The US Hospital Industry: Two Decades of Organizational Change?

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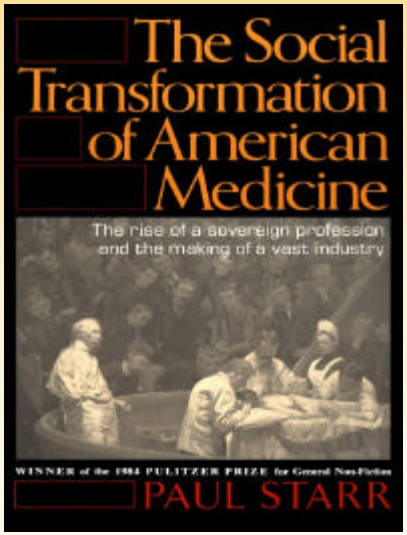
The Changing Environment of US Hospitals

- Hospital industry of 1980s:
  - largely autonomous
  - worried about government regulation and rate setting
- Hospital industry of 1990s:
  - losing power to managed care
  - facing public and private payment constraints
- Hospital industry of 2000s:
  - largely consolidated but bifurcated; some doing exceedingly well and others not

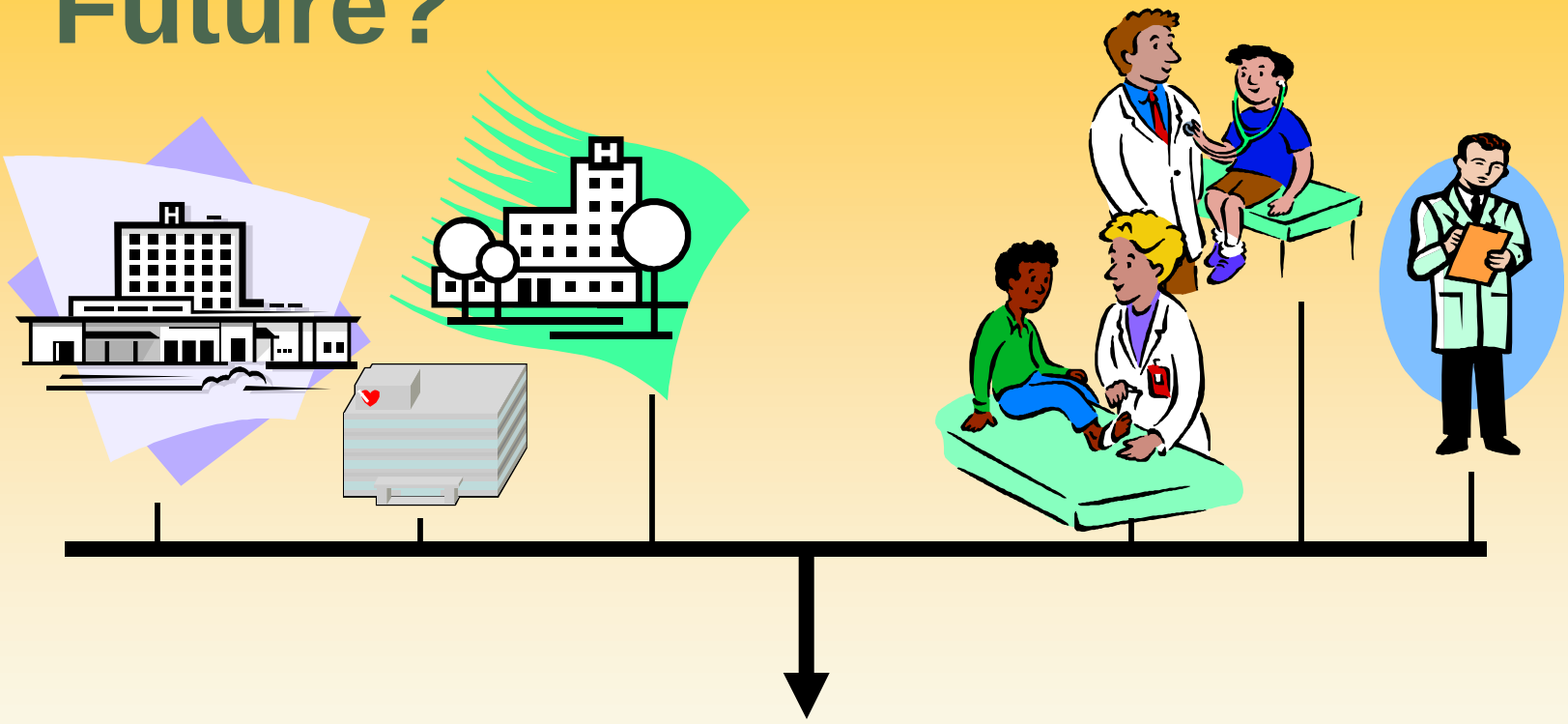
Looking Back to 1980s – What We Thought Would Happen

