Outsourcing, Contracting and Pricing Issues for Employers, Plans and Providers

Pricing Strategy Discussion

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Pricing Presentation Objectives

Prices are in many ways part of the "glue" that binds payers, employers and providers together and is hence fundamental to how we relate to one another.

- Define industry-wide pricing issues/problems
- Define the implications for payers and providers
- Define accelerators to more defensible, value-oriented and even margin enhancing prices and rates

Pricing Issues/Problems

International Perspective
Domestic Perspective

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The Prices We Pay

Given their relative magnitudes, some prices matter more than others.

U. S. Private Healthcare Insurance Dollar - 2003

Source: CMS 2005

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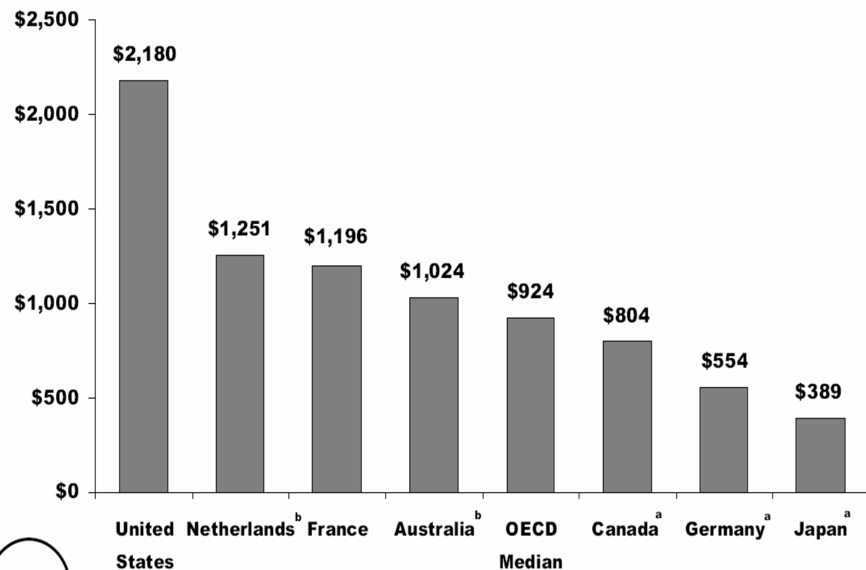
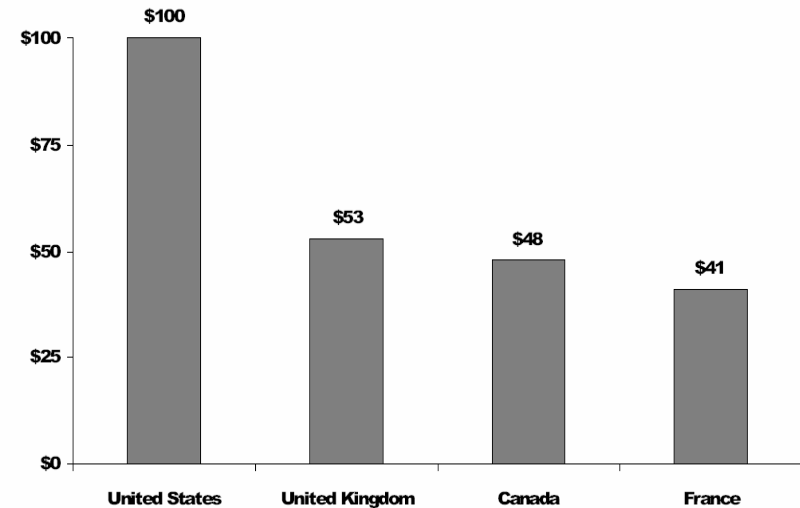
International Comparison

Given international comparisons, some prices warrant particular attention.

