

National Summit on Healthcare Price, Cost and Quality Transparency
How and Why Hospitals Set Prices
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Presented by

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Outline

1. **How do hospitals set prices?**
2. **What are the real facts regarding hospital prices?**
3. **How real is transparency?**
4. **How can you assess the reasonableness of hospital prices?**

How do hospitals set prices?

What prices must cover

- **Average costs**
- **Losses on patients who pay less than cost**
- **Discounts to patients who pay charges**
 - **Uninsured**
 - **Commercial**
- **Reasonable return on investment**
 - **Sustainable growth**

Simple Pricing Example

Payer Mix	# Patients	Payment
Medicare	50	94% Cost
Medicaid	16	80% Cost
Insured (Fee)	16	130% Cost
Insured (% Charge)	12	65% Charges
Uninsured	6	5% Charges

- **Cost**
 - **\$100/Unit**
- **Profit Requirement**
 - **4% or \$400**

Pricing Required

	Gross Revenue @ \$288.90	Net Revenue	Profit (Loss)
Medicare	\$14,445	\$4,700	(\$300)
Medicaid	4,622	1,280	(320)
Insured Fee	4,622	2,080	480
Insured % of Charge	3,467	2,253	1,053
Uninsured	1,733	87	(513)
	\$28,889	\$10,400	\$400

$$\text{Markup} = \frac{28,889}{10,000} = 2.89$$

PRICING MODEL-ALTERNATIVE PAYMENT ARRANGEMENTS

Payer	Volume	Payment 1- Current World	Payment 2 Maryland / All Payer Equity	Payment 3 Commercial Payer Equity
Medicare	50	94% of Cost	95% of Charges	94% of Cost
Medicaid	16	80% of Cost	95% of Charges	80% of Cost
Uninsured	6	5% of Charges	5% of Charges	5% of Charges
Insured Fee Based	16	130% of Cost	95% of Charges	95% of Charges
Insured Charge Based	12	60% of Charges	95% of Charges	95% of Charges
Volume	100			
Cost/Unit \$100 or \$10,000 Total				
Profit 4% or \$400 Total				

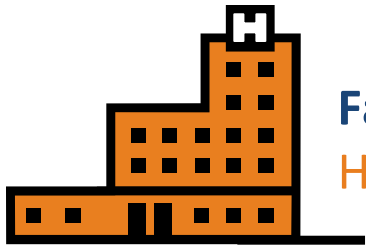
Impact of Alternative Payment on Price

	Payment 1 – Current World	Payment 2 – Maryland/All Payer Equity	Payment 3 – Commercial Payer Equity
Net Patient Revenue			
Medicare	4,700	5,513	4,700
Medicaid	1,280	1,764	1,280
Uninsured	87	35	49
Insured Fee Based	2,080	1,764	2,498
Insured Charge Based	2,253	1,323	1,873
Total Net Patient Revenue	10,400	10,400	10,400
Costs	10,000	10,000	10,000
Net Income	400	400	400
Required Price/Markup	288.87	116.07	164.31

What are the real facts of Hospital Pricing?



Are prices high?



Facility-level charge measure: Hospital Charge Index[®]

Inpatient Charges

Inpatient Charge Index

Formula:

Your Medicare Charge
per Discharge (CMI/WI adj)
US Median Medicare
Charge per Discharge
(CMI/WI adj)

Outpatient Charges

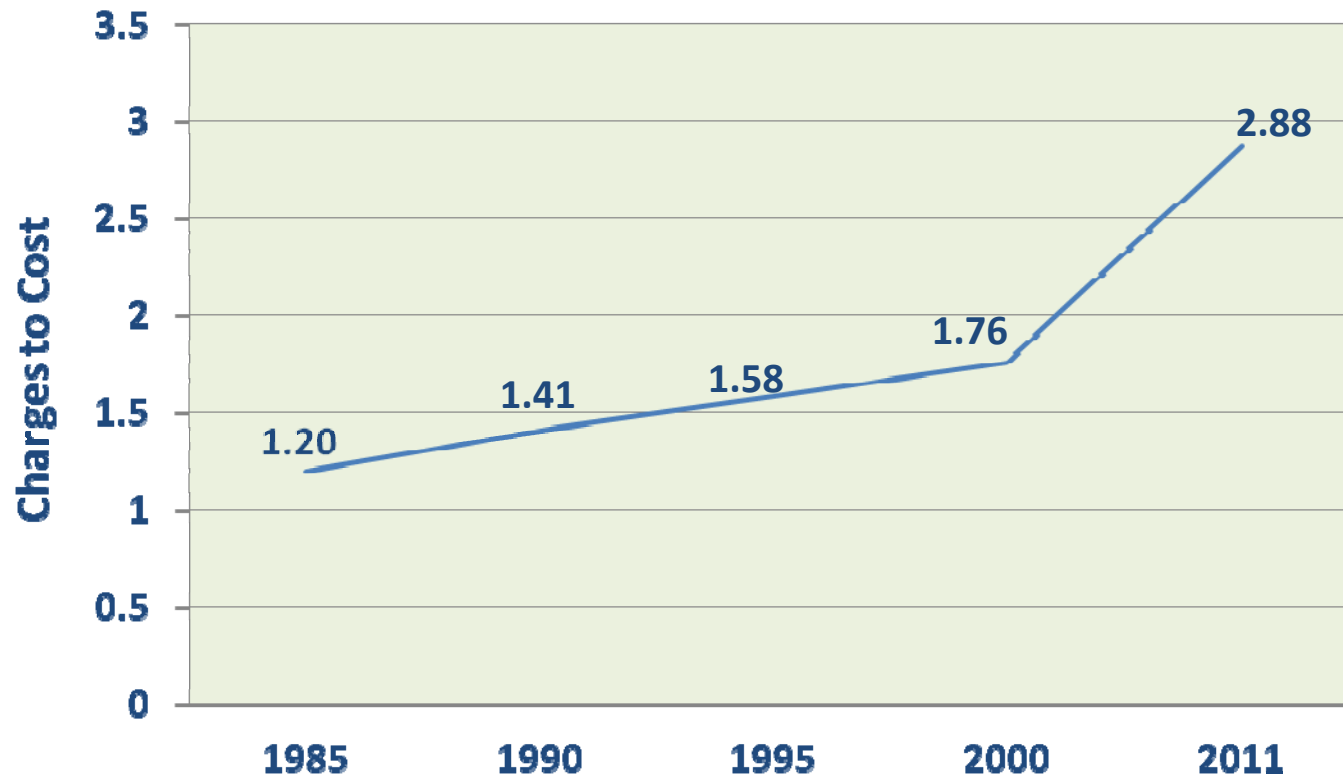
Outpatient Charge
Index

Formula:

Your Medicare Charge
per Visit (RW/WI adj)
US Median Medicare
Charge per Visit (RW/WI
adj)

