

Strategic Management of Health Care Organizations

Sixth Edition

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CHAPTER

6

Developing Strategic Alternatives

"The understanding that underlies the right decision grows out of the clash and conflict of divergent opinions and out of the serious consideration of competing alternatives. . . . Unless one has considered alternatives, one has a closed mind."

Peter F. Drucker

Introductory Incident

Responding to the Leapfrog Group's *Hospital Quality and Safety, Survey*: A Strategic Choice?

The Leapfrog Group publishes the results of its comparative *Hospital Quality and Safety Survey* on a market-by-market basis. The *Survey* is intended to aid consumers in selecting a provider and employers in designing health plans to provide the highest quality of care (see Perspective 6-1). The Leapfrog Group contends that most people have more information about choosing a television set, an automobile or major appliance, than they do about choosing a doctor or a hospital. Therefore, a major goal of Leapfrog is to make medical reporting more accessible and transparent.

Private employers understand that frequent and systemic errors in hospitals are putting a significant number of employees at risk. In addition, years of experience with total quality management have provided these leaders with a sense that low-quality and high-practice variance are contributing to

health insurance premium inflation. As a result, the Business Roundtable – an association of the CEOs of 200 of the Fortune 500 companies – decided to take action and became involved in several initiatives to improve quality. In particular, it provided funding for the Leapfrog Group's start-up.

Leapfrog estimates that if all nonrural US hospitals implemented computer physician order entry (CPOE), ICU physician staffing, and evidence-based hospital referral, more than 65,000 lives could be saved annually and more than 907,000 medication errors could be prevented. Yet, for a hospital's leaders, adopting any of these "Leaps" represents a strategic choice that might preclude pursuing other strategic alternatives. However, choosing not to adopt any of the standards might signal that quality and safety are not major strategic objectives for the institution.

For hospitals already meeting some or all of the Leaps being promulgated, responding to the survey may represent an opportunity to pursue a differentiation strategy emphasizing quality. For example, the Executive Vice President and Chief Operating Officer of the Akron (Ohio) General Medical Center stated that "Akron General's goal is to become the safest hospital in Ohio and Leapfrog is very much a part of our strategy. We know that in comparison to other organizations, our outcomes are much better."¹

However, relatively few hospitals in the United States have CPOE, meet all the evidence-based hospital referral (EHR) volume standards, and employ ICU specialists to meet the intensive-care-unit physician staffing requirements. For example, in one survey of over 1,200 hospitals more than 90 percent indicated they have not implemented CPOE to Leapfrog's standards and 70 percent do not enlist intensive care specialists to oversee patients in the ICU.²

Not everyone in the industry is convinced that Leapfrog is really the answer to patient safety issues. The Patient Safety Officer at Duke University Hospital indicated that she found it hard to believe that there was any evidence that participation in "an expensive data-collection effort enhanced safety" yet "those who don't participate get penalized." The Executive Director of the Vanderbilt Center for Evidence-Based

Medicine (Vanderbilt University Medical Center is on the list) also had misgivings. When considering if Leapfrog's measures are supported by evidence, the answer was "yes" but with qualifications. The evidence, according to the Executive Director, is largely from health services research studies that are based on aggregated data from forecasting models rather than a discrete case study in a hospital or small group of hospitals where its best practices are evaluated in a controlled setting."³

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Sources: Eric W. Ford, PhD, Texas Tech University; Dennis P. Scanlon, PhD, The Pennsylvania State University; and Jon B. Christianson, PhD, University of Minnesota.

Learning Objectives

After completing the chapter you will be able to:

1. Understand and discuss the steps involved in the decision logic of strategy development.
2. Synthesize and integrate strategic thinking accomplished in situational analysis into a strategic plan for an organization.
3. Identify the hierarchy of strategies and strategic decisions required in strategic planning.
4. Understand the nature of directional strategies, adaptive strategies, market entry strategies, and competitive strategies.
5. Identify strategic alternatives available to health care organizations.
6. Provide the rationale as well as advantages and disadvantages for each of the strategic alternatives.
7. Understand that strategies may have to be used in combination to accomplish the organization's goals.
8. Map strategic decisions showing how they are linked as an *ends-means chain*.

Developing a Strategy

Strategic thinking involves an awareness of the environment; intellectual curiosity that is always gathering, organizing, and analyzing information; and a willingness to be open to creative ideas and solutions. Strategic planning concerns reaching conclusions about the information, setting a course of action, and documenting the plan. Therefore, strategic planning is essentially decision making – determining which strategy from among the many available alternatives the organization will pursue.

