

Market Insights

For the Health of Your Health System

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A Closer Look

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Healthcare Dashboard

Important metrics about healthcare, health systems and hospitals

	Most Recent	Trend	Discussion
INDICATORS			
Projected 2014 Health Spending	+6.1%	↑	Up from expected 4% growth in 2013, with expected average spending growth from 2012 to 2022 of 5.8%. ¹
Growth in U.S. National Health Expenditures	+3.8%	↑	National health expenditures grew 3.8% in August 2013 compared to August 2012. Hospital prices grew 1.5%, the lowest rate of growth since December 1998. ²
Hospital Net Operating Revenue Growth	+3.3%	↑	From 2009 to 2012, the total change in net operating revenue among all hospitals was 3.3%, with an average annual change of 1.1%. ³
Total Expense per Discharge	+4.8%	↑	Total expense per discharge increased from 2009 to 2012 by 4.8%, an average change of 1.6%. Expenses during this time increased faster than revenues. ⁴
Average Hospital Operating Margin	3%		Per Fitch, the median operating margin for the 249 hospitals and health systems it rates is 3.0%. The 249 surveyed hospitals rated AA have an average operating margin of 4.2%; hospitals rated below BBB have an average operating margin of -1.3%. ⁵
Percent of Healthcare Expenses Consumed by Various Percentages of U.S. Population	+86.4%		The costliest 1% of U.S. healthcare users account for 21.4% of expenditures; the top 5% account for 49.9%; the top 25% represent 86.4%; and the top 50% represent 97.2% of expenditures. ⁶
Inpatient Hospital Admissions ⁷	-9.25%	↓	Inpatient hospital admissions are down 9.25% since 1991. There was an average of 111.8 inpatient hospital admissions per 1,000 people in 2011, down from an average of 123.2 in 1991. This data suggests an ongoing shift from inpatient to outpatient care.

Bottom Line



Healthcare inflation, hospital revenue growth and prices remain low, while expenses grow at a faster rate. Health system leaders continue to focus on initiatives that lower cost and increase revenue while preserving margins. Many have begun to focus on innovative methods to operate more efficiently and create new revenue streams.

Public Policy Perspective

FDA is taking action to improve drug shortages.

Following the President's 2011 Executive Order to increase enforcement of reporting requirements for manufacturers running low on drugs, the number of new shortages in 2012 was 117, down from 251 in 2011.⁸ Thus far, new shortage numbers continue to trend downward. There have been 109 new shortages in 2013 (through September 30) leading to a total of 294 active shortages.⁹

The FDA has taken two further steps to address drug shortages:¹⁰

- **Notification.** The FDA issued a proposed rule requiring manufacturers of certain important drugs to notify the FDA of a permanent discontinuation or a temporary interruption of manufacturing that is likely to disrupt the supply. The rule also applies to biologics.
- **Strategic plan.** The FDA has released a strategic plan to improve its response to existing or imminent shortages, and to address the underlying causes of drug shortages.

340B program draws greater legislative and regulatory scrutiny.

Participation in the 340B drug discount program has grown significantly, from 591 hospitals in 2005 to 1,673 in 2011.¹¹ Additionally, eligibility for participation was further expanded as part of the Affordable Care Act (ACA).¹²

However, this expansion has recently gained the attention of a number of legislators and regulators. A 2011 GAO (Government Accountability Office) investigation found, "HRSA's [Health Resources and Services Administration] oversight of the 340B program is inadequate to provide reasonable assurance that covered entities and drug manufacturers are in compliance with program requirements."¹³ This report has sparked:

- **Potential legislation.** ASHP's director of federal legislative affairs anticipates the introduction of legislation to limit 340B in the near future.¹⁴
- **Increasing audits.** In 2012, HRSA conducted 51 audits of 340B program participants, and is expected to conduct 400 or more audits in 2013. Also, drug manufacturers have the right to audit 340B participants and have begun doing so.¹⁵

Several articles offer tips and advice for dealing with a 340B audit. Suggestions include:^{16, 17}

- Form an interdisciplinary 340B team that includes leaders outside of pharmacy.

- Create broad organizational understanding of 340B.
- Review all 340B policies and procedures.
- Conduct trial audits on a regular basis.
- Network with other programs that have been audited to learn from their experiences.
- Identify areas of risk and address them in advance of an audit, including system errors.
- Respond quickly to all requests from HRSA.
- Participate in 340B advocacy efforts.
- Access available resources such as the [Office of Pharmacy Affairs \(OPA\)](#); [Apexus](#), the prime vendor for 340B; and [SNHPA](#) (Safety Net Hospitals for Pharmaceutical Access).