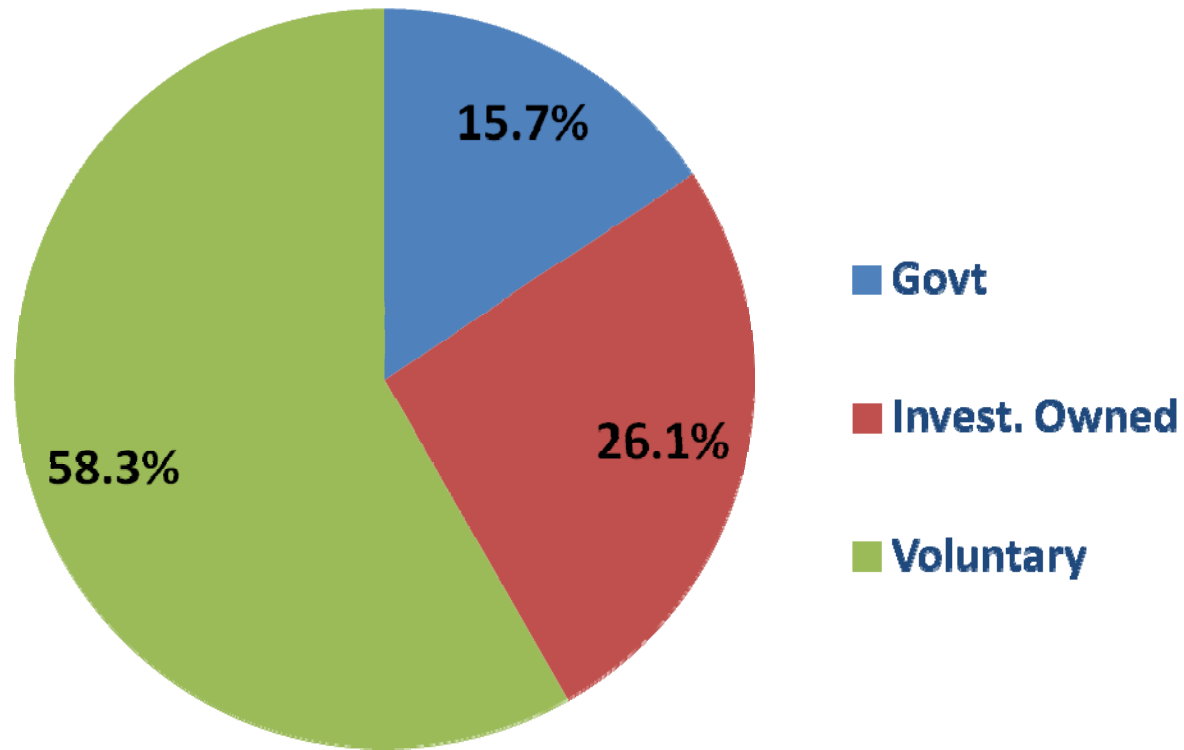
The Hospital Charge Index[®], developed by Cleverley + Associates, compares the Medicare charge per discharge and Medicare charge per visit at the hospital (both adjusted for case complexity and wage index differences) to the US median value for each measure. The result is the most objective overall charge comparison available. A high index score indicates a higher relative charge position.

PRICE-TO-COST RELATIONSHIPS



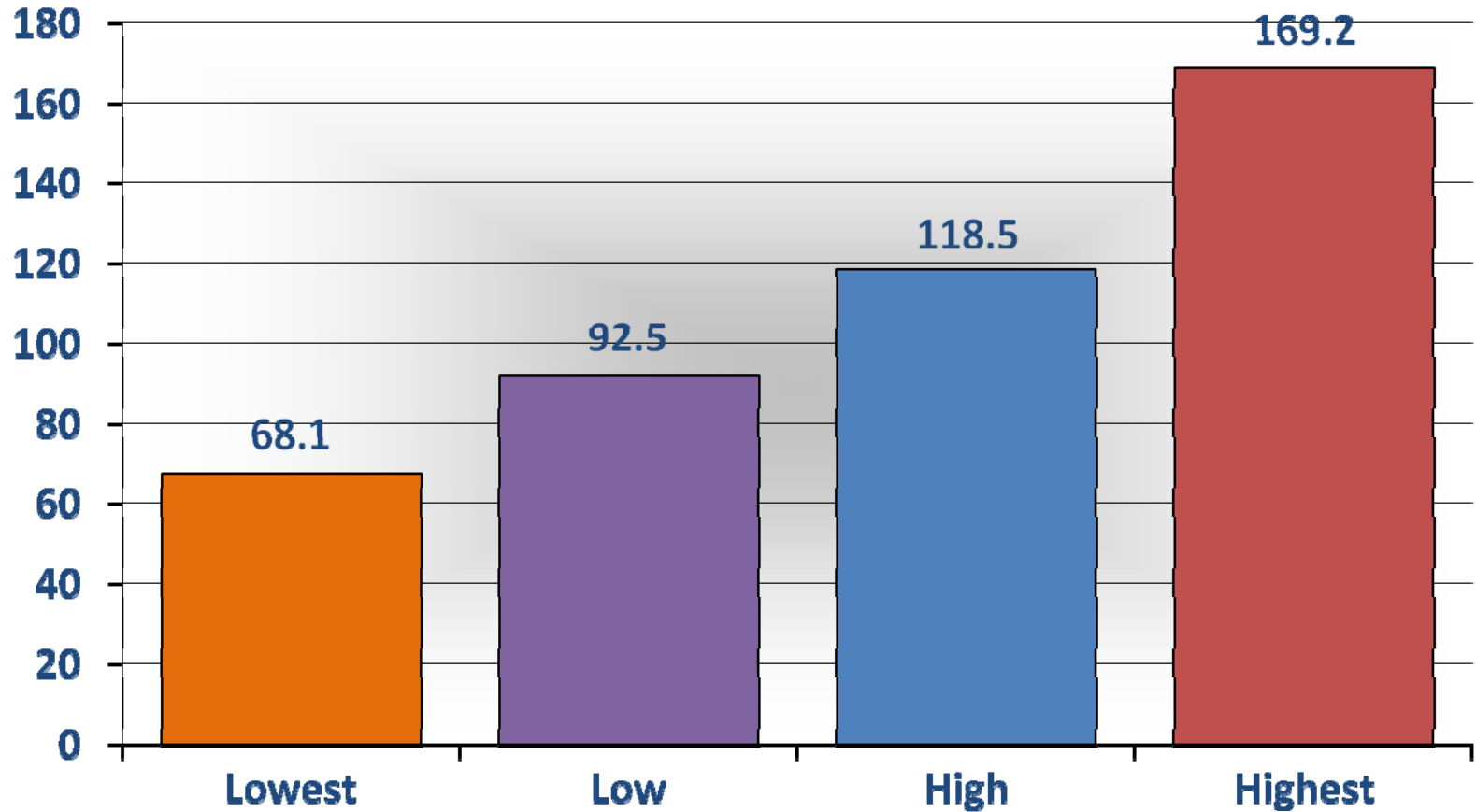
Prices are increasing in latter years due to payment deficiencies

Composition of Hospitals (2953 Acute Care – Non Critical Access Hospitals with 2012 Data)