There are many strategic alternatives available to a health care organization and a particular organization may pursue several different types of strategies simultaneously or sequentially. Therefore, decision logic is required for strategy development. For instance, hospitals selecting to pursue various Leapfrog Leaps, as discussed in the Introductory Incident, are making strategic choices that will both limit and create opportunities to pursue several different strategies (see Perspective 6–1). In what order should strategic decisions be made? A merger or affiliation decision is part of a series of decisions rather than a single decision or an end in itself. In other words, there is a broader strategy that precipitated the merger or affiliation decision; and there will be subsequent strategic decisions that will have to be made to support the decision and make it successful.

Strategy formulation includes development of strategic alternatives, evaluation of alternatives, and strategic choice. This chapter classifies the types of strategies and develops a hierarchy of strategic alternatives. The hierarchy provides a strategic thinking map as guidance in decision making and strategic planning. Chapter 7 discusses strategic thinking methods for analyzing these alternatives to make a strategic choice.

Perspective 6–1 The Leapfrog Group

The Institute of Medicine's (IOM) report *To Err is Human: Building a Safer Health System* found widespread medical errors within America's hospitals – between 44,000 and 98,000 patients suffer death due to systemic errors, with many more suffering avoidable disabilities and other adverse effects.¹ Similarly, the Commonwealth Foundation, for example, gave the

US health care system a score of only 66 out of 100 for value and safety. According to the report, each year in the US we throw away up to \$100 billion on waste and errors and 150,000 people die unnecessarily.²

The Leapfrog Group was created as a catalyst to initiate improvements in hospital patient safety practices. Leapfrog sought to connect evidence-based medicine and management by promoting scientifically proven practices that can be implemented at the hospital level. Further, the organization chose to focus on three practices or “Leaps” that have the potential to save lives by reducing preventable mistakes in hospitals.³ The three Leaps are:

1. Computerized physician order entry (CPOE);
2. Evidence-based hospital referral (EHR); and
3. ICU physician staffing (IPS) using intensive care specialists.

CPOE systems are relatively expensive, rely on decision support software, and require extensive re-engineering of unit workflows. Some physicians resist using CPOE technology, viewing it as a threat to their clinical autonomy, and find re-engineering of work to be an unnecessary inconvenience. The implementation of a system to increase medication safety that relies on bar coding technology to ensure that the patient receives the intended medication faces much less resistance from clinical employees. Two limitations of bar coding, however, are that it does not control for the reduction of adverse drug interactions or the prevention of dosage errors. However, bar coding drugs requires a relatively low capital investment, poses no threat to physician autonomy, and does not disrupt existing workflows significantly.

The EHR Leap is a surgical volume standard related to specific high-risk procedures such as coronary artery bypass grafts (CABGs). To meet the Leapfrog standard, a facility must either exceed the volume expectation or discontinue providing the procedures. Despite strong research findings that higher volume levels for complex surgical procedures are positively correlated with better clinical outcomes, a hospital may feel compelled to perform lower numbers of the procedure to ensure that its community has adequate and readily available access to a full array of services. In this sense, pursuing the clinical quality aspect of a hospital's mission may come directly into conflict with its mission to ensure adequate access for the community.

Lastly, IPS requires staffing a hospital's intensive care unit with physicians specifically trained for that setting. Generally, the decision to use intensive care specialists means that the hospital will have to employ those clinicians. This approach changes the service delivery model of a hospital by asking admitting physicians to cede control of their patients to an ICU physician. To successfully implement such a program requires a significant change in the culture of the admitting physicians. Many hospital administrators cite the unavailability of physicians with the necessary training as a barrier to pursuing this strategy for improving safety.

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2. Suzanne Delbanco, "The Next Big Leap," *Modern Healthcare* 36, no. 41 (October 16, 2006), p. 23.
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Sources: Eric W. Ford, PhD, Texas Tech University; Dennis P. Scanlon, PhD, The Pennsylvania State University; and Jon B. Christianson, PhD, University of Minnesota.

