A Porters Five Forces Approach to the Australian Private Hospital Industry

Bruce Perrott, University of Technology Sydney
Raechel Hughes, University of Canberra

Abstract

This is the first stage of a project designed to better understand the business and marketing dynamics of the private hospital industry in Australia. This stage will use a Porter's Five Forces framework to analyse the main forces at play in the industry. It will attempt to make an objective assessment of the operating environment for industry members. Data for this first stage will be taken mainly from a range of secondary sources

Industry Overview

The underlying driver of the demand for health services will be the ageing Australian population. With a current median age of about 35 years (a 14% rise over the past 15 years), it is expected to rise another 14% to a median age of 40 years by 2016 (Macquarie Research Equities 2003), providing a strong basis for the projected growth and development of private health services. In Australia there are 748 public hospitals and 549 private hospitals. In these hospitals there are 52,000 licensed beds in the public sector and 27,000 in the private sector (Citigroup 2005). In order to understand the industry dynamics, we have utilised the five forces model (Porter 1980).

Competitive Rivalry and Industry Growth

Key changes to industry structure in recent times have occurred mainly in the for-profit sector, such as the Ramsay acquisition of the Benchmark group of hospitals in May 2004, increasing the number of private beds and strengthening Ramsay's geographical market coverage with the addition of ten hospitals in Victoria and South. In the for profit sector, the largest market share is owned by Affinity with 5360 beds (42%). This is followed by Ramsay with 3680 beds (29%).

Healthscope holds a 20% share, with 2585 beds. Nova Health, with 768 beds, holds a 6% share, and finally with just 2% share is Macquarie Health, with 256 beds. The competitive landscape would have looked different to this if Ramsay had been successful in acquiring the Affinity beds in 2003 from the Mayne Group. If this had occurred, then it is unlikely that the Benchmark acquisition would have happened as it did in 2004. Under this scenario, Ramsay could have had a bed market share near 70% (say 8105 beds), Healthscope with about 22% share (2585 beds), leaving Benchmark with 8% market share. More recently, it has been estimated that Affinity has 5367 beds; Ramsay 3967 and Healthscope 2400 (Greenblat 2004). Competitive intensity is not as intense as expected due to the geographical positioning of each hospital, which is located strategically near the markets that yield both patients and medical referrals.

Geographical positioning also substantially reduces the need to aggressively differentiate with product, service and brand strategies. To the degree that these companies compete, there are a number of elements that need to be considered, including the type and reputation of referring doctors (General Practioners and Specialists); the geographical location of the hospital facility; the product/ case mix offered and the availability of quality staff (Patrick Grier, a) 2004). Industry growth is also a factor that can impact on the degree of competitive rivalry existing in an industry at a point in time – if growth is slow, it would be expected that rivalry would be increased (Johnson, Scholes and Whittington 2005). Growth will also have an impact on the level of attractiveness to potential new entrants to the industry, with bed occupancy a good measure of operating efficiency. In 2002-03, this segment had an occupancy rate of 75.6% which was marginally higher than the previous year with 75.2%. It is also significant to note that the occupancy rate was higher in hospitals located in the Capital City Statistical Divisions at 77.3%, compared with 70.9% in Rest of State and Territory Divisions (ABS, 2004). This creates a strong

competitive advantage for companies with hospitals with established operations which have established networks of referring doctors. For acute and psychiatric private hospitals during 2002-03, the net operating margin was reported to be 6%, steady at the level of the previous year but above the average margin for the five years to 2002-03 of 5% (ABS, 2004).

Non Profit Private Hospitals: Private hospitals operated by religious or charitable institutions offer an alternative source of private hospital services to some Australian patients. For the year 2002-03, religious or charitable hospital groups accounted for 37% of the available beds in acute and psychiatric private hospitals. Their occupancy rate of 77.5% for 2002-03 was higher than for acute and psychiatric bed occupancy in the private hospital group overall which was reported at 75.6% for 2002-03(ABS 2004). In this sector, the Sisters of Charity hold a 30% market share, with 2586 beds. Little Company of Mary follows with 1416 beds (17.2 % share), St John of God has 1300 beds (a 15.8 % share); Mercy Health has a 13% share, with 1100 beds. Uniting Health Care, with 993 beds, holds a 12% share, and finally with a 10% share is Mater Health Services (830 beds) (*Department of Health and Ageing, ABS, MRE August 2003*).

