King Saud University
College of Business Administration
Department of Health Administration - Masters` Program

<u>HHA 513 Financing Health Systems</u>
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Healthcare Business Basics

Learning Objectives

- ***The Role of Finance in Health Services Organizations.***
- ***Define the concept of a business in financial terms.***
- ***Describe the alternative legal forms of business.***
- ***Articulate the key differences between for-profit and not-for-profit businesses.***

ROLE OF FINANCE

- ***The primary role of finance within health services organizations is to plan for, acquire, and utilize resources to maximize the efficiency (and value) of the organization.***

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Finance Activities
Estimating costs and profitability, planning, and budgeting

- ***First and foremost, healthcare finance involves evaluating the financial effectiveness of current operations and planning for the future.***

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Finance Activities

Managing financial operations

- ***Healthcare organizations** spend a lot of time managing cash and supply inventories as well as collecting money owed for services rendered.*
- ***Proper management** of these functions is necessary to ensure operational effectiveness and to reduce costs.*

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Finance Activities - Financing decisions

- ***All organizations must*** **raise funds to buy the assets necessary to support operations.**
- ***Such decisions*** **involve many issues, such as the choice between long-term and short-term debt and the use of leases versus conventional financing.**
- ***Senior managers*** **and the financial staff typically make the financing decisions, but these decisions have ramifications for managers at all levels**

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Finance Activities

Capital investment decisions

- ***One of the most critical decisions*** **managers make is the selection of new facilities (including land, buildings, and equipment).**
- ***Such decisions*** **play a key role in a business's financial future.**

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Finance Activities

Financial reporting

- **For a variety of reasons, businesses must record and report to outsiders the results of operations and current financial status.**
- ***This task is typically*** **accomplished with a set of financial statements.**

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Finance Activities

Financial and operational analysis

- ***To achieve and maintain*** **a high level of organizational performance, businesses must constantly monitor both financial and operational conditions and take actions as needed to ensure that goals are met.**

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Finance Activities

Contract management

- **In today's healthcare environment, health services organizations must *negotiate, sign, and monitor contracts* with managed care organizations and health insurers.**

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Finance Activities

***Financial risk management*.**

- ***Many financial transactions*** **that take place to support the operations of a business can, in themselves, increase a business's risk.**
- ***Thus, an important finance staff activity*** **is to manage financial risk.**

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The Four Cs

Finance activities can be summarized by the four C's.

- ***Costs.*** **Costs must be continuously monitored to ensure that they are not excessive for the number of services provided.**
- ***Cash.*** **Businesses must have sufficient cash on hand to meet payment obligations as they occur.**
- ***Capital.*** **Businesses must raise the capital (money) necessary to buy the facilities and equipment to provide services.**
- ***Control.*** **Businesses must control their resources to ensure that they are used wisely.**

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HEALTHCARE SETTINGS

- ***Healthcare services*** **are provided in numerous settings, including hospitals, ambulatory care offices and clinics, long-term care facilities, and integrated delivery systems.**
- **Before the 1980s, most healthcare organizations were freestanding and not formally linked with other organizations.**

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HEALTHCARE SETTINGS

- ***Organizations that are*** **linked tended to be part of *horizontal systems*, which control *a single type of healthcare facility*, such as a group of hospitals or nursing homes.**
- ***Recently, however*, many healthcare organizations have created *vertical systems*, which control *different types of providers* such as medical practices, hospitals, and nursing homes.**

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Hospitals

- ***Hospitals*** **provide diagnostic and therapeutic services to individuals who require more than several hours of care, although most hospitals are actively engaged in ambulatory (walk-in) services as well.**
- ***Hospitals*** **must be licensed by the state and undergo inspections for compliance with state regulations.**

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Hospitals

- ***Hospitals differ in function, length of patient stay, size, and ownership.***
- ***These factors affect the type and quantity of assets, services offered, and management requirements and often determine the type and level of reimbursement.***
- ***Hospitals are classified as either general acute care facilities or specialty facilities.***

