



## **DRG Do-Over**

**Restructuring Your Service Lines to Adjust to  
Revised Reimbursement Schedules**

**HCP Pro Audio Conference**

**Wednesday, December 6, 2006**

# Three Emerging and Converging Themes

- **Market Shifts Driving Medical Migration**
- **Rise and Resonance of Niche Player Nirvana**
- **The Imperative for Sophisticated Service Line Strategy**

- **Overview of DRG Reconfiguration**
  - What is the driving force behind the changes
  - What changes were planned
  - What changes are underway
  - Why should providers take notice
- **Service Line Adjustment and Restructuring**
- **A Long-Range Look and Plan for Redesign**
- **Cost Analysis and Portfolio Measurement as Strategy**
- **Bracing Now for Changes to Your Operations**



**“The World is Changing”**

**J.R.R Tolkien: *The Lord of the Rings***

# Service Line Factors: Why, What, etc.

- Why It's Relevant for Planning and Success
- What It Means in Terms of Likely Impact
- When will the Changes Occur
- Where to Look for Opportunities
- How to Proceed to Succeed

# Why It's Relevant: Planning and Success:

- New Wave of Competitors
  - \* Specialty hospitals, ASCs, etc.
  - \* Physicians as competition
  - \* Retail outlets/operations (i.e. Minute Clinics)
  - \* Medical Tourism
- Realization of the Painfully Obvious
  - \* Hospitals have got to start being more innovative market-driven, and enterprising to survive
  - \* Service Line strategy is best model for market

# What it Means in Terms of Impact

- The reconfiguration is designed to achieve parity
- The eventual goal is to mitigate the impact of high-margin competition/migration
- The Pareto Group is about to lose (some of) its luster
- Hospitals will need to rethink their overarching strategy
- Big hits in the Big Four
- Time to refocus the locus of managerial time and market emphasis

# Fundamental Two from the Guru

There are two questions that every organization should ask:

- \* What business are we in?
- \* How do we achieve a differential advantage?

Peter Drucker

No better time than now to revisit and reconsider these quintessential questions than now

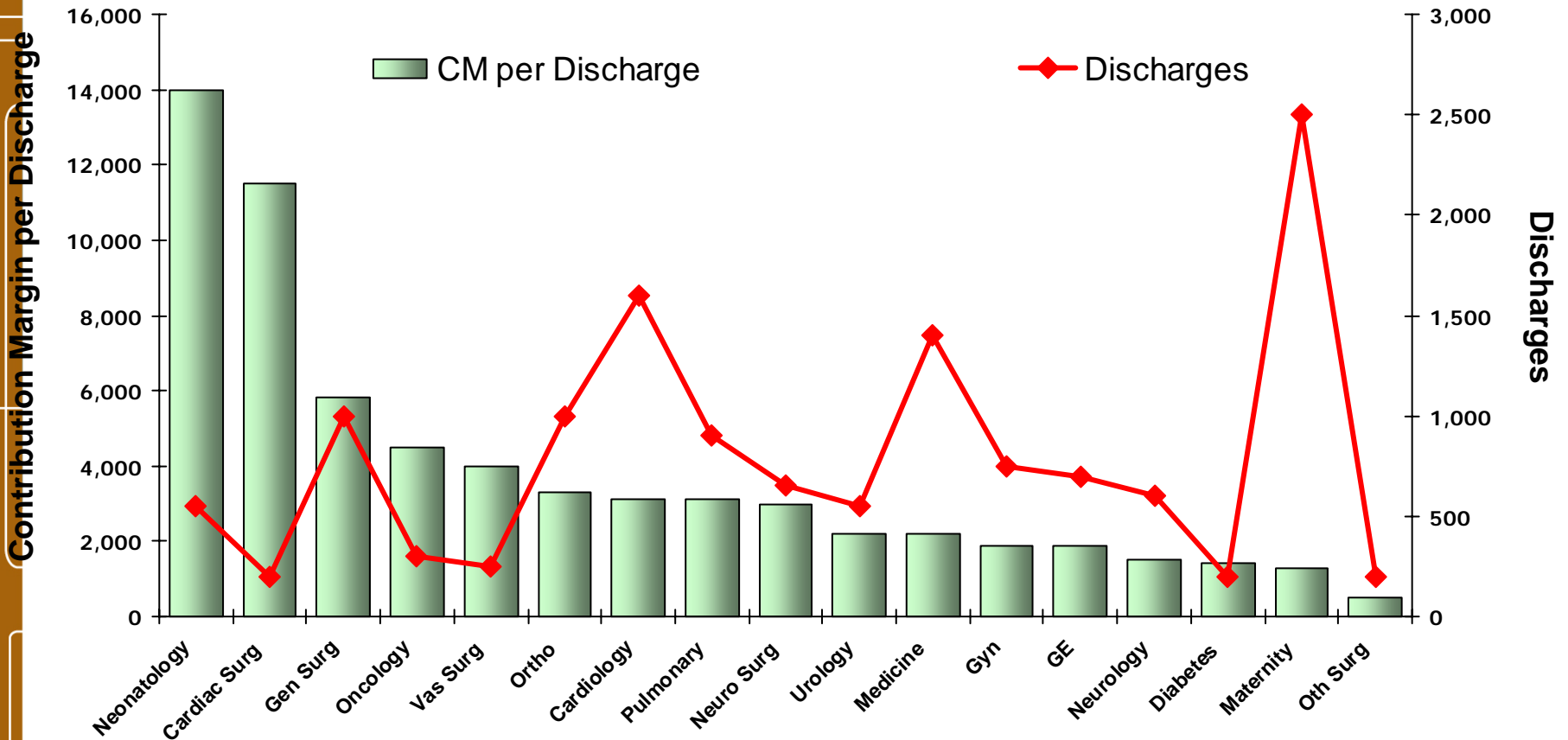
# Portfolio Measurement: *Eight Sequential Steps*

