The Academy
The Health Management Academy

THE ACADEMY H2C **STRATEGIC SURVEY – Q4 2017**

COST & THE EVOLVING PAYMENT MODEL

H2C+ Hammond Hanlon Camp LLC

Melissa Stahl | Senior Research Manager | The Health Management Academy
Melissa Holloway | Health Services Fellow | The Health Management Academy

Key Findings

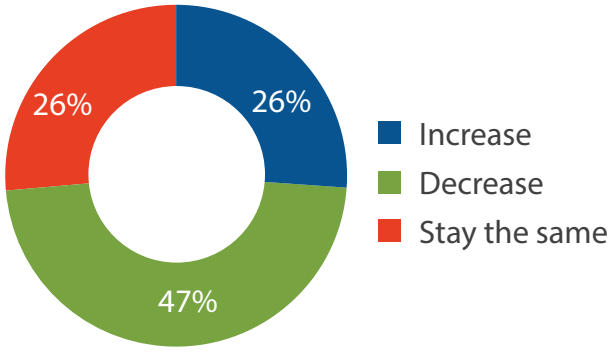
- Responding health systems reported an average operating margin of 3.69% in 2017 (range: 0.2% - 10%), down slightly from 3.98% in 2016 (range: 1% - 8%).
- Most (74%) responding executives anticipate their health system's operating margin will decrease (47%) or stay the same (26%) in 2018, causing the majority of health systems (67%) to more highly prioritize cost reduction in 2018.
- Fee-for-service continues to be the dominant reimbursement method for the largest health systems, comprising 82% of health system revenue in Q4 2017, compared to 18% for value-based payments.

Health Systems Expect Continued Margin Pressure in 2018

Responding health systems reported an average operating margin of 3.69% in 2017 (range: 0.2% - 10%), down slightly from 3.98% in 2016 (range: 1% - 8%).

The majority (74%) of responding health systems expect that their operating margins will either decrease (47%) or remain the same (26%) in 2018, many of them citing operational transformation, declining reimbursements rates, and acquisition activity as current margin pressures (Figure 1).

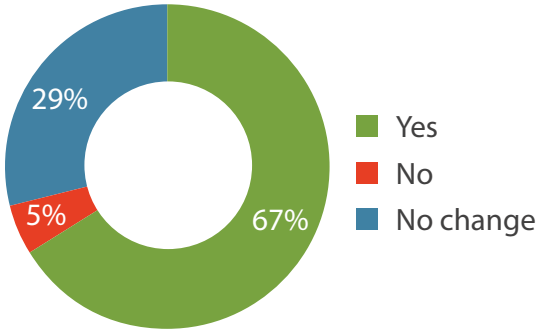
Figure 1. Do you expect your operating margin to increase, decrease, or stay the same in 2018?



"We are struggling with our operating margin and expect continued downward pressure. Most of our revenue is coming from non-traditional sources, which is tough, because we don't want diversification to make up our core business. It's an unstable model." (CMO)

Reflective of the increasing financial pressure, the majority (67%) of health system executives indicated that cost reduction and control will be an even higher priority in 2018 than in 2017 (Figure 2). Almost one-third (29%) of responding health system executives reported no change in the priority level of cost reduction and control, many noting that this was already a high priority and will remain a top priority.

Figure 2. Will/does your 2018 strategic plan refresh prioritize cost reduction/control higher then 2017's?



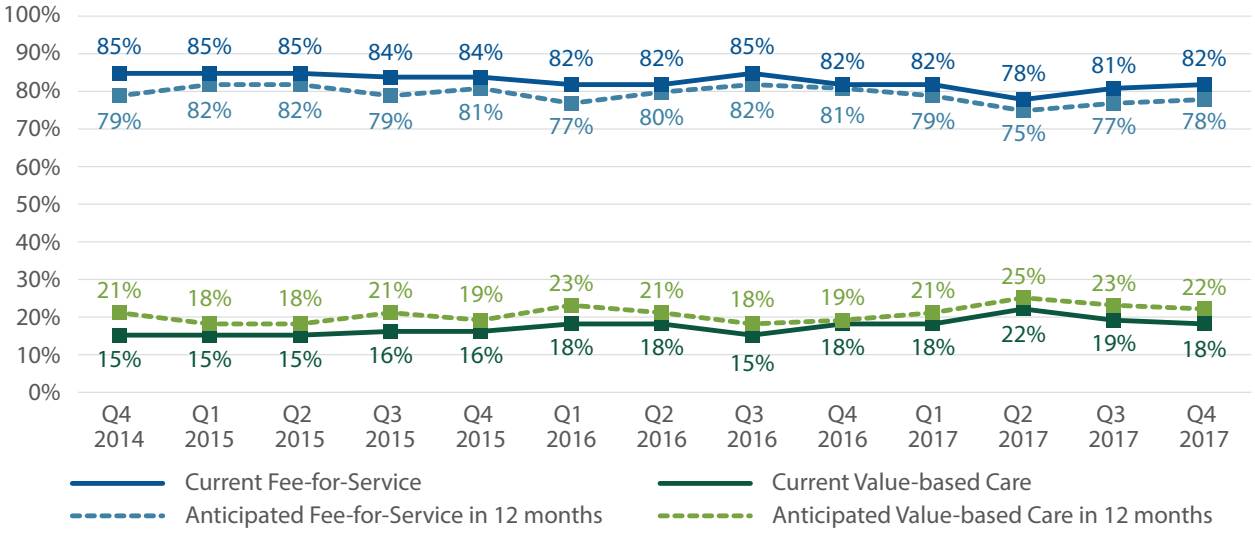
"We feel like cost reduction will be part of our strategic plan as long as we're in business. Things like the big 340B Medicare reduction that just got pushed into place will continue to put more pressure on cost." (CFO)

Many health systems are targeting areas where they can consolidate responsibilities and reduce labor costs, to address their organizational effectiveness and efficiency. There is also a focus on reducing variation in care delivery and standardizing practices.

The Evolving Payment Model

Fee-for-service continues to be the dominant reimbursement method for the largest health systems, comprising 82% of health system revenue in Q4 2017, compared to 18% for value-based payments (Figure 3).

Figure 3. Currently, what percent of your care delivery is fee-for-service and value-based? What do you expect your care delivery to look like in 12 months?



Note: Participating health systems may vary by quarter.

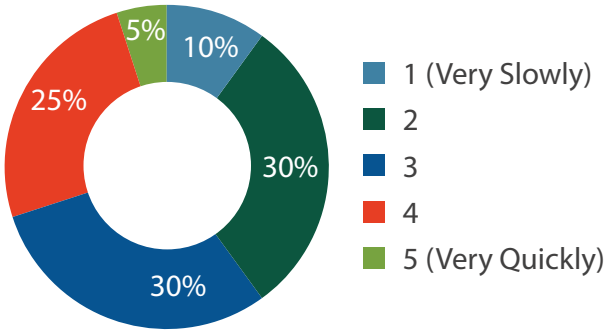
Executives do not anticipate a drastic shift in value-based reimbursements in the next 12 months, predicting that 22% of care delivery will be value-based, an increase of only four percentage points from current estimates. This aligns with health systems' self-reported pace of change towards value-based payment models, with less than one-third (30%) of systems reporting their pace of change as a 4 or 5 on a scale from 1 (Very slowly) to 5 (Very Quickly) (Figure 4).

Even of those systems which are moving more quickly towards a value-based system, many are hesitant to engage in models that incorporate downside risk, entering into arrangements like Medicare Shared Savings Program Track 1.

"We have a lot of shared savings type plans, but not many that are fully at risk. We are moving slowly, but we are getting there." (CMO)

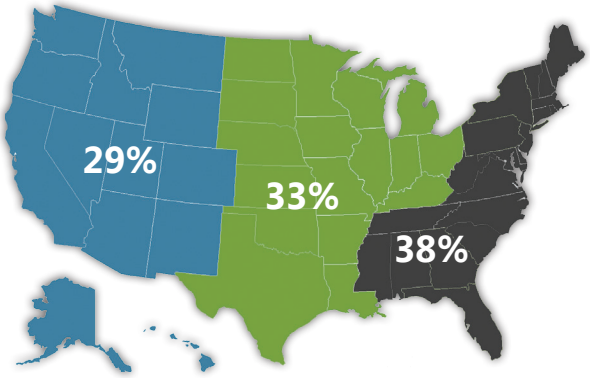
Many health system executives report challenges around increased margin pressure and a current lack of aligned incentives in fully embracing these new payment models, resulting in a slower shift toward value-based care.

Figure 4. On a scale of 1-5, how would you describe the pace of change towards value-based payments at your health system?



Profile of Participating Health Systems

Representative of the various regions of the U.S.



Average Net Patient Revenue

$3.88 BILLION

Own or operate 281 hospitals with 50,742 beds

57% Have a Provider-Owned Health Plan

67% Single-State Systems

33% Multi-State Systems

Participating Health Systems

Advocate Health Care
Aurora Health Care
Avera
Banner Health
BayCare Health System
CONE HEALTH The Network for Exceptional Care
Duke University Health System
FAIRVIEW
HAWAI'I PACIFIC HEALTH Kapi'olani · Pali Momi · Straub · Wilcox
Indiana University Health
Intermountain Healthcare
KAISER PERMANENTE
Lehigh Valley Health Network
Northwell Health
Ochsner Health System
Piedmont HEALTHCARE
PRESBYTERIAN
SPECTRUM HEALTH
UnityPoint Health
Virtua
Yale NewHaven Health

Methodology

In December 2017, The Academy conducted the thirteenth round of its quarterly strategic survey among 21 senior health system executives, including: CEOs, COOs, CFOs, CMOs, CNOs, and CSOs. The survey for the interview consisted of: (1) a tracking section that provides insight into trends around primary strategic areas; (2) a special topic area that allows for an in-depth look into a timely, developing issue. Innovation, consumer engagement, ambulatory and real estate strategies, physician alignment, bundling, data analytics, telehealth, pharmacy strategies, branding, health policy, and cost reduction were topics of previous surveys.

The Health Management Academy, "The Academy"

The Health Management Academy (The Academy) is a membership organization exclusively for executives from the country's Top-100 Health Systems and most innovative healthcare companies. The Academy is the definitive trusted source for peer-to-peer learning in healthcare delivery with a material record of research and policy analysis. Offerings include C-suite executive peer forums, issues-based collaboratives, leadership development programs, research, advisory, and media services. The Academy is an accredited CE provider. More information is available at www.academynet.com.

Hammond Hanlon Camp LLC, "H2C"

Hammond Hanlon Camp LLC ("H2C") is an independent strategic advisory and investment banking firm committed to providing superior advice as a trusted advisor to healthcare organizations throughout the United States. The company traces its heritage back almost 30 years through its predecessor organizations, including Shattuck Hammond Partners.

THE HEALTH MANAGEMENT ACADEMY
515 Wythe Street Alexandria, VA 22314
www.academynet.com

HAMMOND HANLON CAMP LLC
Atlanta | Chicago | San Diego | New York
www.h2c.com