Laboratory Finance
101 AND BEYOND

Jane M. Hermansen MBA, MT(ASCP)
MANAGER, OUTREACH AND NETWORK DEVELOPMENT
MAYO CLINIC, ROCHESTER, MINNESOTA
Learning Objectives

Upon completion of this session, you will be able to:

• Define commonly-used financial terms and how they can be applied within the laboratory
• Analyze laboratory costs through accurate cost accounting
• Describe the different laboratory revenue streams and how to measure them; demonstrate laboratory financial contribution
Tri-Relevance in Healthcare

Patient

Clinical

Operational

Financial
Standard Medical Laboratory Scientist Curriculum

- Urinalysis
- Immunology
- Molecular Diagnostics
- Clinical Immunohematology
- Hemostasis
- Clinical Microbiology
- Hematology
- Clinical Chemistry
- Westgard QC & Method Validation
- Clinical experiences

- New Discoveries and Laboratory Management (16 hours)
“One month into my role as a laboratory leader, I realized I needed to go back to school.”
Definitions

Revenue

• **Net revenue**: Revenue that is **collected** for performing laboratory testing
• **Gross revenue**: Revenue that is **charged** for performing laboratory testing; gross revenue is rarely the same as net revenue
• **Capitated revenue**: Fixed, prearranged payment received per patient enrolled in a health plan
• **Bundled revenue**: Payment based on a patient episode; it does not vary based on services provided
Definitions

Cost

- **Variable cost**: Cost that varies with the number of tests performed (e.g., reagent cost)
- **Direct cost**: Cost that can be fully attributed to the performance of a test (e.g., reagent cost and staff time)
- **Fixed cost**: Cost that does not change with an increase or decrease in the number of tests performed (e.g., instrument cost and rent)
- **Indirect cost**: Cost that is not directly related to test production, such as overhead (e.g., institutional allocations)
Revenue minus cost equals....

**Bottom line:** Calculation of profit or loss for a department.

- **Profit:** Financial gain
- **Net Operating Income:** Revenue less any operating expenses
- **Other nuances:**
  - Net Operating Margin
  - Contribution Margin
  - Gross Margin
  - Operating Margin
If your organization uses terms that you don’t understand, ask for an explanation
Cost Accounting

<table>
<thead>
<tr>
<th>Direct</th>
<th>Indirect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reagents</td>
<td>Electricity</td>
</tr>
<tr>
<td>Labor</td>
<td>Building</td>
</tr>
</tbody>
</table>

- Variable
- Fixed
Institutional overhead can wreak havoc on the bottom line of an outreach program
Do Volumes Matter?

Considerations:
• Fixed costs remain flat
• Variable costs increase proportionally with volume
Laboratory Revenue Streams and Payors

WHAT AND WHO

Revenue Streams
- Inpatient
- Outpatient
- Outreach
- Institutions (hospitals, skilled nursing facilities)
- Community (industrial medicine, health fairs, etc)
- Other (employee health service, research, etc)

Payors
- Government (CMS/Medicaid)
- Independent health plans (insurance company)
- Patient self-pay
- Client/institutional bill
Reimbursement Models

WITHIN A HOSPITAL OR HEALTHCARE SYSTEM

Fee-for-Service
• Patients (or insurance) are charged per the cost of each individual service or product that a physician orders

Capitated
• Bundled payment (Episode of Care)
• DRG
• OPPS

Value-Based
• Episode of Care
• Shared savings programs
• Pay-for-Coordination
• Pay-for-Performance

Getting accurate and discrete revenue for laboratory testing can be a challenge.
Data: Hidden, difficult, but not impossible
Estimate laboratory revenue by applying payor contractual allowance to gross charges
Application of Financial Terms

DAILY USE

Budget
- Revenue
- Costs (routine)
  - Supply
  - Staff
  - Services
- Costs (one-time, unexpected)
- Variation (seasonal, other)

Outreach
- Revenue
- Profit (NOI)
- Volume impact on reducing cost

ROI/Make-or-Buy
- Expand technical platform and capabilities
- Other strategic investments
- Insourcing (reduce sendouts)
Prioritizing Revenue Growth over Cost-Cutting

• “Revenue growth overtook cost control as executives' top priority... While administrators still aim to develop nuanced strategies to cut costs, their focus is now on improving ambulatory access, minimizing clinical variation, boosting primary-care alignment and adapting to population health.”

• "They still haven't taken their foot off cost-cutting, but they can't cut their way out of this economic challenge. They need a balanced margin-management strategy."

~Modern Healthcare, June 12, 2019
Achieve Financial Stability

MIND THE MONEY

• Clean billing practices:
  o Reduce revenue rejections and delays
  o Improve billing practices

• Expand laboratory service
  o Increase test menu complexity

• Manage costs
Financial literacy is a critical skill for laboratory leaders
Transform your Laboratory from Commodity to High-Value Contributor

- Clinical
  - Centers of Excellence
- Operational
  - Optimize staffing, technology
- Financial engine
  - Outreach NOI >30%
  - Monitor KPIs and metrics
- Value-Based Initiatives
  - Control costs
  - Retain revenue
Data is the currency of the laboratory
Learning Objectives - Review

The session is complete! Can you do the following?

✓ Define commonly-used financial terms and how they can be applied within the laboratory
✓ Analyze laboratory costs through accurate cost accounting
✓ Describe the different laboratory revenue streams and how to measure them; demonstrate laboratory financial contribution
Next Steps to Retain Financial Relevance

1. Focus on the Patient
   • Engage
   • Enable
   • Empower

2. Retain and Use your Data
   • Patient Clinical (HEDIS) data
   • Manage population health
   • Drive and support wellness

3. Clinical Decision Support
   • Reduce Waste
   • Manage Utilization

4. Deliver and Communicate Financial Value
   • Net contribution (NOI)
   • Total Cost of Care
Acknowledgements

Contact Information:

• Jane M. Hermansen MBA, MT(ASCP)
  CLMA Past-President
  Manager, Outreach and Network Development
  Mayo Clinic, Rochester, Minnesota
  hermansen.jane@mayo.edu  507-284-3557

References:
