

The economic factors of hospital industry economics essay



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Hospital is an important part of the overall economy in the United States. Health care and Hospital expenditure in the United States is the highest among the 30 high income countries in terms of per capita and percentage of gross domestic product. Within the last few years, the relative price of health care has been slightly increasing.

It is worth specifying what has Economics to do with Hospital? As it is quite known about almost all industrial sectors of the economy, the resources to satisfy unlimited human wants are limited. From the economic point of view about Hospital and Health care, the resources are scarce, and the selection over various patterns of the available resources must be made with ideal decisions so as to minimize opportunity costs.

This piece of research work is an attempt to analyze the economic factors of Hospital Industry. This work presents ‘ hospital’ industry and its economic <https://assignbuster.com/the-economic-factors-of-hospital-industry-economics-essay/>

activities as part of health care industry. This research paper includes detailed analysis of economic traits of hospital Industry, Porter's five force analysis, the major economic and environmental change and the relative driving factors for the change.

Typical Los Angeles, California Hospital

There are a very large number of Hospitals of both Profit and not for profit, ranging from small health centers to highly sophisticated super specialty hospitals in Los Angeles, California. 'Hospital' is the organization whose principle purpose or function is to provide medical care to patients with many different types of ailments.

Health care district was authorized by the section 32121 of California Health and Safety. California's district hospitals are considered to be public Hospitals and they are categorized under State's other public hospitals. Public Hospitals can achieve funding from the federal government as is already done by District hospitals by using intergovernmental transfers to get additional funding (Association of California Healthcare Districts).

SIC/ NAIC codes and hospital industry reports

The North American Industry Classification (NAIC) was established for using as a standard for federal statistical agencies and for classifying the business organization so that statistical data related to a business and economy of US can be effectively collected, analyzed and published. The hospitals are included in Health Care and Social Assistances that are classified under the NAIC code of '62'. Establishments in health care are presented with six digit NAIC code starting from '621111' which is for offices of Physicians to '

624410' which is for child day care services (naics. com). General and specialty hospitals are classified under the NAIC codes starting from 622 (Hospitals) to 622310 (Specialty (except Psychiatric and Substance Abuse) Hospitals).

Establishments that provide health care, medical care and social assistance for individuals are included in NAIC codes of 62. The total number of Health care and subsectors are accounted to be 824, 110 (naics. com). Industries in Hospitals and its subsectors provide a number of services including diagnostic, medical care and treatment services that comprise of physician, nursing and health services to the patients. Hospitals also provide outpatient services. The services offered by establishments in Health care industry are delivered by trained professionals and many of the industries are defined based on the educational degree that practitioners hold.

Hospital Industry and Dominant Economic Traits

Hospital industry is a significant part of Health care industry. According to the Bureau of Labor Statistics (2010), health care industry including hospital industry was one of the largest industries in 2008-2009. Health care sectors provided 12. 3 million jobs for both wage and salary paid workers in the US in 2008. Out of the 20 fastest growing occupations, 10 are related to Hospitals and health care industries. Health care is proposed to generate around 3 million new wage and salary job opportunities from 2010 to 2018 which accounts to be more than any other industry (BLS). A greater majority of the workers in the industry are highly qualified with graduation, post graduation and PhD levels and they are more trained and knowledgeable than other industries.

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A very large number of hospitals and other healthcare establishments that are accounted to be 824, 110 that makes up the total of health care industry in the US. According to Bureau of Labor Statistics, hospitals constitute just 1 percent of all healthcare establishments, but they employ 35 percent of all workforce. Hospitals employ more than 4. 3 million workers. These establishments include a wide range of hospitals from small clinics to highly sophisticated multi specialty hospitals and other offices. Around 75 percent of health care establishments are comprised of physicians, dentists, surgeons, doctors and others including nurses.

According to the Bureau of Labor Statistics (2010), hospitals provide complete medical care including diagnostic services, surgery and continuous nursing services. Different hospitals are specialized in different areas like treatment for mentally sick people, treatment for cancer diseases, hospital for children etc (BLS, 2010). Hospital workers are qualified with higher education and professional training and they are provided of better opportunities than offered in nursing or other sectors of health care industry. It was estimated that around 20 percent of hospital jobs are in service occupation like nursing, psychiatric etc. Apart from the surgeons, doctors and other medical professionals, hospitals employ a large number of management and administrative staffs as well.

Cutler (2000) emphasized that hospital industries include a mix of three modes of production they are government, for profit and not for profit hospitals. As of 1995, 65 percent of acute care hospitals were in not for profit sector, 24 percent were public institutions and 11 were in for profit institutions (p. 1). But this has been changing for last few years. No matter <https://assignbuster.com/the-economic-factors-of-hospital-industry-economics-essay/>

how many they are, these three modes of hospitals provide same services in the health care market and they involve in competition.

