memo file

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Prepared by the North Dakota Legislative Council staff for the Insurance and Health Care Committee

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MANAGED CARE - PROFIT VERSUS NONPROFIT

INTRODUCTION

This memorandum is in response to a request for information relating to differences that may exist between for-profit managed care providers and nonprofit managed care providers. Managed care encompasses a variety of structural models, including health maintenance organizations (HMOs), provider-sponsored organizations (PSOs), preferred provider organizations (PPOs), exclusive provider organizations (EPOs), point of service (POS) plans, and independent practice associations (IPAs). The differences between for-profit and nonprofit managed care organizations are largely subjective, and therefore often vary according to the source.

Information throughout this memorandum is taken from the sources cited.

HISTORY

According to Jan Greene, "Has Managed Care Lost Its Soul?," *Hospital & Health Networks* (May 1997), managed care in part grew out of a goal of ensuring access to affordable health care and was initiated by industrial employers, unions, and doctors. The Health Maintenance Organization Act of 1973 removed legal barriers to HMO development and provided government grants to start HMOs, but as this grant money stopped, investors started to put money into publicly traded managed care companies. By the mid-1990s, for-profit managed care had taken over the market. By 1997, there were approximately 636 HMOs nationwide, with 76.3 percent of the members in for-profit plans and 26.4 percent in nonprofit plans. Harry Nelson, "Nonprofit and For-Profit HMOs: Converging Practices but Different Goals?," *Milbank Memorial Fund* (1997).

SIMILARITIES

According to Nudelman and Andrews, "The "Value Added" of Not-for-Profit Health Plans," *The New England Journal of Medicine* (April 18, 1996), in managed care the money coming in must equal or exceed the money going out. The statement that no business venture can survive for very long if it continually spends more than it makes is as true for nonprofit organizations as it is for for-profit organizations.

Similarities between for-profit and nonprofit managed care organizations include motivation to deliver quality health care at a reasonable cost, operation under tight budgets in a tough financial environment, and benefits and premium costs are comparable in most regions.

DIFFERENCES

A for-profit plan provides a service so it can make a profit, while a nonprofit plan makes a profit so it can provide a service. What the two types of plans do with their profit margins and why they do what they do often constitute the distinctions between them. The major differences between for-profit and nonprofit managed care plans lie in purpose, values and attitude, and behavior. By law, a nonprofit plan must follow the charitable purposes in the corporate articles and bylaws. These purposes typically reflect the values and attitudes of the corporations, and the nonprofit plan acts accordingly. In contrast, a for-profit plan is a moneymaking venture and this purpose permeates the business values and attitudes of the plan such that the profitmaking purpose is a primary drive behind the plan's behavior. The differences addressed in this memorandum are classified as accountability and community service, medical-loss ratio, quality of service and preventive care, and flexibility.

Accountability and Community Service

The nature of a for-profit organization is that it is accountable to the shareholders. One possible result of this accountability is that for-profit capitated managed care plans may strive to provide patients as little care as possible. The countervailing argument in favor of for-profit managed care providers is that in addition to being accountable to shareholders, the providers are also accountable to their stakeholders--patients. Although it is arguable that for-profit plans' contributions to shareholders benefit the economy, close attachments to Wall Street can also produce major upheavals that have direct impact on plans and their members.

Nonprofit managed care providers are accountable to their patients, providers of care, payers, and the communities in which they operate. This accountability is intended to result in nonprofits striving to lessen the burden of illness and to increase the well-being of the people in the community.

While for-profit organizations serve the community via payment of mandatory taxes and optional voluntary community service, nonprofit organizations are mandated to serve the community by virtue of the organization's tax-exempt status. The extent to which

either for-profit or nonprofit HMOs enhance the public good is largely undocumented; nevertheless, considerable data compiled over time by researchers who explore the behavior of for-profit and nonprofit enterprises indicates that, generally, for-profits track economic incentives more closely than nonprofits, and nonprofits perform more activities that economic incentives do not reward. Economists who have studied nonprofit organizations say that nonprofits are more likely than private organizations to provide benefits that are difficult to measure and evaluate.

