

# CHAPTER 1

## The Nature of Strategic Management

### SUGGESTIONS FOR EFFECTIVE TEACHING

We usually start the first class by asking the questions presented at the end of the Introductory Incident: “What will the future look like for health care in these two cities?” “What new strategies are required to enable these hospitals to compete successfully in the ever-changing health care environment?” The Introductory Incident points out that although the United States has the most advanced health care system in the world, it has many problems and is undergoing rapid change. The Incident highlights how hospitals in two cities (Boston and Nashville) have dealt with this “white water change” and “hypercompetition.” Further, the Incident illustrates the nature of strategy and how organizations respond to changing environmental conditions. In addition, discussing the network model (Boston) and the vertically integrated model (Nashville) will give students a sense of possible strategic options. This approach encourages students to begin thinking about developing rational, well-thought-out strategic responses to a changing environment.

After some discussion of the differences in the Boston and Nashville markets, we begin discussing “change” as the primary reason for the need for strategic management. The first section in the chapter discusses many changes that are currently taking place in health care. These changes are categorized into legislative/political, economic, social/demographic, technological, and competitive changes. We classified these changes to encourage students to begin to organize their thinking (using a systems approach). These are the same categories that will be introduced in Chapter 2.

To stimulate student thinking and participation in class discussion, we try the following exercise. We ask the class to suggest external issues that will require responses from health care organizations. Sometimes it is helpful to cite what happened beginning in the 1990s through today (developments in managed care, AIDS, imaging, outpatient surgery, and others) and then ask students to speculate on the changes likely to take place from today to the year 2005. This exercise helps students understand the magnitude of change facing all health care organizations. The following format may be used to generate discussion.

What changes have taken place? (1990 through Today)		Speculate on possible future changes. (Today through 2005)	
World	Health Care	World	Health Care

Another useful exercise that illustrates the amount and rate of change in the health care industry is to discuss with the students the changes cited in the first pages of Chapter 1 (bulleted list). After this discussion, ask the students to speculate on the changes they might have to face as health care administrators in their first few years of work.

It should be noted that not only is there more change taking place than ever before, the rate of change is increasing. This phenomenon has been called white water change. The only way to cope with white water change is to strategically manage the organization. In addition, it seems certain that there will be more change in the health care industry in the next ten years than in the past ten years. We try to have students speculate about the kinds of changes that will take place. Perspective 1-2 suggests the amount of change through the changing language of health. It's fun to ask students to add to the list.

At some point, we usually say, "If there is no change expected, you really don't need strategic management -- you need long-range planning." This is a good point to make sure students understand the difference (see page 43). At any rate, once we have the students convinced that there is considerable external environmental change, we call attention to the bulleted list on page 13. This list helps link the process of strategic management with change. We tell the students that the strategic management process is how organizations cope with change – it is the process by which we can lead organizations in dynamic environments. We leave the list up on the board and as points are made, refer back to the list for as reinforcement. Personally, we don't emphasize the definition on page 13, but rather the perspectives the bulleted list provides.

Next, we try to differentiate between strategic management (as a philosophy or way of managing), strategic planning (as the process of developing a plan) and strategy (the plan). Exhibit 1-2 is useful in highlighting the future orientation of strategic management.

After we have established a need for strategic management and what it is, we move to the foundations. We emphasize its military and business origins (mostly emphasizing the business part) and ask the students why health care organizations have adopted it as a management philosophy. This question quickly gets us back to change but most students get the point. In this discussion, we also differentiate strategic management from health policy. Mike Morrissey does a nice job of explaining health policy in Perspective 1-4. This discussion should conclude that strategic management concerns one organization coping with a changing environment while health policy concerns many organizations and the "rules" for provider and consumer behavior.

We introduce the systems perspective to encourage students to think about classes, categories, and relationships – to order or make their thinking more systematic. To us, strategy is a disciplined thought process – "strategic thinking." We usually put the bulleted list on page 23 on the board next to the strategic management bullets and ask students to talk about how they "work together." We like to conclude that these are the fundamental skills of leadership – systems thinking and strategic

thought processes. We emphasize that leaders must be strategic thinkers and may use systems concepts to better understand the relationship of the organization to its environment and the relationships within the organization. Successful leaders see these relationships and create a vision for new relationships in the future.

As a way of introducing the model of strategic management, we begin by discussing the “map and compass” -- our metaphor for the strategy process. In our view strategic management involves creating models or maps (processes) for thinking about strategy concepts but with the understanding that users will also have to think – reinvent the processes or use their compasses – when the maps no longer work or they lose their way. However, if strategic thinkers understand what they are trying to accomplish, through the compass (leadership) they will get back on track and be able to redesign their maps (current understanding of strategic management). This metaphor is useful in relating Mintzberg’s design versus learning schools as well as management versus leadership. We explain that analytical or rational approaches to strategic management rely on the development of a logical sequence of steps or processes (linear thinking). Emergent models rely on intuitive thinking, leadership, and learning (lateral thinking). The analytical model is similar to a map whereas the emergent model is similar to a compass. Both may be used to plot a course to a defined destination but in some cases they may indicate different directions. Maps are better in known worlds, compasses are more helpful when there is less certainty and only a general sense of direction is indicated

We discuss that a model is an organizing framework to conceptualize a complex process. Without some type of organizing framework, strategic management becomes an overwhelming task. A model shows relationships and the underlying logic of a phenomenon. Models are abstractions of reality (short-cuts to storing masses of data). Models draw upon “systems” thinking — they illustrate interrelationships. A model can clearly show the necessary steps in a process and become a means for communicating the steps.

At this point, we go to board and duplicate Exhibit 1-5 – What the organization *should* do, What the organization *can* do, and What the organization *wants* to do. Then we move to the analytical model of strategic management, Exhibit 1-4 – The Map. We emphasize that this map will start the students on their strategic management journey but that they must be willing to reinvent it (emergent learning – the compass). We also show how the model may be applied at various levels in the organization – corporate, business/division, organizational unit, and functional unit.

## LECTURE NOTES

Introductory Incident: A Tale of Two Cities. The Introductory Incident points out that although the United States has the most advanced health care system in the world, it has many problems and is undergoing rapid change. The Incident highlights how hospitals in two cities (Boston and Nashville) have dealt with this “white water change.” Further, the incident illustrates the nature of strategy and how organizations respond to changing environmental conditions.

The instructor may want to start the discussion of the chapter by asking the questions presented at the end of the incident: “What will the picture look like in the year 2005?” “Will a new health care delivery system be created in the United States?” “How can individual health care organizations chart their way through the changes occurring in the industry?” “How do organizations know where to compete and where not to compete?” “What strategies will help health care organizations cope with all the changes and position them to survive?” This approach encourages students to begin thinking about developing rational, well-thought-out responses to a changing environment.

I. Why Health Care Organizations Need Strategic Management.  
Learning Objective 1

- A. Many environmental changes are taking place. The instructor may ask the class to suggest external issues that will require responses from health care organizations. Sometimes it is helpful to cite what happened beginning in the 1980s through today (PPS, managed care, AIDS, Balanced Budget Act, and others) and then ask students to speculate on the changes likely to take place from today to the year 2005.

Another useful exercise that illustrates the amount and rate of change in the health care industry is to discuss with the students the changes cited in the first pages of Chapter 1 (bulleted list). After this discussion, ask the students to speculate on the changes they might have to face as health care administrators in their first few years of work.

It should be noted that not only is there more change taking place than ever before, the rate of change is increasing. This phenomenon has been called “white water change.” The only way to cope with white water change is to strategically manage the organization. (Perspective 1-1 cites eight forces in the health care environment and Perspective 1-2 suggests the amount of change through the changing language of health care.) In addition, it seems certain that there will be more change in the health care industry in the next ten years than in the past ten years.

- B. Health care organizations have increased substantially in size. Point out the latest consolidations, mergers, and acquisitions taking place in health care.
- C. The economy is more global – many new markets and competitors.
- D. Many industries overlap (hotels operating nursing homes, hospitals offering home health care, and so on).
- E. Competition has increased (from within as well as outside the traditional health care industry).

## II. Defining Strategy and Strategic Management.

### Learning Objective 2

- A. Strategic management is an externally oriented philosophy of managing an organization that links strategic thinking and analysis to organizational action. As an explicit philosophy of managing an organization, strategic management:
- Provides a framework for thinking about the “business,”
  - Creates a fit between the organization and its external environment,
  - Provides a process of coping with change and organizational renewal,
  - Fosters anticipation, innovation, and excellence,
  - Facilitates consistent decision making,
  - Creates organizational focus, and
  - Is the process of organizational leadership.
- B. Strategic management is a philosophy of managing that encourages leadership, is externally oriented, and provides a perspective or way of thinking (more than a technique). Strategic management attempts to achieve a fit between the organization’s external environment and its internal situation.

## III. What Strategic Management Is Not.

- A. Strategic management provides no guarantees for success.
- B. Strategic management is not merely a technique – it is a philosophy of management.
- C. Strategic management is not a process of completing paperwork nor a series of documents, but an attitude.
- D. Strategic management is not a process of simply extending into the future what the organization is doing today. An attempt is made to identify issues that will be important tomorrow in order to begin to deal with them today.

## IV. The Foundations of Strategic Management.

### Learning Objective 3

- A. Strategic management has its origins within the military.
- B. Business enterprises have successfully used strategic management for a number of years and must be credited with enhancing and promoting its concepts and methods.

- C. There has been an evolution of the concept of strategic management. Initially it had a distinctly planning flavor – extending today’s operations and budgets into the future. However, over time strategic management became a system to identify and understand environmental changes that enabled the organization to be successful in its environment.
  - D. In the past twenty-five to thirty years, strategic management concepts have been employed within health care organizations.
- V. Strategic Management Versus Health Planning Policy.  
Learning Objective 3
- A. Although health care planning existed prior to 1970, these planning efforts tended to be federal, state, or local health policy planning. (See Perspective 1-4 for an explanation of health policy and Exhibit 1-2 for the major health care cost and control events.) Strategic planning, however, is organization specific and designed to help an individual organization cope with the changing environment (such as federal, state, and local health care policy).
  - B. The difference between strategic planning and other forms of health planning are that strategic planning:
    1. Is directed toward defining the organization’s relationship to its environment,
    2. Takes the organization as the whole unit of analysis,
    3. Is a market-driven and market-based approach,
    4. Puts more emphasis on qualitative rather than quantitative analysis,
    5. Places the development of strategic plans under the direct control of the chief executive officer without delegation,
    6. Requires that the strategy be clearly stated and persuasively communicated throughout the institution,
    7. Creates final planning goals, objectives, and programs that must be vigorously implemented,
    8. Requires that middle management be carefully prepared to engage in strategic planning,
    9. Emphasizes data collection and analysis for the “nuts and bolts” of the health institution’s business,

10. Requires that strategic planning be integrated with other management functions, and
11. Places a strong focus on gaining and sustaining a competitive advantage.

