

The Precarious Pricing System for Hospital Services

Christopher Tompkins

Stuart Altman

Efrat Eilat

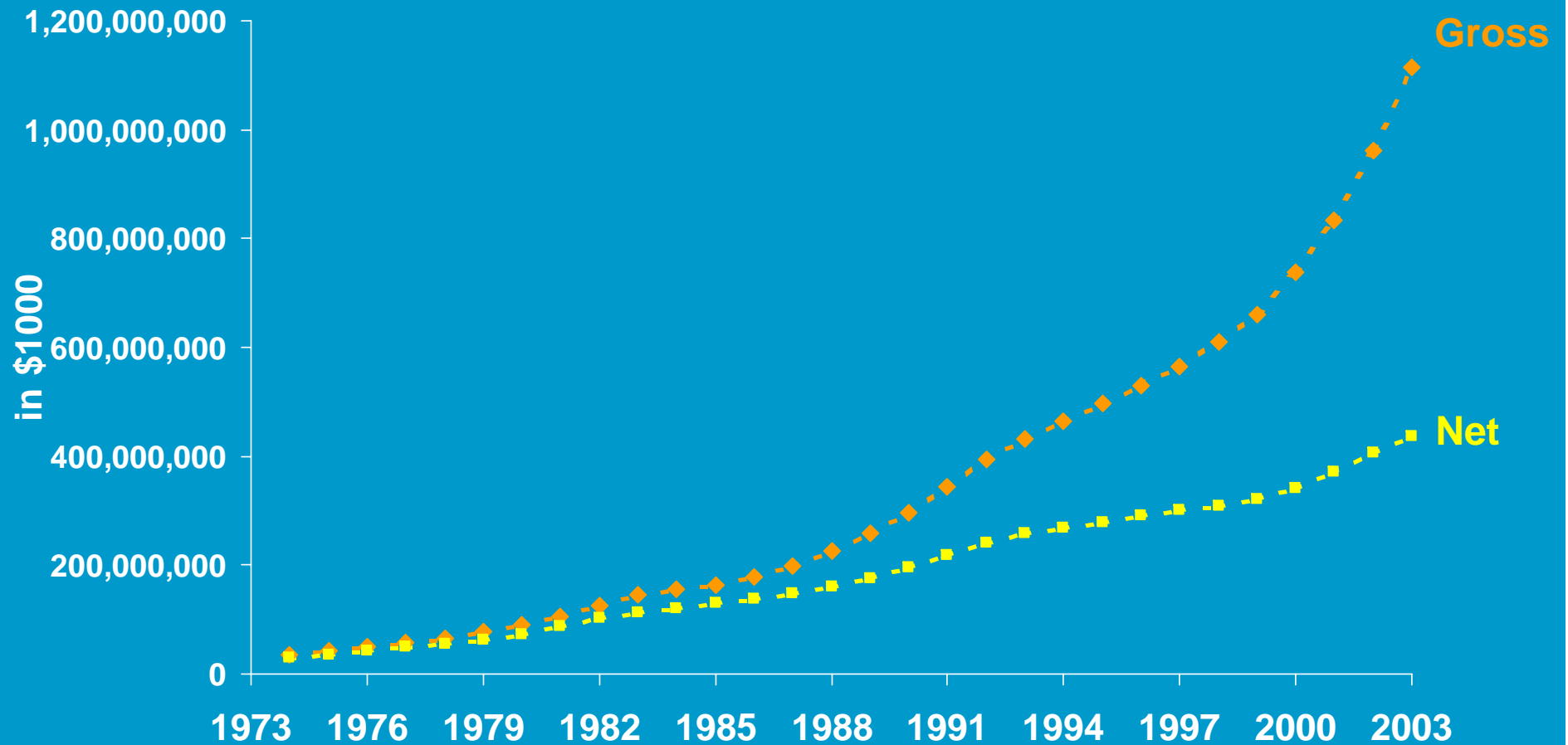
Purpose

- How did we get here?
- How does a hospital set its prices?
- What are the negative consequences?
- Are present practices sustainable?