- Paul Starr in The Social Transformation of American Medicine (1982) described the future of the hospital industry.



- Many prognosticators that followed presented a similar picture.

What Was This Vision for the Future?



Regional/National Health Conglomerate

Pathways to Regional/ National Health Care Conglomerates

- Changes in hospital ownership to for-profit
- Horizontal integration through the development of multi-hospital systems
- Diversification and corporate restructuring into “poly-corporate” enterprises
- Vertical integration into HMOs
- Increased industry concentration of ownership and control

Source: Starr (1982: 429)

Key Questions

- What came to pass and what did not in Starr predictions for hospital industry?
- What does this mean for the hospital industry and markets today?
- How has this affected hospital financial circumstances?

Horizontal Integration of Hospitals

- Hospitals are increasingly part of multi-hospital arrangements:
  - 30.8% were in systems in 1979
  - 53.6% were in systems in 2001 with an additional 12.7% in looser health networks
- However, systems are still predominantly non-profit and are local in focus

1990 to 2001 Changes in Multi-Hospital Systems

Ownership Type	1990	1994	1998	2001
Public (non-federal)	6.8%	7.5%	7.1%	7.4%
Voluntary non-profit	60.5%	61.5%	61.8%	64.8%
For-profit	32.7%	31.0%	31.1%	27.8%

Source: Analysis of AHA Annual Survey, 1990-2001.

1990 to 2001 Changes in Multi-Hospital Health Systems

# of MSAs system owns hospitals	1990	1994	1998	2001
1 MSA	56.5%	60.1%	60.5%	63.9%
2 MSAs	13.3%	13.1%	13.7%	13.4%
3 MSAs	8.2%	6.3%	6.9%	6.5%
4+ MSAs	22.0%	19.7%	18.9%	16.2%

Source: Analysis of AHA Annual Survey, 1990-2001.

Hospital Diversification: Prediction

- Many predicted hospitals would get involved with several different health and non-health related ventures:
  - outpatient services such as dialysis
  - nursing homes, retirement centers
  - retail pharmacies
  - durable medical equipment distributors
  - hearing aid and eyeglass stores
  - managing & leasing medical office space
  - management consulting services
  - real estate management

Hospital Diversification: Reality

- Hospitals experimented but increasingly focused on services closely tied to traditional inpatient/outpatient care
- Hospitals added and dropped services largely depending on reimbursement opportunities
- Hospital strategy currently focuses on being a technology leader in a market not being a diversified corporation

Vertical Integration: Prediction

- Starr and many that followed him believed:
  - governments and employers would press for more efficiency in health care
  - would push for integrated health delivery and financing, like Kaiser Health Plan and Group Health
  - hospitals and other health providers would grudgingly integrate to survive in market
- Initial horizontal integration of hospitals thought to be a platform for vertical integration

Vertical Integration Activities of Health Systems

	1994	1996	1998	2001
MD arrangements:				
% with contractual affiliations	58.5%	53.4%	49.2%	31.8%
% that own MD practices	29.1%	25.2%	23.4%	18.2%
Provider-owned insurance:				
% with HMOs	19.2%	20.9%	21.3%	16.1%
% with PPOs	26.0%	22.8%	22.2%	16.5%

Source: Bazzoli et al., Health Affairs, 2001 and author's analysis of 2001 data

Concentration of Ownership and Control

- **Prediction:** Multi-hospital systems would centralize not only ownership but control
  - Starr believed that shift in locus of control would occur as national/regional systems formed
- **Reality:** Research indicates:
  - most systems are local not regional or national
  - about 70% of systems delegate certain authorities to affiliated hospitals
  - substantial variability exists in mixture of centralized/decentralized control

Why Were So Many Predictions Wrong?