In recent years the expansion of health care systems, fragmentation of markets, the growth of investor-owned hospital companies, and an emphasis on cost containment have induced individual health care organizations to adopt strategic management.

## VI. Systems Perspectives. Learning Objective 4

- A. Strategic management is a study of relationships between cooperating and competing systems. The use of the systems approach requires managers to define the organization in broad terms and attempt to identify the important variables and interrelationships that will affect a decision.
- B. Within organizations, we can visualize interacting technical subsystems, social subsystems, informational subsystems, structural subsystems, and so on. In addition, management itself can be viewed as being made up of various subsystems such as planning, staffing, organizing, directing, and controlling.
- C. Managers must be strategic thinkers. Managers may use systems concepts to better understand the relationship of the organization to its environment and the relationships within the organization. Successful managers see these relationships and create a vision for new relationships in the future. (Refer to Perspective 1-5 for another view of systems thinking – Mu-Shin.)

## VII. Strategic Management Models. Learning Objective 5

- A. Why we need a model of strategic management. A model is an organizing framework to conceptualize a complex process. Without some type of organizing framework, strategic management becomes an overwhelming task. A model shows relationships and the underlying logic of a phenomenon. Models are abstractions of reality (short-cuts to storing masses of data). Models draw upon “systems” thinking — they illustrate interrelationships. A model can clearly show the necessary steps in a process and become a means for communicating the steps.
- B. There are many ways to think about the strategic management process in organizations. (Refer to Exhibit 1-3 for Mintzberg’s ten schools of thought.)

- C. Analytical or rational approaches to strategic management rely on the development of a logical sequence of steps or processes (linear thinking). Emergent models rely on intuitive thinking, leadership, and learning (lateral thinking).
- D. It is not a question of which model is right or better, but when and under what circumstances they are useful to understand what managers do or should do.
- E. The methods are both complementary and contradictory – the analytical model is similar to a map whereas the emergent model is similar to a compass. Both may be used to plot a course to a defined destination but in some cases they may indicate different directions. Maps are better in known worlds, compasses are more helpful when there is less certainty and only a general sense of direction is indicated.

VIII. An Analytical Model of Strategic Management – The Map.  
Learning Objective 6 (Exhibit 1-4)

- A. Situational analysis (Refer to Exhibit 1-5.)
  - 1. External environmental analysis – What the organization *should* do.
  - 2. Internal environmental analysis – What the organization *can* do.
  - 3. Mission, vision, values, and objectives – What the organization *wants* to do.
- B. Strategy formulation.
- C. Strategic implementation.
- D. Strategic control.

IX. Emergent and Intuitive Strategic Management – The Compass.  
Learning Objective 7

- A. Sometimes it is difficult to envision the future in a dynamic environment. Different environmental characteristics require new and different ways of defining strategy. Managers must create and discover an unfolding future. In such an environment the destination as well as the route may turn out to be unexpected and unintended.
- B. Strategy emerges spontaneously from the chaos of challenge and contradiction, through a process of real-time learning and politics.

- C. A particular outcome for an organization may be intended (deliberate strategies), unrealized, or emergent. (Refer to Exhibit 1-6.)
- X. Lessons for Health Care Managers.
- A. Strategic management is complex and difficult.
  - B. No single approach may be adequate.
  - C. Some logical approach is needed as a starting point.
  - D. Models should not be applied blindly.
  - E. Strategic management is not always a structured, well-thought-out exercise. Sometimes we learn by doing.
- XI. Levels of Strategic Management. (Exhibit 1-7)  
Learning Objective 8
- A. Corporate level – answers the question, “What business(es) are we in?” It implies multiple markets/products/technologies. In addition, it questions, “What business(es) should we be in?”
  - B. Division level – “How (or on what basis) do we compete?” Competition in a single market (single product line, well defined market, one technology); SBU or SSU. NOTE: In the health care field, SSU or strategic service unit is used most frequently (as we have throughout this text). This is a good place to make sure the students understand the similarities and the subtle differences between SBUs (strategic business units) and SSUs (strategic service units).
  - C. Organizational unit level – strategies typically concern one organization competing within a specific well-defined service area such as a hospital or long-term care facility.
  - D. Functional level – delineates strategies within functional departments such as finance, marketing, clinical, administrative or support areas such as culture change, reorganization, upgrading facilities, and so on.
- XII. Responsibility for Strategic Decisions. (Perspective 1-6)  
Learning Objective 9
- A. Although the CEO has the ultimate responsibility, strategic management has become a line job with each manager responsible for the strategic implications of his or her decisions.
  - B. Over the past decade, many large formal planning staffs have been dissolved as organizations learned that strategy development cannot take place in relative isolation.

XIII. Benefits of Strategic Management for Health Care Organizations.  
Learning Objective 10

- A. Strategic management is a way of managing that provides an organizational self concept and vision for the future – a philosophy of management.
- B. Vertical and horizontal communication throughout the organization is enhanced.
- C. Strategic management encourages innovation and change. Responding to change is the key to success.
- D. It is probable that the strategically managed organization will experience increased revenues and reduced costs (greater profitability). Several studies are provided in the References listed at the end of the chapter.

NOTE: You may want to assign Appendix A: Analyzing Strategic Health Care Cases at this point and schedule a class meeting to discuss your philosophy of case analysis.

QUESTIONS FOR CLASS DISCUSSION

1. What types of changes are likely to occur in the health care environment in the next several years?
  - Increased government regulation aimed at reducing the costs of health care;
  - Legislative attempts to deal with the millions of uninsured and underinsured Americans needing medical care;
  - An aging population that will consume a greater portion of health care services and require more geriatric services;
  - Increased costs of high technology to provide quality care;
  - Rising number of AIDS patients requiring greater intensity of care;
  - A continued shift from inpatient services to outpatient/ambulatory care and alternative health care delivery systems;
  - The changing nature of managed care and preventive care; and
  - The plight of small, rural hospitals that are likely to fail.

The health care industry is dynamic. Managers must be able to anticipate change and position their organizations to take advantage of emerging opportunities and avoid

external threats. The next decade will bring many changes that must be identified and planned for in order for health care organizations to maintain quality of care, enter new markets, and continue operations. Strategic management is a creative process that fosters innovation and change within the organization to meet consumers' needs. As a philosophy, it provides a basic understanding of how and why an organization survives and grows.

2. What is the rationale for health care organizations' adoption of strategic management?

Health care leaders will have to cope with change and position their organizations to take advantage of emerging opportunities while avoiding external threats. Strategic management has become a major thrust guiding the management of all types of contemporary organizations. Business organizations embraced strategic management as a way to anticipate and cope with a variety of external forces beyond their control. The environmental uncertainties and competitive pressures that moved business organizations to adopt strategic management now beset health care organizations. Strategic management provides a basic understanding of how and why an organization survives and grows.

3. Explain white water change and hypercompetition. Why are these occurring? What affect will they have on the management of health care organizations?

Change has become so rapid, so complex, so turbulent, and so unpredictable that it is sometimes called chaos or white water change. Hypercompetition is a condition of rapidly escalating competitive activity based on price-quality positioning, competition to create new know-how and gain first-mover advantage, competition to protect or invade established product or geographic markets, as well as competition based on deep pockets and the creation of even deeper-pocketed alliances. In hypercompetition the frequency, boldness, and aggressiveness of dynamic movement by players accelerates to create a condition of constant disequilibrium and change. We truly are moving irrevocably beyond an awareness of "turbulent environments" to a recognition of our participation in a truly chaotic world. Health care managers will have to understand that in order for their organizations to survive, they will have to monitor environmental change and constantly renew their organizations. Strategic management can help health care managers sort out and cope with this new era of hypercompetition.

4. What is a strategy?

A strategy is a pattern in a stream of decisions that positions an organization within its environment and results in the "behavior" of an organization. Strategic planning is a set of processes to understand the situation an organization faces (internally and externally) and to develop decision making guidelines for it. A plan or strategy results from strategic planning. Strategic management, the broadest concept of the three, is an externally-oriented philosophy of managing that links strategic planning to operational decision making. It attempts to achieve a fit between the organization's external environment and its internal capabilities in order to position the organization for the future.

5. Trace the evolution of strategic management. Have the objectives of strategic management changed dramatically over its development?

The concept of strategy is derived from the military. In the 1940s several authors began to relate strategic management to business. Strategic planning developed in the 1960s and 1970s as leading companies began practicing and publicizing its merits. Early on, strategic management included planning and budgeting, with planning being the central theme.

In the past twenty to twenty-five years, strategic management concepts have been employed within health care organizations. Prior to 1970, individual organizations had few incentives to employ strategic management because most health care organizations were independent, freestanding, not-for-profit institutions, and health services reimbursement was on a cost-plus basis. (Exhibit 1-3 presents the evolution of health planning since 1900.)

In recent years the expansion of health care systems, the fragmentation of markets, the growth of investor-owned hospital companies, and the emphasis on cost containment have induced individual health care organizations to investigate strategic management.

Throughout its history, strategic management has retained its basic emphasis on planning but has been expanded to encompass implementation and control. More and more health care organizations have committed to the process as a means of managing increasingly large, complex, and diversified organizations in dynamic environments.

6. What are the characteristics of strategic management. How is strategic management different from traditional health policy planning?

As suggested in Exhibit 1-2, there has been substantial health planning in the United States, however, strategic planning is organization specific. Strategic planning helps an individual organization respond to state and federal policy and planning efforts, as well as to a variety of other external forces. The major differences between strategic planning and other forms of health planning are that strategic planning:

- Is directed toward defining the organization's relationship with its environment,
- Takes the organization as a whole as the unit of analysis,
- Is a market-driven and market-based approach,
- Puts more emphasis on qualitative rather than quantitative analysis,
- Places the development of strategic plans under the direct control of the chief executive officer without delegation,
- Requires that the strategy must be clearly stated and persuasively communicated throughout the institution,

- Creates final planning goals, objectives, and programs that must be vigorously implemented,
- Requires that middle management be carefully educated and prepared to engage in strategic planning,
- Emphasizes data collection and analysis for the “nuts and bolts” of the health institution’s business,
- Requires that strategic planning be integrated with other management functions, and
- Places a strong focus on gaining and sustaining a competitive advantage.

7. Why is a “systems approach” helpful to strategic managers?

A systems approach provides managers with a framework for understanding and integrating knowledge from several specialized areas. Systems thinking defines the organization in broad terms and identifies important variables and interrelationships that may affect decisions. In other words, systems thinking enables managers to understand the “big picture” and develop a broader perspective rather than devoting attention to minor components of the total system.

A systems approach allows managers to consider and integrate the many important external and internal variables that health care managers continually face. A large, complex problem may be broken down into more manageable components.

