

CVSHealth Takes \$66 Billion Page from Amazon's Playbook



By *Chuck Dinerstein, MD, MBA* — October 30, 2017



Courtesy of S. Jones on Flickr [1]

This week CVSHealth [1] offered \$66 billion to purchase Aetna. Let that thought wash over you for just a moment; the corner pharmacy is about to buy the 3rd largest health insurance company, the largest merger of 2017. You can find the usual business analytics [here](#) [2], [here](#) [3] or a contrarian analysis [here](#) [4]. The analysis mentions at least three concerns:

- The threat of Amazon entering the healthcare arena
- The synergy (if you are a capitalist) or anti-trust (if you are not a capitalist) of combining retail sales, pharmacy benefit management, and a payer.
- The continued consolidation of the marketplace

All valid economic and legal issues. I have written about pharmaceutical pricing in the past, [here](#) [5] and [here](#) [6]; but both my and other analyst's close up view misses a more significant, change in business relations, an Amazon effect - a strategy for controlling markets. [1] Whether Amazon enters the pharmaceutical market, isn't the real driver in this offer.

One of the overlooked reasons for Amazon's purchase of Whole Foods was that it facilitates their push into the grocery business, Amazon purchased its biggest customer, Whole Foods. By ingesting the grocer they immediately had additional insights into consumers, an infrastructure that allows them to scale up to a large size quickly and it gave Amazon's core product, its logistics and selling platform more clout. I would argue that the CVSHealth offer is much the same, they are purchasing one of their best customers, Aetna.

Absorbing Aetna will give CVS more direct access to 23.1 million people with enough income to purchase healthcare insurance and another 15.2 million people using specialized medications. [2]

That is a lot of ‘pre-qualified’ customers, but more importantly, CVS gets their healthcare information, so that they can make more accurate predictions about the demand for their core business, retail pharmaceuticals. And they get the customers and the healthcare information with little cost, measured as organizational change. Aetna brings along a well-functioning infrastructure to sell and administer healthcare ‘benefits.’ And of course, the purchase of Aetna will increase the purchasing power of CVS, lowering their acquisition costs for their core product, retail pharmaceuticals.

The CVS proposal has other more traditional, direct financial implications that are important, but not in the same way. In writing about pharmaceutical prices the money to be made lies in the difference between the acquisition cost and the selling price. That spread has been divided up by the insurance companies, the pharmacy benefits managers, and the retail pharmacies; but the Aetna purchase allows CVS to control the entire chain, to capture all the value. The difference between acquisition cost and selling price is all theirs; they do not have to share with anyone. And even if they do share some largesse with Aetna’s beneficiaries, CVS will have another financial advantage, the ‘float.’ The float is simply the money you have taken in and not yet paid out, money that you can temporarily invest. In 2015 Aetna had \$916 million in revenue from their \$3 billion in investments. [3] That is a lot of money to use for other acquisitions. And if you doubt the power of the ‘float’ understand that this was a critical early component to Warren Buffett’s success.

We are all familiar with the term monopoly when the seller controls the market. The CVSHealth offer for Aetna should be considered in another, less familiar way – as a monopsony. Monopsony is when a large buyer controls the market. CVSHealth wants it both ways, control as buyer and seller. They recognize the same benefits in their acquisition of Aetna that Amazon finds in acquiring Whole Foods. The continued consolidation of the healthcare industrial complex is becoming worrisome - at least for physicians and policymakers. Is this bid by CVSHealth the market version of single payer?

[1] Inspiration for this connection comes from [Amazon’s New Customer](#) [7], from Ben Thompson’s blog, Stratechery.

[2] Aetna [fact sheet](#) [8]

[3] Aetna [financial statements](#) [9]

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Links

[1] <https://www.flickr.com/photos/pixeljones/178181224/>

[2] https://www.washingtonpost.com/news/wonk/wp/2017/10/26/why-cvs-health-would-want-to-buy-aetna/?utm_term=.b1be0f82d6b1

[3] <https://www.cnn.com/2017/10/27/with-amazon-on-the-horizon-cvs-looks-to-strike-first-with-aetna-deal.html>

[4] <https://www.forbes.com/sites/brucejapsen/2017/10/27/why-cvs-wont-buy-aetna/#8b5e98f425cc>

[5] <https://www.acsh.org/news/2017/06/01/spread-%E2%80%93-exploring-reason-high-cost-pharmaceuticals-11339>

[6] <https://www.acsh.org/news/2017/06/02/spread-%E2%80%93-exploring-reason-high-cost-pharmaceuticals-part-2-11340>

[7] <https://stratechery.com/2017/amazons-new-customer/>

[8] <https://www.aetna.com/about-us/aetna-facts-and-subsiaries/aetna-facts.html>

[9] <http://investor.aetna.com/phoenix.zhtml?c=110617&p=irol-reportsAnnual>