The Economist

American hospital companies
Bigger and better

America's big hospital groups will continue to gobble up competitors

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HOSTILE takeovers are never polite. One fight in America, however, has become particularly ugly. In December a huge stockmarket-traded hospital company, Community Health Systems, announced that it wanted to buy another, Tenet Healthcare, for $3.3 billion. The bid soon became a brawl. In the saga's most recent chapter, Tenet filed a lawsuit accusing Community of overbilling government and private health-insurance schemes. Community denies this and, as *The Economist* went to press, was due to present a more detailed rebuttal.

Although this bid battle has become unusually rancorous, it is in line with a broader trend of consolidation in the huge but fragmented business of providing hospital care. In 2009 America's hospitals soaked up one-third of all national health-care spending, or $759 billion, roughly equal to the entire GDP of the Netherlands. In the long term an ageing population will produce more invalids and thus more business. In 2014 the "Obamacare" health reforms will bring 32m newly insured patients. The less good news is that the health reforms also bring new regulations and intense pressure to contain costs. This is strengthening the argument for consolidation among hospital operators.

Mergers are nothing new in the industry. In 1979 only 31% of America's hospitals were part of a larger hospital system. By 2001 more than half were. The rationale for joining a larger chain is simple. It means better access to capital for renovation and expansion, better management and—most important—more clout when negotiating treatment prices with health insurers.

Now, the health reforms are piling on the pressure to merge. Obamacare requires hospitals to invest heavily in technology, even as the government cuts payments for treatments. Hospitals will increasingly have to demonstrate the quality of their services. Small hospitals may struggle to meet such demands; bigger groups will be better equipped. Besides, now is a good time to be doing deals, says Gary Lieberman of Wells Fargo. Credit markets have offered favourable terms to hospital groups raising money. And thanks to the downturn there has been ample supply of not-for-profit hospitals for sale. Community's bid for Tenet is the biggest deal now in the works. The combined companies would have annual revenues of $22 billion, second only to HCA, which last month raised $3.79 billion in an initial public offering

(IPO). But plenty of smaller deals are going on. Vanguard Health Systems, which this month filed for an IPO, has bought hospitals in Detroit, Chicago and Arizona in the past year. HCA seems likely to use at least some of its IPO cash to make more acquisitions.

Big hospital operators must still grapple with Obamacare's new requirements. And in some cases, growing larger brings its own challenges. Vicki Bryan of Gimme Credit, a bond-research firm, worries that Vanguard's shopping spree (and dividends to its shareholders) have left it with excessive borrowings. Another worry is that although there are many benefits to being big, realising them takes time. HCA's recently improved earnings, Ms Bryan contends, are largely due to changes in accounting and billing models. Tenet says Community has boosted revenue by keeping patients in hospital unnecessarily; Community denies this vehemently.

Nonetheless, the hospital-merger wave still has far to go. HCA, despite being the industry's leader, controls less than 5% of the market. There are many more deals to come, the only question is how quickly.

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