Primer on Avoidable Costs
Every health care institution needs to reduce avoidable costs.
These days, every health care provider needs to focus on reducing avoidable costs—not just health system operating expenses, but the total cost to payers—even if risk-based reimbursement contracts are not on the horizon.

### Avoidable Costs in the U.S. Health Care System
According to the Institute of Medicine

<table>
<thead>
<tr>
<th>AREAS OF OPPORTUNITY</th>
<th>AVOIDABLE COSTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unnecessary Care</td>
<td>$210B</td>
</tr>
<tr>
<td>Administrative Inefficiencies</td>
<td>$190B</td>
</tr>
<tr>
<td>Inefficiently Delivered Services</td>
<td>$130B</td>
</tr>
<tr>
<td>High Prices</td>
<td>$105B</td>
</tr>
<tr>
<td>Fraud and Abuse</td>
<td>$75B</td>
</tr>
<tr>
<td>Missed Prevention Opportunities</td>
<td>$55B</td>
</tr>
</tbody>
</table>

### Three reasons why:

1. As the American population ages, patients will be sicker, more likely to be Medicare/Medicaid beneficiaries, and more likely to receive medical care rather than surgical procedures. That means hospitals can expect an influx of comparatively unprofitable cases, unless patients are managed better outside the hospital than they are today.

2. Value-based purchasing programs, which affect the entire health care industry, in part reward institutions for how well they reduce avoidable spending.

3. It can take years to become skillful at managing avoidable costs in populations, so even if providers are not early adopters of capitated or shared-savings models, they should start building their population cost-management competencies now.
Until health care providers are paid for the total cost of care, the financial incentives for reducing utilization are mixed. Substituting physical therapy for a joint replacement procedure means lower payments to doctors and hospitals, for instance.

But for populations already being managed, such as health system employees, cost avoidance has a direct financial benefit. Likewise, interventions that reduce low-profit medical inpatient admissions can be economically rewarding. And Medicare’s value-based purchasing programs also offer incentives for reducing preventable admissions.

Avoidable Cost Intervention Decision Tree in Fee-for-Service Environment

- **Will reducing cost impact our revenue?**
  - No
    - **IMPLEMENT**
    - Prescription Drugs
  - Yes
    - **Can we selectively apply the intervention to our employee population?**
      - No
        - **DO NOT IMPLEMENT**
      - Yes
        - **Will the intervention improve performance on value-based purchasing metrics?**
          - No
            - **DO NOT IMPLEMENT**
          - Yes
            - **IMPLEMENT**
            - Avoidable Readmissions
        - **Are we willing to accept the impact on our income statement?**
          - No
            - **DO NOT IMPLEMENT**
          - Yes
            - **IMPLEMENT**
            - Imaging, Pathology

- **Will the intervention improve case mix?**
  - No
    - **DO NOT IMPLEMENT**
  - Yes
    - **IMPLEMENT**
    - Medical Admissions, Emergency Room
Avoiding health care costs doesn’t have to mean reducing profits—even in fee-for-service economics.
The best way to identify populations and conditions with the biggest cost-reduction opportunities is to look at avoidable cost benchmarks: rates of utilization and spending for specific health care services in comparable well-managed populations.

Other ways to identify avoidable costs have some disadvantages. The patients with the highest costs don’t always have the highest avoidable costs, nor do they necessarily continue to have high costs in the future. Similarly, looking at how utilization varies person-by-person only tells you that variation exists, not why the variation is happening. To understand the reasons for the variation, you need to benchmark the use of specific health care services.