Potential Industry Entrants

The two important considerations in reviewing the topic of new entrants to the Australian Private Hospital Industry are the levels of attractiveness and the barriers to entry. Industry income form the focus of operations for this analysis (acute and psychiatric) has increased in money terms by 9% per anum over the five years to 2002-03. Removing the adjustment for price changes over the period, the figure shows a 6% growth. Taking income as a key indicator of industry growth, then it can be concluded that the industry would be only *moderately attractive* to potential entrants. Net operating margin can be reviewed in our effort to assess the level of industry attractiveness in

terms of future profitability of potential entrants. This has been discussed above and shows an average of 5% for the five years to 2002-03. In terms of profit attractiveness, in can be concluded that the level of industry attractiveness is *low to moderate.*

There are a number of complications that potential entrants would face in executing a strategy of establishing new greenfield (ie building hospitals from scratch) private hospital operations in Australia. The first is the substantial capital cost involved, estimated to be in the order of $450,000 per private hospital bed in 2004, making is difficult to achieve an acceptable level of profit margin under current operating conditions (Patrick Grier, b), 2004). The second is the long lead times necessary to find sites, purchase land, gain the various approvals, and build hospital capacity strategically positioned adjacent to prime Australian markets. The third and probably the most difficult would be in recruiting and securing the optimum mix of referring medical practioners. The fourth most critical factor would be the recruiting of nursing and hospital general staff in a market environment that is already suffering from a critical shortage. The run on effect of this would be for the tendency to push up ongoing costs for this important ingredient to the private hospital industry operating dimension.

A general conclusion from the potential new entrant dimension is that it would be relatively unattractive to enter the Australian private hospital industry by way of setting up new facilities. Hence the most likely entry strategy would be through the acquisition of an existing operation which was most closely aligned to meeting the strategic objectives and fit of the acquiring organisation. This could be a large offshore company looking to diversify geographically and/or in terms of product and case mix. As the assets of each company are specialised and therefore only able to be applied to the business of private hospital operations, assets could not be readily

applied to another business or industry on a similar scale. Hence the likelihood of industry exit would be by way of selling the whole business or individual hospitals combinations to existing competitors or new industry entrants.

Industry Attractiveness Overview

This section will briefly summarise the circumstances of each of the five industry elements or forces and make a summary assessment in terms of each areas relative attractiveness: or unattractiveness ; ☺ to industry members. ☹

Industry Core

Through progressive rationalisation and consolidation, the for–profit sector of the industry theoretically operates as an oligopoly with three main companies owning 92% of the market in private hospital beds. In the not-for-profit sector there are only four main groups operating in the industry. Under such a market structure one would expect to see intense rivalry manifest in terms of aggressive marketing activity in order to maintain or build market shares. However in the case of the private hospital industry, each company and hospital has its unique positioning near key markets and referring doctor networks, limiting the competitive rivalry between the companies in the industry. The negative effect of limited competitive rivalry also means that it would be more difficult for an individual company to build market share through aggressive marketing similar to what could happen in most other industries when markets are not as protected. This limit on the level of competitive rivalry also has longer term benefits to shareholders of the three key companies.

Another favourable dimension is the outlook for industry growth. Due to the ageing Australian population outlined in this paper and the increasing awareness of the need for high quality health care, the demand for health services is likely to continue to grow in the foreseeable future. Hence the return to shareholders of companies in the private, for profit industry should be maintained provided costs are contained and market shares are not lost to competing industries such as the not for profit or day care. The search for growth may involve varying degrees of diversification, whether it be into closely associated health services not currently being offered by the private hospital sector or moving into the closely associated industry of aged care. Alternatively, for those more adventurous, diversifying into the emerging wellness industry, the birth of which is currently being forecast (Pilzer 2002). The beginning of a huge industry described as the 'Wellness Industry" is anticipated. Health care is reactive, while the wellness industry will be proactive and dedicated to preventing people becoming customers of the healthcare industries. In summary, it can be stated that the competitive environment for private hospital members is generally favourable; 

Entrants

There are moderately high barriers to entry in this industry. High capital costs and the difficulty in finding and building new hospitals in locations close to viable markets presents a formidable hurdle for potential new entrants to the industry. It has been suggested that the current capital costs of building and commissioning a hospital bed is about $450,000 (Grier, b) 2004). Entry on a relatively large scale could take place through acquisition. Such an entrant could be a company with substantial funds to invest into diversified geographical markets. An example here may be a large US health care company, or a health insurance company wanting to integrate forward from insurance to health service provision. Industry entry under these circumstances cannot be

classified as a negative threat to shareholders as it could be assumed that such an entrant would need to pay a premium to encourage shareholders of the target organisation to sell controlling interest in a private health care company. Following this rationale it can be said that the threat of new entrants impacting on industry players in a negative or damaging way to shareholder assets, and returns is low; 

Substitutes

Substitutes, or alternative health services, include:

- Not for Profit hospitals: Medium to High threat depending on hospital location
- Public Hospitals: Low to Medium threat depending upon type of service
- Day Care hospitals: Medium threat depending upon type of service and location
- Technology as a Substitute to private hospital care (eg *e-health*): Low threat
- Reduction in need/demand for private health services: Nil threat

Following this rationale it can be summarised that the combined threat of substitutes impacting on industry players in a negative or damaging way to shareholder interests or assets, and returns is low. Hence this element is favourable to industry members; 

Suppliers

This variable has the potential to be most critical for members of the for profit private hospital industry in managing viable hospital units. Individual organisations rely on key groups to supply quality and timely services and products to the various hospital locations. Each of the main supplier components are summarised as follows;

Medical practitioners: Having a strong network of referring doctors is a fundamental prerequisite to viability and success. Case histories show that non support of doctor groups can lead to serious underperformance of both individual hospitals and company groups in this industry (Grier, a)

2004). In Australia, Nursing Staff are well organised in terms of union representation and enjoy a strong positive image with the press and the public. Nurses therefore have strong collective bargaining power with private hospital groups. Hence they are in a strong position to negotiate conditions and pay structures.