- Assumed pressures on hospitals would be unrelenting and uni-directional
- Did not consider increased ability of hospitals to fend off pressures as they consolidated
- Did not recognize extent of organizational inertia
- Did not recognize the importance of local connections
- Did not realize the resilience of non-profit form even in face of financial distress

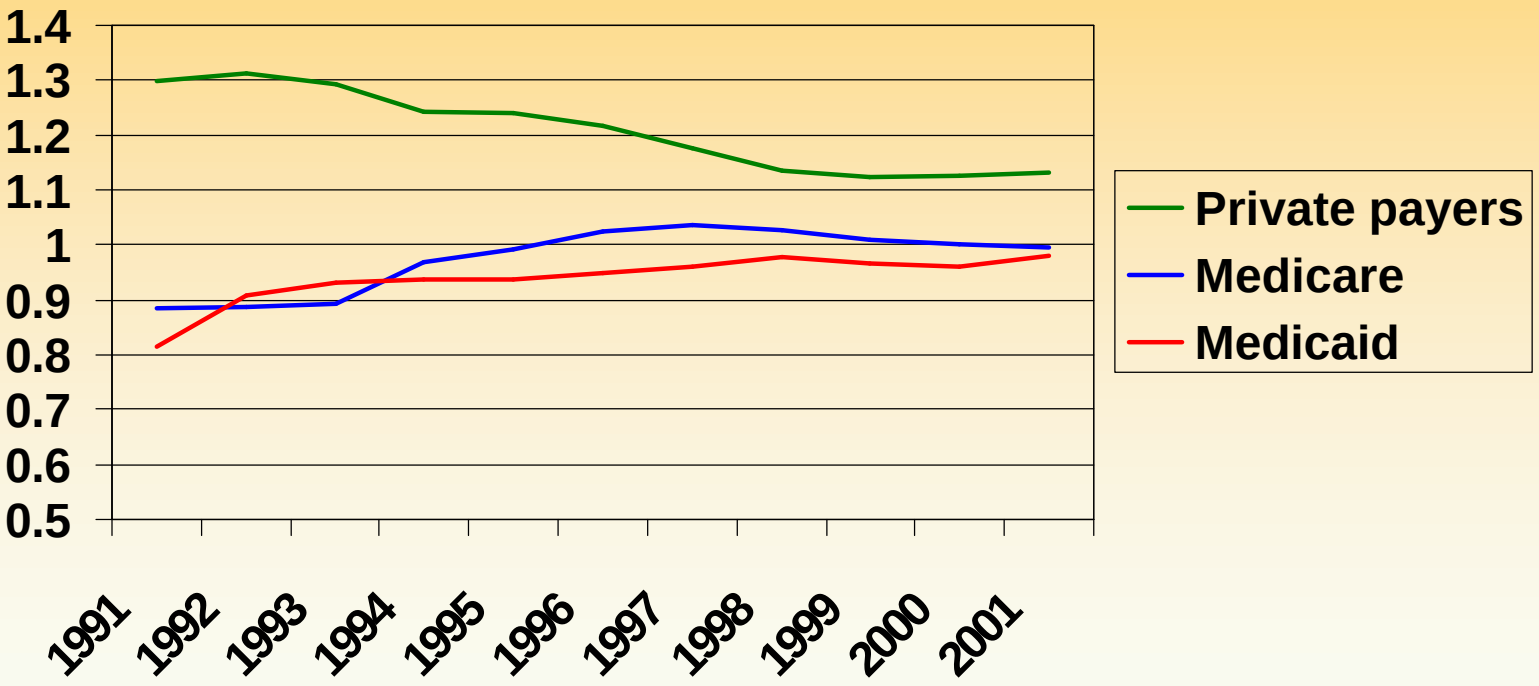
So What Does Hospital Industry Look Like Now?