Methods

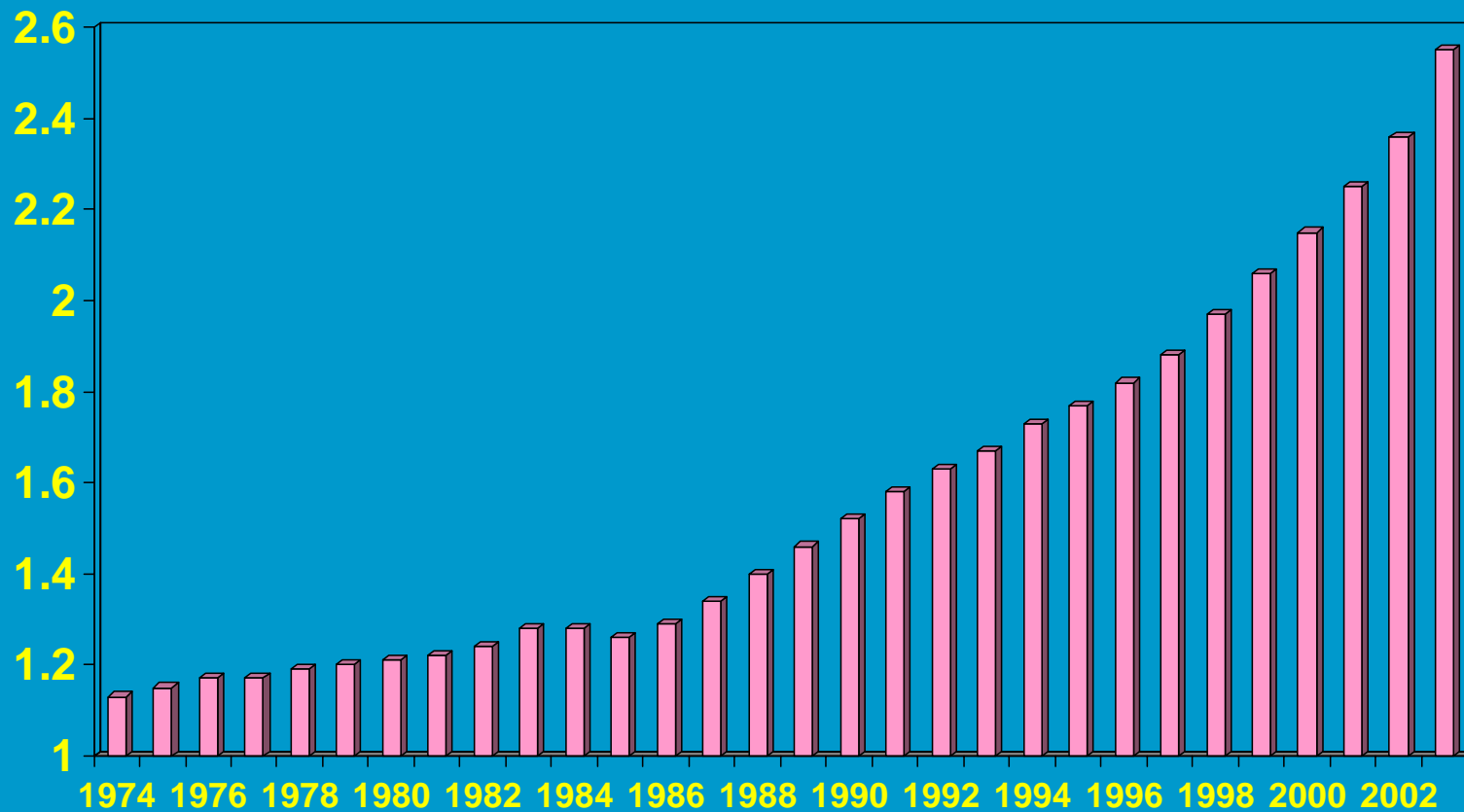
- Literature
- Interviews
 - Hospital executives, financial experts
 - For profit, Not-for-profit
 - National, Regional
 - Convenience sample
- Authors' calculations using available data

Gross and Net Patient Revenues Diverging



Source: American Hospital Association, AHA Hospital Statistics

Ratio of Gross to Net Patient Revenue is Increasing



Source: Authors' calculations based on AHA Hospital Statistics

How did we get here?

- Long history of charge- and cost-based payments
- Government moved away from both:
 - Medicare PPS (and RBRVS, outpatient PPS)
 - Medicaid rate-setting
- Large private insurers and managed care:
 - Negotiated fixed payment rates
 - Negotiated discounts off charges

How does a hospital set its prices?

