Hospital Concentration, DSH Payments, and Access for the Uninsured in Los Angeles County and the State of California

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Study Goals

This project examines how recent trends toward concentration within the hospital industry among hospital chains and the increase in for-profit ownership affects access to affordable healthcare in Los Angeles. Specifically, it investigates the impact of hospital concentration on:

(1) costs and revenues, which affects the affordability of employer-provided coverage for those that have it, and
(2) the competitive position of the public hospitals, which have traditionally provided a safety net to the uninsured and underinsured.

The primary focus of this study is Los Angeles County, since for-profit hospital growth has been greatest in this region. For comparison purposes, we also examined data for hospitals in the rest of California, excluding Los Angeles County. We examine how hospitals performed from 1995-2000 in Los Angeles County and in the rest of California in providing care to the uninsured, staying solvent, and taking advantage of funding designed for safety net providers.

Methodology

The data sources used in this study are readily available from the California Office of Statewide Health Planning and Development (OSHPD) and the California Department of Health Services. The main data set used in this study is the Hospital Annual Financial Data files for 1995-2000. These data are reported on a hospital fiscal year basis by each acute care hospital in California, and include information on revenues, patient days, discharges, expenses and other variables at the hospital level. Acute care hospitals are defined by OSHPD as hospitals with at least half of their patient days classified as acute. This definition does not include long-term care facilities, or psychiatric or rehabilitation hospitals. To make the results comparable across all years of the study (1995-2000), the dataset was converted to a calendar year format by prorating the fiscal year data reported by each hospital to fit into a calendar year.

The second source of data used in this study is Disproportionate Share Hospital (DSH) payment data collected by the Department of Health Services. These data track DSH payment information for each hospital, and also collects data on the transfer payments

made by public hospitals into the DSH fund. These data were only available for 1998-2001.

Background

The number and proportion of private hospitals has been increasing in the state of California and in the county of Los Angeles since the mid-1990s, while the number of government and district owned hospitals remained steady. Specifically, there was an increase in the number of hospitals in the county owned by hospital systems. For example, Tenet Healthcare Corporation increased their market share from 8% in 1995 to 15% in 2000. In addition, Tenet's concentration has greatly increased their payments from the Disproportionate Share Hospital (DSH) program. In California, Tenet owned 8 hospitals in 1995 that received DSH payments; by 2000, they owned 17. In Los Angeles County, Tenet went from owning one DSH hospital in 1995 to owning 6 by the year 2000

Recent reports by the Institute for Health and Socio-Economic Policy and the California Nurses Association found that hospital systems in California had precipitated substantial markups on drug charges over costs, high Medicare outlier payments, and high workers' compensation claims. Tenet has been accused of using their gross charges to disproportionately drive up the cost of health care in California.[1] In response to these claims, Tenet published a report stating, "gross charges do not accurately reflect the amount that hospitals are actually paid for the services they provide."[2] The concern for California is that higher hospital charges may in fact result in higher payments and higher profit margins for hospitals without necessarily increasing access to hospital care, particularly for uninsured patients who depend on safety-net hospitals and programs.

There are approximately 4.5 million uninsured people living in California, representing about 15% of the state's population.[3] But the proportion of the uninsured is particularly high within some ethnic and racial groups. Latinos have the highest rate of uninsurance - over 28.3% are uninsured in California - and they also have the lowest rate of job-based insurance of any ethnic group (42.3%). Latinos constitute a disproportionate number of the uninsured both statewide and in Los Angeles County because they represent such a substantial portion of the population (Figure 1).

In Los Angeles County, safety net hospitals and health centers struggle to provide care to the large, diverse group of uninsured and underserved patients. Money and access are serious issues in dealing with this population, and government hospitals bear the brunt of providing care for the uninsured while receiving limited funds to do so.

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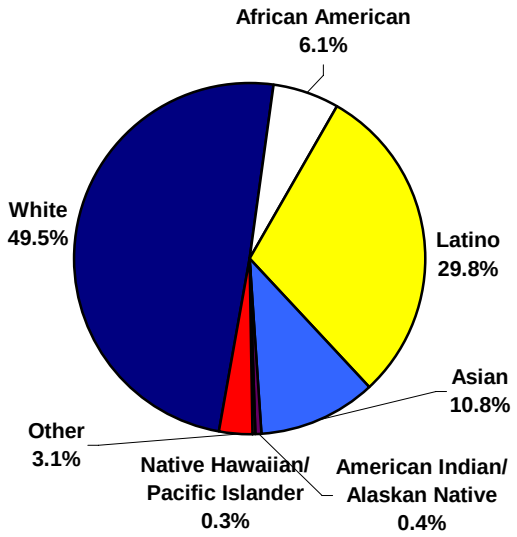
[1] Tenet Health Care Corporation, Drugs and Hospital Charges: Impact on Health Care Costs in California and Nationwide. Prepared by the Institute for Health and Socio-Economic Policy: Orinda, CA. February 2003.

[2] California Acute Care Hospital Net Patient Revenue Per Patient Day Comparison: Prepared by Tenet Healthcare Corporation in association with Henry W. Zaretsky and Associates, February 2003.

[3] ER Brown, N Ponce, T Rice, SA Lavarreda, *The State of Health Insurance in California: Findings From the 2001 California Health Interview Survey*, Los Angeles: UCLA Center for Health Policy Research, 2002.

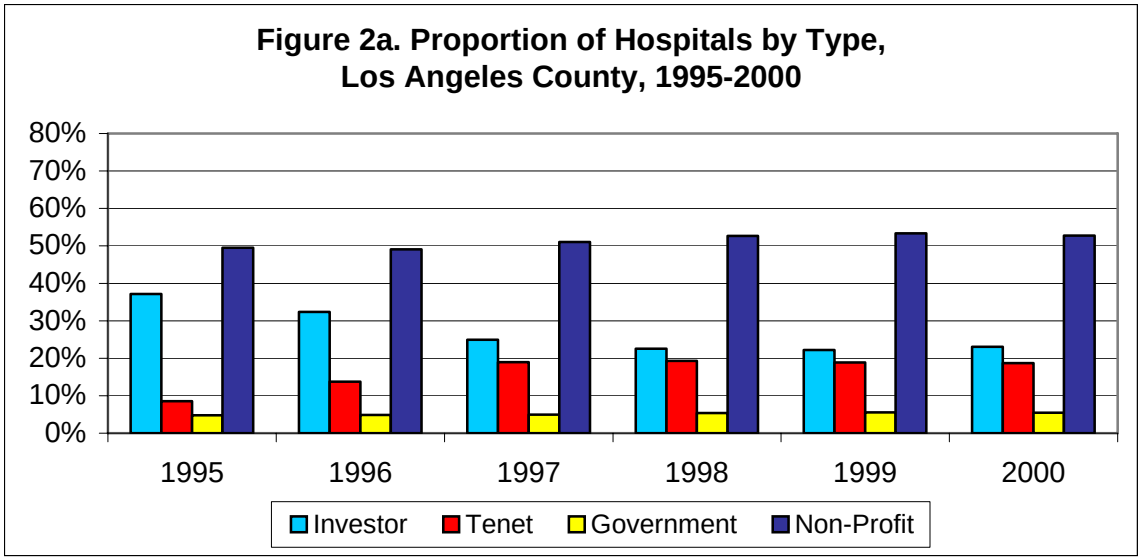
Figure 1. Racial and Ethnic Distribution in the State of California, CHIS 2000

