

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: “In the age of rising costs and increasing quality demands, is it, then, the worst of times only for the hospital sector?” “Are hospitals the dinosaurs of today’s health care world?” 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 “whitewater 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 mentions 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 discussed 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 has happened beginning in the year 2000 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 2010. 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? (2000 through Today)		Speculate on possible future changes. (Today through 2010)	
World	Health Care	World	Health Care

It should be noted that not only is there more change taking place than ever before, but the rate of change is increasing. This phenomenon has been called “whitewater change.” The only way to cope with whitewater 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.

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. The difference is discussed under the heading “The Foundations of Strategic Management.” Once we have the students convinced that there is considerable external environmental change, we indicate that strategic management is how organizations cope with change – deal with dynamic environments.

After we have established a need for strategic management, we move to the foundations. We emphasize its military and business origins (primarily 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 1-3. This discussion should conclude that strategic management concerns one organization coping with a changing environment whereas health policy concerns many organizations and the “rules” for provider and consumer behavior.

As a way of introducing the model of strategic management, we begin by discussing the “map and compass” – our metaphor for planning and learning. In our view, strategic management involves creating models or maps for thinking about strategy concepts but with the understanding that users will also have to think – reinvent 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 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 school versus the learning school to our model of strategic management as it incorporates analytical approaches (strategic planning) as well as learning concepts (strategic thinking and managing the strategy). 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.

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.

Next, we introduce strategic management as the organizational mechanism to cope with change. This requires introducing strategic thinking, strategic planning (as the process of developing a plan), and managing the strategy (carrying out the plan). We introduce

Exhibit 1-3 as the vehicle to discuss and differentiate these concepts. It may be used as the model or map for the entire book and course.

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 making is a disciplined thought process – “strategic thinking.” 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.

LECTURE NOTES

Introductory Incident: The Tale of Two Cities Continues. 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 “whitewater change.” Further, the Incident illustrates the nature of strategy and how organizations respond to changing environmental conditions.

- I. Managing in a Dynamic Environment.
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 provide some historical perspective citing what happened in the 1980s through today (PPS, managed care, AIDS, Balanced Budget Act, HIPAA, and others) and then ask students to speculate on the changes likely to take place from today to the year 2010.
 - B. 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 “whitewater change.” The only way to cope with whitewater 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.
 - C. Major shifts in the health care industry include the changes in health care financing and industry restructuring. Health care organizations have increased substantially in size. Ask the students to point out the latest consolidations, mergers, and acquisitions taking place in health care in their state, nationally and internationally.
 - D. The economy is more global – many new markets and competitors.
 - E. Many industries overlap (hotels operating nursing homes, hospitals offering home health care, and so on).

- F. Competition has increased (from within as well as outside the traditional health care industry).
- G. It is the adoption of strategic management that has allowed organization to cope with industry change and shifts.

II. The Foundations of Strategic Management.

Learning Objective 2

- 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 long-range 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.
- E. Although health care planning existed prior to 1970, these planning efforts tended to be federal, state, or local health policy planning. (See Perspective 1-3 for an explanation of health policy and Exhibit 1-1 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).
- F. 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.

III. The Dimensions of Strategic Management.

Learning Objectives 3 and 4

- A. There are many ways to think about the strategic management process in organizations. (Refer to Exhibit 1-2 for Mintzberg's ten schools of thought.)
- B. 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).

- C. 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.
- D. 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.

IV. Combining the Analytical and Emergent Views into a Single Model.
Learning Objective 5 (Exhibit 1-3)

- A. Why do 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. Strategic management –As illustrated in Exhibit 1-3, strategic management has three elements – strategic thinking, strategic planning, and managing the strategic momentum. These activities are interdependent and activities in one element affect, and are affected by, the others. The model incorporates the analytical/planning approach and the emergent/learning views of strategic management.
- C. Generally, strategic management is an externally oriented philosophy of leading and managing an organization using strategic thinking and periodic strategic planning. Strategic thinking is a way of thinking or mindset underlying the strategic management philosophy. Strategic planning is the periodic process of creating strategy or a plan using strategic thinking. Managing the strategy concerns the active implementation of the strategic plan using strategic thinking. Strategic thinking occurs at an individual level, strategic planning is usually a periodic group activity, and managing the strategic momentum is a continuous organization-wide process of actively pursuing strategic goals. Strategic management is the term commonly used to describe all three activities.

