Healthcare Revenue Cycle Management (RCM): A Growth Engine

By Mark Russell and Aaron Elson

The healthcare industry in the U.S. is undergoing a significant transformation due to changing regulations (e.g., ObamaCare), a transitioning coding system and increasing pressures on healthcare providers to improve patient services while simultaneously lowering costs. While these trends are causing chaos for all parties involved, they are also generating attractive business opportunities, particularly for the outsourced business services (OBS) sector. In fact, the healthcare industry has become one of the largest growth engines for the OBS sector due to a number of factors, including:

- The aging population in the U.S.
- Struggling financial conditions for the U.S. hospitals and other healthcare providers
- Stubbornly high unemployment rates driven by stagnant economic growth
- Changes in legislation and regulatory compliance that make it more difficult for healthcare providers to manage certain functions internally

RCM has become one of the most popular functions for healthcare providers to outsource due to its critical importance and the significant challenges to manage it internally in an efficient and cost effective manner.

This report provides an overview of the U.S. healthcare RCM industry including its primary service offerings, key market trends, and future growth opportunities. Due to our involvement as a strategic advisor to the RCM industry and its level of attractiveness to strategic and financial buyers, we have also incorporated an overview of the recent merger and acquisition (M&A) activity within this industry and market trends we see unfolding going forward.

If you have any questions or wish to confidentially discuss your business interests, please contact a member of our strategic advisory team at hq@kaulkin.com or visit http://kaulkin.com/contact_us/index.php
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Revenue Cycle Management: What is it?

Revenue cycle management (RCM) is the fundamental process that enables a company to be paid for providing their services. For most healthcare providers, RCM includes everything from pre-registering a patient all the way through the final zero balance invoicing for a particular visit. An effective RCM process is an important component for all companies. Due to the struggling financial performance, RCM has become a fundamental component to the profitability of U.S. healthcare providers.

Within RCM services, it is important to understand where in the cycle a particular company’s offerings exist. It is also important to understand where your competitors are, what your service offerings are in relation to the overall cycle and the relative growth rates of each sub-sector. The easiest way to break these areas out is in relation to the “intervention” in healthcare terminology. The “intervention” refers to the time in the cycle, at which the service is performed. Thus, there are three stages in the cycle: pre-intervention, intervention and post-intervention.

It is important to also understand that there are three broad levels of activity within RCM:

- The first level includes patient access, pre-registration, entitlement and eligibility verification as well as self-pay, which includes co-pays.
- The second level represents an intersection between information technology and administrative / RCM. More specifically, this includes coding, transcription, voice recognition, natural language processing (NLP), mobile health and generation / manipulation of electronic medical and health records (EMR / EHR).
- The third level consists of account collections, receivables management, and early-out account transfers.

Some parts of the healthcare RCM process require on-site staff support, while others can be fully outsourced or even automated with the right partner. Certain aspects like coding, billing and other functions can be labor intensive, require specialized training or must be performed in a low cost environment to be financially viable, which has driven healthcare providers to one conclusion: outsourcing. When determining an appropriate outsourcing strategy, many healthcare providers have opted for American based niche market specialists as opposed to lower cost offshore options in order to better manage their performance results, vendor relationships and overall reputation in the marketplace. While many areas of the economy are stagnant or shrinking, the healthcare expenditures have reached record levels prompting a significant restructuring in terms of M&A activity and elevated valuations.

This chart illustrates the functional areas of healthcare RCM services, and gives some insight into why these areas are increasingly outsourced. The black fields are the primary targets while red represents healthcare IT and blue represents physician responsibilities.
The Evolution of RCM

Pre-RCM

In the early 1980s, all the precursor elements of modern RCM existed, but they were viewed as individually necessary but not wholly integrated. The intention of developing an RCM system was to implement a routine procedure that would be wholly accepted, so that payments could be properly documented.

Generally, these consisted of task oriented job titles, not specific functions or business units. Viewed as a process, patients were first registered and scheduled. Then, after the doctor saw the patients their charts went to the records room for follow up dictation and clearing, then to the coders, then to the billing specialists. Some billable items were never billed due to mistakes driven by inefficient administrative processes and poor quality assurance procedures. Rejected reimbursements also had a good chance of being written off as bad debt as opposed to being reviewed and resolved.

