ECONOMIC NOTE

Montreal Economic Institute
Ideas for a More Prosperous Nation

November 2014
Health Care Series

The Positive Role of Profit in the Field of Health Care

by **Yanick Labrie**

Few topics of public debate elicit more emotion in people than the role of the private sector in health care. It is often argued that profit has no place in this sector, especially when it comes to hospital care. Some people think that the profit motive would encourage "the cutting of corners," that profit would add to the cost of providing a service, or that for-profit medical facilities would avoid the more complex cases or those perceived to be "less profitable."

Are these beliefs justified? This *Economic Note* will shine a light on this question, based on the experiences of countries in Europe. In these countries, the private sector plays a leading role within health care systems that, like Canada's, are based on universal coverage, but where patients can choose which facilities will treat them, and where public funding follows the patient.

Does the profit motive encourage "the cutting of corners"?

As both experience and economic theory teach us, private companies must necessarily offer goods and services that are valued by consumers if they want to prosper. The profit motive pushes them to do their best to satisfy their clients. A company that does not manage to do this will see its market share eroded, to the benefit of competitors.

According to a widely held belief, however, health care is a "social" sector where this economic logic does not apply and where the profit motive does not serve the public interest. Health care facilities administered by private companies would therefore likely offer lower quality services and abuse vulnerable patients in order to amass the maximum possible profits.

However, the revenues of privately run medical facilities depend on the number of patients they treat. In order to attract clients, they have to maintain their reputations. They have to adapt their practices to the expectations and preferences of patients and continually look for new and better ways of responding to their needs. In a competitive environment where the money follows the patient, hospitals that cut on service quality drive away their clients and simply cannot make a profit.

This popular belief is also contradicted by numerous foreign experiences. La Ribera University Hospital in the Valencia region of Spain is an eloquent example of a medical facility run by a private company that ensures its profitability by continually improving the quality of its services. It attracts patients from all over Spain, who are taken care of at no charge regardless of income level.[1] A survey showed that 91% of patients are satisfied with the care received and 95% would choose this hospital again if they needed treatment.[2] The hospital rewards its employees with performance bonuses and maintains a motivating work environment, as shown by an absenteeism rate of 2.5%, well below that of public hospitals[3] (see Table 1).

This *Economic Note* was prepared by **Yanick Labrie**, an economist with the Montreal Economic Institute who holds a master's degree in economics (Université de Montréal).

*The MEI's **Health Care Series** aims to examine the extent to which freedom of choice and private initiative lead to improvements in the quality and efficiency of health care services for all patients.*

Following the success of La Ribera University Hospital, nine other districts in the Valencia and Madrid regions decided to entrust the administration of health services to the same private group, Ribera Salud. This organization manages to avoid waiting lists in its hospitals despite receiving 26% less public funding than other comparable public hospitals. Emergency room patients are seen by a doctor within less than 60 minutes, compared to an average of 131 minutes in public hospitals in Valencia. The average wait time for elective surgery is 32 days, which is two to three times shorter than in the region's public hospitals.[4]

Table 1 — La Ribera University Hospital, Valencia, Spain Under private management since 1999

Indicator	Performance
Cost / Public funding (hospitals run by Ribera Salud)	Around 26% lower than comparable public hospitals in Valencia
Wait times (hospitals run by Ribera Salud)	Emergency rooms: Less than 60 minutes to see a doctor, compared to an average of 131 minutes in public hospitals in Valencia Elective surgeries: 32 days on average, compared to 60 or 90 days in public hospitals
Patient satisfaction	91% satisfied by services received 95% hospital loyalty
Working conditions	Performance bonuses Absenteeism rate of 2.5%, well below that of public hospitals

Sources: Neelam Sekhri, Richard Feachem and Angela Ni, "Public-Private Integrated Partnerships Demonstrate the Potential to Improve Health Care Access, Quality, and Efficiency," *Health Affairs*, Vol. 30, No. 8, 2011, pp. 1502-1503; World Health Organization, "Spanish Health District Tests a New Public-Private Mix," *Bulletin of the World Health Organization*, Vol. 89, No. 12, 2009, pp. 892-893; European Commission, *Health and Economics Analysis for an Evaluation of the Public Private Partnerships in Health Care Delivery across EU — Annexes*, 2013, pp. 97-110.