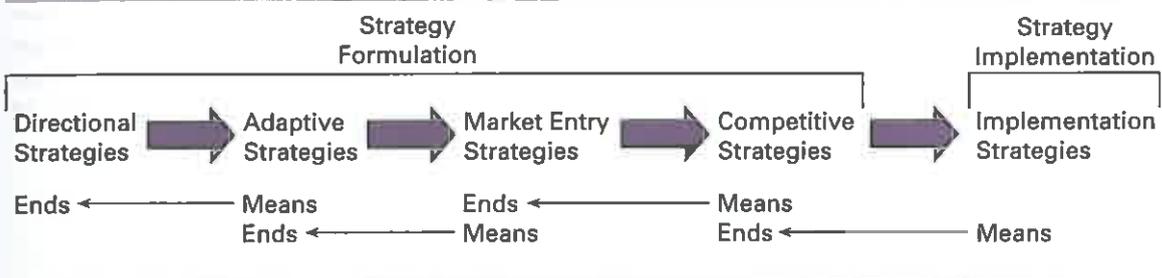
Linking Strategy with Situational Analysis

As demonstrated by the check list in Exhibit 6-1, the strategies selected by the organization should address external issues, draw on competitive advantages or fix competitive disadvantages, keep the organization within the parameters of the mission and values, move the organization toward the vision, and make progress toward achieving one or more of the organization's strategic goals. This check-list procedure is an important part of the strategic thinking process and helps to assure consistency of analysis and action. Each selected strategy should be tested against these questions. Strategies that do not have a "yes" in each column should be subject to additional scrutiny and justification.

Exhibit 6-1: Check List for Linking Strategic Alternatives with Situational Analysis

Strategic Alternative	Addresses an External Issue?	Draws On a Competitive Advantage or Fixes a Competitive Disadvantage?	Fits with Mission, Values?	Moves the Organization Toward the Vision?	Achieves One or More Strategic Goals?
Strategy 1	Yes	Yes	Yes	Yes	Yes
Strategy 2	Yes	Yes	Yes	Yes	Yes
Strategy 3	Yes	Yes	Yes	Yes	Yes

Exhibit 6-2: The Decision Logic of Strategy Formulation



The Decision Logic of Strategy Development

The decision logic of strategy formulation is illustrated in Exhibit 6-2. Decisions concerning five categories of strategies – directional strategies, adaptive strategies, market entry strategies, competitive strategies, and implementation strategies – should be addressed sequentially with each subsequent decision more specifically defining the activities of the organization. The first four of these strategy types make up strategy formulation and specify how the organization will define and attempt to achieve its mission and vision. Implementation strategies include objectives and plans for the organizational units to accomplish the strategies (managing strategic momentum).

As demonstrated in Exhibit 6-2, strategies form an *ends-means chain*. Thus, the organization must first establish or reaffirm and reach consensus on its mission, vision, values, and strategic goals (directional strategies) – the ends. Next, the adaptive strategies must be identified and are the means to accomplishing the directional strategies. *Adaptive strategies* are concerned with the type and scope of operations and specify how the organization will expand, reduce, or maintain operations. Third, market entry strategies must be selected and are the means to accomplish the adaptive strategies. *Market entry strategies* indicate the method for

carrying out the adaptive strategies. Fourth, competitive strategies must be determined and are the means to carrying out the market entry strategies. *Competitive strategies* determine the organization's strategic posture and identify the basis for competing in the market. Finally, *implementation strategies* (value adding service delivery strategies, value adding support strategies, and action plans) must be developed to carry out the adaptive, market entry, and competitive strategies. The scope and role of the four strategy formulation types and the implementation strategies are summarized in Exhibit 6-3.

At each stage in the ends-means decision chain, previous upstream decisions and the implications for subsequent downstream decisions must be considered and perhaps reconsidered. As strategic managers work through strategic decisions, new insights and perspectives may emerge (strategic thinking) that suggest reconsideration of previous strategic decisions. Therefore, although the decision logic for strategic decisions is generally sequential, in practice it is very much an iterative process. Strategy includes a plurality of inputs, a multiplicity of options, and an ability to accommodate more than one possible outcome. Where mission and vision are ignored, or where there is no ends-means linkage between vision and strategy, strategy has no end object. In these situations, strategy suffers from being a means without an end, an end in itself, or a means of achieving an

Exhibit 6-3: Scope and Role of Strategy Types in Strategy Formulation

Strategy	Scope and Role
Directional Strategies	The broadest strategies that set the fundamental direction of the organization by establishing a mission for the organization (Who are we?) and vision for the future (What should we be?). In addition, directional strategies specify the organization's values and the strategic goals.
Adaptive Strategies	These strategies are more specific than directional strategies and provide the primary methods for achieving the vision (adapting to the environment). These strategies determine the scope of the organization and specify how the organization will expand scope, reduce scope, or maintain scope.
Market Entry Strategies	These strategies provide the method of carrying out the adaptive strategies (expansion of scope and the maintenance of scope strategies) through purchase, cooperation, or internal development. Market entry strategies are not used for reduction of scope strategies.
Competitive Strategies	Two types of strategies, one that determines an organization's strategic posture and one that positions the organization <i>vis-à-vis</i> other organizations within the market. These strategies are market oriented and best articulate competitive advantage.
Implementation Strategies	These strategies are the most specific strategies and are directed toward value added service delivery and the value added support areas. In addition, individual organizational units develop objectives and action plans that carry out the value added service delivery and value added support strategies.

