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Reducing Hospital Prices While Increasing Net Revenues

By Mark Jeziorski

Hospital prices have been in the press recently. Newspapers around the country have been publishing stories highlighting the wide disparities in prices for common medical procedures and tests among hospitals in close proximity to each other. Concerned about its prices being high, one hospital undertook an initiative to reduce its prices. This hospital was able to dramatically decrease prices, improve its median ratio of prices to wage adjusted APC payments and increase net revenues.

Hospital Profile (Rounded Numbers)

Beds: 500 (Acute, Rehabilitation and Psychiatric)

Gross Revenues: $1.5 billion

Total Patient Days: 120,000

Discharges: 21,000

Payor Mix: 70% Governmental (i.e. Medicare, Medicaid and County)

Objectives

The management of this hospital undertook a major initiative to review and lower its hospital's prices. Specifically, management's objectives were to 1) decrease prices 2) have the new prices set at a reasonable percentile relative to comparable hospitals' prices and 3) decrease the ratio of prices to wage adjusted APC payments. In addition, management 1) wanted no change in gross revenues, 2) did not want a decrease in net revenues, 3) did not want prices to be below payment rates (e.g. wage adjusted APC payments) and 4) wanted prices to be based on a methodology that was reasonable and easy to understand. As part of this initiative, management also wanted to stop charging for general pharmacy and supply items since these items are generally not separately reimbursed by its third party payors.

Approach

The approach taken to achieve the objectives for this initiative was to construct models that calculate the changes in gross and net revenues resulting from pricing changes. Management provided its ideal price point relative to the comparable hospitals' prices and ideal ratio of prices to wage adjusted APC payments. Prices were developed based on the ideal price point and ratio of prices to wage adjusted APC payments. The changes in gross and net revenues were calculated using these prices. Management then reviewed the gross and net revenue changes and revised the price point and ratio of prices to wage adjusted APC payments. New prices were developed and the gross and net revenues were re-calculated. This process continued until an outcome was achieved that met all of the objectives for this initiative.

In the end, the prices were set at or below the 60th percentile of the comparable hospitals prices with a median ratio of prices to wage adjusted APC payments of 2.5. There were a few prices (approximately 3%) that ended up being above the 60th percentile. The majority of these prices were above the 60th percentile so that the prices would be above the wage adjusted APC payments.

Current (Pre-Initiative) Prices and Rates

The following table presents what the hospital's current prices/rates were in three categories that represent the majority of the non supply/implant and pharmacy/pharmaceutical prices. The table shows the percentage of prices relative to the percentiles of the comparable hospitals' prices/rates. For example, two percent (2%) of the hospital's current room and board rates were higher than all of the comparable hospitals' rates, fifty-nine percent (59%) were greater than the 75th percentile of the comparable hospitals' rates and sixty-one percent (61%) were greater than the 60th percentile of the comparable hospitals' rates.

Category	Current Prices Relative to the Comparable Hospitals' Prices/Rates		
	> 100th	> 75th	> 60th
Room & Board	2%	59%	61%
Non-Cost Based Items With CPT/HCPCS Codes[1]	20%	31%	39%
Operating Room Time	25%	33%	36%
Overall for Above Categories	20%	32%	39%

[1]Cost–based items include pharmacy, pharmaceuticals, supplies, implants, etc.

The ratios of the currents prices to the wage adjusted APC payments varied from 0.2 to 27.7. The median ratio of prices to wage adjusted APC payments was 3.0.

New Prices and Rates

Forty-four percent (44%) of the hospital's prices were decreased, forty-two percent (42%) of the prices remained the same and thirteen percent (13%) of the prices were increased. Ninety-seven percent (97%) of the room and board, non-cost based items with CPT/HCPCS codes and operating room time charges were set at or below the 60th percentile of the comparable hospitals' prices.