Does profit add to the cost of providing a service?

Some critics argue that it would cost society more to fund services provided by private companies, insofar as profit is added to the other costs of providing services.[5] The error here consists in overlooking the role of competition and in assuming that costs are inflexible and are the same for all medical facilities. Yet the usefulness of the profit motive is precisely that it pushes private providers to increase their efficiency—that is, to reduce costs for a given volume of services of a certain quality—by doing a better job of allocating available resources.

In a competitive environment where the money follows the patient, hospitals that cut on service quality drive away their clients and simply cannot make a profit.

The experience of Germany is particularly telling in this regard. In the early 1990s, many public hospitals were faced with recurring deficits, and their infrastructure was gradually deteriorating. It is at this moment that restrictions preventing hospital privatization were lifted in several Länder,[6] leading the number of private hospitals to increase by 95% from 1991 to 2012.[7] New management techniques were then applied, entailing cost reductions and significant efficiency improvements for these hospitals.[8]

A number of private groups stand out in the German health care system, which includes nearly 700 private for-profit hospitals.[9] One of these groups, Rhön Klinikum, owns ten hospitals, including a university hospital made up of two pavilions in the neighbouring cities of Giessen and Marburg. Operating with substantial deficits when it was purchased in 2006, this 2,262-bed hospital quickly returned to profitability after the company invested 547 million euros to modernize its infrastructure and build a new cancer centre.[10] The company distinguishes itself today by its ability to limit the outbreak and spread of hospital-acquired infections in its facilities. The search for efficiency gains, then, does not happen to the detriment of patient safety. On the contrary, if the company did not provide high-quality care, its investments simply could not be profitable.

Do for-profit hospitals neglect the "less profitable" cases?

In comparisons of the public sector and the private sector, we often encounter the stereotype of the private sector concentrating on the less difficult cases, and on patients with above-average incomes. However, in a competitive context where hospitals are remunerated based on the complexity of pathologies, for-profit medical facilities have an interest in attracting the difficult cases, especially insofar as they can treat them more efficiently and less expensively than their competitors.

In Germany for example, private hospitals treat patients who are older on average and who have more serious health conditions

than those in public hospitals. The data also show that private for-profit hospitals are better-equipped to treat difficult cases and more complex pathologies. Moreover, a larger proportion of beds in these hospitals are reserved for emergency room and intensive care patients.[11]

In France also, private facilities treat all patients and do not discriminate on the basis of income or the seriousness of cases. Private hospitals and clinics have long been integrated into the public system and established in all regions of France, and even more so in those regions where average incomes are lower.[12] Private medical facilities treat the beneficiaries of Couverture médicale universelle (the poorest patients) in the same proportions as the others.[13] Given that the way hospitals are funded takes into account complications and the severity of cases treated, private health care facilities take on difficult cases at a rate that is comparable to that of public hospitals.[14]

Table 2 — Saint Göran Hospital, Stockholm, Sweden Under private management since 1999

Indicator	Performance
Public funding	Around 10% lower than that of comparable public hospitals in the county
Wait times	Emergency rooms: 42 minutes on average to see a doctor, versus 57 minutes in comparable public hospitals
Patient satisfaction	90% of patients are satisfied with the services received
Working conditions	Highest employee satisfaction index and lowest absenteeism rate due to illness among Stockholm hospitals

Sources: Randolph K. Quaye, "Is the Swedish Welfare State in Retreat? Current Trends in Swedish Health Care," *International Journal of Health Care Quality Assurance*, Vol. 20, No. 5, 2007, p. 399; Socialstyrelsen, *Väntetider vid sjukhusbundna akutmottagningar*, Report, December 2013, pp. 20-21; Capio, *Fact Sheet: We renew and unite*, 2012; Capio, *2013 Annual Report*, pp. 32-39.

The experience of the Capio Group

The experience of the Capio Group shows how the profit motive can lead to a better utilization of resources, to the benefit of the company, patients and the public system.

