

Cigna's \$1.5 Billion Buy of Great-West Reflects Growing Competitive Pressures

OLDWICK, N.J. December 03 (BestWire) — Cigna Corp.'s planned \$1.5 billion acquisition of Great-West Healthcare is the latest example of the fierce competitive pressures facing regional health insurers when they attempt to go head to head with the biggest health insurers in the United States. But in an ever-consolidating industry, some companies may survive and perhaps thrive by steering clear of the markets the giants are focused on and by developing a niche by serving certain customers.

Last week, Cigna said it would buy the Denver-based subsidiary of Great-West Life & Annuity Insurance Co., the U.S. unit of Canada's Great-WestLifeco Inc., for about \$1.5 billion cash in a deal Cigna says would expand its presence in the western United States.

Great-West is a good example of a regional health-care company that "was trying to compete against the big managed care companies nationally and wasn't able to gain the critical mass," said Scott Wood, co-chief operating officer of Independence Holding Co. (NYSE: IHC), a small, regional health insurer that's looking to grow its fully insured health business by targeting small businesses, which Independence defines as companies with two to 50 employees.

Great-West was "a BUCA wanna be," he said. BUCA refers to Blue Cross Blue Shield companies owned by WellPoint, as well as UnitedHealth Group, Cigna and Aetna, the four biggest health insurers in the United States. It also refers to independent Blues plans that generally dominate in the states where they do business.

For its part, Great-West Lifeco, one of Canada's biggest life insurers, said the sale would allow its focus in the United States to be on its financial services businesses.

Great-West Healthcare has about 2.2 million covered lives, including about 1.5 million medical members in employer-based plans. "This acquisition aligns very well with our strategy by enhancing our competitiveness in the middle market segment and expanding our participation and offerings in the small business segment," said H. Edward Hanway, Cigna's chairman and chief executive officer, in a statement. Cigna defines its small-business segment as employers with 50 to 200 employees/dependents, said Wendell Potter, a Cigna spokesman.

In a research note, Carl McDonald, an equity analyst with CIBC World Markets, wrote that Great-West has had "a structural issue," in that its 2.2 million enrolled members are geographically dispersed. "As a result, there aren't too many places where the company has enough volume to command unit costs with providers comparable to the market leaders, like the Blues, Aetna, Cigna and United and it leaves Great-West reliant on rental networks."

This put Great-West at a competitive disadvantage and makes it more difficult to sell new business, particularly now that employers are more focused on medical costs than the administrative service fee charged by insurers, McDonald wrote. "This is a problem that Cigna will be able to largely solve immediately upon the close of the deal, since Cigna should switch most of the acquired members onto its more favorable provider contracts."

The issues Great-West experienced aren't unique, as they are challenges faced by every third-tier plan in the market, McDonald noted, who also noted that Fiserv also lacked "geographic concentration."

UnitedHealthcare last month said it would buy most of the health-related

businesses of Fiserv Inc. for \$775 million cash. To be acquired, among other businesses, is Fiserv Health, an administrator of health benefits.

The Blues and UnitedHealth have great power to negotiate steeper provider discounts than the smaller companies, which simply can't compete on that basis, said Samuel Fleet, president and CEO of AmWins Group Benefits, a wholesale broker and third-party administrator. "That's what's driving them to sell."

Matthew Borsch, an equity analyst with Goldman Sachs, wrote in a note that Great-West "has struggled to grow earnings in health care over the past two years, as had Fiserv, which is indicative of the cyclical slowdown and intensification of competitive pressures across the industry."

In the 25 largest urban markets, there's usually two or three of the "behemoth" BUCAs "slugging it out in that market and we don't attempt to get into that scuffle," said Wood. Great-West tried to compete in those big urban centers, but couldn't achieve the necessary volume to get the same provider discounts that the big companies got, he said.

Independence Holding, which sells major medical insurance for individuals and families, small group major medical and short-term medical and limited medical insurance, instead focuses on second- and third-tier cities and rural communities where Wood said the big players aren't focused. For example, in Arizona, the big city is Phoenix. But half the population is outside Phoenix, in Flagstaff or Tucson, where the company is focused.

So what's the impact of the continued consolidation on agents and brokers? Greater revenue pressure, said Fleet. If there's 10 different health insurance carriers in a given market whose products they can offer as an option to their employer clients, but those 10 are reduced to five and the five shrinks to three, the carriers don't have to pay as much in commissions as before because there's less competition, he said.

And what do employers think about the merger and acquisition mania? Employers and labor unions that have a contract with a company involved in a merger often have questions about changes in services, contracts and fees, said Edward Kaplan, national health practice leader with the Segal Co., an employee benefits consulting firm. "In some cases, the changes are for the better and sometimes for the worse and sometimes, these mergers lead to RFPs [request for proposals] to check the market."

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