The Health Care Industry

As you learned in Chapter 1, the U.S. Census Bureau considers more than 830,000 businesses part of the health care industry. Under code 62 of the North American Industry Classification System (NAICS), the government tracks the activities of the sector of the economy it calls health and social assistance. The businesses in code 62 are divided into four categories: ambulatory health care services, hospitals, nursing and residential care facilities, and social assistance. Each category is further divided. Every 5 years, the Census Bureau tracks the economic activity by measuring number of employees, size of payroll, and revenues. Revenues are broken out by what types of products are being sold (U.S. Bureau of the Census 2012).

The Impact of the Economy

Businesses in the United States operate in a **market economy** (also called a private or free enterprise system). Competition is the central feature of a market economy. Anyone can open a business and offer whatever product he or she chooses. The business will succeed if it can provide a product that the market (customers) wants. The business must provide value—measured by the quality of the product and the level of customer satisfaction—to make itself different from its competitors. Dr. Anderson, the ophthalmologist described in the chapter profile, is facing the question of how to remain competitive.

market economy An economy in which many sellers compete for customers.

Some parts of the health care industry do not operate in a true market economy. In some geographic regions, there may be only one or two hospitals or only three dentists. A market where there are only a few sellers is called an **oligopoly**. If a pharmaceutical company holds a patent and sells the only drug for heartburn, then it is a **monopoly**. In markets where there is very little competition, sellers can raise prices and do not have to be as sensitive to their customers.

oligopoly An economy with only a few sellers.

monopoly An economy with only one seller. The one seller is able to set whatever price it chooses.

The allocation of resources in a market economy can be understood by understanding the demand and supply of goods. From the customers' side, the lower the price of a product falls, the more of it they are willing to buy. For example, if the price of cough syrup is $3.59, I might buy two bottles. If the price was $2.79, I might be willing to buy three bottles, and so on. This is the **demand** for the product.

demand The amount of a good a buyer is willing to purchase at a given price.

From the producers' side, the higher the price goes, the more they are willing to produce for the market. At $2.79 per bottle, the manufacturer might be willing to produce one bottle; at $3.59, the manufacturer might be willing to produce two bottles. This is the supply for the product. As shown in Figure 2.3, the two sides meet at a point called the equilibrium price or the price at which the amount consumers demand and the amount that the producers supply are equal. In our example, the equilibrium price is $3.59.

This basic economic model helps us understand the behavior of consumers and producers. The model can be used to understand why the price of generic drugs is less than brand-name drugs or why a nurse will change jobs to obtain a raise.

The health of the overall economy can be analyzed by studying data known as **economic indicators**. Among the key indicators that tell us how the economy

economic indicators Key measurements that provide information about the health of the economy.

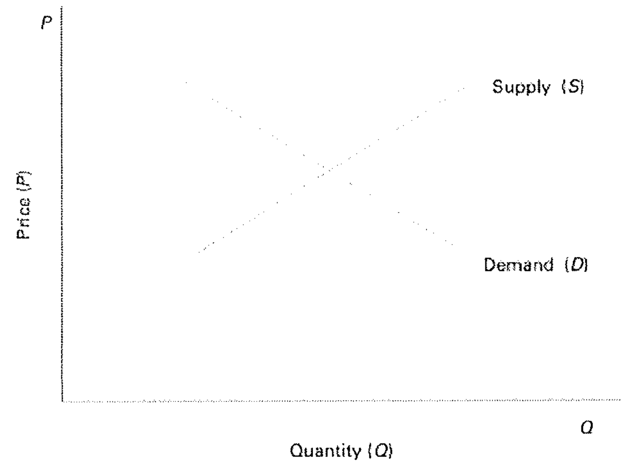

Figure 2.3 Supply and Demand

is doing are the interest rate, the inflation rate, and the unemployment rate. Studying changes in these indicators helps health care managers plan for the future (Lee 2014).

interest The amount, stated as a percentage, paid to borrow money.

Interest is the price paid when an individual or business borrows money. The price is quoted as an annual percentage rate. The lower the interest rate, the cheaper it is to borrow money. This encourages businesses and individuals to borrow, which allows them to spend more.

inflation An increase in the price level.

Inflation is an increase in the general price level, or average of prices at a given time. Inflation occurs when total spending in the economy increases in relation to the supply of goods, often during the expansion phase of the business cycle. Inflation has a variety of causes, such as a high demand for bank loans, heavy spending by the government, and a continuing demand for wage increases. Because prices tend to rise faster than incomes, consumers become afraid their savings will lose value as purchasing power declines. Often this leads consumers to spend their savings.

unemployment A lack of jobs in an economy for those willing and able to work.