Consumable Medical supplies: Most consumables used in private hospitals are supplied by industries that are oligopolies in structure. Hence individual supplying companies can usually exercise some control over price and supply conditions. Protheses are a costly component of some medical treatments and are supplied by a limited number of suitable manufacturers. It has been said that supplying manufacturers are specified by medical practitioners in 20 -40% of cases that require the use of a prothesis (Grier, b) 2004).

Medical Equipment: Over time the private health industry has become increasingly dependent on advancing technology by way of high capital cost equipment which is used for diagnostics and treatment of medical conditions, with limited suppliers, creating limited opportunity for competitive buying. In summarising the impact of the suppliers, it can be said that they have the potential to impact on industry players in a negative or damaging way. Even if this influence is not activated, they hold a latent power which can be used in negotiating conditions of supply to industry members. 

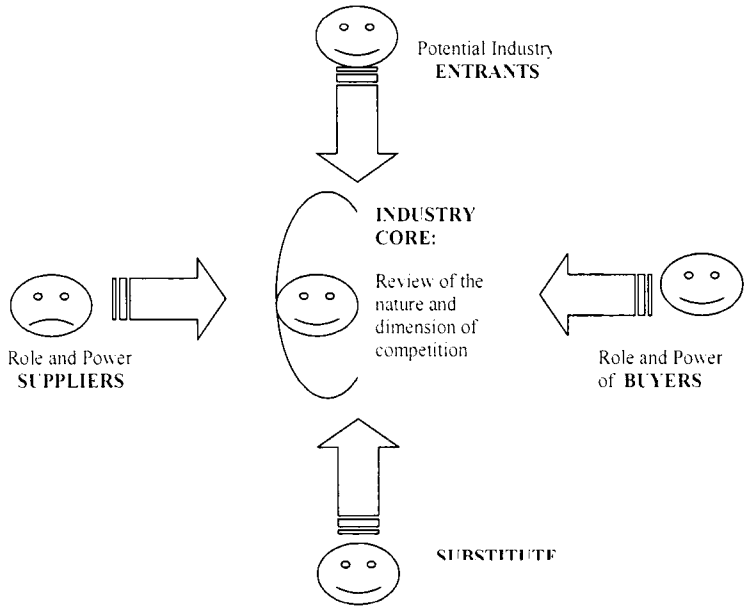
Buyers

In summarising, the role of patients in isolation to other influencing factors, it can be said that their ability to impact on industry players in a negative or damaging way to shareholder interests or assets and returns is low. Hence this element is favourable to industry members; 

Overview

Figure D summarises the status of the private hospital. Overall it is a favourable operating environment for industry members, with four assessments being summarised as favourable and only one as being potentially unfavourable.

Figure D ***Industry Attractiveness Summary***



Adapted from Michael Porter

Implications for marketing & future issues

Following on from this analysis, what are the implications for marketers and managers in the private hospital industry? A major and constant focus on profit margin management; there are strong pressures from the health insurance funds to contain prices charged for hospital services. Hence a critical and ongoing management skill is to run hospital operations to acceptable quality standards with less costly resources is constant operational innovation. Another dimension of

margin management is to actively manage case mix by increasing the proportion of services with higher profit margins. Strategic management skills will become more critical as pressure builds to find future revenue and growth opportunities. These opportunities will come through varying combinations of; the successful introduction of new products and services, increased penetration to high priority market segments, or accessing new markets not currently being served. These opportunities may be in areas closely related to the existing business or could include opportunities more diverse from the traditional private hospital business such as; aged care, preventative health care, 'wellness' and disease prevention services. As strategic priorities are established, detailed marketing objectives and strategies need to be formulated and implemented with cost accountability and key performance indicators used for tracking and monitoring progress. Given the power distribution of key stakeholders in the industry, a key ongoing management skill and process will be the effective management of relationships with key supplier groups such as the medical practitioners, health insurance funds and equipment suppliers. It is likely that changing government health policy and strategy both at the Federal and State level will impact on management in this sector, and there will be further industry consolidation as individual companies attempt to achieve growth targets, gain effective market coverage, reduce market area competition, and gain from the benefits of economies of scale. Rising costs and pressures on revenue will also cause a squeeze on profit margins, ultimately causing industry members to diversify from the traditional core business in their attempts to achieve growth targets, diversify risk, and build profit margins and return on investment.

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