operational end, rather than being a design or plan for achieving the organization's mission and vision.¹

Strategic decisions should be based on as much information and strategic thinking as possible. Sometimes strategic thinking occurs in situational analysis and at other times it occurs when managing strategic momentum. Before the strategic plan is adopted, it is important to remember that organization-wide understanding of, and commitment to, the strategies must be developed if they are to be managed successfully (strategic momentum). The choice of a strategic alternative creates additional direction for an organization and subsequently shapes its internal systems (organization, technology, information systems, culture, policies, skills, and so on). Strategic momentum is reinforced as managers understand, commit, and make decisions according to the strategy.

Exhibit 6-4 presents a comprehensive strategic thinking map of the hierarchy of strategic alternatives. The hierarchy represents a number of strategic alternatives available to health care organizations. This map not only identifies the alternatives but also the general sequential relationships among them. Using this organizing framework or decision logic in strategy formulation keeps it from becoming overwhelming and focuses strategic thinking. As strategic managers work through the strategic decisions, new understandings, insights, and strategies may (and in fact, should) emerge. Therefore, decision makers must work through the decision logic and back again, ensuring that all the proposed strategies make sense together. Strategic thinkers must always be able to see the bigger picture.

Exhibit 6-4: Strategic Thinking Map – Hierarchy of Strategic Decisions and Alternatives

Direction Strategies	Adaptive Strategies	Market Entry Strategies	Competitive Strategies	Implementation Strategies
	Expansion of Scope	Purchase	Strategic Posture	Service Delivery
<ul style="list-style-type: none"> • Mission • Vision • Values • Goals 	<ul style="list-style-type: none"> • Diversification • Vertical Integration • Market Development • Product Development • Penetration 	<ul style="list-style-type: none"> • Acquisition • Licensing • Venture Capital Investment 	<ul style="list-style-type: none"> • Defender • Prospector • Analyzer 	<ul style="list-style-type: none"> • Pre-service • Point-of-service • After-service
	Reduction of Scope	Cooperation	Positioning	Support
	<ul style="list-style-type: none"> • Divestiture • Liquidation • Harvesting • Retrenchment 	<ul style="list-style-type: none"> • Merger • Alliance • Joint Venture 	<ul style="list-style-type: none"> Marketwide • Cost Leadership • Differentiation 	<ul style="list-style-type: none"> • Culture • Structure • Strategic Resources
	Maintenance of Scope	Development	Market Segment	Unit Action Plans
	<ul style="list-style-type: none"> • Enhancement • Status Quo 	<ul style="list-style-type: none"> • Internal Development • Internal Venture • Reconfigure the Value Chain 	<ul style="list-style-type: none"> • Focus/Cost Leadership • Focus/Differentiation 	<ul style="list-style-type: none"> • Objectives • Actions • Timelines • Responsibilities

Decision makers should be prepared to adjust and refine earlier decisions in the decision logic as they make “downstream” decisions.

How-to formulas, techniques, or a linear process, of course, can never replace strategic thinking. Many of the greatest achievements in science, law, government, medicine, or other intellectual pursuits are dependent on the development of rational, logical thinkers; however, linear thinking can limit potential.² Leadership is essential to foster creativity and innovation and allow for the reinvention of the strategy formulation process. Strategy formulation involves managing dilemmas, tolerating ambiguity, coping with contradictions, and dealing with paradox.³ Often leaders must creatively resolve the tension between competing information and alternatives and generate new options and solutions.⁴ In addition, strategy development cannot ignore the entrepreneurial spirit, politics, ethical considerations, and culture in an organization. The strategy formulation decision logic discussed in this chapter provides a starting point. It should foster strategic thinking, not limit it. The map starts the decision makers on their journey.

