

## FEATURE

# Medicare and Medicaid Breakeven: Achieving an Elusive Goal

[Lea E. Radick](#)

Among the mounting concerns vying for healthcare leaders' attention in today's frenetic environment, cost transformation remains an urgent need in most organizations.

Squeezed by the downward pressure from commercial and government payers, flat volume, evolving consumer expectations, and emerging competition in the outpatient space from new entrants, healthcare provider organizations face the challenge of transforming their cost structures, according to a 2018 Kaufman, Hall & Associates LLC report.

Healthcare leaders shared their cost-reduction goals to alleviate pressure on hospital margins.

Sixty percent of healthcare executives say their organizations have set a goal of achieving revenue and expense breakeven with Medicare, or believe their organizations should consider that goal, according to the Kaufman Hall report *2018 State of Cost Transformation in U.S. Hospitals and Health Systems: Time for Big Steps*.

Recent Medicare Payment Advisory Commission data underscores how difficult it is for healthcare organizations to break even on Medicare. In its March 2019 report on Medicare payment policy, MedPAC reveals that in 2017, hospitals' aggregate Medicare margin was -9.9 percent, down slightly from -9.7 percent in 2016. Furthermore, the commission projects the overall Medicare margin will decline to about 11 percent in 2019. Even the 291 most efficient hospitals—as defined by MedPAC—lose an average of 2 percent on each Medicare case, according to the report.

To address concerns that high-quality hospitals are losing money under Medicare, MedPAC recommends that for 2020, Congress increase the 2019 Medicare base payment rates for acute care hospitals by 2.8 percent.

John H. Goodnow, FACHE, CEO, Benefis Health System, Great Falls, Mont., anticipates a payment boost would help the most efficient hospitals achieve Medicare breakeven, and other hospitals, too, if those with high operating costs zero in on cost reduction.

However, Ryan S. Gish, managing director, Kaufman Hall, Skokie, Ill., says benefits from a pay increase would depend on the underlying inflation of hospital expenses. If hospital expenses increase less than the proposed 2.8 percent, hospitals could anticipate an improved Medicare margin, but if they are above 2.8 percent, Gish predicts the Medicare deficit would grow.

Kaufman Hall's report suggests Medicare breakeven is a good initial goal for organizations to establish and work toward, but it is not likely a sufficient long-range goal for cost restructuring. Instead, Kaufman Hall predicts that many hospitals and health systems will need to reduce costs by double digits.

"We would probably target somewhere beyond [Medicare] breakeven so that we're prepared and in position to hit aggregate profitability targets over a multiyear period," Gish says. "Getting to breakeven will be insufficient because there's going to be ongoing multiyear and longitudinal cost pressures."

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*- Ryan S. Gish, Kaufman, Hall & Associates LLC*

### **The Importance of Medicare Breakeven**

For healthcare providers, achieving or progressing toward Medicare breakeven is both an end in itself and a driver of overall efficiency and cost savings. It is an important goal for organizations because Medicare is the predominant payer, Gish says, adding that it is difficult for healthcare organizations to continue providing the communities they serve with programs and services if they are losing money on Medicare.

He notes that as hospitals and health systems have historically shifted costs to commercial payers to make up that difference in profitability and hit sustainable levels of functionality, Medicare is increasingly important because

it's becoming more and more difficult to continue that cost shifting.

Healthcare organizations struggle to achieve Medicare breakeven for a variety of reasons, which Gish says break down into uncontrollable and controllable factors.

Uncontrollable factors include general inflationary pressures such as pharmaceuticals, utilities and ensuring the payment of competitive wages. Controllable factors might include not investing in a strong cost-accounting system, which could help an organization understand productivity data, cost information and what is driving Medicare losses, or not designing a workforce performance incentive structure in a way that would better achieve productivity goals and outcomes, thereby lowering the overall cost structure, Gish explains.

However, there are steps that healthcare organizations can take to move toward achieving the elusive goal of Medicare breakeven. Gish breaks these approaches into three categories: cost restructuring, business restructuring and clinical transformation.

Traditional cost restructuring or margin improvement efforts might include focusing on staffing and reducing supply chain costs. For example, Gish suggests organizations analyze their overhead structure to determine whether vice presidents, directors and managers are operating at the right levels.

