Merging with For-Profits: Flawed Strategy

Such Affiliations Benefit Neither the Catholic Hospital Nor Society

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In the current healthcare environment of shrinking government reimbursement, healthcare systems are searching for new sources of capital. Mergers among Catholic systems are common, and linkages with other not-for-profit systems frequent. But now some Catholic systems are eyeing mergers with for-profit systems. This approach to survival raises some serious questions:

- What would such a merger mean for the mission of a particular Catholic healthcare system or facility?
- What do such mergers mean for the well-being of society at large?

Implications for Not-for-profit Organizations

Leaders of not-for-profit organizations who are thinking about merging with for-profits should consider five implications of such a move.

Pursuit of Profit The fundamental purpose and driving force of for-profit business is the pursuit of profit. The fundamental operating principle—both economic and legal—must be the maximization of profit for the organization's owners (shareholders).

In contrast, the not-for-profit organization is by its nature mission driven. The ultimate objective of a not-for-profit organization is to meet a need of society or its members. It is the power of the mission that draws together the various persons and resources involved in the organization. And it is the commitment to the mission that gives the organization its focus, influence, and corporate energy.

To the extent that commitment to the mission is weak or diluted, a not-for-profit organization loses its power to accomplish its purpose. Although a not-for-profit healthcare organization must operate in the same marketplace as for-profit entities, its driving force and source of institutional power are fundamentally different from theirs. For this reason, not-for-profit organizations have "mission effectiveness" and "values integration," departments and activities unlikely

Summary Some Catholic healthcare organizations, seeking new sources of capital, are eyeing mergers with for-profit systems. However, such mergers raise questions about their effects on both the mission of particular Catholic institutions and the well-being of society at large.

For-profit organizations are driven by the pursuit of profit. They market "products." This pursuit naturally shapes their decision-making rationales, employee relations, and business priorities. Not-for-profits, on the other hand, provide "public goods"—goods that for-profits either will not provide or will not provide adequately—and this mission shapes their priorities, decision making, and employee relations differently.

What is more, economic power is unequal between the two kinds of organization. Since not-for-profits are seeking capital when they merge with for-profits, they usually do so from a position of relative disadvantage. When conflicts arise, the for-profit partner generally prevails. The not-for-profit partner then finds itself, not merged with, but acquired by the for-profit.

Throughout U.S. history, not-for-profits have performed a function neglected by both government and private companies. Now, in the 1990s, the whole social welfare framework of our society is under attack. A moral-political crisis questions the very concept of the voluntary sector. If Catholic healthcare organizations allow themselves to be swallowed by for-profits, who will care for the voiceless and the vulnerable?

to be found in for-profit organizations.

Decision Making Because of their different primary driving forces, for-profit and not-for-profit organizations also have different decision-making rationales. Management guru Peter Drucker points out that, in for-profit organizations, profitability will unquestionably be the primary measure of performance.[1] But, in a not-for-profit organization, the measure of performance will be derived from the organization's specific mission. In the latter case, decision making will inevitably be more complex, since judgments will have to be made concerning their impact on both mission and the bottom line.

Drucker makes the point that not-for-profits are fundamentally "human change agents"—they must measure performance in terms of service to people, of meeting human needs. Their specific challenge—and their distinctiveness—lies in combining both financial efficiency and social responsibility criteria.