- Annual budget cycle
 - Initial revenue model
 - Initial cost model
 - Options to raise revenues; reduce costs
 - "Painful" reconciliation

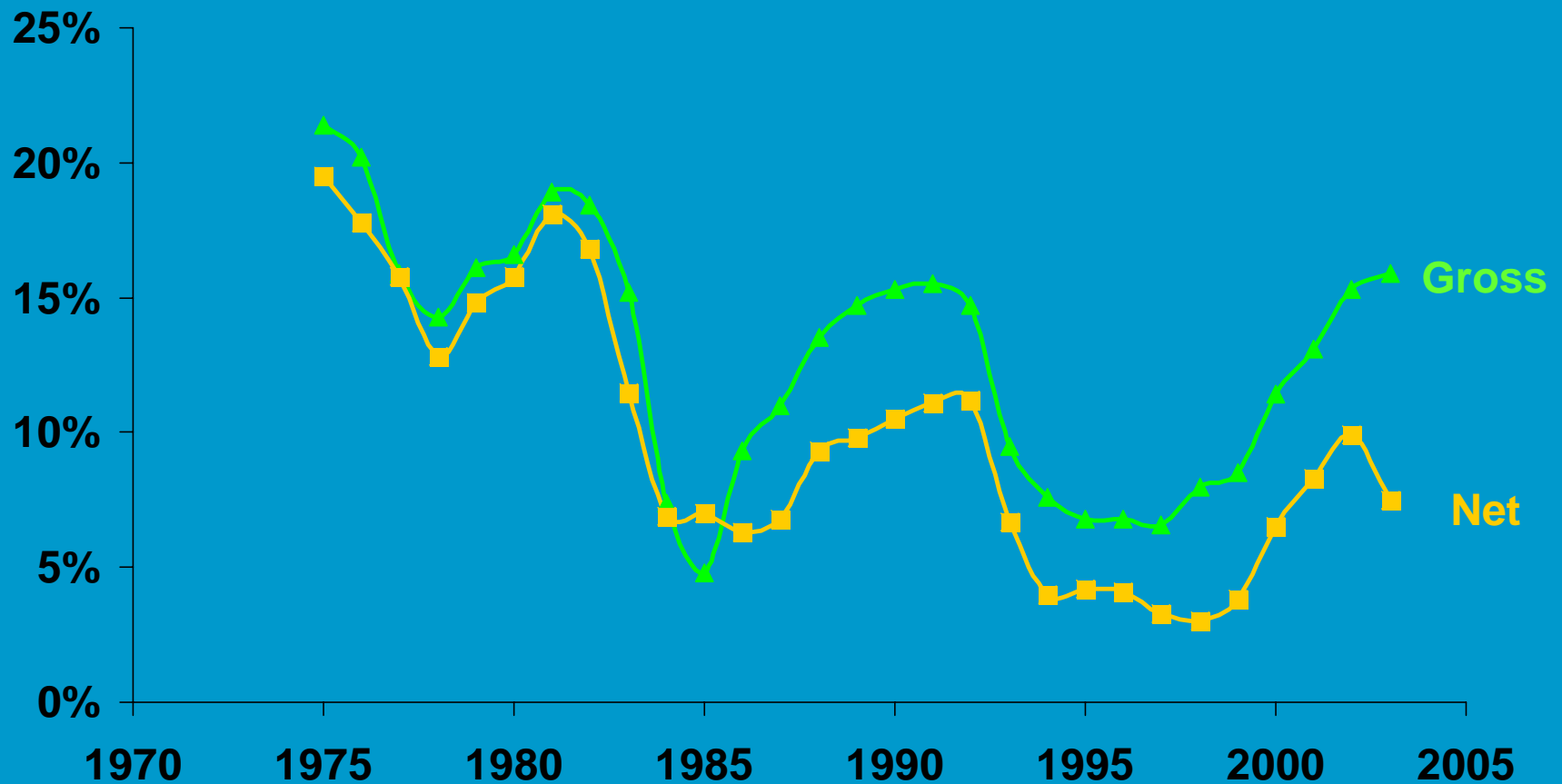
Limiting factors

- Local competitors' prices
 - PR
 - Not to drive away business
- Strategic orientation of hospital leadership
 - Reconciliation process: cost versus revenues
 - Mission
 - Acceptable or necessary rate of return
- Rate corridors and logical consistency
 - Indefensible differences among similar codes

The Result?