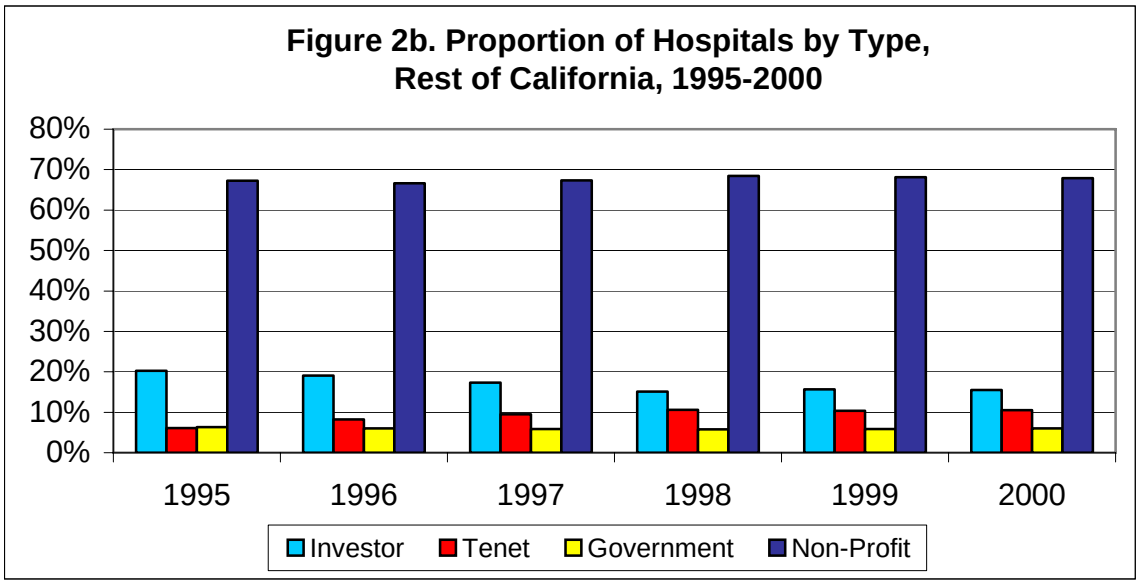


Hospital Concentration

The hospital climate has changed within the last decade in California and in Los Angeles County. Although investor-owned hospitals, government hospitals, and non-profit hospitals have not undergone large changes in terms of distribution in the state, some subsets of these groups have experienced noticeable changes. For example, investor-owned hospitals, once spread out fairly evenly between some smaller corporations and private operations, are now more likely to be dominated by corporations attempting to gain market share and provide services to many more patients in wide areas.

The most prominent change within the group of investor-owned hospitals was the growth of Tenet Healthcare Corporation. In 1995, Tenet had 9 hospitals in Los Angeles County, and 17 hospitals in the rest of California, representing an 8.5% market share in Los Angeles and only 5.3% in other areas of California. However, in 2000, Tenet owned 17 hospitals in Los Angeles and another 23 in the rest of the state, representing a market share of 18.5% in Los Angeles (Figure 2a) and 7.9% in the rest of the state (Figure 2b). Overall, Tenet added 14 hospitals statewide within five years. This growth has occurred while Los Angeles County's government hospitals have been facing financial pressures due to cutbacks and a growing uninsured population.





Profitability of Hospitals in Los Angeles and California

To determine the financial status of California's hospitals in California, we examined operating margins and total margins using data from the OSHPD calendar year financial dataset created for this study.

Operating margin was calculated by dividing the net revenue from operations by the sum of net patient revenue and other operating revenue. Total margin was calculated by dividing the net income by the sum of net patient revenue, other operating revenue, and non-operating revenue.

Figure 3a. Average Total Margin from 1995-2000, Los Angeles County

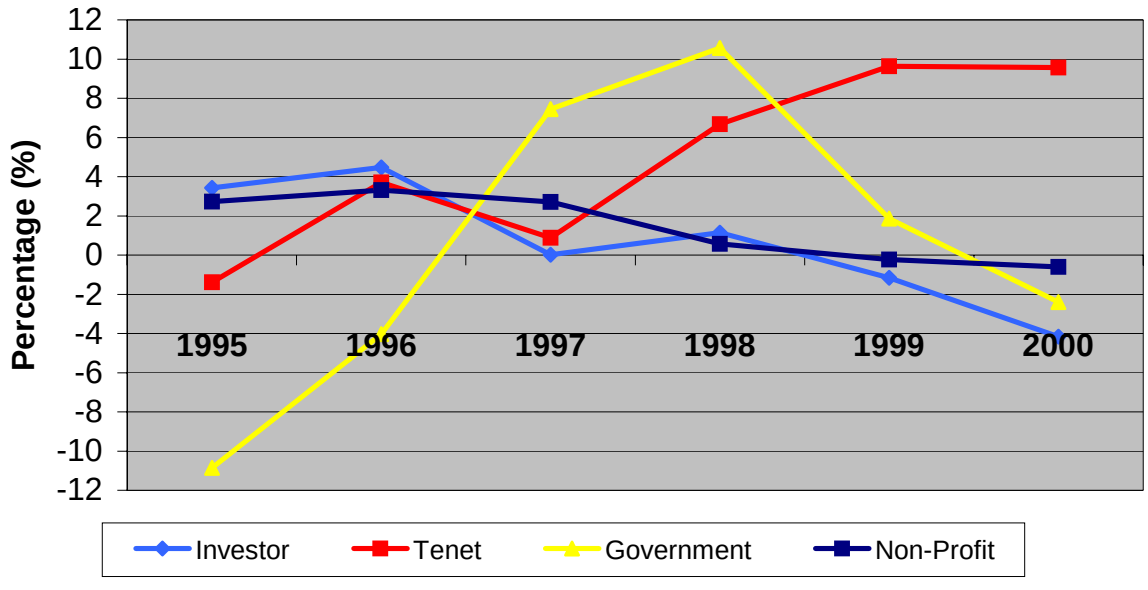
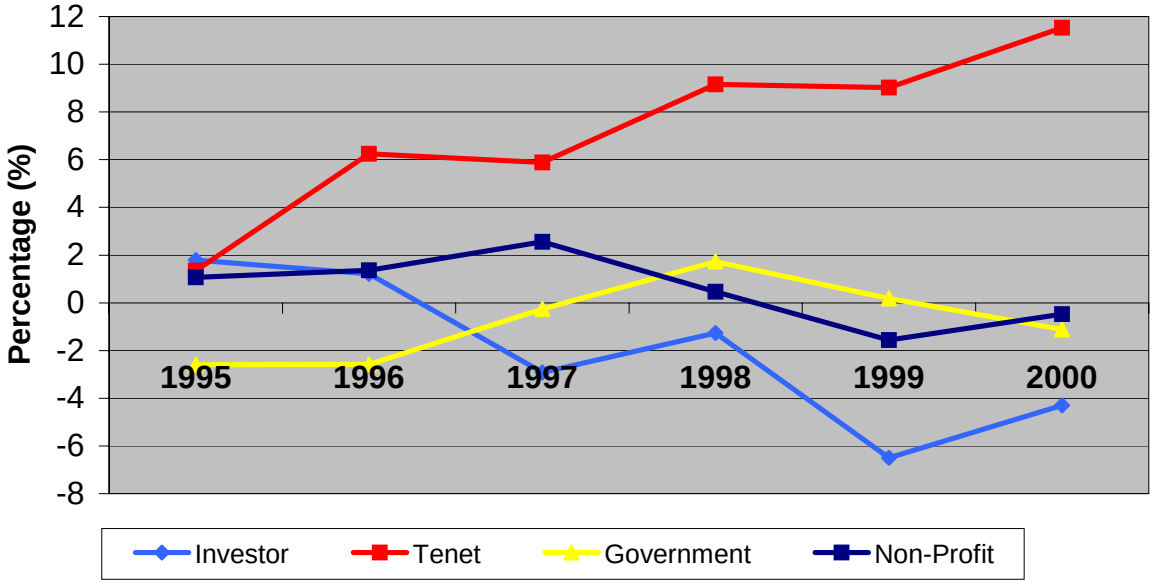


Figure 3b. Average Total Margin from 1995-2000, Rest of California



The average total margin for Tenet hospitals grew at a healthy rate in Los Angeles County and the rest of California through 1999 (Figures 3a and 3b). From 1998 to 2000, total margins declined for all hospitals in Los Angeles County and for all hospitals in the rest of California except Tenet hospitals. Furthermore, Tenet hospitals were the only hospitals with positive total margins in Los Angeles County and the rest of California in

2000.