8. What is a strategic thinking? How is it different from leadership?

Strategic management is an attitude – a way of thinking. Strategic management requires a broad base of leadership throughout the organization and asks everyone to think as leaders. In a strategic context this process is called strategic thinking. Vision and a sense of the future are an inherent part of strategic management. Strategic thinkers are constantly inventing the future – creating windows on the world of tomorrow. Strategic thinkers draw upon the past, understand the present, and envision a better future.

Strategic thinkers are visionaries. They know what they want to become and what they want their organizations to be. Strategic thinkers look at assumptions, understand system interrelationships, create scenarios, and calculate the odds. Strategic thinkers forecast external technological and demographic changes, as well as critical changes in the political and regulatory arenas. Perspective 1-6 presents several habits of successful CEO strategic leaders.

Strategic thinking, therefore, is an important foundation of strategic management. However, leadership is not confined to just the CEO or the top of the organization. For strategic management to be successful everyone should be encouraged to be a leader. Everyone should be encouraged to think strategically.

9. What is meant by the statement, “Strategic managers should try to create the future?”

By using strategic management, the future is planned for and is thus created to some extent rather than simply allowing events to occur and reacting to them. By monitoring the external environment, the organization is less likely to be taken by surprise and better able to deal with and affect change as it occurs. When an organization plans for events, such as a health care organization lobbying for changes in reimbursement practices, it can often cause these events to happen, thus creating the future. Organizations that are busy reacting to daily problems lack the opportunity to create the future.

10. Why are conceptual models of management processes useful for practicing managers?

Conceptual models are useful because they are abstractions of reality that attempt to identify, simplify, and explain processes, patterns, and relationships inherent to a phenomenon. By eliminating much superfluous data, models enable managers to better understand complex processes and their interdependent variables as well as the underlying logic. Models facilitate learning and help achieve consistency in application.

11. What is a “strategic thinking map?” How are strategic thinking maps useful? What are their limitations?

Through a theoretical model, managers can gain an appreciation of the required inputs to strategic management, the processes involved, and the outputs of the process. A strategic thinking map is diagram of the theory. These maps depict strategy processes and are designed to start the process and to ignite strategic thinking. The strategic thinking maps will start us on the journey to developing a comprehensive strategy for the organization but the map cannot anticipate every contingency. Today’s templates will not be adequate for solving all of tomorrow’s problems. Therefore, we will have to think, analyze, use our intuition, and reinvent as we go. If strategy can be described in a disciplined way, then there will be an increased likelihood of its successful implementation. Strategy maps will help organizations view their strategies in a cohesive, integrated, and systematic way.

12. Compare and contrast the analytical model of strategic management with the emergent learning model. Which is most appropriate for health care managers?

Analytical or rational approaches to strategic management rely on the development of a logical sequence of steps or processes (linear thinking). Emergent models, on the other hand, rely on intuitive thinking, leadership, and learning. Both approaches are valid and useful in explaining the process of strategic management. Neither the analytical nor the emergent model, by itself, is enough. Both approaches are required. It is difficult to initiate and sustain organizational action without some logical plan. Yet in a dynamic environment, such as health care, we must expect to learn by doing and establish new directions as we progress.

13. Describe the “setting” for health care management. Is the setting too complex or changing too rapidly to accurately predict future conditions?

The “setting” for health care management is the external environment made up of the broader general environment and the more specific health care environment. The general environment includes all organizations and individuals outside of the health care industry (government, business, education, religion, and so on). The health care environment concerns information generated within the health care industry (primary providers, secondary providers, regulators, patients, and so on).

The setting is complex and rapidly changing which does lead to difficulty in accurately predicting future conditions. Therefore, when engaging in strategic management the organization must monitor the important trends and shifts in information in the general environment that relate to health care.

Focusing attention on the areas of technology, social, political, regulatory, economic, and competitive activities provides strategic managers with information to identify issues and analyze their impact. When referring to the general environment, the environmental analysis process is called macroenvironmental analysis; when referring to the health care environment it is called industry analysis or service category/area analysis. Through macroenvironmental analysis and service area analysis, the organization can best position itself within the external environment and implement a strategy that will help assure success.

14. In the analytical model, what are the major processes of strategic management? What types of subprocesses occur within each process? How are they linked together?

The organizational processes that managers use include situational analysis, strategy formulation, strategy implementation, and strategic control. These aid the organization in understanding the system of competitive behavior and the impact of a strategy. That is, they aid in developing the understanding, ability, and willingness to act in order to best position the organization within the external environment and implement a strategy that will help assure success.

Situational Analysis – the interaction and results of external analysis, internal analysis, and statement of vision, mission, values, and goals. It forms the basis for the development of strategy and drives the strategy.

1. External environmental analysis – analysis of opportunities and threats to determine what the organization *should* do.
2. Internal environmental analysis – represents the capabilities of the organization or what the organization *can* do. This analysis reveals strengths and weaknesses of the organization.
3. Vision, mission, values and goals – codification or declaration of the situation and determination of direction to state what the organization *wants* to do.

Vision – view of or hope for the future that management believes is optimum for the organization.

Mission – represents consensus and codification of the understanding of the external opportunities and threats, the internal strengths and weaknesses, and the organization’s purpose and vision. It is a statement that differentiates the organization from others of its type.

Values – the way we “do business” or the guiding principles of the organization.

Goals – specify the major direction of the organization and link the mission to organizational action. Unlike mission, objectives are clear, measurable, and quantitative.

Strategy Formulation — answers the questions: “What business we are in?” “What business should we be in?” “How are we going to compete?” Strategy formulation consists of two interrelated activities:

1. Development of vision, mission, values and goals (directional strategies) which set the broadest direction for the organization, and
2. Development of the adaptive, market entry, and positioning strategies, and the writing of the strategic plan.

Strategy Implementation – development of value adding service delivery and support strategies and unit action plans. Service delivery strategies include pre-service, point of service, and after-service strategies. Support areas include culture, structure, and strategic resources. Unit action plans are developed for each organizational unit and are made up of unit objectives, activities to achieve the objectives, timelines, and budgets.

Strategic Control – process to ensure the selected strategy is on target. Steps include:

1. Establish standards (objectives),
  2. Measure performance,
  3. Evaluate organizational performance against the standards, and
  4. Take corrective action, if necessary.
15. What is meant by “realized strategies”? How can strategies be realized if they were never intended?

Realized strategies can be either deliberate or emergent. Deliberate strategies are intentionally developed by management and subsequently realized by the organization. Emergent strategies were never intended nor expected by management but did occur over time because of forces in the external or internal environment, because no strategy was developed at the outset, or because the strategies were displaced along the way. Thus, a strategy can be realized (it occurs) but it was never intended.

16. What can go wrong with well-thought-out strategies that were developed using all the steps of the analytical model of strategic management?

Two major occurrences can lead to things going wrong despite a strategy that is well-thought-out and conceived:

1. There may be a reformulation of the strategy during implementation because the organization learns and feeds back information to formulation, thus modifying the strategy as it is implemented (strategic control).
2. The external environment may be volatile – in a period of great turbulence. Thus, strategists may be unable to accurately predict conditions and the organization may be subject to a powerful external momentum.

17. At what organizational level(s) may a strategy be developed? If more than one level, how are the levels linked by the planning process?

Strategy may be developed at any level of the organization, however, the strategies will have a different scope as well as purpose at different organizational levels. Strategic management creates a hierarchy of strategies that are linked. The implementation of strategy at one level is linked to the formulation of strategy at another level. To illustrate, functional level strategies should help to achieve organizational strategies, organizational strategies are the means to achieving divisional level strategies, and divisional level strategies are the means to achieving corporate level strategies.

Corporate level – the broadest level of strategic management. It defines the general markets or “businesses” in which the organization operates.

Divisional level -- semi-autonomous organizational units (SBUs or SSUs) that operate within the various markets. This level deals with how an organization should compete in a given market as well as allocation of resources to achieve a competitive advantage in that market.

Organizational unit level – strategies typically concern one organization competing within a specific well-defined service area such as a hospital or long-term care facility

Functional level – strategies are developed within functional departments -- marketing, finance, clinical, human resources, and administrative, or support areas – culture, organization structure, facilities and equipment to support higher level strategies.

18. How has the role of the strategic planner changed over the past several decades? What new skills will be essential for the strategic planner in the next millennium?

In the past, formulation of the strategy was primarily a staff activity. The planning staff would formulate the strategy and submit it for approval to top management. Over the past decade, many large formal planning staffs have been dissolved as organizations learned that strategy development cannot take place in relative isolation. Today, the coordination and facilitation of strategic planning typically is designated as the responsibility of a key manager (often the CEO) and development of strategy has become a line job with each manager responsible for the strategic implications of his or her decisions. The rationale underlying this approach is that no one is more in touch with the external environment (regulations, technology, competition, social change, and so on) than the line manager who must deal with it every day. However, someone must coordinate the organization's overall strategy and facilitate strategic thinking throughout the organization. Perspective 1-6 illustrates the changing role of the strategic planner over the past three decades.

19. Explain and illustrate the possible benefits of strategic management. What types of health care institutions may benefit most from strategic management?

Strategic management is a philosophy and benefits are not always quantifiable. One benefit that can be quantified is improvement in long-term financial performance (increased ROI or ROA, reduced days in accounts receivable, high occupancy, and so on). Strategic management helps tie the organization together with a shared value system and provides managers with specific goals and sound direction in decision-making. Another benefit is an increase in communication throughout the organization, as well as better overall coordination. Further, innovation and change are encouraged, thus lessening the resistance to change.

All types of health-care institutions may benefit from strategic management, but those that are large in size, offer many diverse services through interrelated functions, have low profitability, face low market growth in a highly competitive environment, or encounter frequent technological and regulatory change will benefit most.

20. Select a health care organization you are familiar with and discuss the demands of strategic management for the organization.

University of Alabama at Birmingham (UAB)  
University Hospital

UAB has a dynamic environment because of its location, as well as rapid changes in technology, research, and teaching facilities. Therefore, it requires deliberate strategies to formally focus and position itself within the environment. In addition, within the dynamics of the health industry, UAB has emergent strategies and strategies that are not realized. In order for the organization to function in its environment and to survive, UAB should have a formal strategic management process that assesses the situation, formulates strategies, implements appropriate strategies, and controls the strategies.

