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Balancing IP & OP Reimbursement Increases to Maximize Margin Opportunity

By Richard Bajner and Eric Logue

Can inpatient reimbursement increases achieve balanced margins across inpatient and outpatient services? When should hospitals prioritize inpatient or outpatient unit reimbursement increases to protect or maximize future margins?

Traditionally, hospital margins have been largely driven by outpatient services. However, as a result of increased scrutiny on outpatient payment levels by commercial payers, reduced outpatient elective volumes, new market entrants from lower cost freestanding centers, and continued cost shifting to patients, financial executives are reconsidering their managed care strategy so as to balance their margins across inpatient and outpatient services and protect future margins.

Key Questions

You should consider the following questions when determining how to balance inpatient and outpatient margins.

Can hospitals 'balance' margins across inpatient and outpatient lines of service? Variables that impact margins vary drastically by inpatient and outpatient care. It is customary for inpatient services to drive a majority of total charges; at the same time, inpatient services typically drive a small (or negative) amount of the total net margin. But could your facility achieve equal margin distribution across inpatient and outpatient? If so, what's required? The case below illustrates a 400-bed hospital:

- Inpatient revenues
  - 60 percent of charges but only 15 percent of the overall margin (IP and OP)
  - 55 percent of charges are driven by Medicare and Medicaid
  - 27 percent of charges are driven by managed care
  - Managed care unit reimbursement at 209 percent of Medicare

- Outpatient revenues
  - 40 percent of charges but 85 percent of the overall margin (IP and OP)
  - 44 percent of charges are driven by Medicare and Medicaid
  - 40 percent of charges are driven by managed care

- Managed care unit reimbursement at 276 percent of Medicare

This hospital may attempt to balance margins across inpatient and outpatient by, for example, increasing inpatient unit reimbursements to the outpatient percentage of Medicare. However, as the scenario below shows, solely relying on unit reimbursements to balance margins will likely result in achieving unrealistic discounts—in this case, achieving greater than 90 percent of charges.

[1]

	A	B	C	D	E	F	G	H	I	J	K	L	M
1		Inpatient					Outpatient					Changes	
2		Charges	Charge Mix	Revenue	Net Margin	% of Medicare	Charges	Charge Mix	Revenue	Net Margin	% of Medicare	IP Rev at OP % of MCR	IP POC at OP % of MCR
3	Managed Care	$393.8	27%	$271.2	$118.7	209%	$433.1	40%	$299.1	$173.2	276%	$358.2	91%
4	Medicaid	$196.0	14%	$45.6	-$40.9	71%	$124.4	12%	$26.1	-$9.4	84%		
5	Medicare	$531.2	37%	$175.0	-$26.2	100%	$251.8	24%	$63.0	-$10.9	100%		
6	Other	$318.3	22%	$100.9	-$27.8	96%	$260.8	24%	$57.0	-$17.7	87%		
7	**Totals**	**$1,439.3**	**100%**	**$592.7**	**$23.8**		**$1,070.0**	**100%**	**$445.2**	**$135.3**			
			0							change in revenue-->		$87.0	

The example illustrates that achieving unit reimbursement increases alone often cannot achieve "balanced" margins. Therefore, balancing margins encompasses a larger margin strategy inclusive of an analysis of revenue and cost components.

Key take-away: Hospitals need to look at what revenue streams they can affect (e.g., managed care rates) when developing a managed care strategy to balance inpatient versus outpatient margins. Because inpatient revenues are driven more strongly by non-negotiable cases, such as Medicare and Medicaid, this is frequently not achievable.

When should hospitals prioritize inpatient or outpatient unit reimbursement increases to protect or maximize future margins? While balancing net margin across inpatient and outpatient may not be feasible, hospitals should still look to implement payment strategies that protect and maximize future state margins. But what variables should be considered in analyzing whether you should implement larger inpatient unit reimbursement increases to protect or maximize future margins?

- Volume trends: Where will your facility grow over the next three to five years? By inpatient versus outpatient? By service line?
- Price sensitivity: How will changing benefit models that shift additional costs to patients impact volumes? How are you prepared to succeed under such payer strategies?
- Rates position versus market: How do your rates compare versus the market?
- Competitive pressures: What services is your competition looking to grow? What new competition is attempting to enter your market?

[1] Source: Navigant Consulting Analysis, Client Confidential; 2011

Margin management strategies require a multi-step process to assess your current margin profile and implement strategies to ensure a more balanced portfolio.

- Step 1: Review baseline strategies, financial plan, and historical margin drivers
- Step 2: Project revenue and cost scenarios
- Step 3: Evaluate and model the potential strategies and scenarios to rebalance margins by service line, inpatient versus outpatient, etc.
- Step 4: Implement margin driven negotiations.
  - Renegotiation
  - Charge description master pricing

In a future article for the Payment & Reimbursement Forum, we will describe margin management analytics and techniques being implemented at leading providers to ensure future success.

The Bottom Line

Successful margin strategies can't solely rely on commercial unit reimbursement increases. Instead long-range margin strategies must consider a myriad of other payment and growth strategies, along with assessing cost savings opportunities, to ensure future successes.

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Forum members: Please share your comments, questions, and insights about this article on the **Payment & Reimbursement Forum's Linked In discussion site**:

- Is your organization considering balancing margins by IP and OP lines of service?
- How are you considering your long range financial opportunities or risks?
- What other key questions do you have about balancing inpatient and outpatient margins?

Or perhaps you have a discussion starter?

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