V. Strategic Thinking.
Learning Objective 4

- A. Strategic thinking:

- requires a mindset – way of thinking,
- acknowledges the reality of change,
- questions current assumptions and activities,
- builds on an understanding of systems,
- envisions possible futures,
- generates new ideas,
- considers fitting the organization to the external environment, and
- requires thinking as leaders.

B. Why engage in strategic thinking? Strategic thinking is required because of the dramatic change that organizations face – whitewater change and hypercompetition.

C. Strategic thinking is everyone's job. Everyone should be encouraged to think strategically and consider how to reinvent what they do in light of the changing environment.

VI. Strategic Planning.
Learning Objective 4

A. Strategic planning:

- provides a sequential, step-by-step process for creating a strategy,
- involves periodic group strategic thinking (brainstorming) sessions,
- requires data/information, but concerns consensus and judgment,
- establishes organizational focus,
- facilitates consistent decision making,
- reaches consensus on what is required to fit the organization with the external environment, and
- results in a documented strategic plan.

B. 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.
4. Strategy formulation.
5. Planning the implementation.

C. Why engage in strategic planning? Strategic planning provides a structured process for reaching consensus and documenting strategic thinking. Having a periodic structured process initiates reconsideration, discussion, and documentation of all the assumptions.

- D. Strategic planning is a group process. Strategic planning requires that key strategic thinkers periodically come together to share ideas and develop a map for the organization.

VII. Strategic Momentum.

Learning Objectives 5 and 6

- A. Managing the strategy: Day-to-day activities to manage the strategy to achieve strategic goals.
- the actual work to accomplish specific objectives,
 - concerns decision-making processes and their consequences,
 - provides the style and culture,
 - fosters anticipation, innovation, and excellence,
 - evaluates strategy performance through control,
 - is a learning process, and
 - relies on and initiates strategic thinking and periodic strategic planning.
- B. Why engage in managing the strategic momentum? 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. 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.)
- D. An organization-wide activity. As with strategic thinking, everyone must strategically manage.

VIII. Benefits of Strategic Management for Health Care Organizations.

Learning Objective 7

- 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 Notes listed at the end of the chapter.

IX. 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.

X. Systems Perspectives.
Learning Objective 8

- 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.)

XI. Strategy Scope and Perspective – Levels of Strategic Management.
Learning Objective 9 (Exhibit 1-7)

- A. Corporate level – “What business(es) are we in?” It implies multiple markets/products/technologies. In addition, it questions, “What business(es) should we be in?”
- B. Divisional 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 level – strategies typically concern one organization competing within a specific well-defined service area such as a hospital or long-term care facility.
- D. Unit level – delineates strategies within departments such as finance, marketing, clinical, pharmacy administrative and so on.

XII. Responsibility for Strategic Decisions.
Learning Objective 10 (Perspective 1-7)

- 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. 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.

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. Explain why strategic management has become crucial in today's dynamic health care environment.

Strategic management has become crucial in today's dynamic health care environment because significant change comes from many sources. Health care leaders have to deal with complex and sometimes conflicting issues and trends. It is likely that there will be new

opportunities and threats to organizations that have yet to be identified or fully assessed. And, it seems certain that there will be more change in the health care industry in the next ten years than there has been in the past ten.

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. 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.

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 (managing the strategic momentum). 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.

4. How is strategic management different from traditional health policy?

As suggested in Exhibit 1- 1and Perspective 1-3, 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.

5. 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.

6. 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.

7. 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 a 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 develop 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.

8. What are the major activities of strategic management? How are they linked together?

A model or map that accounts for the analytical and emergent views of strategic management that illustrates and organizes the major components is presented in Exhibit 1-3. As illustrated in Exhibit 1-3, strategic management has three elements – strategic thinking, strategic planning, and strategic momentum. These activities are interdependent and activities in one element affect, and are affected by, the others. The model incorporates the analytical/planning approach and the emergent/learning views of strategic management. As suggested in Exhibit 1-3, strategic managers must become strategic thinkers able to evaluate the changing environment, analyze data, question assumptions, and develop new ideas. They must also be able to develop and document a plan of action through strategic planning. Strategic planning has three parts – situation

analysis, strategy formulation, and planning the implementation. Strategic planning is a decision-making and documentation process and creates the strategic plan. Once a strategic plan is developed, strategic managers must manage the strategic momentum. As strategic managers attempt to carry out the strategic plan they must evaluate its success, will learn more about what works, and must utilize new strategic thinking that may initiate new strategic planning. Strategic momentum may provide new insights for the implementation planning, strategy formulation, or the situation.