- Identify/prioritize the service lines that are strategic/core
- Measure what matters
- Narrow down to two or three overall projects
- Assign accountability to a mini-CEO for each project
- Assess market position for each of the options
- Develop business plans
- Compete aggressively/strategically
- Execute according to the determined plan

## *Prioritize the Service Lines*

- Decide what the criteria will be (i.e. DRGs)
- Choose something that enables competitive comparison
- Choose something that provides relative ranking
- Work with existing resources—cost account.
- Consider outside data acquisition
- Become data-driven and results focused

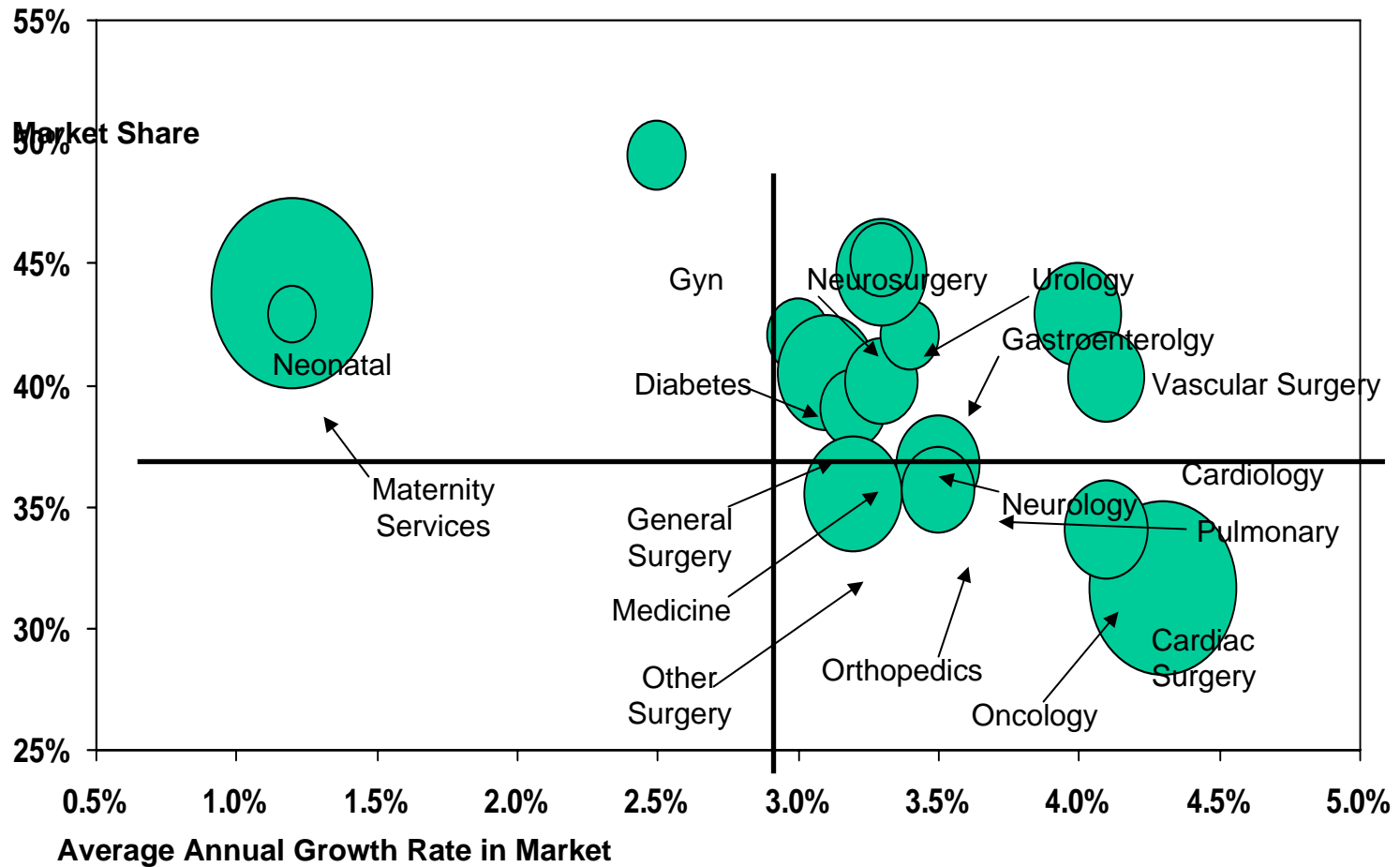
# First Step: Profile the Portfolio



# Measure what Matters

- Using the data criteria identify of reporting significance
- Consider the audiences that receive/review the reports
- Ensure that the items measured reflect the organization's characteristics of existence
- Don't confine to strictly quantitative
- Determine what success would mean

# Service Lines: Another Typical View



Size of bubble represents Contribution Margin per Discharge

# *Narrow Down to Two or Three*

- Develop a means for representing/ranking all the identified opportunities
- Using determined decision-making criteria, isolate the new product/service opportunities that are optimal
- Utilize the exercise to calculate the probable financial outcome for the organization and use projected #s
- Map out the strategy with old information and with expected changes (in DRGs) and create scenarios
- Keep the tool or mechanism dynamic for periodic review and re-assessment

