The Fateful Choice of Sharon Hospital

By CHARLENE LaVOIE

Sharon Hospital has pronounced its choice for the future: partnership with a for-profit hospital corporation.

For-profit hospital corporations have an interesting history. In the 1940's and 50's, physicians helped finance small hospitals in the South and West, using the depreciation from the hospital buildings and equipment as tax shelters. These small for-profit hospitals grew up in places where there was no tradition of nonprofit hospitals, or places where suburbs were growing quickly and urban nonprofit hospitals were slow to move in.

A new crop of for-profit hospital corporations was fertilized with the enactment of Medicare in 1965. Initially, the Federal health insurance for the elderly provided benefits to for-profit hospitals, such as a guaranteed return on equity, a dollar-for-dollar reimbursement of all borrowing and reimbursement on the basis of depreciation as a surrogate for repayment of principal. No other business in the United States enjoys such benefits. The reimbursement for depreciation, especially when accelerated depreciation was used for additional tax advantages, was a virtual growth engine—an invitation to spend and spend quickly, fueling the growth of the new for-profit hospital corporations.

Before Medicare, not one for-profit hospital corporation was in the economic "big leagues." Within five years after Medicare was adopted, four of the for-profit hospital corporations reached the "Fortune 100" status—Humana and Hospital Corporation of America in the South, and American Medical International and National Medical Enterprises in the West.

The rampant inflation in health care that followed Medicare's passage was blamed on all hospitals. But researchers have determined that a significant part of the unnecessary inflation, at least that segment not devoted to patient care, was the result of reimbursements to the investors who sold their ownership interests in the hospitals, particularly the doctors who owned the small hospitals, in exchange for stock in the new corporations—giving, incidentally, the new companies an opportunity to step up the "basis" or cost of the acquisitions.

The Government realized that and, in various pieces of legislation between 1965 and 1982, unsuccessfully sought to curtail the inappropriate benefits. Powerful legislators in Congress were influenced by the Federation of American Hospitals, a for-profit trade association, to maintain the status quo. The nonprofit hospitals did not have the same clout to promote their agenda—public funds for indigent care, medical education and research, none of which was embraced by for-profit hospitals—because in the 1970's the American Hospital Association permitted for-profit hospital corporations to be members. It's easy to see how the agenda of the nonprofit hospitals would get lost in this environment, and how the philosophy of nonprofit hospitals would eventually be influenced.

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But in 1982, during the Reagan Administration, prospective reimbursement was introduced as a substitute for retrospective—or after-the-fact—payment for services. Prospective reimbursement consisted of fees set in advance based on diagnosis-related groups, known as DRG's. That made the profit or nonprofit status of the hospital irrelevant—there was a certain amount of money per DRG, adjusted for severity, period. For-profit hospital corporations faced a dilemma: how much money would there be for investors who demanded a return in excess of the cost of capital and inflation versus how much went into patient care.

The for-profit hospital corporations responded in various ways. Some went out of business (American Medical International, National Medical Enterprises) but re-emerged as parts of new companies (Tenet). Some went into the insurance business (Humana) with unfortunate results for shareholders. The largest in the field, Hospital Corporation of America (HCA), divided itself into a real-estate investment trust and a company to manage hospitals.

The part of HCA that actually owned hospitals was later acquired by Columbia, a start-up company. Columbia engaged in business practices that, while not significantly different from other for-profit hospital corporations, achieved wide publicity and the attention of the Federal Government. A variety of scandals involving financial manipulation of coding resulted in a fine of nearly $1 billion against Columbia before it changed its name to—Hospital Corporation of America.