

# The price is right

Consumer directed healthcare puts pricing back in the marketing mix.

BY KAREN CORRIGAN

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**W**hen it comes to hospital pricing strategies, healthcare marketing executives are missing in action. That's because the cost-based pricing systems prevalent in their organizations have largely been the domain of the finance department, which establishes the charge master and negotiates rates with third-party payors. Insured consumers rarely see the list price or negotiated rates, and payors set their copayments and deductibles. The unlucky self-pay patient gets a shocking bill for the full list price, from an overinflated charge master designed to optimize reimbursement from private insurers.

The principal goal of hospital pricing systems is reimbursement: recovery of the cost of labor, supplies, and other expenses to provide patient care. Budget cycle after budget cycle, charge masters are manipulated, reimbursement rates are negotiated, and costs are aggressively managed in attempts to achieve a bottom-line target. Consumer market forces are basically absent from the process, and many believe this to be a significant cause of runaway costs in the healthcare industry.

However, a number of forces are converging to effect more consumer influence in the selection, purchase, and use of health services and products:

- increasing demand fueled by the growth and aging of the population
- rising consumer expectations for better quality and service
- product innovations to stimulate consumer spending for health services and products
- changes in health benefits that transfer the financial burden for health purchasing decisions back to consumers



For organizations such as health systems and hospitals, these trends signal a fundamental shift in the basis for competition in the industry—one that can be characterized as a consumer-choice market offering numerous options in retail-like environments. When such a change occurs in an industry, so do the competitive requirements. Market leaders will be those that more rapidly recognize and adopt the new capabilities/competencies that the market requires.

This means it's time to take a hard look at healthcare's marketing capabilities. In competitive consumer markets, marketing is a core business competency. Advanced marketing strategies are more about finding/creating new markets with fresh sources of revenue than about promotions. This means more emphasis on market intelligence, market segmentation, product innovation, packaging, channel management, and yes—pricing strategies.

Healthcare organizations' greatest challenge in developing pricing strategies will be navigating the paradigm shift, from price as a means to recover costs to price as a vehicle to establish value. This complex process will require most to live in multiple worlds—regulated reimbursement, negotiated contracts, and competitive market pricing—and demand greater-than-ever alignment of brand, product, channel, and customer marketing processes with pricing decisions.

Value pricing will be a critical marketing skill for healthcare organizations in the new consumer-choice market. The switch to higher deductibles, tiered benefits, and individual health-fund management through health savings account (HSA) plans means consumers have more incentives to shop price as part of the overall purchasing decision process. Many health systems are also diversifying into the retail services arena, to capture consumer discretionary spending for items ranging from fitness to cosmetic surgery and alternative medicine.

### Consumer Directed Plans

With the express purpose of giving consumers more responsibility and accountability for healthcare spending, employers are increasingly offering consumer directed plans (CDPs). These generally include high-deductible medical coverage, a health fund or HSA to use toward medical expenses, and information and decision-support tools to help consumers make more informed choices.

In January 2006, America's Health Insurance Plans (AHIP) estimated 3.2 million enrollees in HSAs. The number seems small at first glance, but it's triple that reported in 2005 (which was double that of 2004). Forrester Research estimates total CDP enrollment at less than 5% of the commercially insured market, and industry experts anticipate that number to be closer to 8% by the end of 2006.

The rate of growth is a critical watch point, along with the percentage of employers indicating interest in adopting CDPs in the near future, and the significant investments of health insurers/financial organizations to build infrastructure or

acquire CDPs. Another indicator of the growth potential for CDP enrollment is entrepreneurial activity by industry newcomers, such as Revolution Health (supported by industry moguls and well-known individuals including America Online cofounder Steve Case, former Hewlett-Packard CEO Carly Fiorina, and Gen. Colin Powell).

Information Strategies Inc., which researches and publishes trends in the small and midsize employer market, predicts that the number of HSA-insured Americans will approach 7.4 million by the end of 2006. Adding the employees currently under an employer-sponsored HRA, the total number will be 13.7 million.

Microsoft, Nokia, General Motors, and Fujitsu Ltd. are among the large employers providing HSA benefits. Tax incentives President Bush recommended in his 2006 State of the Union address are designed to fuel growth in the small-business and individual sectors as well. According to AHIP, 27% of CDPs with an HSA were sold to small employers that previously didn't offer health benefit coverage for their employees.

Lumenos and Definity Health were two early entries in the CDP marketplace. (They have been acquired by WellPoint Inc. and United Health Group, respectively.) Other established health insurance brands are quickly moving to build or acquire the infrastructure for supporting growth in CDP membership. These include relationships with financial institutions, and development of consumer information and decision-support systems. For example, Humana offers an easy-to-use, Web-accessible HSA planner to help members project how much they will spend on health-related services and products in a year.

Some brands are establishing innovative delivery options. American Community Mutual Insurance Company's 24/7 TelaDoc provides medical consultations to members of its new CDP, Precedent. For \$35, policyholders can have licensed primary care physicians diagnose, recommend treatment for, and prescribe medications for routine and minor illnesses—all by telephone.

Equally established brands that are new to the health benefits sector include American Express. It recently partnered with WellChoice Inc. (the parent company of Empire Blue Cross Blue Shield) to offer American Express HealthPay Plus, a debit-type card to help employees pay for medical expenses from their HSAs. Members can also apply for a line of credit, to cover costs that might exceed their HSA balances.

