HOSPITAL VERTICAL ARRANGEMENTS: RATIONALE & PERFORMANCE

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QUESTIONS TO BE ADDRESSED

1. What vertical arrangements have emerged in the market ?

2. What are the key drivers of this behavior ?

3. How do these arrangements affect cost and quality ?

4. How do these arrangements affect bargaining power and other competitive dynamics between hospitals and payers ?

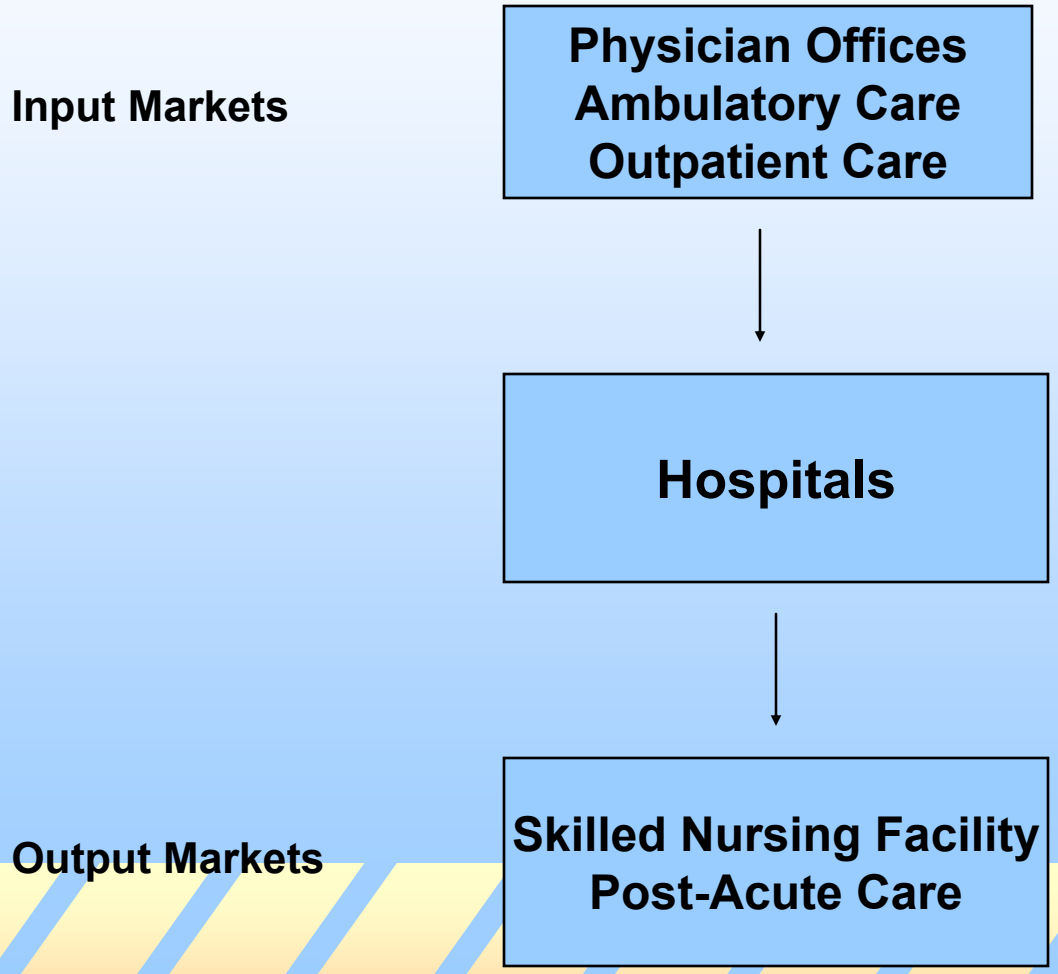
5. Do consumers prefer these arrangements ?
   Do employers or insurers prefer these arrangements ?

