

DIS-INTEGRATING HOSPITALS

It's no secret that services formerly provided to hospital inpatients and outpatients are migrating to other delivery settings, including physicians' offices and free-standing ambulatory sites. What is not as clear is the impact that this shift is having on hospital financial performance. That is because while some services are moving out of the hospital, an increase in patient acuity and growth in admission rates have been driving census growth in the hospital. Many hospitals today are full, masking the impact of what we will call "dis-integration."

Dis-Integration

The shifting of diagnosis and treatment services out of hospital inpatient and outpatient settings to physicians' offices and free-standing ambulatory care settings.

The problem, of course, is that the services that are leaving are higher margin diagnostic and treatment procedures, and the growth is often in the form of medically complex cases with higher length of stay. When the latter push hospitals over the length of stay implicit in case-based reimbursement rates, the "replacement" utilization has a negative impact on margins. High-margin services are replaced by lower, or negative, margin services while utilization levels remain high.

Complicating matters is the fact that because market data on outpatient and physician office services is limited, or non-existent, understanding the true scope of dis-integration can be difficult.

To see the full picture, we conducted a longitudinal analysis of the Per Member Per Month (PMPM) claims experience of a medium-sized employer-sponsored health plan.¹ This data allowed us to track aggregate changes in a care delivery site over a three-year period (2002-2004). The analysis included approximately 25,000 covered lives with a typical commercial profile.

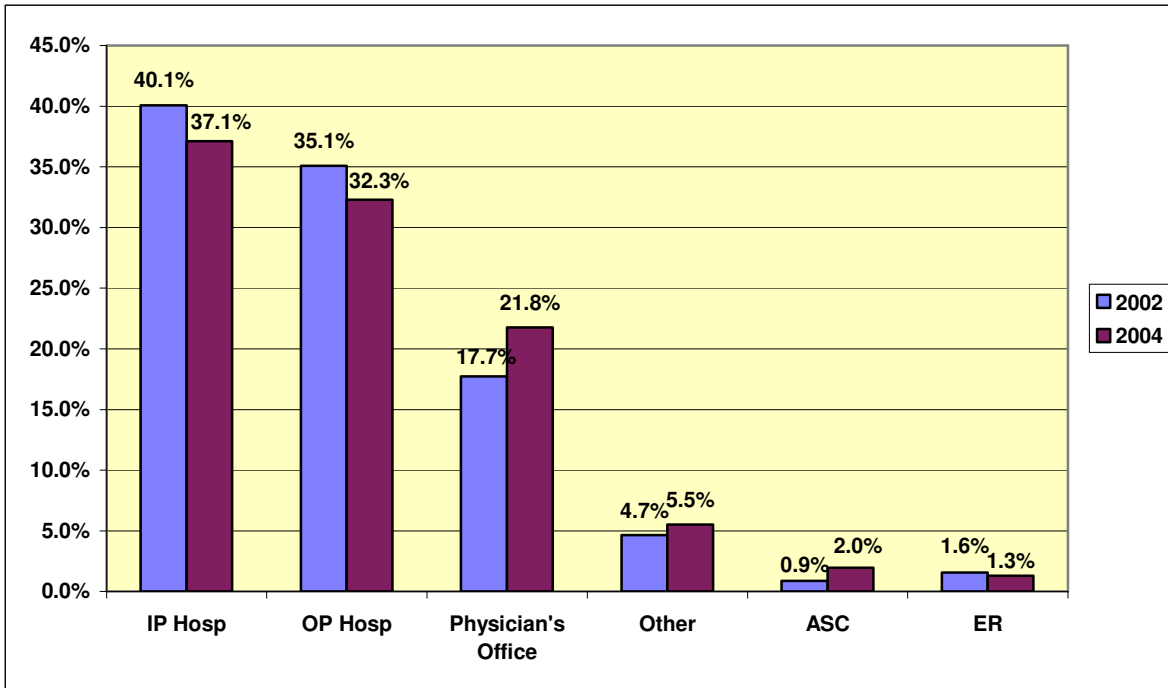
**Change in Per Member Per Month Claims Paid by Site of Service
2002 - 2004**

Location	\$ Per Member Per Month		Change 2004/2002	
	2002	2004	\$	%
IP Hosp	\$ 66.93	\$ 63.49	\$ (3.44)	-5.1%
OP Hosp	\$ 58.57	\$ 55.25	\$ (3.32)	-5.7%
Physician's Office	\$ 29.58	\$ 37.26	\$ 7.68	26.0%
Other	\$ 7.77	\$ 9.45	\$ 1.68	21.6%
ASC	\$ 1.49	\$ 3.36	\$ 1.87	125.5%
ER	\$ 2.65	\$ 2.24	\$ (0.41)	-15.5%
Grand Total	\$ 166.99	\$ 171.05	\$ 4.06	2.4%

During the study period, overall plan expenditures grew modestly from \$167 to \$171 PMPM, or 2.4%. This relatively low total growth masked significant changes in the sites where care was delivered. Hospital inpatient services, accounting for 40.1% of claims, or \$66.93 PMPM in 2002, declined 5.1% between 2002 and 2004. Surprisingly, hospital outpatient services, accounting for 35.1% of claims, or \$58.57 PMPM in 2002, declined at a comparable rate of 5.7%. Physician's offices experienced the most significant gains, increasing \$7.68 or 26%. Ambulatory surgery claims more than doubled, while claims in other outpatient settings grew over 20%.

¹ Analysis relied on a proprietary database and claims management software provided by InforMed LLC.

**Change in Share of Claims Paid by Site of Service
2002 - 2004**



Implications

What does this mean for a typical hospital? For a hypothetical hospital with a 230 patient census and 40% commercial payer mix, approximately \$1.0M annual commercial revenue would have moved from hospital based care to alternative settings between 2002 and 2004.

The strategic implications are potentially profound. Loss of higher margin procedures stresses hospital financial performance. Even more important, a sustained shift in healthcare service economic value to non-hospital providers (physicians, investor owned ambulatory services) threatens to change hospital's role as the "hub" of the healthcare delivery system. Patients will have growing choices in terms of where to seek healthcare services. Physicians, and particularly larger, integrated multi-specialty groups with the capital to add technology based services, will play an increasingly important role in influencing consumer decision making.

InforMed, LLC is a private company providing third-party administration, information and reporting, and medical management services for employer-sponsored health plans. For more information, see www.InforMed-LLC.com or contact Harry Spring at harrys@informed-llc.com.

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