Compare your population’s health care spending to avoidable cost benchmarks to figure out where you should focus.
Methods for Identifying Avoidable Costs

**Population**

**Scope**

**Specificity**

- **Highest Cost Patients**
  - Costliness analysis to identify high users of care
  - Enables targeting individuals for care management

- **Utilization Variability**
  - Often used as a proxy for avoidability
  - Identifies broad cost drivers for a population

**Avoidable Cost Benchmark**

- Compares actual costs against well-managed populations
- Allows targeted management of populations, conditions based on feasibility
In our work with hospitals and health systems through the Crimson Population Risk Management analytics initiative, we have found that inpatient medical admissions, outpatient surgery, and prescription drugs consistently rank among the top cost-avoidance opportunities. The Crimson Population Risk Management cohort includes 50 institutions in 17 states, representing 700,000 covered lives (predominantly health system employees, and their dependents).

When you’re searching for avoidable costs, be sure to slice your data by payer type. For example, while ED use is a distant fifth among avoidable cost drivers in the overall population, ED use is the second biggest area of avoidable costs for Medicaid enrollees.
Your population can almost certainly spend less on inpatient medical admissions, outpatient surgery, and prescription drugs.

CPRM Top Ten Areas of Opportunity to Capture Avoidable Cost
Difference Between Actual Spend PMPM$ and Well-Managed Benchmark, 2011

<table>
<thead>
<tr>
<th>Service</th>
<th>Actual Spend PMPM$</th>
<th>Well-Managed Benchmark PMPM$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inpatient Medical Admissions</td>
<td>$23.98</td>
<td>$21.57</td>
</tr>
<tr>
<td>Outpatient Surgery</td>
<td>$18.20</td>
<td></td>
</tr>
<tr>
<td>Prescription Drugs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Emergency Room</td>
<td>$7.02</td>
<td></td>
</tr>
<tr>
<td>Outpatient Pathology/Lab</td>
<td>$6.37</td>
<td></td>
</tr>
<tr>
<td>Physician Office Visits</td>
<td>$6.21</td>
<td></td>
</tr>
<tr>
<td>Inpatient Surgical Admissions</td>
<td>$6.09</td>
<td></td>
</tr>
<tr>
<td>Outpatient Clinic</td>
<td>$5.50</td>
<td></td>
</tr>
<tr>
<td>Outpatient MRI</td>
<td>$4.87</td>
<td></td>
</tr>
<tr>
<td>Outpatient MR</td>
<td>$3.93</td>
<td></td>
</tr>
</tbody>
</table>
To reduce overall health care costs, it is as important to fund the right interventions as it is to reduce unnecessary utilization. Milliman MedInsights, which supplies the benchmarks for Crimson Population Risk Management, found that “well-managed” populations have more spending on immunization, physical exams, and preventive screenings than “loosely managed” populations, yet their overall health care spending is substantially lower.

### Difference Between Loosely and Well-Managed Benchmarks

<table>
<thead>
<tr>
<th></th>
<th>Commercial PMPM, 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>NORMAL DELIVERY</strong></td>
<td>($0.14)</td>
</tr>
<tr>
<td><strong>POST-ACUTE CARE</strong></td>
<td>($0.16)</td>
</tr>
<tr>
<td><strong>WELL-BABY EXAMS</strong></td>
<td>($0.28)</td>
</tr>
<tr>
<td><strong>IMMUNIZATIONS</strong></td>
<td>($2.48)</td>
</tr>
<tr>
<td><strong>PHYSICAL EXAMS</strong></td>
<td>($3.06)</td>
</tr>
<tr>
<td><strong>PREVENTIVE SCREENINGS</strong></td>
<td>($5.85)</td>
</tr>
<tr>
<td><strong>TOTAL OPPORTUNITY</strong></td>
<td>($11.97)</td>
</tr>
</tbody>
</table>
Scrutinize **under-spending** as well as overspending.
Be realistic about which avoidable costs you can tackle, and when.
As you build your population health management infrastructure, be aware that just because you have identified areas of avoidable cost does not mean that you are ready to address them. Consider not only your organizational readiness to tackle the avoidable costs, but also the investment required and the financial return to the institution if you succeed.