Examples of general environmental issues of concern include:

<u>Environment</u>	<u>Issue</u>
Government	Changes in Medicare/Medicaid coverage, taxes, and reimbursement fees
Business	Reducing the amount of health care coverage in employee benefits, improving technology
Religion	Abortion, euthanasia
Research	Experiments on embryos and animals, women's health issues

Examples of industry environmental issues include:

<u>Industry Segment</u>	<u>Issue</u>
Planning/regulatory	Changes in CONs
Primary providers	Competition in various services
Secondary providers	New medications
Representatives	JCAHO regulations, AISH regulations
Individual/patients	Employee morale, patients' attitudes

## CHAPTER 2

### Understanding and Analyzing the External Environment

#### SUGGESTIONS FOR EFFECTIVE TEACHING

For Chapters 2 and 3, we usually assign a group project that incorporates the information presented in both chapters. We ask students to select a service category and a service area and conduct a complete external environment (Chapter 2) and service area competitor analysis (Chapter 3). The service area and competitor analysis portion of the project is discussed in the “Suggestions for Effective teaching” for Chapter 3.

The project tends to have two phases – one is to identify the macro issues (general/societal and industry) and the second phase deals with service areas and competitor issues. Chapter 2, of course, concerns the general/societal and industry issues. For this portion of the project, students should identify the general issues (economic, political/ regulatory, social, technological, and competitive) that affect all industries and organizations. This represents the general context for “doing business.”

As pointed out in the text, these can be very important issues that have long-term impact on the development of industries. Industry issues tend to have high, more immediate impact. These more specific “rules for doing business” will affect a number of service categories. This project helps students recognize that there are “layers” of issues that they should consider in order to be effective strategic thinkers. For the project students should be asked to use one of the organization techniques presented in the text. Students typically use Trend/Issue Identification and Evaluation (Exhibit 2-6 and 2-7), however, stakeholder analysis, scenarios, focus groups and so on should be encouraged.

Typically, we ask student groups to present their environmental analysis sometime around mid-term.

#### LECTURE NOTES

Introductory Incident: E-Health Transforms Health Care Delivery. E-health is any electronic exchange of health care data or information across organizations. It has occurred in three areas – business, clinical, and consumer with the business areas of administration and finance become most developed. E-health will change the availability of information and its ease of access and thus many aspects of the practice of medicine. The Internet provides two particular potential advantages for the health care organization that invests in and uses the technology – standardization of communication and automated eligibility, claims, and referrals. However, there are some barriers to implementation. They include the amount of time, expertise, and money required. Security will also be an issue. The key to disease management may be incorporating a number of technologies working together. E-health and the use of the Internet is an issue all health care organizations will have to consider in their strategic planning.

- I. Importance of Environmental Influences.  
Learning Objective 1
  - A. Significant changes are taking place in the health care environment. (Refer to the Introductory Incident for an excellent example.)
  - B. Effectiveness – doing the right things. Although the “right” thing is a judgment, monitoring the external environment and thinking about the critical factors for success will help managers evolve their organizations to meet the demands of the environment. For example, in the 1990s, building health care networks designed to create a continuum of care seemed to be the “right” thing to do. By 2002, many health care organizations were rethinking these decisions and began engaging in “disintegration.”
  - C. Efficiency – doing things right. Because of an emphasis on cost containment, there is increasing pressure for increased efficiency. (Refer to Perspective 2-1.)
  
- II. The Need for Environmental Analysis.  
Learning Objective 1
  - A. Eliminate surprises in the external environment.
  - B. Position the organization within its environment.
  - C. Identify current strategic issues.
  - D. Detect weak signals of change in order to prepare for the future.
  
- III. The Goals of Environmental Analysis.  
Learning Objective 2
  - A. To classify information.
  - B. To identify and analyze current issues.
  - C. To detect weak signals of emerging issues.
  - D. To speculate on likely future issues.
  - E. To provide organized information.
  - F. To foster strategic thinking.
  
- IV. Limitations of Environmental Analysis.  
Learning Objective 3
  - A. Cannot foretell the future.

- B. Cannot enable managers to see everything.
  - C. Cannot always obtain pertinent and timely information.
  - D. Cannot eliminate the gap between external events as they occur and the interpretation of the meaning and importance of those events.
  - E. Cannot ensure prompt response to take advantage of opportunities.
  - F. Cannot change strongly held top management beliefs that inhibit strategic responses.
- V. Description of the External Environment.  
Learning Objective 4 (Exhibit 2-1)
- A. General environment.
    - 1. Government institutions (legislature, courts, police).
    - 2. Business institutions (Kellogg, IBM, McDonald's).
    - 3. Educational institutions (Johns Hopkins, UAB, public schools).
    - 4. Religious institutions (Baptist, Catholic, Jewish).
    - 5. Research organizations and foundations (American Cancer Society, CDC, American Institutes of Health).
    - 6. Individuals and consumers (Grandma, Uncle Joe, neighbor, friend, you!). (Refer to Perspective 2-3 for views on our aging society.)
  - B. Health care environment. (Refer to Exhibit 2-2.)
    - 1. Organizations that plan and regulate primary and secondary providers.
      - a) Federal (DHHS, CMS).
      - b) State (CON, Public Health Departments). (Refer to Perspective 2-4 for the pros and cons of CONs.)
      - c) Accrediting (JCAHO).
    - 2. Organizations that provide health services (primary providers) e.g. hospitals, HMOs, physician offices. (Refer to Perspective 2-5 for the growth in health purchasing groups.)

3. Organizations that provide resources for the health care system (secondary providers) e.g. laboratories, insurance companies, pharmaceutical and medical supply companies.
4. Organizations that represent primary and secondary providers, e.g. AMA, AHA.
5. Individuals involved in health care and patients, e.g. physicians, nurses, people needing treatment for injury or disease, or preventive care, consumer groups such as AARP.

VI. Process of Environmental Analysis.  
Learning Objective 5 (Exhibit 2-3)

- A. Scanning to identify signals of environmental change. (See Exhibit 2-4.)
  1. Sources of information for planners outside the organization. Learning Objective 6 (Refer to Exhibit 2-5.)
    - a) Personal (university expert).
    - b) Impersonal (library).
  2. Inside the organization.
    - a) Personal (inside technical experts).
    - b) Impersonal (company surveys and studies).
- B. Monitoring identified issues (tracking trends, developments, dilemmas, and possible events).
- C. Forecasting future direction of issues.
- D. Assessing organizational implications of issues.

VII. Environmental Analysis Tools.  
Learning Objectives 7 and 8

- A. Simple trend identification and extrapolation (plot incidence of disease, teen pregnancy, and so on).
  1. Use trend/issue identification charts. (See Exhibit 2-6.)
  2. Use issue plotting. (Refer to Exhibit 2-7.)
- B. Solicitation of expert opinion.

1. Delphi technique (a panel of experts to evaluate and predict health care industry consolidation trends and impact).
  2. Nominal group technique, brainstorming, and focus groups. (Perspective 2-7).
  3. Dialectic inquiry (competing management teams presenting positive and negative arguments on the probable impact of proposed legislation).
- C. Stakeholder analysis. (Refer to Exhibit 2-8.)
- D. Scenario writing and future studies. (Refer to Exhibit 2-9.)

Exhibit 2-10 provides a summary of the primary focus, advantages, and disadvantages of the various environmental analysis techniques.

#### QUESTIONS FOR CLASS DISCUSSION

1. Why is environmental analysis important for an organization?

Increasingly, the external environment has become a factor in the success of health care organizations. In order for health care providers to be effective (doing the right thing), they must have an understanding of the external environment in which they operate and anticipate as well as respond to significant shifts. The organization must respond to the threats and be prepared to take advantage of the opportunities.

Environmental analysis includes the process of understanding the relevant issues in the external environment and assessing their implications for the organization. The results of the external environmental analysis directly influence the organization's development of mission, vision, values, and goals, as well as the internal analysis, all of which influence the external environmental analysis. An organization must be well positioned in its external environment to accomplish its mission.

Environmental analysis seeks to eliminate many of the surprises in the external environment and seeks to enhance the planning efforts of the organization. Organizations should engage in environmental analysis if they are involved in making capital allocations, confronted with unexpected environmental changes and surprises from different kinds of external forces, faced with increasing competition, interested in becoming more market oriented, and dissatisfied with present planning results.

2. Most health care managers would answer "yes" to many of A. H. Mesch's questions to determine if an organization needs environmental analysis. Are there other questions that seem to indicate that health care organizations should be performing environmental analysis?

Although Mesch's questions are probably enough to suggest that most health care organizations should be practicing strategic management, asking for further

questions requires students to think about the unique aspects of health care and how the industry is changing.

Several questions might be:

1. Is the service area changing?
  2. Is there greater government intervention or control being considered or implemented?
  3. Is the structure of the industry changing?
  4. Are organizations from other industries entering the industry?
  5. Are new organizational forms emerging?
  6. Are many new product and service delivery methods being introduced?
3. What are the specific goals of environmental analysis?

The overall goal of environmental analysis is to position the organization within its environment. Specific goals include:

1. Classifying and ordering information flows generated by outside organizations.
  2. Identifying and analyzing current important issues that will impact the organization.
  3. Detecting and analyzing the weak signals of emerging issues that will impact the organization.
  4. Speculating on the likely future issues that will have significant impact on the organization.
  5. Providing organized information for the development of the organization's mission, vision, values, goals, internal analysis, and strategy.
  6. Encouraging strategic thinking throughout the organization to foster adaptability.
4. What are the limitations of environmental analysis? Given these limitations, is environmental analysis worth the effort required? Why?

Environmental analysis is a process for understanding the external environment, however, it provides no guarantees for success.

Limitations of environmental analysis:

- No one can foretell the future.
- Environmental managers cannot envision everything.
- Pertinent and timely information is sometimes difficult or impossible to obtain.

- There may be delays between the occurrence of external events and management's ability to interpret them.
- Sometimes there is a general inability of the organization to respond quickly enough to take advantage of the issue detected.
- Managers' strongly held beliefs sometimes inhibit them from detecting issues or interpreting them rationally.

Despite these limitations, environmental analysis is worth the effort because the benefits outweigh the limitations. In order to survive, the organization must be able to adapt and respond to change and be aware (to the best of its ability) of the environment in which it exists.

Environmental analysis permits the detection of the majority of issues that will affect the organization. It is used to read signals that indicate what requirements will have to be met in the near future in order to survive or at least improve chances for success. Managers never have access to perfect information; however, environmental analysis should provide them with a base of information to identify, analyze, anticipate, and plan for changes in the environment that will impact their organization. If managers are astute, environmental analysis will provide signals for the most significant events. It is management's responsibility to monitor and "read" the signals.

5. Why is it important to be able to identify influential organizations in the external environment? How may these organizations be categorized?

Influential organizations in the external environment create the change that health care managers must monitor. The information that these influential organizations create can be classified as technological, political, social, regulatory, economic, or competitive issues. The organization must understand the new information and be in a position to respond. That is, the organization must have a window on the health care environment and the general environment to be able to identify and monitor the information created.

Organizations within both the general environment and the health care environment create information flows through their normal operations that may impact a variety of other organizations, the entire health care industry, or a specific health care organization. Identifying these organizations permits the careful monitoring of their activities.