Directional Strategies: Mission, Vision, Values, and Goals

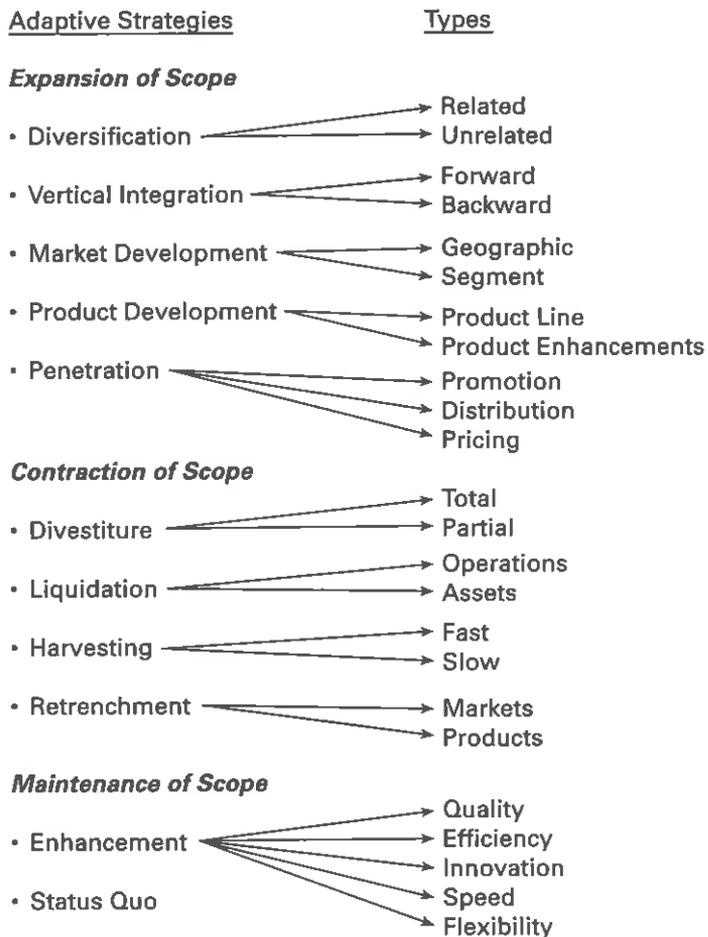
Chapter 5 explored mission, vision, values, and strategic goals and indicated that these elements are part of both situational analysis and strategy formulation. They are a part of situational analysis because they describe the current state of the organization and codify its basic beliefs and philosophy. In addition, these directional strategies are a part of strategy formulation because they set the boundaries and indicate the broadest direction for the organization. The directional strategies should provide a sensible and realistic planning framework for the organization.

Because formulation of the mission, vision, values, and strategic goals provides the broad direction for the organization, directional strategic decisions must be made first. Then the adaptive strategies provide further progression by specifying the type and scope of product/market expansion, reduction, or maintenance. The adaptive strategies form the core of strategy formulation and are most visible to those outside the organization. After the adaptive strategies have been selected, the directional strategies should be re-evaluated. Seeing the directional strategies (ends) and the adaptive strategies (means) together may suggest refinements to either or both. This broader perspective is essential in strategic thinking.

Adaptive Strategies

From a practical standpoint, whether the organization should expand, reduce, or maintain scope is the first decision that must be made once the direction of the organization has been set (or reaffirmed). As shown in Exhibit 6–5, several alternatives are available to expand, reduce, or maintain the scope of operations. These alternatives provide major strategic choices for the organization.

Exhibit 6-5: Strategic Thinking Map of Adaptive Strategic Alternatives



Expansion of Scope Strategies

If expansion is selected as the best way to perform the mission and realize the vision of the organization, several alternatives are available. The *expansion of scope strategies* include:

- *diversification,*
- *vertical integration,*
- *market development,*
- *product development,* and
- *penetration.*