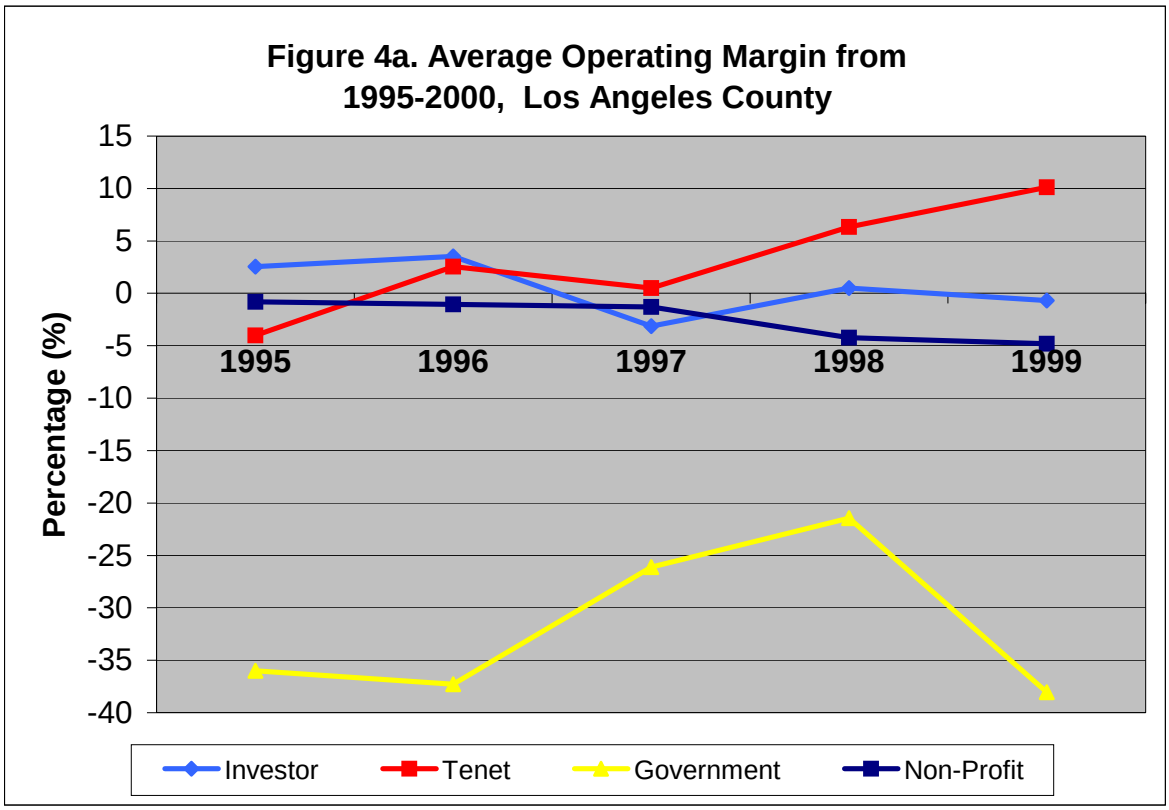


Figure 4a. Average Operating Margin from 1995-2000, Los Angeles County
Percentage (%)
15
10
5
0
-5
-10
-15
-20
-25
-30
-35
-40
1995
1996
1997
1998
1999
Investor
Tenet
Government
Non-Profit

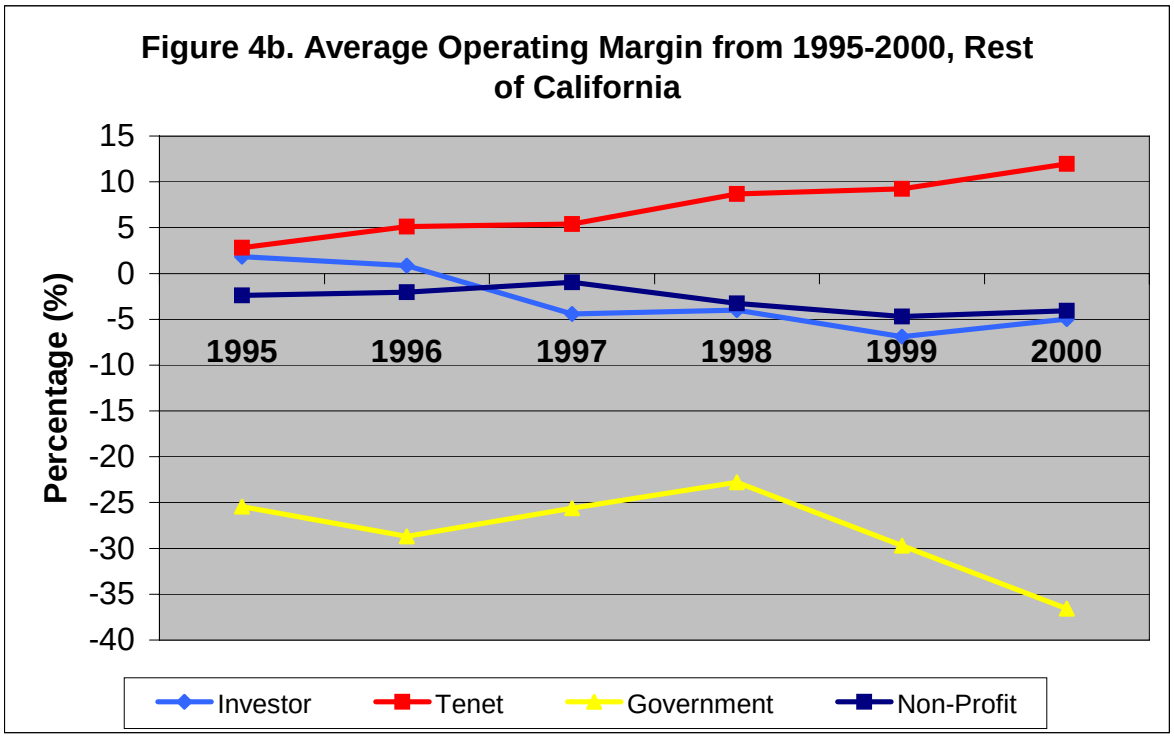


Figure 4b. Average Operating Margin from 1995-2000, Rest of California
Percentage (%)
15
10
5
0
-5
-10
-15
-20
-25
-30
-35
-40
1995
1996
1997
1998
1999
2000
Investor
Tenet
Government
Non-Profit

Much like the total margins in California, operating margins for Tenet hospitals in Los Angeles County and in the rest of California showed large increases from 1995 to 2000 (Figures 4a and 4b). In Los Angeles County, government hospitals displayed negative operating margins for all five years, while non-profits and other investor-owned hospitals started with positive operating margins in 1995 and had negative margins in 2000. These trends were very similar to those seen in the rest of California. Government hospitals on average showed consistently negative operating margins, in both Los Angeles and the rest of the state. These levels hovered between -25% and -35% margins for all six years. These charts show that government hospitals all over California are having far more financial trouble than non-profits and private hospitals, while Tenet hospitals are prospering financially.

In looking at the operating and total margins, it is important to examine the factors contributing to profitability (or lack thereof) within each hospital group. For example, why are Tenet hospitals faring so much better in terms of profitability, and how are they able to grow at the pace they are without facing financial difficulty? To explore this question, it is necessary to examine the differences between revenues and expenses for each hospital group.

Table 1a. Net Patient Revenue per Adjusted Patient Day, Los Angeles County, 1995-2000

	1995	1996	1997	1998	1999	2000	1995-2000 (% change)
Investor	$1,144	$1,096	$945	$947	$982	$995	-13.0%
Tenet	$1,431	$1,267	$1,226	$1,327	$1,320	$1,379	-3.7%
Government	$1,130	$1,178	$1,378	$1,524	$1,505	$1,525	35.0%
Non-Profit	$1,133	$1,144	$1,142	$1,139	$1,162	$1,203	5.2%

Table 1b. Net Patient Revenue per Adjusted Patient Day, Rest of California, 1995-2000

	1995	1996	1997	1998	1999	2000	1995-2000 (% change)
Investor	$1,225	$1,222	$1,136	$1,161	$1,158	$1,206	-1.5%
Tenet	$1,395	$1,335	$1,383	$1,420	$1,442	$1,558	11.6%
Government	$998	$1,036	$1,128	$1,259	$1,258	$1,267	27.0%
Non-Profit	$1,152	$1,180	$1,199	$1,217	$1,233	$1,285	11.5%

In both Los Angeles and the rest of California, government hospitals experienced the largest increase in average net patient revenue per adjusted patient day (Tables 1a and 1b). Tenet hospitals, government hospitals, and non-profit hospitals had increases in net patient revenue per day from 1995-2000 in the rest of California, while investor-owned hospitals displayed a loss. However, in Los Angeles, investor-owned and Tenet-owned hospitals showed a decrease in revenue per adjusted patient day, while government hospitals and non-profits showed increases in net patient revenue per adjusted patient

day. For Tenet, this is largely due to the fact that they acquired more hospitals with lower net patient revenue per day, which caused their average to decline, rather than a true reduction in average patient revenue.