With in recent years, the hospital industry has been facing the fluctuation that the pace of technological innovation and advanced and managed health care has caused in reduction in numbers of inpatient demand. Even when population was growing, it was accounted that the total number of ‘ hospital days’ spent in the United States was reduced by 35% between 1980 and 1995 (Cutler, p. 1).

The US hospital industry includes around 6500 hospitals that contribute annual revenue of more than \$ 500 billion per year. Major companies work in the hospitals industries are Kaiser, HCA (Hospital Corporation America), Tenet Health care etc. Health Management Associates operates around 59 hospitals throughout rural areas and Community Health System operates around hundreds of hospitals in many states of the US. Community Health Services, LifePoint Hospitals, MedCath and Catholic Health Initiatives are some other major companies that involved in hospital industries in the US.

Demographics and advances in medical care and the technology used are the drivers for the demand for hospital. Even though different hospitals provide almost similar kind of services, the profitability depends on each one’s effectiveness in providing the services with the use of advanced technology and innovation. When large hospitals compete in the market with advanced services, multi specialty facilities and so on, small hospitals compete by providing specialized services in specialized areas.

The major revenue come from in-patient hospital care (it makes up of around 55% of the industry) and out-patient services where in customers do not require to stay overnight, selling of prescription drug, surgeries, contributions and funding etc.

Economic Factors of Hospital Industry

The basic economic factors of any industry are demand, supply and the distribution. Similarly, the market for hospital and health care is controlled by the factors namely demands for health care, supply and distribution of the same. McGuire and Henderson (1998) argued that, economically, health is not a commodity, but health care can be considered to be a commodity that is exchangeable through health care centers like hospitals and nursing home (p. 33).

Health care is a process in which certain inputs are combined to bring out the output. According to Jacobs and Rapoport (2004), health care is a process in which factors of production like hospital services, medical instrument and equipment services and pharmaceuticals are combined in different quantities so as to yield an output (p. 18).

McGuire and Henderson (1998) argued that health care is a heterogeneous commodity and also an intermediate commodity in the sense that it not consumed for itself. He emphasized that the matters of being heterogeneous and intermediate is because there is clear difference between a simple head ache and brain tumor (p. 40). More specifically, it is not always clear about whether the head ache is a symptom of a more dreadful condition or not. All

these may be because of poor information that patients have about their
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diseases even when they feel a simple headache. According to McGuire and Henderson (1998), for the above reason and other reasons, the nature of the commodity health care can be perceived differently on the two side of the market, that is, the distinction between what is wanted which is ' health' and what is supplied which is ' health care' (p. 40).

Five Force Analysis of Hospital Industry

The Five Force Analysis of Michael Porter (1979) helps an economist and marketer contrast the competitive environment of a particular industry. This model has been widely considered to be a useful tool in conducting an external analysis of the industries. the five force analysis helps us determine the severity of the competition in the market and the market overview with regard to seller, buyer and suppliers.

Figure below shows Hospital Industry's five force analysis that helps gain a thorough understanding of Hospital Industry by analyzing five forces of its external environment. This analysis would help determine the competitive situation and profit potential of a particular industry.

Figure -1

The threat of New Entrants

The first element of the five force analysis is the potential threat of new entrants in to the existing market. Hospital Industry is normally considered to be a flexible one and entering in to the market is quite easy as compared to other industries as there the competition is severe and fierce.

The threat of entrance can be occurred due to many reasons like need for capital, need for brand awareness and economies of scale etc. Government regulations can constrain hospital industry. The government regulations restrict the types of services that can be provided by hospitals. It means hospitals entrants cannot easily manage or existing hospitals cannot expand without showing greater need for the general health care from the community side. Feldman (2000) emphasized that government regulation of the hospital industry stems from a fundamental constraint and destruct of market solution in health care context. Federal government in the US has played vital role in expanding regulatory control on hospital services. Regulation, re-regulation and de-regulation are continuously happening in various parts of the country today (p 172).

There merging and acquisition process can happen between hospitals instead of directly expanding the physical facilities and thus they can expand with current facilities. But, Federal Department of Justice viewed that this type of merger and acquisition and business combination is a violation of the Sherman Antitrust Act that has brought restriction on competition.

Power of Suppliers

The power of supplier is a significant force in the Porter's five force analysis. As in any other industry, supplier has vital role in influencing the market through the raw-materials and resources that they can hold and subsequently they can influence the costs. Licensed, qualified and experienced medical personnel are a scarce in the Hospital industry. The US economy faces lack of nurse and medical practitioners.

