

Horizontal Integration in Health Care

In the United States, health maintenance organizations (HMO) have become a powerful force in the health care sector. HMOs are health insurance companies that people choose for their health care coverage. Often companies' contract with HMOs on behalf of their employees for health insurance coverage. The HMOs then "supply" patients to health care providers. Thus, the HMOs can be viewed as the suppliers of the critical input – patients – to health care providers. In turn, the revenues of health care providers are dependent on the number of patients who pass through their system. Clearly, it is in the interests of HMOs to bargain down the price they must pay health care providers for coverage. They have gained bargaining power through horizontal integration, merging with each other until they have gotten large enough to control a large volume of patients. But now there are signs that this strategy is backfiring, for the health care providers are also resorting to horizontal integration.

For an example of how this process is being played out, consider how the relationship between HMOs and hospitals has evolved in eastern Massachusetts over the past decade. In the early 1990s, three big HMOs controlled 75 percent of the market for health insurance in eastern Massachusetts. In contrast, there were thirty-four separate hospital networks in the region. Thus, the insurance providers were consolidated, while the health care providers were fragmented, giving the insurance providers considerable bargaining power. The HMOs used their bargaining power to demand deep discounts from health care providers. If a hospital wouldn't offer discounts to an HMO, the HMO would threaten to remove it from its list of providers. Because losing all of those potential patients would severely damage the revenues that a hospital could earn, the hospitals had little chance but to comply with the request.

This began to change in 1994 when two of the most prestigious hospitals in the region, Massachusetts General and Brigham & Women's Hospital, merged with each other to form Partners HealthCare System. Since then, Partners has continued to pursue the strategy, acquiring other hospitals in order to gain power over HMOs. By 2002, it had seven hospitals and some 5,000 doctors in its system. Other regional hospitals pursued a similar strategy, and the number of independent hospitals a similar strategy, and the number of independent hospital networks in the region fell from thirty-four in 1994 to twelve by 2002.

In 2002, Partners started to exercise its strengthened bargaining power by demanding that HMOs accept a fee increase for services offered by Partners hospitals. One of the biggest HMOs, tufts quickly realized it had little choice but to change its policy and accept the fee increase. Tufts went back to Partners and agreed to a 30 percent fee increase over three years. Clearly, bargaining power in the system had shifted away from the HMOs and toward the hospital networks. However, in 2001, the Massachusetts attorney general received so many complaints from employers about rising health care premiums that he launched an investigation into market power and anticompetitive behavior among health care providers in eastern Massachusetts, although he has stated that he is not focusing on Partners.