Category	New Prices Relative to the Comparable Hospitals' Prices/Rates		
	> 100th	> 75th	> 60th
Room & Board	0%	0%	0%
Non-Cost Based Items With CPT/HCPCS Codes[1]	1%	2%	3%
OR Time	0%	5%	15%
Overall for Above Categories	1%	2%	3%

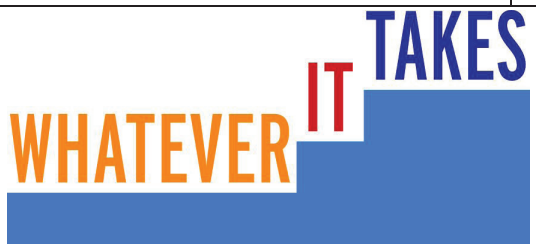
Comparing the new prices to the current prices, it can be seen that the profile of prices relative to the comparable hospitals' prices changed significantly. The percentage of prices that are the highest relative to the comparable hospitals' prices was reduced from twenty percent (20%) to one percent (1%) and the percentage of prices that are above the 60th percentile of the comparable hospitals' prices was reduced from thirty-nine percent (39%) to three percent (3%).

The median ratio of prices to wage adjusted APC payment was decreased from 3.0 to 2.5. The new ratio of 2.5 is twenty-two percent (22%) below the lowest ratio for the comparable hospitals. Also, the hospital stopped charging for general pharmacy and supply items which is essentially having a zero price for these items.

Gross and Net Revenue Impacts

Gross revenues are projected to increase by 0.4% as a result of the pricing changes. The change in net revenues related to all contracted commercial payment terms except the "lesser of" provisions and before the impact of the pricing changes on outlier payments is projected to be $1,500,000. The pricing changes are projected to result in a net revenue decrease of $400,000 because of the "lesser of" contract provisions. Outlier payments are projected to decrease by $400,000 as a result of the pricing changes. Overall, net revenues are projected to increase by $700,000.

Category	1st Yr Change in Net Revenues
Net Impact Before Outlier Payments and "Lesser of" Provisions	$1,500,000
Impact of "Lesser of " Contract Provisions	-400,000
Impact on Outlier Payments	-400,000
Total Change In Net Revenues in First Year	$700,000



Key to Achieving Outcome

In the case of this hospital, the key to increasing net revenues while decreasing 44% of the prices and not changing 42% of the prices was *accurately* modeling *all* reimbursements impacted by price changes and modeling *all* contract provisions that would impact net revenues from changes in prices. Only by modeling *all* reimbursements and *all* contract provisions that would impact net revenues from pricing changes could net revenues be optimized for a given change (or no change) in gross revenues and the change in net revenues be accurately projected.

Reimbursements impacted by price changes include, but are not limited to, items paid a percentage of charges unless they are included in a case rate, items paid a percentage of charges up to a cap, claims paid a percentage of charges, claims paid a percentage of charges up to a cap, inpatient outliers, outpatient outliers, etc. Accurately modeling some of these reimbursements impacted by price changes was a significant undertaking. One of the reasons for the undertaking being significant was that claims data had to be utilized to model some managed care payors' payments because the payments were a percentage of charges up to cap for all charges on the claim excluding select carve-outs for implants and pharmaceuticals.

Also critical to achieving the desired outcome was the modeling of all contract provisions that impact net revenues when prices were changed. Two of the more significant contract provisions in the case of this hospital included "lesser of" provisions and caps on charge increases. If these contract provisions were not modeled, the hospital would have projected significantly more net revenues then what was achievable and would have ended up with less net revenues than if the provisions were modeled. The hospital would have ended up with less net revenues because modeling these provisions allowed the hospital to mitigate the impact that the contract provisions were having by appropriately adjusting prices.

Summary

Hospital prices are in the spotlight once again. This situation may prompt some hospitals to consider lowering their prices. These hospitals can take heart in the fact that one hospital was able to reduce a significant number of prices while increasing net revenues. The key to achieving this outcome was *accurately* modeling *all* reimbursements impacted by price changes and modeling *all* contract provisions that impact net revenues from pricing changes.

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