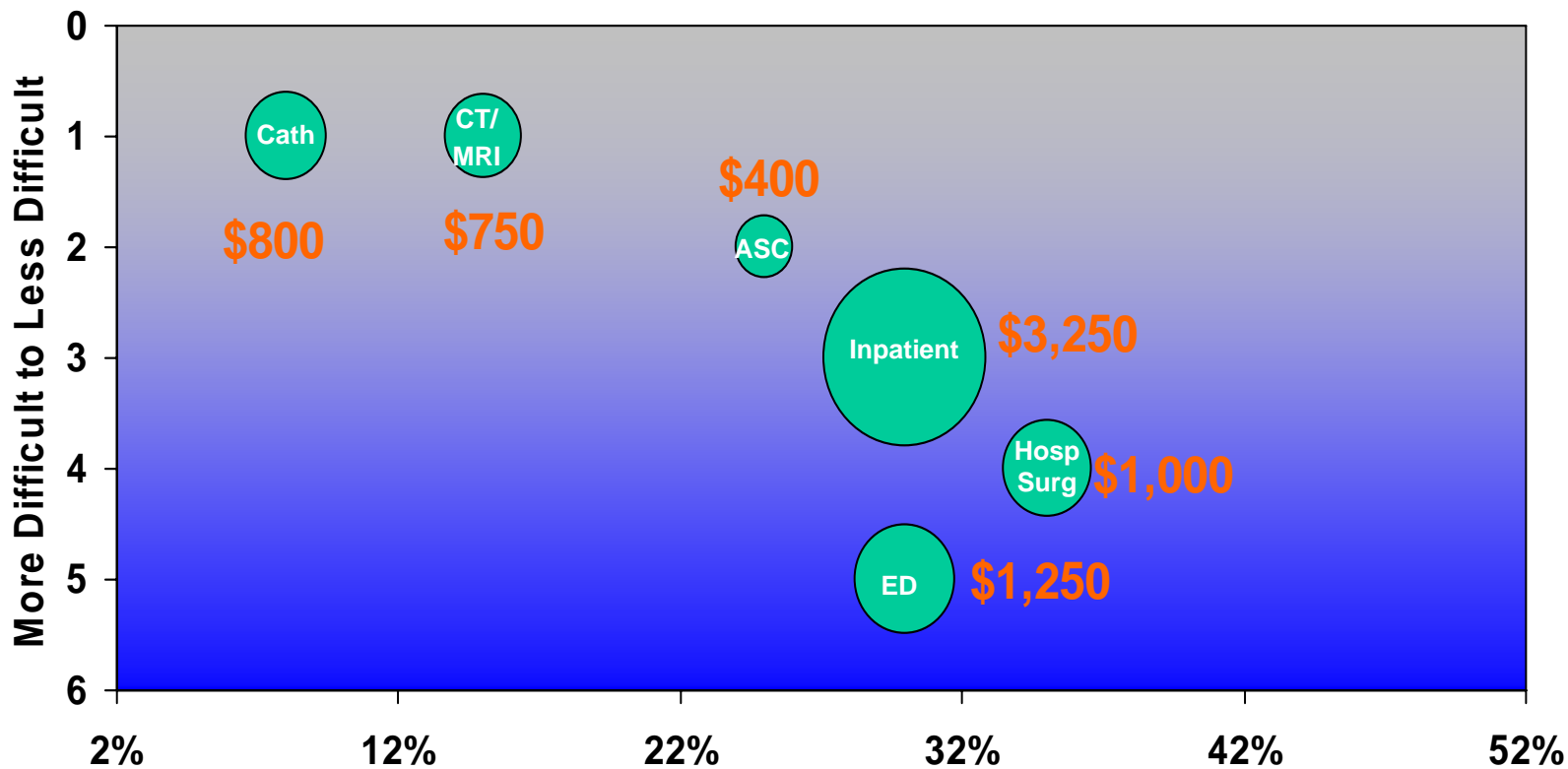
# *Assign Accountability to Mini-CEO*

- Review the existing managerial framework in the context of the current reimbursement structure and projected
- Assess managerial talent pool and culture
- Consider matrix vs direct accountability
- Develop structure for multi-disciplinary, cross-department involvement, with two/three major lines
- Include physicians in the eventual team

# Assess Market Position

- Identify the key market considerations especially competition
- What impact will the revised DRG payment and position have on your competition
- Conduct market research for qualitative measures
- Consider quality metrics in comparison data
- Develop projections for 5-10 year horizon for all competitors, especially niche players
- Include exit options in the strategy

# Relative Value / Difficulty of Moving Share



# Develop Business Plans

- Assign responsibility for business plan to individual responsible for the core service line
- Conduct sufficient market research for relevant competitive and differentiating measures
- Pivot off key components of strategic plan and factor in changes in reimbursement schematic
- Synchronize execution on implementation with organizational strategic plan
- Incorporate the business plan into the ongoing strategic plan cycle