Ivanov and Blue (2008) argued that a severe shortage of nurses exists in the United States and even with a large number of foreign trained nurses who are now working in the United States. According to estimation, the undersupply of nursing will reach 800, 000 by 2020 (p. 174). According to Jonas (2003), the U. S department of Health and Human Services estimated the nursing shortage to be 350, 000 in the year 2000 and 875, 000 in the year 2020 (p. 39).

Hospitals need to compete against nursing homes for the skilled clinical workers. Hospitals need to compete against nursing homes for the skilled clinical workers. As adequate qualified nurse cannot be hired, the employers will be compelled to find workers from outside agencies by offering higher pay. This can create economic trouble in the country.

When price of the pharmaceuticals dramatically increase day by day, this increase can be a burden on many third parties and patients are unable to meet their need. As hospitals have recently entered in to capitation program and they agreed to offer the services only for a fixed amount per patient; this can be negotiated in anticipation of more increase of prices for pharmaceuticals. This can have a negative impact on the profit margin of the Hospitals.

Substitute Products

Another important force of Porter's analysis is the availability of substitutes in the market. The availability, prices, qualities and features and even its advertisements can have major impacts in on the business strategy. The

alternative medicines like acupuncture, music therapy and naturopathy are
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becoming a trend among many people even when these medicines fail to provide innovative and technological assistance for their practice.

Treweek (2006) found that alternative therapies are mainly used for chronic diseases like back pain, allergy, anxiety, depression etc. The research showed that there was amazing increase of 47.3 % in the visits to alternative practitioners, from 427 million to 629 million. The personal expenditure on alternative medicines was estimated at \$ 2.7 billion in 2007 (p. 368).

Apart from the alternative therapies that still remain as growing challenge on the Hospitals, the private outpatient surgery centers, blood test units etc situated out of the Hospital also can have significant negative impacts on the revenue of the Hospitals.

The Power of Buyers

Another important element of Porter's five forces is the bargaining power of buyers. This element shows the extent to which the buyers are able to bargain in the industry. Majority of the hospital payments are made by third parties like insurers and consumers make around 10 % of the total payments. As far as consumers are concerned, they make very less portion of the payment and hence they are least bothered about the prices being charged by the hospitals. The payments made by ' Medicare' and ' Medicaid' represent about 60% of the total hospital payments. The bargaining power thus seems to be less compared to other industries.

Competitive Rivalry

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The fifth factor of the Five Forces Analysis is the competitive rivalry. The degree of competition that exists among the hospitals, degree of pharmaceuticals differentiation, cost conditions and other competitive factors can have significant influence on the industry. Shi and Singh (2009) put forth the fact that nonprofit hospitals compete head on with for profit hospitals. Competition among US hospitals commonly occur in the same communities for the same patients with revenues coming from the same public and private third part sources (p. 193).

The Porter's five force analysis can help understand the external environmental factors that influence the competitive strategy of the industry.

Drivers of Change in the Hospital Industry

There have been tremendous changes in the Hospital Industry in the recent years. The Modern hospital has become a figure that functions with the help of a number of advanced technologies like X-rays, scan, laparoscopic surgery, bypass surgery etc. More specifically, hospital is a centre where even common people come to know about various technologies used in the health care practices. The major drivers for the changes in the Hospital industry includes New Technologies, Patient Family centered Space and Competitive forces.

Latest Technologies

The hospitals are increasingly looking for information technology in order to make health care more effective and to bring better cost effective medical care practices. Apart from the very commonly used techniques and <https://assignbuster.com/the-economic-factors-of-hospital-industry-economics-essay/>

technologies around the world, wireless patient record keeping and advanced imaging technologies have become new trends throughout the hospitals.

Technologies bring over all changes in the way the hospital is functioned. Hospital can improve its in-patient and out-patient services and it can thereby provide services with the help of technologies that help time saving and gain cost effectiveness.

The general criticism of technology and its application to the industries is that ' Technology replaces the workers and creates unemployment'. But, as far as health care is concerned, the relative risk involved in creating unemployment is much lower than any other industries and also it should be perceived from the point of view that bringing technological change is imperative for efficient health care practice.

Dranove and White (1999) stated that technology can play vital role in health care in two ways: through changes in the technology of offering medical care and through changes in information technology. The changes in Hospitals due to the technology and innovation will be understood overtime that changes in Hospitals have been determinants of cost and quality care (p. 13).

Patient and Family Space:

A worldwide trend that can be found in hospital industry is that both patients and their families are increasingly demanding facilities within the hospital so that they can experience ' home-like' atmosphere. The growing numbers of

super specialty hospitals with increased number of single family rooms and facilities like restaurants show that patients and their families demand comfortable stay facilities in the hospital. This trend can have dramatic impact on the hospital industry in the coming future.