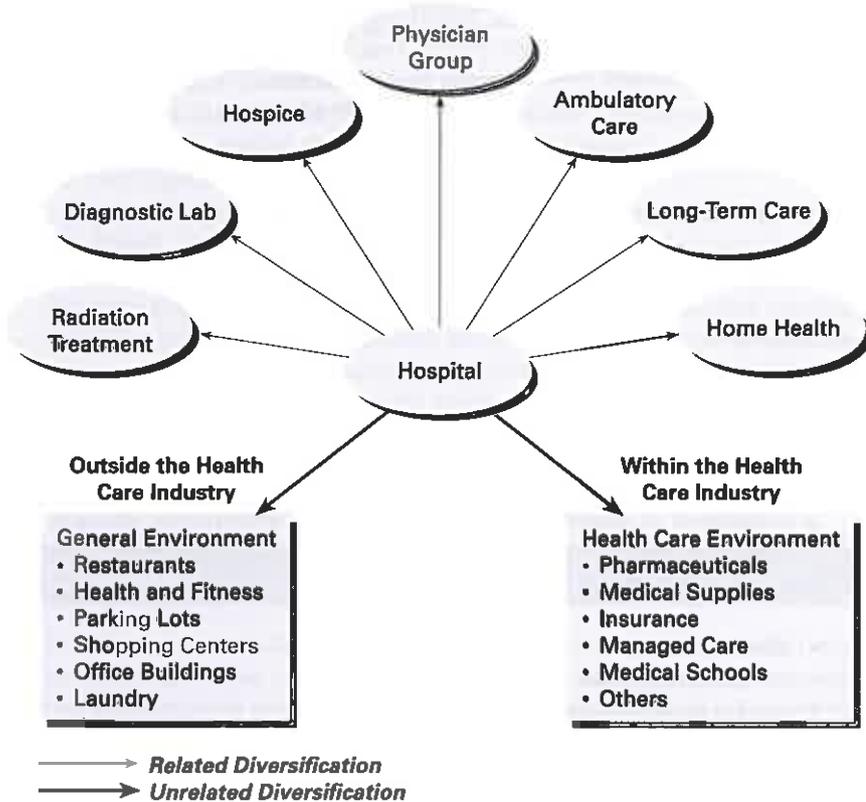
DIVERSIFICATION

Diversification strategies, in many cases, are selected because markets have been identified outside of the organization's core business that offer potential for substantial growth. Often, an organization that selects a diversification strategy is not achieving its growth or revenue goals within its current market, and these new markets provide an opportunity to achieve them. There are, of course, other reasons why organizations decide to diversify. For instance, health care organizations may identify opportunities for growth in less competitive or less regulated markets such as specialty hospitals, long-term care facilities, or outpatient care.

Diversification is generally seen as a risky alternative because the organization is entering relatively unfamiliar markets or new businesses that are different from its current activities. Organizations have found that the risk of diversification can be reduced if markets and products are selected that complement one another. Therefore, managers engaging in diversification seek synergy between corporate divisions (SBUs).

There are two types of diversification: related (concentric) and unrelated (conglomerate) diversification. Exhibit 6-6 illustrates possible related and unrelated diversification strategies for one type of primary health care organization.

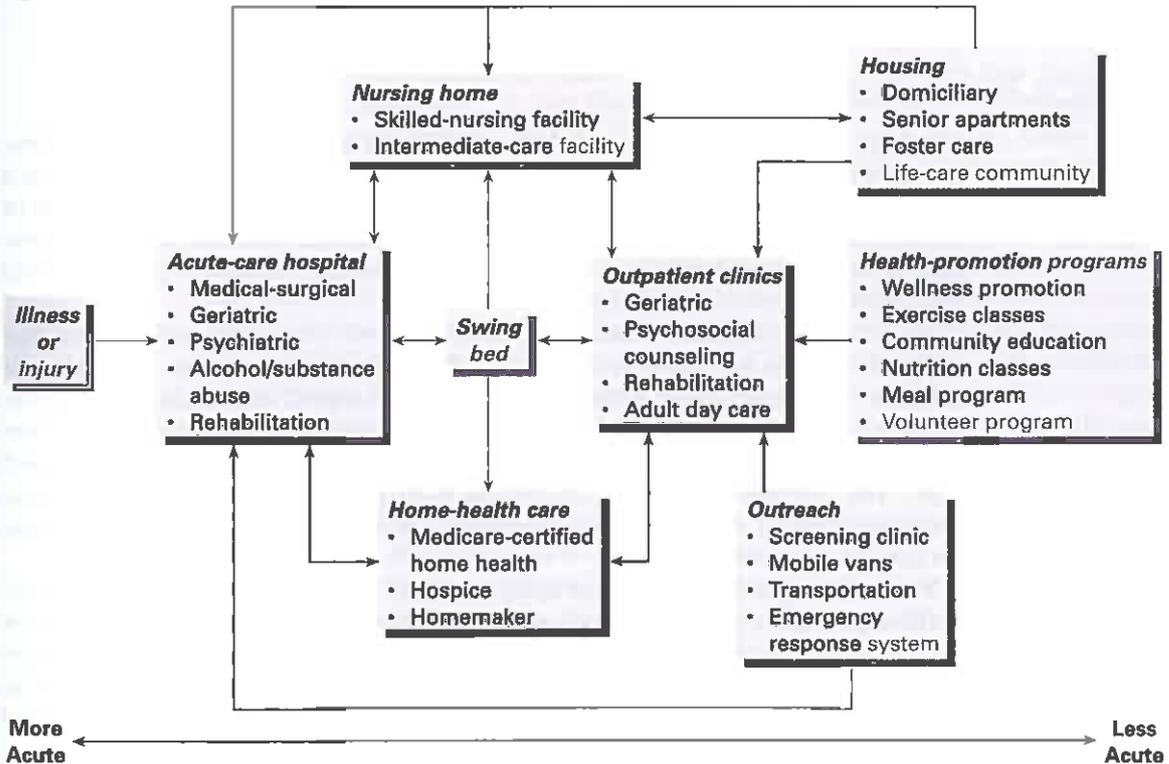
Exhibit 6-6: Related and Unrelated Diversification by a Primary Provider



In *related diversification*, an organization chooses to enter a market that is similar or related to its present operations. This form of diversification is sometimes called *concentric diversification* because the organization develops a "circle" of related businesses (products/services). Exhibit 6-7 illustrates the circle of related products for a hospital that is interested in diversifying into another segment of the health care market, the long-term care market.