Categories of organizations in the external environment:

General Environment

- Government institutions
- Business organizations
- Educational institutions
- Religious institutions
- Research organizations, foundations
- Individuals/consumers

Health Care Environment

- Planning/regulatory organizations
- Primary providers
- Secondary providers
- Provider representatives
- Individuals/patients

For many health care organizations, much of the environmental analysis may be confined to an immediate service area.

6. What four processes are involved in environmental analysis? What are their subprocesses?

The four processes in environmental analysis are scanning, monitoring, forecasting, and assessing.

Scanning – the process which seeks to identify signals of environmental change. It involves the surveillance of the relevant environments in order to detect early signs of emerging change and to identify change already under way. In addition, it includes viewing and organizing internal information in order to direct attention to the relevant issues that will affect the organization.

Subprocesses:

- View external environmental information.
- Organize information into desired categories.
- Identify issues within each category.

Monitoring – the process of searching for additional information to confirm or disprove the trend, development, or dilemma and the likelihood of the occurrence of an event. It involves tracking the environmental issues identified in the scanning process.

Subprocesses:

- Specify the sources of data – organizations, individuals, or publications.
- Add to the environmental database.
- Confirm or disprove issues (trends, developments, dilemmas, and the possibility of events).
- Determine the rate of change within issues. This has a narrower focus than scanning; the objective is to accumulate data concerning the identified issue.

Forecasting – the process concerned with developing plausible projections of the direction, scope, speed, and intensity of environmental change.

Subprocesses:

- Extend trends, developments, dilemmas, or occurrences of an event.
- Identify the interrelationships between issues and between environmental categories.
- Develop alternative projections.

Assessing – involves determining what the projected trend means for the organization in terms of its relationship with the external environment. This process is largely non-quantifiable and, therefore, judgmental (not an exact science). Usually a result of this activity is labeling the issues as opportunities or threats.

Subprocesses:

- Evaluate the significance of the extended (forecasted) issues upon the organization.
- Identify the forces that must be considered in formulation of the vision, mission, internal analysis, and strategic plan.

The information collected during environmental analysis influences the formulation of the vision, mission, internal analysis, and strategy of the organization.

7. How does the scanning process create a “window” to the external environment? How does the window concept help in understanding organizations and the types of information they produce?

The scanning function may be viewed as a process of moving a lens across the array of external organizations in search of current and emerging patterns of information. Using the window, the viewer can focus on organizations that are likely to produce relevant data rather than attempting to know everything about all occurrences (an impossible task anyway). Diverse and unorganized data generated by these external organizations and individuals can then be compiled and organized into meaningful categories.

The scanning process accumulates, categorizes, organizes, and evaluates the information that (prior to this process) was diverse, unorganized, sporadic, mixed, and unassessed. The scanning process acts as a window on the external world through which the organization can focus on technology, social, regulatory, political, economic, and competitive trends, dilemmas, and events important to the organization. This viewing process must sort diverse, unorganized data into organized, evaluated information. This process eliminates information that is not relevant to the mission of the organization.

8. Why is the process of environmental analysis as important as the product?

The process is as important as the product because the environment is continually changing and therefore the product must change as well. The process forces managers to “think strategically,” discuss issues, and to formally and informally develop solutions (strategies). The process itself does not change; however, it results in a changing product. In effect, the process provides a road map for dealing with the dynamics of the environment. The organization attempts to identify and analyze current, emerging, and likely future issues. Then, information is gathered for the issues identified.

9. What are some important technological, social, political, regulatory, economic, and competitive issues that are affecting health care today?

It may be helpful to stimulate students’ thinking to return to the bulleted list of the legislative/political, economic, social/demographic, technological, and competitive changes in chapter 1. Asking the question “What has changed since this list was developed?” or “Are these trends/issues still relevant?” should start the discussion. Students will typically discuss issues such as:

Technological – high cost of technology, DNA mapping, non-intrusive imaging, laser technology, continual change is required to keep current.

Social – demand for access to health care, demand for quality care, AIDS, the aging population, new focus on women’s health, death with dignity, abortion.

Political/Regulatory -- third-party payors’ increasing share of health care costs, physician payment reform, IRS regulations, COBRA, national budget deficit, the Balanced Budget Act and Medicare reimbursement cuts such as the phasing in of the resource based relative value system (RBRVS) as a mechanism to decrease Medicare part B payments to physicians, means to provide health care to the 44 million who are uninsured.

Economic – increased pressures to reduce health care costs, shortages of nurses and other non-professional personnel.

Competitive -- growth of managed care, continued health care industry restructuring, failures/closures continuing, entrance of the hotel industry into long term care.

10. Which of the environmental analysis tools and techniques are most useful?

The technique selected for environmental analysis will depend on such factors as the size of the organization, the diversity of the products and services, and the complexity and size of the markets (service areas). Organizations that are relatively small, do not have a great deal of diversity, and have well-defined service areas may opt for simple techniques that may be carried out “in-house,” such as trend identification and extension, in-house nominal group technique or brainstorming, or stakeholder analysis. Such organizations may include independent hospitals, HMOs, rural and community hospitals, large group practices, long-term-care facilities, hospices, and county public health departments.

Health care organizations that are large, have diverse products and services, and have ill-defined or extensive service areas may want to use techniques that draw upon the knowledge of a wide range of experts. As a result, these organizations are more likely to set up delphi panels and outside nominal and brainstorming groups. In addition, these organizations may have the resources to conduct dialectics concerning environmental issues, and engage in scenario writing. Such techniques are usually more time consuming, fairly expensive, and require extensive coordination. Organizations using these techniques may include national and regional for-profit health care chains, regional health systems, large federations and alliances, and state public health departments.

Ultimately, the technique selected for environmental analysis may depend primarily on the style and preferences of management. If used properly, any of the techniques can provide a powerful tool for identifying, monitoring, forecasting, and assessing environmental issues.

11. Using Exhibit 2-8 as an example, develop a “stakeholder map” for a health care organization in your metropolitan area or state. On this map show the important health care organizations and indicate what impact they may have on the industry.

The stakeholder map may be in the form of a diagram as shown in Exhibit 2-8. Some stakeholder maps show the relationship of the stakeholder to the organization with a plus sign (for positive relationship) or a minus sign (for a negative relationship). However, many organizations may be both positive and negative under different circumstances. For a discussion of hospital stakeholders and an example of a stakeholder map see Linda E. Swayne, Peter M. Ginter, and W. Jack Duncan, *The Physician Strategist: Setting a Strategic Direction for Your Practice*, Irwin Professional Publishing, 1996 and Myron D. Fottler, John D. Blair, Carlton J. Whitehead, Michael D. Laus, and G. T. Savage, “Assessing Key Stakeholders: Who Matters to Hospitals and Why?” *Hospital & Health Services Administration* 34, no. 4 (1989). As an alternative to a diagram, a simple table may be developed showing the stakeholder, general purpose or mission of the stakeholder, and the nature of the relationship of the stakeholder to the organization.

12. Go beyond your immediate data and speculate on the major forces that will affect the delivery of health care in the year 2010.

Some major forces that will affect the delivery of health care in the year 2010 will be new developing technology such as gene splicing to eliminate various diseases, use of the Internet, continuing investment in research to trigger the use of the body’s own immune system to fight disease, new drug developments, the real possibility of socialized medicine, and social concerns about the environment and its affect on health. (Remind the students of Perspective 1-1, Eight Special Forces. Perspective 6-5 provides some ideas concerning health care delivery organizations of the next decade.)

In addition, as the population ages, there is an increased need for more long term care facilities, retirement homes for those who do not yet need 24-hour skilled nursing care, and programs that will pay for long-term care. With the events of September 11, 2001, bioterrorism will continue to be a issue for health care and public health for years to come.

13. Which of the scenarios in Exhibit 2-9 do you think is most likely? Why? Based on today’s available information (trends, issues, dilemmas, and so on) develop your own scenario of health care in 2010.

The scenario that is most likely will depend upon the external issues most relevant at the time the assignment is made.

## CHAPTER 3

### Service Area Competitor Analysis

#### SUGGESTIONS FOR EFFECTIVE TEACHING

For Chapters 2 and 3, we usually assign a group project that incorporates the information presented in both chapters. We ask students to select a service category and a service area to conduct a complete external environmental analysis (Chapter 2) as well as a service area competitor analysis (Chapter 3). The external environmental analysis portion of the project was discussed in the “Suggestions for Effective Teaching” for Chapter 2.

Once the macro issues (general and health care) have been identified, students should complete a competitor analysis for a selected service category and service area. We generally provide the following outline as an initial guide:

1. Specify the Service Category.
2. Delineate the Service Area.
  - General
  - Economic
  - Demographic
  - Psychographic
  - Health Status
3. Perform a Service Area Structure Analysis.
  - Threat of New Entrants
  - Intensity of Rivalry
  - Threat of Substitutes
  - Power of Customers
  - Power of Suppliers
4. Do a Competitor Analysis.
  - Competitor Strengths and Weaknesses
  - Critical Success Factors
  - Strategic Groups
  - Mapping Competitors
  - Likely Responses of Competitors
5. Identify Service Category Critical Success Factors.
6. Identify and Map Strategic Groups.
7. Provide a Synthesis.

An extended example of a service area competitor analysis is provided at the end of this chapter for eye care services, Refractive Surgery (service category) in Charlotte, Mecklenburg County, North Carolina (service area). (See Perspective 3-8, Exhibits 3-8, 3-9, 3-10, and 3-11.) Students typically choose service categories such as home health, long-term care, rehabilitation, and so on. Service categories that are very competitive such as dentistry, plastic surgery, and ophthalmology are typically somewhat easier to do. The students often define a local service area that facilitates

gathering the necessary general, economic, demographic, psychographic, health status, and competitor information.

These analyses are presented in class and a paper submitted to the instructor. We suggest that the external environmental analysis and the service area competitor analysis presentations should last about 30 minutes.

## LECTURE NOTES

Introductory Incident: Competitive in Cleveland. The Cleveland market has evolved from mostly stand-alone hospitals to larger systems. Two dominant integrated systems have emerged – the Cleveland Clinic Foundation and the Case Western Reserve-related University Hospitals Health System. These systems were the result of a variety of strategic moves – market entry, market exit, and closures – by competitors. Because of Cleveland’s two-system situation, consumer groups, employer coalitions, and physician groups are concerned that fewer providers will lead to escalating costs. However, both systems continue to make strategic moves to create areas of excellence and gain market share. It appears that this service category (acute care), in this service area (Cleveland and surrounding counties), remains as competitive as ever.