Goldsmith (00) is of the opinion that the concept of family-centered care is as old as organization, but, is recently getting growing attention from the hospital management due to the increase of its demand from the patients and their families (p. 51). Hospitals have recently adopted the strategy for facilitating family space and providing amenities within the hospital premises. These include family centered maternity care, mother-baby care room, holding nursery and respite area, family room for dining and resting during the postpartum time etc.

Competitive Pressure

Hospital industry is highly competitive. Most hospitals in the US are characterized by relatively highly competitive with strategies of providing quality services and use advanced technology. The trend of fierce competition and using competition tools in the Hospital industry can drive a number of changes.

In the US, for profit and not for profit hospitals compete each other to attract more number of customers. While thinking from the view point of competition in health care to gain more number of patients, it can be considered that this competition can in turn decrease the value of health care. Porter and Teisberg (2006) argued that the struggle to accumulate

bargaining power has led health plans to merge and compete each other to <https://assignbuster.com/the-economic-factors-of-hospital-industry-economics-essay/>

gain as many members as possible. But, gaining more number of people has little impact on the value of health care (p. 41).

Environmental Changes in Hospital Industry within last 5 years

Hospitals were undergoing various environmental changes in recent years. The environmental changes include economic, legal, technological and other changes. Almost all sectors within the US economy and worldwide economy have faced the severe and worst economic crisis in the history. This has brought many challenges and changes on hospital industry.

Economic Changes

Hamilton (2008) reported that hospitals have been facing unpredictable cash flows because of delayed payments from Medicare and health insurance companies because of economic crisis (bnet. com). Even though consumers have to spend little on the payment for the health care, the economic crisis hit insurance companies that in turn resulted in delayed payments.

Businesswire. com (2009) reported that most of the hospitals (60 %) were found vulnerable to the economic crisis in the surveys conducted. The report highlights are:-

60% of the respondent hospitals have seen vulnerable to the crisis

47% of the hospitals foresee staff cuts (It is an economic change with larger impact on the economy)

73% of the respondent hospitals were found as increasing their cost of care related to meeting new safety standard

84% hospitals were attempting to reduce spending

These show that recent economic crisis has brought many economic changes on the hospital industry.

Organizational Changes

Pindus and Greiner (2010) described that the key organizational change in the hospital industry include a move towards outpatient based care and nursing homes. There was a move to managed care and an increase in the number of for profit health care providers. Changes in ownership and management patterns have been reflected in the concentration of hospital industry by the way of merger and there was an increase in the for profit hospitals as well. (urban. org).

Patient care change

In order to satisfy the growing demand for family centered care and amenities from patients and families, hospitals have undergone facilitating family centered care units and providing amenities. The changes were found in the organizational and workplace cultures within the hospital industry (Pindus and Greiner, 2010).

Technological Change

As discussed earlier, hospitals are common symbols of technological changes. In recent years, hospitals in the US introduced a number of technological assistances in diagnosing and treating the patient. Radiation therapy in oncology seems to be a very advanced step forward as it helps millions relieve from the severe ailment and pains of cancers. Bar code technology and wireless communication technology have recently been brought to the health care so that errors can be reduced and effective communication can be maintained.

Potential changes in the Hospital Industry

Internet style computing was a target of many hospitals in the US and now it is going to be real within near future. The Obama government's plan to spend 19 billion US dollars to bring the electronic health record system will potentially give a forward motion to the dream of internet-style computing (Lohr 2009).

The electronic health record

The electronic health care project is designed to deliver individually tailored public health information and alerts to electron health record in the offices of concerned doctors. The detailed description regarding the ailment, patient's location and age and symptoms will be passed on to the offices through electronic health record system and the doctors will be informed of patient's dangerous conditions.

Internet associated facilities can bring major changes in information transfer and in handling effective communication. Web-based facilities will enable

physicians and workers to collaborate and perform Health care tasks in an <https://assignbuster.com/the-economic-factors-of-hospital-industry-economics-essay/>

easier way. Patient and medical research information is moving to digital forms instead of paper forms. So, the application of natural language processing to health care will be becoming of vital importance in the near future (Lohr, 2009).

Pharmacy Benefit Management

Pharmacy benefit management depends on technological advances mainly in the field of biotechnology. Combinatorial chemistry will enable Pharmacy Benefit Management to deliver more effective and same time expensive pharmaceuticals.

Kongstvedt (2007) describes how Pharmacy Benefit Management can be made useful with the help of combinatorial chemistry and throughput. High throughput and combinatorial chemistry will allow a geometric improvement in the number of chemicals