The general assumption underlying related diversification is that the organization will be able to obtain some level of synergy (a complementary relationship where the total effect is greater than the sum of its parts) between the production/delivery, marketing, or technology of the core business and the new related product or service. For hospitals, the two primary reasons for diversifying are to introduce nonacute care or subacute care services that reduce hospital costs, or to offer a wider range of services to large employers and purchasing coalitions through capitated contracts.⁵ The movement of acute care hospitals into skilled-nursing care is an example of related diversification.

Exhibit 6-7: Long-Term Care Options for Hospital Diversification



Source: *Health Care Management Review* 15, no. 1, p. 73. Copyright © 1990. Reprinted by permission of Aspen Publishers, Inc.

On the other hand, in *unrelated diversification*, an organization enters a market that is unlike its present operations. This action creates a "portfolio" of separate products/services. Unrelated diversification, or *conglomerate diversification*, generally involves semi-autonomous divisions or strategic service units. An example of unrelated diversification would be a hospital diversifying into the operation of a restaurant, parking lot, or medical office building. In such a case, the new business is unrelated to health care although it may be complementary (synergistic) to the provision of health services.

Research on diversification indicates that financial performance increases as organizations shift from single-business strategies to related diversification, but performance decreases as organizations change from related diversification to unrelated diversification.⁶ Single-business organizations may suffer from limited economies of scope whereas organizations using related diversification can convert underutilized assets and achieve economies of scope by sharing resources and combining activities along the value chain. Unrelated diversification has been found to increase strain on top management in the areas of decision making, control, and governance. In addition, unrelated diversification makes it difficult to share activities and transfer competencies between units. Sharing activities and transferring competencies has been particularly difficult in hospital diversification.⁷ Unrelated diversification has been generally unsuccessful in generating revenue for acute care hospitals.

VERTICAL INTEGRATION

A *vertical integration* strategy is a decision to grow along the channel of distribution of the core operations. Thus, a health care organization may grow toward suppliers or toward patients. When an organization grows along the channel of distribution toward its suppliers (upstream) it is called *backward vertical integration*. When an organization grows toward the consumer or patient (downstream) it is called *forward vertical integration*.

A vertically integrated health care system offers a range of patient care and support services operated in a functionally unified manner. The expansion of services may be arranged around an acute care hospital and include pre-acute, acute, and post-acute services or might be organized around specialized services related solely to long-term care, mental health care, or some other specialized area.⁸ The purpose of vertical integration is to increase the comprehensiveness and continuity of care, while simultaneously controlling the channel of demand for health care services.⁹

Vertical integration can reduce costs and thus enhance an organization's competitive position. Cost reductions may occur through lower supply costs and better integration of the "elements of production." With vertical integration, management can better ensure that supplies are of the appropriate quality and delivered at the right time. For instance, some hospitals have instituted technical educational programs because many health professionals (the major element of production in health care) are in critically short supply.

Because a decision to vertically integrate further commits an organization to a particular product or market, management must believe in the long-term viability of the product/service and market. As a result, the opportunity costs of vertical integration must be weighed against the benefits of other strategic alternatives such as diversification or product development. Examples of vertical integration would be a hospital chain acquiring one of its major medical products suppliers (backward integration) or a drug manufacturer moving into drug distribution (forward integration).