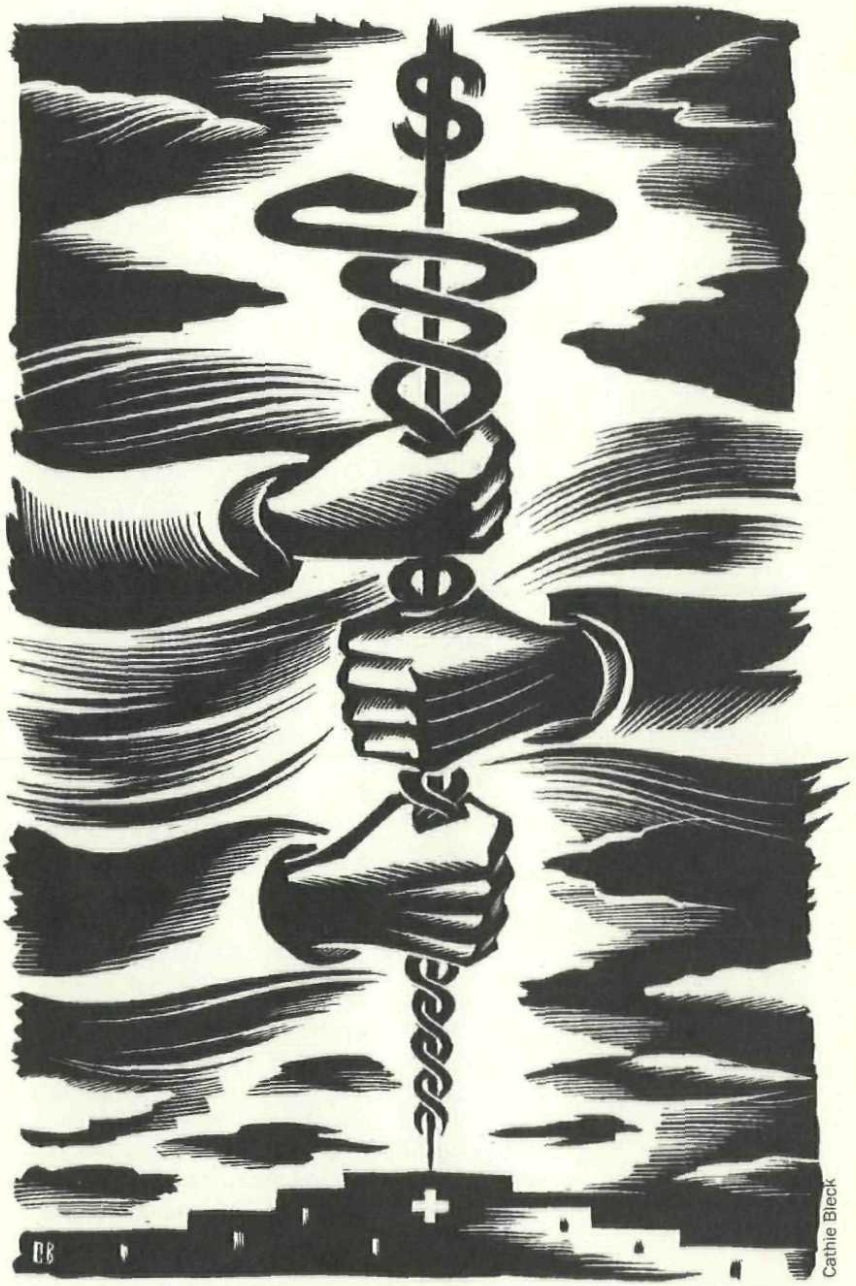
Let us take an example from the housing sector. Two developers, one for-profit and the other not-for-profit, formed a partnership to build affordable housing for low-income families and individuals. After 14 years the for-profit partner, citing financial losses, refused to provide tenants with maintenance and other services. But these services were seen as essential by the not-for-profit partner, whose mission was to provide high-quality, service-enriched housing. The partnership broke down completely, and the housing's original purpose was preserved only after costly legal action.

For-profit and not-for-profit organizations have fundamentally different rationales for decisions about investment, employment policies, product delivery, and customer service. Not-for-profit institutions must resolve such questions in terms of their effect on people. This is all the more challenging, since quantitative tools for measuring profitability are well developed and taught in schools of hospital administration, whereas other performance measures are not taught and are less familiar because they are considered "soft," less quantifiable. Can two fundamentally different rationales for judging performance and risk coexist in one organization?

For example, in making a decision whether to abandon a line of business that does not support itself financially, a for-profit entity will necessarily focus primarily on the bottom line. A not-for-profit, by contrast, will ascertain the service's importance to the overall fulfillment of its mission and then, if its continuation is justified, seek creative ways to finance it.

Employee Relations For-profit and not-for-profit organizations have different principles governing employee relations. Criteria for internal equity based on Catholic social teaching's concepts of distributive and social justice will differ from marketplace standards based on supply and demand. The corporate culture of a Catholic not-for-profit, reflecting the dignity accorded to the person and her or his work, will ideally promote mutuality, cooperation, and equality, in contrast to the competitive status seeking fostered in a for-profit atmosphere.

In not-for-profits guided by Catholic social teaching, for example, employment patterns will be more inclusive and less likely to reflect the institutionalized sexism, racism, ethnocentrism, ageism, and homophobia that characterize main-



Cathie Bleck

stream American society today. Women and members of minority groups will be more likely to be valued for their intelligence and managerial ability than for the sake of appearances; their opportunities for promotion are likely to be greater.

Also, the value that not-for-profits place on employee participation in decision making will be higher than in those organizations which, responding to the currently fashionable emphasis on team building, use "empowerment" as a ploy to get employees to buy in to decisions already made at the top.

According to the principles of Catholic social teaching, participation in decisions that affect one's life is a basic human right. In a Catholic not-for-profit guided by these principles, mutuality and coresponsibility in community will be promoted as values in themselves. Widening the groups from which input is sought will be a response to the fundamental dignity of persons, each of whose ideas merits some consideration. Leaders of such organizations will form teams that, besides increasing productivity, encourage cooperation in the workplace and create a work environment that enables individuals to contribute their best.

