Last month's cover story asked three prominent health care experts to define their visions of a government agency that would enforce the same sort of "transparency" in medicine that helped free up financial markets. Due to a production error, the input of one of those experts — Regina Herzlinger, PhD, professor of business administration at Harvard Business School — was not printed in its entirety. Below is the complete article.

HEALTH CARE SHOULD BE MORE 'TRANSPARENT'

BY REGINA HERZLINGER, PHD

When Franklin D. Roosevelt created the federal Securities and Exchange Commission to require regular audited disclosure and broad dissemination of corporate financial performance, he was blanketed by a blizzard of criticism from the business community.

After all, business people contended, there was no need for the government to require disclosure. The American way was to provide voluntary, not mandatory, disclosure. And why federalize it? "We are the U.S., not the U.S.S.R."

There were state commissions in place to regulate capital markets. And the costs of compiling the information would surely outweigh its benefits. No generally accepted accounting procedures (GAAP) existed at that time, so the measurement task would be Herculean. And what would all the dumb bunny investors who did not know a debit from a credit do with all that info?

Roosevelt was not dissuaded. He felt that many state commissions were ineffectual and frequently had overlapping requirements. Companies went crazy trying to comply, or at least, those that bothered to try.

Westinghouse, which no longer exists but which at one time was a great industrial player, went for 10 years without reporting to its stockholders.

When FDR — through the SEC — made such reporting mandatory, he was viewed as somebody who would bring down the entire system because the cost of compiling this information would be too great.

Case for transparency

What happened? We now have the most efficient capital markets in the world. The cost of dealing with money has steadily decreased and it's much easier to raise money in the U.S. in the publicly traded financial markets than in any other country.

One of the reasons is because the SEC's reporting requirements increased the so-called transparency of the market. Once the SEC kicked into gear, a parallel process for generating GAAP went into effect, leading to auditable measures of performance.

Ordinary people have a fair degree of trust in the veracity of the financial data that are being used to measure performance. So we put our money into the stock market, vastly swelling the availability of capital to be reinvested in the economy. For the dumb bunnies, mutual funds that invest money on our behalf were created. Mutual fund performance is also regularly measured and broadly available.

Regina Herzlinger, PhD, of Harvard Business School, argues that information required by the federal SEC was key to revolutionizing our capital markets. A similar sort of agency is key to transforming health care.

PHOTOGRAPH BY WEBB CHAPPELL

Right now, health care information is an oxymoron. What do you know about the performance of the surgeon and hospital that are going to do your open-heart surgery? In contrast, how much do you know about the performance of the company in which you own 1,000 shares of stock?

See what I mean? Health care, too, is in need of transparency. Health insurance products clearly do not meet consumers' needs, in part because they are so standardized. An SEC for health care would enforce the sort of transparency that helped free up financial markets with mutual funds that were tailored to the needs of individual investors.

Take the 57-year-old woman who is very interested in having long-term care insurance as part of her benefits. If she were let loose on a truly open market, a number of insurers would figure out ways to offer such a policy. For instance, they might invent one that includes a higher deductible in exchange for more coverage at the tail end.

Insurers wouldn't be the only ones affected. Physicians and other deliverers of health care services would have to report their performance as well.

Resistance guaranteed

Providers and insurers are no more eager to have their performance measured than businessmen were in the 1930s. The existing players will, of course, resist change.

They already complain of the difficulty of measurement. Some, for example, note that some primary care physicians who contract with HMOs treat fewer than 60 diabetics out of their panel of 1,500 to 2,000 patients. They ask: "How can you hold this person responsible for performance in diabetes?"

My response is that a doctor who sees so few diabetics probably should not be treating them at all. The transparency that a health care SEC creates would ensure that diabetics find their way to those who best treat the disease.

It's interesting to look at what happened in the mutual fund industry.

Many people thought John C. Bogle was crazy because, about 25 years ago, he started a mutual fund, indexed it, and sold it to the public. The smart money laughed that no American would buy that product. That crazy man started the Vanguard Group.

So while the existing players are saying "It's not going to work," there's another John C. Bogle out there who right now is saying "This is going to change."

Information required by the SEC was key to revolutionizing our capital markets. A similar sort of SEC is key to transforming health care.

***Regina Herzlinger, PhD,** is professor of business administration at Harvard Business School.*