With great advances in computing, databases and information systems capabilities, the healthcare industry began shifting away from paper-heavy and labor-intensive tasks to more efficient, automated procedures. The technical complexity of these activities prohibited many of the hospital and provider systems from developing these technologies in-house, which led to the growth of the outsourcing of these services.

Modern RCM

The evolution of our modern concept of the RCM industry is rooted in the mid-80s, but really reached a tipping point around the mid-90s. In the mid-80s, the hot item was the integration of IT into the awareness of hospital administrative departments with the increasing importance of Chief Information Officers as critical members of the upper management team. Following the growth of in-house IT departments in the late 80s, the 90s saw revenue pressures and a huge wave of hospital consolidations, which led to the first wave of IT outsourcing. Initially designed as a hardware backbone for the various in-house departments that managed the revenue cycle for healthcare providers, this partner relationship would eventually become viewed as the basis of what we now know as revenue cycle management.

Since the mid-2000s, we have been experiencing another wave of healthcare provider consolidations, driven by economic conditions, changing regulations and rising costs. This cost focused trend has caused healthcare providers to look at other non-core services to outsource, resulting in a redefining of the RCM marketplace.
RCM BPO-Market Size

The U.S. Census Bureau estimates the U.S. healthcare industry at $2.7 trillion currently. Hospital care accounts for the largest portion at $831.5 billion, projected to grow to $1.1 trillion by 2016.

According to numerous industry sources (ST Advisors, Compass, Nelson-Hall), the total size of the RCM outsourced services market currently sits at approximately $5 billion, with growth projected to nearly $9 billion by 2015, approximately a 14.6% CAGR. According to Nelson Hall, the primary area of focus in the market segmentation is the pre-intervention area, followed closely by the post-intervention services: medical billing, coding, and transcription. Post-intervention services have traditionally been the focus of healthcare RCM activity, but over time these markets have matured and experienced increased competition, resulting in diminished revenue growth rates. Recent legislative as well as market trends have created and fueled the growth in pre-intervention services.

Pre-Intervention consists of the following:

1. **Insurance Verification / Eligibility**
   Prior to a patient actually visiting the office, successful practices need to verify that the patient has currently in-force health insurance or entitlement membership, as well as eligibility to receive the scheduled services they are going to receive. A lack of actual health insurance or eligibility for a particular service is one of the leading causes of uncompensated care leading to A/R write-offs.

2. **Patient Scheduling**
   Handling all of the patient volume, scheduling and registration.

3. **Support Services**

**Segment Growth Rates (CAGR)**

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<th>Segment Type</th>
<th>Growth Rate</th>
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<tr>
<td>Pre-intervention</td>
<td>27%</td>
</tr>
<tr>
<td>Medical Coding</td>
<td>17%</td>
</tr>
<tr>
<td>Post-intervention</td>
<td>9%</td>
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RCM Market Growth

![Bar chart showing RCM Market Growth from 2011 to 2015 with segments for Support Services, Medical Coding, and Post-Intervention.](chart.png)
Current Trends

The healthcare provider landscape has recently been going through its own trend of consolidations due to pressures on revenues and profits, credit ratings downgrades / access to capital and the lowest admissions rates in 20 years. Administrative efforts to contain and decrease costs have been successful, though revenue growth is still not yet back to historical levels. According to recent data from Moody’s Investor Service, revenue growth came in at 4.5% for 2010, down from historical levels of 7%. The good news here is that, due to outsourcing of RCM operations, revenue growth has begun to rise and in 2011 came in at 5.3%. While not quite at historical levels, we are still nonetheless happy to see the improvement.

In another recent report, Moody’s also reported that 20% of hospitals surveyed are operating in the red, and 63% report operating between break-even and 5% operating margins.

Hospital admissions rates actually declined by .4% according to data from the National Hospital Discharge Survey conducted by the Centers for Disease Control (CDC), in their 2010 report, the most recent data available.

If revenue, operating margins and revenue growth numbers in the healthcare provider industry are so slim, how can they be outsourcing, and why is revenue cycle management such a hot topic today?