Hospital Charge Index 2012 Quartile Medians

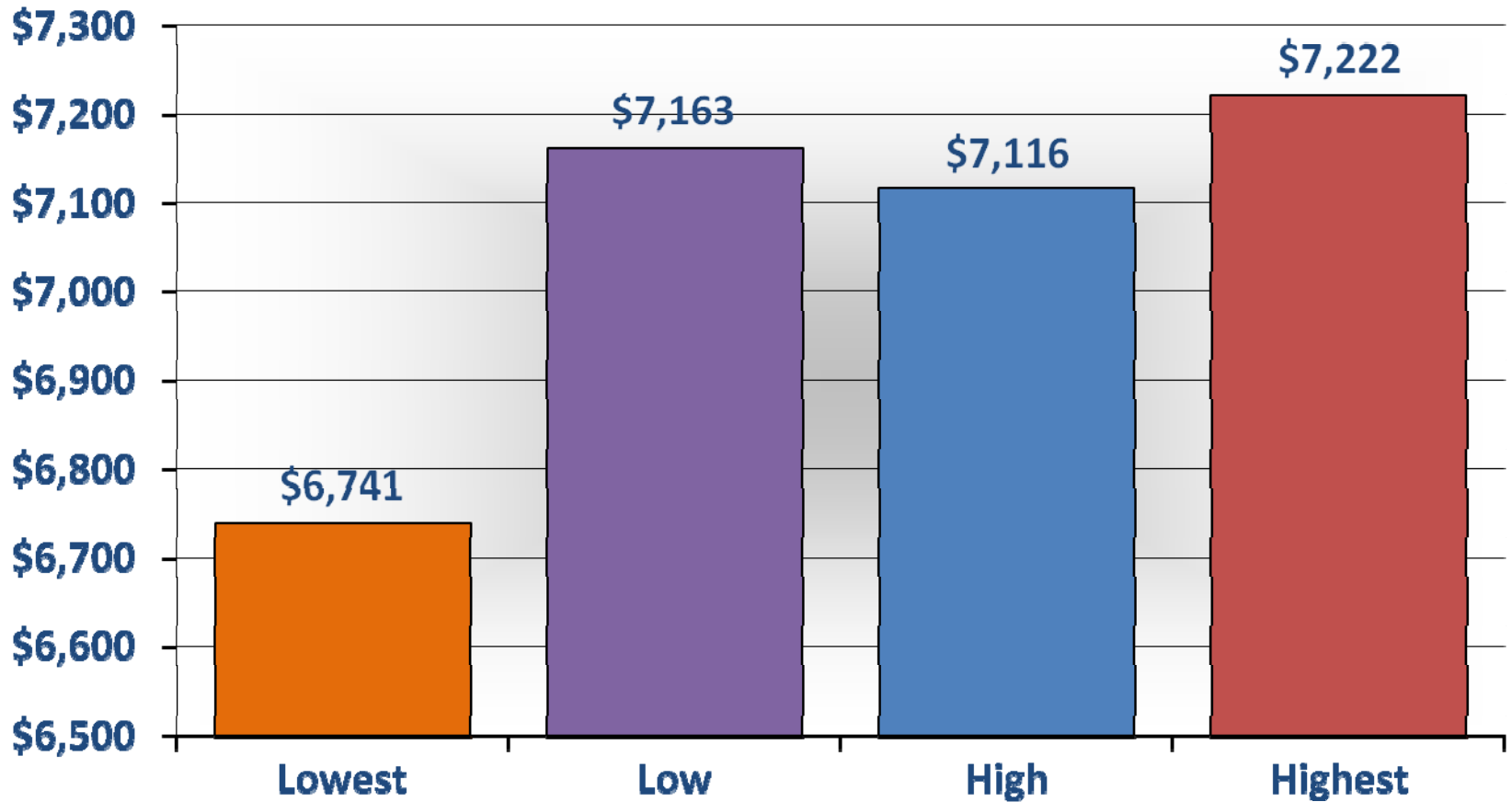
Hospital Charge Index



Large variations in hospital prices exist

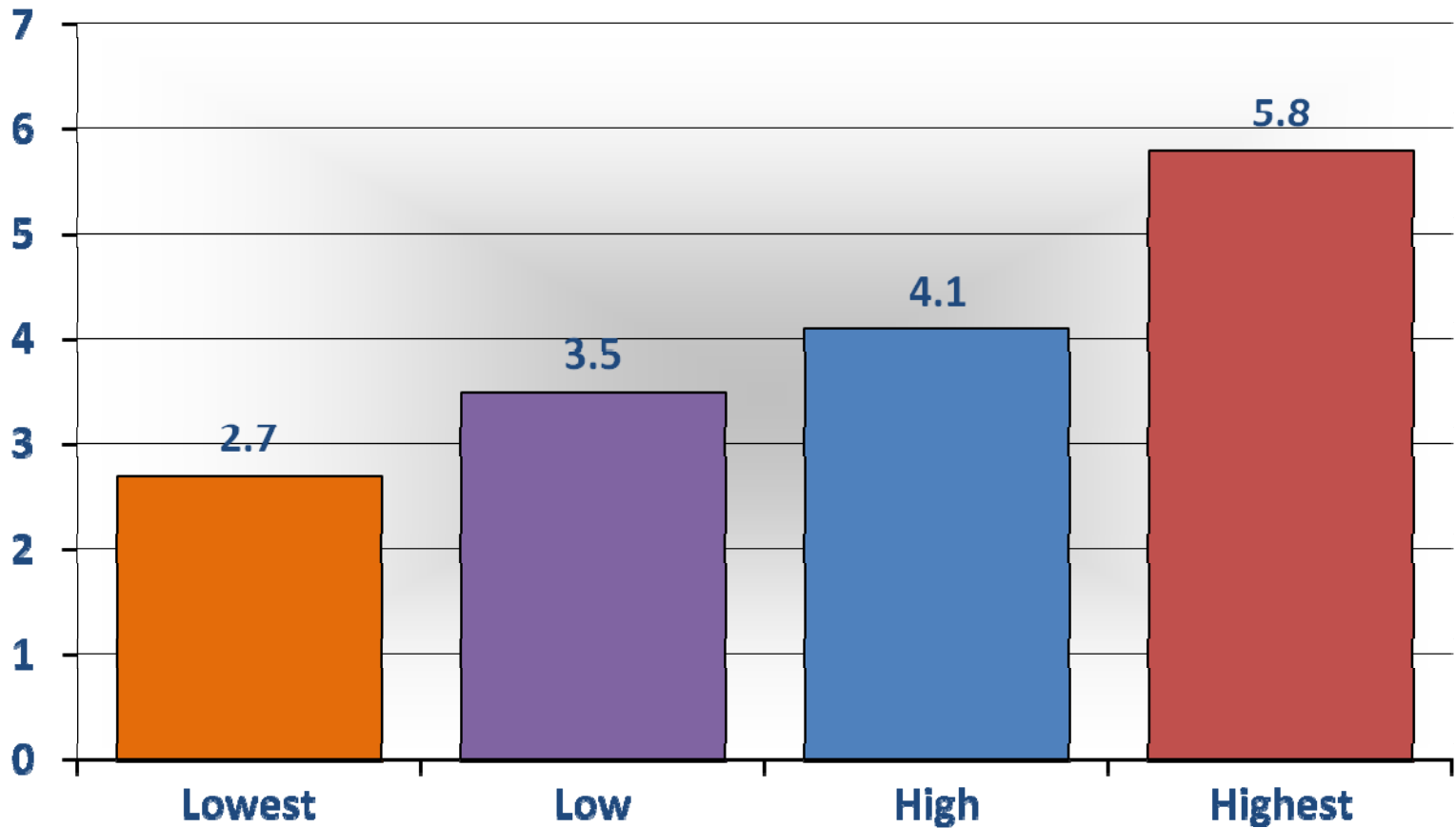
Cost and Price Relationship)

Median Cost per Discharge (CMI and WI Adj)



