A Theory of Organizational Response to Hospital Regulation: A Reply

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A recently published general theory of organizational response to regulation is examined. A number of problems are observed in regard to the basic assumption underlying the theory, the directionality of predicted relationships forming the theory, the exclusion of goal attainment as a realistic motivation for managing, and the generality of the theory.

Recently Cook, Shortell, Conrad, and Morrisey (1983) presented a theory of organizational response to regulation in the hospital sector. Cook et al. indicate that their work "provides a framework for considering this issue by suggesting a more general theory of organizational response to regulation" (1983, p. 194). Considering the trends toward greater regulation of organizational activities in the health services field and considering the past regulatory trends in many other industries (e.g., communications, banking, insurance), such a theory is welcomed. Few businesses are likely to escape significant regulatory control in the future (Dunlop, 1976; Toffler, 1983). Even with the current Administration's efforts to deregulate, the average firm continues to exist in an environment of actual and impending control and regulation (Weidenbaum, 1975). Managers and management theorists need a more rigorous understanding of how regulation can influence the structure, process, and outcomes of organizational endeavors.

There has been little response to the Cook et al. work. However, if this theory is to provide a general framework for conceptualizing the organizational response-regulation relationship, then it requires close scrutiny.

The present analysis concerns the basis assumption—the foundation—underlying the theory and the variables that may have been omitted or understated. Is the theory appropriate for guiding future empirical analysis and management strategy?

An Appropriate Assumption?

The foundation to the Cook et al. theory is the assumption that "all organizations strive to maintain their autonomy and identity, reduce uncertainty, and prevent unnecessary dependence on their environments—in this case the regulatory environment" (1983, p. 197). Is this assumption compatible with reality? The present authors believe that this interpretation may be excessively liberal and that organizations do not predominantly seek autonomy in the manner suggested by Cook et al.

Health care facilities might seek dependence under rate review (RR) and certificate-of-need (CON) programs. First, consider the growing adoption of prospective rate reimbursement centered on the RR concept. Hospitals with a significant patient load comprised of public assistance patients may actually seek greater alliance with and less autonomy from the regulatory agency (Foster, 1982). These hospitals must clearly communicate to the agency the composition of their patients. If the regulatory agency does not accurately adjust its reimbursement mechanism for the percentage of public assistance patients served, the severity of the case mix for these patients, and the contribution to underfunding resulting from a heavy component of public assistance
service, hospitals may be forced to reduce or cease some operations or services (Berki, 1983; Dowling, 1974).

The use of diagnosis related groups (DRGs) as an extension of the RR concept may result in even greater dependence and less autonomy by hospitals in relation to regulatory agencies (Young & Saltman, 1982, 1983). Hospitals with disproportionately severe patient case mixes may encounter financial difficulties unless cooperation is achieved with the regulatory agency (Young & Saltman, 1982, 1983). DRG rates are based on “normal” cases, and hospitals with excessive numbers of severe cases must prove to the regulatory agency that they deserve supplemental funding. Without the supplement they cannot afford to serve patients with severe conditions or unusually extended lengths of stay.

CON is a good example of regulation that may encourage health organizations to collaborate with the regulatory agency (i.e., health systems agency). Many hospitals and nursing homes are now pressing for the continuation of CON programs even though the effectiveness of CON has not been entirely demonstrated (Salkever & Bice, 1976). CON has created licensed franchises for health facilities in many urban areas. Rather than seeking increased autonomy from this form of regulation, health facilities may actively support their dependence on CON by lobbying for legislative allocations to CON budgets. They clearly choose a regulated rather than a free market.

There also is evidence from nonhealth care organizations suggesting that managers may pursue dependence instead of autonomous existence (Owen & Braeutigam, 1978). The cable television industry, truckers and Teamsters fighting ICC deregulation, and airlines against FCC deregulation are examples illustrating that it is often advantageous for firms to be dependent on regulation (Stigler, 1971). Like CON for health facilities, the dependence helps to sanction oligopoly or monopoly services. Although the preceding examples seem to favor dependence, it might be argued that in no case is this “unnecessary” dependence. Such a conclusion is open to interpretation (Pfeffer & Salancik, 1978). For example, a nursing home owner may support dependence on CON because it provides a franchise. Is this unnecessary dependence? For the owner who will benefit from high occupancy and the possibilities for high profits, the dependence is necessary. For the taxpayer who wants lower taxes, the franchise may prohibit competition that could drive down the price of care if other regulatory adjustments also were made (Salkever & Bice, 1979).

Regulation and control of professional lobbyists and guaranteed loans to the automobile industry (e.g., Chrysler) and the aviation industry (e.g., Lockheed) suggest that manufacturers seldom hesitate to respond to the benefits of regulatory or governmental agency alliances (Owen & Braeutigam, 1978). The behavior of the firms may not be uniform or consistent (i.e., continually seeking help or continually avoiding regulation), but these examples do suggest that the Cook et al. interpretation of autonomy-seeking behavior by organizations may be too liberal—organizations do not always seek autonomy as the Cook et al. theory suggests.

Cause and Effect

The next significant problem with the Cook et al. theory is the depiction of cause and effect. Although the theory is not specific, it suggests that: (1) increasing regulatory intensity causes an increasing organization response that results in decreasing autonomy (Cook et al.’s Hypothesis 12) and (2) decreasing regulatory intensity causes a decreasing organizational response that results in increasing autonomy (Cook et al.’s Hypothesis 1). These cause and effect relationships suggest a continuum of managerial responses to regulatory intensity.