# Compete Aggressively and Strategically

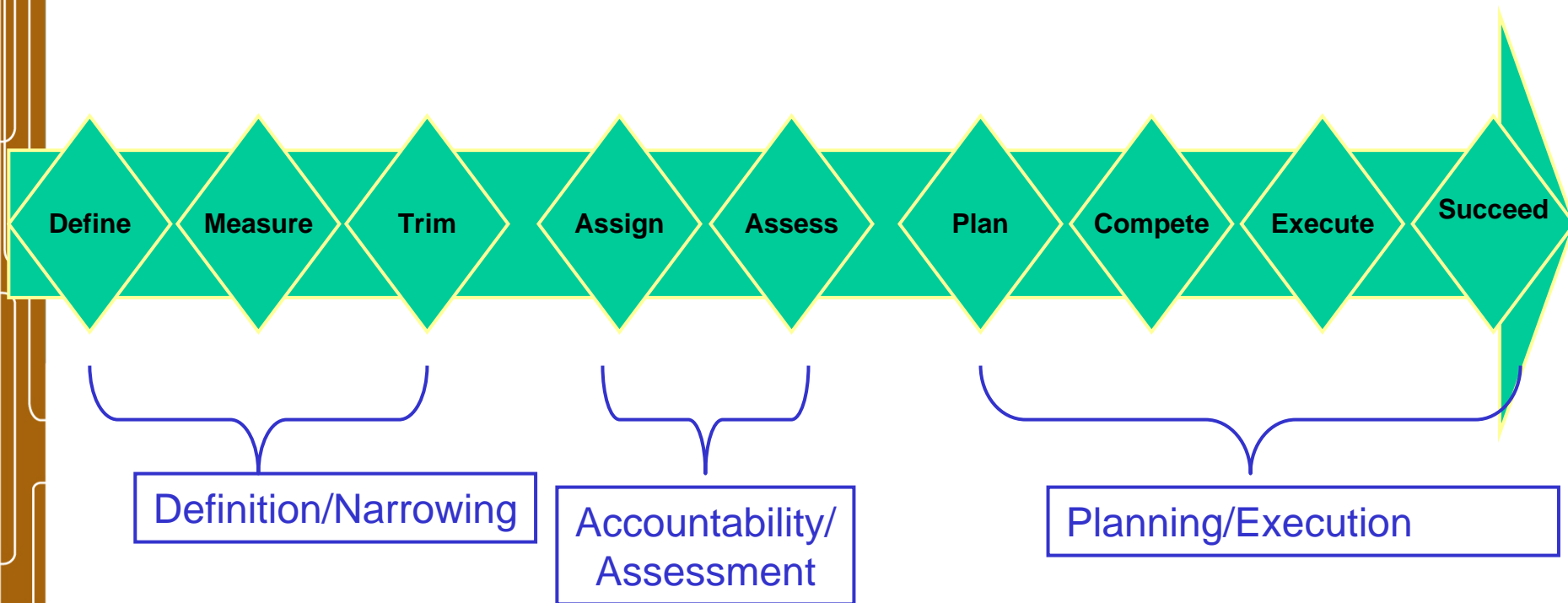
- Accountability for competitive success rests with mini-CEO and team
- Financial incentives should align with service line success measures
- Ensure adequate resources to get job done—responsibility with accountability
- Marketing & advertising staff need to be integrally involved in strategy and execution
- Incorporate ongoing reconnaissance of competition
- Become fixated on consumer focus—consider new competition like retail and medical tourism

# *Execute According to the Determined Plan*

- The business plan should guide and direct the execution of the identified strategies
- The plan should outline expectations by management and trigger points for modifying the strategy
- Core metrics should be outlined in terms of the strategic plan parameters and quantifiable targets
- Communication throughout the organization and among all stakeholders, as well as senior mgmt is critical

# Service Line Strategy and Structure

## Eight Sequential Steps to Success





# Implications for the Healthcare Industry

## A Complex and Uncertain Path

# A Long-Range Look and Plan for Redesign

*...a look back...*

## Rebasing Background

- April 14<sup>th</sup>, 2006 CMS proposed several changes to the Medicare inpatient prospective payment system (IPPS) for FY 2007
- The largest change to the program since its inception in 1983

## The Issue

- Variation in charge-setting policies across hospital departments that favor procedural cost centers over routine cost centers
- Differences in severity of illness among patients within a given DRG

## CMS Proposal – New methodology for “rebasing” DRG weights

- More accurately reflect the cost of care with the intent to reduce financial incentives for specialty hospitals
- Elevate payment rates for medical admissions at the expense of surgical cases (particularly cardiac and orthopedic procedures)

# What to Expect

## Outcome

- Move from a charge-based to a cost-based methodology for calculating DRG weights

## Implementation – 3 year transition period

- FY 2007 DRG weights will be 33% cost based
- FY 2008 DRG weights will be 66% cost based
- FY 2009 DRG weights will be 100% cost based