Nonprofit managed care providers that follow their missions make important contributions to the knowledge base in health care, including prevention, primary care for chronic conditions, and outcome research. These efforts often result from partnerships with local businesses, county and state health departments, primary and secondary schools, and medical schools. This community responsibility often fosters the training of primary care physicians and medical research in disease management, design of care, and organization and financing of health care. Lawrence and Ludden, "Trusting in the Future: The Distinct Advantages of Nonprofit HMOs," *The Milbank Quarterly*, (Vol. 75, No. 1, 1997). An advantage of research performed by nonprofits is that the research results are made public and applications of research findings act as catalysts in setting many of the standards that all health care plans must meet in order to compete in the marketplace.

In the past, one of the community benefits associated with nonprofit managed care plans has been that they generally favored rating and underwriting practices that protect the community and spread the risks versus for-profit plans that typically set prices according to risk pools. However, market pressures are moving nonprofits away from pure community rating practices.

Medical-Loss Ratio - Percentage of Premium to Medical Care

The medical-loss ratio is frequently evaluated when comparing for-profit managed care plans to nonprofit managed care plans. This ratio is the percentage of premium to medical care provided. For-profit plans try to keep this percentage as low as possible--typically about 80 percent--and return approximately 10 to 12 percent to shareholders. Nonprofit plans try to keep this percentage as high as possible--approximately 90 percent--and reinvest any profit into the plan.

For-profit plans claim that because they do not have the tax benefits nonprofits have, for-profit plans are forced to be more administratively efficient and less of the premium goes toward administrative expenses. One thing to remember when comparing medical-loss ratios is that numbers can be easily manipulated.

Quality of Service and Preventive Care

The results of studies that compare the quality of care between for-profit HMOs and nonprofit HMOs tend to favor integrated nonprofit HMOs. Integration of members' care across the continuum of services is better achieved by nonprofit HMOs because the balance of power between physicians and management makes it possible to systematically determine the best approach and implementation, there is experience in controlling variation of treatment, there is a strong ability to influence practice pattern among physicians, and there is less likelihood that other kinds of businesses will diffuse their corporate culture.

The for-profit plans and the nonprofit plans each seem to claim that they are the driving force behind improvements in quality of service and medical care. For-profit plans argue that unlike nonprofit plans, for-profits, by virtue of their organizational structure, have access to the large amounts of capital that are required to organize and operate quality service plans. Supporters of nonprofit plans argue that for-profit plans are less likely to invest in preventive care because it does not make short-term profits. The success of a for-profit plan is measured quarterly. Nonprofit plans are more likely to invest in preventive care because the success of a nonprofit managed care plan is measured on the basis of life span and quality of life. Supporters of for-profit plans claim that there is no correlation between the profit status of a for-profit plan and levels of preventive care services.

Flexibility

For-profit managed care providers may be more flexible and able to adjust to changing markets. For-profit plans, in comparison with nonprofits, are often more experienced with information-based quality management, have clearly defined treatment systems and advanced information systems, adhere to cost-savings goals without obligation to donors or other community constituent, and often have lower employee pay scales. Sharon J. Jackson, "Why Managed Care? Why Now?," *The Journal*, (Vol. 7, Issue 1). As discussed above, for-profit plans are able to obtain capital through the sale of stock and can therefore efficiently enter a market, develop and expand networks, aggressively establish prices, and use new information and administrative systems that allow them to be competitive.

However, nonprofit plans may offer more stability by better managing variation by building collaborative ventures between physicians and managers that emphasize partnership, sharing, and integration of

decisionmaking. One possible drawback to stability on the part of nonprofits is that stability can also cause stagnation and inability to change.

CONCLUSION

With rising health care costs and ever-increasing competition, the trend has been for managed care such as HMOs to be offered by for-profit plans and, as a result, to be more of a mechanism to utilize doctors and hospitals more efficiently and less of a method of creating a more rational, humane form of health care delivery. It is increasingly difficult to evaluate the social contributions of nonprofits because as for-profit plans enter the arena of managed care, the barriers between for-profits and nonprofits are crumbling. For example, traditionally community friendly premium rating used by nonprofit plans is deteriorating, and economic incentives encourage for-profit plans to invest in communities.