Costs do affect prices but other factors are more critical

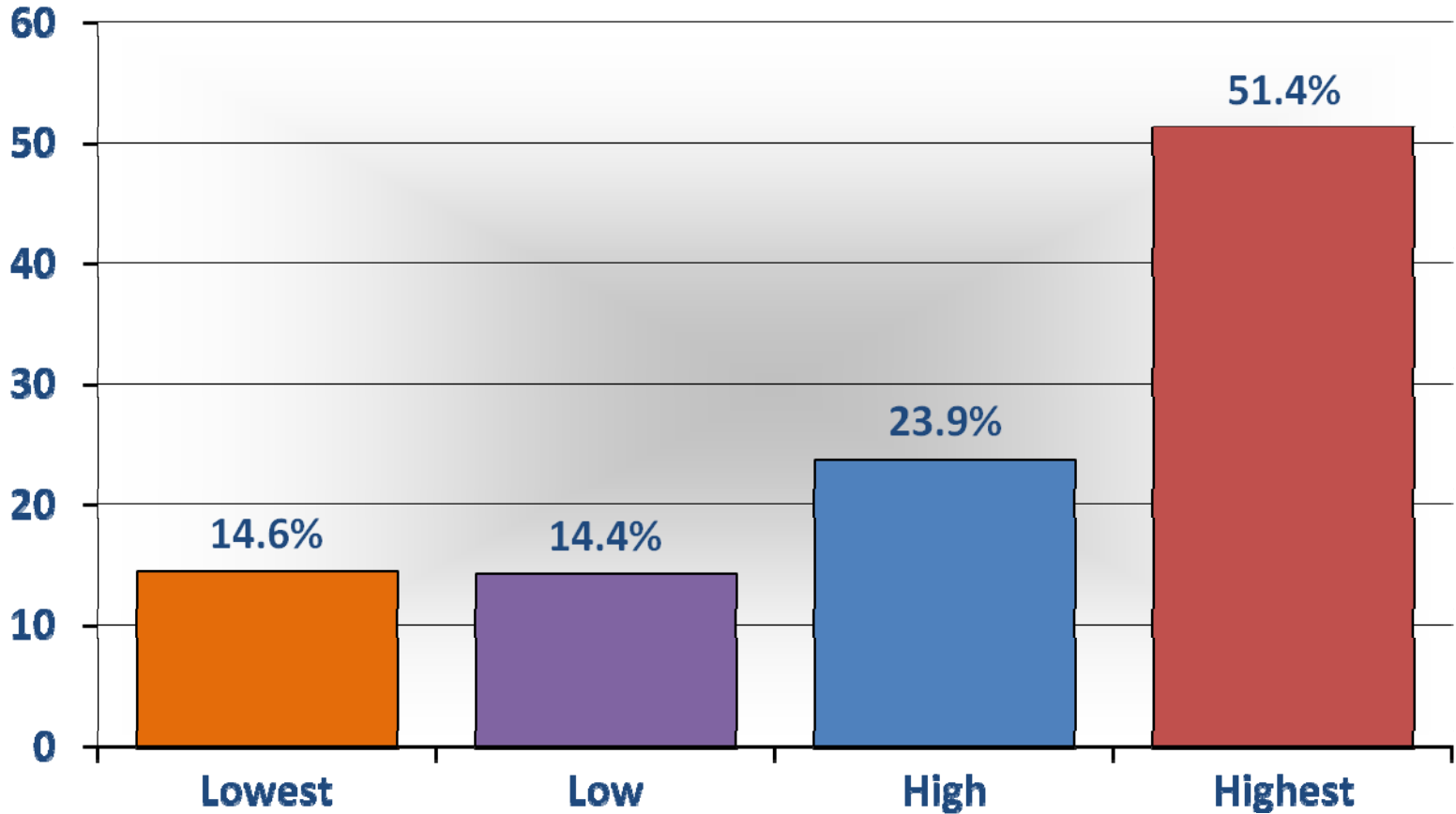
Median Total Operating Margin %



Higher prices do lead to higher margins

Ownership and Pricing

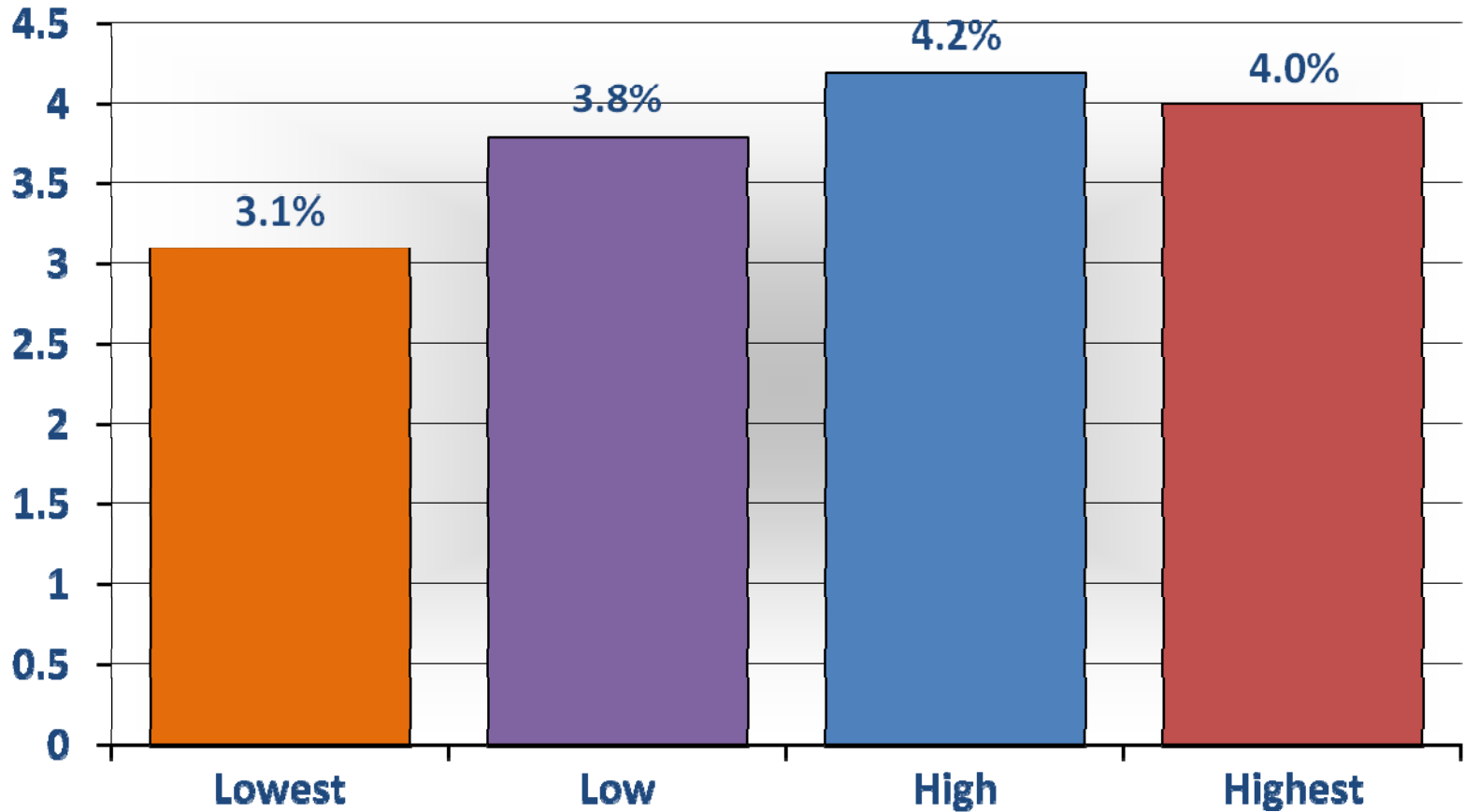
% Investor Owned



IO hospitals are much more likely to have higher prices

Profits for Voluntary Non-Profit (VNP) Hospitals

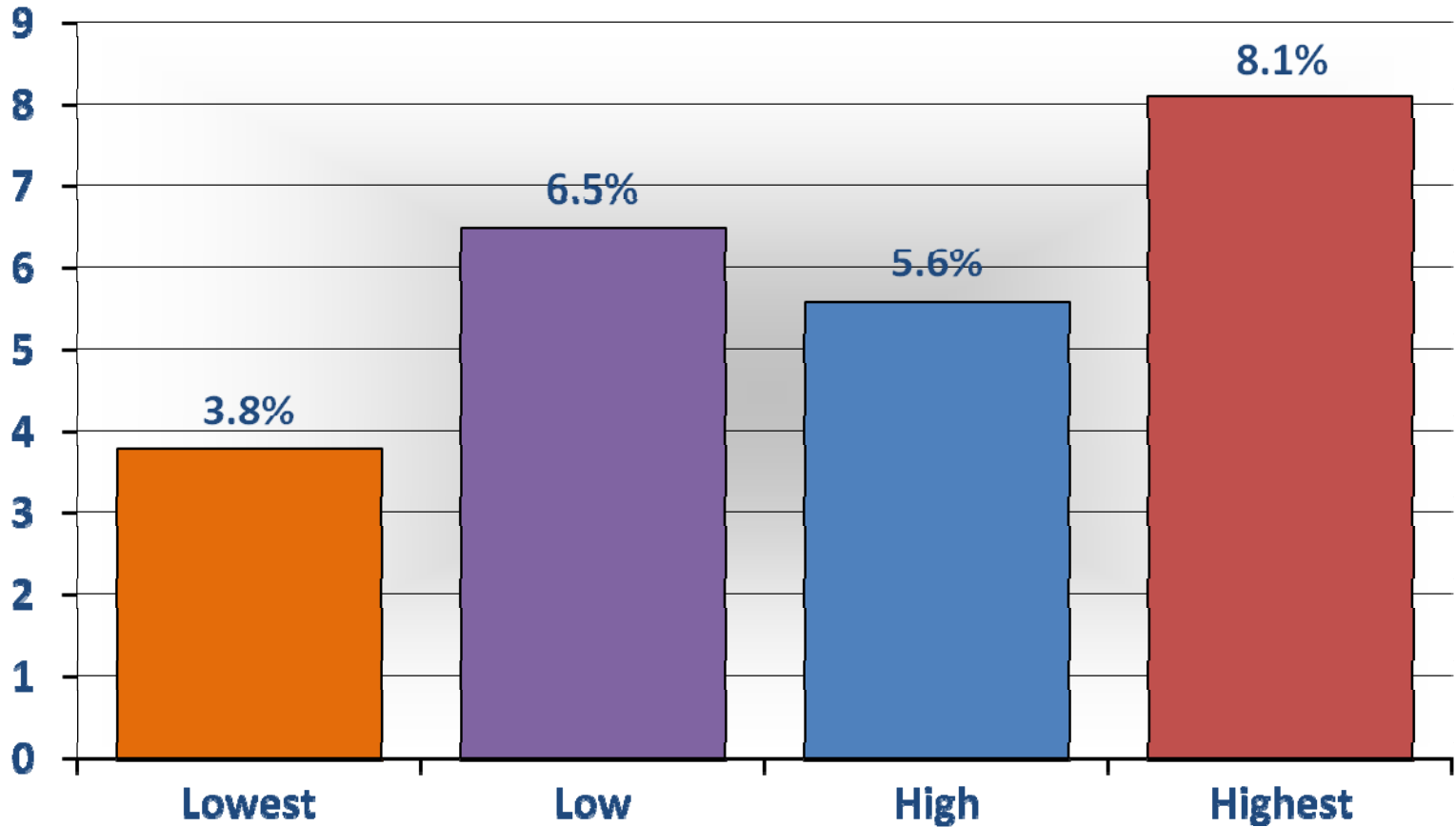
Median Operating Margin %