Consolidation of not-for-profit healthcare providers has been sweeping the industry lately, very similar to the last consolidation trend from the 1990s to around 2005. This most recent trend has been driven by the recession and by hospitals seeking bond-rating stability post credit-crunch, beneficial economies of scale, greater operating efficiencies and ability to engage in strategic / financial investments. Individuals have been foregoing care due to unemployment, which has also created a larger patient base qualifying for Medicaid. The most recently released data from the CDC on hospital admissions shows a .4% decline in hospital admissions year over year, which has not been observed in prior recessions. Decreases in patient volume are due to patients losing employer based health coverage, cobra, and employment altogether and thus foregoing both necessary and elective healthcare. Commensurate decreases in revenues due to uncompensated care have led to bond rating downgrades and decreased access to capital markets, especially for smaller hospitals. When patients lose their employment, they defer their medical care, or are shifted to Medicaid, which typically pays less than private insurance for the same services. All of this has been squeezing the revenues of healthcare providers. While counterintuitive to an increase in business process outsourcing, healthcare providers have been forced to leverage the economies of scale and efficiency offered by outsourcing firms to combat decreases in revenues and profits.

According to CMS data, in 2010 healthcare expenditures in the U.S. accounted for nearly 18% of GDP, projected to rise to 20% by 2021. Recent legislation intends to address the issue, but creates a huge burden on necessary capital expenditures and investments that would be difficult in flush times, let alone such a prolonged recession. Specifically, the revenue per transaction will be decreasing, as will the overall expenditures from the federal and state governments as the entire country aims to reduce spending on health care.
Medicare payments have been and are slated to continue to decrease (thanks to the Affordable Care Act) at the same time as patient volume and encounter / billing volume is expected to increase (also due to the ACA). Recovery Audit Contractors (RACs) are also heavily auditing reimbursements across all 50 states, putting further pressure on reimbursement revenues as the industry undergoes the fundamental shift from encounter-based reimbursements (where providers are reimbursed on a per-visit basis) to results or value based reimbursements (where reimbursements are tied to the outcomes of healthcare, not just the number of times a patient is seen). Up to 30 million additional individuals may qualify for Medicaid; however, the Supreme Court ruled recently that states may legally decline to participate in the proposed increases in Medicaid enrollments, which will continue to dampen the benefits of increased enrollment which helps to offset the revenue pressures seen lately.

All of this continues to pressure hospitals to consolidate, simultaneously increasing the need in industry for not only outsourcing, but end-to-end solution providers, or a verifiable way to exchange data from one service to another through Electronic Data Interchange (EDI) standards.

Future

The consolidation trend among providers has also led to a wave of consolidations among outsourcing vendors. The consolidation trend taking place in the RCM industry is projected to not only continue, but accelerate as deadlines approach through 2015. This will mean both opportunity as well as potential uncertainty for niche healthcare RCM service providers. Opportunity in that much of the recent and predicted consolidation activity has been of strategic, not just financial motivation. Acquiring firms are looking to fill gaps in their service offerings. The trend has been moving toward fully integrated, end-to-end solution providers, integrating additional aspects of the full RCM cycle, as well as toward increasing access to capital, bond-rating stability and away from over-specialization.

Investing trends within the RCM industry through 2015 will be driven by mandates such as the Affordable Care Act, ICD-10 implementation (likely pushed back to October, 2014, though not yet official), and unspent Tarp Stimulus funding (Meaningful Use incentives administered through Medicare / Medicaid) intended to drive investments in the Meaningful Use and implementation of technology and services pertaining to Electronic Medical and Health records. Similarly, since March of 2012, penalties began for those organizations not fully on board with the HIPAA 5010 EDI mandates for the electronic interchange of data. The incentive payments will drive total investments much greater than the dollar amount of the allocated funding under TARP due to the mandate to implement. Also, with the massively increased rate of investments in clinical systems, a commensurate increase in outlay on administrative systems / RCM will follow.
Obstacles / Uncertainties