Bottom Line



Even with bumps in the road, ACA continues to move forward, which over time will help bring more patients into the healthcare system. Meanwhile, 340B program participants need to prepare for tighter scrutiny of the program, which will require organization-wide attention.

- **What drug shortage strategies have you employed to minimize impact? Have you experienced much relief from the FDA focus on shortage reduction?**
- **If you are presently participating in the 340B program, what are your greatest concerns?**
- **Have you formed a multidisciplinary team to educate organizational leaders about 340B and prepare for audit?**
- **What has been your personal and organizational involvement in advocacy efforts related to 340B?**

Financial Focus

Over 1,400 hospitals to experience decrease in CMS reimbursement in 2014 due to value-based purchasing penalties.¹⁸

The results for the second year of Medicare’s Hospital Value-Based Purchasing shows that 1,451 hospitals will experience a decrease in their reimbursement rate in the coming year. Alternately, 1,231 will receive increased reimbursement. Under Hospital Value-Based Purchasing, reimbursement is based on performance for three quality measures:

- 45% based on a hospital’s score in following basic clinical standards of care
- 30% based on patient satisfaction
- 25% based on a hospital’s mortality rate

In two of the three measures, pharmacy plays a significant role. Clinical process of care is based on 13 measures, *9 of which have pharmaceutical implications*. Additionally, the patient experience of care is based on eight measures, *four of which have pharmaceutical implications*.



- How has your organization been impacted by adjustments in CMS reimbursement rates? What steps are you taking to optimize reimbursement in the coming year?
- What are the hospital’s most important quality-related initiatives?
- What are supply chain and C-Suite leaders’ top concerns and priorities for your organization?
- How is your pharmacy contributing to your organization’s transition to value-based reimbursement and population health management?

Hospital leaders focus on cost reduction and transition to value-based reimbursement.

Recent articles by *HealthLeaders* focus on the cost-reduction priorities of hospital CEOs and the top concerns of CFOs.

Cost-Reduction Priorities for CEOs ¹⁹	Top Concerns for CFOs ²⁰
<p>At HealthLeaders’ CEO Exchange, 75% of CEOs cited cost reduction and efficiency as one of their top two financial priorities for the next three years. Areas of focus are:</p> <ul style="list-style-type: none">• Tackling physician utilization of tests, imaging, procedures and other products and services that drive costs.• Reducing cost variation, particularly among outliers and worst performers.• Preparing for new reimbursement structures by readying for the transition to value-based payment while still living in a fee-for-service world.• Achieving staff buy-in to make the transition possible.• Developing trustworthy data to identify the best opportunities to reduce costs.	<p>When asked about the biggest financial problems their organizations face, CFOs are focused on:</p> <ul style="list-style-type: none">• Implementing EMRs. CFOs are concerned about EMRs and other forms of technology improving efficiency and delivering a positive ROI.• Aligning physicians. New models are needed to create greater alignment.• Dealing with the uncertainty of health insurance exchanges. The impact on hospitals is uncertain, particularly in the first year.• Preparing for value-based reimbursement. CFOs are worried about investing to create the infrastructure and capabilities for value-based reimbursement and population health management.

Bottom Line



Health system leaders are focused on transitioning from fee-for-service to value-based reimbursement while adjusting to lower reimbursement rates. Many institutions have initiatives within pharmacy that are focusing not only on meeting value-based purchasing measures, but also looking at emerging markets with revenue opportunity.

Supply Chain Strategies

Improving hospital supply chain could improve profitability as much as 21%.

A report by consulting firm McKinsey & Company²¹ refers to the overall healthcare supply chain as inefficient, fragmented and incomplete, with weaknesses that put patients at risk, cost billions and lessen the healthcare sector's ability to address its challenges. Compared to fast-moving consumer goods, McKinsey found that the pharmaceutical supply chain has opportunity for more efficiency.

	Inventory (days)	Obsolescence (% of sales)	Manufacturing lead time (days)
Pharmaceuticals	258	3.1	120–180
Fast-moving consumer goods	72	0.5	3–7

As a result of supply chain inefficiencies, there are opportunities for healthcare manufacturers and providers to dramatically improve their profitability by transforming their supply chain. McKinsey identified five specific capabilities that can have a dramatic impact on performance and on the bottom line.