VNP hospitals appear to price services to achieve a target operating margin

Profits for Investor Owned Hospitals

Median Operating Margin %



IO hospital pricing is related to operating margins

Uncompensated Care (WKS S-10) 2012 Medicare Cost Reports

	Medicaid, SCHTP	Charity	Bad Debt	Total
Lowest	2.6	1.5	2.5	6.8
Low	2.8	1.8	2.4	7.8
High	2.3	2.3	2.5	8.0
Highest	2.9	1.8	2.1	7.4

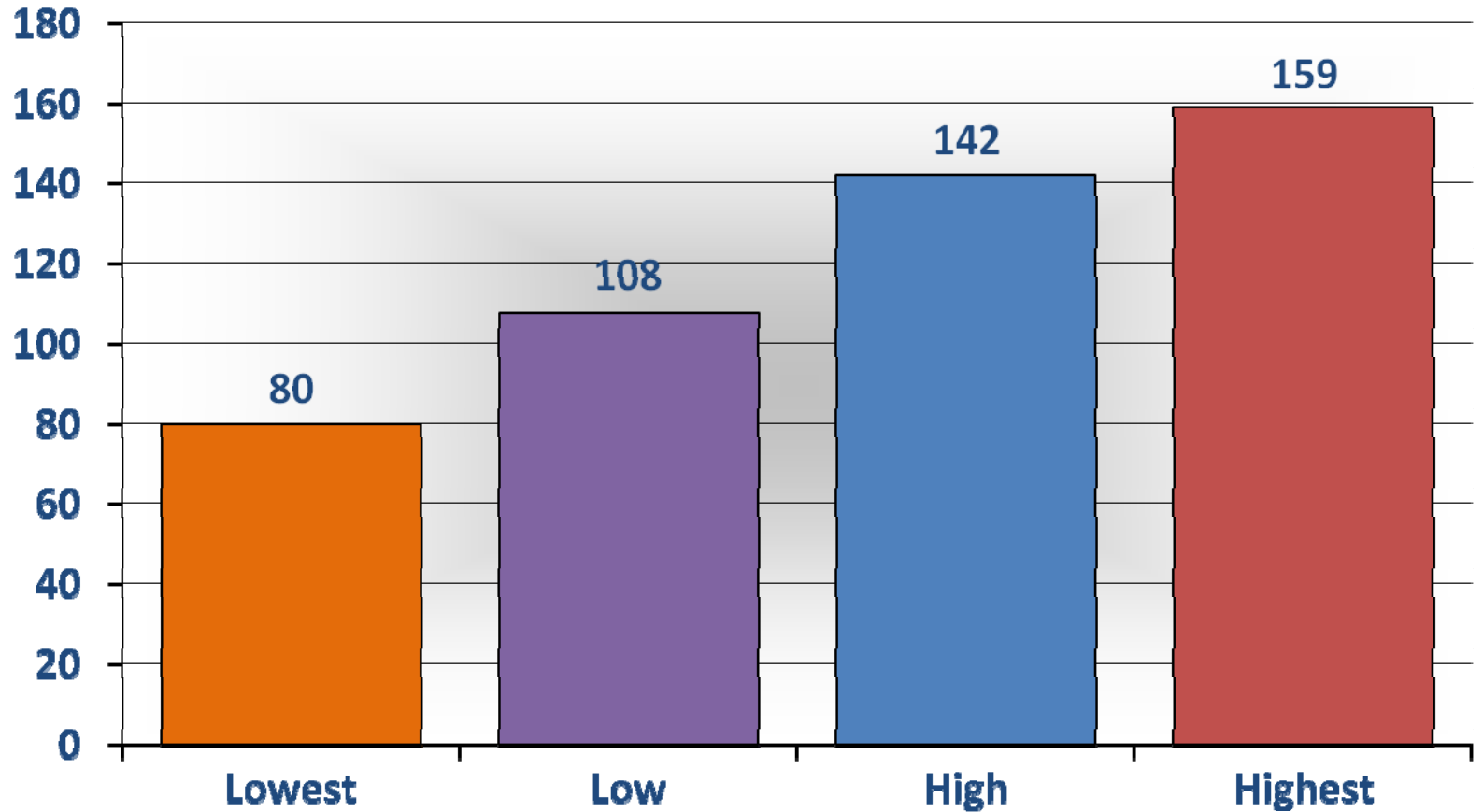
There is some association between pricing and uncompensated care