- Many hospitals are consolidated in local health systems or networks
- Systems and networks vary markedly in degree of centralized control:
  - at one extreme, parent organization establishes all policy and makes all key decisions
  - at other extreme, system/network is basically a “shell”, perhaps centralized administrative functions and centralized capital financing
- A large minority of hospitals not involved, either by choice or because undesirable

How Does this Play Out in Health Plan Negotiations?

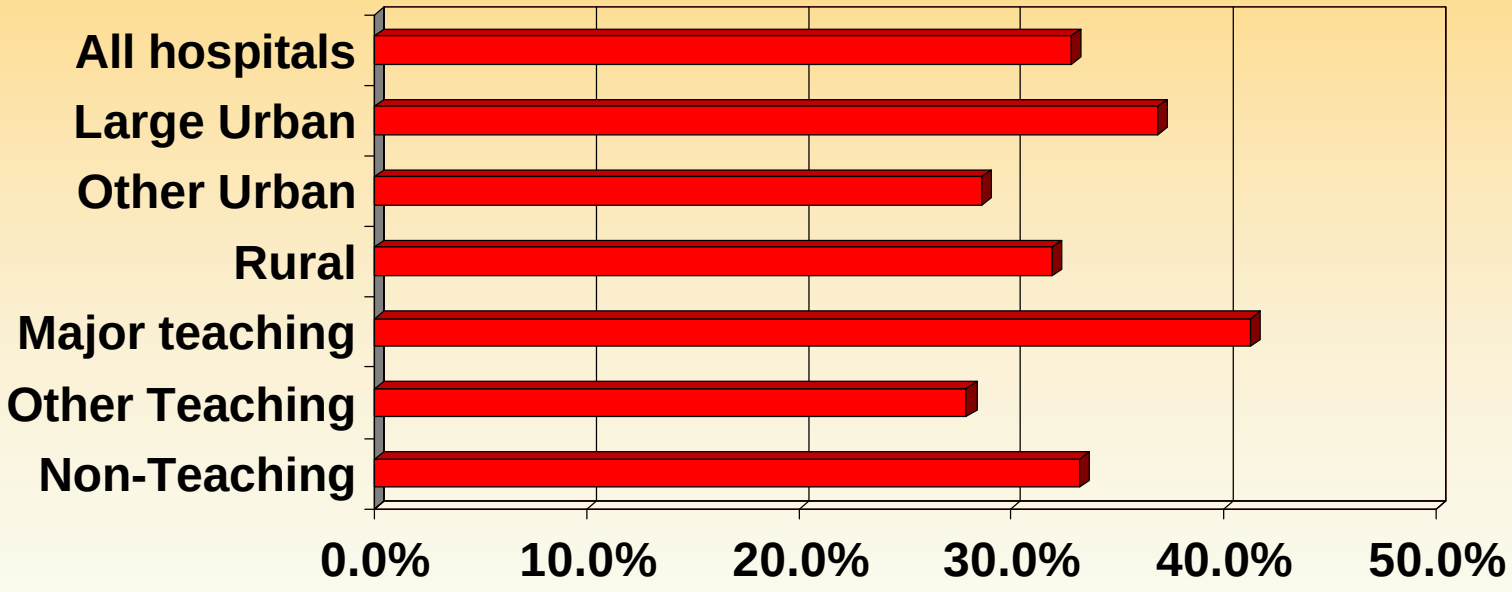
- Centralized systems with well-recognized affiliates have much power in health plan negotiations
- Some systems – especially decentralized ones – have little influence; any power that exists resides in individual affiliates
- For hospitals left out:
  - those not joining systems by choice likely to be powerful
  - those not joining systems because undesirable, little influence