"It's the Prices, Stupid!"[1]





B. Frogner et al., "Multinational Comparisons of Health Systems Data, 2005," Commonwealth Fund, April 2006. Prices = payments, adjusted for purchasing power parity

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International Comparison (continued)

Observations

- Relative to 30 other countries, U.S.'s per capita health spending is not driven by different use rates, service mix intensity or excess capacity
- Rather, it's the **PRICES** that make U.S. expenditures/capita 2+ times other countries
  - Inpatient price/day
  - Pharmaceutical prices
  - Physician prices
  - Outpatient facility service prices
- **Outpatient/capita** spending (including physicians) is 3x of OECD median, yet U.S. OP visits/capita and CT & MRI machines/capita are not far from OECD medians

Sources: Based on G.F. Anderson et al., "It's the Prices, Stupid: Why the United States Is So Different from Other Countries," Health Affairs 23 no. 3; and G.F. Anderson et al., "Health Care Spending and Use of Information Technology In OECD Counties," Health Affairs 25 no. 3

Pricing Becoming Top of Mind Issue

Other factors are accelerating downward pricing pressure.

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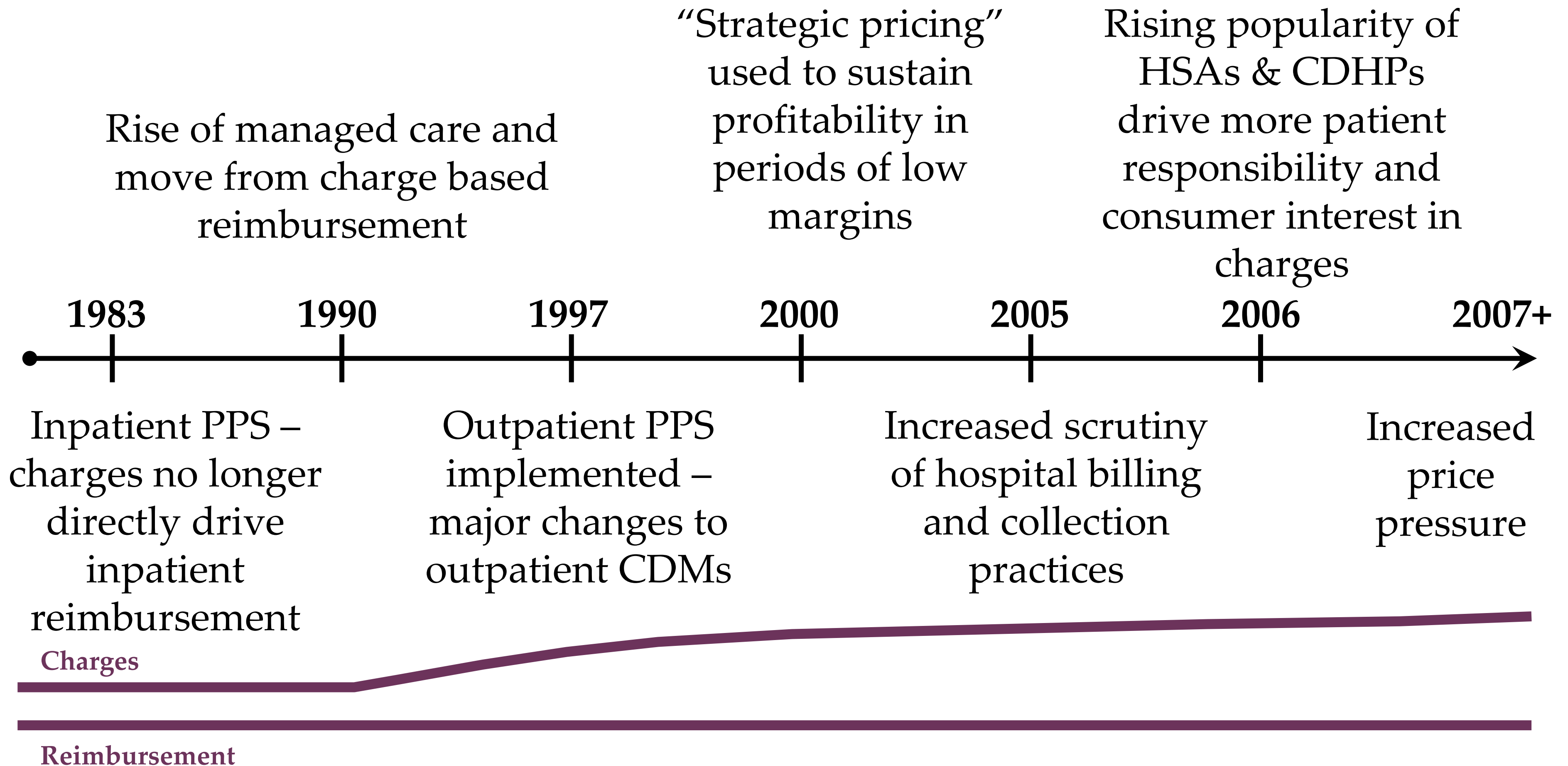
Pricing - How Did We Get Here?