Charity Care (WKS S-10) 2012 Medicare Cost Reports

	Govt.	IO	VNP
Lowest	1.6	0.5	1.5
Low	1.8	0.5	2.0
High	2.6	0.9	2.7
Highest	4.3	1.3	2.7

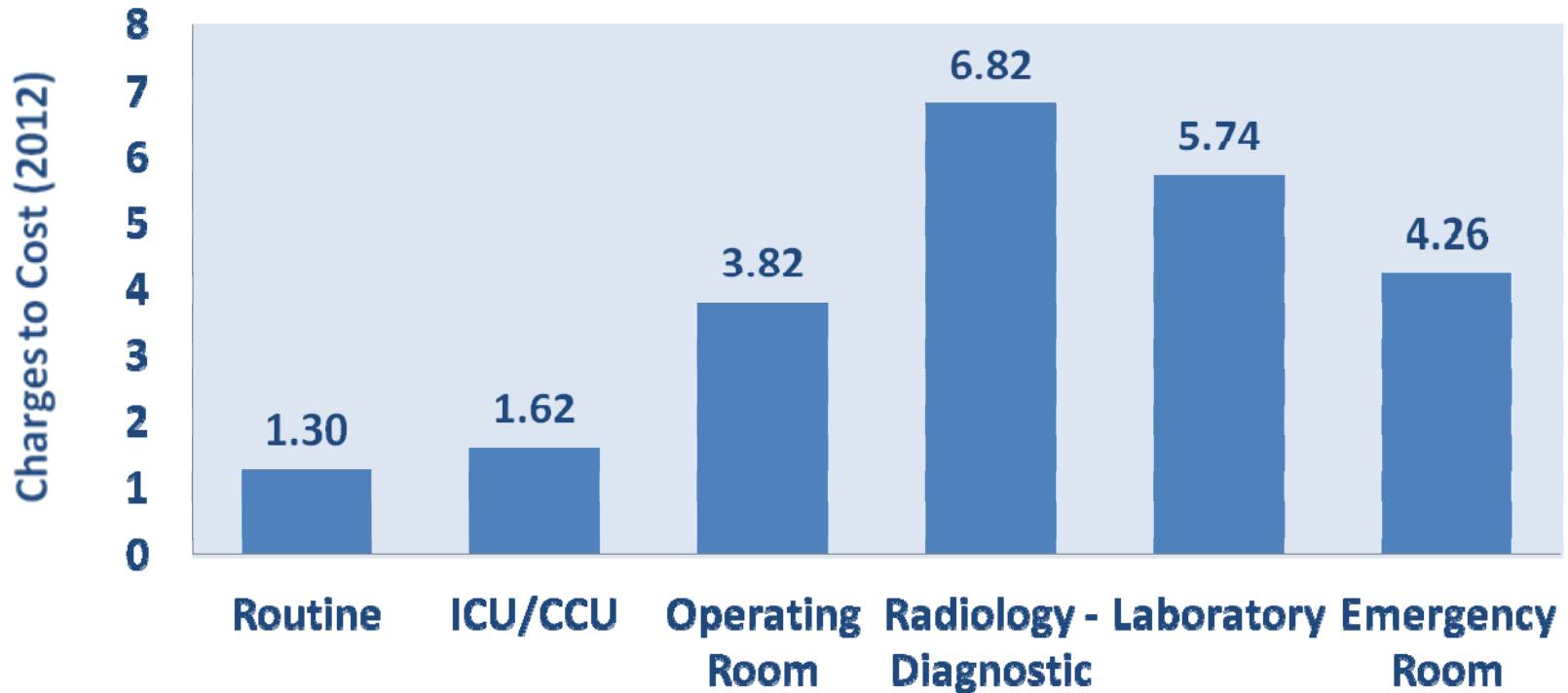
Charity care increases are associated with higher prices across all ownership groups

Median Net Patient Revenue (Millions)



Larger hospitals are more likely to have higher prices

DEPARTMENTAL PRICE-TO-COST RELATIONSHIPS



Prices have increased more in areas with percent of charge payment

How Real is Price Transparency

States with Existing Legislation and Disclosure of Healthcare Costs (National Conference of State Legislatures)

AZ	NV
AR	NH
CA	NC
CO	OH
DE	OK
FL	OR
IL	PA
IN	RI
IA	SD
KY	TX
ME	UT
MA	VT
MN	VA
MO	WA
NE	WI

State Example - California

- **Prices for top 25 most common OP procedures**
- **Written estimates of charges for expected services**
- **CDM disclosure**
- **Fair pricing**

Laposcopic Cholecystectomy (CPT- 47562) - 2012

	Hospitals		
	A	B	C
OSHPD Reported	\$41,395	\$15,200	\$26,690
Average CMS Claim	53,638	19,894	28,529
CPT Price	31,145	10,292	21,562

Fair Pricing Information Example - Required Payment by Federal Poverty Level (FPL)

Level	Payment
< 200% FPL	0
200 to 260% FPL	25% Medicare
260 to 320% FPL	50% Medicare
320 to 350% FPL	75% Medicare

Reasonableness of Hospital Prices

Price defense

Relating pricing to ROI: the public-utility approach


Public utilities have used a Return on Investment (ROI) model to justify price increases to rate regulatory boards. The approach isolates the price variable from the ROI formula (below) and “tests” the remaining elements. If it can be proved that ROI, Cost, and Investment are not excessive, then price must also not be excessive. In the following pages, we present these tests.

ROI Formula

ROI =

$$\frac{(\text{volume} \times \text{price}) - (\text{volume} \times \text{cost})}{\text{investment}}$$