- I. Why Do Competitor Analysis?  
Learning Objectives 1 and 2
  - A. With the increase in industry consolidation, emphasis on the “bottom line” in not-for-profit as well as for-profit organizations, niche marketing, and emphasis on competitive advantage, we felt that health administration students would increasingly need to develop competitor analysis skills. As a result, the chapter has more of a “business flavor” (creating competitive advantage). Some health care experts suggest that such a business approach subjugates quality of care issues to bottom line issues. Competitor analysis, however, is central to strategy as competitors’ actions often determine an organization’s success or failure. This is an interesting issue that may be posed to students. A lively debate usually follows.
  - B. External analysis provides the context by identifying the general and industry issues that may impact individual health care organizations.
  - C. Competitive analysis focuses on the specific competitive market and competitors within that market.
  - D. In the past competitor analysis may not have been necessary in analyzing health care markets. However, the industry has changed because of the following factors:
    1. Increases in managed care.
    2. Efforts to reduce cost.

3. Efforts to increase efficiency.
4. Increases in the number and size of for-profit health care organizations.
5. Changes in perspective concerning competition.
6. Over supply of hospital beds in some areas.
7. New organizations entering markets.
8. Decline of friendly competition. (Refer to Perspective 3-1.)
9. Separation of consumers of health services from payors.

## II. Specific Purpose of Competitor Analysis.

### Learning Objective 1

#### A. Organizations should engage in competition analysis:

1. To gain an understanding of competitors. (Refer to Perspective 3-2.)
2. Identify any vulnerabilities of competitors.
3. Assess the impact of its own strategic actions. (Refer to Perspective 3-3.)
4. Identify potential moves that competitors might make that could endanger the organization's position.

#### B. The process helps develop and identify competitive advantage.

#### C. Types of competitor information.

1. General.
2. Offensive.
3. Defensive.

## III. Impediments to Effective Competitor Analysis.

#### A. Misjudging industry and service area boundaries.

#### B. Poor identification of the competition.

#### C. Overemphasis on competitor's visible competence.

- D. Overemphasis on where, rather than how to compete.
  - E. Faulty assumptions about the competitors.
  - F. Paralysis by analysis.
- IV. A Process for Service Area Competitor Analysis. (Refer to Exhibit 3-1.)
- A. Defining the service categories.
    - 1. It is important to focus competitor analysis on specific service categories. The service category may be very broad such as acute inpatient care or very specific such as pediatric hematology-oncology.
    - 2. Each service category may have a different geographic and demographic service area.
  - B. Defining the service area. (Refer to Exhibit 3-2.)  
Learning Objective 3
    - 1. Geographic boundaries – vary by service category (emergency room boundaries are closer to the hospital than open heart surgery geographic boundaries).
    - 2. Service area profile – includes economic, demographic, and community health status indicators (different economic conditions may call for different competitive actions). (Refer to Exhibit 3-3.)
  - C. Service area structure analysis. Porter’s competitor analysis. (Refer to Exhibit 3-4 for a diagram of Porter’s competitor analysis and Exhibit 3-5 for an example using the analysis.)  
Learning Objective 4
  - D. Conducting competitor analysis and mapping strategic groups.  
Learning Objectives 5 and 6
    - 1. Competitor strengths, weaknesses, and strategies. (See Exhibit 3-6 for potential competitor strengths and weaknesses.)
    - 2. Critical success factor analysis.
    - 3. Strategic groups.
    - 4. Mapping competitors (See Exhibit 3-7 for a map example).
    - 5. Likely competitor actions or responses.

E. Synthesizing the analysis.  
Learning Objective 7

NOTE: Assign Appendix B: Oral Presentations for Health Care Professionals well in advance of the first case analysis or the oral presentation of the Service Area Competitor Analysis in order for students to prepare properly. We have found that expectations are raised and the quality of oral presentations is significantly better through the use of this Appendix.

QUESTIONS FOR CLASS DISCUSSION

1. What is competitor analysis? Why should health care organizations engage in competitor analysis? Should not-for-profit organizations perform competitor analysis?

Competitor analysis is the process by which an organization attempts to further define and understand its industry through identifying its competitors, determining the strengths and weaknesses of these rivals, and anticipating their strategic moves. It embodies both competitor intelligence to collect data on rivals and the analysis and interpretation of the data for strategic decision making. During the past decade, because of fundamental changes within the health care industry brought about by the influences of managed care, efforts to reduce costs and increase efficiency, and the increasing presence of for-profit health care organizations, every segment of the industry has become highly competitive. Not-for-profit organizations need competitor analysis because evidence of intense competition has manifested itself in a number of markets, where previously independent hospitals have combined along ownership lines to form competing systems.

2. What is the relationship between general environmental analysis and service area competitor analysis?

The process of environmental analysis is one of focusing on increasingly more specific issues. Once the general and industry trends and issues in the external environment have been identified and assessed, a more specific analysis is required. In the past, general environmental analysis was sufficient for most health care organizations. General and industry technological, social, political, regulatory, economic, and competitive issues provided enough information to make most strategic decisions. Service area competitor moves and countermoves were relatively insignificant. Today a more focused competitor analysis is required. Through this process of analyzing competitors, organizations must identify, create, and sustain a clear competitive advantage – some basis upon which they are willing to compete with anyone.

3. What competitor information categories are useful in competitor analysis? Are these categories appropriate for health care organizations? How can these information categories provide focus for information gathering and strategic decision making?

It is useful to classify competitor information as general, offensive, and defensive. This classification system will aid in strategy development in later stages (strategy formulation) of the strategic management process.

General competitor information is important for an organization to:

- Avoid surprises in the marketplace,
- Provide a forum for executives to discuss and evaluate their assumptions about the organization's capabilities, market position, and the competition,
- Develop awareness of significant and formidable competitors that require the organization to respond,
- Help the organization learn from rivals through benchmarking (specific measures comparing the organization with its competitors on a set of key variables),
- Build consensus among executives concerning the organization's goals and capabilities, thus increasing their commitment to the chosen strategy, and
- Foster strategic thinking throughout the organization.

Offensive competitor information is helpful to:

- Identify market niches and discontinuities,
- Select a viable strategy, and
- Contribute to the successful implementation of the strategy.

Defensive competitor information will aid in:

- Anticipating competitor's moves, and
- Shortening the time required to respond to a competitor's moves.

Depending on the intent of the competitor analysis, an organization might use all of these categories or just one or two. For example, in the early stages of competitor analysis, the organization may seek only general information. As an organization plans to enter new markets, offensive information may be the primary focus of the competitor analysis. In the face of strategic moves by a powerful competitor, defensive information may take precedence.

4. What are some impediments to effective competitor analysis? How may these impediments be overcome?

The six impediments to effective competitor analysis include:

- Misjudging industry and service area boundaries,
- Poor identification of the competition,
- Overemphasis on competitors' visible competence,
- Overemphasis on where, rather than how to compete,
- Faulty assumptions about the competition, or
- Paralysis by analysis.

To avoid a focus that is too narrow, the service category and service area must be defined in the broadest terms that are useful. In today's health care environment, competition may come from very non-traditional competitors (outside the health care industry). Typically, health care managers have focused their analysis on local served markets. However, a local or regional focus may lead to delays in recognizing changes in the service area boundaries. Clearly, misjudging how the service category or service area is defined will lead to poor competitor analysis.

Another possible flaw of competitor analysis is the improper or poor identification of just which organizations are the competitors. In many cases health care executives focus on a single established major competitor and ignore emerging or lesser known potential competitors. Less visible attributes and capabilities such as organizational structure, culture, human resources, service features, intellectual capital, management acumen, and strategy may cause misinterpretation of a competitor's strengths or strategic intent. In addition, effective competitor analysis requires predicting how competitors intend to position themselves. Although often difficult, determining competitors' strategic intent is at the heart of competitor analysis. An effective competitor analysis should focus on what rivals can do with their resources, capabilities, and competencies — an extension of what competitors are currently doing to include possible radical departures from existing strategies.

Accurate and timely information concerning competitors is an extremely important first step in competitor analysis. Misjudging or underestimating competitors' resources, capabilities, or competencies is a serious misstep. Faulty assumptions can suggest inappropriate strategies for an organization. Poor environmental scanning perpetuates faulty assumptions. Because of the quantity of data that can be collected concerning the external environment and competition, paralysis by analysis can occur. In environments undergoing profound change, volumes of data are generated and access to it becomes easier. Under such conditions, information overload is possible and separating the essential from the nonessential is often difficult. As a result, it should be emphasized that the intent of competitor analysis is to support strategic decision making and over-analysis or "endless" analysis should be avoided. Competitor information must be focused and contribute to strategy formulation.

5. Explain the steps or logic of competitor analysis.

As illustrated in Exhibit 3-1, the process of service area competitor analysis begins with understanding and specification of services or service categories that the organization provides to its customers. Next, the service area must be identified. Then the service area structure or competitive dynamics should be assessed. Competitors providing services in the same category in and around the service area must be analyzed. Each of the organizations can be positioned against the important dimensions of the market and assessed as to their likely strategic moves. Finally, the results of the analysis must be synthesized and implications drawn. These conclusions will provide important information for strategy formulation.

6. Why must the service categories be defined first in competitor analysis for health care organizations?

Many health care organizations have several service categories or products and each may have different geographic and demographic service areas. Identifying service categories is seldom an easy task and the level of specificity will vary with the intent of the analysis. For a multi-hospital chain deciding to enter a new market, the service category may be defined as acute hospital care but for a rehabilitation hospital, the service category might be defined as physical therapy or orthopedic surgery. In addition, because many health care services can be broken down into more specific sub services, the level of service category specificity should be agreed upon. For example pediatric care may be broken down into well-baby care, infectious diseases, developmental pediatrics, pediatric hematology-oncology, and so on.

7. Why is it important to clearly define the service area in competitor analysis?  
How does managed care penetration affect service area definition?

Health care organizations generally focus their environmental analyses on their service areas or community. The service area is considered to be the geographic area surrounding the health care provider. It is usually limited by fairly well-defined geographic borders. Beyond these borders services may be difficult to render due to distance, cost, time, and so on and are probably not competitive. Therefore, a health care organization must not only define its service area but also analyze in detail all relevant and important aspects of the service area.

Managed care interrupts the normal decision making by consumers. An employed individual today usually has some choice in health care insurance. The employer may offer one or more different “plans.” Once the consumer has selected a managed care plan, the availability of further choices becomes more restrictive. And, in fact, the more the HMO attempts to control health care costs (structures health care delivery more), the more restricted choice becomes for consumers.

8. How does the use of Porter’s analysis help identify the major competitive forces in the service area?

Porter suggested that the level of competitive intensity within the industry is the most critical factor in an organization’s environment. In Porter’s model, intensity is a function of the threat of new entrants to the market, the level of rivalry among existing organizations, the threat of substitute products and services, the bargaining power of buyers (customers), and the bargaining power of suppliers. The strength and impact of these five forces must be carefully monitored and assessed. Porter’s approach is a powerful tool for assessing the level of competitive intensity within the health care service area.

