

Exhibit 3–5: Using Porter’s Industry Structure Analysis

The Hanover House Nursing Home, a skilled-nursing facility, used differentiation as its major competitive advantage. In its early years, in a less regulated environment, the home was very profitable. As the facility began to age, and with increasingly stricter regulations for long-term care, profit margins began to deteriorate. The administrators of Hanover House used Porter’s Industry Structure Analysis to better understand the forces in their external environment. The following is a summary of their analysis.

Threat of New Entrants

The supply of nursing homes and other long-term care facilities is currently limited because there is a moratorium on additional beds within the geographic area. Competition is based on process or quality. If the moratorium is lifted, it will remain costly to enter the market because it is highly regulated. The greatest threat as a new entrant (when the moratorium is lifted) will be hospitals attempting to compensate for decreasing occupancy rates. Switching costs are low for hospitals (the same bed can be used for acute care or long-term care). Access to the distribution channel is high as hospitals have many of the required resources, including access to nurses, familiarity with the regulations, and capability to enter quickly (by converting acute care beds to long-term care).

Intensity of Rivalry Among Existing Organizations

Although there is competition, the long-term care industry is not fiercely competitive. Hanover House has six competitors – Mary Lewis Convalescence Center, Hillhaven, Altamont Retirement Community, St. Martins in the Pines, Lake Villa, and Kirkwood – that have relatively stable market shares. Because the service has both quality and dollar value, there is the opportunity to differentiate, and switching costs are high for the consumer. It is a highly regulated area and, therefore, not a great deal of diversity among competitors is apparent. The long-term care industry is maturing but remains a rapid-growth industry driven by demographic and social trends (the graying of America and the deterioration of the extended family). The most significant factor creating rivalry is the high fixed assets, which make exit difficult and success important.

Threat of Substitute Products and Services

There are few substitute products for nursing home care. Home care is a substitute but an increasingly less available alternative because of the mobility and dissolution of the family unit. Other alternatives include nonskilled homes, retirement housing, and domiciliaries. Increased costs and DRGs have virtually eliminated hospitals as an alternative. On balance, substitutes do not appear to be a strong force in the nursing home industry.

Bargaining Power of Customers

The power of the customer in the industry is generally high. The major consumer, the government, purchases over 45 percent of nursing home care and regulates reimbursement procedures as well as the industry. Therefore, significant levels of information are available. In addition, for private-pay customers, the purchase represents a significant investment and comparison shopping is prevalent. Product differentiation tends to reduce buying power but relatively low switching costs and government involvement make nursing home care a buyers’ market.

Bargaining Power of Suppliers

Because the product is simultaneously produced and consumed in service industries, labor is the major supplier in the nursing home industry. Although Hanover House is unionized, it has maintained good labor relations, and the union is not particularly powerful. Most who work in long-term care have selected the field to satisfy their need to care for others or make a contribution rather than to earn large salaries. Suppliers are not a dominant force in the nursing home industry.

Source: Elaine Asper, “Hanover House Nursing Home,” an unpublished case study.