

# Estimate of the Situation

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## Health Care and the Economy of Scale Myth

*Economy of Scale Definition: a reduction in the cost of producing something (as a car or a unit of electricity) brought about especially by increased size of production facilities —usually used in plural. – Merriam Webster Dictionary*

*“Economies of scale are a good thing. If we didn't have them, we'd still be living in tents and eating buffalo.” - Jamie Dimon*

Merriam Webster's dictionary claims that the term “economy of scale” first appeared in print in 1944. Economy of scale ideas are said to have contributed to Henry Ford's successful employment of mass production techniques in 1908. However, the underlying concepts are generally credited to Adam Smith, the 18<sup>th</sup> Century economist. Economy of scale (and related economy of scope) principles are staples in masters of business administration programs.

Therefore, as U.S. hospitals struggle to identify and adjust to the existential challenges presented by “the new normal”, it isn't surprising that many would instinctively return to universally accepted business concepts for solutions. Unfortunately, there is a significant probability that health care consolidation and acquisition strategies that rest on those time-tested ideas will ultimately fail. Here's why:

- Economy of scale ideas originally worked well in very large centrally-directed industrial production and manufacturing concerns. They have been less successful in the modern era, particularly in service sector enterprises such as health care where success depends more directly on market-driven feedback loops.
- The traditional power of “big” has been almost completely negated by the pace of change and the power of cost-effective information, communication, medical, and transportation technology. The ability to anticipate and react quickly to market forces trumps size. The ability of hospital purchasing groups to leverage buying power further levels the playing field in the supply sector.
- Forgive the less-than-perfect analogy, but when two ships are sinking because of hull leaks their chances of survival are not enhanced by lashing them together and adding weight at the top.

FJB



7667 N.W. Prairie View Road, Suite 204  
Kansas City, Missouri 64151  
(816) 587-2120  
<http://bradyinc.com>