Executive War College 2011

Why Your Hospital Lab Outreach Program Leaves Big Money on the Table: Six Ways to Boost Net Revenue and Net Profits

Presented by
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Chief Executive Officer

Basis

- Data from 9th Annual National Outreach Survey (2010)
- Experience as a lab executive in hospital and independent labs
- Knowledge gained from working with clients
- Interviews
  - Tom Hirsch of Laboratory Billing Solutions
  - John Leskiw of Quadax
Billing and collections is always among the top five weaknesses in this survey.

Range of profitability from 15 to 25 percent with core labs generally higher than stand-alone labs.
Are margins being squeezed? What can you do to counteract that trend?

Most of my comments today are focused on the 79 percent of outreach programs where the hospital does the billing.
9th Annual National Outreach Survey
Bad Debt and DSO

<table>
<thead>
<tr>
<th>Bad Debt Rate</th>
<th>Days Sales Outstanding (DSO)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum</td>
<td>Maximum</td>
</tr>
<tr>
<td>Upper Quartile</td>
<td>Upper Quartile</td>
</tr>
<tr>
<td>Median</td>
<td>Median</td>
</tr>
<tr>
<td>Lower Quartile</td>
<td>Lower Quartile</td>
</tr>
<tr>
<td>Minimum</td>
<td>Minimum</td>
</tr>
<tr>
<td>Average (Mean)</td>
<td>Average (Mean)</td>
</tr>
<tr>
<td>11.0%</td>
<td>110</td>
</tr>
<tr>
<td>7.3%</td>
<td>49</td>
</tr>
<tr>
<td>4.0%</td>
<td>41</td>
</tr>
<tr>
<td>2.4%</td>
<td>32</td>
</tr>
<tr>
<td>1.0%</td>
<td>26</td>
</tr>
<tr>
<td>5.0%</td>
<td>45</td>
</tr>
</tbody>
</table>

Know the Bad Debt Rate 27.3%
Don’t Know 72.7%

Know the DSO 29.4%
Don’t Know 70.6%

73 percent and 71 percent of outreach programs do not know their bad debt or DSO.

For those who know this information, performance has been trending better over the last few years.
Reasons Why $ is Left On The Table

Top 6 Countdown

In Reverse Order of Significance
From Six to One

Reason #6

NOT FIRING “BAD” CLIENTS
#6 Not Firing “Bad” Clients

- All business is not “good” business
- Need systems to measure profitability by client
- Case study - Midwestern Hospital

### Profitability By Client - Rank Order

<table>
<thead>
<tr>
<th>Account Code</th>
<th>Revenue Six Months</th>
<th>Total Cost Six Months</th>
<th>Annualized Profit/Loss</th>
<th>Test Volume</th>
</tr>
</thead>
<tbody>
<tr>
<td>Client 1</td>
<td>$35,357</td>
<td>$169,054</td>
<td>($246,993)</td>
<td>22,083</td>
</tr>
<tr>
<td>Client 2</td>
<td>$18,022</td>
<td>$131,983</td>
<td>($223,123)</td>
<td>18,331</td>
</tr>
<tr>
<td>Client 3</td>
<td>$43,711</td>
<td>$145,613</td>
<td>($303,893)</td>
<td>20,234</td>
</tr>
<tr>
<td>Client 4</td>
<td>$7,084</td>
<td>$47,959</td>
<td>($32,749)</td>
<td>6,881</td>
</tr>
<tr>
<td>Client 5</td>
<td>$3,977</td>
<td>$32,544</td>
<td>($28,533)</td>
<td>7,270</td>
</tr>
<tr>
<td>Client 6</td>
<td>$7,203</td>
<td>$34,434</td>
<td>($26,482)</td>
<td>5,477</td>
</tr>
<tr>
<td>Client 7</td>
<td>$6,162</td>
<td>$36,792</td>
<td>($20,620)</td>
<td>5,110</td>
</tr>
<tr>
<td>Client 8</td>
<td>$9,636</td>
<td>$36,988</td>
<td>($28,449)</td>
<td>5,208</td>
</tr>
</tbody>
</table>

### Midwestern Hospital

Many of the Top Revenue Clients Were Unprofitable

**Before**
- Losing $400K annually
  - Client pricing
  - Cost of couriers
  - Large service area
  - Confusing revenue with profitability

**After**
- Profitability of $1M
  - Raised client pricing or dropped client within 60 days
  - Limited service area to reduce courier costs
  - Reduced client base by 30%
  - Dropped many of largest clients

**Impact**
- Shift of $1.4M in Profitability
#5 Taking “Cast-Off” from National Labs

- Too good to be true?
- Beware of:
  - Missing or incomplete billing or demographic information
  - Collection problems
  - Compliance issues
  - Low volume
  - Lacking IT skills
  - Low margin business
- Case study
“Cast-Offs” Were Not Profitable

Case Study: Mid-Atlantic Health System

<table>
<thead>
<tr>
<th></th>
<th>Before</th>
<th>After</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Physician Office Business</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenues</td>
<td>4,012,986</td>
<td></td>
</tr>
<tr>
<td>Expenses</td>
<td>4,194,799</td>
<td></td>
</tr>
<tr>
<td>Contribution Margin</td>
<td>(181,813)</td>
<td>821,017</td>
</tr>
<tr>
<td>Contribution Percent</td>
<td>(5)</td>
<td>27</td>
</tr>
<tr>
<td><strong>Nursing Home Business</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>931,058</td>
<td></td>
</tr>
<tr>
<td>Expenses</td>
<td>1,288,958</td>
<td></td>
</tr>
<tr>
<td>Contribution Margin</td>
<td>(357,900)</td>
<td></td>
</tr>
<tr>
<td>Contribution Percent</td>
<td>(38)</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contribution Margin</td>
<td>(539,713)</td>
<td></td>
</tr>
<tr>
<td>Contribution Percent</td>
<td>(11)</td>
<td></td>
</tr>
</tbody>
</table>

Total Change of $1.4M!