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Hospitals

- ***General acute care hospitals* provide general medical and surgical services and selected acute specialty services.**
- ***Such hospitals*, which account for the majority of hospitals, have relatively short lengths of stay, typically a week or less.**

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Hospitals

- ***Specialty hospitals**, such as psychiatric, children's, women's, rehabilitation, and cancer facilities, limit the admission of patients to specific ages, sexes, illnesses, or conditions.*

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Hospitals

- ***The number of specialty hospitals has grown significantly in the past few decades because of the belief that such hospitals can provide better patient services than can hospitals that treat all conditions.***
- ***In addition, specialty hospitals often experience lower costs than general hospitals because they do not require the overhead associated with providing many different types of services.***

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Hospitals

- ***Hospitals** vary in size from fewer than 25 beds to more than 1,000 beds; general acute care hospitals tend to be larger than specialty hospitals.*
- ***Although economists** do not all agree, the general belief is that the optimal hospital size is about 400–500 beds.*

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Hospitals

- ***Hospitals* are classified by ownership as governmental, private not-for-profit, or investor owned.**
- ***Despite the expressed differences in mission* between investor-owned and not-for-profit hospitals, not-for-profit hospitals are being forced to place greater emphasis on the financial implications of operating decisions than in the past.**

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Ambulatory (outpatient) Care

- ***Ambulatory care* encompasses services provided to patients who are not admitted to a hospital or nursing home.**
- ***Traditional outpatient settings include* clinics, medical practices, hospital outpatient departments, and emergency departments.**

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Ambulatory (outpatient) Care

- ***Nontraditional settings*, such as home health care, ambulatory surgery centers, urgent care centers, diagnostic imaging centers, rehabilitation and sports medicine centers, and clinical laboratories, have emerged and are seeing substantial growth.**

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Ambulatory (outpatient) Care

- ***The latest innovation in ambulatory care is the retail clinic, a small clinic operated in a retail store (such as a Hyper Market) and staffed by a physician assistant or nurse practitioner.***
- ***Compared to hospital-based services, these innovative settings offer patients more amenities and convenience and, in many situations, lower prices.***

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Ambulatory (outpatient) Care

- ***Many factors have contributed to the expansion of ambulatory services, with technology leading the way.***
- ***Often, patients who once required hospitalization because of the complexity, intensity, invasiveness, or risk associated with certain procedures can now be treated in outpatient settings.***

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Ambulatory (outpatient) Care

- ***In addition, health insurers have encouraged providers to expand their outpatient services by requiring authorization for inpatient services and instituting payment mechanisms that provide incentives to perform services on an outpatient basis.***

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Ambulatory (outpatient) Care

- ***Finally**, starting a business that provides outpatient care is easier than starting a new hospital.*
- ***Ordinarily**, ambulatory facilities are less costly to operate and less frequently subject to licensure and certificate-of-need (CON) regulations than are hospitals, and they generally are not accredited.*

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Ambulatory (outpatient) Care

- ***Historically, ambulatory care managers have handled routine management tasks such as billing, collections, staffing, scheduling, and patient relations, while the owners, often physicians, have tended to the important business decisions.***
- ***However, a more complex healthcare environment, coupled with growing competition, is forcing managers of ambulatory care facilities to become more sophisticated in making business decisions, including finance decisions.***

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Long-term Care

- ***Long-term care consists of healthcare (and some personal care) services provided to individuals who lack all or some functional ability, specifically in the activities of daily living such as eating, bathing, and locomotion.***

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Long-term Care

- ***This type of care usually covers an extended period and may be given as an inpatient or outpatient service.***
- ***Although the most common users* of *long-term care are the elderly, the services are available to individuals of all ages.***

