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Using Credit Scoring To Manage Hospital Bad Debt

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Recently a colleague forwarded two charts, both unrelated to healthcare, with a quick comment: "Pass these along to your hospital CFO pals and ask what their 2008 bad debt will look like." The charts show recent precipitous drops in average workers' earnings and home prices. Bad news indeed, and just another problem in a stack of issues confronting hospital financial managers.

Most hospitals have had stable performance over the past 20 years. But infrastructure demands and changes in reimbursement dynamics will create huge financial challenges over the next decade. Health system executives face aging physical plants, the need to invest in expensive new technologies, impending cuts in public reimbursement, difficulties in recruiting allied health professionals, the elimination of payments by the Centers for Medicare and Medicaid Services and commercial payers for "never events" and other errors, increased patient responsibility for payment, and, of course, a deepening recession. All these issues will conspire to make financial managers' roles more difficult than ever before.

Patients' increasing financial burden for care will be one of their most difficult and delicate tasks. CMS reports that patients already pay 12% of all healthcare costs out of pocket, and that figure is expected to rise to 20% in the next several years. Developing approaches that can help determine who can, should, and will pay—without appearing heavy-handed or coldhearted in the communities you serve—will test even the most skilled and experienced professionals.

Even before the economy's downturn, a rapidly growing percentage of workers and their families--particularly those whose coverage depended on small business—were being priced out of a healthcare coverage market that, over the past five years, has grown 4.4 times as fast as general inflation and 3.7 times as fast as workers' earnings. Workers whose employers have continued to provide coverage—these businesses recognize that lost productivity costs are significantly higher than premiums—have seen their benefits shrink and their out-of-pocket requirements increase, transferring a substantial percentage of cost to them.

High-deductible health plans, with and without health savings accounts, are gaining increasing traction among employers. A recent Watson Wyatt/National Business Group on Health study found that nearly half of all employers now offer some form of high-deductible plan. But another just-released survey, this one from the Employee Benefits Research Institute and the Commonwealth Fund, found that 5.5 times as many employers are *not* funding HSAs as are funding them.

These trends mean that more patients are responsible for healthcare bills than at any time in decades. As America's economy has weakened in recent months, consumers have almost certainly found it harder to meet their obligations.

While significant increases have not shown up yet in national uncompensated care figures—these are undoubtedly lagging the market dynamics—health systems around the country are anecdotally reporting spikes in bad debt, a worrisome harbinger of things to come. For example, the Pennsylvania Healthcare Cost Containment Council recently issued a report showing that hospital margins rose for the fifth consecutive

year, from 5.4% in 2006 to 6.5% in 2007, a 20.7% increase. But uncompensated care costs rose by 12.3% in 2007, the highest in five years.

The bad debt dilemma

In 2005, U.S. healthcare providers set aside an estimated $129 billion, or about 7% of total revenues, to cover bad debt, the research and consulting firm Kaulkin Ginsberg reports. In 2006, the nation's community hospitals spent about $31.2 billion on bad debt, according to the American Hospital Association. This figure is more than one-third higher than the 5% average total margins reported by the hospital sector in 2005. Now, with changes in coverage and the economy, bad debt is likely to skyrocket.

The challenge facing health system financial managers is how to put mechanisms into place that can optimize the capture of recoverable funds, without creating ill will in the communities they serve.

Health credit scoring

The opportunity to help providers manage accounts receivable has created an enormous business sector within healthcare—Kaulkin Ginsberg sizes it at $2.4 billion—and the fastest growing subsector is healthcare credit scoring for the patient portion of debt. Several firms have developed proprietary methodologies that assess historical payment information inside and outside of healthcare to evaluate the likelihood that a patient will pay for the care they have received. SearchAmerica has been in business more than a decade, and claims more than 900 hospital clients. For the past five years, credit bureau Equifax has offered a "payment predictor" to healthcare providers. Canopy Financial uses consumer credit scoring to analyze lending offers to owners of high-deductible health plans at the point of service.

More recently, Fair Isaac, developer of the well-known FICO score, teamed with the for-profit hospital chain Tenet Healthcare Corp. and the venture capital firm North Bridge Venture Partners, each investing $10 million into consulting firm Healthcare Analytics, to develop what the industry is referring to as "MedFICO," a healthcare-specific tool. Tenet provided a core research set of $100 billion in hospital patient billing records on which the algorithms presumably are built.

As strong as these tools promise to be, credit scoring is not a perfect science. Five years ago, the Consumer Federation of America analyzed more than half a million credit scores and found that 29% were 50 or more points lower than they should have been. Which makes IXI, a new entrant to this sector, perhaps the most interesting resource. Like other patient financial analysis firms, IXI's evaluations include consumer spending data, which indicate tendency to pay, and the firm has tested its scoring capabilities against select hospitals' patient payment information. But unlike them, this firm hosts a $24 trillion collaborative data repository of major American financial institutions containing information on their customers' investments (like stocks, bonds, and certificates of deposit). This lets IXI identify patients' capacity to pay, a key difference. With this information, health systems can sift through patient accounts receivable to identify who is able to pay, in addition to who is likely to pay.

Managing a difficult situation

Hospitals and health systems face an intensifying financial environment that will demand rigorous approaches to financial management. Credit scoring—objectively identifying and rating patients who have the capacity and likelihood to pay—can be an important tool to figure out which patients will pay easily, who will need prompting, whom to pursue aggressively and whom to simply write off.

Consumer advocates are nervous that hospitals and doctors could use credit scores to deny care. Healthcare blogs that have discussed the credit scoring issue have been overwhelmed with responses from concerned consumers, including those who anecdotally report their suspicions that hospitals are already using these tools to deny care.

Assurances from healthcare credit scorers and from American Hospital Association spokesperson Alicia Mitchell that, "we treat first and ask questions later," will go only so far. The deepening financial pressures that hospitals are experiencing make these new tools essential. A larger question is whether hospitals will avoid using the analyses prospectively.

Sensible health systems will focus on refining their effective use of these technologies and, equally importantly, bolstering confidence that credit scoring will not be used to pre-empt the care of patients with high financial risk.

Brian R. Klepper, PhD is a healthcare analyst, commentator and principal of Healthcare Performance Inc. in Atlantic Beach, FL. He may be reached at bklepper@gmail.com , or 904.246.9643.

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