9. Why is an identification and evaluation of competitor strengths and weaknesses and the determination of strategy essential in competitor analysis?

Organizations have a unique resource endowment and a comparison with a given competitor will help to illuminate the relationship between them and to predict how they compete with (or respond to) each other in the market. Both quantitative and qualitative information may be used. Competitor information is not always easy to obtain and it is often necessary to draw conclusions from sketchy information. A list of possible

competitor strengths and weaknesses is presented in Exhibit 3-6. Such information may be obtained through local newspapers, trade journals, focus groups with customers and stakeholders, consultants who specialize in the industry, securities analysts, outside health care professionals, and so on.

10. What are the benefits of strategic group analysis and strategic mapping?

A strategic group is a number of organizations within the same industry making similar decisions in key areas. The grouping of organizations according to strategic similarities and differences among competitors can aid in understanding the nature of competition and facilitate strategic decision making.

Organizations within a group follow the same or similar strategy along the strategic dimensions. Group membership defines the essential characteristics of an organization's strategy. Within a service category or service area, there may be only one strategic group (if all the organizations followed the same strategy) or there may be many different groups. Usually, however, there are a small number of strategic groups which capture the essential strategic differences among organizations in the service area.

More specifically, the usefulness of strategic group analysis is that it:

- Can be used to preserve information characterizing individual competitors that may be lost in studies using averaged and aggregated data,
- Allows for the investigation of multiple competitors concurrently,
- Allows assessment of the effectiveness of competitors' strategies over a wider range of variation than a single organization's experience affords,
- Provides a means of summarizing information to bring key dimensions of strategy in high relief, and
- Captures the intuitive notion that "within group" rivalry and "between group" rivalry differ.

11. Why should a health care organization attempt to determine competitors' strategies and likely strategic responses?

Strategy formulation is future oriented requiring that management anticipate the next strategic moves of competitors. These moves may be projected through an evaluation of competitor strengths and weaknesses, membership in strategic groups, and the characterization of past strategies. In many cases competitor strategic objectives are not difficult to project given past behaviors. Strategic thinking is a matter of anticipating what is next in the stream of consistent decisions.

12. What is the purpose of the synthesis stage of service area competitor analysis?

In order to be useful for strategy formulation, general external environmental analysis (Chapter 2) and service area competitor analysis (as covered in this chapter) must be synthesized and then conclusions drawn relating what is known about the general environment with what is known about the local competition. For example, managed care in some states has become the norm for employed individuals. However, managed care is much less developed in other states. This affects the future in that

competitors may opt to contract for managed care delivery on an exclusive basis that in effect restricts choices of other health care providers and patients.

It is easy for strategic decision makers to be overwhelmed by information. To avoid paralysis by analysis, external environmental analysis should be summarized into key issues and trends (including their likely impact) as well as key competitors and their strategies.

13. Conduct a service area competitor analysis for a health care market with which you are familiar.

The last section of the text provides a comprehensive example of a service area competitor analysis beginning with service category definition and ending with a synthesis of the analyses – Eye Care Services, Refractive Surgery (service category) for Charlotte, Mecklenburg County, North Carolina (service area). (See Perspective 3-8, Exhibits 3-8, 3-9, 3-10, 3-11, and text material.)

## CHAPTER 4

### Internal Environmental Analysis And Competitive Advantage

NOTE: Users of previous editions will discover that major sections of this chapter have been changed to emphasize a way to identify an organization's competitive advantage. The process utilized in this edition is more detailed and designed to be more practical than in previous editions.

### SUGGESTIONS FOR EFFECTIVE TEACHING

We have found the most useful way to teach the material in this chapter is to actually develop an example of how the value chain can be used to determine the likely avenues to competitive advantage. To see an illustration we suggest you review the article W. Jack Duncan, Peter M. Ginter, and Linda E. Swayne. (1998). Competitive advantage and internal organizational assessment. *Academy of Management Executive* 12, no. 3, (1998), pp. 6-16. The EDGAR data base located on the Internet at [www.sec.gov](http://www.sec.gov) offers a number of health care examples that may be used.

### LECTURE NOTES

Introductory Incident: Health Stop 2025. This futuristic introductory incident can be used in many ways. Ask students to imagine walking through a local shopping mall and happening upon the Health Stop. The point is the importance of value creation – imagine a health facility that really creates value through service to customers!

Much of modern health care operates for the convenience of providers or insurance companies. Often the convenience of patients is not seriously considered; however, health stops kiosk operates for the convenience of the customer just as other retail stores in the mall. And, why shouldn't it? Could an entrepreneurial businessperson create a competitive advantage with a Health Stop type organization? This incident provides an excellent opportunity to discuss the factors that will lead to success in health care organizations of the future.

- I. Analyzing the Internal Environment. To this point, strategic management has been discussed almost exclusively in terms of the need to “fit” the health care organization to its external environment. This chapter focuses on the importance of the internal environment as it relates to developing sustainable competitive advantage. Strategic effectiveness requires flexibility and the ability to adapt to changing conditions. At times, the demands of long-term adaptability may conflict with the demands of short-term efficiency.  
Learning Objectives 1 and 2.
- II. Value Creation in Health Care Organizations. Organizations are successful only when they create value. In industries such as health care, the importance of value must be emphasized to satisfy customers. (Perspective 4-1 provides a good illustration of the need to balance price and cost in order to create value.)  
Learning Objective 3

- III. The value chain is integral to the search for competitive advantage. When strategic leaders are looking to develop strategically relevant strengths and weaknesses into competitive advantage, the investigation should be in areas where the opportunity to create value occurs. Encourage students to become familiar with the value chain and service delivery and support activities. (Exhibit 4-1.)
- A. The value chain is an excellent place to reinforce total systems thinking discussed in Chapter 1. Encourage students to think of the components of the value chain as subsystems. (Perspective 4-2 can be used as an effective supplement to the service delivery discussion.)
- B. It is important that students understand the service delivery activities as they relate to pre-service, point-of-service, and after-service. We like to encourage students to think of the health care organization as an input-transformation-output system and visualize patients flowing through a clinic and value being created all along the way. It is equally important that the value creating possibilities of support services – culture, structure, and resources be included (This is a good place to discuss Perspective 4-3.)  
Learning Objective 4
- C. Reviewing external opportunities and threats and relating them to internal strengths and weaknesses enables managers to understand the organization's strengths and weaknesses that may lead to competitive advantages.
- IV. The primary objective of the chapter is discovering competitive advantage and the starting point is understanding the process provided in Exhibit 4-3. (See Perspective 4-5.) Encourage students to locate strengths and weaknesses in the various components of the value chain and classify them as resources, competencies, and capabilities.  
Learning Objective 5
- A. Resources – stocks of human and nonhuman factors. (Perspective 4-4.)
- B. Competency – knowledge and skills that can be a source of competitive advantage.
- C. Capabilities – architectural competence and the organization's ability to deploy resources and competence.  
Learning Objective 6
- V. Identifying the competitive relevancy of each strength and weakness may be accomplished through the application of the four questions: Is it valuable in the marketplace? Is it rare among competitors? Is it easy to imitate? Is it sustainable?  
Learning Objective 7

- A. We suggest beginning with Exhibit 4-5 and introducing students to the various patterns of responses to the four questions.
  - B. Note that any strength or weaknesses that begins with a no answer to the value question may be disregarded because it will not have any competitive importance.
  - C. The competitively relevant strengths have a response patterns as follows: Value – high; Rare – yes; Ease of Imitation – Difficult; Sustainable – yes (HYDY). Strengths with this pattern have the possibility of developing long-term competitive advantage.  
Learning Objective 8
  - D. It is important to understand that strengths with other response patterns may be deserving of leaders' attention. Some strengths may not be sustainable but need to be utilized to their greatest advantage while the organization possesses them. Sometimes attention has to be given to strengths because they are easy to imitate and competitors will adopt them. Exhibit 4-6 is an example of different response patterns.
  - E. Competitively relevant weaknesses must be considered as well. If an organization is weak in an area that is important to patients, is the only organization that possesses the weakness, correcting the weakness is difficult, and competitors can sustain their advantage, the organization faces a genuine competitive disadvantage. (Use Exhibit 4-7 and Exhibit 4-8 in this discussion.)
  - F. Finally, the in-depth discussion of competitively relevant strengths and weaknesses is essential to narrow choices during strategy formulation. Exhibit 4-9 illustrates how the competitively relevant strengths and weaknesses can be used to suggest appropriate positioning strategies – uniqueness drivers (differentiation) or cost drivers (cost leadership). (Perspective 4-6 is a good “closer” for the chapter.)
- VI. The HealthGate example illustrates application of the methods outlined in the chapter. HealthGate is an interesting example to discuss because the organization has attempted to build a competitive advantage through the development of its own information sources and has formed alliances with a number of outstanding organizations in related businesses.

#### QUESTIONS FOR CLASS DISCUSSION

1. It has been said that the rules of success are written outside the organization but competitive advantage must be found within the organization. Explain this statement.

Much of the discussion in Chapters 1 through 3 has been devoted to the argument that the rules of success are written outside the organization. Insurance companies, patients, physicians, and other stakeholders define competitive rules. In addition,

economic and competitive conditions, demographics, cultural values, and so on influence the rules of success. A health care organization, however, must look within to find its unique competitive advantage. The resource-based view of strategy as well as the more contemporary knowledge-based view suggest that the resources, competencies, and capabilities of an organization will ultimately define its competitive advantage. The challenge is to identify and capitalize on what provides the greatest likelihood of achieving a true competitive advantage. This chapter is built around a process for uncovering competitive advantage.

2. Why is value creation an important concept to health care organizations? Is value creation more or less important in health care than in other industries?

Value creation is the underlying basis for successful competition in all industries. Although value creation is talked about more today, it has always been the key to success in competitive industries. The old saying “people will pay for value” is no less true in health care than in any other industry. Price, of course, is important; however, other factors affect a consumer’s perception of price. For example, when given a choice, people often select a more expensive health insurance plan because they are willing to pay more for choice of a physician, convenience of providers, and numerous other factors. Within health care organizations all employees are involved in value creation and leadership should assist them in determining numerous ways to create value for consumers.

3. Which activities, service delivery or support, are more important in the organizational value chain? Explain your answer.

Because service delivery activities are the most visible to patients, they must be given very high priority; however, value creation can take place at any point along the value chain. Many health care organizations do an excellent job of creating value with support activities such as efficient information systems, a patient friendly culture, modern facilities and equipment, and a streamlined organization structure. Ultimately, value creation is an attitude much like quality. When present, it can be seen in both the service delivery and support activities.

4. Why is the value chain consistent with total systems concepts discussed in Chapter 1? Why is a systems approach to internal environmental analysis important?