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Long-term Care

- ***Long-term care is a hybrid*** **of healthcare and social services.**
- ***Nursing homes are*** **a major provider of such care.**
- ***Nursing home care*** **is offered at three levels:**
  1. **skilled nursing,**
  2. **nursing, and**
  3. **residential care.**

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Integrated Delivery System

- ***Many healthcare experts have inscribed the benefits of providing hospital care, ambulatory care, long-term care, and business support services through a single integrated delivery system.***

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Integrated Delivery System

The potential benefits of integrated delivery system include:

- ***Patients are kept in the corporate network of services.***
- ***Providers have access to managerial and functional specialists.***
- ***Information systems that track all aspects of patient care, as well as insurance and other data, can be developed more easily.***

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Integrated Delivery System

- ***Larger, multipurpose organizations have better access to capital.***
- ***The ability to recruit and retain management and professional staff is enhanced.***
- ***Healthcare insurers can be offered a complete package of services (one-stop shopping).***

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Integrated Delivery System

- ***A full range of healthcare services, including chronic disease management and health-status improvement programs, can be better planned and delivered to meet the needs of a defined population.***
- ***Incentives that encourage all providers in the system to work together for the common good of the system can be created, which has the potential to improve quality and control costs.***

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Business Basics

- ***The basic concepts of healthcare finance* are mostly the same regardless of the specific sector (e.g., hospital vs. long-term care vs. medical practice) and organizational setting.**
- ***However*, some aspects of healthcare finance are influenced by the unique nature of particular types of healthcare organizations.**

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Business Basics

- ***First*, *we consider the nature of businesses.***
- ***Is the provision of health services a business, and, if so,***
- ***how are such businesses formed, and***
- ***what are the implications of being a business as opposed to a pure charity?***

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Business Basics

- ***Then, we explore the consequences of being a health services business that is organized as a not-for-profit corporation.***
- ***Does not-for-profit status influence an organization's goals and objectives, and, if so, does it affect the practice of finance?***

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Concept of a Business

What is a business?

- ***From the viewpoint of a group of accountants, the answer probably would involve financial statements, such as the income statement and balance sheet.***
- ***Financial accounting involves identifying, measuring, recording, and communicating the economic events and status of an organization.***

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Concept of a Business What is a business?
Financial accounting

- ***This information is summarized and presented in a set of financial statements, the three most important of which are the income statement, the balance sheet, and the statement of cash flows.***
- ***Because these statements communicate financial information, financial accounting is often called "the language of business."***

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Concept of a Business What is a business?

- ***If you asked a group of lawyers, the answer likely would include legal forms of business. Business entities can be one of three basic legal forms:***

1. ***proprietorship or partnership,***
2. ***corporation, or***
3. ***hybrid (having a combination of characteristics from the first two types).***

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Concept of a Business What is a business?

- ***From a financial (economic) perspective, a business can be thought of as an entity—its legal form does not matter—that it is:***
  1. ***obtains financing, or capital, from the marketplace;***
  2. ***uses those funds to buy land, buildings, and equipment (that is, assets);***
  3. ***operates those assets to create goods or services; and***
  4. ***sells those goods or services to create revenue.***

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Concept of a Business What is a business?

- ***A business is an entity that raises capital in the marketplace; invests those funds in assets; and uses those assets to create goods or services, which it sells.***
- ***Businesses differ from pure charities in the sense that businesses sustain themselves by revenue obtained from sales, while pure charities are sustained primarily by contributions.***

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Concept of a Business What is a business?

- ***In a sense, pure charities, as well as government agencies, are budgetary organizations in that their funding is constrained by external forces (contributions or appropriations), and each year they must operate within the budget.***
- ***Businesses, however, are not so constrained; they can influence their "funding" by selling more products or services.***
- ***Yet, in spite of differences, all three types of organization (businesses, pure charities, as well as government agencies) must operate in a financially prudent manner.***

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Alternative Forms of Business Organization

- ***Sole proprietorship***
- ***Partnership***
- ***Corporation***
- ***Hybrid forms***

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Concept of a Business What is a business?