Different Priorities When economic and medical issues clash and trade-offs are necessary—as is increasingly the case when budgets are tight—the fundamental nature of an institution will dictate which one has priority. The documented differentials in patient selection patterns between for-profit and the not-for-profit hospital systems in the United States is a case in point. As Paul Starr observed presciently in his 1982 study of American medicine:

> Profit making enterprises are not interested in treating those who cannot pay. The voluntary hospital may not treat the poor the same as the rich, but they do treat them and often treat them well. A system in which the corporate enterprises pay a larger part is likely to be more segmented and more stratified. With cutbacks in public financing coming at the same time, the two-class system in medical care is likely to become only more conspicuous.[2]

"Products" and "Public Goods" For-profit and not-for-profit organizations also differ in what they offer the public. For-profit businesses have to define their "product" in terms of what consumers are willing and able to pay for. On the other hand, the not-for-profit sector arose in American society precisely to meet societal needs that the for-profit sector will not meet, or will not meet adequately. Economists call the kind of goods that are provided in the public or not-for-profit sectors "public goods." Such goods either *cannot* be provided privately (e.g., clean air or water) or *should not* be (e.g., elementary and secondary education) because ability to pay should not be the primary determinant of who receives the service.

Part of the problem facing healthcare is the fact that our society (alone among the industrial democracies) has not yet decided that healthcare for all *is* a public good. The dilemma is that for-profit businesses are not going to deliver affordable healthcare for all (any more than they are going to deliver affordable housing). And as long as we as a society are unwilling to declare healthcare a public good—and organize the incentive system and financial structures necessary to deliver it to everyone—the need will go unmet and not-for-profit healthcare systems will continue to struggle with the conflict between their mission and the economic realities of shrinking public funds and inadequate private resources.

Catholic social teaching holds that healthcare is a basic need to be met by society—a public good, not a commodity whose provision depends on a person's ability to pay for it. The market, which dictates the direction of resource allocation in the for-profit sector, is inadequate to meet all the needs of society.[3] Thus the provision of public goods requires organizations that define their product in terms of public service.

But economic power is unequal between the two different kinds of entity. Not-for-profit institutions, which historically have not focused on balance-sheet issues to the exclusion of other priorities, will likely enter mergers with for-profits from a position of relative economic disadvantage. It is precisely their economic need for capital that leads not-for-profits to consider a merger in the first place. When, therefore, conflicts arise between for-profit and not-for-profit partners' priorities, decision-making rationales, and product definitions, the not-for-profit will be unlikely to prevail. It will then find it has lost its identity—an acquisition, rather than a merger, has in effect taken place.

For all these reasons, mergers between for-profit and not-for-profit healthcare systems appear to be a fundamentally flawed strategy for not-for-profits. Leaders should directly address their not-for-profit organization's ability to survive, rather than allowing it—in the guise of a merger—to be taken over by a for-profit.

Societal Aspects of the Question

A second set of arguments against mergers of not-for-profit and for-profit healthcare organizations stems from the importance of the not-for-profit sector for society as a whole. In the United

States—in contrast to other Western industrial market economies with socially conscious democratic political systems—the not-for-profit sector has a particular function in addressing societal needs neglected by the for-profit sector and not assigned to the public sector. Throughout U.S. history, private voluntary organizations have been a third sector, relied on to provide public services, particularly to the poor and vulnerable. At a time when the whole social welfare framework of our society is under attack, Catholic hospitals and systems have a key social responsibility to bolster this third sector.

Public confidence in the not-for-profit sector has been undermined by economic anxiety.

Lester Salamon, director of the Johns Hopkins Institute for Policy Studies, in addressing Independent Sector's annual conference in October 1995, eloquently described the crisis facing the not-for-profit sector in the United States—a crisis with fiscal and moral-political dimensions of great importance.[4]

Salamon pointed out that federal budgetary changes already enacted or tentatively approved will, over the next seven years, reduce federal spending on health, education, social services, cash and in-kind assistance, employment and training, and housing and community development by a total of $773 billion. This set of programs, 38 percent of the current federal budget, will absorb 55 percent of the budget cuts required to meet congressional balanced budget goals. Healthcare spending will be cut by 25 percent. These budgetary changes will cost not-for-profit organizations $263 billion in federal funds between 1995 and 2002.[5]

Private giving cannot possibly make up for this huge reduction. To do so, as Salamon points out, by 2002 private giving would have to increase at 16 to 20 times its growth rate in recent years. And Independent Sector data reveal that the share of household income devoted to public giving has been declining—from 2 percent in 1989 to 1.7 percent in 1993.[6] The fiscal crisis for not-for-profits is very real and will persist.

