Want to catch up on all of our Life Sciences articles? [Click Here.]

Health Insurance Mergers Put Consumers Last

June 24, 2016
By John A. Quelch

Cigna's chief executive recently admitted what many have expected: the health insurance mega-mergers are running into regulatory resistance and approvals may not be forthcoming, if at all, until next year. Rightly so. The Justice Department should reject these mergers that would result in three $100 billion companies controlling the U.S. health insurance industry.

In August 2015, Aetna agreed to pay $230 per share for Humana's stock, Anthem $188 per share for Cigna. Today, Humana stock trades at $189, while Cigna is priced at $129, a 20% and 30% discount respectively. There are legitimate reasons for stock market skepticism.

The Justice Department must surely worry about the effects of industry consolidation. Remember when your local bank was acquired by a regional bank that was then acquired by a national bank. Remember the improved customer service you experienced with each passing consolidation, plus the wonderful new products and lower fees you enjoyed as you shared in the synergies resulting from these acquisitions. There is precious little evidence that quality improves when industries consolidate. Invariably, quality deteriorates and prices rise.

The history of the health insurance industry promises as much. Research shows that health insurer consolidation between 1998 and 2006 increased prices by 7 percent.

The American Hospital Association estimates that the Anthem-Cigna merger will reduce competition for commercial health insurance in 817 local markets serving 45 million consumers. The Aetna-Humana merger is less of a concentration threat when examined geography by geography but overly consolidates the Medicare Advantage market.

There are no scale economies, even in information technology investment, that can justify mergers of this magnitude. In fact, they may create diseconomies. Any synergies will be offset by severance and restructuring costs. The lengthy integration of company cultures always distracts staff attention away from customer needs.

Defenders of the mergers argue that the savings they generate in synergies will not be pocketed but be passed through to consumers because the Affordable Care Act caps health insurer profits at 15 percent of premium revenues. However, over half of the privately-insured are self-insured and the cap doesn't apply to their plans. And even if prices remain stable, fewer competitors must mean less non-price competition. The proponents don't quite claim that the mergers are a quid pro quo for the health insurers going along with the ACA, especially after they have lost millions on sick consumers who signed on to their policies through the health care exchanges. The health insurers are in no mood to be generous to consumers. They want their money back.

In reality, the mergers reflect a desire to accrete market power for health insurance payers at the expense of hospital providers. Yes, there were over one hundred hospital mergers last year but the provider sector remains vastly more fragmented than the health insurance sector. The principle of countervailing power suggests that approving the insurance company mergers will simply trigger more disruptive consolidation in the hospital sector, further distancing consumers from their local hospital providers.

No, these health insurance mergers promise nothing to consumers other than the aggravation of being shunted around to meet regulatory needs. A Cigna spokesperson admitted as much, anticipating "alternative ways to structure membership that could alleviate some market share concerns." If you live in a county or local market where the combined market share of the merged companies is deemed excessive, your health insurance may be transferred by the company you selected to an unrelated third party, but of course it's all for the greater good. Unfortunately, in rural areas, there are often few alternative payers willing to take on these divested consumers. Divestitures may help a merged company avoid tripping over local market concentration ratios but they do a disservice to the affected consumers.

The megamergers will reduce innovation. Fewer players have fewer incentives to innovate and it's harder for disruptive newcomers to break into the industry. The difficulties are revealed in the failure of many new not-for-profit insurers funded under the Affordable Care Act. Successful health insurance startups such as Oscar in New York State are few and far between.

The merging companies respond by pointing to their new go-to-market approaches that could benefit each other's members. For example, Humana has used creative market segmentation programs to target the lifestyle behaviors of chronically sick Medicare patients and thereby reduce their costs of care to below the reimbursement rates set by the government. Humana pockets the difference but appears to share little of the savings with the patients whose efforts make them possible. Even if it has merit, there's no need for Aetna to merge with Humana to bring this value-based approach to Aetna's members. Recruiting several consumer marketing executives could fill the gap.

Finally, the absence of industry leader UnitedHealth from the merger merry-go-round is telling. Their management apparently understood these consumer and regulatory realities. Meanwhile, chief executives at the four companies have decided that mergers are a quicker way to goose their share prices than to pursue the heavy lifting of organic growth. All four will receive eight or nine figure payouts if the mergers are approved. No doubt, they'll be passing along a big chunk of their windfalls to the members whom they claim to care so much about.

Health insurers have historically been run by actuaries who delight in making plans complex and unintelligible and are better at selling to employers than to individual consumers. This is changing but not fast enough. What the health insurance industry needs is not mega-mergers but a new wave of chief executives who put the interests of consumers first. If they did so, their stock prices would take care of themselves.

John A. Quelch is the Charles Edward Wilson Professor of Business Administration at Harvard Business School.

You can find this article online here: http://thehill.com/blogs/congress-blog/healthcare/284730-health-insurance-mergers-put-consumers-last