Key Factors for Prioritizing Opportunities to Capture Avoidable Costs

**ORGANIZATIONAL CAPABILITIES**
- What degree of control do we have in managing this cost?
- What additional investment will be needed to inflect this cost?

**COST OPPORTUNITY**
- What is the relative size of the opportunity?
- How common is this opportunity across our managed populations?

**FINANCIAL OPPORTUNITY**
- What financial benefit can we expect to accrue from inflecting these costs?
- Can we maintain a sufficient margin if we pursue this opportunity absent risk contracts?
Your new **key competencies**: provider engagement, care management, and plan management.

To manage **avoidable costs**, providers will need capabilities few have mastered today, including functions typically associated with payers.

For one thing, providers will need to be able to engage other health care providers effectively in collaborative initiatives: a familiar challenge, but a challenge nonetheless.

Reducing avoidable costs will also require care management competencies, such as patient-centered medical home programs—delivering and coordinating care across time and locations.
Ultimately, providers will need to go even further, adopting insurance-based cost control levers such as utilization management and value-based benefit design. These functions require skills completely different from caring for patients or operating a health care facility, and require a new business model—one that’s more like an insurance company than a provider of health care services.

Visit the Care Transformation Center’s home page to access research and resources on developing new competencies.

advisory.com/ctc
Prepare to transform care, not just reduce it.
To thrive under total-cost accountability, health care providers will need to not just reduce utilization, but transform it: helping patients make the best choices about what types of care they get. In some cases, this means promoting lower-cost care settings: home health instead of skilled nursing facilities, for example. In other cases, patients (and the system as a whole) would be better off from a less-intensive intervention, such as physical therapy rather than surgery.

Care transformation will require tremendous management effort and major cultural upheaval, but the results will be worth it—more effective, less intensive, more responsible care for our patients and our communities.

### Range of Options for Capturing Avoidable Costs

<table>
<thead>
<tr>
<th>Tactic</th>
<th>Rightsizing Utilization</th>
<th>Identifying Value-Add Alternatives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eliminate unnecessary services</td>
<td>Reduce overuse of necessary services</td>
<td>Shift services to lower-cost care settings</td>
</tr>
<tr>
<td>Was this test clinically appropriate?</td>
<td>Does this test need to be repeated?</td>
<td>Substitute with effective, lower-cost care</td>
</tr>
<tr>
<td>Routine EKG in low-risk patients</td>
<td>Two CT scans versus one scan</td>
<td>What is the most appropriate level of care for this patient?</td>
</tr>
<tr>
<td>Home health versus SNF: community hospital versus tertiary</td>
<td>Physical therapy rather than surgery</td>
<td>Should we consider clinical alternatives?</td>
</tr>
</tbody>
</table>

**Example**
Learn More
This piece is based on a larger research initiative on avoidable costs. To learn more and access additional resources, visit advisory.com/avoidablecosts.

More Support on Avoidable Costs

Population Health Advisor
Cohort-driven collaborative supporting the Chief Transformation Officer combining in-person peer summits with ongoing, in-depth research and customized guidance.
advisory.com

Crimson Population Risk Management
Performance technology initiative that helps hospitals manage total cost and quality for defined populations—including self-insured employee plans—and inform risk-based contract negotiations with payers.
advisory.com/crimson

ev solvent HEALTH

Population health and managed services company that provides technology, tools, and on-the-ground resources to support health systems in executing on their population health and care transformation objectives.
ev solventhealth.com
Sources


2 Per member per month.

3 Well-managed benchmarks represent cost and utilization targets derived from claims data in a highly effective managed care environment (e.g., staff model HMO or globally capitated provider group). Targets are developed from over two billion claims from Milliman clients, published HMO data, clinical chart reviews, and actuarial judgment. Loosely managed benchmarks are derived from providers that have some utilization review, pre-authorization, and case management but are generally not tightly managed.

4 Post-acute care includes SNF, hospice, and home health care.