1. Better **segment** products, markets and customers; create custom supply chains and not a one-size-fits-all approach.
2. Be **agile and ready** to change and respond quickly.
3. **Measure** and benchmark all key aspects of the supply chain.
4. **Align** around global standards that support data interchange.
5. **Collaborate** across the healthcare value chain.

Healthcare can learn from retail supply chain best practices.

Research has found that the healthcare supply chain could benefit significantly from adopting several retail supply chain best practices.²² These best practices from retail include:

- Adoption of automation and scanning technology
- Collaborative planning with suppliers, which involves working together on forecasting and inventory planning
- Data standardization
- Actual usage inventory management



Bottom Line



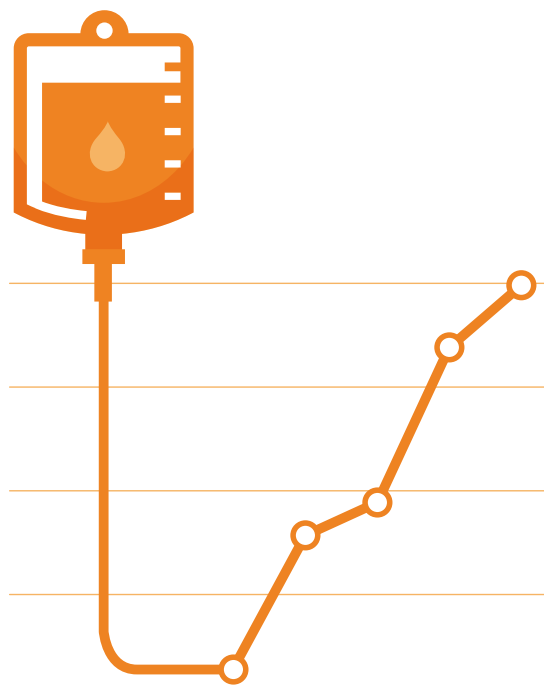
Big opportunities lie ahead for hospitals to improve profitability through more effective supply chain management. Much can be learned from best practices within healthcare and from outside the industry.

- What are the major initiatives to improve profitability through supply chain management? What are the biggest barriers?
- Which of the retail supply chain best practices mentioned above does your organization presently practice or may consider practicing in the future?
- What practices have the greatest impact on your supply chain?

Explosion in Specialty Drug Market

Significant Revenue Opportunities Ahead for Hospitals

By Robert Scholz, MS, MBA, R.Ph.,
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The specialty pharmaceutical industry is on the cusp of one of the largest growth periods in history. In 2009, specialty drugs represented 20% of all drug costs.²³ However, by 2018, specialty drugs are expected to make up 50% of overall drug costs for commercially insured individuals.²⁴ Further, in 2008, 25% of all drugs approved by the FDA were considered specialty drugs. Now, more than 50% of all drugs being approved are specialty drugs, and 900 biologics are in various stages of development.²⁵

This growth trajectory for medications treating diseases such as cancer, rheumatoid arthritis, multiple sclerosis and HIV means one of most significant revenue opportunities that hospitals have seen in many years. This explosion of the specialty pharmaceutical market offers hospitals that are already in or are moving into the specialty pharmacy market the potential for very significant margin growth. Leading health systems that are adding specialty pharmacy capabilities are forecasting revenue potential in the tens of millions of dollars.

The average specialty medication costs
50 times more
than the average traditional drug²⁶

As specialty pharmaceuticals grow, clearly there will be competition among various channels to be the providers of these profitable drugs. This includes hospitals and health systems, mail order pharmacies, retail pharmacies, and even physician practices. Therefore, those health systems that fail to pursue this opportunity may be left behind.

Advantages for Health System Pharmacies

In this changing competitive landscape, health system pharmacies have important and valuable advantages in adding specialty pharmacy that include:

- **Clinical expertise.** Health systems have the disease-state specialists on staff — both physicians and pharmacists — that are needed for specialty pharmacies. Also, health systems already have extensive experience and expertise caring for complex, chronically ill patients who use specialty pharmacies.
- **Monitoring.** Some specialty drugs require clinician monitoring and may require tests, such as blood tests. Health system hospitals have this monitoring capability easily accessible, while some other channels do not.
- **Care coordination.** A specialty drug is typically part of an overall treatment plan. If a drug is shipped via mail order or provided by an outside retail pharmacy, the provider may not be part of the overall care process and may not have the best exposure to the patient's history, treatment plan or the

patient's medical staff. A health system's pharmacy has ongoing relationships with the patient's medical staff and has easy access to a patient's medical records. This provides greater continuity of care and can help achieve improved medication adherence.