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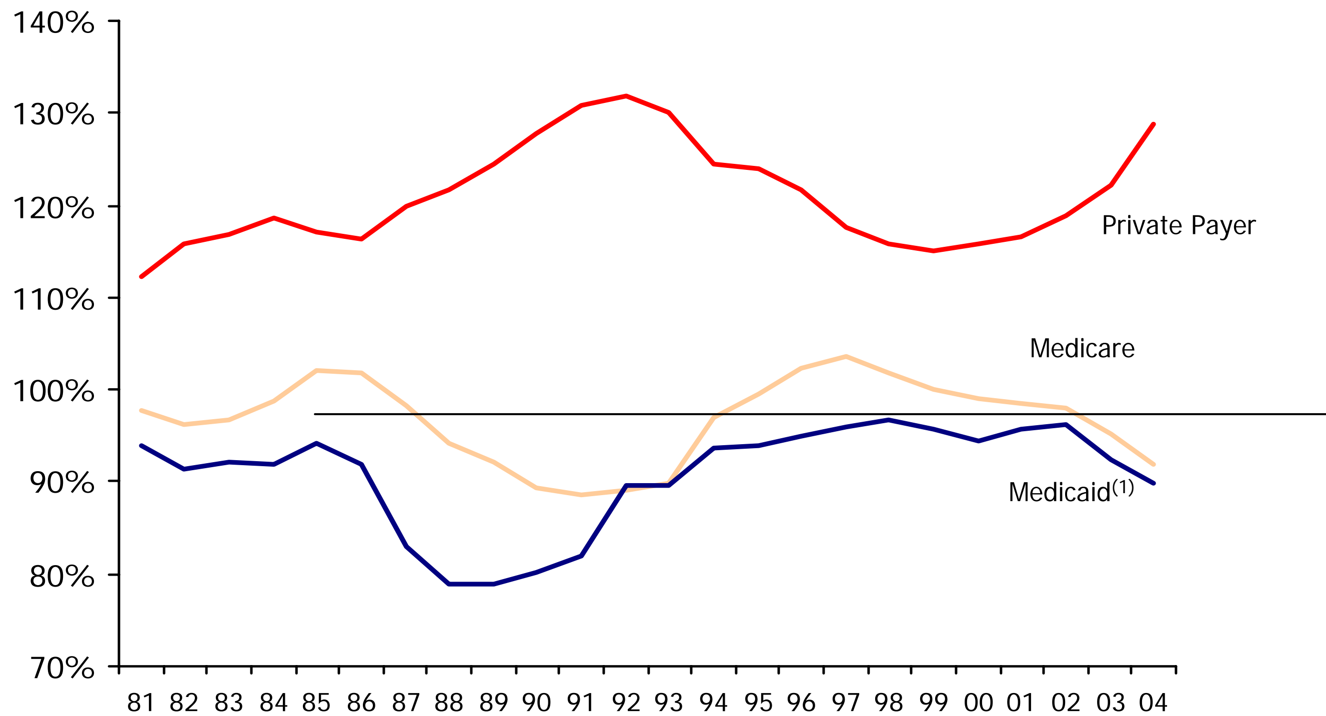
Assertion 1: Pricing Issue Will Intensify

Unsustainable trends, by definition, must come to an end.

Cost Shifting and Hospital Payment to Cost Ratios



Source: The Lewin Group analysis of American Hospital Association Annual Survey data, 1981 – 2004, for community hospitals

(1) *Includes Medicaid Disproportionate Share payments*

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Assertion 2: Reflect on the Levers We Control

How can reimbursement approaches (that we control) encourage the right investments rather than promote more cost shifting?

Upside Down Economics

Service	Assumed Core Competencies	Level of Competition	Typical Hospital Positioning	Typical Hospital Reimbursement/ Profitability
Standard Outpatient Imaging and Therapy	• Price • Proximity • Convenience	High	Poor	High
Planned Surgery (IP and OP)	• The Surgeon • Volume/scale • Nursing Expertise	Moderate	Poor-Moderate (depends on CON)	High
Inpatient Medicine	• Acute treatment • ALOS management	Low	Strong	Low
Mission-Oriented Services	• Volume/scale • 24 Hr Orientation • Full Service Orientation	Very Low	Very Strong	Low to Medium

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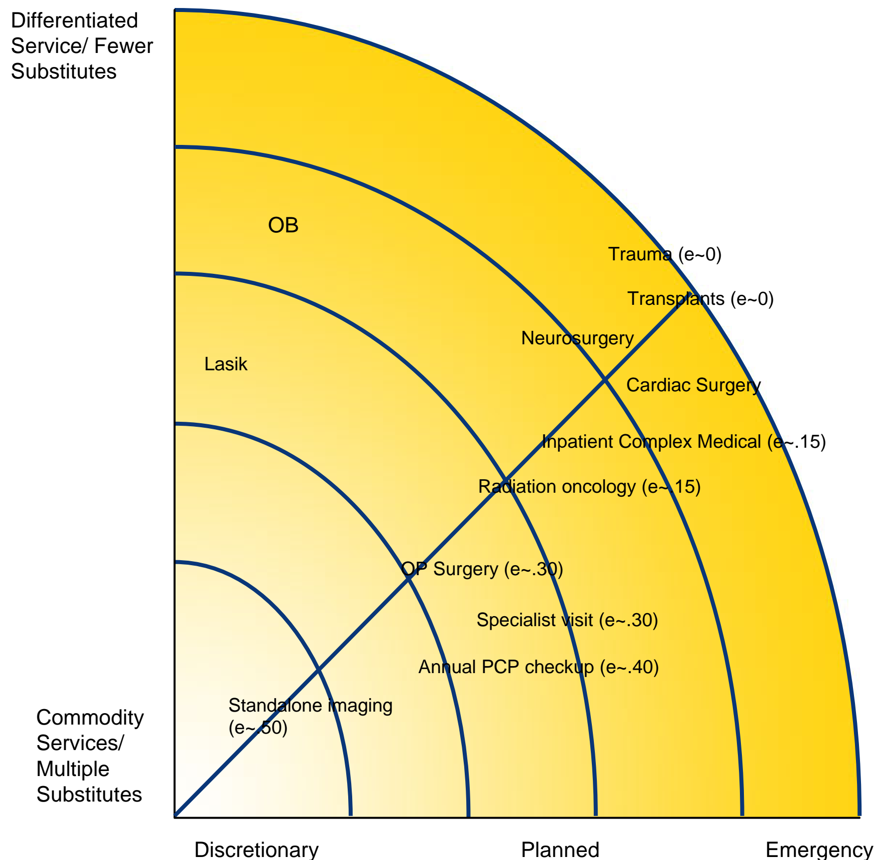
Payer/Provider Implications

Payer Implications – Get the Incentives Right

Service/Patient Segmentation



Action Items

- Payers should segment medical expenses by service acuity and patient price sensitivity
- Evaluate benefit design, network design and provider reimbursement strategy by segment
  - What's our reimbursement strategy for commodity ambulatory services?
  - Where do payment rates need to increase (e.g., HIT, chronic care)?
  - Zero sum vs. positive sum
- Beware of blunt instruments which ignore patient and service segments (e.g., HDHP, tiered networks)
- Influence provider's clinical and capital decision making to ensure more cost effective and efficient care

Source: Elasticities based on Navigant research, Rand Health Insurance Experiment and Ringel J. S. et al, *The Elasticity of Demand for Health Care*, 2002.