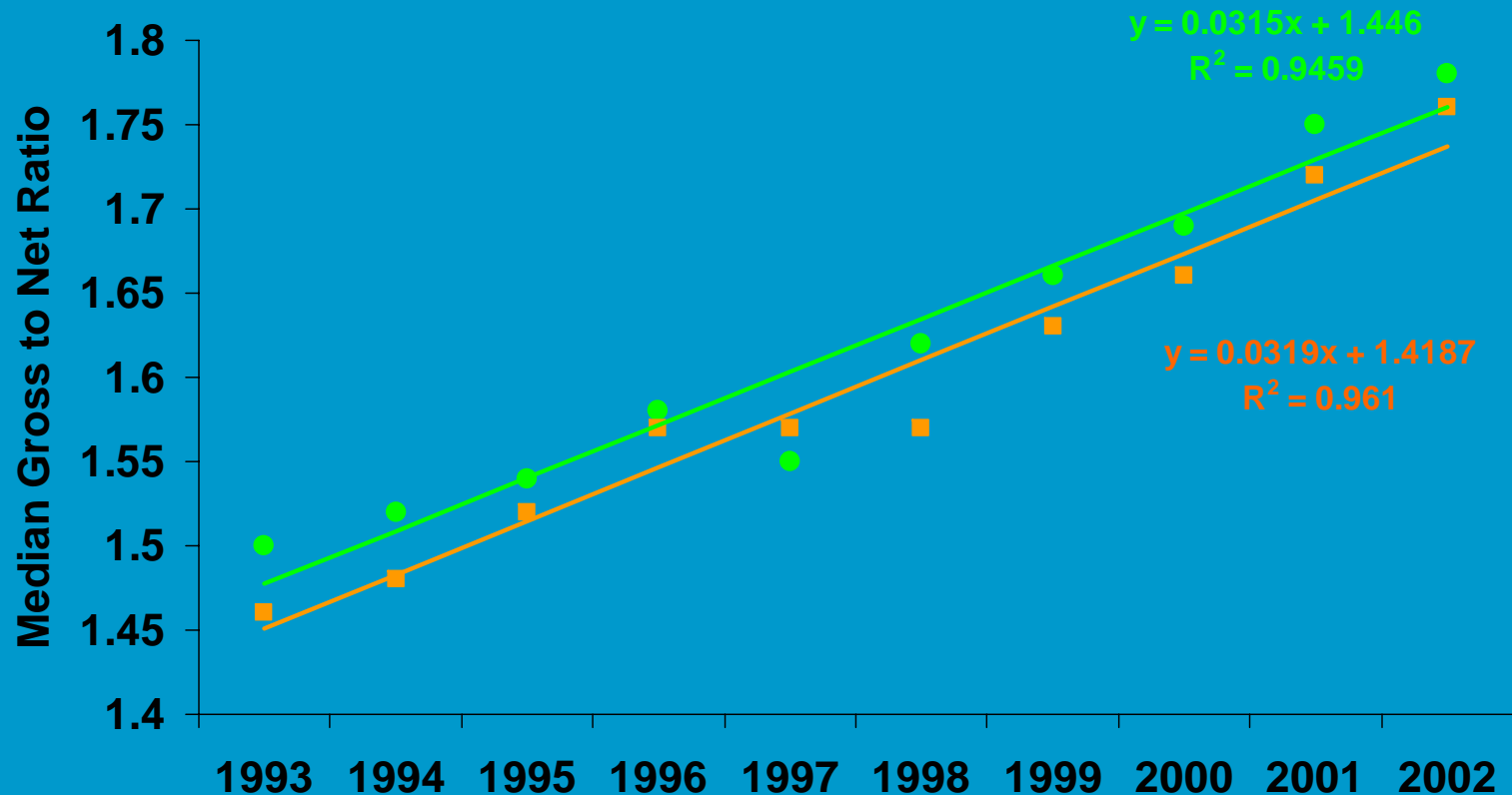
- Across-the-board average price increase
- Variable prices increases:
 - Larger increases yielding greater returns
 - Charge-related services
 - Services infused with new technology
- Highly variable and idiosyncratic “charge master” (list prices) at each hospital