While revenue per adjusted patient day increased most at government hospitals, expenses per adjusted patient day increased at an even higher rate for government hospitals in Los Angeles and the rest of the state (Tables 2a and 2b). Tenet was actually able to decrease its average operating expenses per patient day. In Los Angeles County, Tenet's net patient revenue per day decreased by 3.7%, but their expenses decreased by 17.5% from 1995-2000. In contrast, government hospitals in Los Angeles County had an increase in revenue of 35% (from $1,130 to $1,525) from 1995-2000, but they ended up spending 47.2% more per day (from $1,540 to $2,267); by 2000, government hospitals were losing over $750 per adjusted patient day in Los Angeles County.

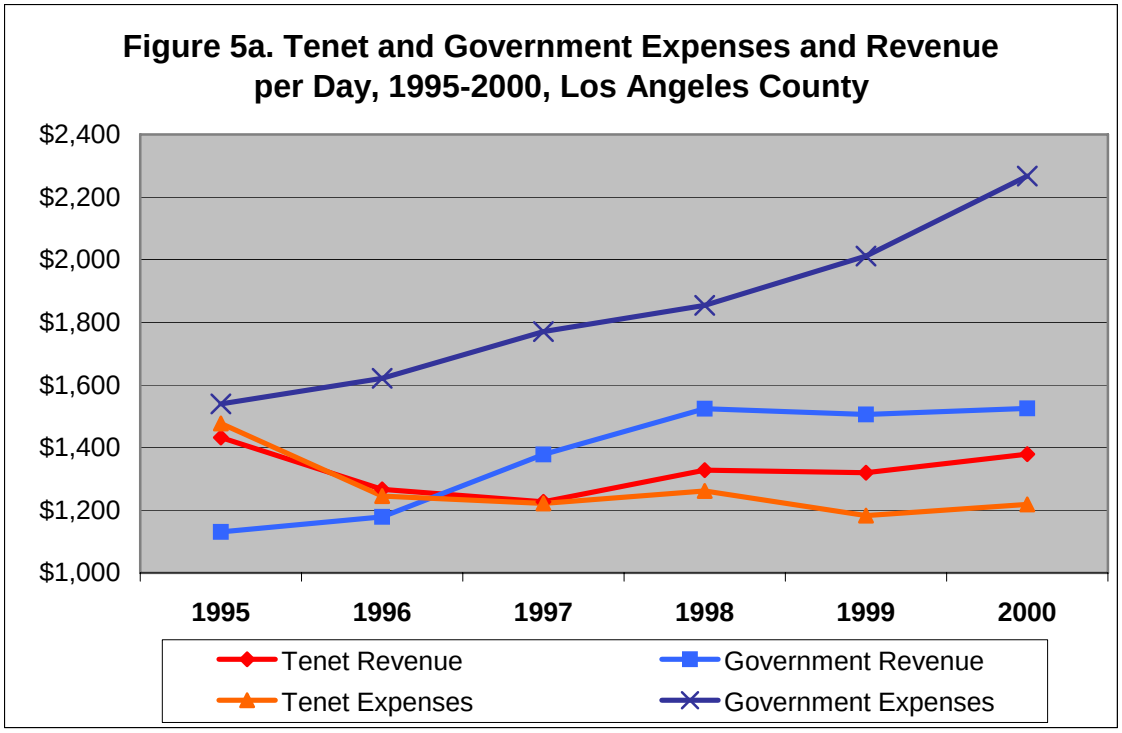
Table 2a. Total Adjusted Operating Expenses per Adjusted Patient Day, Los Angeles County, 1995-2000

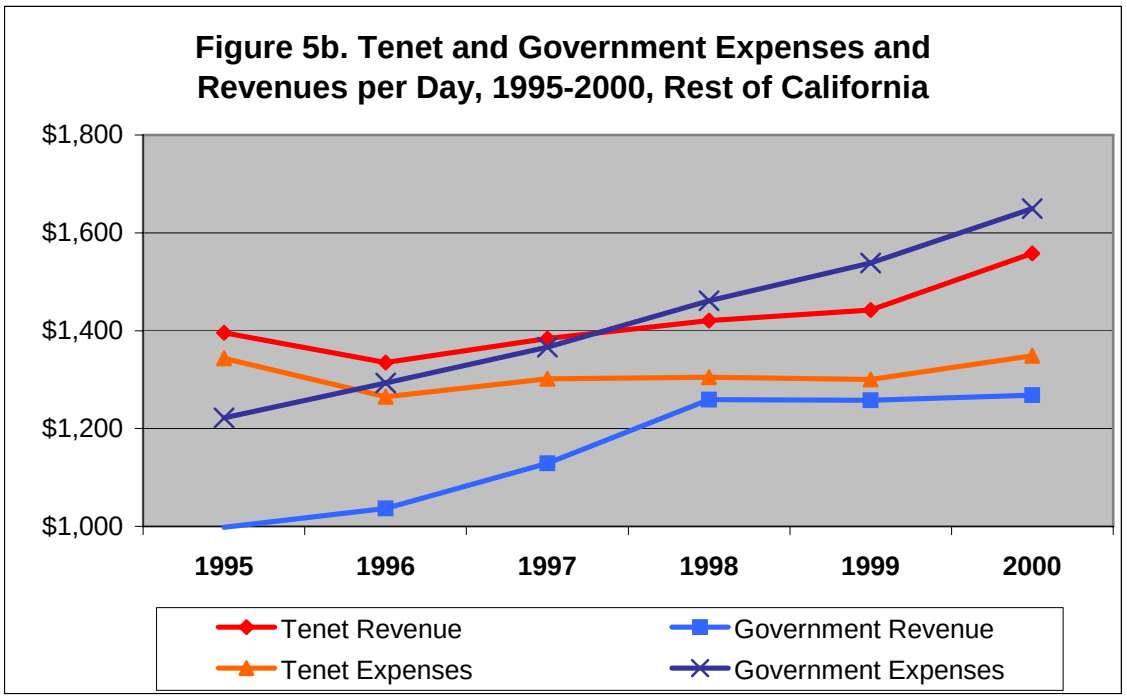
	1995	1996	1997	1998	1999	2000	1995-2000 (% change)
Investor	$1,121	$1,014	$928	$942	$990	$1,046	-6.6%
Tenet	$1,477	$1,245	$1,221	$1,261	$1,183	$1,219	-17.5%
Government	$1,540	$1,622	$1,771	$1,854	$2,011	$2,267	47.2%
Non-Profit	$1,170	$1,071	$1,070	$1,200	$1,242	$1,281	9.5%

Table 2b. Total Adjusted Operating Expenses per Adjusted Patient Day, Rest of California, 1995-2000

	1995	1996	1997	1998	1999	2000	1995-2000 (% change)
Investor	$1,198	$1,187	$1,174	$1,201	$1,228	$1,247	4.1%
Tenet	$1,343	$1,265	$1,302	$1,305	$1,300	$1,349	0.4%
Government	$1,222	$1,293	$1,366	$1,461	$1,538	$1,649	35.0%
Non-Profit	$1,183	$1,221	$1,218	$1,260	$1,302	$1,345	13.8%

As shown in the Figures 5a and 5b, the gap between expenses and revenue among government hospitals in Los Angeles continues to grow from 1995 to 2000, so that by 2000, expenses per day exceeded revenue per day by over $750. Operating expenses in Tenet hospitals were fairly stable, while government hospitals in Los Angeles faced a serious problem of rising expenses without sufficient growth in patient revenue.





In the rest of California, government hospitals have much lower expenses per patient day. Nevertheless, government hospitals throughout the state have higher expenses than revenue.

Why Are Tenet-Owned Hospitals Financially Successful?

In the prior sections, the data showed that Tenet hospitals have higher operating margins and total margins than any other group of hospitals and that these higher profit margins were primarily due to relatively high patient revenue and low operating expenses.