But even more serious, according to Salamon, is the moral-political crisis, a fundamental questioning of the very concept of the voluntary sector.[7] Critics seeking to shrink the government's role in providing for social welfare, civil rights, and environmental protection are also attacking the not-for-profit sector, which, insofar as it performs these functions, they see as an extension of government. Tax exemptions for not-for-profits have come under increasing attack as various states and municipalities seek new revenue sources.

Public confidence in the not-for-profit sector has been undermined by pervasive economic anxiety spawned by stagnant real incomes, widespread job losses, and heightened fears of the future. This angst generates a climate which encourages people to seek scapegoats. Public support for causes served by not-for-profits is also undermined by a gap between people's idea of what such organizations should be and the current reality.

In the conventional view, not-for-profits are small-scale voluntary groups serving the unfortunate. Most people do not realize that such organizations must often become complex bureaucracies capable of collaborating with governments to deliver healthcare and other social welfare services. In fact, this combination of the not-for-profit sector's flexibility and service-delivery capacity with the public sector's revenue-generating capability has been one of the major institutional innovations of the past two decades. As the nation has sought to move away from social programs conducted from, as well as funded by, Washington, DC, collaborative partnerships between the public and not-for-profit sectors have multiplied and grown in scope and sophistication.

But the very effectiveness of this kind of partnership has attracted the ire of the right wing. The credibility of not-for-profits as advocates for those left poor and resourceless by the marketplace is now under attack.

Preserving Civil Society

Our nation is at a crossroads, asking itself, What kind of a people do we want to be? As we grapple with setting direction for our public policy for the next generation, the United States needs a strong third sector—a vibrant civil society—between the for-profit sector and the state.[8] This is especially true now, when confidence in the public sector is at low ebb and the voice of labor as a counterweight to that of business is weak. Catholic

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dedicated to serving the population in the institution's service area, according to Sr. Keaveney.

Lessons Learned

Sr. Keaveney offered the following advice for providers, board members, and government agencies that are adopting managed care for Medicaid recipients:

- Know the people you will serve and respect their needs. Make decisions that provide the kind of healthcare you yourself would want.
- Provide new services as needed. The Medicaid population needs transportation and other support services that help people follow through with their care. Providers should develop partnerships with other organizations to provide these services.
- Designate a specific date on which all beneficiaries will convert to managed care. If people enter the program a few at a time, the per capita payment to a single agency or solo practitioner will not be enough to cover catastrophic care or other costly treatments, and providers will have severe cash flow problems.

Managed Care's Promise

Sr. Keaveney believes managed care for Medi-Cal offers strong advantages besides cost savings. "Fee-for-service Medi-Cal covered only the sickest patients," she said. "Managed care offers a greater opportunity for improving the health of the population by covering primary care, prevention, and education."

She noted, however, that managed care holds the potential for underutilization and lack of access. "We will have to monitor the program to be sure recipients are getting the care they need," she said. *—Judy Cassidy*

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healthcare institutions, with records of long and faithful service in their communities, have a unique moral authority and credibility that enable them to serve and advocate for the common good. If this presence is diminished and these voices silenced, who will speak for the voiceless and the vulnerable whom the market neglects?

Rather than allowing our institutions to be co-opted by the for-profit sector, it is imperative that we collaborate more within the not-for-profit sector, renewing the sector's commitment to serving the public good. We must, in the words of a recent British report, participate in the creation of an effective civil society, "the other invisible hand . . . the invisible hand of generosity, help and moral commitment that sustains a sense of community and mutual responsibility."[9] □

NOTES

1. Peter Drucker, *Managing Nonprofit Organizations*, HarperCollins, New York City, 1990, p. 107.
2. Paul Starr, *The Social Transformation of American Medicine*, Basic Books, New York City, 1982, pp. 448.
3. See Pope John Paul II, "Centesimus Annus," *Origins*, May 16, 1991.
4. Lester M. Salamon, "The Crisis of the Nonprofit Sector," presentation at the Annual Conference of Independent Sector, Boston, October 24, 1995.
5. Salamon, pp. 5-6.
6. Salamon, p. 7
7. Salamon, pp. 8-18.
8. See Joseph Bernardin, "Making the Case for Not-for-Profit Healthcare," Catholic Health Association, St. Louis, 1995.
9. Geoff Mulgan and Charles Landry, *The Other Invisible Hand: Remaking Charity for the 21st Century*, Demos, London, 1995.

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