9. Differentiate among the terms strategic management, strategic thinking, strategic planning, and strategic momentum.

Generally, *strategic management* is an externally oriented philosophy of leading and managing an organization using strategic thinking and periodic strategic planning. *Strategic thinking* is a way of thinking or mindset underlying the strategic management philosophy. *Strategic planning* is the periodic process of creating strategy or a plan using strategic thinking. *Strategic momentum* concerns the active implementation of the strategic plan using strategic thinking. Strategic thinking occurs at an individual level, strategic planning is usually a periodic group activity, and strategic momentum is a continuous organization-wide process of actively pursuing strategic goals. Strategic management is the term commonly used to describe all three activities.

10. Who should be doing strategic thinking? Strategic planning? Managing the strategic momentum?

<i>Strategic Activity</i>	<i>Description</i>	<i>Scope</i>
Strategic Thinking	Fundamental strategic skill, a way of thinking, mindset underlying strategic management.	Individual
Strategic Planning	Periodic process of creating a plan (strategy) using strategic thinking.	Group
Strategic Management	The continuous philosophy of leading and managing an organization using strategic thinking and periodic strategic planning.	Organization

11. Explain whitewater change and hypercompetition. Why are these occurring? What effect 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 whitewater 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.

12. Is strategic thinking enough? Why do we engage in strategic planning? What are the elements of strategic planning?

The organizational processes that managers use include situational analysis, strategy formulation, and planning the strategy implementation. 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 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.

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

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

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.

Strategy Formulation – answers the questions: “What business are we 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 competitive strategies, and the writing of the strategic plan.

Planning the Implementation – development of specific activities to carry out value adding service delivery and support strategies. Service delivery strategies include pre-service, point of service, and after-service strategies. Support areas include culture, structure, and strategic resources. Action plans are developed for each organizational unit and are made up of objectives, activities to achieve the objectives, timelines, and budgets as well as controls to monitor and modify the objectives' based on accomplishments.

13. 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 or 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.

14. What can go wrong with well-thought-out strategies that were developed using all the steps in strategic planning?

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 subjecting the organization to powerful external forces.
15. 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.

16. 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.

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, unit-level strategies should help to achieve organizational-level 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 level – strategies typically concern one organization competing within a specific well-defined service area such as a hospital or long-term care facility.

Unit level – strategies are developed within departments – marketing, finance, clinical, pharmacy, 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 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 several decades.

19. What is meant by the statement, "Strategic leaders 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.

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. For the organization to function in its environment and to survive, UAB should have a formal strategic management process that includes strategic thinking, strategic planning –assesses the situation, formulates strategies, and plans for implements action, and manages strategic momentum.

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 health care industry environmental issues include:

<u>Industry Segment</u>	<u>Issue</u>
Planning/regulatory	Changes in CONs, interpretations of HIPPA, moratorium on specialty hospitals with MD ownership
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 General Environment and the Health Care 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 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 general/societal and health care industry issues and the second phase deals with service area competitor issues. Chapter 2, of course, concerns the general/societal and health care 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 environment 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 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: Tax Exempt Status for Hospitals Under Scrutiny. About 85 percent of the 5,000 hospitals in the United States are not-for-profit, but some of them are facing legal challenges to maintain their tax exempt status. In federal class-action lawsuits filed in June 2004, some hospitals have been accused of “breach of contract” based on the agreement that the not-for-profits have with the government to receive tax exempt status in return for treating uninsured patients. At issue is the practice by many hospitals to charge uninsured patients full price whereas insured patients have a negotiated price that is significantly lower. As the economy declines there are more uninsured patients and hospitals have been advised to increase collection of bad debts to maintain their viability. The lawsuits allege that the hospitals do not deserve tax exempt status because of their aggressive collection practices and their lack of charity care as they overcharge uninsured patients. Hearings on federal tax exemptions for not-for-profits are being planned by the chair of the House Ways and Means Committee.

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 improvements in efficiency.

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 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 2-5 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, , ACHME).
 - 2. Organizations that provide health services (primary providers) e.g. hospitals, HMOs, physician offices. (Refer to Perspective 2-3 on the effect of specialty hospitals.) Organizations that provide resources for the health care system (secondary providers) e.g. laboratories, insurance companies, pharmaceutical and medical supply companies.
 - 3. Organizations that represent primary and secondary providers, e.g. AMA, AHA.
 - 4. Individuals involved in health care and patients, e.g. physicians, nurses, people needing treatment for injury, 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 for identified 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 2-6).
 - 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. What types of changes are likely to occur in the health care environment in the next several years? Explain how any major shift in an industry creates a wide range of changes throughout the industry.

