Thoughts on News of Further Industry Consolidation

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By Gary R. Goodhile
Principal & Co-Owner
Sullivan Benefits

Three recent and in my view significant announcements have rocked the employee benefit health plan provider space! Granted significant change has become the norm since passage of the ACA and all that led up to it from a legislative standpoint; industry consolidation has been in process going as far back as the early 90's. What makes these announcements different is the impact they could have on an already highly consolidated market.

Shoe Drop 1: This one put me back on my heels. In December 2017, CVS Health announced their intent to acquire Aetna (the 3rd largest Health Plan in the US) for $67.5 billion.

This news reinforces the magnitude of profit being made by Pharmacy Benefit Managers (PBM's) in this country. CVS, once a local pharmacy chain, has grown to be a staple of many communities throughout the United States. CVS Health reported total net revenues of $184.8 billion in 2017, of which $130.6 billion (70.6 percent) was attributable to their PBM business (CVS Caremark, the largest PBM in the country). That's right, pharmacy was responsible for well over two thirds of their revenues, and an even more disparate percentage of their profits.

As an industry veteran that was around in the early to mid-80's, I remember when insurance companies were introducing pharmacy cards that were purported to create great convenience for the member ($1 and $2 co-pays at the time), while saving money for employer sponsored plans by negotiating significant discounts and passing them back to the plan. With the benefit of hindsight, it turns out that was the sales pitch, "the Bait" and then "the Switch" came as time went on and pharmacy costs grew larger. Remember, pharmacy claims back then were a very small percentage of the overall claim cost, they were flowing under the radar unchecked for years. These PBM's became very sophisticated in negotiating financial arrangements that were extremely beneficial to their own bottom lines. They passed on a small percentage of those savings to the insurers that they contracted with. The insurers, for the most part, kept those savings for themselves and very little flowed back directly to the employer sponsored plan, and even less to the consumer.

CVS Health acquiring the 3rd largest health plan in the country, feels like the tail wagging the dog, but it is a well-financed tail, thanks to their investment in the PBM business.

Shoe Drop 2: In late January 2018, Amazon, J.P. Morgan and Berkshire Hathaway announced that they will form an independent health care company that will provide benefits to their own employees – news that provided a jolt to the financial markets when announced. This is not the first alliance of large entities aiming to disrupt the complex and convoluted health care market space. To date, most have seen little success.

What makes this news different is the entrance of Amazon into the health care arena. Amazon could be a game changer! Think about the disruption to so many well established industries that Amazon has already caused. Consider their ability to deliver goods with unprecedented speed and convenience, the consumer loyalty that they have established, and the bargaining power that they could bring to an industry like pharmacy. Couple that with GenX and Millennial consumers that are aging and beginning to consume more health care. They buy regularly online and through Amazon now, why not purchase prescriptions there too?

The Amazon component is intriguing and just may have legs!

Shoe Drop 3: Not to be outdone, CIGNA Health Care (the 5th largest health plan in the country) recently announced their intent to acquire Express Scripts (the second largest PBM in the country) for $54 billion.

This will reshuffle the deck when you look at the largest health plans and what PBM they utilize. In effect, all of the top 5 health plans will now own their own PBM, with the exception of Aetna which will be owned by their PBM (assuming all of these deals pass regulatory review). These new ownership structures may also cause angst for many local health plans throughout the country who contract with one of the top three PBM's today (CVS, Express Scripts, Optum – close to 75% market share). For example, Blue Cross Blue Shield of Massachusetts contracts with Express Scripts – will they want to continue to contract with a PBM that is owned by their competitor?

In closing, regardless of how this all shakes out this has certainly been an interesting start to the year! The two mergers have a long way to go before approval (remember Anthems recent attempt to acquire CIGNA). If they are approved, I believe it may create opportunity for a smaller PBM or two to grow market share by taking advantage of the angst at the local level referenced above. If Amazon were to jump into the pharmacy business and actually does what PBM's promised in the 80's and passes far more of the savings back to employer sponsored plans and consumers, that truly could be a game changer! More to come as the year unfolds, stay tuned!

In the interim, as always, contact any member of the Sullivan Benefits Team with any questions, comments or requests for more information.