1. What vertical arrangements have emerged in the market ?

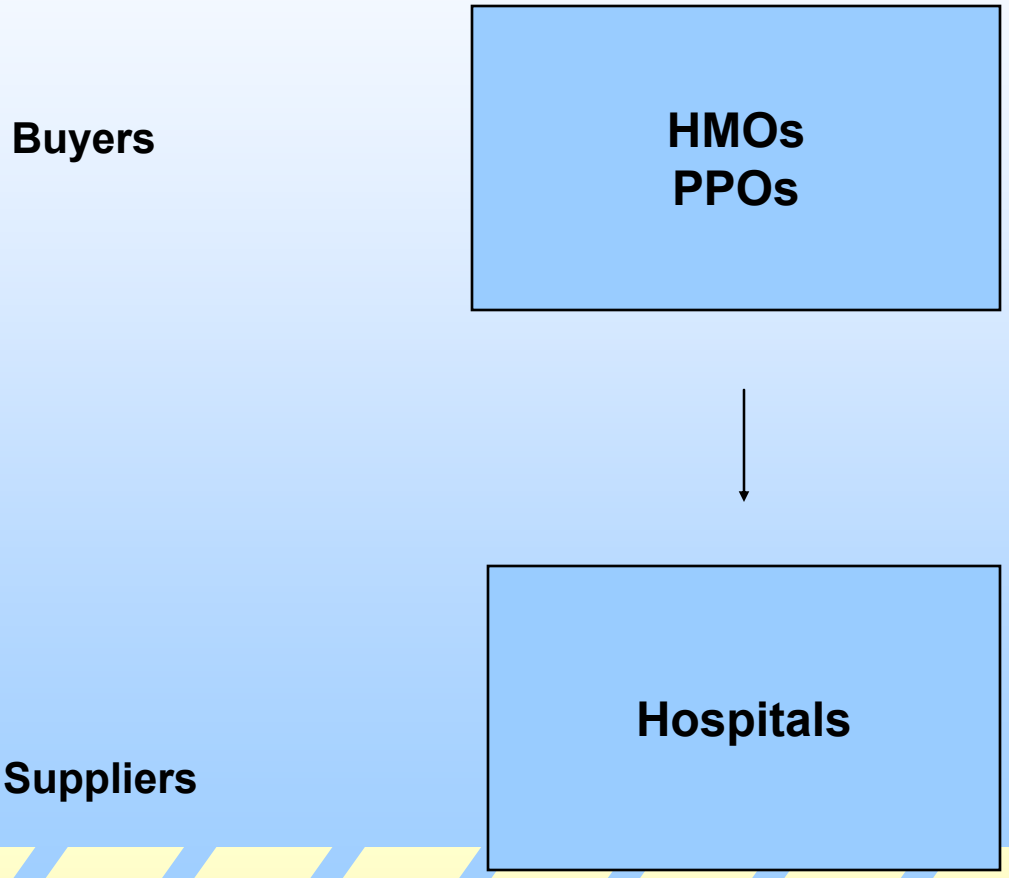
THREE BUSINESS MODELS OF HOSPITAL VERTICAL INTEGRATION

- Partnerships with Physicians
- Managed Care Vehicles
- Continuum of Care Efforts

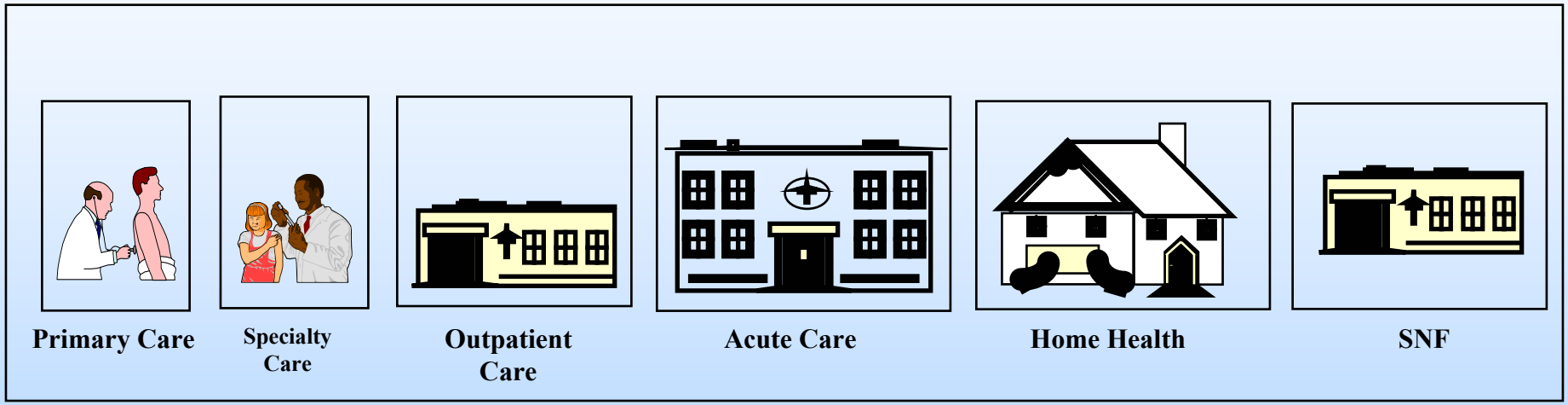
VERTICAL INTEGRATION INTO INPUT & OUTPUT MARKETS



VERTICAL INTEGRATION INTO INSURANCE



Continuum of Care Efforts



Integrated Delivery Network (IDN)