## Fiscal Year 2007 – October 1, an interim step toward refined DRGs to improve recognition of severity within the existing DRG system

- Create 20 new DRGs
- Modifying 32 others



# Planning for the Future

<u>MDC</u>	<u>MEDICAL</u>		<u>SURGICAL</u>	
Circulatory	Chest Pain/Syncope	↓	CABGs	↓
	Cardiac Cath/PTCA/Stents	↓	Valves	↓
	Pacemakers/ICDs	↓	Other CV Proc	↓
	Other Medical	↑	Vasc. Proc	↓
			Amputations	↑
Digestive	All	↑	Appendectomy	↓
			All Other	↑
Hepatobiliary	All	↑	Lap. Cholys	↓
			All Other	↑
Orthopedics	All	↑	Joint Replacement	↓
			Spine Procedures	↓
			All Other	↑
Obstetrics	All	↑	All	↑
Myeloprol & Poorly Diff Neoplasms	All	↑	All	↓
Infectious & Parasitic Disease	All	↑	All	↑
Mental Disease	All	↑		
Alcohol & Drug	All	↑		

# Projected Revenue Change By Service Line

*The Advisor Board estimates a 9% overall reduction in revenue*

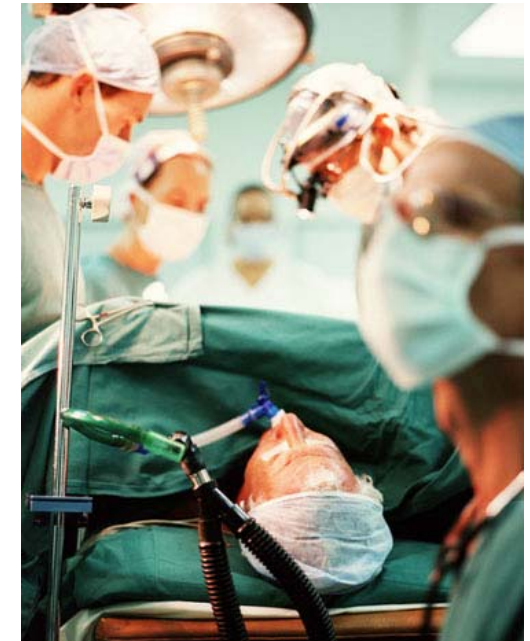
<u>Medical vs. Surgical DRGs</u>		
	<u>NATIONAL</u>	<u>Sample</u>
MEDICAL	9.7%	8.5%
SURGICAL	-3.0%	-3.1%

<u>Key Service Lines</u>		
	<u>NATIONAL</u>	<u>Sample</u>
GENERAL MEDICINE	13.3%	12.3%
<b>CARDIAC SERVICES</b>	<b>-9.0%</b>	<b>-8.5%</b>
ORTHOPEDICS	2.7%	3.5%
GENERAL SURGERY	5.4%	3.7%
NEUROLOGY	4.5%	4.9%
VASCULAR SERVICES	0.5%	0.8%
<b>ONCOLOGY</b>	<b>8.1%</b>	<b>7.7%</b>
SPINE	-0.7%	-1.4%
UROLOGY	3.3%	0.3%
ENT	6.7%	7.5%
GYNECOLOGY	5.8%	6.9%
THORACIC SURGERY	1.7%	-0.1%
TRAUMA (MEDICAL)	12.5%	11.3%
NEUROSURGERY	3.9%	3.1%
<b>OBSTETRICS</b>	<b>36.8%</b>	<b>42.9%</b>
OPHTHALMOLOGY	9.6%	1.0%

# Biggest Losers

## Selected Services

	<u>NATIONAL</u>	<u>Sample</u>
ORTHOPEDIC RECONSTRUCTION	-0.6%	-0.5%
STENTS, ALL	-28.3%	-27.6%
STENTS, DRUG ELUTING ONLY	-28.9%	-28.9%
PACEMAKERS	-12.7%	-12.1%
CABG	-5.3%	-5.3%
SPINAL FUSION	-6.0%	-4.8%
ICDs	-22.7%	-23.1%
STENTS, BARE METAL ONLY	-24.7%	-23.9%
HEART VALVES	-4.7%	-4.8%



