

# HOSPITAL FINANCE 101

This 30,000-foot view of hospital finance serves as an overview of the various entities that pay for healthcare and an explanation of hospitals' revenue sources. A basic understanding of hospital finance is crucial as leaders continue to create policy that shapes the healthcare system.



## WHAT ARE THE SOURCES OF HOSPITAL REVENUES?

### Reimbursement for patient care is hospitals' primary source of revenue.

- Patient care services, both inpatient and outpatient, comprise around 93% of hospital revenues.
- "Room and board" for admitted patients, X-rays, physical therapy, nursing care and other support services are examples of patient care services.
- Hospital revenues are split roughly in half between inpatient and outpatient, with **51%** derived from inpatient and **49%** derived from outpatient services.

### Non-patient care services create additional revenue for hospitals.

- Examples include parking garages, cafeterias and gift shops

### Other sources:

- Investment income
- Grants and donations

## WHAT FACTORS DRIVE HOSPITAL COSTS?

Due to the ongoing pressures from payers to ratchet down reimbursement, hospitals vigilantly monitor the many additional elements that drive their costs. Two primary sources of expense are labor and capital costs.

### Workforce expenses

By far, labor costs are hospitals' greatest expense. Hospitals depend on a highly trained workforce to provide the advanced level of care and service that patients depend on.

- Payroll and benefits comprise **48%** of total hospital expenses, and this does not include contract labor, which can add significantly to hospitals' overall labor costs.

### Capital costs

To maintain the standards patients expect and to keep up with medical advances, hospitals are constantly investing in the newest technologies and ensuring that their buildings are able to meet the demand for services. The most common sources of capital expenditures include:

- IT advances
- Medical technology advances
- Facilities construction



## WHAT ARE THE SOURCES OF HEALTH COVERAGE?

Typically, the bulk of a hospital bill is not paid for directly by the patient, but rather by an entity that provides health insurance, commonly termed the payer.

### GOVERNMENT PAYERS

To provide a safety net, government programs provide health insurance for specific populations that might otherwise have difficulty obtaining coverage. Medicare and Medicaid, the two largest government payers, together cover around **34%** of the U.S. population.

#### Medicare

- A federal program established in 1965, Medicare is generally available to people age 65 and over as well as to certain persons under age 65 with disabilities or with end-stage renal disease.
- Hospitals are reimbursed for inpatient and outpatient services based on a prospective payment system (predetermined, fixed amounts that the federal government agrees to pay based on a patient's diagnosis and treatment).
- About **14%** of the U.S. population is covered by Medicare.

#### Medicaid

- Established in 1965, Medicaid is a joint federal/state program that provides health insurance to eligible low-income and medically vulnerable people. States administer the program under broad federal guidelines specifying minimum coverage standards.
- In Ohio, hospitals are reimbursed for inpatient and outpatient services based on prospective payment systems.
- About **20%** of the U.S. population is covered by Medicaid.

#### Military

- A small number of people – **1.4%** of the population – receives coverage through the military or Veterans Administration.

### PRIVATE PAYERS

Private insurance – obtained either through an employer or purchased directly by an individual – covers **56%** of the U.S. population.

#### Employer-based health insurance

- Employers contract with insurance companies to offer health insurance to their employees, and the employee and employer share the cost of the insurance premium.
- Covers **50%** of the U.S. population

#### Direct-purchase health insurance

- Individuals who are self-employed or who do not receive health insurance through their employer can purchase health insurance directly from an insurance company, including through HealthCare.gov, the federal health insurance marketplace.
- Covers **6%** of the U.S. population

### UNINSURED

Over 29 million people, comprising **9%** of the U.S. population, are uninsured.

## WHAT ARE PAYER MIX AND SERVICE MIX?

Because of variations in reimbursement rates based on who is paying and what services are being provided, hospitals can face wide variations in their financial viability. Examining hospitals' payer mix and service mix can illuminate why some hospitals have more difficulty maintaining a positive bottom line than others.

### Payer mix

This is the proportion of hospital payments received from different payers. Nationally, in 2018 hospital costs were distributed across various payers as follows:

- Medicare: 42.0%
- Medicaid: 18.3%
- Private Payers: 32.2%
- Uncompensated Care: 4.1%
- Other: 2.1%

### Why does payer mix matter?

- Public payers do not fully cover the cost of services provided. In 2018:
- Medicare payments covered **87%** of the costs associated with delivering services to Medicare patients.
  - For Ohio hospitals, this resulted in an **\$88.3 million shortfall** in 2018.
- Medicaid payments covered 89% of the costs associated with delivering care to Medicaid patients.
  - For Ohio hospitals, this resulted in a **\$786.0 million shortfall** in 2018.

### Service mix

- Some services tend to be reimbursed more favorably than others.
- For example, surgical care is more profitable than medical care.
- Hospitals tend to lose money on emergency departments, trauma units, burn units and intensive care units.

## WHAT IS UNCOMPENSATED CARE?

Uncompensated care refers to services for which hospitals are not reimbursed. This includes charity care and bad debt.

**Charity care** is care provided to patients who do not have the ability to pay.

- Northeast Ohio hospitals provided **\$230.9 million** in charity care in 2018.

**Bad debt** refers to care for which hospitals expected to be paid but were not.

- Northeast Ohio hospitals provided **\$411.3 million** in services in 2018 in this category.

## SOURCES

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