Business restructuring may involve exploring joint ventures for strategic or financial reasons, and identifying service lines, such as lab services, that may no longer be viable for the organization.

Clinical transformation, or value-creation activities, entails addressing unnecessary or unwarranted clinical variation, such as transfers of care on the outpatient side through acute care and post-acute care settings. With this approach, leadership must determine whether optimal care processes are in place that deliver the highest-value, highest-quality outcome for the lowest price.

Despite the struggle for many healthcare organizations to reach Medicare breakeven, one health system is achieving this goal while being a more than 75 percent government-pay provider.

### **Benefis Health System Great Falls, Mont.**

Goodnow is a spirited evangelizer of the Benefis approach, which is heavily reliant on cutting cost, a motivated, highly productive staff, and a flat,

multitasking management structure.

Benefis serves approximately 163,000 residents in a 13-county region, many of whom are Medicare beneficiaries. In 2008, with close to half of its business composed of Medicare recipients, Benefis set a long-term goal to achieve Medicare breakeven.

“We’re looking at this and realizing we lose a lot of money on every single case we see for half our business, which is a horrid business model. On top of that, I really do find cost shifting onto commercially insured patients to be kind of distasteful,” Goodnow says. Motivated by five factors—continued success, independence, industry sustainability, its value equation and its gross payer mix—Benefis began to tackle Medicare breakeven starting with productivity and labor expenses.

“Labor’s about 50 percent of total expenses in any hospital, and if you can’t better manage your labor and improve your productivity at your organization, it is impossible to break even on Medicare,” Goodnow says.

Benefis lists 10 critical factors to successfully achieving Medicare breakeven (see sidebar below). Of these success factors, Goodnow singles out culture and focus as particularly critical.

Calculations for Getting to Medicare Breakeven

	\$2 billion organization (50% Medicare)	\$500 million organization (55% Medicare)
Medicare payments	\$1,000,000,000	\$275,000,000
Costs	\$1,096,000,000	\$330,000,000
Margin	\$(96,000,000)	\$(55,000,000)
Margin %	-9.6%	-20%
Cost Reduction % to Breakeven	-8.8%	-16.7%

Source: Kaufman, Hall & Associates LLC

Both culture and focus start at the top with the CEO, explains Forrest Ehlinger, chief financial and resource officer with Benefis. “As long as you’re committed and the entire organization is committed to getting it done, you can be successful. But, you have to focus and you must have the right people to get the culture in place,” Ehlinger says.

Another important factor is incentive compensation, according to Goodnow. All Benefis employees are accountable for the organization’s financial performance, and all managers and above are measured on their productivity and budgets, Ehlinger explains.

As Benefis sought to achieve and seeks to maintain Medicare breakeven, it also focuses on using Lean management and lowering administrative expenses; reducing supply chain costs, including physician preference items; maintaining moderate debt; and leaving no rock unturned. There are savings

to be found no matter where you look in a health system.

For example, Benefis renegotiated vendor contracts, canceled unnecessary contracts, switched vendors and group purchasing organizations after a competitive selection process, and entered into a guaranteed savings contract with its new GPO. It also reduced supply chain costs through eliminating unused inventory and unnecessary maintenance processes, adopting energy-efficiency processes, switching to alternative materials and reducing physician preference item costs.

Benefis achieved its goal of Medicare breakeven for the past seven years. Since beginning its journey toward Medicare breakeven in 2008, its reimbursement of allowable cost has increased from 84.4 percent to 108.5 percent. Evidence of the health system's success can be measured in a variety of ways. Operating margins have remained strong, increasing from 3.8 percent in 2008 to 6.2 percent in 2018, and it continues to deliver on its value equation—lower-than-expected costs plus good outcomes—resulting in lower infection and injury rates.

Having achieved Medicare breakeven, Benefis says the strategy it has executed has not only kept the health system successful in a challenging payer market, but it has also prepared Benefis to look ahead. It is investing in its future in numerous ways to protect its strong market position.

Its cost structure positions the health system well for the continuing evolution in the healthcare marketplace, including narrow network steerage and reference-based pricing.

Despite Benefis' success in achieving Medicare breakeven, Goodnow acknowledges the challenges.

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- *John H. Goodnow, FACHE, Benefis Health System*

“This is not an easy road to follow, and you've really got to stick to it, you really have to hold people accountable,” he says. “It is a multiyear journey, and it's really now ingrained in our culture.”

