

# Plan Management Navigator

## *Analytics for Health Plan Administration*



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## CVS – AETNA: COMMENT ON VERTICAL INTEGRATION

This *Plan Management Navigator* comments on the proposed merger between the two organizations, a pharmacy chain and a health insurer. Notably, CVS has been rolling out more walk-in clinics (“MinuteClinics”) that are usually under the same roof as their pharmacies. Our brief perspective stems from being analysts of the industry for 35 years, plus our focus on administrative cost optimization.

- 1) The CVS-Aetna strategy is a validation of the integrated approach of Independent / Provider – Sponsored (“IPS”) plans who use our benchmarking services. It focuses them on how to make the business of combining insurance and health care delivery successful, rather than whether it is the optimal strategy to begin with. Optimizing administrative costs is a key element of achieving success, and most of the largest IPS plans use our Benchmarks to do so.

For Blue Cross Blue Shield Plans, the transaction creates an impetus to synthesize arrangements similar to CVS-Aetna. To internally fund this integration (or a contract-based solution with similar economics) Blue Cross Blue Shield Plans will continue to engage in enhancing the cost and outcome performance of their core business of insurance. Again, most Blue Cross Blue Shield Plans are users of our Benchmarks.

Vertical integration has, with only a few exceptions like Highmark, not been common among Blue Cross Blue Shield Plans, but it is not a reach to expect it to develop. Highmark owns a hospital system and a few more Blue Cross Blue Shield Plans own physician practices. Hospitals were the founders of Blue Cross and it is within memory that the logo of the American Hospital Association was superimposed on in its cross logo.

- 2) There is a back to the future quality of this transaction. Len Abramson was the founder of U.S. Healthcare. He was a pharmacist by training and, after working in his own pharmacy, worked for then (thinly) publicly-traded company RH Medical. (We vaguely recall that RH Medical bought his pharmacy, but we acknowledge the fallibility of memory.) RH Medical was a proprietary hospital company, which operated Abington-based Rolling Hills Hospital when it was a general acute care hospital. At that time, RH Medical formed a non-profit HMO, under Mr. Abramson’s direction, funded in part through the HMO Act of 1973. This 50,000 member company, HMO of Pennsylvania, converted to for-profit status around 1980 with Mr. Abramson as President. It became U.S. Healthcare once it had entered markets out of Pennsylvania like New York, Florida and Texas. In the 1990s, the company acquired Aetna. (Okay, that was because the reverse-triangular merger was designed to get around the goodwill amortization impact of the merger under then GAAP, but what the heck.) So, the organization that started as the brainchild of a pharmacist employed by a hospital company is now to be acquired by a pharmacy chain.

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- 3) RH Medical was not the only hospital company that contemplated forward integration in the 1980s. Humana's earlier focus was hospitals: it owned just under 90 general acute care hospitals. Central to its commitment to superior measurable value was to avoid channel conflicts that impeded its strategy. So, it formed a health insurance company to allow patients to "pre-select" Humana hospitals through the vehicle of the insurance affiliate's Humana hospital panel. Recognizing that channel conflicts continued and the need to develop expertise in managing physicians, Humana formed a system of 160 primary care clinics, typically in areas where there were no Humana hospitals.

Humana's vertical integration efforts failed and the hospitals were sold to HCA. Today's Humana is the product of the former hospital system's vertical integration experiment. But there were two important lessons. From a hospital perspective, the health plan cannot be solely viewed as a distribution system to the hospital panel, even if the panel is the owner. Therefore, the health insurance arm must operate with its own integrity. An element of that may well be that the insurer be of sufficient size that the distribution system relationship to the hospital does not distort the integrity of the health plan.

The Humana clinics (disposed of piecemeal) also yielded an interesting lesson. It turned out that the most successful ones had a strong complement of an associated pharmacy. Other chains of clinics learned similar lessons as to the importance of an onsite pharmacy offering. In retrospect, pharmacy can be the lever to the success of a primary care capability which is necessary to the success of a vertical integration strategy. CVS - Aetna appear to have recognized the importance of pharmacy, along with treading carefully on channel conflicts with physicians.