- ***Some project cardiac service line total revenue decreases of 30%***
  - ***40-50% reduction for some specialty hospitals***
- Full impact estimated between \$1.5 -\$2.5 million***

# Plan for Redesign

- Hospitals have historically invested a disproportionate share of capital and management “bandwidth” to procedural service lines.
- With surgical margins expected to diminish, future capital planning can’t ignore other areas of the hospital portfolio to sustain growth – known as 2<sup>nd</sup> tier services or 3<sup>rd</sup> rate margin contributors.
- Look to medical diagnosis and specialties for opportunities to grow and shift margins
  - One example, oncology, estimated to gain significantly.
- Opportunities to recapture market share from specialty providers.
  - Retool services and throughput for efficiency
- Re-price and re-contract services to minimize losses from other 3<sup>rd</sup> party payers.

***Begin Planning Now***



## The Strategic Imperative

***“Healthcare Organizations cannot  
be all things to all people”***

***Anonymous***

## A Futuristic View



**PHASE 2 CONSULTING**

*A RehabCare Company*

## Three Important Questions that require consideration.....

- *What do your “core four” look like?... a.k.a. “Meltdown or Minor”*
- *How does it affect competition?.... a.k.a. “Outrunning the Bear”*
- *Opportunities on the Periphery?...a.k.a. “Mavens of Medicine”*

# Important Backdrop Considerations

- **Transparency**
  - Quality: Mounting interest/demand for comparative measures and pay for performance incentives.
  - Pricing: AHA's recent announcement coupled with CMS initiatives and administrative statements.
- **Culture of Consumerism (*Moi-Care*)**
  - Retail operations like “Minute Clinics” in Wal-Mart's, CVS Pharmacy and now Winn-Dixie.
  - Medical Tourism.
  - Migration away from medical campus.

# Bracing Now for Significant Change

- Determine your current cost accounting capability
- Assess your dependence on “core four” and other such lines
- Drill down on (and assess) the sub-service line impact
- Outline the relative impact on the competition
- Identify and codify the differentiation factor
- Finalize the decision to either play hard ball or get an expansion team with the physicians
- Make sure someone is minding the change
- Update the plan frequently; data-based



# Getting to the Top of the World

- Working with data, identify the highest value service lines
- Map out the impact of reimbursement changes
- Identify strategy for mitigating competition
- Consolidation of low-margin service lines
- Use quality measurements as differentiator—
- Always factor in the rebasing of DRGs—  
niche player impact and opportunity
- Plan for displacement of smaller/low  
margin lines and reduction of core four
- Assess impact of managed care
- Identify money losers—scenarios



# Consumers as the Crown Prince

- The market-orientated approach may be given a chance to reign
- HSAs and rising consumerism may take center stage—Goldman Sachs projection realized
- If strategic differentiation is based on market factors, such as consumer appeal, convenience, cost, quality-how now?
- Does the organization display market discipline?
- Emphasis should be on strategy, marketing, perception positioning
- Turn niche player nirvana into nightmare
- Employees need to be ambassadors
- Big winners-marquee names, savvy providers, entrepreneurial players and physicians
- Big losers—small, high-priced, old campus-focused providers



## At the End of the Day...



## ...Trends with Little Bend

- Strategic planning—ultimate value in the *process*
- Reinvention--emphasis on innovation and new product/revenue stream identification
- Quality strategy--with physicians and caregivers as drivers
- Positioning to key audiences
- Service line focus and SBU management—connecting with the consumer/patient
- Communication—critical at all levels—outward focus
- Pricing needs to be more transparent and strategic
- Efficiency is always in style (and demand)
- Consumer/patient relations as the emerging (and essential) link

## **Salt Lake City, Utah Office**

2120 South 1300 East, Suite 301

Salt Lake City, UT 84106

Telephone: 800-995-0097

Fax: 801-596-2127

## **Austin, Texas Office**

5914 West Courtyard, Suite 360

Austin, TX 78730

Telephone: 512-346-0500

Fax: 512-343-9275

## **St. Louis, Missouri Office**

7733 Forsyth Boulevard, Suite 2300

St. Louis, MO 63105

Telephone: 800-677-1202 ext 2105

Fax: 314-659-2376