The value chain itself can be thought of as both a system (a value system) and as part of a larger system (the organizational system). This is consistent with total systems theory that assumes all systems are part of a larger system and composed of smaller systems. In this case the service delivery and support activities represent subsystems of the total value creation system. In turn, the service delivery subsystem is composed of subsystems such as pre-service, point-of-service, and after-service activities. Support activities are composed of subsystems such as culture, organization structure, and strategic resources. In this sense, the value chain is perfectly consistent with the systems concepts discussed in Chapter 1.

5. Why is the concept of competitively relevant strengths and weaknesses so important to internal environmental analysis?

Competitively relevant strengths and weaknesses are critically important to internal environmental analysis because they provide focus. Often, when assessing the internal environment of a health care organization it is tempting to develop such a long list of strengths and weaknesses that it is impossible to determine which ones are the most important in a competitive sense. By carefully evaluating each strength and weakness according to its value, rareness, ease of imitation, and sustainability the strategic leader can identify those strengths and weaknesses that are most likely to provide a competitive advantage or disadvantage.

6. What is the difference between objective and subjective strengths and weaknesses? Give examples of each type of strength and weaknesses in a health care organization.

Objective strengths and weaknesses are clear by quantitative or “hard” standards. A health care organization may have a location that cannot be matched or duplicated by any of its competitors. This is an objective strength. An organization that has financed growth through excessive debt possesses an objective weakness. Subjective strengths and weaknesses relate to perceptions. We may believe, for example, that our “quality” of health care delivery is better than anyone in our area but the objective, quantitative data relative to outcomes may not support our subjective claim. At the same time, our past history may cause physicians to be reluctant to apply for staff positions in our hospital. The past may be nothing but a perception in the physicians’ minds, but it is a subjective weakness.

7. Discuss the resource-based view for internal environmental analysis. Why is it important to understand organizational differences in order to use this approach?

Resources are the stocks of human and nonhuman factors that are available for use in producing goods and services. Resources may be tangible as in the case of land, labor, or capital or they may be intangible as in the case of intellectual property, reputation, and goodwill. Health care organizations with considerable resources are, at least temporarily, able to define the basis for competition.

The resource-based view argues that valuable, costly-to-copy resources provide the key to sustainable competitive advantage. The basic assumption of this view is that “resource bundles” used to create and distribute services by health care organizations are unevenly developed across firms explaining, to some extent, the ability of each to effectively compete. Organizations with marginal resources break-even, those with inferior resources disappear, and those with superior resources make profits.

The resources the health care organization possesses often account for organizational differences. These differences can be the result of location, funding, personnel, or numerous other factors. According to the resource-based view the

differences in organizational resources is the key to understanding competitive advantage and disadvantage.

8. Briefly explain the differences between tangible and intangible resources in health care organizations. Which type is more important? Why?

Tangible resources can be interpreted with one or more of the senses. Buildings are tangible resources as are medical equipment and parking lots. These resources are extremely important because they constitute genuine wealth to the health care organization. Many of a health care organization's most important resources, however, are intangible. Think of the value of the Mayo Clinic's reputation. Its reputation cannot be seen, touched, smelled, tasted, or heard but it is real. Sometimes intangible resources are the most important type possessed by a health care organization.

9. Briefly define what is meant by competitive advantage. Is competitive advantage an identical concept to sustained competitive advantage? Why or why not?

Competitive advantage may be thought of as an "edge" that one health care organization has over other health care organizations. When possessing a competitive advantage, an organization can use it to "win" more customers in the marketplace by providing more or better services than any of its competitors. A competitive advantage means literally that a particular health care organization is better at something than other competitors. Competitive advantage can be achieved by possessing unique and rare resources, competencies, or capabilities. In order to provide a competitive advantage, the resources, competencies, or capabilities must be difficult to imitate and be valued by customers in the relevant service area. However, merely possessing a competitive advantage does not ensure that an organization will achieve a sustained competitive advantage.

Competitive advantage and sustained competitive advantage are not identical concepts because a health care organization may have a competitive advantage in the short-run but not be able to maintain or sustain it. If a competitive advantage, for example, is easy to imitate a competitor that is losing in the market place will imitate the competitive advantage and eliminate the competitor's ability to sustain the competitive advantage.

Any one or all of the attributes that an organization possesses may change causing the sustainability of the competitive advantage to erode over time. Patient tastes may change and alter the value attached to the resources, competencies, or capabilities. Eventually, competitors may imitate or improve on the strategic assets and erode competitive advantage. A sustained competitive advantage requires constant monitoring, change, and innovation. A competitive advantage may be attained, but it is not guaranteed.

10. What are the differences between capabilities and competencies? How are capabilities related to both resources and competencies?

Competencies can accurately be thought of as skills possessed by individuals and in this sense, competencies are inherently human. Surgeons possess important skills, as do nurses and pharmacists. Capabilities are integrative abilities. Some of the most important capabilities possessed by many health care organizations are their strategic leaders and managers. Managers are able to plan, organize, and control and in the process coordinate individual and group behavior toward the accomplishment of organizational goals. Managers, therefore, represent some of the key capabilities of successful health care organization. Strategic leaders build coalitions and inspire performance and in the process focus actions toward the accomplishment of organizational goals. Leadership represents an important capability that is critical for the success of a health care organization.

11. Why are capabilities referred to as architectural competencies? How are capabilities related to both resources and competencies?

Capabilities are architectural competencies because the ability to bring together groups and individuals and focus their actions toward organizational goals is basically an organizational or architectural skill. Frequently, capabilities are directed toward the effective integration of resources and competencies. Unique individuals with unique skills (competencies) are brought together and provided resources (laboratories, databases, and so on) and collectively constitute very important organizational capabilities.

12. Briefly discuss the differences between distinctive and threshold competencies. Which type of competency is more important and why?

Competency is defined as “knowledge and skills” that may be a source of sustained competitive advantage. Some writers prefer to include competencies within the general category of intangible resources and, thus, make them inclusive of things such as technology, management information systems, and so on. Although there is no inherent problem with this classification, competency is knowledge and skill based and is, therefore, inherently human. The “purposeful coordination of resources and competencies” is yet another potential source of sustained competitive advantage.

In order to enter a particular market or offer specific services, the organization must possess, at a minimum, threshold competencies. These competencies are the minimally required knowledge and skills necessary to compete in a particular area. In order to offer cardiac services, an acute care hospital must have a minimum number of clinical personnel with specific knowledge and skill. Although all organizations offering cardiac services presumably possess threshold competencies and develop core competencies, only one or two will develop the knowledge and skills to the point where it becomes a distinctive competency. This type of competency is a highly developed strength that can be critical in developing a sustained competitive advantage.

Threshold competency is important because it is the minimum competency needed to enter a particular industry or market. Distinctive competency, however, is more important because it leads to competitive advantage.

13. When searching for competitive advantage, which characteristic of a strength or weakness (value, rareness, imitability, sustainability) is most important in a health care organization? Discuss your response.

Competitive relevant strengths and weaknesses possess value, are rare, are difficult to imitate, and can be sustained. In this sense all characteristics are important but not equally important. Value is by far the most important single characteristic of a strength or weaknesses. If the strength does not have value, the other characteristics are irrelevant in a competitive sense. In the same manner if a weakness is not valued in the marketplace the weaknesses will not lead to any competitive disadvantage.

14. Why are some strengths and weaknesses that are not competitively relevant deserving of attention by health care strategists? Provide one example of a strength and weaknesses that are not competitively relevant but are deserving of attention.

Begin by defining competitively relevant strength and weaknesses. A competitively relevant strength relates to something that is valued in the marketplace, is rare, hard to imitate, and can be sustained. A health care facility located at the epicenter of the fastest growing section of its service area has a competitively relevant strength. Convenience is valued and a central location is convenient. Real estate in the area is hard to obtain so a central location for a health care facility is rare. Land is limited so imitating the location is difficult and the organization has the ability to sustain the advantage by paying the rent. The location certainly represents a competitively relevant strength and may be the basis for a sustained competitive advantage. Assume that all the previously listed facts are true in another location except that land is available for purchase by other health care organizations. The strength represented by the location is now important but not competitively relevant in the truest sense because it is relatively easy to imitate. The health care strategist will pay attention to the strength and take advantage of the location while recognizing that it will not be the source of a sustained competitive advantage.

A competitively relevant weakness is one that is valued in the marketplace, is not possessed by most of our competitors, is difficult for us to fix, and our competitors can sustain their advantage. An example of this might be a reputation possessed by a public hospital. A good reputation is valued in the market place and the public hospital's competitors all have better reputations than the public health care facility. It is very hard to "fix" a bad reputation, and competitors can maintain their better reputation. This bad reputation has the potential for a genuine competitive disadvantage. Assuming that another hospital has worse facilities than competitors, the facilities can be improved over time and the weakness overcome. The worse facilities do not constitute a sustained competitive disadvantage if the leadership fixes the problem. Therefore, this weakness is not competitively relevant in the strict sense but does demand attention.

15. Why is resource leveraging an important concept in internal environmental analysis?

Resources are more effectively directed toward strategic goals when they are concentrated. Prioritizing goals and focusing on a relatively few things at one time aid in concentrating limited resources. Successful concentration of resources requires not only focusing on a relatively few things but also focusing on the right things – those activities that make the greatest impact on patients’ perceived value.

Resources can be combined to create synergy or “higher order value.” Linking activities provide unique opportunities to integrate functions such as operations, service, and technological development. That is, “creative interweaving of different types of skills” creates competitive advantage.

Increasing the resource multiplier by reducing the time between expenditure of resources and their recovery through revenue generation (expediting success) is an important means of resource leveraging. Reducing the payback period of technological improvements in health care organizations is a substantial resource recovery challenge. On one hand, high quality service delivery depends on state-of-the-art technology. On the other hand, this type of technology is expensive and usually has a relatively short economic life. Careful planning is required to ensure that payback is evaluated and accelerated in every possible way. Interestingly, a great deal of resource leveraging is a matter of attitude and a willingness to take reasonable risks, do things in new and innovative ways, learn from the experiences of others, and generally pursue excellence in all aspects of organizational performance. Thinking of resources as fixed stocks limits the aspiration of managers. Resources should be thought of in innovative and nonfinite terms to ensure that they can be used not just as ordinarily intended but in ways that take them beyond their customary uses.

As important as resources, competencies, and capabilities are an organization’s vision or strategic intent should never be limited by its present stock of resources, competencies, or capabilities. Often the strategic leader’s most important role is to create a gap or chasm between the aspirations of employees and the organization and the resources, competencies, and capabilities it has available to realize its aspirations. This introduces the dual concepts of stretch and resource leveraging. In concluding, competitive advantage ultimately requires three things on the part of health care strategists: an understanding of the external environment, an understanding of the internal environment, and an understanding of the organization’s aspirations and strategic intent or what the organization *should* do, what it *can* do, and what it *wants* to do.