Tests

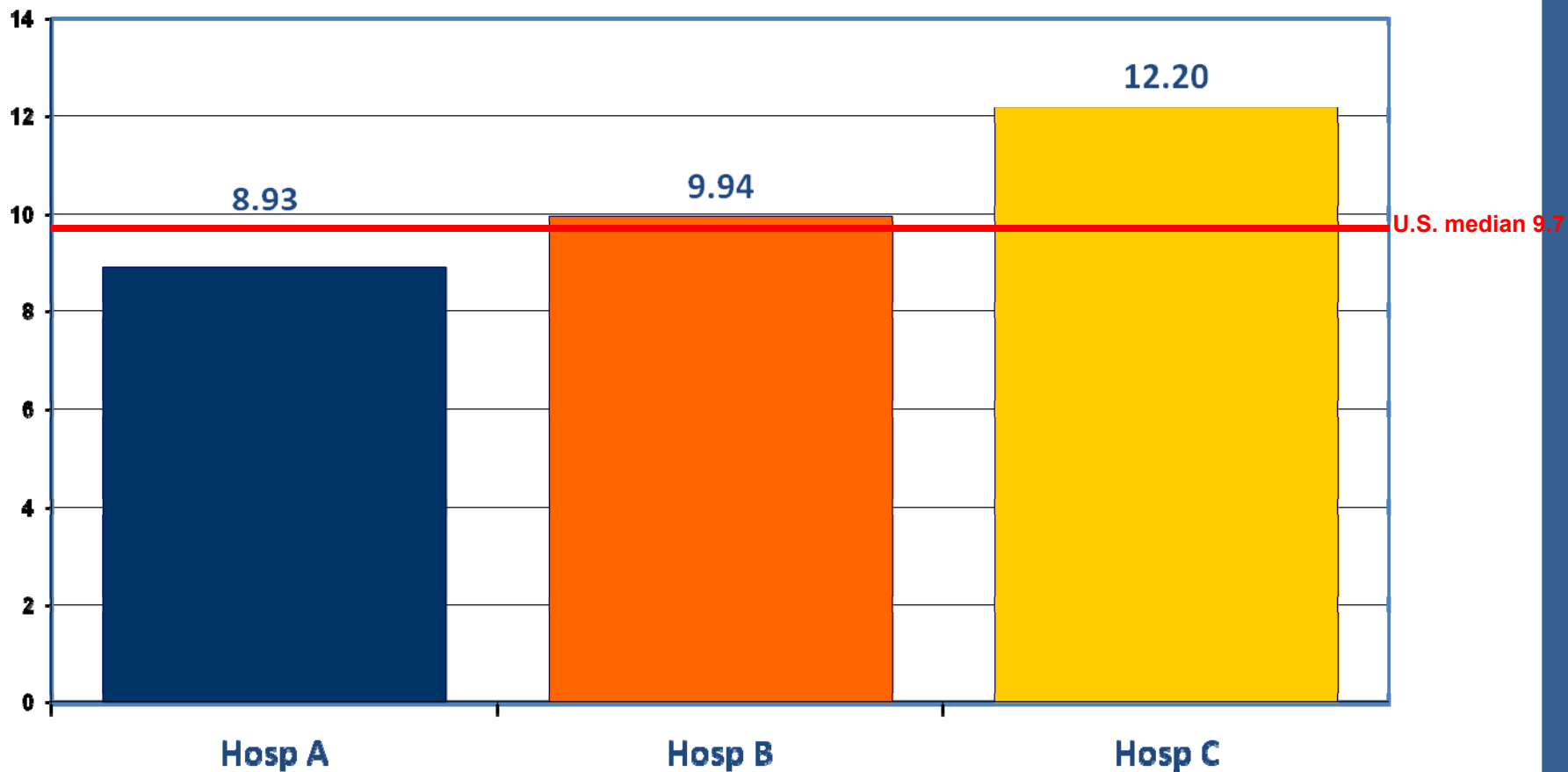
1. Is ROI excessive?
 2. Is cost excessive?
 3. Is investment excessive?
-  If “no” to all three, price is not excessive.



Is ROI excessive?

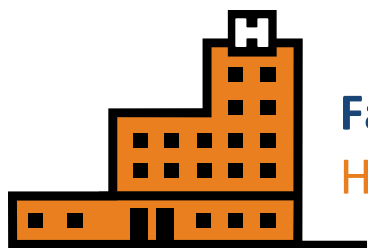
ROI is not excessive

EBIDA to Assets %





Is cost excessive?



Facility-level cost measure: Hospital Cost Index[®]

Inpatient Costs

Inpatient Cost Index

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Outpatient Costs

Outpatient Cost Index

Formula:

Your Medicare Cost
per Visit (RW/WI adj)
US Median Medicare Cost
per Visit (RW/WI adj)

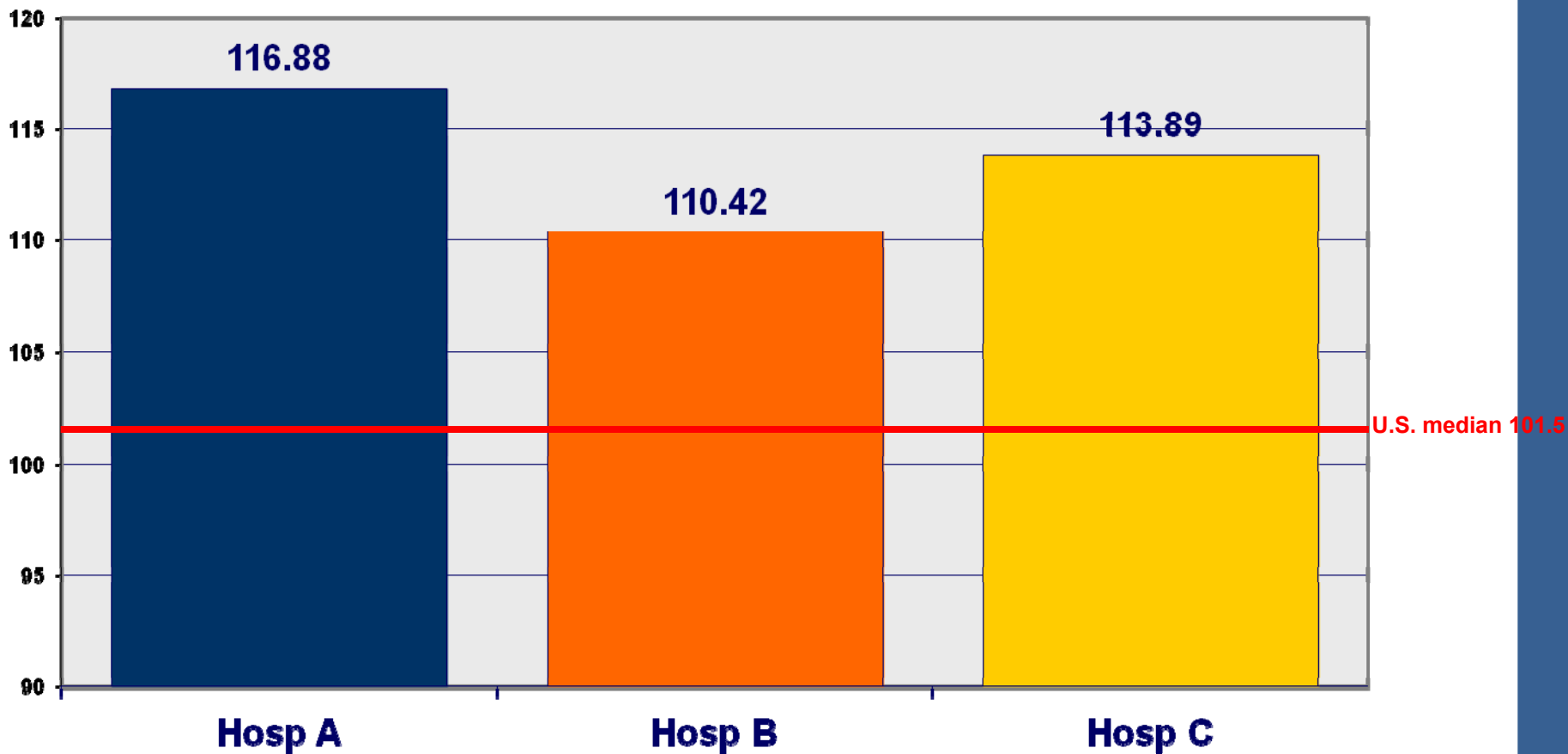
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Is cost excessive?