Why is it that Tenet hospitals were able to achieve and maintain these profit margins during a period when every other hospital group (investor owned, government, and non-profit hospitals) in Los Angeles County and the rest of California have struggled to maintain positive margins? One factor that is largely responsible for Tenet's ability to achieve high profits in the current healthcare market is the Disproportionate Share Hospital (DSH) payment system.

This program provides subsidies to hospitals that care for large proportions of uninsured and Medi-Cal populations. The program is partially funded through payments from participating government hospitals as well as the state Medi-Cal and federal Medicare programs. In California, DSH transfers are made to the DSH fund, and the hospitals that pay in, as well as some other hospitals, receive money from that fund. For example, a government or non-profit hospital may pay into the DSH fund $10 million. Then, depending on the amount of uncompensated care and Medi-Cal services they provide, they may receive $20 million. Tenet-owned and other investor-owned hospitals may receive DSH payments, but they are not required to pay into the fund.

As Figure 6a shows, government hospitals receive the bulk of DSH funds, because they handle the largest proportions of uninsured and Medi-Cal patients. Tenet hospitals, while they do not care for a significant portion of the uninsured or Medi-Cal patients, were able to increase their DSH revenue by almost 70% in Los Angeles County between 1998 and 2001. A recent study conducted by the UCLA Center for Health Policy Research concluded that Tenet hospitals were able to increase their DSH revenues by actively pursuing expectant mothers that qualified for Medi-Cal and by inflating their charges for charity care, bad debt, and indigent care.[4]

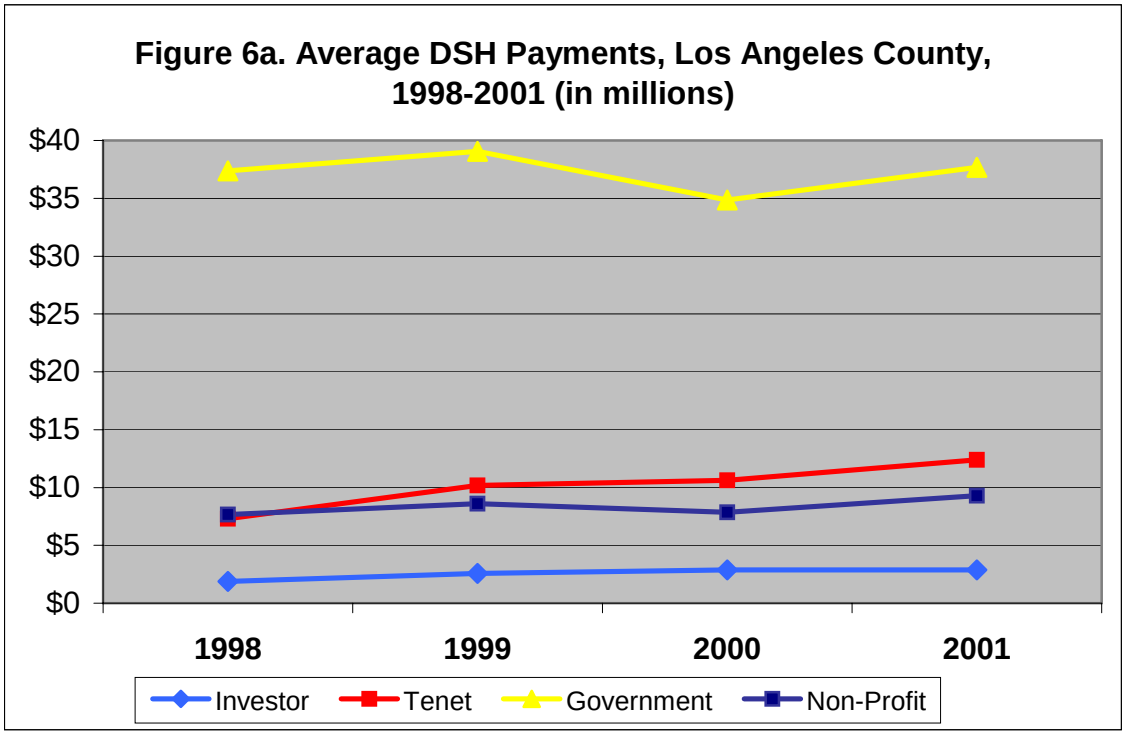
That study, using OSHPD data and Department of Health Services data on DSH payments from 1998-2001, looked at two major components of Tenet's DSH pattern of admissions:

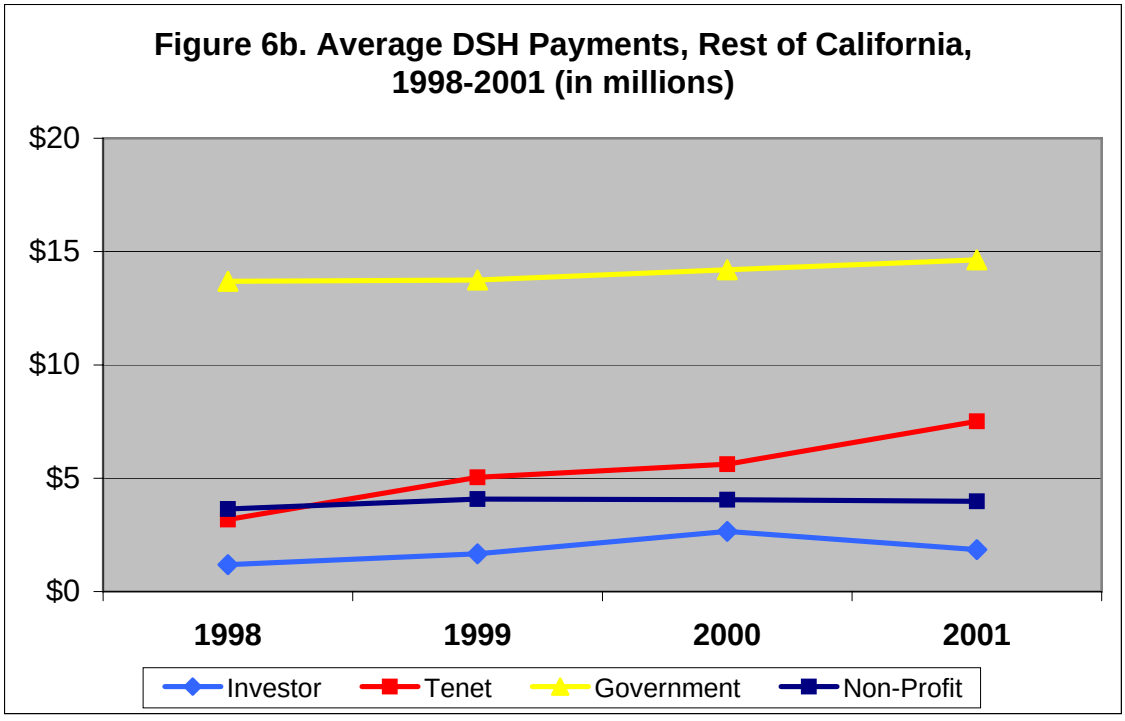
(1) The characteristics of the patients they treat, and
(2) The expenditures spent caring for those patients.

An interesting finding is that 75% of Tenet's Medi-Cal patients in the state were pregnant women or newborn babies. Because babies count as separate patients, Tenet hospitals received twice as many DSH 'credits' for caring for a mother and her newborn as other hospitals would receive for caring for a sicker, more expensive cancer patients on Medi-Cal. Mothers and their newborns normally have very predictable, inexpensive needs

[4] GF Kominski. *Tenet Medi-Cal Disproportionate Share Hospitals: High on Profits, Low on Patient Care Benchmarks*. UCLA Center for Health Policy Research, September 2003.

while receiving care, but the Medi-Cal and Medicare DSH payment formulas do not adjust for the relative severity of the patient treated by DSH hospitals.