Unemployment is the lack of jobs for those who are willing and able to work at the going wage rate. Although some unemployment is considered normal in an economy, economists become concerned when the number of unemployed rises above the normal level (called full employment). The health care sector generally has a lower unemployment rate than the overall economy.

business cycle Regular cycles of decline and growth in an economy over a time period.

The regular cycles of growth and decline, called the **business cycle**, pull together these economic pieces. There are four possible scenarios: prosperity, recession, depression, and recovery. Each is measured by the change in the GDP per quarter. Figure 2.4 presents the relationship between the key economic indicators and the stage of the business cycle.

In the prosperity phase of the business cycle, times are good—GDP is increasing, and the interest rates, inflation, and unemployment are all low.

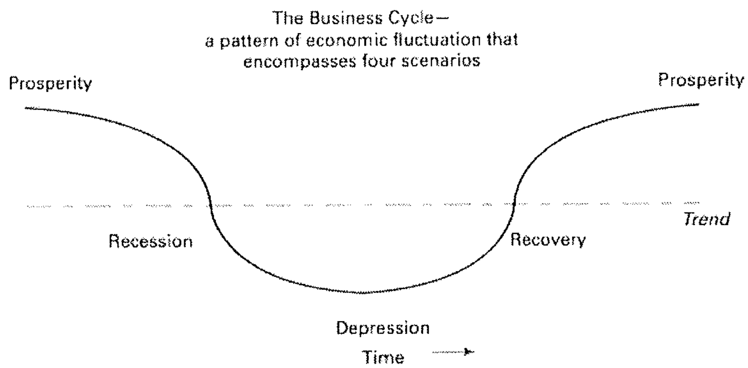

Figure 2.4 The Business Cycle

Because individuals have jobs, they have extra money in their pockets. This is money they can spend on items beyond necessities. For instance, an individual might decide to have elective surgery, get braces, or buy a pair of prescription sunglasses. Health care providers also spend money: they add additional employees, buy new equipment, and expand the office building. Businesses that are doing well might decide to add additional health care benefits for their employees, which in turn improves the health care provider's business.

In the recession phase, the economy slows down. Inflation and interest rates begin to increase. This causes businesses and individuals to spend less and to borrow less because these activities are more expensive. Individuals may only seek the health care services they must have. Businesses may lay off employees and cut health care benefits as they try to save money. Health care providers might also have to cut staff and postpone purchases of new equipment. All these strategies were seen during 2007–2010, when the United States was in a period of recession. The unemployment rate exceeded 10 percent in most areas of the country, and the number of uninsured increased.

If a recession persists, it is called a depression. Economic activity comes to a near standstill. Individuals buy only the necessities, and they may not be able to afford all of those. Unemployed individuals turn to the government for health care or do without.

The government may intervene in the free market economy to move the economy into the recovery phase. The government can lower interest rates and cut taxes to stimulate spending. In the recovery phase, things begin to improve. Businesses hire back employees, and businesses and individuals are able to purchase the items they need.

Economic cycles appear inevitable. The difficult part of a manager's job is to predict how often a cycle will occur and how long any of the phases will last. Like other businesses, the health care industry must monitor and assess economic conditions to make appropriate decisions.

The Role of Government

Even though the United States does not have a national health system, the government's involvement in health care is significant. Government actually plays three roles: as a provider of health care services, as a payer for services provided by others, and as a regulator of health care providers. The first two roles are discussed in other chapters of this book; government's role as a regulator is discussed here.

Government regulates health care by using the political process to make laws. The idea for a law can come from anywhere. Doctors and hospitals might want the level of Medicaid reimbursement increased. Older individuals on fixed incomes might want a law that sets prices for prescription drugs. A professional organization might want to change the licensure standards for its members. Each group would contact its legislator to make its ideas and needs known.

Industry representatives work with legislators to influence the political process. The American Medical Association and the American Hospital Association, as well as medical associations at the state level, lobby legislators to protect the interests of their membership.

Industries also create their own regulatory groups so that government will decide no additional regulation is needed. The **Joint Commission** (formerly JCAHO) is a case in point. TJC evaluates and accredits nearly 17,000 health care organizations in the United States to improve the quality and safety of health care services. Its standards are considered so good that TJC accreditation often substitutes for federal certification surveys for Medicare and Medicaid (www.jointcommission.org).

Joint Commission (TJC) National organization that evaluates and accredits health care organizations.

Traditionally the laws that the government uses to regulate health care have had two broad objectives. One objective has been to ensure fair competition in the marketplace. Another objective has been to protect the public.

The **antitrust** laws are an example of how the government regulates competition. These laws are presented in Table 2.2. Basically, antitrust law prohibits businesses from taking actions that lessen competition. This can include mergers, attempts to create monopolies, and price fixing and price discrimination

antitrust An area of federal law that prohibits monopolization and other activities that lessen competition in the marketplace.