Trends in Hospital Payment to Cost Ratios



Source: MedPAC Report to Congress, March 2003

Percent of Hospitals with Negative Total Margins: 2000

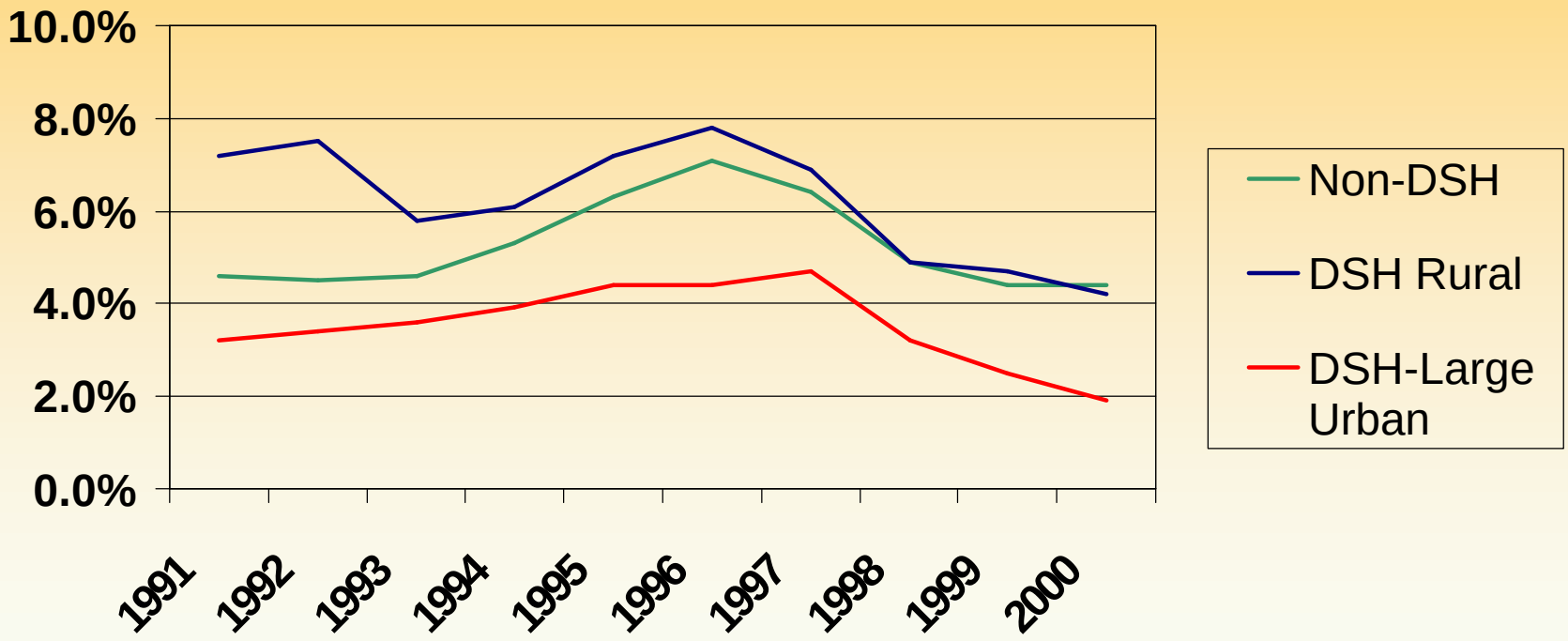


Source: MedPAC Report to Congress, March 2003

Special Pressures on Hospital Safety Net

- Safety net hospitals faced same pressures as other hospitals in 1990s and 2000s *plus*:
  - growing number of uninsured
  - confusion about Medicaid eligibility under Welfare Reform
  - reductions or limited growth in indigent care subsidies
  - Medicaid managed care
- Total margins of DSH hospitals have declined

Trends in Total Margins of DSH and Non-DSH Hospitals



Source: MedPAC Report to Congress, March 2003

What Does the Future Have in Store for Hospitals?

- Pressures:
  - Increasing demand for services
  - Continued cost pressures
  - Increasing number of uninsured
  - Declining payment/support from states
  - More price sensitive consumers (?)
- Financial performance:
  - continued bifurcation highly likely
- Future structural/organizational change
  - let's not fall into the prediction trap again