As Figure 6a shows, DSH payments to hospitals in Los Angeles made up a significant

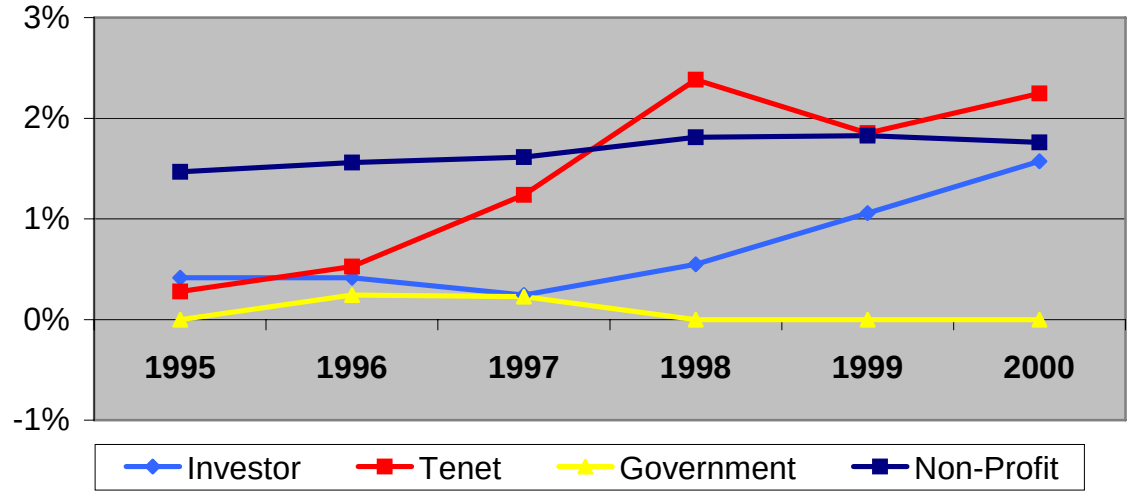
amount of revenue. In Los Angeles, Tenet hospitals showed an increase from 1998 to 2001 of almost 70%, while government hospitals were fairly stable. Non-profits showed a slight increase (21%) and other investor-owned hospitals had a 53% increase (partially due to the fact that their starting point was only $1.8 million in 1998).

Figure 6b indicates a similar trend in the rest of California. Tenet hospitals increased their DSH revenue by 136%, while investor-owned hospitals showed a 55% increase and non-profit and government hospitals had less than 10% DSH revenue growth between 1998 and 2001.

The Uninsured, Charity Care, Bad Debt, and Access to Care

The volume of uncompensated care, bad debt, and charity care is an important determinant of a hospital's ability to provide care and maintain services while remaining financially viable.[5] As Figures 7a and 7b show, charity care expenses were on the rise in Tenet hospitals and investor-owned hospitals, while they remained fairly stable in government and non-profit hospital settings. In Los Angeles, charity care cases in government hospitals are automatically moved into the county indigent care pool, so no charity care is usually shown for those patients, unless they come from outside of the county or medical service area. However, in California, government hospitals had larger charity care levels than any other type of hospital.

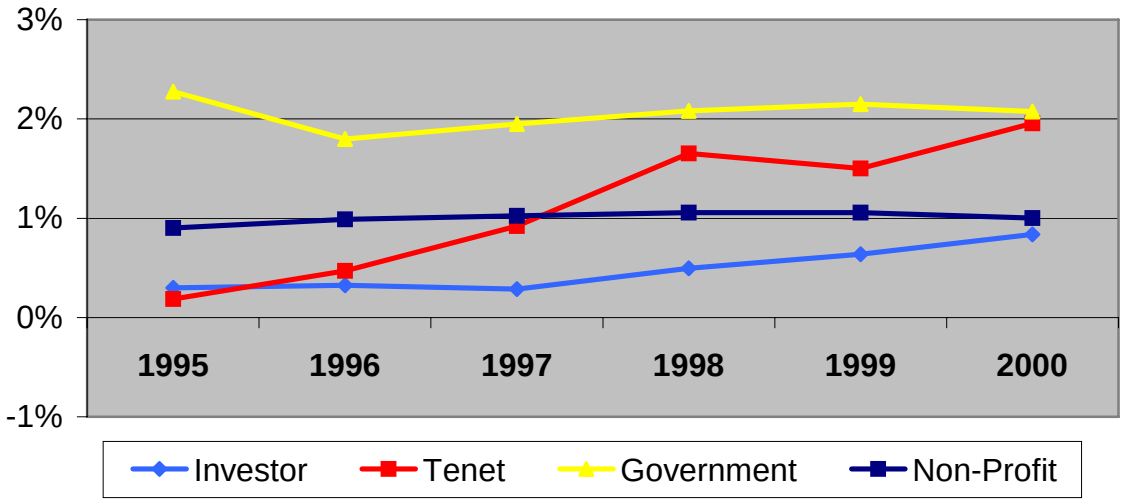
Figure 7a. Adjusted Charity Care Expenses* as a Percentage of Total Operating Expenses, 1995-2000, Los Angeles



*These expense figures were adjusted by a Case Mix Index (CMI) for each hospital created by the California Office of Statewide Health Planning and Development.

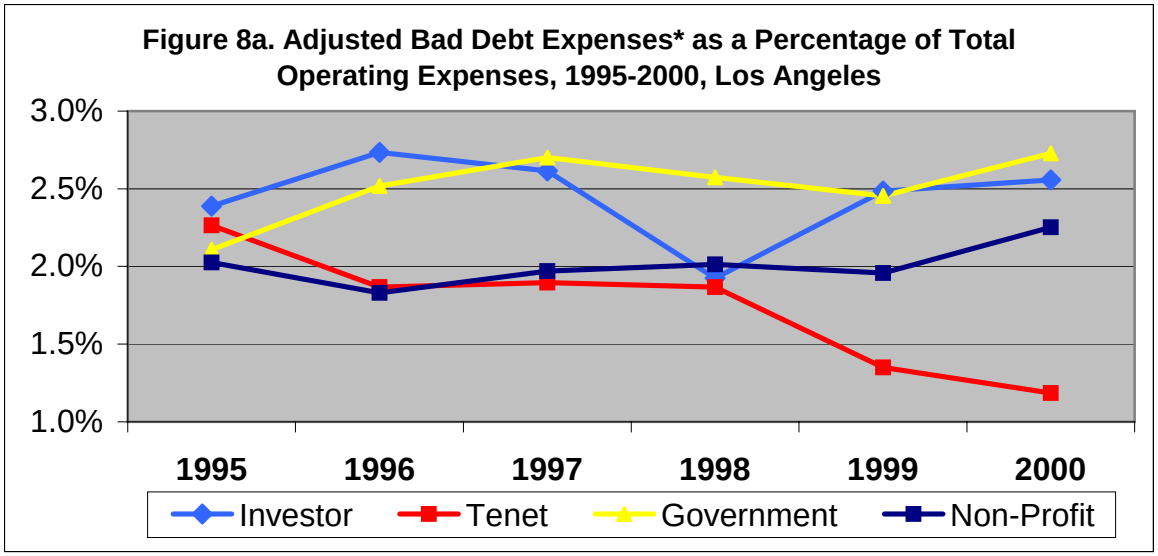
[5] A Markus, D Roby, S Rosenbaum. *A Profile of Federally Funded Health Centers Serving a Higher Proportion of Uninsured Patients*. Kaiser Commission on Medicaid and the Uninsured, June 2002.