Table 2.2 *Antitrust Laws*

1890	Sherman Antitrust Act	Prohibits restraint of trade and monopolization
1914	Clayton Act	Restricts practices such as price discrimination, exclusive dealing, and tying contracts where the effect "may be to substantially lessen competition or tend to create a monopoly"
1914	Federal Trade Commission Act	Establishes Federal Trade Commission to investigate business practices that are unfair methods of competition
1936	Robinson–Patman Act	Prohibits price discrimination; prohibits selling at unreasonably low prices to eliminate competition

Table 2.3 *Consumer Protection Laws*

1906	Pure Food and Drug Act	Established Food and Drug Administration; prohibits misbranding and adulteration of food and drugs
1938	Federal Food, Drug, and Cosmetic Act	FDA given authority to regulate cosmetics and therapeutic products
1962	Kefauver-Harris Drug Amendment	Manufacturers required to test safety and effectiveness of drugs; generic or common drug name must be on label
1983	Orphan Drug Act	Sets incentives and grants exclusive marketing rights to promote development of drugs for rare diseases
1984	Drug Price Competition	Shortens application process for approval of Patent Term Restoration Act for generic versions of certain drugs
1990	Americans with Disabilities Act	Protects rights of people with disabilities

(www.usdoj.gov/atr/). Health care organizations must make decisions within the boundaries of antitrust laws. For example, a hospital that limits the number of physicians admitted to its medical staff may be accused of conspiring to limit competition from other physicians and medical groups. A health maintenance organization (HMO) or participating provider option (PPO) might be accused of price fixing and price discrimination when it negotiates fees and contracts. Dr. Anderson, the profile's ophthalmologist, could be in violation if she discussed fees with other similar physicians in her region. Although potentially more efficient for the business, a merger of two hospitals or medical groups has the potential to lessen competition because patients would have fewer choices of health care providers.

Legislatures also pass laws that are expected to protect the public. Table 2.3 presents some examples of laws that are broadly related to the public's health. Some legislation designed to protect the public specifically regulates how health care providers must behave. Examples are presented in Table 2.4. Some legislation, like the Social Security Act of 1965 that created both Medicare and Medicaid, has been in existence for almost 40 years but continues to be important to health care businesses because of the influence reimbursement policies and amounts have on patients and providers alike. Some legislation, such as the Affordable Care Act, is relatively new, so its full impact cannot yet be determined.

An important piece of legislation that directly regulates health care is HIPAA, cited earlier. Although the law was passed in 1996, some provisions did not go into final effect until April 2003. Continuing debate about how the health care industry would comply with the law's provisions and whether the law would actually achieve its intent caused part of the delay. The legislation has five parts, or titles. Title I provides for insurance portability. Title II includes two major components. The first deals with fraud and abuse and reform of

Table 2.4 *Health Care Laws*

1946	Hill-Burton Act	Also called the Hospital Survey and Construction Act; federal government funded construction of private facilities pursuant to a Certificate of Need; facility required to provide care to underserved populations; enforcement regulation passed in 1979
1965	Medicare/Medicaid	Part of the Social Security Act; Medicare provides health care insurance (including hospitalization) for elderly and patients with disabilities; Medicaid provides health care for the indigent
1989	"Stark I"	Amendment to the Social Security Act, which prohibits referrals to clinical lab service where provider has a financial interest
1993	"Stark II"	Expands Stark I to include referrals to "designated health services"
1996	HIPAA	Provides for health insurance portability and protects the privacy of health records
2009	ARRA	Special provisions to protect laid-off workers and to encourage electronic records technology
2010	Affordable Care Act	Patient Protection and Affordable Care Act; requires U.S. citizens to have health insurance. Expands government programs. Specifies insurers' ability to deny coverage and raise premiums

medical liability. The second mandates administrative simplification, which includes privacy and security provision for health data and requires electronic data interchange (EDI). Title III involves taxes; Title IV, the requirements for group health plans; and Title V, revenue offsets.

The American Recovery and Reinvestment Act of 2009 (ARRA) includes the "HITECH Act" (Health Information Technology for Economic and Clinical Health Act), which adds programs under Medicare and Medicaid related to electronic health records technology. In another section, ARRA provides temporary COBRA subsidies to recently laid-off workers to cover 65 percent of the insurance premium.