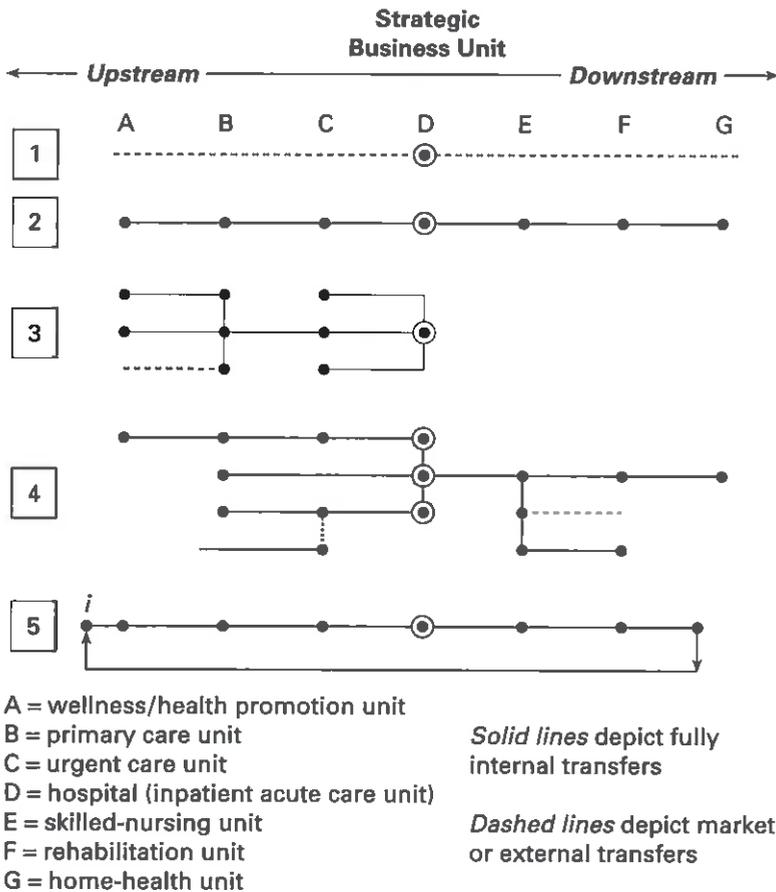
Whether a strategic alternative is viewed as vertical integration or related diversification may depend on the objective or intent of the alternative. For instance, when the primary intent is to enter a new market in order to grow, the decision is to diversify. However, if the intent is to control the flow of patients to various units, the decision is to vertically integrate. Thus, a decision by an acute care hospital to acquire a skilled-nursing unit may be viewed as related diversification (entering a new growth market) or vertical integration (controlling downstream patient flow). Vertical integration is the fundamental adaptive strategy for developing integrated systems of care and is central to many health care organizations' strategies.

Numerous extensive health networks are the result of integration strategies. One study showed that over 70 percent of US hospitals belong to health networks or systems.¹⁰ The major reason that hospitals join networks and systems is to help to secure needed resources (financial, human, information systems, and technologies), increase capabilities (management and marketing), and gain greater bargaining power with purchasers and health plans.¹¹ However, it appears that the pace of integration has slowed. In fact there has been some degree of "disintegration," with health care systems divesting health plans, physician groups, home health care companies, as well as selling or closing hospitals and divesting themselves of skilled care services or facilities.¹²

To expand the supply of patients to various health care units, several patterns of vertical integration may be identified.¹³ In Exhibit 6-8, an inpatient acute care facility is the strategic service unit or core technology that decides to vertically integrate. Example 1 represents a hospital that is not vertically integrated. The hospital admits and discharges patients from and to other units outside the organization. Example 2 illustrates a totally integrated system in which integration occurs both upstream and downstream. In this case, patients flow through the system from one unit to the next, and upstream units are viewed as "feeder" units to downstream units.

Example 3 represents a hospital that has vertically integrated upstream. In addition, more than one unit is involved at several stages of the integration. For instance, there are two wellness/health promotion units, three primary care units, and three urgent care units. The dashed line represents the receipt of patients via external or market transfers. Example 4 illustrates a multihospital system engaged in vertical integration. Three hospitals form the core of the system, which also contains three nursing homes, two rehab units, a home-health unit, three urgent care facilities, three primary care facilities, and a wellness center. It is important to note that simply adding members to create an integrated health

Exhibit 6-8: Patterns of Vertical Integration Among Health Care Organizations



Sources: Adapted in part from K. R. Harrigan, "Formulating Vertical Integration Strategies," *Academy of Management Review* 9, no. 4 (1984), pp. 638-652. Reprinted by permission of Academy of Management. And adapted in part from Stephen S. Mick and Douglas A. Conrad, "The Decision to Integrate Vertically in Health Care Organizations," *Hospital and Health Services Administration* 33, no. 3 (fall 1988), p. 351. Reprinted by permission from Health Administration Press, Chicago.

system is not enough. Institutions must be truly integrated and create a "seamless" system of care to achieve the desired benefits for patients (effectiveness) and cost savings (efficiency).

Finally, some health care systems are closed systems with fixed patient populations entirely covered through prepayment. Thus, whereas in Example 2, the health care organization is vertically integrated, in Example 5, patients are a part of the system. This insurance function is shown as an additional unit and identified by the letter *i* in the example.