Costs are above the US

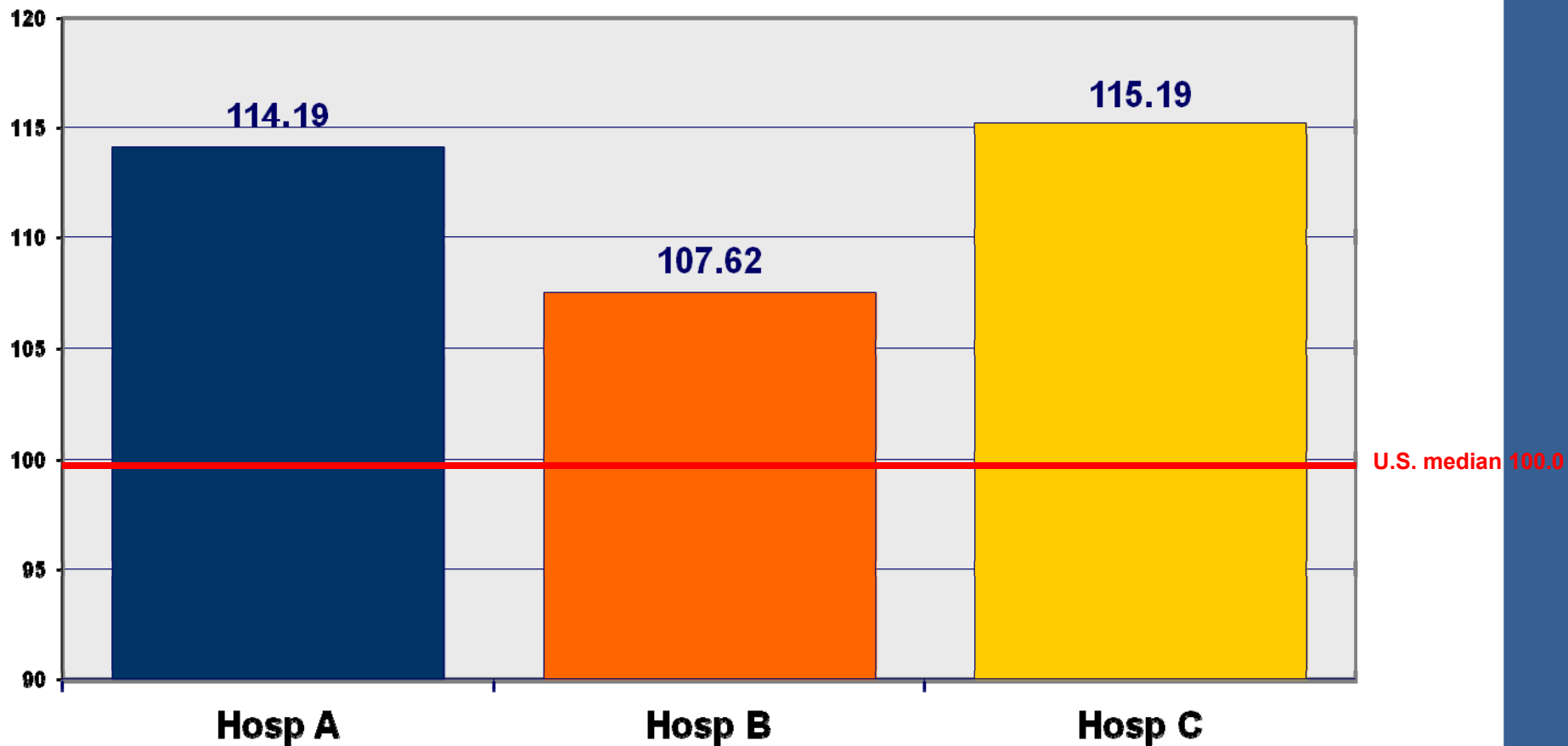
Hospital Cost Index® — 2012





Is cost excessive?

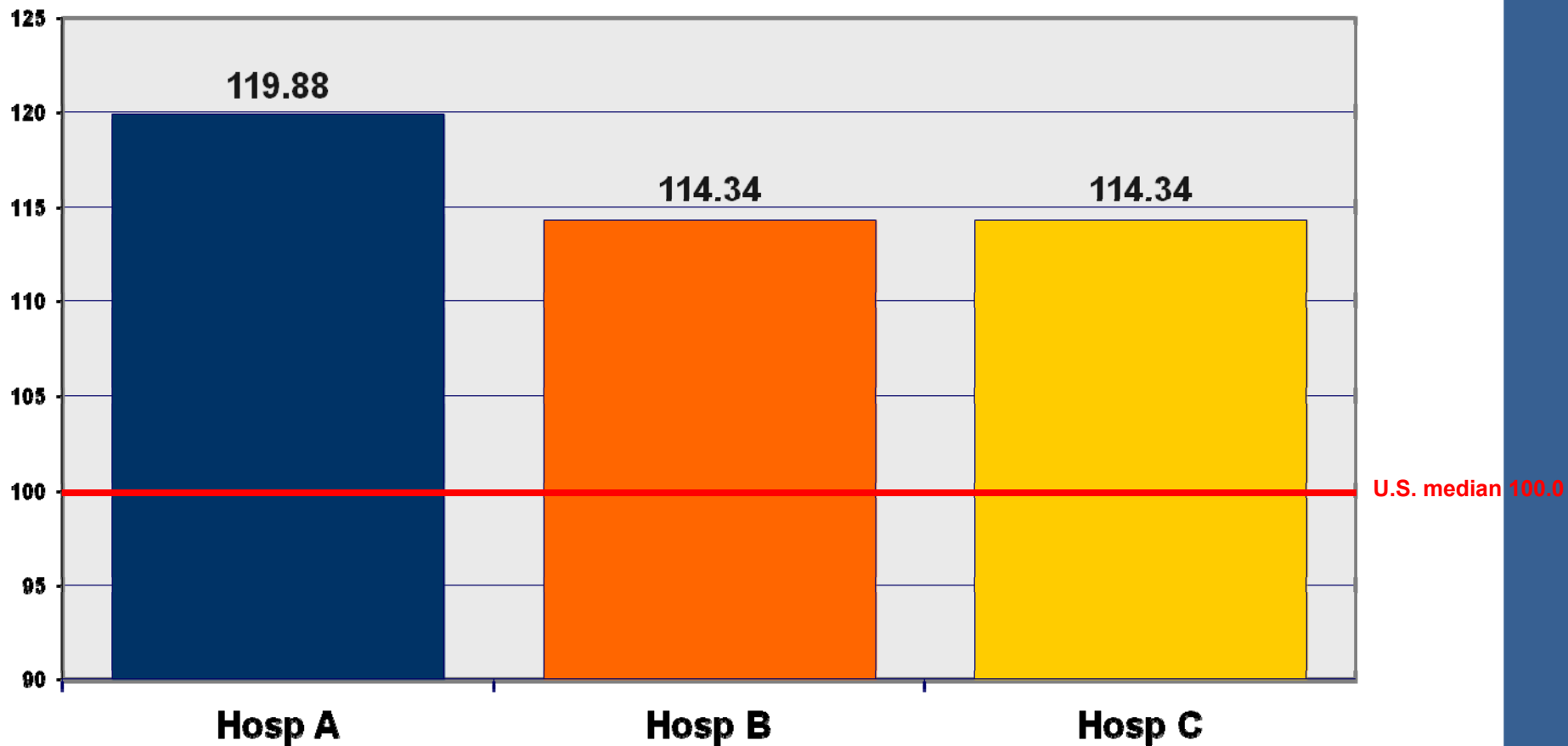
Inpatient Cost Index – 2012





Is cost excessive?

Outpatient Cost Index – 2012





Is investment excessive?

Lower FAT,
average plant age

	<i>Revenue to Net Fixed Assets (FAT)</i>	<i>Average Age of Plant</i>
Hosp A	1.32	9.80
Hosp B	1.64	9.60
Hosp C	1.79	52.03
US Avg	2.55	10.00

Conclusions

- **Cost shifting has been the primary driver behind hospital price increases.**
- **Most VNP hospitals set prices to recover costs and earn a reasonable margin.**
- **Hospitals with low costs and reasonable profit levels should not be criticized for prices which appear high.**