Under strict regulation, organizations respond with strategies that help maintain autonomy (Gupta & Lad, 1983). Yet, at the extreme depicted above, some health facilities inevitably will lose their autonomy despite this strategic behavior (Williamson, 1975). Under low levels of regulation, organizations respond less frequently to regulation. Autonomy remains high because the organization experiences a relatively regulation-free environment. Hence the benefit of not having to undertake strategic behavior in response to regulation is maintenance of the organization’s independence and freedom of discretion.

Do organizations actually respond to increasing regulation in this manner? And do the outcomes from these actions result in the variations
in autonomy as the model indicates? A careful analysis of these predicted relationships and thoughtful reflection on how organizations are strategically managed must raise a critical issue here. The Cook et al. theory implies that regulatory intensity is a determinant of organizational response. The direction of influence is from regulation to strategic response.

Consider the benefit from responding to high regulatory intensity as suggested by Cook et al. in their Hypothesis 12. Despite the response, the organization may still discover that its autonomy has dissipated. Strategically, managers may ask why should the firm bother to respond to regulation if it eventually will lose autonomy anyway (Fischer, 1983; Post & Mahon, 1980)? Why not save the time, effort, and expenditure of resources by not responding to regulation? The outcome may be the same—autonomy decreases.

Under decreasing regulation it is possible that an organization may try harder to increase autonomy. This strategic action is opposite to that predicted by Cook et al. In their model they view an environment with low regulation as one that does not evoke substantial organizational response. Autonomy remains high. But what about the organization that prefers to implement various strategies to prevent encroaching regulation (Kotter, 1979; Pfeffer & Salancik, 1978)? Do organizations not value a regulation free environment and strive to maintain it through the allocation of resources in an effort to resist regulation? The outcome may be the same—autonomy decreases.

In conclusion, the Cook et al. theory is too deterministic and not probabilistic enough. Game-like responses to regulation suggested by Owen and Braeutigam (1978) and others have not been adequately incorporated in the Cook et al. theory. A static model is the ultimate result. Organizations are viewed as static entities that initially resist regulation and then seek to minimize its influence until optimal regulation is reached. At that point they succumb and lose autonomy. The present authors believe that organizational responses are better characterized as more dynamic, give-and-take processes.

Organizational Goals

The Cook et al. model also fails to incorporate aspects of performance, end-results, goals or outcomes (Thompson & McEwen, 1958). Cook et al. seem to deemphasize the idea that organizations operate to achieve an explicit or implied level of performance or end-result. The guiding criteria

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The Cook et al. model also fails to incorporate aspects of performance, end-results, goals or outcomes (Thompson & McEwen, 1958). Cook et al. seem to deemphasize the idea that organizations operate to achieve an explicit or implied level of performance or end-result. The guiding criteria
for decisions are the organizational goals. When pursuing these end-results it may be necessary to adjust for regulation, but regulatory intensity seldom is the predominant motivation for decision making (Post & Mahon, 1980). Organizational responses are developed in light of goals and the variables that moderate goal attainment (such as regulatory intensity).

This problem in organizational motivations for decision making and response formulation is evident in Cook et al.'s theory. According to them, organizational responses are a function of regulatory intensity, exogenous factors, and modifying factors. The question here is where do organizational goals fit in? Complex organizations such as hospitals must address regulation if they are to survive. However, whether external regulation or internal goals receive primary attention is the issue raised here.

Cook et al.'s theory could be reformulated to include the idea that performance is a function of regulatory intensity, organizational responses, exogenous factors, modifying factors, and unexplained variance. This reformulation conveys the importance of the interaction of organizational goals and the regulatory environment. This redepiction provides a better foundation for understanding micro and macro organizational responses (Pfeffer & Salancik, 1978; Post & Mahon, 1980; Thompson & McEwen, 1958).

There is merit in using performance as the dependent variable in a theory of organizational response to regulation. Foremost, by incorporating performance, a revised Cook et al. theory then would have more congruence with other management theories (Goodman & Pennings, 1977). Most of the contemporary management theories inevitably return to the acid test—are goals accomplished (Van de Ven & Ferry, 1980)? As the Cook et al. theory presently stands, this question about organizational goals is left hanging. When modified to incorporate performance, the theory is more conducive to maintaining existing lines of research, which have centered on performance as a dependent variable.

Limited Generalizability

A final concern involving the Cook et al. theory is its limited generality. It retains a very narrow focus on hospitals; however, it presents itself as a general theory applicable to most other organizations. The impact of third party reimbursement and lack of incentives to achieve operating economies make hospitals different from business, public, or voluntary organizations. Yet, Cook et al. insist that the reaction of hospitals to regulation provides a framework from which other organizations can form similar responses in their environments. Cook et al. may have inadvertently suggested that their theory is generalizable, considering the uniqueness of the hospital regulatory environment. Whether the uniqueness of the hospital regulatory environment permits such generalization is questionable.

Even if the theory is more limited than acknowledged by Cook et al., it is appropriate to encourage discussion on how organizations respond to regulation. Certainly their examination of hospitals has provided insights that are useful in understanding the effect of private sector regulation. As it stands, the theory may be incomplete. However, this sort of theory building and discourse is presently needed to advance existing paradigms and empirical research.

Recapitulation

Despite its shortcomings, Cook et al.'s theory is a useful starting point for further conceptualization and empirical research. The challenge is to take this initial theory and refine it until it is capable of explaining all responses by organizations to regulation.

This discussion of Cook et al.'s theory has attempted to caution researchers on these points:

1. an assumption about autonomy seeking on the part of organizations that may not depict the real world.
2. confusion in the cause and effect relationships among variables that explain organizational responses in diverse situations.
3. the exclusion of goals as a major guideline for organizational responses to the intense regulatory environment.
4. limitations on the generality of the theory to regulation in the private sector (i.e., applications beyond hospitals).

These problems do not vitiate the theory; they merely suggest that additions based on reconceptualization of the theory should accompany empirical tests of its predictions.
References


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