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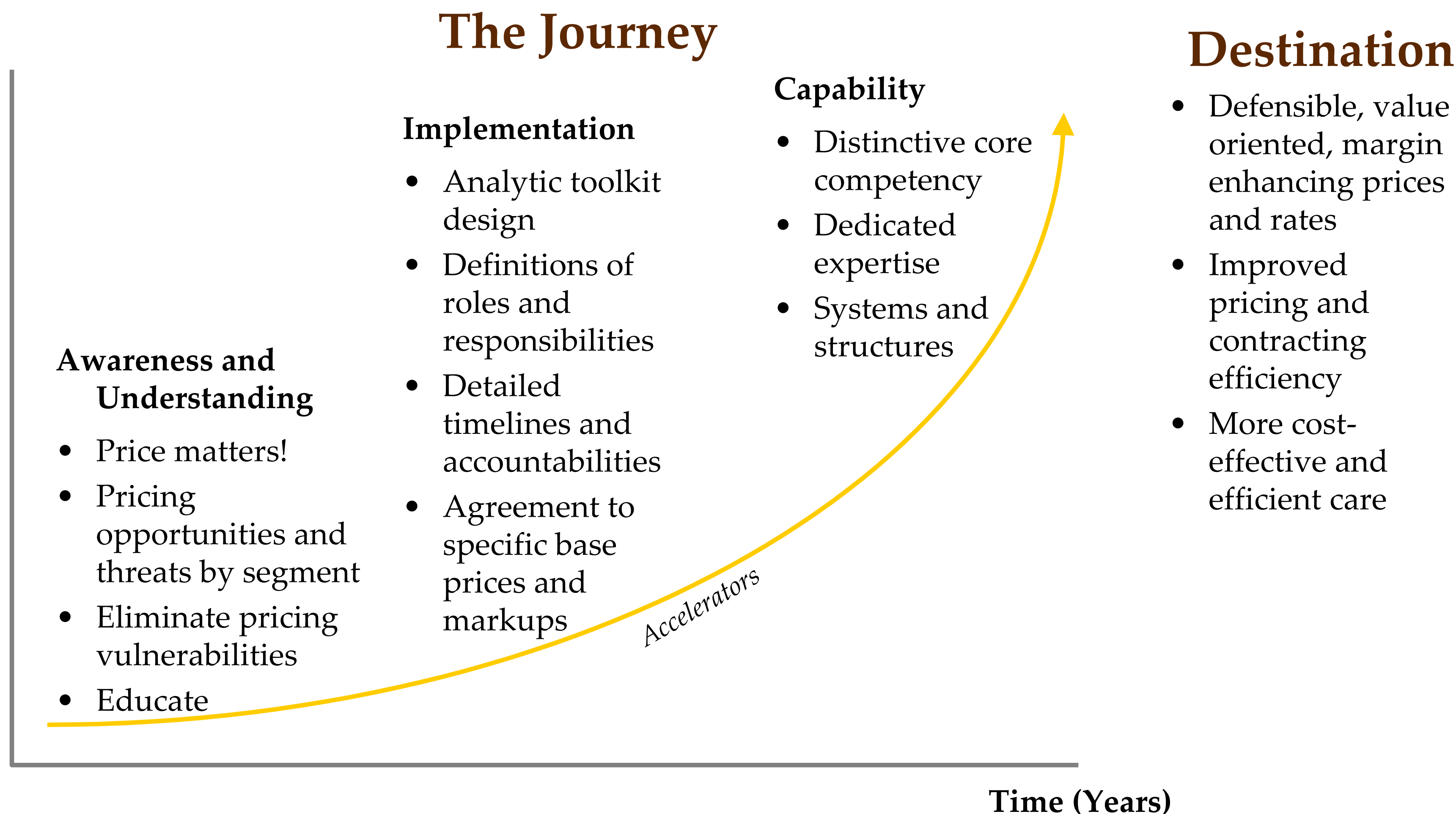
Provider Implications – Pricing (and Contracting) Journey

Providers can likewise commit to a multi-year initiative to achieve defensible, value-oriented and margin enhancing prices and rates.



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Key Accelerators

Several 'accelerators' can expedite progress toward more defensible, value oriented and even margin enhancing prices/rates – as well as more cost-effective, efficient care.