In the next several years, health care organizations will likely have to cope with some or all of the following legislative/political, economic, social/demographic, technological, and competitive changes:

Legislative/Political Changes

- More regulation of health plan activity including legislation to curb health plan abuse, disclosure rules, mandates for clinical protocols, and privacy of medical records.
- Incremental legislative reform rather than large-scale health or social programs.
- Legislative efforts to reduce escalating health care costs.
- Health care will continue as a political “hot potato” because of medical inflation, pressures to control the cost of Medicare, and so on.

Economic Changes

- Moderate but consistent increases in the cost of health care, accounting for perhaps as much as 20 percent of the gross domestic product (GDP).
- Employers unwilling to shoulder the entire burden of increasing costs for health care insurance and health care for their employees.
- Over 15 percent of Americans are without health insurance – a number that is predicted to be 48 million by 2009.
- Forced mobility of patients from one health care provider to another will escalate because of changes in the health plan selected by employers.
- Pressure to reduce the costs of administration of health care will increase.

Social/Demographic Changes

- An aging population and increased average life span will place capacity burdens on some health care organizations while a lessening of demand threatens the survival of others. By 2020, the US population over the age of 65 is expected to reach 53.7 million.
- The Hispanic population, many of whom do not speak English or speak it poorly, will continue to grow. Hispanics could become the largest minority child population as early as 2010. By 2050, one out of four Americans will be Hispanic.
- A more ethnically diverse and better-educated population will develop.
- An increase in income disparity is expected – a critical factor in determining health care delivery.
- “Tiered” access to health care is anticipated, with the division between the tiers becoming more extreme.
- There are predictions of critical shortages of nonphysician health care professionals and primary care physicians, yet a surplus of physicians within some specialties and in some geographic regions.

Technological Changes

- The high costs of purchasing new, sophisticated, largely computer-based technologies to meet the demand for high-quality health care will continue to rise.
- Significant advances in medical information technology are anticipated, such as automation of basic business processes, clinical information interfaces, data analysis, and telehealth.
- New technologies will emerge in the areas of drug design, imaging, minimally invasive surgery, genetic mapping and testing, gene therapy, vaccines, artificial blood, and xenotransplantation (transplantation of tissues and organs from animals into humans).

Competitive Changes

- Further consolidation will be seen within the health care industry because of cost pressures and intensified competition.
- The disintegration of some health care networks can be expected.
- Health care corporations will continue to expand into segments that have less regulation, and into businesses outside of the traditional health care industry.
- The importance of market niche strategies and services marketing will increase.
- Outpatient care and the development of innovative alternative health care delivery systems will continue to grow.
- The decreasing viability of many of the nation's small, rural, and public hospitals means there will be a reconfiguration of the rural health care delivery system.
- Increasing numbers of physician executives will have leadership roles in health care organizations.
- More emphasis will be on preventive care through wellness programs and healthy behavior.
- An increased emphasis will be placed on cost containment and measurement of outcomes of care (cost/benefit).
- A changing role for public health is expected, moving back to "core" activities (prevention, surveillance, disease control, assurance) and away from the delivery of primary care.
- A shortage of 800,000 nurses will occur by 2020.

2. Why is environmental analysis important for an organization?

Increasingly, the external environment has become a factor in the success of health care organizations. 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.

3. 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/service 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.

4. Most health care managers would answer “Yes” to many of A. H. Mesch’s questions to determine whether 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 sufficient 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:

- Is the service area changing?

- Is there greater government intervention or control being considered or implemented?
- Is the structure of the industry changing?
- Are organizations from other industries entering the industry?
- Are new organizational forms emerging?
- Are new product and service delivery methods being introduced?

5. 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:

- a. Classifying and ordering information flows generated by outside organizations.
 - b. Identifying and analyzing current important issues that will impact the organization.
 - c. Detecting and analyzing the weak signals of emerging issues that will impact the organization.
 - d. Speculating on the likely future issues that will have significant impact on the organization.
 - e. Providing organized information for the development of the organization's mission, vision, values, goals, internal analysis, and strategy.
 - f. Encouraging strategic thinking throughout the organization to foster adaptability.
6. 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 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.

7. 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.

8. 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 to detect early signs of emerging change and to identify change already under way. In addition, it includes viewing and organizing internal information 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 nonquantifiable 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 mission, vision, internal analysis, and strategic plan.

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

9. 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 data 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 data that is not relevant to the mission of the organization.