Created in Sweden in 1994, the Capio Group offers a wide range of medical, surgical and psychiatric treatments. It has some 60 medical facilities and 11,875 employees in Sweden, Norway, France, Germany and the United Kingdom. In 2013, its hospitals and specialized health care clinics received over 4.3 million patients, almost none of whom had to spend a single penny to be treated.[15] Capio is owned by private investment funds and its annual sales figure exceeds 1.3 million euros.[16]

The usefulness of the profit motive is that it pushes private providers to increase their efficiency by doing a better job of allocating available resources.

In 2012, Stockholm County renewed Capio's contract to run Saint Göran Hospital, specialized in the treatment of emergency cases, for an additional nine years. Its public funding was reduced by 10% compared to its previous level and compared to that of similar hospitals in the county.[17] Equipped with more than 300 beds, it is among the best hospitals in Sweden in terms of care quality and safety, and in terms of speed of access.[18] The average emergency room wait lasts 42 minutes, versus 57 minutes in the country as a whole.[19] All Swedes, whatever their income levels, can be treated there without discrimination.

Since its administration was turned over to the Capio Group in 1999, the Saint Göran Hospital's operating costs have remained below those of other public hospitals in Stockholm. Health administrators and economists are almost all in agreement that the privatization has been an outright success and that this approach leads to improved efficiency in the provision of care.[20] Members of the hospital staff, for their part, think that their work environment is more satisfying than it was before[21] (see Table 2).

France represents one of the Capio Group's biggest markets. French patients are free to choose their care providers, and 40% of patients needing to be hospitalized are cared for in private hospitals or clinics.[22] The Caisse nationale d'assurance maladie determines the fees to be paid for medical procedures. These are 22% lower on average for private medical facilities,[23] which amounts to an implicit recognition of their superior efficiency.

To make a profit, a clinic or hospital must therefore be sure to use its resources very efficiently, among other things by maintaining high occupancy rates for its beds and operating rooms, and by optimizing patient length of stay. Indeed, the length of hospital stays in French hospitals managed by Capio went from 4.6 days in 2009 to 4.2 days in 2012 with no drop in observed quality level. If this had been the case in all French hospitals, it is

estimated that the total number of beds could have been reduced by up to 36%, freeing up resources for other purposes.[24]

Conclusion

As can be seen from the experiences of other countries, private for-profit hospitals and clinics, or public medical facilities run by private companies, can help to improve the productivity of the hospital sector. Motivated by profit, among other things, these facilities find ways to organize their work that lead to increased efficiency, reduced costs and shorter wait times.

For-profit medical facilities have an interest in attracting the difficult cases, especially insofar as they can treat them more efficiently and less expensively than their competitors.

These experiences show that a health care system can remain public and universal all while allowing entrepreneurs to compete to provide services and attract clients, instead of leaving patients trapped in a public monopoly that fails to respond adequately to the demand for treatment.