1. Evaluate your market/portfolio
2. Internal/external education, consensus and communications plan
3. Standard pricing formula/methodology
4. Pricing and contracting toolkit
5. New roles/responsibilities
6. Implement solution for a segment of the organization

Source: Based on M. Nugent upcoming article in HFM

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Accelerator #1: Evaluate Your Market/Portfolio

Health systems operate multiple businesses, making this analysis all the more important.

1. Less competitive market segment; longer term/strategic perspective
   - Play defense; reduce risk of public scrutiny of prices
   - Defensible pricing engagement
2. Shorter term/budget oriented perspective, regardless of market dynamics
   - Increase specific prices/rates to help offset budget shortfalls or opportunistically improve financial position
   - CDM price optimization and short term contracting tactics
3. Competitive, retail oriented market segment and longer term/strategic perspective
   - Incorporate price into a multi-year strategy to grow/defend market share, dependant on the type of service: commodity or proprietary
   - "Pricing transparency strategy" or "retail pricing and contracting strategy"

How Hospitals are Responding

Option #1: Wait and See Approach

- Stick to **traditional pricing techniques**
  - Multiple of Medicare
  - Across the board charge master increases
  - Avoid the $100 aspirin
  - Pricing is the last step in the budgeting process (rather than one of the first)
- Ignores inevitability of more price based competition/downward pricing pressure for commodity services
  - Continued investments in bells and whistles

How Hospitals are Responding (continued)

Option #2: Defensible Pricing Approach

Common Activities

- Board and senior management education sessions on state of pricing
- Updated billing and collections policies (including charity care)
- Standardized CDM with key price and compliance vulnerabilities resolved
- Updated cost accounting policies/procedures
- Standard defensible pricing formula/methodology

Common Mistakes

- "Magic bullet" software – only focus on CDM prices
- Ignore contracted rates and out of pockets
- Hastily posting prices (with no other data to demonstrate value for price)
- Pursuing an across the board ambulatory price decrease without a clear sense of cost structure, patient price sensitivity or breakeven volumes

How Hospitals are Responding (continued)

Option #3: Price to Value Approach

- Focuses on creating/demonstrating **value** for the **price** and **rate** to payers, patients
  - Defensible prices/rates by segment
  - Margin enhancing prices/rates by segment
- Requires strategic assessment of **price vs. value relationship** as part of a broader portfolio reconfiguration, price transparency or pricing/contracting strategy
- Forces a more deliberate discussion of how volume, service mix, cost reductions, capital investments, prices and rates will achieve annual budget targets by segment
- May entail **higher reimbursement for proprietary services and lower reimbursement for commodity services** while eliminating costs
- Can uncover new ways to use price to enhance margins, including peak pricing

Key Issue: How Will Payers Respond?

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Provider/Payer Win-Win: Value Oriented Pricing

