

"hospital corporation
of america" by kester,
w. carl essay sample



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“Hospital Corporation of America” by Kester, W. Carl Essay Sample

I. Introduction

Hospital Corporation of America (HCA) is propriety, hospital management company founded in Nashville, Tennessee in 1968 with only one, 150-bed hospital and then grew to become the nation’s largest hospital management company. As of 1981, HCA owned or managed 349 hospitals in the United States and overseas.

During the 1970s, HCA achieved its growth by acquisition of existing hospitals and construction of new ones. During the period of 1968-1981, it constructed 70 new and replacement facilities and acquired or leased the remaining 279 of its hospital. Each year HCA evaluated many potential acquisitions and areas for construction, with the criteria for selection including the target community’s need for health care services, the quality of the target hospital’s medical staff and personnel, the population growth pattern in the area served, the facilities’ suitability for future expansion, and the hospital’s overall financial position.

Although HCA’s operation generated substantial cash for reinvestment, still it needed external financing for its ambitious construction and acquisition program. In early stage of development, external financing were mainly from revolving credits to finance hospitals under construction, industrial revenue bonds and privately placed, long-term mortgage loans fro insurance companies funded completed hospitals and acquisitions. Other sources were difficult to tap at first, due to the newness of propriety hospital industry and

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the small size and short track record of HCA, and the poor image of hospital management companies at that time. However, HCA could finally manage it as the industry matured, and HCA's strong performance became recognized.

II. Key Issues

Since its establishment, HCA's growth has been contributed by acquiring hospitals, constructing new ones, expansion of services, and the signing of new management contracts. Similarly to any other businesses that new markets are to be developed by developing a supply chain to service that area and building a customer base, but in this sector HCA had to spend more substantially comparing with other industries. It meant a more substantial investment in capital to purchase equipment, acquire other hospital management corporations or to build new hospitals.

New construction and acquisition activities of HCA have been quite aggressive and they had to work it out carefully for such new facilities to generate a required return and most profitable. Roughly 40% of HCA's U. S. facilities were only the hospitals in their areas. Such strategy helped HCA to gain impressive revenues year after year in steadily manner, started at \$172, 650 in 1972, \$506, 484 in 1976 to \$2, 406, 472 in 1981. Net profits also grew steadily in the same fashion proving that HCA has been doing very well as a business and their performance shows the effectiveness of their business strategy.

However, beginning the business like a real-asset company for sometime with substantial investment in hospital construction, HCA's strategy has been proved to be effective, but in the long run a change in this strategy is <https://assignbuster.com/hospital-corporation-of-america-by-kester-w-carl-essay-sample/>

foreseen. As the whole scene was stated by Bill McInnes - Vice President of Finance " There is a feeling here that we must be prepared to strike while the iron is hot. There are only 7, 000 hospitals out there, and we can't expect to have them all. With, perhaps, three to five good years [of growth by acquisition] left", we will have to move along expeditiously to get our fair share."

Taking into account the regulatory change in the near future, it became obvious that HCA's business strategy is in need of revision. Since the change in regulatory environment will constitute a less favorable environment where hospitals will have to compete based on price in addition to in other aspects, HCA should immediately study measures for cutting costs in of their operation. Once the certificates of need are no longer required, it becomes evidence that the emergence of hospitals will take form and possibly the shortage of patients in areas with too many hospitals will seriously affect their strategy and targets. In addition, as HCA continues into the future with the consumers more cost conscious about the healthcare provider that they choose, it will also affect them.

Under such circumstances, HCA should continue its strategy as aggressive as possible with their existing strategy of acquisitions and new construction likes " to strike while the iron is hot". To build their base in areas that do not currently have a hospital or only have one will help to ensure that HCA has a strong user base that does not have to look for the cheapest hospital in the area, as there is no other choice for the customers. In parallel with continuing growth, HCA should introduce efficient program to make their existing hospitals to reduce costs, and increase bed occupancy rates. This <https://assignbuster.com/hospital-corporation-of-america-by-kester-w-carl-essay-sample/>

increased profitability will serve more effectively for HCA once the regulatory change in adverse fashion than present. And while regulatory change is still a prediction, and the profitability is not of utmost importance in HCA's strategy, they still have enough time to consider it.