Reason #4

WRITE-OFF BALANCE TOO HIGH
#4 Write-Off Balance Too High

- Write-off balance for many hospitals is $50
- For labs, should be $3 to $5 (difference of tenfold)
- Typical co-pay or deductible ranges from $25 to $48
- What does this mean to an average lab?

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Example Calculation of Lost Money from Write-Offs

- Typical lab has a co-pay/deductible on 20 percent of patients
- A lab seeing 1,000 patients per day will have 200 patients getting an average bill of $35

$35 \times 200 \text{ Patients} \times 260 \text{ Billing Days/Year} = 1.82\text{M Lost to Write-Offs}^*$

Can you afford to leave that on the table?

*Data from Laboratory Billing Solutions.
Reason #3

UNTIMELY FOLLOW-THROUGH ON MISSING BILLING INFO

#3 Untimely Follow-Through—Missing Billing Info

- Should be within 24 to 48 hours
- Percent collection is disproportionate to time to follow up
  - After 60 to 90 days, likelihood of getting information from physician office or patient goes down
  - May exceed filing limits (90 days for most commercial payors)
  - DSO goes up (25 to 30 days for national labs versus 50 to 110 days for hospital labs)
- Collection rates go down
#2 Not Working Denials

- Percent denials varies by lab; estimated at 10 to 30 percent on average*
- Common in hospital settings; some hospitals do not follow up on denials; see the next example for financial impact

*Data from Laboratory Billing Solutions and Quadax.
#2 Not Working Denials

Example Calculation of Not Working Denials

- A lab seeing 1,000 patients per day will have claims from 10 to 30 percent (100 to 300) of patients denied

<table>
<thead>
<tr>
<th>No. Claims Denied</th>
<th>Revenue Loss¹</th>
<th>Daily Loss</th>
<th>Business Days</th>
<th>Annual Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>$68</td>
<td>$6,800</td>
<td>260</td>
<td>$1,768,000</td>
</tr>
<tr>
<td>200</td>
<td>$68</td>
<td>$13,600</td>
<td>260</td>
<td>$3,536,000</td>
</tr>
<tr>
<td>300</td>
<td>$68</td>
<td>$20,400</td>
<td>260</td>
<td>$5,304,000</td>
</tr>
</tbody>
</table>

Working denials makes a material difference in the revenue and profitability of an outreach program.

Reason #1

MANUAL REQUISITIONS VERSUS ONLINE ORDER ENTRY
#1 Manual Requisitions Versus Online Order Entry

- The most successful labs have online order entry for 80 to 90 percent of client base
  - Accuracy
  - Completeness
  - Timeliness
  - No denials
  - No re-work

- Outcome:
  - Costs down
  - Profitability up
  - Revenue up

Want Some “Free” Money?

- Computerized OE?
- Timely Follow-Through Missing Information?
- Working Denials
- Reduce Write-Offs
- No Cast-Off from Nationals
- Firing “Bad” Clients

Cumulative Financial Improvement\(^1\)

\(^1\) Example lab with 1,000 requisitions per day or 13 to 15M in annualized net revenue.

\(^2\) Does not include impact of timely follow-through on missing information or computerized order-entry.

This slide is meant to be hypothetical. We recognize that it is unlikely that any one lab will have all these problems…
How Can Things Be So Bad?

Part of the Bigger Picture

9th Annual National Outreach Survey
Access to Information - Key Performance Indicators

CLIENT SERVICES:
- Hold Time for Incoming Calls: 18.3%
- Rate of Abandoned Calls: 18.3%
- Number of Calls Per Day per Service Rep: 18.3%

COURIERS:
- Lost Specimens: 62.9%
- Missing Pickups: 60.3%

SPECIMEN PROCESSING:
- Quantity/Not Sufficient: 67.3%
- Data Entry Error: 63.8%
- Specimen Integrity Compromised: 63.8%
- Volume of Requisitions: 57.7%
- Volume of Tests: 69.2%
- Volume of Requisitions or Tests by Hour of Day: 34.8%
- Variances to Average by Client: 43.3%

TESTING:
- Turnaround Time for Key Tests to Client: 51.5%
- Corrected Reports: 63.5%
- Quality Control Failures: 51.0%

BILLING:
- Gross Revenue Per Requisition: 22.9%
- Patient Mix by Client: 28.8%
- Net Revenue Per Sales Rep: 5.8%
- Net Revenue Per Requisition: 17.3%
- Earnings by Client: 15.4%
- Profitability by Client: 20.2%
- Profitability by Sales Rep: 4.8%
Information to Manage Your Business

Do you have the information, management reports, and key performance indicators to manage your business?

- Yes: 33.3%
- No: 66.7%

Most lab executives today are managing multi-million dollar businesses by “Braille.”

The Solution: Run Like a For-Profit

- Information, systems, tools to manage your business
- Performance metrics
- Control charts
- Think and act like a for-profit

Margins are too thin to manage by Braille!
Planting the Seeds…

Apply What You Learned Here Today and Watch Your Lab Business Grow!

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