- **Patient education and support.** Patients using specialty drugs are often on these drugs for life. Manufacturers may provide starter kits, but patient education must go further. Health system pharmacies are well situated to provide initial and ongoing education and counseling, and are available as needed for ongoing patient assistance and support.²⁷
- **Elimination of white bagging and brown bagging.** White bagging is when a drug is shipped to a physician's office or health system pharmacy for preparation and administration and brown bagging is when it is shipped directly to a patient, who is expected to bring it to a clinician or pharmacy for treatment. In both instances, there can be issues with quality, product safety and waste. A specialty pharmacy operated by a health system eliminates the issues associated with white bagging and brown bagging.
- **Contracting and billing.** A specialty pharmacy should have expertise in both contracting and billing, which is an existing capability of health system pharmacies.
- **Compliance.** Any specialty pharmacy must have a legal department that ensures compliance with all regulations, something that a health system's ambulatory pharmacy already understands.²⁸
- **Formulary management.** A specialty pharmacy must work with physicians and payers to promote cost-effective and appropriate treatment to optimize patient outcomes.²⁹ This is another area where health systems pharmacies already have extensive experience.

Next-Step Options

For health systems that see the opportunity in specialty pharmacy, several important steps include:

- **Become educated.** While the opportunity surrounding specialty pharmacy is significant, it is a complicated, expensive undertaking. A health system needs to understand all of the competencies that are needed. This includes considerable infrastructure and back-office capabilities. Examples include the ability to deal with pre-authorization, patient education and 24/7 patient assistance. This [white paper from Avella](#) provides a good primer.
- **Decide on a strategy.** Among the options available to health systems are:
 - *Do nothing.* Health systems can take a "wait and see approach," but this creates a risk of falling behind.

A specialty pharmacy operated by a health system eliminates the issues associated with white bagging and brown bagging.

- *Do it yourself.* A health system can develop in-house all of the capabilities needed for specialty pharmacy.
- *Partner.* Several entities have been formed that work with health systems to help operate specialty pharmacies. These entities, with different business models, include [Premier's Specialty Pharmacy and Care Management Program](#), [UHC](#) and [Excelera](#). These programs bring various tools and capabilities to help health systems create and operate a specialty pharmacy.
- **Get accredited.** Some payers require accreditation and some manufacturers will only provide access to their drugs to specialty pharmacies that are accredited. For more information about the specialty pharmacy accreditation process, see [URAC](#), one of healthcare's largest and most experienced prestigious accrediting bodies for specialty pharmacy.
- **Start small.** Creating and operating a specialty pharmacy can be complex, and at times manufacturers limit access to drugs. One way to begin is to start small, with a limited number of specialty drugs, perhaps focused on just one disease state. This will provide experience, create credibility and build a platform for growth into other disease areas.

Several health systems have already embarked on this journey, including [Mayo Clinic Specialty Pharmacy](#), [Fairview Specialty Pharmacy](#) and [Vanderbilt Specialty Pharmacy](#).

Conclusion

The trends are clear: the specialty pharmaceutical market is growing quickly. As the landscape evolves, health system pharmacies are well positioned to capitalize on this trend, already having the clinical expertise, care-coordination capabilities and back-office capabilities that are required.

Embarking on this journey requires choosing a strategy and adding any lacking capabilities. Health systems that seize this opportunity have important strategic decisions to consider, but the long-term revenue potential could be enormous.

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- 3 [Hospital Financial Trends](#), HealthLeaders Media in partnership with Truven Health Analytics, August 13, 2013
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- 5 [Fitch: 20 Statistics on Hospital Financial Margins](#), *Becker's Hospital Review*, September 6, 2013
- 6 [Statistical Brief #421: Differentials in the Concentration in the Level of Health Expenditures across Population Subgroups in the U.S., 2010](#), Agency for Healthcare Research and Quality, August 2013
- 7 Avalere Health, Analysis of American Hospital Association Annual Survey data, 2011, for community hospitals. U.S. Census Bureau: National and State Population Estimates, July 1, 2011
- 8 [FDA Takes Two Important Actions on Drug Shortages](#), FDA News Release, October 31, 2013
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- 25 [Specialty Today + Tomorrow](#), Prime Therapeutics
- 26 Ibid.
- 27 [Guide to Selecting the Appropriate Specialty Pharmacy](#): 10 Elements a Payer Should Consider in the Decision Process, Avella Specialty Pharmacy
- 28 Ibid.
- 29 Ibid.

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