10. 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.

11. 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, Medicare Part C coverage for pharmaceuticals, 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 – change in managed care, continued health care industry restructuring, failures/closures continuing, entrance of the hotel industry into long term care.

12. Which of the environmental analysis strategic thinking frameworks are most useful? Why?

The approach 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 strategic thinking frameworks 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/services, and have ill-defined or extensive service areas may want to use strategic thinking frameworks that draw on 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 approaches are usually more time consuming, fairly expensive, and require extensive coordination. Organizations using these approaches may include national and regional for-profit health care chains, regional health systems, large federations and alliances, and state public health departments.

Ultimately, the strategic thinking framework selected for environmental analysis may depend primarily on the style and preferences of management. If used properly, any of the frameworks can be a powerful tool for identifying, monitoring, forecasting, and assessing issues in the general and health care environments.

13. 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 physician 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* (Chicago: Irwin Professional Publishing, 1996). For a hospital stakeholder map see 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.

14. 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 on the external issues most relevant at the time the assignment is made.

Some students may develop a scenario that incorporates a single payor system whereas other students may envision an "Oregon" plan throughout the United States or a system of individual health accounts (IHAs) provided by employers or government (for the medically indigent).

15. A strategic plan is based on a set of beliefs and assumptions that management holds in terms of the environment. What are some of those assumptions for a health care organization in your community?

The instructor can assign a specific organization and have students develop individual lists that are brought to class and discussed. Or, students may select different organizations and the lists they develop can be compared for similarities and differences.

16. What are an organization's strategic assumptions? How may the strategic assumptions be evaluated as part of managing the strategic momentum?

The strategic assumptions are the basic beliefs that management holds concerning the external opportunities and threats. These assumptions may be evaluated as the strategy is being managed (implemented). A series of strategic thinking questions designed to provide signals concerning the extent of change for external issues is presented in Exhibit 2-11. These questions might help to surface signals of new perspectives regarding the assumptions. Strategic thinking may indicate the emergence of new external factors that will affect the organization and suggest areas where additional information will be required in future planning efforts or changes to current plans. Strategic momentum requires strategic thinking about the assumptions and monitoring achievement of the set objectives to determine whether the organization should maintain its current strategies or change strategies to better accomplish its strategic goals.

17. 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.

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. After the events of September 11, 2001, bioterrorism will continue to be an issue for health care and public health for years to come.

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:

- I. Specify the Service Category.
- II. Delineate the Service Area.
 - General
 - Economic
 - Demographic
 - Psychographic
 - Health Status
- III. Perform a Service Area Structure Analysis.
 - Threat of New Entrants
 - Intensity of Rivalry
 - Threat of Substitutes
 - Power of Customers
 - Power of Suppliers
- IV. Do a Competitor Analysis.
 - Competitor Strengths and Weaknesses
 - Critical Success Factors
 - Strategic Groups
 - Map Competitors
 - Likely Responses of Competitors
- V. Identify Service Category Critical Success Factors.
- VI. Identify and Map Strategic Groups.
- VII. 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 3-7, Exhibits 3-8, 3-9, 3-10, and 3-11.) Students typically choose service categories such as a children’s hospital, a cardiac unit in a hospital, home health, long-term care, rehabilitation, and so on. Service categories that are very competitive because of the large number of competitors, such as dentistry and plastic surgery, are typically somewhat easier to do (in that all aspects of the service area competitor analysis could be completed). 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: Competition Revs Up in the Indianapolis Service Area. A heart-care building boom is occurring in many cities, although the volume for open heart surgery seems to be declining. In the Indianapolis service area, cardiac capacity increased 15–20 percent in the past three years due to MedCath, a for-profit corporation that builds and operates free-standing heart hospitals. MedCath partnered with cardiologists, cardiovascular surgeons, and other physicians to deliver patient-focused health care to those with cardiovascular disease. MedCath targeted states, such as Indiana, that did not have certificate of need (CON) laws. As a defensive ploy, Indianapolis service area hospitals forged their own partnerships with physicians to consolidate or expand heart surgery programs. Each of the four hospital systems built free-standing heart hospitals, and two of them were built as joint ventures with physicians. Health and medical care in the Indianapolis service area is very competitive leading observers to wonder whether each of the heart centers will perform sufficient numbers of surgeries to survive.

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.
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 to:
 1. Gain an understanding of competitors. (Refer to Perspective 3-3.)
 2. Identify any vulnerabilities of competitors.
 3. Assess the impact of the organization’s own strategic actions on others.
 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 3-2.)