Until recently, much debate in the industry revolved around the possibility of the Supreme Court striking down the Affordable Care Act, but it was constitutionally upheld as a tax, affirming the power of Congress to institute an individual mandate on healthcare. One important provision was struck down, allowing states to opt out of Medicaid expansions. With the certainty of increased healthcare coverage, elimination of pre-existing conditions eligibility exclusions and increases in Medicare / Medicaid enrollment, increasingly large and more frequent investments in HCIT and administrative systems, as well as M&A activity will continue through 2015, with 2015 or 2016 likely representing a near-term plateau in both deal-volume as well as transactional valuation. This is all assuming that whoever holds the presidential office next term, current legislation will take full effect as planned. The more time that elapses with things as they are, the more likely events will transpire as predicted.

One key topic that is drawing attention in the RCM industry is the eventual transition away from ICD-9. There is debate in the industry about the possibility of bypassing the transition to ICD-10 altogether and waiting for a timeline to implement ICD-11. This is unlikely to happen, especially with the announcement of a delay to October, 2014 for implementation of ICD-10 in the U.S. The guidelines for ICD-11 will be released by WHO to the World Health Assembly in May of 2015, with a U.S. version that could take until 2020 to be released. Further, the current status of ICD-9 is such that certain types of body systems and diseases have run out of codes, causing codes from other disease classifications or body systems to be used, creating confusion and inefficiencies in both healthcare as well as research. Some current procedures may not even have codes, causing unrelated codes to be used creating great inefficiencies in billing and appeals.

Opportunities

All of the obstacles and uncertainties presented actually represent opportunities, but only for firms that act now. Those who wait will be left out in the cold. Michael Alper, in “New Trends in Healthcare Outsourcing” by Aspen Publishing draws a parallel between healthcare transaction processing and the financial services industry by explaining that single healthcare transactions cost $25, with currently necessary services adding between $25 and $80 per transaction, with claims paperwork costing upwards of $250 billion per year. In the financial services industry, banks and brokerages have been able to decrease their costs per transaction to less than one penny. Current trends and skyrocketing costs in billing and reimbursement create the necessity for the industry to undergo the sizeable shifts we see at present, but this will require health care providers to leverage the economies of scale offered by RCM BPO centers. Outsourcing firms that can handle the encounter volume (efficiently and effectively) while integrating direct patient billing, A/R and collections seamlessly while minimizing and handling complaints / managing the patient relationship will win out.
Having established that revenues are down puts great pressure on healthcare providers to contain costs. What action does this translate to in terms of management’s decisions on outsourcing?

A link between revenue pressures / cost containment and outsourcing exists both intuitively and empirically. Through an analysis of financial data from 357 hospitals over six years including governmental, for profit and non-profit institutions, a clear link between cost-containment initiatives and increased outsourcing of non-clinical services (over clinical) is established. These findings are controlled for “scale, scope, patient, and product market characteristics,” as well as organizational type and equity structure. (Ramji et al)

While the hospital sector has been undergoing a large consolidation trend, the RCM space has remained very fragmented. 2012 results show consolidations in RCM are picking up, and both the pace and size of deals will increase as the industry trends away from fragmented niche providers to more comprehensive solution providers. Small, niche providers that do not seek shelter inside a larger organization, or seek to form joint ventures will find that they are unable to survive in the leaner environment being carved out by current legislation, economic, demographic and consumption trends within healthcare.

With the increasing acceptance of outsourcing and simultaneous increase in forces requiring marked increases in operational efficiency, there may also be growth in offshore outsourcing. This opportunity for growth will come from the greater economies of scale offered by offshore firms in terms of man-hour labor rates, as well as their significant head-start in ICD-10 compliance.