Annual Growth Rates in Gross and Net Patient Revenue



Source: Authors' calculations based on AHA Hospital Statistics

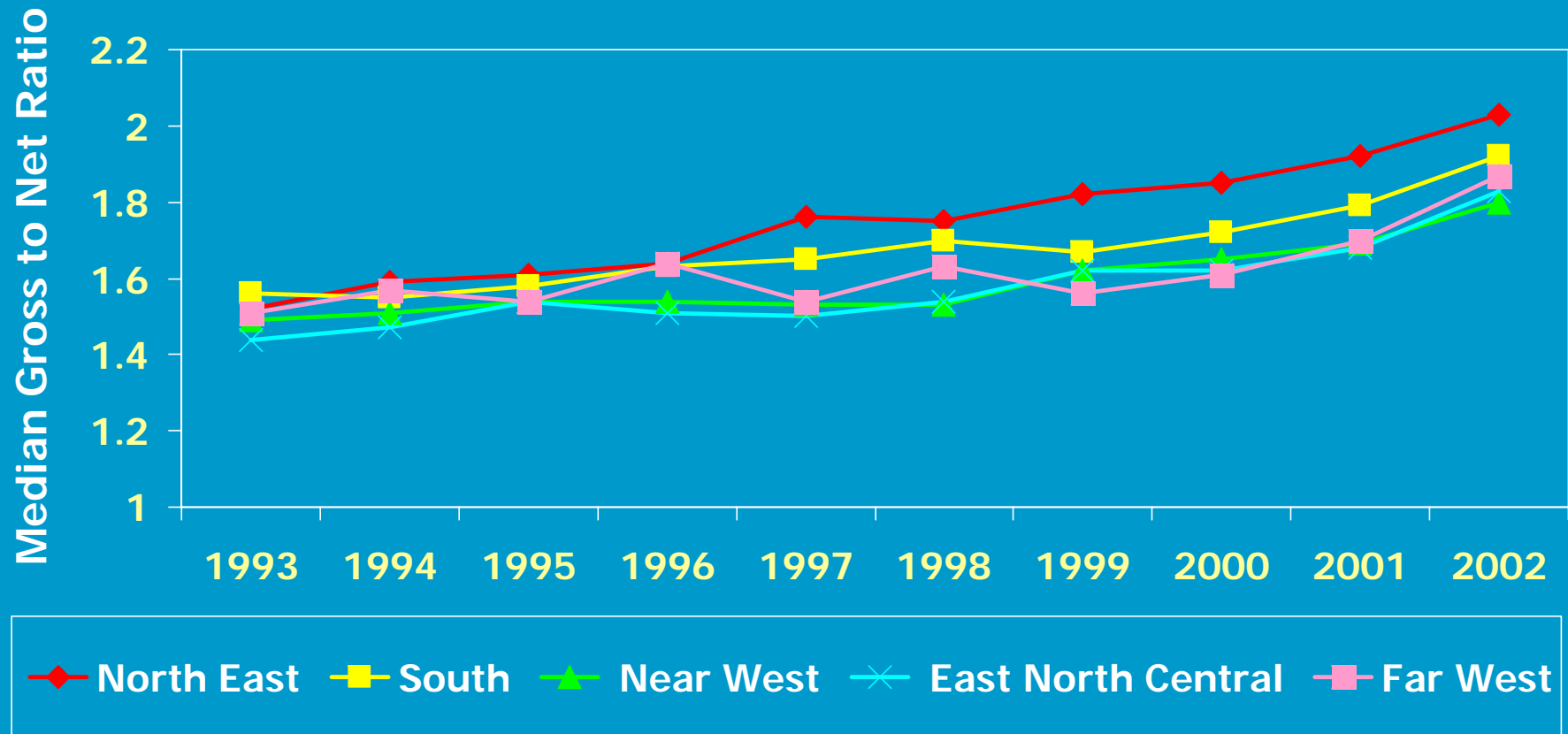
Similar Trends in Gross to Net Price Ratio for Inpatient and Outpatient



Source: Authors' calculations based on the Almanac of Hospital Financial & Operating Indicators, Ingenix, Inc.

