Pharmacy Operations: A Cost Center or Revenue Driver?

For the past 20 years, pharmacies have functioned as cost centers for hospitals and health systems, with financial and pharmacy leaders maintaining laser-like focus on curbing expenditures. Yet, as reimbursement models evolve, there are emerging opportunities to realize revenue from pharmacy operations. Since most outpatient settings are reimbursed a percentage of submitted charges, and inpatient settings are paid fixed amounts under a prospective payment (regardless of the charges), there are different opportunities for revenue growth depending on the location.

It can be confusing for hospitals and health systems to navigate these changing dynamics because in some cases, increases in pharmacy costs result in increased revenue, while in others, they do not. As a result, it is essential for organizations to understand the effect that additional cost has on margin. If organizations view the function as strictly one way or the other, they may do themselves a financial disservice—missing opportunities for revenue growth or pursuing strategies that fall short in terms of financial benefits. Broad strategies to cut pharmaceutical costs may negatively impact margin, especially when the patient mix is predominately outpatient.

Moving high-cost therapies to the outpatient space

One approach that straddles the line between cost-cutting and revenue-generating involves shifting patient volume for certain high-cost therapies—such as infusions—to the outpatient setting. There are two reasons why a healthcare organization might consider this strategy. One is that the health system may see additional revenue due to outpatient reimbursement which is tied to percentage of charges. Another is that delivering care in this location tends to be less expensive than inpatient care. This aggregate effect can significantly improve margins for service lines with high pharmaceutical costs.

Although making this shift could be beneficial, it is not a sure thing. “Before pursuing this strategy, it is critical for organizations to complete a thorough proforma. When making strategic investments in new areas such as infusion services, understanding the impact on a line-item basis is important,” says Dr. Scott Mark, Vice President and Solutions Architect for Craneware. “Unfortunately, most organizations have difficulty accessing this level of detail, and if they can, they are not able to reconcile it by drug, payer and medical condition. Those that can, are able to use this insight to make more informed decisions that yield stronger performance.”

Optimizing the formulary

Another strategy for realizing pharmacy revenue and controlling costs is to be more strategic when selecting drugs for the formulary. For many diseases, there are different treatment pathways, and each have their own benefits and side effects. In most organizations, decisions about which therapies are approved for the formulary have been led by clinicians. An organization may even give its physicians freedom to choose different drugs within specific classes. That said, this approach is not the best financial strategy. “Even within a therapeutic class, some drugs are covered by payers and some are not,” says Mark. “So, while there may be several therapeutically equivalent drugs, payers have streamlined what they are going to reimburse, and this has financial ramifications for the healthcare organization and the patient. Historically, the consequence of using a drug not approved by the payer rests on the patient because he or she is held responsible for any remaining balance between payer reimbursement and hospital billing. As hospitals shift volume to the outpatient space, failing to account for payer formulary coverage can now significantly impact hospital margins. As such, organizations must have a clear understanding of the financial consequences linked to any clinical choices."

Laying the foundation for a shift in perspective
It can be hard for organizations to know where to start revisioning pharmacy's role in revenue generation. Here are three best practices that organizations on the forefront of this work often follow:

Work closely with payers to determine areas of exposure. Data-savvy organizations are working with payers to identify therapies where there is risk of insufficient reimbursement. Through these discussions, organizations are framing contractual language and setting up arrangements to make certain they will be paid at a specific rate when therapies are initiated. Often, these negotiations result in mandatory therapeutic steps or approvals, referred to as prior authorizations, which must be followed. Failure to follow these steps can also result in non-payment.

Note that organizations frequently experience hurdles when implementing a consistent prior-authorization process. In part, this is because payers put rigor around these requests, which can be challenging to navigate, especially by clinicians unfamiliar with them. Another problem is that it is often unclear who in the health system is responsible for obtaining prior authorization, and if the organization doesn't have a process to halt the initiation of therapy until the prior authorization is in place, the organization may end up not getting paid at all. Moreover, organizations that do not have the data analytics capacity to verify payment may not even realize that they did not get paid. As healthcare organizations establish a prior authorization process, they need to define how that process will work within the organization and make sure they consistently follow established procedures.

Connect reimbursement to actual usage. It is essential for organizations to understand whether they are being reimbursed for the medications they are providing. "Today, when a drug is administered, hospital information systems are designed to effectively bill for it," says Mark. "While clinical systems can effectively provide extensive details, which are necessary to meet payer requirements for payment, they do not ensure that steps are followed or prior authorizations are obtained. Further, once submitted on the claim, organizations have limited transparency into the payment details that are necessary to connect the dots between billing and payment to know with certainty whether they were paid for the services they provided. Connecting the line items within claims to reimbursement is the game-changing piece that high-performing organizations are focusing on to make strong, data-driven decisions."

Have pharmacy participate in financial forecasting. Clinical, financial and data analytics leaders have been managing organizational financial forecasting for clinical service lines. "The time has come for the pharmacy to assume a leadership role in these conversations," says Mark. "Pharmacy plays a valuable part in recommending therapeutic alternatives that might meet clinical requirements while optimizing financial outcomes. This can provide leverage in payer conversations, providing essential data for the organization to be more proactive and informed during negotiations to ensure financial awareness."

Data-driven insights are needed to fuel change
Without meaningful insights, organizations may struggle to make optimal operational decisions with pharmacy services that maximize financial outcomes. Conversely, when hospitals and health systems have access to the right data, they can more fully appreciate context and potential ramifications. Consider the abovementioned infusion center example. In this case, solid data could show whether opening a clinic is viable, and point to the infusion drugs that are the most clinically and financially variable. Data can also reveal whether one location over another is preferable in terms of profitability.

Perhaps the payer mix is more favorable in one of the locations or maybe the population in a certain area is more in need of infusion services. Comprehensive data can also help organizations negotiate optimal payer contracts that ensure full and proper reimbursement.

Not only is it important to have robust information before making a decision, it is also critical to monitor data over time to make sure various market factors won't negatively affect performance. "Pharmacy costs represent about 20% of overall hospital costs, and they are the single largest expense outside of labor," says Mark. "Any blip in pharmacy costs and revenue can change the profitability of an entire organization. That's why it's critical to work with a knowledgeable partner like Craneware that has deep experience in the nuances associated within the pharmacy space and can provide the full complement of data on which to make well-informed and strategically lucrative decisions."

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