

Fight or Flight: The Threat of Specialty Competition and the Service Offerings of General Hospitals

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Abstract: The growth of the specialty hospital industry has been one of the most important changes to the hospital industry in recent years. This new organizational form – focused on specific services such as cardiac surgery – may facilitate higher quality, lower cost care. With fixed prices and imperfect physician agency, however, this type of organizational innovation may also lead to altered incentives for incumbent general hospitals and unclear impact on welfare. A diversified incumbent may attempt to predate entry by shifting resources toward the profitable services lines that are targeted by the entrant (e.g., buying up scarce inputs or making large fixed investments that must be replicated by an entrant). Either of these actions would make the market less attractive to a focused entrant but would come either at a cost to the service line from which the incumbent transfers resources or due to increased intensity of services for marginal patients. We study the response of incumbent general hospitals to the introduction of the Medicare Modernization Act (MMA) of 2003, which placed an effective moratorium on the construction of new specialty hospitals. We measure market desirability using a model of entry thresholds (Bresnahan and Reiss, 1991) and test for non-monotone changes in the intensity of contested services lines before and after the MMA moratorium across the distribution of *ex ante* entry likelihood (Ellison and Ellison, 2007; Dafny, 2005). We find empirical evidence for changes in the rate of cardiac catheterization, particularly for healthier patients – one way to “search” for more patients. We do not find, however, that these investments affect the rate of low profit services provided by general hospitals.

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