Steven M. Berkowitz, MD, FACC, senior vice president and chief physician executive at Northern Light Health, Brewer, Maine, concurs. “It's a formidable

challenge. It will require a multidisciplinary approach and working closer than ever with physicians to implement the most efficient care protocols to make it as simple and cost effective as possible for our patients as they traverse the various levels of care,” says Berkowitz, an invited speaker at ACHE’s 2019 Congress on Healthcare Leadership.

He acknowledges that Northern Light Health, an integrated healthcare system comprising nine member hospitals, has not yet achieved Medicare breakeven, noting, however, that it is a goal the health system hopes to achieve.

To reach that goal, Berkowitz says the health system is examining how to best reduce its cost per episodes and lengths of stay for its key diagnostic episodes such as cardiac catheterizations and hip and knee surgeries.

### **Medicaid Breakeven**

Even more formidable than achieving Medicare breakeven is the prospect of achieving Medicaid breakeven, according to Berkowitz. “It’s a totally different animal, and a totally different reimbursement, and in many cases, lower than Medicare,” he explains.

There is much more variability with Medicaid depending on the community served, says Kaufman Hall’s Gish. Whereas a health system in a more affluent, suburban community might deal predominantly with Medicare issues, urban and rural hospitals are likely going to deal both with Medicare and Medicaid issues.

“I know personally of no organizations that are there at that level,” Berkowitz says. However, he stresses that rather than pitting the achievability of Medicare breakeven versus Medicaid breakeven, a total cost-reduction plan is the more viable approach. “We must as hospital systems reduce our costs of care, regardless of how we measure it; cost per case, cost per episode, cost per whatever.”

### Benefis Health System: Medicare Breakeven Success Factors

- ✓ Ensuring there is firm commitment from senior management, led by the CEO and supported by the board of directors
- ✓ Stressing the strategic importance of cost reduction and making it one of the key institutional strategic priorities
- ✓ Entrenching a cost-reduction mindset throughout management ranks, including by making cost reduction one of the key incentive compensation measures
- ✓ Emphasizing the importance of cost reduction with all employees through consistent and continuous communication
- ✓ Measuring results on an apples-to-apples, year-to-year basis, reporting those results often and celebrating cost reduction successes
- ✓ Including physicians—employed and nonemployed—as partners in the cost-reduction effort
- ✓ Preparing for a marathon, not a dash; it took four years of concerted effort for Benefis to reach Medicare breakeven
- ✓ Enhancing productivity will be a big part of cost reduction, particularly in the earlier stages; however, there are limitless additional opportunities to reduce cost
- ✓ Including external partners in cost reduction—your group purchasing organization is a good example
- ✓ Being persistent, not becoming discouraged and not being talked into why “you are different and/or can't reduce costs”—you are not, and you can

In addition to achieving Medicare breakeven, Goodnow says Benefis is close to achieving Medicaid breakeven; the health system is reimbursed for 95.5 percent of its cost of caring for Medicaid patients.

“Medicaid breakeven takes the same approach and discipline as Medicare breakeven,” Goodnow says. However, even with the impact of the so-called bed tax, Medicaid reimbursement is less than Medicare, he explains. Many states, including Montana, use the bed tax to increase Medicaid reimbursement, Goodnow adds.

He credits the health system’s multiyear cost reductions, cost discipline and added revenue from Montana’s bed tax with helping it move in the

direction of achieving Medicaid breakeven, too.

“Unlike many organizations, we can’t do a lot of cost shifting to commercial insurance since most of our business (76 percent) is already governmental. Commercial is 21 percent and shrinking at Benefis Health System,” Goodnow says. Uninsured patients account for the remaining 3 percent of Benefis’ 2018 gross payer mix.

Despite the additional challenges associated with Medicaid breakeven, the same issues and strategies apply as in achieving Medicare breakeven, Gish explains.

At the end of the day, achieving Medicare breakeven boils down to having timely and accurate cost information by payer class, implementing caregiving best practices and reducing supply chain costs, according to Berkowitz. “There

is no secret sauce here; it's just a lot of hard work with the hospitals and the physicians.”

*Lea E. Radick is a writer with Healthcare Executive.*