Figure 7b. Adjusted Charity Care Expenses* as a Percentage of Total Operating Expenses, 1995-2000, Rest of California

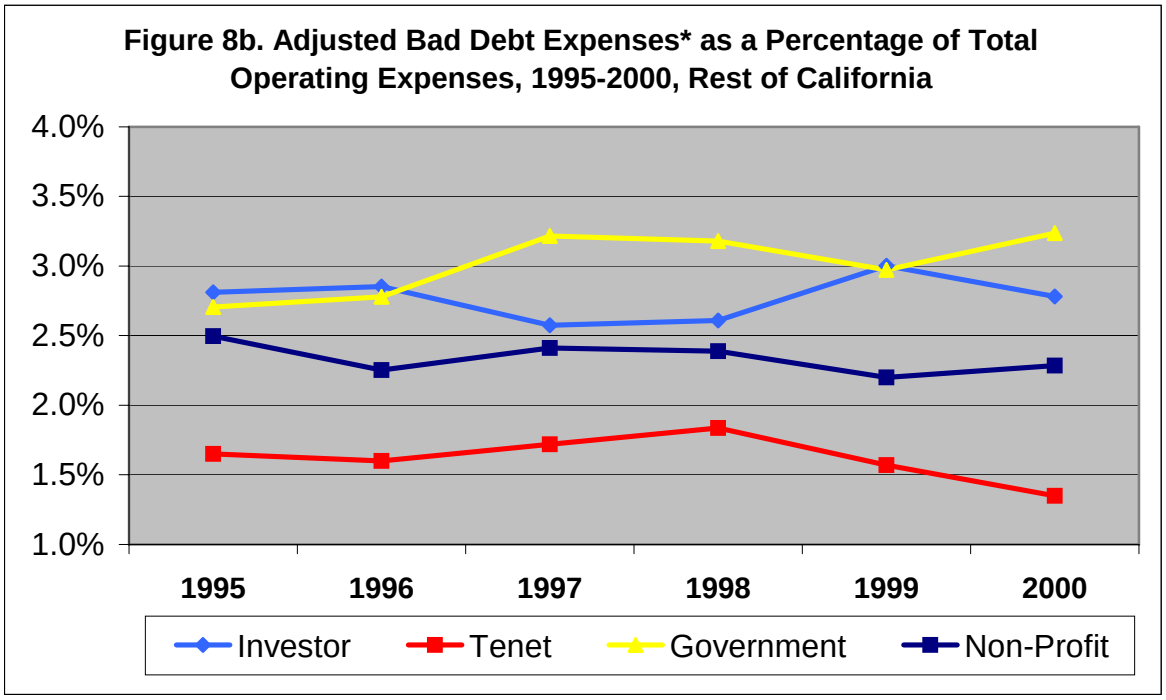


*These expense figures were adjusted by a Case Mix Index (CMI) for each hospital created by the California Office of Statewide Health Planning and Development.

The most noticeable trend in Figures 8a and 8b is that Tenet-owned hospitals have much lower bad debt levels than other hospital types. Bad debt usually is an indicator of how much uncompensated care a hospital provides; it is the amount of revenue that is expected from patients, but is not received and thus written-off as a loss. Between 1995 and 2000 in Los Angeles, Tenet hospitals showed a decrease in bad debt from over 2% of total operating expenses to almost 1%. During the same period, government, non-profit, and investor-owned hospitals hovered above 2%. Two possible explanations account for the decline in Tenet's bad debt. As shown in Figure 7a, Tenet's charity care increased substantially during this period, suggesting that they were more aggressive in identifying patients as charity care at time of admission. Another possibility is that Tenet was more aggressive in pursuing collections, particularly among self-pay patients, and thus was able to reduce its bad debt. In the rest of California, the trend was very similar, Tenet hospitals decreased to close to 1% while government hospitals reached the 3% mark.



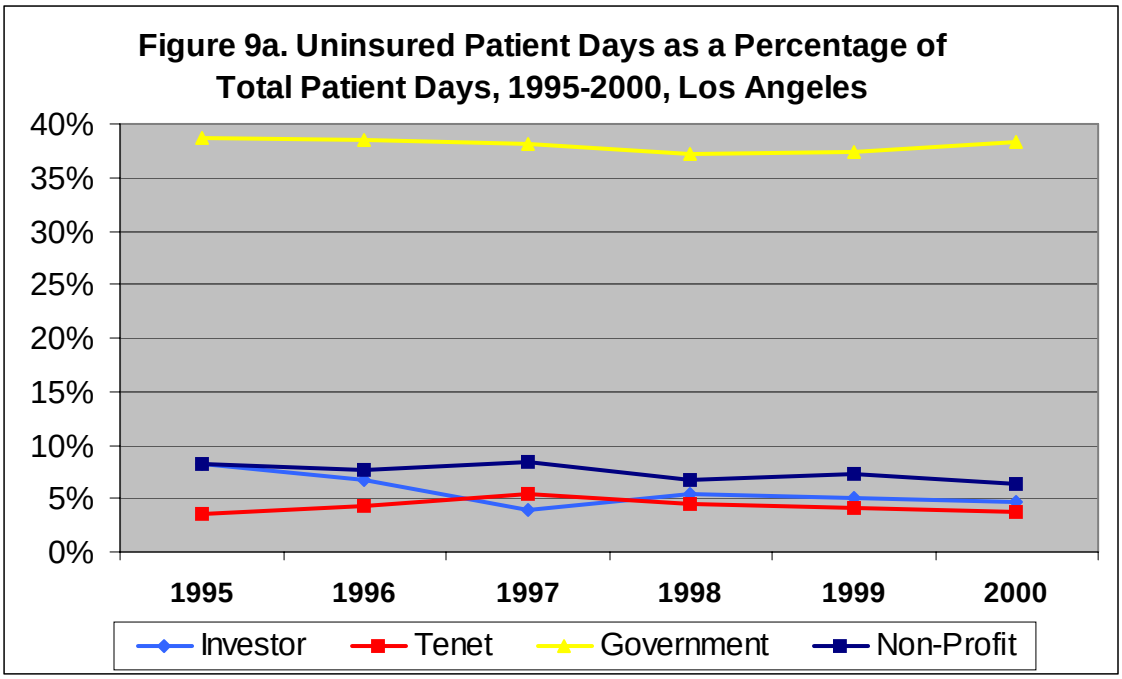
*These expense figures were adjusted by a Case Mix Index (CMI) for each hospital created by the California Office of Statewide Health Planning and Development.



* These expense figures were adjusted by a Case Mix Index (CMI) for each hospital created by the California Office of Statewide Health Planning and Development.

As shown in Figures 9a and 9b, government hospitals provide a substantial amount of care for uninsured patients compared to all other hospitals, both in Los Angeles and the rest of the state. In Los Angeles County, uninsured patient days make up almost 40% of total patient days in government hospitals, but only about 5% in all other hospitals. Tenet hospitals, which receive the largest portion of DSH payments after government hospitals, show the lowest levels of uninsured care, ranging from 3.4% to 3.7% from 1995 to 2000.

In the rest of the state, as shown in Figure 9b, uninsured patient levels are somewhat lower for government hospitals compared to Los Angeles County government hospitals, but still substantially greater than all other hospitals.