- ***Proprietorship A simple form of business owned by one person. Also called sole proprietorship.***
- ***Partnership An unincorporated business that is created and owned by two or more people.***
- ***For-profit corporation A legal business entity that is separate and distinct from its owners and managers.***

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Proprietorships and Partnerships Advantages

A partnership shares similar advantages to a proprietorship

1. ***low cost and ease of formation***
2. ***subject to few government regulations, and***
3. ***pays no corporate (business) income taxes***

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Proprietorships and Partnerships Disadvantages

Proprietorships and partnerships have several disadvantages, including the following:

1. ***Selling an ownership interest in the business is difficult.***
2. ***Proprietors and partners have unlimited personal liability for the debts of the business, which can result in losses greater than the amount invested in the business.***
3. ***The life of the business is limited to the life of the owners.***

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For-profit Corporations

- ***A for-profit (investor-owned) business may be organized as a corporation, but a not-for-profit business must be organized as a corporation.***
- ***A for-profit corporation is a legal entity that is separate and distinct from its owners and managers.***

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For-profit Corporations

- ***The creation of a separate business entity provides the following primary advantages:***
    1. ***unlimited life,***
    2. ***ease of ownership transfer, and***
    3. ***limited liability***
- ***For-profit corporations can more easily raise money in the financial markets than sole proprietorships or partnerships can.***

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For-profit Corporations

- ***For-profit corporations* have two primary disadvantages.**
- ***First*, corporate earnings typically are subject to double taxation.**
- ***Second*, setting up a corporation and fulfilling the subsequent requirement to file periodic government reports are more costly and time-consuming activities than are required to establish a proprietorship or partnership.**

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For-profit Corporations

The value of any for-profit business, other than a small one, generally is maximized if it is organized as a corporation for the following reasons:

1. ***Limited liability reduces the risks borne by the owners (shareholders).***
2. ***A business's value is dependent on growth opportunities, which in turn are dependent on the business's ability to attract capital (funding).***
3. ***The value of any investment depends on its liquidity (a liquid investment), which means the ease with which it can be sold for a fair price.***

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For-profit Corporations

- ***For tax purposes*, *a standard for-profit corporation is called a C corporation.***
- ***However*, *if they meet certain requirements, one or a few individuals can form a for-profit corporation and elect to pay taxes as if the business were a proprietorship or partnership, hence avoiding double taxation.***

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For-profit Corporations

- ***Such a corporation, which differs only in how the owners are taxed, is called an S corporation.***
- ***Although S corporations are similar to two of the hybrid forms (discussed next) in terms of taxes, the hybrid forms provide more flexibility and benefits to owners***

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Hybrid Forms of Organization

- ***Limited partnership***
- ***Limited liability partnership***
- ***Professional corporation***
- ***S corporation***

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Hybrid Forms

Proprietorship, Partnership, and Corporation historically have dominated the business scene, there is another form known as the hybrid form that has features associated with both partnerships and for-profit corporations.

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Hybrid Forms

- ***Several hybrid forms of business are used by healthcare businesses.***
- ***In general, the hybrid forms are designed to limit owners' liability without having to fully incorporate.***
- ***For example, in a limited liability partnership (LLP), the partners have joint liability for all actions of the partnership, including personal injuries and indebtedness.***

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Hybrid Forms

- ***However*, *all partners enjoy limited liability regarding professional malpractice because partners are only liable for their own individual malpractice actions, not those of other partners.***
- ***In spite of limited malpractice liability*, *the partners are jointly liable for the partnership's debts.***

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Hybrid Forms

- ***This hybrid business model combines the qualities of traditional nonprofit models and for-profit enterprises.***
- ***Social entrepreneurs start this type of hybrid business to make a profit while making a positive social impact.***
- ***They usually have several social ventures running alongside their daily profit-making operations.***

THANK YOU