

Mitigating Risk with Price Transparency

By Karl Kimball

Health care historically never thought of itself as an industry. However, the pressures that traditional U.S. health care providers are feeling is industrial in nature i.e., competition, quality of service, price competition, and consumer (patient) value.

Hospitals are challenged to be competitive but find it extremely difficult to both comprehend and also take actionable steps to thwart the competition. Perhaps the first and most important step for hospitals is to provide price transparency. Consumers must know what the price is for health services. Hospitals will be forced to follow the same course all other industries have been forced to follow i.e. price transparency. Consumers do not accept a continuous chain of discovery and follow-on charges. Consumers demand fixed prices. However, price transparency carries risks for hospitals. These risks are especially high because hospitals don't know their true costs for services and therefore are reluctant to give fixed prices. The simple task of providing prices for services is difficult for a hospital because the traditional way hospitals determined costs is based upon estimation algorithms of RCCs and RVUs. Both methodologies fail because they are based upon averages and are so inaccurate it puts the hospital at very high risk. Further, quality initiatives to improve services and provide price transparency are all but impossible with RCCs and RVUs because the incremental cost changes of a quality program are small compared to the error introduced by averaging based methodologies.

Scientifically, hospitals have not followed the science of quality (Edwards Deming model) and Activity Based Costing used to determine true costs and hence provide a solid scientific foundation for pricing. Hospitals must adopt these methodologies that will allow them to understand costs, which leads to profitability, and finally price transparency. Deming put forward a definition of quality as "meets requirements". This defined quality as set of metrics rather than a subjective evaluation. The early Volkswagen Beetle represented a low end car that was highly reliable because of a low maintenance air cooled engine. The Volkswagen Beetle was manufactured with very few flaws and met the criteria that set the standard for "economy car". The consumer got exactly what they expected when they purchased a Beetle, low price, low maintenance, and high reliability. Activity Based Costing is primarily a methodology of measuring the consumption of resources for a specific activity. This methodology is the heart of modern day supply chain and manufacturing that every successful company in every industry uses to insure that costs are known and pricing can be transparent. Without known costs all other metrics are meaningless, i.e. profit, price, and quality.

Price transparency is an extremely important topic for all hospitals. The ease and low cost of international travel has created more than just vacation time abroad, it has created access to markets that now cater to consumers. Dubbed "medical tourism", the attraction of low cost health care on par with the best of U.S. health care combined with the luxury and services of a vacation resort is increasingly the choice for major clinical procedures. Soon, even routine procedures will become routine for the consumer to seek outside the U.S., because they can be combined with a vacation or business

trip. Consumers will opt for treatment where the convenience, cost, and quality combination makes it their best choice. The bottom line is that there is now competition for traditional health care.

The driver for this competition is not the chance for the consumer to have their hip replaced in an exotic location. The driver is cost. The continuing rise in U.S. health care costs is the driver that is creating choice for the consumer. Competition is also coming from the bottom i.e. retail health care from Walmart and others who provide affordability. Walmart leverages their low overhead to provide specific, high profit, high volume procedures. Again, low cost health care providers target and commoditize procedures that provide a combination of convenience, cost, and quality attractive to the consumer. Eventually retailers will dig deep into the mainstream health care market cherry picking and commoditizing more and more procedures.

The path to price transparency for hospitals is a path to industrialization for health care. Hospitals must transition because their competitors are taking their market away. For Hospitals to be successful they must provide price transparency and insure that the profit and quality they provide is competitive to stave off competition. Price transparency is the goal for hospitals to be competitive, however the price hospitals must pay is the cost to transition to scientifically sound methodologies such as the Deming model and Activity Based Costing.

About the Author: Karl Kimball is Vice President of North America for Cortell Health and a member of the Texas Lone Star HFMA Chapter. Kimball holds a BS in Mathematics from University of Texas at Arlington and has worked many years in web based applications, business intelligence, and workflow automation. Karl has been a major contributor to the development of international standards and has been an ANSI Advisory Board member, a POSIX contributor, JTC 1 Delegate, workgroup leader for the ISO transaction processing standards. He has held various executive and leadership roles for IBM, Apple, Datapoint, and was a founding member of Corporation for Open Systems. Karl can be reached at karl.kimball@cortellhealth.com.