Source: The Advisory Board Company

PARTNERSHIPS WITH PHYSICIANS

- Medical Staff-organized IPA
- Physician-Hospital Organization [PHO]
- Management Services Organization [MSO]
- Group Practice without Walls [GPWW]
- Foundation Model
- PCP Acquisition & Salaried Model

GROWTH AND DECLINE OF PARTNERSHIPS (1994-1998)

	1994	1995	1996	1997	1998
IPA	20.3%	22.7%	23.8%	20.9%	19.3%
PHO	27.6%	32.9%	33.2%	30.9%	30.0%
MSO	15.4%	18.9%	22.2%	19.1%	17.3%
GPWW	6.4%	6.8%	7.4%	5.6%	4.6%
Foundation	11.5%	13.8%	13.1%	8.2%	7.0%
Acquisition	16.1%	18.4%	19.8%	20.0%	20.7%

2. What are the key drivers of this behavior ?

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Integrated Delivery Networks: A Detour On The Road To Integrated Health Care?

It may no longer make sense for providers to venture beyond the hospital's walls to develop integrated solutions.

by Lawton R. Burns and Mark V. Pauly

ABSTRACT: This paper reviews the rationales and evidence for horizontal and vertical integration involving hospitals. We find a disjunction between the integration rationales espoused by providers and those cited in the academic literature. We also generally find that integration fails to improve hospitals' economic performance. We offer seven lessons from hospitals' efforts to integrate and then suggest four alternative models for achieving integrated delivery of health care services.

3. How do these arrangements affect cost and quality ?

PERFORMANCE OF VERTICAL IDNs

PCP Acquisitions

- Small number of capitated lives
- Heavy financial losses per acquired PCP
- Small increase in physician loyalty
- Failure to capture majority of referrals
- Lower willingness to cooperate with practice guidelines

Physician-Hospital Alliances

- Failure to attract HMO covered lives
- Little infrastructure to manage capitated risk
- Failure to increase physician loyalty
- Failure to improve hospital efficiency (cost per day)
- Failure to impact hospital quality (mortality rates, rates of avoidable hospitalization for ambulatory care-sensitive conditions)
- No economies of scope
- Decline in prevalence of alliances post 1996

PERFORMANCE OF VERTICAL IDNs

Hospital-Sponsored HMOs

- Under-capitalization
- Inability to sufficiently grow & compete
- Substantial financial losses in early years
- Huge medical loss ratios
- No actuarial or marketing expertise
- Conflicting capital needs with rest of IDN

Hospital Continuum of Care Efforts

- Long-term care efforts derailed by BBA 1997
- Small markets with relatively low revenues
- No IT capability to link dispersed alternate sites
- No economies of scope in combining inpatient & outpatient

4. How do these arrangements affect bargaining power and other competitive dynamics between hospitals and payers ?

Impact on Competitive Dynamics

- No empirical tests of these dynamics to date
- One study about to get underway
- Recently published CTS study (based on field interviews in 12 sites) suggests that physician-hospital integration can leverage managed care firms
- Problem with this research finding: vertical integration empirically confounded with horizontal integration (the stronger force of the two)
- Critical assumption in this research: hospitals can align with physicians and forge cooperative bargaining unit
- The theory behind PHOs, MSOs, ISMs, etc.

Scenario Where Hospital-Physician Integration Might Have Leverage

- Hospital partner is dominant player in local market
  ("must have" hospital in insurer network)
- Hospital has very large network of primary care physicians
  (PCPs can be both owned and contracted)
- Insurer afraid it can get locked out of PCP market if it doesn't do business with hospital partner
- Describes the Partners Healthcare vs. Tufts negotiation

5. Do consumers prefer these arrangements ?

Do employers or insurers prefer these arrangements ?

When was the last time you went to a doctor and asked for some integrated healthcare ?

- Consumers don’t really know they exist
- Some employers (e.g., BHCAG) view them as wasteful and duplicative
- Insurers view them as contracting cartels that seek to extract higher prices in exchange for no added value
- Providers have yet to make the case they add any value

Thank you for listening