References

1. World Health Organization, "Spanish Health District Tests a New Public-Private Mix," *Bulletin of the World Health Organization*, Vol. 89, No. 12, 2009, pp. 892-893.
2. Neelam Sekhri, Richard Feachem and Angela Ni, "Public-Private Integrated Partnerships Demonstrate the Potential to Improve Health Care Access, Quality, and Efficiency," *Health Affairs*, Vol. 30, No. 8, 2011, pp. 1502-1503; World Health Organization, *ibid*.
3. World Health Organization, *ibid*.
4. European Commission, *Health and Economics Analysis for an Evaluation of the Public Private Partnerships in Health Care Delivery across EU — Annexes*, 2013, pp. 97-110.
5. Canadian Health Services Research Foundation, *Mythbusters: For-profit ownership of facilities would lead to a more efficient healthcare system*, March 2004.
6. Patrick Jeurissen, *For-Profit Hospitals: A Comparative and Longitudinal Study of the For-Profit Hospital Sector in Four Western Countries*, Doctoral thesis, Erasmus University, Rotterdam, 2010, pp. 145-147.
7. Statistisches Bundesamt, *Grunddaten der Krankenhäuser*, Fachserie 12 Reihe 6.1.1, 2012, p. 14.
8. Oliver Tiemann and Jonas Schreyögg, "Changes in Hospital Efficiency after Privatization," *Health Care Management Science*, Vol. 15, No. 4, 2012, pp. 310-326.
9. The largest private groups are Fresenius-Helios (111 hospitals and approximately 69,000 employees), Asklepios (36 hospitals and 106 specialized medical clinics, and approximately 34,500 employees), and Sana Kliniken (43 hospitals and 19 specialized medical centres, and approximately 29,000 employees). For its part, the Rhön Klinikum group has 10 hospitals after having sold some 40 medical facilities to Fresenius-Helios in the fall of 2013. It has around 15,000 employees.
10. Rhön Klinikum, *Annual Report 2013*, pp. 61 and 76.
11. Boris Augurzky, Andreas Beivers and Rosemarie Gülker, *Privately Owned Hospitals 2012*, RWI Materialien Vol. 73, 2012, pp. 26-31.
12. Olivier Faure and Dominique Dessertine, *Les cliniques privées : deux siècles de succès*, Presses universitaires de Rennes, 2012, p. 148; Victor Mennessier, *La place du privé dans le système hospitalier français*, Speech delivered as part of a conference organized by the Montreal Economic Institute, October 16, 2008.
13. Fédération de l'hospitalisation privée, *L'hospitalisation privée en France : enjeux et perspectives*.
14. Olivier Guérin and Jocelyn Husser, "Les effets incitatifs de la T2A pour les établissements de soins : vers une nouvelle répartition des actes médicaux?" *Vie et Sciences de l'entreprise*, No. 189, 2011, pp. 12-22.
15. In Sweden for example, less than 2% of patients treated by Capio clinics pay privately for the services they receive. The majority of Capio's revenues come from governments or public insurers. See Maria Blomgren and Eva Sundén, "Constructing a European Healthcare Market: The Private Healthcare Company Capio and the Strategic Aspect of the Drive for Transparency," *Social Science & Medicine*, Vol. 67, No. 10, 2008, p. 1515. Capio, *2013 Annual Report*, Capio presentation.
16. Capio, *Ibid*., p. 83.
17. *Ibid*., p. 32.
18. "A hospital case," *The Economist*, May 18, 2013; Lena Burström *et al*., "Physician-Led Team Triage Based on Lean Principles May Be Superior for Efficiency and Quality? A Comparison of Three Emergency Departments with Different Triage Models," *Scandinavian Journal of Trauma, Resuscitation and Emergency Medicine*, Vol. 20, No. 57, 2012.
19. Britta Walgren, "Suède: la *modern medicine* appliquée," *Dialogue Santé*, No. 14, May 2014; Socialstyrelsen, *Väntetider vid sjukhusbundna akutmottagningar*, Report, December 2013, pp. 20-21.
20. Randolph K. Quaye, "Is the Swedish Welfare State in Retreat? Current Trends in Swedish Health Care," *International Journal of Health Care Quality Assurance*, Vol. 20, No. 5, 2007, p. 399.
21. David Rae, *Getting Better Value for Money from Sweden's Healthcare System*, OECD Economics Department, Working Paper No. 443, September 2005, p. 22.
22. Agence technique d'information sur l'hospitalisation, *Hospitalisation — chiffres clés 2013*.
23. Ministère du travail, de l'emploi et de la santé [France], *Rapport 2011 au Parlement sur la convergence tarifaire*, p. 83.
24. Capio, *S'engager pour une médecine moderne de qualité*, January 2014, p. 14.

910 Peel Street, Suite 600
Montreal (Quebec) H3C 2H8, Canada
Telephone: 514-273-0969
Fax: 514-273-2581
Website: www.iedm.org

The Montreal Economic Institute is an independent, non-partisan, not-for-profit research and educational organization. Through its publications, media appearances and conferences, the MEI stimulates debate on public policies in Quebec and across Canada by proposing wealth-creating reforms based on market mechanisms. It does not accept any government funding.

The opinions expressed in this study do not necessarily represent those of the Montreal Economic Institute or of the members of its board of directors.

The publication of this study in no way implies that the Montreal Economic Institute or the members of its board of directors are in favour of or oppose the passage of any bill.

Reproduction is authorized for non-commercial educational purposes provided the source is mentioned.

Montreal Economic Institute © 2014

Illustration: Ygreck