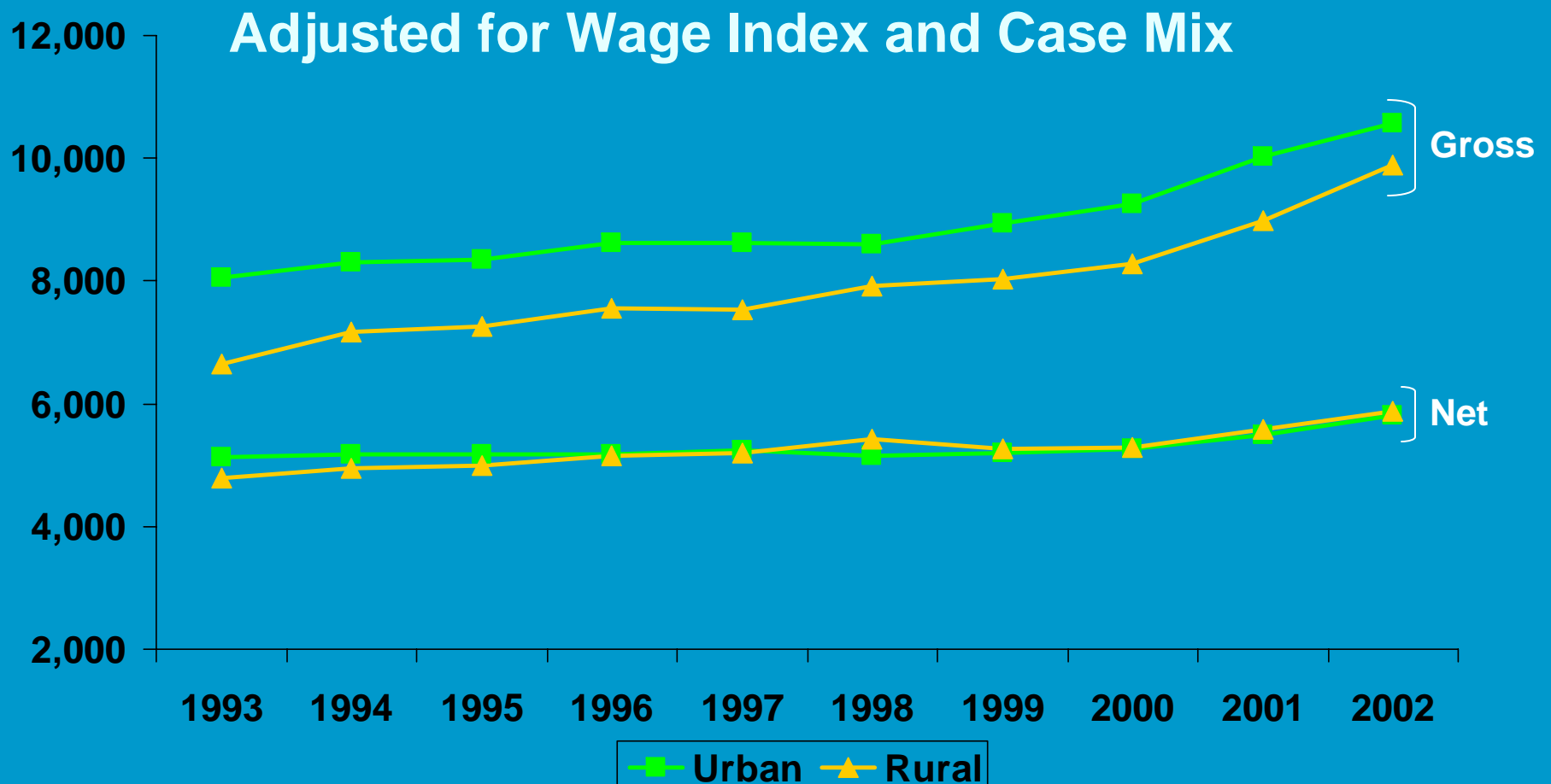
Ratio of Gross to Net Patient Revenue By Region

Adjusted for Wage Index and Case Mix



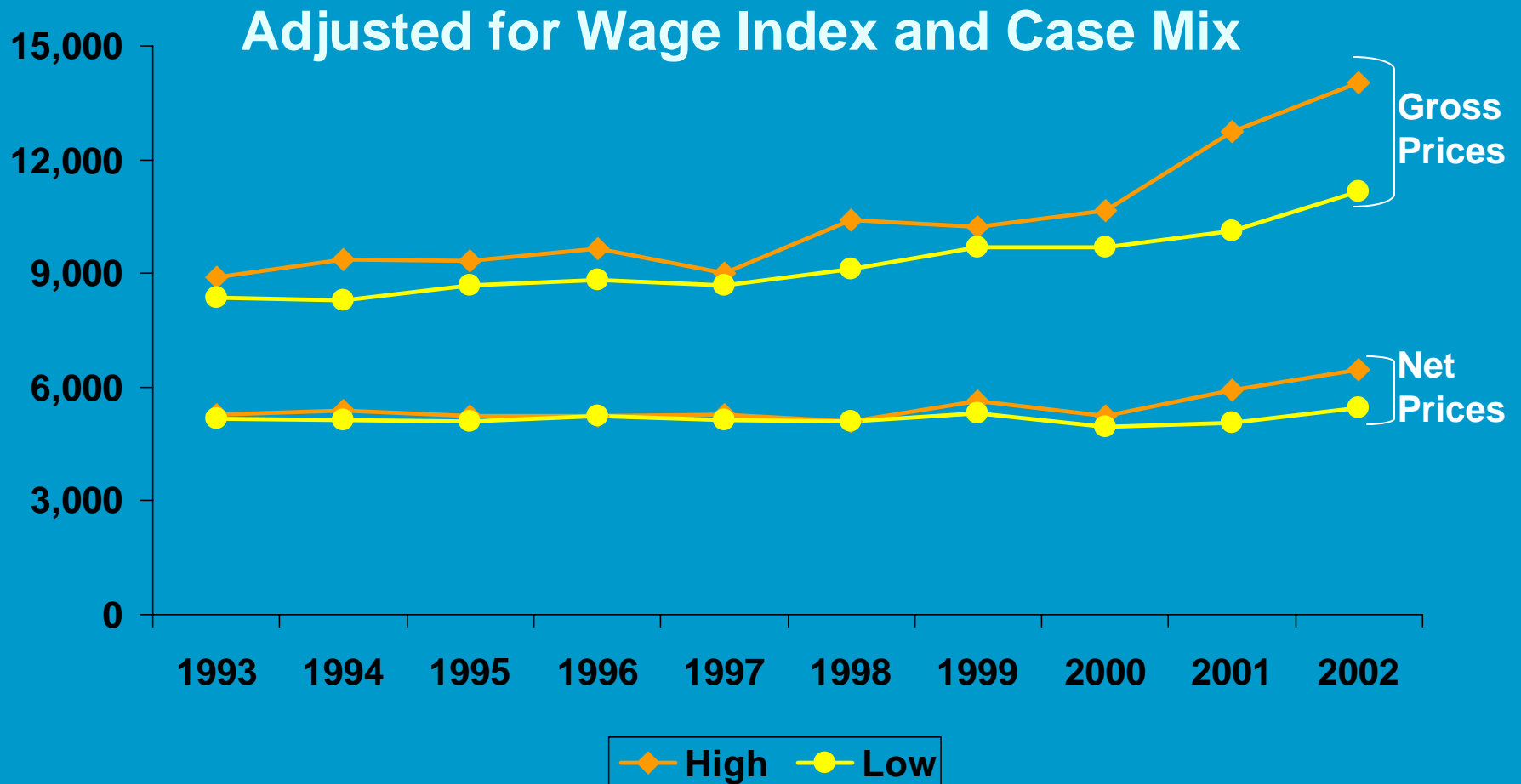
Sources: The Almanac of Hospital Financial & Operating Indicators, Ingenix, Inc.

Gross and Net Prices per Discharge Urban versus Rural



Sources: The Almanac of Hospital Financial & Operating Indicators, Ingenix, Inc.

Gross and Net Prices per Discharge By MC Penetration Rate



Sources: The Almanac of Hospital Financial & Operating Indicators, Ingenix, Inc.

What are the negative consequences?

- Uninsured are (were) billed full charges
 - Government, AHA, and many hospitals have tried to move away from this
- Hospitals have many “prices” for virtually every service: “The average price is correct for nobody.”
- Not situated for “transparency in pricing” or even “consumer driven” choices

Are present practices sustainable?

- Trend lines seem ominous
- Hospitals may be reaching the limit of their ability to provide “equal treatment” for essentially “unequal payment”

Conclusions

- Prices are “logical” from an accounting and institutional perspective
- Prices are often hard to explain across institutions
- Data do support effects from competition and managed care

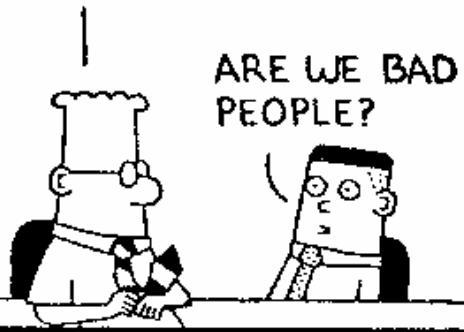
Conclusions

- Uninsured need to be shielded
- Other government interventions seem more questionable
 - Favoring HSAs
 - Dictating the charge master
- May be time to begin a new chapter in hospital pricing

OUR ASSIGNMENT
IS TO MAKE OUR
ACCOUNTING SYSTEM
LESS TRANSPARENT.