HCA relies heavily on finance to continue its current growth, but in the future that reliance will most likely decrease. Regulatory conditions are expected to affect the way in which HCA and other proprietary hospital management corporations operate, so growth will be less of a major factor in the profitability of HCA. Currently HCA should focus on growth while growth is still possible. The goal of 60% debt is a reasonable goal, but should not be adhered to at the expense of future profitability. Even while some new acquisitions need time to generate a significant return on profit, in the long run HCA can create revenue generators out of all of their properties. The more properties that HCA holds towards the end of the growth cycle, the more potential for profit growth remains within HCA's holdings.

If HCA continues with carrying a higher level of debt, it may cost them the credit rating. And once their credit rating decreases, it may be difficult for them to access debt market for future growth. However, it may not all that be a disaster as some past similar cases such as DuPont lost its long-standing AAA bond rating after its acquisition of Conoco in 1981 without a dramatic rise in its cost of debt or decreased access to the debt market. If HCA is not one of the companies that can lose their rating and continue to receive a high level of low interest debt then they will be forced to slow their growth.

The best case scenario is that HCA continues to be an aggressive player in the market and not decrease its debt and does not lose its preferred borrower status despite its loss of credit rating. If HCA does lose their low interest rates they have several courses of action. The recommended course of action is for HCA to continue to acquire hospitals at their current rate. This steady rate of borrowing at an increased interest rate will hurt HCA's profitability, but if they also implement the plan recommended above to reduce costs, they can easily cover the increased interest rate and further prepare themselves for the projected industry deregulation.

Losing their credit rating will cause HCA to have a tougher time of accessing the market, but the increased property value that they hold will help to ensure that HCA is not in default on any loans. Many lenders and capital brokers will realize that HCA is able to meet their debts with their current profitability, their projected profitability increases and their immense property holdings. With the projected changes coming to the market, HCA will not need as large an amount of debt as it becomes less of a real estate agent for hospitals and more of an agent of improved efficiency and productivity within these hospitals.

III. Recommendations

It is recommended that HCA try to maintain its current target debt ratio while continue with its growth objective, even more aggressive on short-term basis for the next few years to get its desired market share. It sounds a self-contradictory strategy at first! Still it should be feasible considering: Those hospitals in slowdown, less profitable areas should be considered for sale or

spin-offs to reduce debt ratio; The expansion of services and getting new management contracts will help generating substantial cash for reinvestment.

In case of regulatory change applied and the loss of credit rating happened causing difficulty for HCA to access debt market, the followings are recommended for HCA's top management so as to maintain and achieve future objective:

Taking into account the current rapid development of new technology, consideration should be given to applying new technology for new services. Such new services are advantage in that it does not require as substantial investment as in case of new construction and acquisition. It can be provided on the basis of existing hospitals and equipment, facilities. Additional costs for this may involve the training of existing staffs or newly recruited staffs, procurement of new equipment (for the use of new equipment, technology). Expansion of services and getting more new management contract are recommended on the same basis.

HCA should carefully reviewing existing hospitals in terms of profitability, running cost taking into account past years' operation records. This will serve either the cutting cost to improve profitability, effectiveness and provide basis for selection of slowdown, less profitable and promising hospitals to sell, or to select subsidiaries/units for spin-offs to refocus to the selected core businesses.

Considering the fact that HCA has been based on those areas where

population growth and regulatory environment are more favorable, it is <https://assignbuster.com/hospital-corporation-of-america-by-kester-w-carl-essay-sample/>

recommended that, once the adverse regulatory change becomes evidence, HCA should consider its business in other potential areas, including international ones such as rapidly developing cities such as Shanghai (China), Ho Chi Minh City (Vietnam), etc. The reason is clear that in such a community, the population growth is considered among high rate in the globe and people's income are more and more increased with improving living standard. Their spending pattern are shifting dramatically far from being saving and conservative, ie. among other things, they are longing for better health care services rather than how much does it costs.

IV. References

(1) Brealey, Richard A. and Stewart C. Myers, Principles of Corporate Finance, 7th edition (2004) Irwin/McGraw-Hill.

(2) Kester, W. Carl, Case study: Hospital Corporation of America, Harvard Business School Publishing, Item Number 9-283-053.