- 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 3-1.)
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 Appendix B.

QUESTIONS FOR CLASS DISCUSSION

1. What is entailed in service area 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 and health care 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 on 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 service area 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 service area 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? 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 five forces framework 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. Students assess each of the forces but often neglect to synthesize their analysis to state whether the overall situation is a favorable or unfavorable one for a new competitor or for an established competitor to offer a new service.

9. Why is an identification and evaluation of competitor strengths and weaknesses and the determination of strategy essential in service area 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, web sites, 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 that 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?

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 service 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.) It serves as a template for students to develop their own service area competitor analysis for a service category of interest to them.

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. For an illustration see W. Jack Duncan, Peter M. Ginter, and Linda E. Swayne, "Competitive Advantage and Internal Organizational Assessment," *Academy of Management Executive* 12, no. 3 (1998), pp. 6–16. The EDGAR database located on the Internet at www.sec.gov offers a number of health care examples that may be used.

LECTURE NOTES

Introductory Incident: Adding Value at York Hospital. York Hospital is a not-for-profit, 79-bed hospital located on the southern coast of Maine. Beginning in 1995, York Hospital focused on providing outstanding patient care based on its organizational vision, "Caring, Listening, Satisfying...One by One." Patient care starts before the patient arrives at the hospital and extends to after they return home. The PATH program (patient approach to health) initially focused on maternity patients but was so successful in developing patient loyalty that it was expanded to all patients. Both physicians and employees have embraced the PATH program, believing it to be a better way to organize and deliver optimal value to patients from each inpatient experience. The hospital averages 90 percent of its patients rating it "exceptional" on satisfaction surveys.

- I. Analyzing the Internal Environment.
Learning Objective 1
 - A. 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.
 - B. 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.
- II. Value Creation in Health Care Organizations.
Learning Objective 2

- A. Organizations are successful only when they create value.
 - B. In industries such as health care, the importance of value must be emphasized to satisfy customers.
- III. Value Chain and Competitive Advantage.
- A. 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.)
 - B. The value chain concept is excellent for reinforcing 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.)
 - C. 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, for example, 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 3
 - D. 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. Competitive Advantage.
Learning Objective 4
- A. The primary objective of the chapter is discovering competitive advantage through resources, competencies, and capabilities. The starting point is understanding the process provided in Exhibit 4-3. (See also Perspective 4-5.)
 - 1. Resources – stocks of human and nonhuman factors.
 - 2. Competency – knowledge and skills that can be a source of competitive advantage.
 - 3. Capabilities – architectural competence and the organization's ability to deploy resources and competence.

- B. Encourage students to locate strengths and weaknesses in the various components of the value chain and classify them as resources, competencies, and capabilities.

IV. Competitively Relevant Strengths and Weaknesses.

- A. 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 5
- B. We suggest beginning with Exhibit 4-5 and introducing students to the various patterns of responses to the four questions.
- C. Note: 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.
- D. 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 6
- E. 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.
- F. 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 (HNDY). (Use Exhibit 4-7 and Exhibit 4-8 in this discussion.)
- G. 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.)

- V. The American Healthways, Inc., example illustrates application of the methods outlined in the chapter.

QUESTIONS FOR CLASS DISCUSSION

1. It has been said that the rules for 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 for 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 for 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 to be able to choose 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 subsystems. 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 an objective and subjective strength and weakness? Give examples of each type of strength and weakness 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 of competitive advantage. Why is it important to understand organizational differences 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 are the key to understanding competitive advantage and disadvantage.

8. Briefly define what is meant by competitive advantage. Are competitive advantage and sustained competitive advantage identical concepts? 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. 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. For example, if a competitive advantage is easy to imitate, a competitor that is less successful in the market place will imitate the more successful organization and remove its 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.

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

Competencies can accurately be thought of as knowledge and 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 whereby an organization musters resources, skills, and knowledge in unique ways, coordinates diverse operational skills, and integrates multiple streams of technologies to produce desired services. 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.

10. Why are capabilities referred to as architectural competencies? Would you consider management a capability or a competency? Explain your answer.

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.

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 organizations. 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. When searching for competitive advantage, which characteristic of a strength or weakness (value, rareness, imitability, sustainability) is the most important in health care organizations? 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 weakness. 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 weakness will not lead to any competitive disadvantage.

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

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 poor reputation, and competitors can maintain their better reputation. This poor 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.

13. 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.

Although resources, competencies, and capabilities are important, 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.