

Vertical Integration in Health Care: The Next Stairway to Heaven?

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“CVS to Buy Aetna for \$69 Billion in a Deal That May Reshape the Health Industry” – NY Times, December 2017

“Why Does Walgreens Want to Buy AmerisourceBergen?” – Fortune, February 2018

“Anthem to Acquire Aspire Health” – Business Wire, May 2018

“Amazon Snatched PillPack Away From Walmart” – Bloomberg, June 2018

Over the past several years, the health care industry news headlines have read more like celebrity tabloid gossip, rife with both official announcements and speculated rumors of mergers and acquisitions involving some of the largest players in the game. Although there are various ways to go about business growth, choosing to integrate is undoubtedly a more aggressive approach to expansion.

In industries that are more technology-driven, a well-played acquisition can automatically create an assured formula for success. The right move can result in the elimination of direct competition while boasting efficiencies and economies of scale. Cost savings are delivered through increased levels of production and often times as the competition within the industry gets a boost, the inherent cost savings is passed down to the consumer.

In the health care industry, however, joining forces with another competitor by traditional means of horizontal integration does not always necessarily pass along guaranteed cost savings to the organization or, more importantly, to the patient. In fact, by avoiding the knee-jerk reaction to devour direct competitors and established rivals, and instead carefully selecting opportunities that create complementary synergies, health care companies can achieve the upper hand.

In the current health care arena, vertical integration may prove to be a more strategic approach to gaining additional market share and increased success. Currently, the key players in the medical marketplace aren't necessarily looking for growth opportunity outwards as much as they are upwards.

There Are Two Paths You Can Go By

Horizontal Integration

In the horizontal integration business model, a company grows by combining with other companies that provide the same types of products or services. Usually in the forms of mergers and acquisitions, this approach can offer attractive outcomes, such as increased size, robustness,

and even the ability to readily enter new markets without the high costs associated with a startup venture.

Businesses can extend their reach to people or places that were once not possible and can leverage an existing company to do so. Mergers that result in increased productivity output can, in turn, drive down industry costs by decreasing cost per unit.

This is most notable among industries in which capital costs are high to begin with and immediately puts smaller competitors who produce less volume at a disadvantage regarding both cost and quality. Although capital costs are also high in health care, this same school of thought doesn't completely translate.

There is no evidence to say that horizontal integration of health care entities results in absolute price decreases or enhanced quality outcomes. Furthermore, horizontal integration of large organizations that result in the domination of market share or elimination of competition within an industry can be classified as a monopoly.

Vertical Integration

The Oxford dictionary defines vertical integration as “the combination in one firm of two or more stages of production normally operated by separate firms.” Companies that operate in various points of a given supply chain can adopt a vertical integration strategy that eliminates the middle man and diversifies the services and products offered. In health care terms, vertical integration is more specifically the creation of strategic combinations of alliances in an effort to enhance the delivery of health care.

There is no doubt that vertical integrations have been trending upwards in recent years and one could suspect that even more are on the horizon. Hospital systems, drug manufacturers, wholesale distributors, pharmacy benefit managers (PBMs), retail pharmacy outlets, and medical insurers have all jumped on the bandwagon to form unique synergies across the health care industry.

After all, a vertically integrated health care system can offer an expansive array of patient care and health services, resulting in greater efficiencies and lower costs.

All That Glitters is Gold

But what really is driving so many standalone players to pursue partnerships? It is not uncommon to see corporations coming together. In fact, we have been witnessing this for decades across many industries, but this motivation feels different.

Traditionally speaking, some of the most common reasons companies join forces are to generate more profits, to diversify operationally, or to expand geographically. Vulnerable companies are often times prey to more robust companies offering the same or similar services and succumb to acquisitions in times of financial trouble.

However, the partnerships being created across the health care don't seem to be driven merely

out of poor financial health. Are businesses within the health care industry simply looking to grow or are they looking at diversification as the only way to survive?

In today's marketplace, companies are up against a variety of challenges. Increasing costs of both health care services and medications, particularly specialty medications, are causing patients to choose between food and other necessities in order to pay for prescription drugs. Legislation and federal regulations that threaten the bottom line are also forcing an outside of the box approach to delivering health care in a more economic fashion.

The Piper is Calling Us to Join Him

The Amazon Effect is a term used to describe the disruption of retail markets both online and brick and mortar stores by e-commerce. The term itself is a nod to Amazon and its early and continuing domination of the retail market through various disruptions.