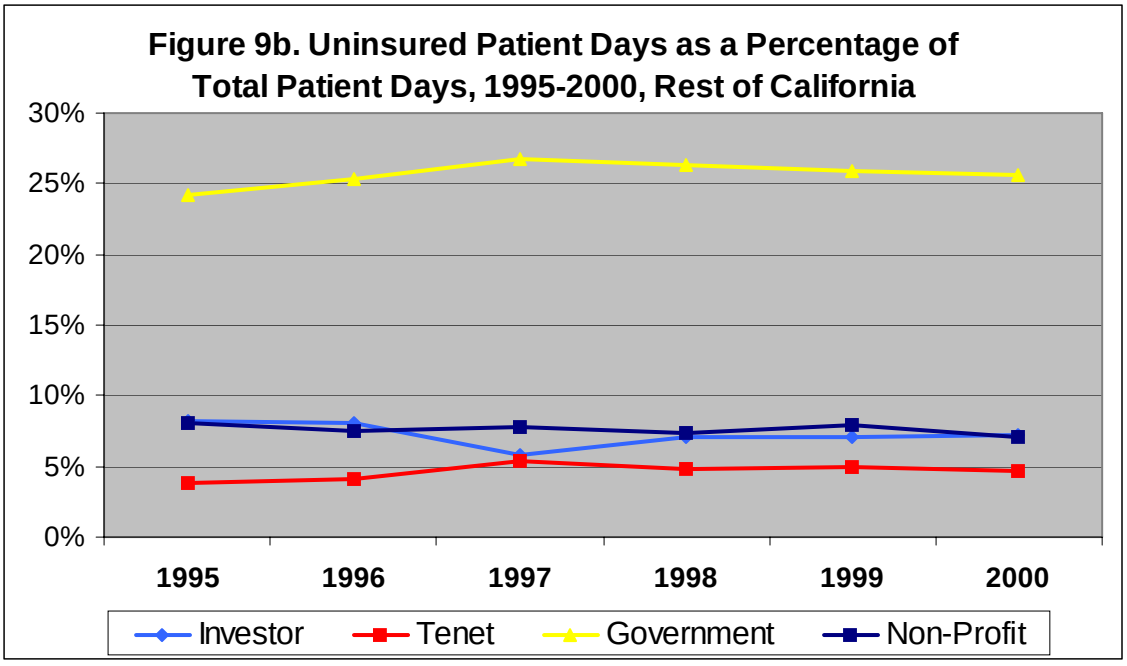


Figure 10a. Average Case-Mix Index, Los Angeles, 1995-2000

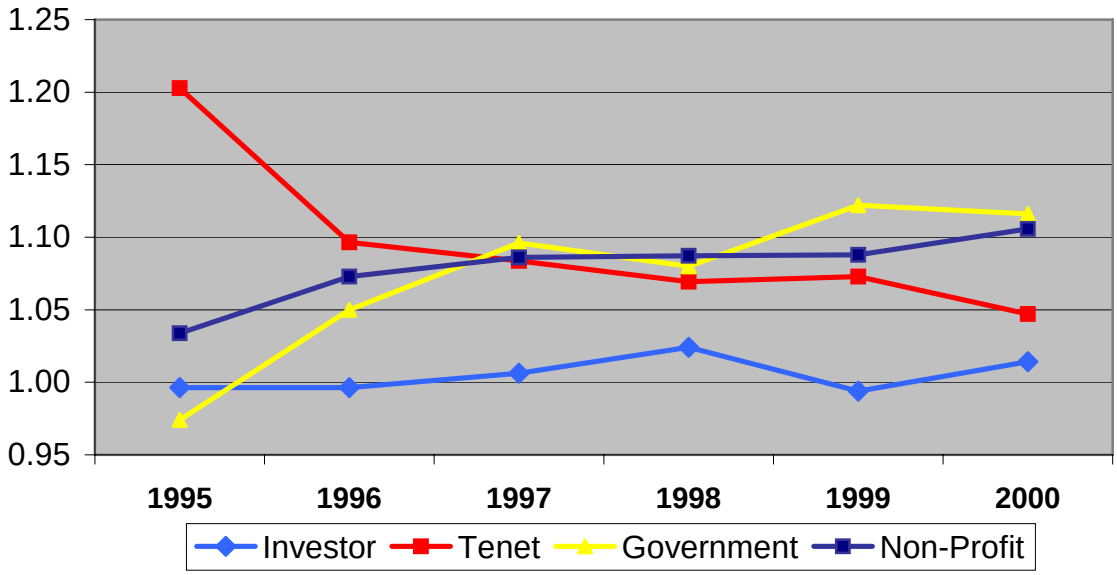
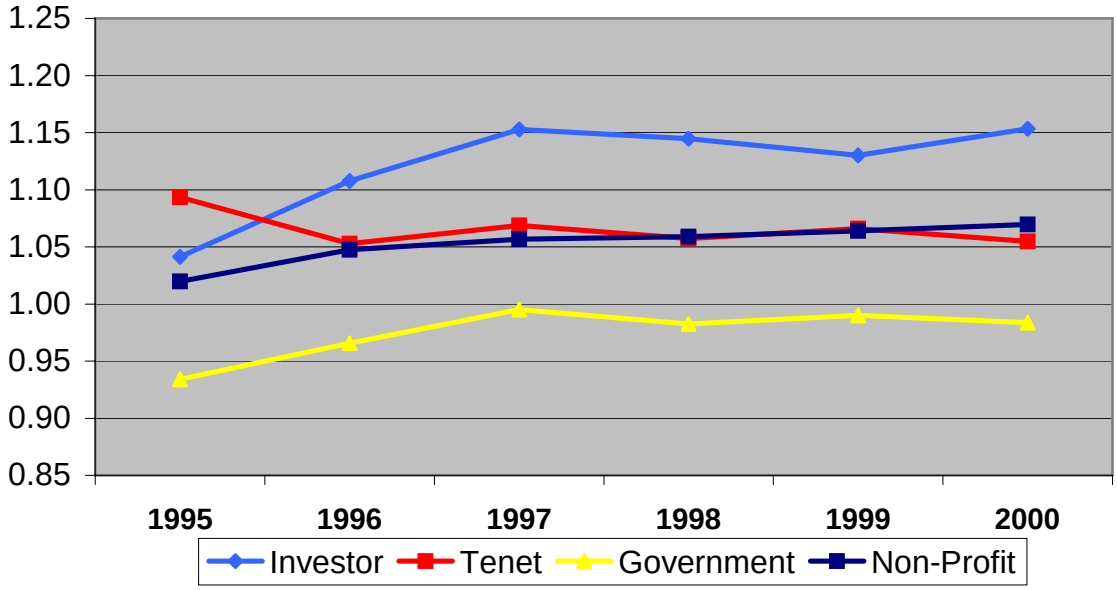


Figure 10b. Average Case-Mix Index, Rest of California, 1995-2000



As shown in Figures 10a and 10b, the average case-mix index (CMI) of non-profit and government hospitals in Los Angeles County continuing to rise form 1995-2000, but dropped precipitously in Tenet hospitals. This finding is consistent with the evidence discussed earlier that Tenet is targeting Medi-Cal admission for normal delivery as a

strategy for increasing DSH payments. These cases at generally among the least severe as measured by the CMI, so increasing the volume of these cases would generally result in a reduction in the hospital's CMI.

Conclusions

This study examines trends in hospital costs and revenues to determine how hospitals in Los Angeles County and the rest of California have responded to a variety of financial challenges during the period from 1995-2000. This period is a particular interest because one major hospital for-profit chain – Tenet – substantially increased its market share within Los Angeles County. During a period of rapid market consolidation, a number of potential spill-over effects might be expected to occur in the market place. One possibility is for the new market leader to exercise its market power by negotiating higher prices from third-party payers. Although Tenet was able to increase its revenue per adjusted patient day in the rest of California, its revenue per adjusted patient day actually fell in Los Angeles County due to a change in its mix of hospitals; Tenet obtained hospitals that had lower average severity and thus lower revenues per adjusted patient day.

Another consequence of rapid consolidation may be a substantial reduction in expenses due to greater efficiencies of a large chain, where many administrative and operating expenses can be lowered through economies of scale and aggressive purchasing practices. Clearly, Tenet engaged in aggressive cost cutting, both in Los Angeles and the rest of California, and this contributed to its relatively high profit margins during 1995-2000. This is clearly one of the potential advantages of hospital chains, namely, that they can achieve greater efficiency than stand-alone facilities.

Finally, another consequence of market consolidation may be pursuit of revenue maximization, including aggressive collection practices targeted to self-pay patients and aggressive pursuit of government reimbursement formulas. Tenet appears to have pursued this strategy to an extreme degree, particularly with regard to Medicare payment for hospital outlier payments, and has faced substantial fines from the federal Centers for Medicare and Medicaid Services for rapid increase in outlier patients.[6] Although less well documented, this report and the companion study of DSH payments,[7] shows that Tenet's profit margins grew during the 1995-2000 period because of its rapid increase in DSH payments, while other hospitals in Los Angeles County and the rest of California showed no growth in these payments. Yet during this same period, Tenet's share of uninsured patient days declined and remained the lowest of any hospital group. Thus, at a time when the County's health care system has faced substantial financial threats, Tenet was successful in rapidly increasing its DSH payments without any increase in uninsured patient days and with a large decline in the average severity of its patient mix. These trends suggest that the primary beneficiaries of concentration in the hospital market in

[6] See, for example, summary of Tenet's response to the Balanced Budget Act of 1997 at **http://www.calnurse.org/cna/press/111302.html**.

[7] GF Kominski. *Tenet Medi-Cal Disproportionate Share Hospitals: High on Profits, Low on Patient Care Benchmarks*. UCLA Center for Health Policy Research, September 2003.

Los Angeles County were the shareholders of Tenet stock, although these gains have largely eliminated during the past 12 months since Tenet has been the target of multiple investigations. Nevertheless, Los Angeles County government hospitals continue to struggle financially while a greater portion of DHS payments continue to go to Tenet hospitals. Unless limitations in the formula for distributing DSH payments are addressed by the state legislature, the efficiencies associated with hospital concentration may continue to be offset by the costs imposed on the public sector by aggressive revenue maximization practices.

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