The Patient Protection and Affordable Care Act was signed into law by President Obama in March 2010, although some of the provisions did not take effect until 2014, and some aren't fully implemented until 2020. The legislation is often referred to it as "Obamacare" or the "Affordable Care Act." The primary purpose of the legislation was to expand access to insurance coverage through mandates, subsidies, and insurance exchanges; preliminary data indicate that the number of uninsured has decreased since 2010. The act provides mechanisms for uninsured individuals to obtain private insurance, mandates employers provide basic plans, and expands government programs such as Medicare and Medicaid. There are restrictions on insurance companies' ability to restrict access to health insurance or to charge excessive premiums for coverage. Some of the specifics are described in later chapters. The law also created a number of programs to improve the quality and effectiveness of health care as well as programs aimed at prevention. The Department of Health and Human Services has created a website to provide information about the Act, as well as a database for tracking insurance coverage.

Integrating Business and Its Environment

As you have seen, the state of the economy, as well as changes in federal and state laws, can dramatically affect a health care business. Although managers can't change the environment, they can change the business's activities to meet the demands of the environment. As part of the process of developing business plans and strategies, managers assess the environment. This involves collecting data to understand what the environment is like at the present moment. It also involves making predictions or forecasts of what the environment will be like in the future. Managers can use a number of techniques to integrate the business activity with what is occurring in the environment around it.

Many managers use a technique called **SWOT analysis** to determine where the business is in relation to its environment (Thompson and Strickland 2003). SWOT stands for *S*trengths, *W*eaknesses, *O*pportunities, and *T*hreats. As illustrated in Figure 2.5, managers analyze the strengths and weaknesses of their business and try to identify opportunities and threats in the environment. Managers then try to match strengths with opportunities to plan for the future.

SWOT analysis
Amethod used by businesses to analyze the external environment.

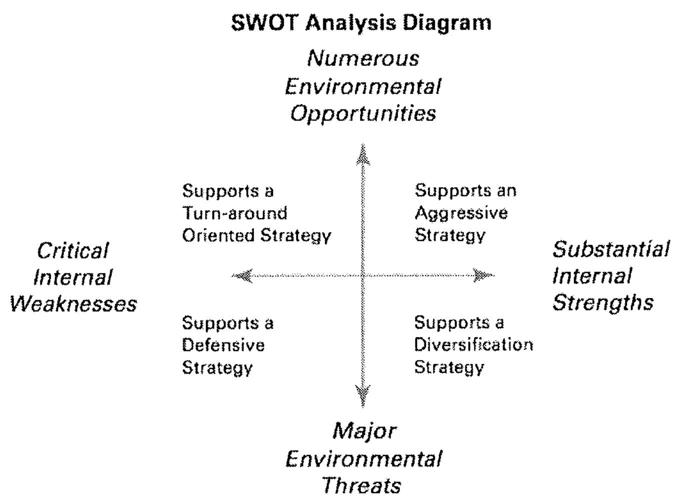

Figure 2.5 SWOT Analysis

Career Profile: Networking and Security

Like all businesses, health care businesses rely on computers to do their work. Networking professionals perform the behind-the-scenes tasks to keep businesses operational. A computer network connects all the different computing devices using hardware and software so they can communicate. The connection can be wired (made with physical cables) or wireless. The computing devices include desktop computers, laptops or tablets, medical equipment, printers, and even the office phone system. The advantage of a networked system is the ability to share an Internet connection, peripherals, and files. The network administrator monitors the system to be sure everything is working and takes care of issues when it isn't. The administrator might need to install new computers or printers or update software. An increasingly critical task is maintaining proper network security.

To become a network administrator, a person learns about network operating systems and hardware such as routers and servers. Most classes involve both the theory and hands-on experience with devices. A person who wants to work in a health care setting should seek out internship opportunities in the field. In addition to obtaining an associate's or bachelor's degree, network administrators obtain industry certification such as the CCNA (Cisco Certified Network Administrator).

Computer viruses and malware continue to proliferate, and all networks are vulnerable to hackers. Network administrators are responsible for installing and maintaining software to protect against these threats. The network administrator also manages the credentials and passwords of everyone who has access to the network and routinely backs up the system. However, increased risk has created additional employment opportunities in the area of computer security. Cybercrime is defined as any type of crime that happens using a computer or website. Illegal network access, identity theft, fraud, and viruses are all forms of cybercrime. Computer security degrees are available from the associate's to master's level. The training focuses on how the crimes are committed and how they can be prevented and detected.

Summary

Health care is a business as well as a delivery system. Business involves providing a product or service to customers for a profit. Health care businesses must define what their product or service is and who their customers are. The business may be legally organized as a sole proprietorship, a partnership, or a corporation. Regardless of form, the business will perform the key business functions of management, marketing, accounting, production, and information technology. Two external environments impact the operation and design of health care businesses: economic and political-legal. These environments are the frame of reference in which health care businesses make decisions. SWOT analysis can be used to integrate the decision-making process with conditions in the external environment.