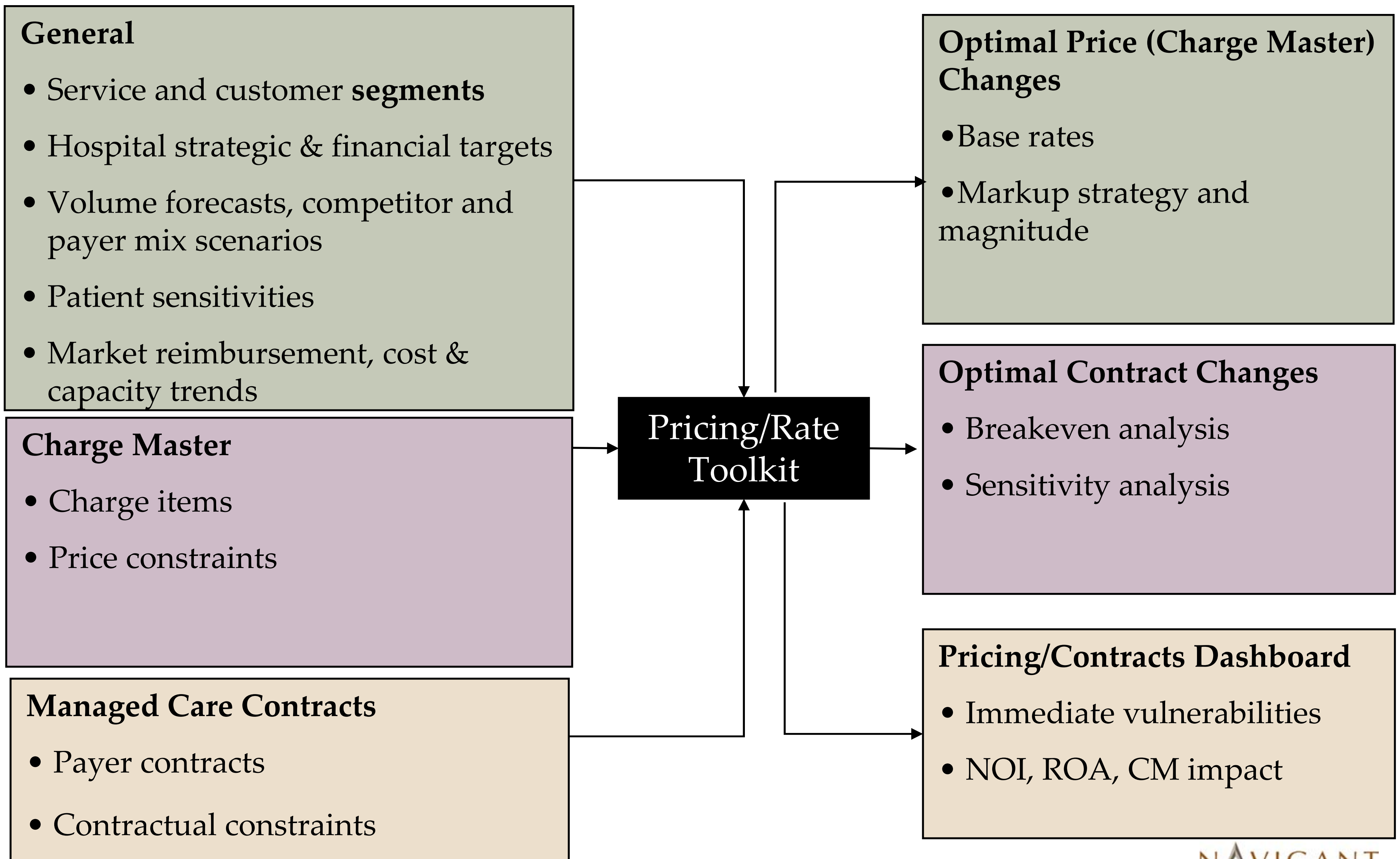
Peak Pricing Example

- Hospital's asset productivity varies greatly depending on machine and time of week (e.g., imaging and operating suites are typically empty on weekends, but overrun early in the week)
- Hospitals beginning to integrate scheduling and financial systems to offer peak and off-peak price differentials to better match supply and demand (and forego unnecessary capital investments)

No Peak Pricing	Peak Pricing
Higher prices sustained, but: New competitors enter Duplicative capital investments Lower asset productivity Lower margins	Lower prices on average, so: Less attractive market entry Higher volume for incumbent hospital Less excess capital investments Greater asset productivity and margins

- Peak pricers view long-term capital costs as avoidable rather than fixed and anticipate a competitor's downstream reactions to the initial pricing decision.
- That is, these organizations integrate pricing and capital investment decisions to make both decisions more strategically

Accelerator #4: Provider/Payer Toolkit



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Summary: Strategic Price and Rate Management Process

Although this process reflects the provider's perspective, many payers should re-evaluate their processes.

1. Establish the organization's pricing/contracting intent
2. Define actionable customer segments
3. Segment services across service lines
4. Compile a market intelligence fact base
5. Understand pricing alternatives
6. Define price ranges for services
7. Model revenue and margin scenarios across the contractual portfolio
8. Prepare/conduct the negotiation with target payors
9. Organize to market/communicate value

Competitive Positioning (steps 1–3)

Pricing Science (steps 4–7)

Contracting Strategy (step 8)

Management (step 9)

Source: M. Nugent "The Price is Right?" HFM December 2004

Thank You!

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