WE DON'T WANT
INVESTORS TO KNOW
WHAT WE'RE DOING.



ARE WE BAD
PEOPLE?

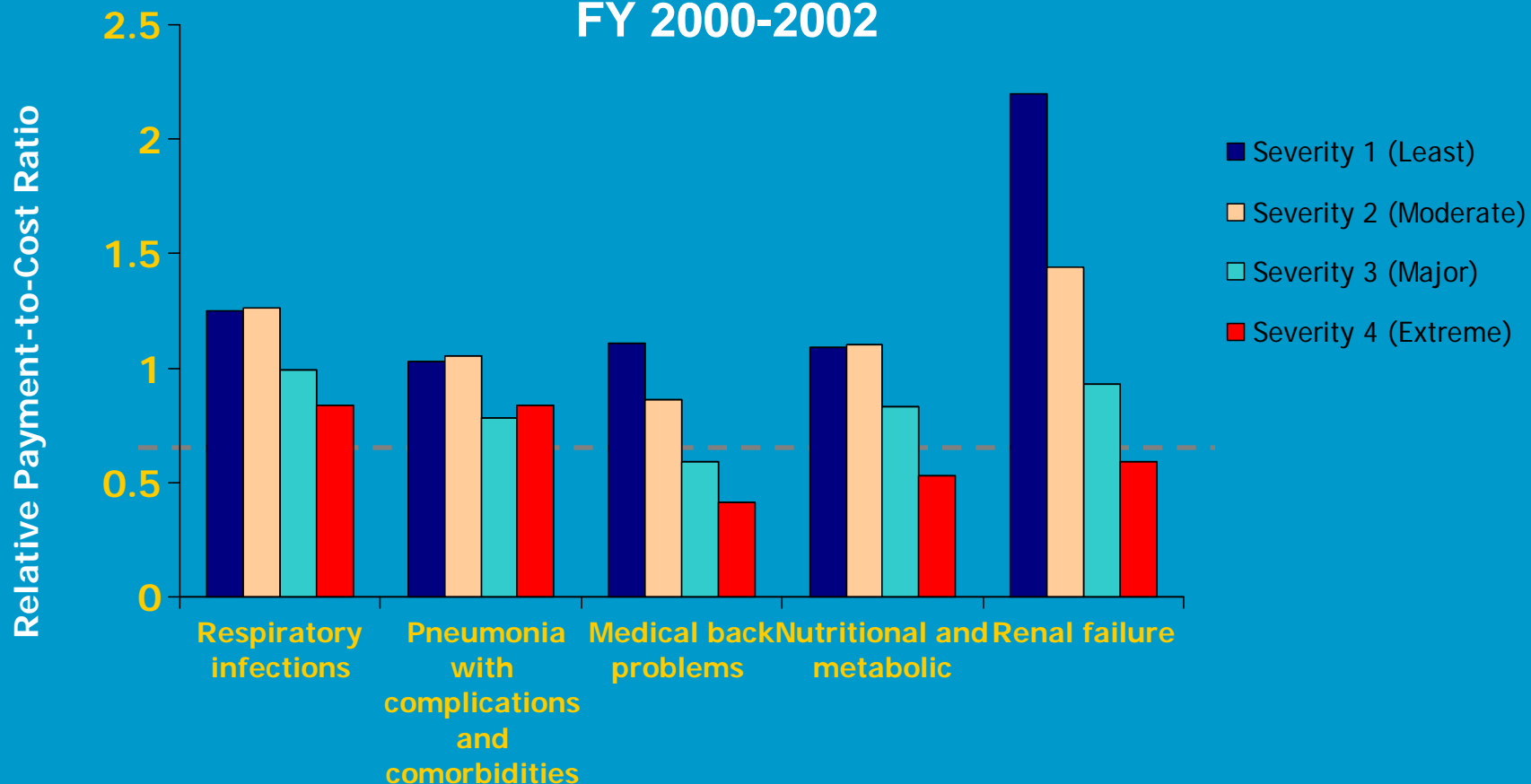
© 1999 United Eastern Securities, Inc.





Payment-to-Cost Ratios By Selected DRGs

Average Payment-to-Cost Ratios Across and Within Selected DRGs
FY 2000-2002



Source: MedPAC analysis of Medicare hospital inpatient claims and cost reports from CMS, fiscal year 2000-2002. Copied From Lewin Group.

Level of Variation Across States Vary

Highest to Lowest State Charge Ratio for Selected Procedures

