence how and where healthcare consumers receive care and who will provide it. Certain specialty practices, acute care, and high-end services like transplants, trauma, and intensive care will continue to fall under the domain of traditional providers. Impacts on safety net providers and academic medicine are truly unknown at this time. The overall movement and shifts in the realm of healthcare finance, supply chain, and utilization management will continue to shape and reform healthcare consumption across the country. The lower-cost options which are easy to access, including those that Amazon and Walmart may offer, will challenge traditional health care channels. These changes may drive healthcare towards a consumer-led model as opposed to a provider-directed model.

## *How to Respond?*

Providers may be asking, “how can I effectively respond to the emergence of large corporations with seemingly endless funds and resources?” No easy fix exists; however, there is a proven approach to combat these changes. That solution is to provide (or continue to provide, in most cases) high-quality, low-cost, convenient care. This value equation is hard to disrupt.

One option is to weather the storm and “stay the course.” Although it may seem that doing nothing and continuing current operations may be foolish, many patients value the steady relationship they have with their doctors and providers which is sustainable through a time of great change.

Another alternative is to collaborate where possible. While this approach may result in providers forfeiting some or all control or ownership, strategic partnerships could prove valuable by allowing physicians and providers to remain relevant with access to patient care channels.

Ultimately, it is important to be aware of the substantial changes occurring across the healthcare industry and assess their impact on your practice and market position. Disruption and change are constants in healthcare. Still, many providers have the ability to adapt positively to the changes and succeed even in the midst of this wave of vertical and horizontal integration and the expansion of retail service offerings in the industry.



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