However, the Amazon Effect has made its way to health care and is shaking up the industry as a result. With their expertise in logistics and shipping, as well as their sheer size, it remains to be seen how Amazon could revolutionize the health care and pharmacy arena.

Whether they choose to dominate drug delivery, cut exclusive deals with insurers, use their size to purchase generic drugs cheaply, or actually buy directly into the pharmacy business by acquiring a PBM or drug distributor, Amazon's next move could turn the pharmacy market upside-down. Amazon's acquisition of PillPack, a visionary pharmacy startup company with a focus on technology, could transform the way in which most people obtain their prescription medications and supplements.

In the PillPack business model, individual pill packets are labeled and customized depending on the patient and regimen before being shipped directly to your front door. Patients who take multiple medications are able to synchronize their refills so that all medications can be shipped at once. Amazon could potentially break into the pharmaceutical market by leveraging PillPack's ability to ship prescriptions across the continental United States.

In reality, health care is ripe for a disruptor such as Amazon. The pharmaceutical industry doesn't seem to be patiently waiting on the sidelines either to learn Amazon's exact intent.

This possible threat and other changes in the current health care market are spawning creative partnerships that were once unprecedented and unthinkable. Examples of these collaborations are bringing about unique service models.

Pharmacies now have walk-in clinics, while insurers, providers, manufacturers, and PBMs are increasingly joining forces in some form or another. Even health systems are considering adding insurance arms as some vertical integrations begin to squeeze high cost hospitals by offering preventative and outpatient care, thereby decreasing emergency department visits.

The PBM model is also changing. As vertical integration is occurring all around us and perhaps even within your current organization, PBMs are looking for ways to manage the high costs of

specialty medications. Even though most specialty drugs effect smaller patient populations, these patients tend to have higher medical expenses. Specialty pharmacy is at the epicenter of this and will play a critical role in bridging pharmacy and medical benefits.

Sometimes Words Have Two Meanings

Vertical integration is not foolproof and, as with any type of business venture, can be quite risky. Not only are mergers and acquisitions costly and time consuming, but in recent years, several high-profile mergers and acquisitions between health care companies have come under intense scrutiny by the media and government agencies. In some cases, these deals have even been blocked.

The Department of Justice and the Federal Trade Commission have raised concerns on several occasions that mergers in the medical marketplace could result in newly formed entities that would ultimately limit competition, drive out smaller providers, and raise prices in an industry in which everyone is creatively trying to reduce costs.

Negative synergies can reduce the overall value of the business. When giant companies announce that they are coming together, the perception is not always viewed as positive.

Mergers and acquisitions can result in changes in public perception, as well as internally shakeup a company, which can have detrimental consequences. Loss of focus and conflicting cultures can result in decreased productivity and confusion amongst both senior leadership and employees; however, if successful, vertical integrations can yield many competitive advantages.

And It Makes Me Wonder

Can vertical integration drive down costs while taking health care to new heights? Will creating new combinations of alliances within the health care arena help us reach greater efficiencies in health care and decrease overall costs? If more entities combine at various intervals of the supply chain, does it create the potential for information sharing, and integrated systems—not just companies? In this utopia, value-driven, outcomes-based models have the potential to flourish.

Buying the Stairway to Heaven

As vertical integration continues to address some of health care's biggest challenges, it is also a necessary means to stay competitive and relevant in today's fickle environment. At the end of the day, integration in health care should deliver several key items that directly improve patient outcomes, cost control or expenditure regulation, increased health proficiency, increased access, and the implementation of new health services and standards of care.

No matter the type, integration should seek to enhance the quality of our health care system and evolve best practices, as well as drive efficiencies. And in terms of patient care, how high should we aim? Well, the sky is the limit.

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About the Author

Jacqueline Hanna earned her Bachelor of Science in Biological Sciences from the University of Pittsburgh before earning her Doctor of Pharmacy degree from Duquesne University in 2011. She received her Master of Science in Pharmacy Business Administration (MSPBA) program at the University of Pittsburgh, a 12-month, executive-style graduate education program designed for working professionals striving to be tomorrow's leaders in the business of medicines. Jacqueline has spent the last 4 years working in specialty pharmacy, initially as a clinical pharmacist and most recently working on a variety of high-profile specialty operations projects. In her current role, she is able to channel her passion for patient care into innovation and process design while being part of a concerted effort to transform specialty operations and improve the patient experience.