The trend of hospital consolidations has created organizations with sufficient market bargaining power to increase the reimbursement rates they receive from private health insurance payers. Consequently, the trend has shifted to include consolidations between payers and providers, in order to create synergies as well as to increase revenues while decreasing expenses.
RCM Best Practices: Benchmarks for M&A Targets

Specific examples of best practices, as recommended by HFMA include the following:

- Pre-registration rate of scheduled pts 95%
- Insurance verification rate 95%
- Collection of co-pays prior to service 95%
- Bill hold days 3-4 days post discharge
- Late charges as % of total charges <3%
- Overall denial rate <4%
- Appeals overturned at rate of >50%

Both hospital administrators, as well as outsourcing firms must begin to look at the RCM cycle holistically and seek out as well as provide complete, end-to-end solutions. Those RCM firms that follow this practice will be better positioned to capture larger shares of the market, at an earlier stage, allowing them to reap the benefits of the massive and fundamental shifts in the marketplace for the future. As revenues decrease under new legislation and market trends, healthcare providers will need to focus on their core strengths and outsource RCM needs.

RCM Industry Overview

2012 was also a breakout year for revenue cycle management service providers. M&A activity in this market increased substantially over the previous year, with 37 transactions completed representing $1.2 billion total deal value in 2012 vs. only 10 transactions generating $159 million in deal value in 2011.
Noteworthy RCM M&A Transactions in 2012

• **CARDON OUTREACH™** Cardon Healthcare’s acquisition of Outreach Services – Combined two prominent players in the Medicaid eligibility market, now called Cardon Outreach

• **Adreima**’s acquisition of Accounts Receivable Management and Data Services, Inc. (ARMDS) – Diversified Adreima’s RCM service offerings and geographic footprint

• **The T-SYSTEM** T-System’s acquisition of Marina Medical Billing Service – One of several acquisitions made by T-System in the past year so far, expands T-System’s market presence in the emergency medical services industry

• **Optimum Outcomes** Optimum Outcome’s acquisition of Absolute Collection Service – Strategic acquisition that diversifies Optimum’s RCM and ARM servicing capabilities in the healthcare market, and expands its geographic footprint

• **TA Associates** TA Associates acquisition of a majority stake in Omega Healthcare Management Services – Further evidence of financial buyer interest in the growing RCM market

• **Sutherland Global Services’** acquisition of Apollo Health Street – Strategic acquisition that establishes Sutherland’s foothold in the growing RCM market

• Sanjiv Goenka Group’s strategic investment into FirstSource – Indian based conglomerate diversifying into the growing Indian based BPO market; FirstSource previously acquired MedAssist, making it one of the larger RCM service providers in the U.S. market

• **Parallon Business Solutions** acquisition of Martin Fletcher, a strategic consulting firm servicing hospital clients – Enables Parallon to further expand its RCM services capabilities and geographic footprint

Given the size and growth potential of the U.S. healthcare RCM market, we do not anticipate a slowing down of M&A activity in this sector anytime soon.

However, we are seeing signs of market maturing within certain RCM sectors such as Medicaid eligibility, as some companies are performing quite well while others are struggling to maintain acceptable profit margins. Within these sectors, we anticipate further consolidation of vendors in 2013.

As the U.S. market continues to experience rising healthcare costs due to the retirement of the baby boom generation, the RCM market will experience more business volume. This will give rise to additional interest from strategic buyers (e.g., IT services companies seeking to expand into the RCM services market) and financial buyers. As a result, we expect the healthcare RCM market to be a major contributor to the M&A performance within the OBS sector for the next several years.
About Kaulkin Ginsberg

Since 1991, Kaulkin Ginsberg has provided value-add strategic advisory services tailored specifically to outsourced business services (OBS) companies. Our client-centric approach covers almost every stage of a company’s lifecycle and enables us to maintain long standing and intimate relationships as trusted and reliable strategic advisors.

Service offerings include:

M&A Services
We have completed over 130 transactions representing north of $3 billion in aggregate deal value. We are deeply experienced in advising owners and acquirers of mid-market firms in buying and/or selling a business.

Strategic Consulting
Kaulkin Ginsberg is the leader in providing strategic consulting services to the ARM industry where our services are valued and utilized from the board room to the court room.

Valuation Services
For nearly a quarter century Kaulkin Ginsberg has been the leading authority on the valuation of privately owned companies within OBS.

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Kaulkin Ginsberg litigation support professionals have a track record of success; our findings have never been invalidated in any court or formal proceeding.

Market Intelligence & Analysis
We believe that executives should be armed with the most relevant and timely information enabling them to make informed decisions. To that end, we provide a number of free resources to assist you.

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