Proponents of CDPs believe that the high-deductible design will influence consumers to play a much larger role in healthcare, by:

- becoming more selective and knowledgeable about providers, treatment options, and the cost of various services and products.
- bearing a greater share of the financial responsibility for those decisions.

The goal is to create empowered consumers who will assert market forces to improve the value and affordability of health services.

The underlying assumption is that personal responsibility for higher out-of-pocket expenditures will put consumers in charge of where and how their money is spent. How much of the consumer's bank account is at stake? Presuming that a CDP-enrolled individual has a deductible of \$2,500 and a \$1,050 HSA, the first \$1,050 of medical expenditures would be drawn from the HSA; the individual would assume responsibility for the difference of the deductible until the major medical insurance policy kicked in. Out-of-pocket contributions vary, but can be as much as an annual \$5,250 for an individual and \$10,500 for a family.

Will price competition keep a lid on costs? Advocates point to consumer health services such as laser eye surgery, plastic surgery, and in vitro fertilization, where market forces are prevalent. When compared with traditional reimbursable healthcare, in which a third party pays for services, healthcare costs have grown much slower—or in some cases decreased. The prevailing belief is that where consumers are directly involved in the selection of a provider and personally responsible for payment of the bill, competitive forces will succeed

in stimulating innovation to add greater value and hold down costs.

### Retail and Catered Services

The growth in demand for retail health and catered medicine is another indicator of consumer interest in—and willingness to spend money for—health-related products and services that deliver differentiated value. This medical and surgical retail care in customer-catered environments includes services such as concierge physician practices, cosmetic surgery, laser eye surgery, executive evaluations, predictive imaging, and medical consults. It has found a sizeable and profitable audience. Consider the statistics:

- In 2005, Americans spent \$12.4 billion on cosmetic surgery and \$8.2 billion on surgical procedures.
- Also in 2005, 1.5 million LASIK eye procedures were performed. The average price ranged from \$1,500 to \$2,000 per eye.
- The weight loss market is a \$47 billion category that includes surgery, weight management counseling, and products. In 2005, 170,000 gastric bypass surgeries were performed. The average price ranged from \$15,000 to \$20,000.



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- Nationwide, there are about 250 concierge physician practices. Prices range from \$1,500 to upwards of \$10,000 for patients who elect their personalized services.
- Medical spas are the fastest growing component of the spa industry. Facilities doubled from 200 to 400 between 2002 and 2004, and revenues are projected to hit \$1 billion next year.
- Primary care clinics located in retail environments are the hottest innovations in healthcare. They cater to consumers' convenience needs by facilitating quick access to diagnoses and prescriptions, and are perfectly positioned to serve the minor health requirements of HSA members. Prices for most services range from \$45 to \$75.

Traditional health systems and hospitals have had varying degrees of success diversifying into retail health and catered medicine, for a number of reasons. But as more aim to adopt innovative models of CDPs, pricing will certainly be a strategic consideration.

### Implications and Guidance

In the new consumer-choice market, one of the more important understandings for health systems and hospitals is that best value isn't always about lowest price. American consumers are a savvy bunch. Perceived quality differences—where real benefit differences exist—play heavily in the value equation. Consumers don't always shop at the closest supermarket, or buy the lowest-priced brand of an item in convenience or luxury categories.

Skeptics continue claiming that consumers lack the knowledge to make informed decisions about such a complex industry. But almost 20% of adults comprise a quality-conscious segment of health consumers. This segment can recognize quality differences across providers of general and specialty care, and is more likely to change hospitals/doctors to access higher quality choices (and influence others to do the same).

Here's what marketers should do to better prepare their organizations for this new consumer-choice market:

- Start the critical conversation about competitive pricing strategies with healthcare organization executives, finance officers, marketing managers, and others in the organization—today. Discuss and debate the strategic, business, legal, ethical, and competitive issues regarding pricing decisions.
- Prepare to disclose and talk about prices. A recent *Wall Street Journal* editorial posed the question, "Why such a mystery about medical prices?" The truth is that few healthcare executives understand the prevailing pricing systems in their own organizations. And slow adoption of evidence-based practice means significant variations in resource consumption, lengths of stay, error incidents, and care outcomes between providers and between markets—which creates wide swings in the cost of care delivery.
- Define and inventory those services and procedures that are more apt to be price-sensitive, and establish strategies and processes for quoting and negotiating price.
- Develop package prices for select episodes of care, much like what's done for cosmetic surgery and laser eye surgery.
- Be prepared for the effects of competitive-consumer pricing on negotiated contract rates with third-party payors, and any regulatory constraints.
- Help the organization understand the impact of pricing decisions on competitive positioning, and vice versa. The brand is one of the more powerful tools for influencing consumer decision making and selection.
- Promote organizational learning of market pricing approaches (e.g., core, optional, captive, bundling), variations in strategy (e.g., for new market entry vs. mature markets), and discriminatory adjustments for key segments, products, or markets.

The rapidly developing consumer-choice market will offer numerous challenges and opportunities for health systems, hospitals, and other healthcare providers. But time is running out for organizations to establish the strategies, programs, and systems necessary for being successful in the new world of enhanced consumerism.

Where real market forces are in play, organizations that provide the best value are rewarded; consumers stick with those that serve them well. Organizations that don't do this will witness the growth and prosperity of their more market-ready competitors. **MHS**

### Additional Reading

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