HEALTH CAPITAL GROUP

Health Capital Group White Paper

Comparing the Financial Health and Charitable Care of 340B and Non-340B Hospitals

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Executive Summary

- The majority of not-for-profit hospitals in the US participate in the 340B Drug Pricing Program, enabling them to generate tens of billions of dollars in profits from paid sales of prescription drugs that are procured at a steep discount from manufacturers.[1] The distribution of those profits across hospitals and the share of the profits that make their way to patients are unknown both to the public and policymakers.
- Medicare Part B, Medicaid managed care, and Affordable Care Act (ACA) health plans often reimburse 340B entities and their contract pharmacy partners for 340B drugs at a significant markup to the 340B drug acquisition cost.[2] The 340B program thus generates significant indirect costs for taxpayers, though such expenses are not identified directly in the federal budget.[3]
- Although non-profit status is a program eligibility requirement for hospitals to participate, the 340B program does not differentiate between profitable and unprofitable hospitals. The program has grown exponentially since it began, generating additional profits for both unprofitable and very profitable hospitals. It is a useful exercise for policymakers to understand the relative financial health of the full spectrum of 340B participants so that they may consider whether the program is still delivering on its original intent. We find that in 2021, the top-performing quintile of 340B hospitals generated operating margins

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1 Masia N, "340B Drug Pricing Program: Analysis Reveals $40 Billion in Profits in 2019." https://340breform.org/wp-content/uploads/2021/05/AIR340B-Neal-Masia-Report.pdf.

2 https://www.gao.gov/assets/gao-15-442.pdf. Medicare Part B reimburses 340B hospitals at ASP plus 6 percent regardless of the price the 340B hospital paid for the prescription drug; https://www.gao.gov/products/gao-18-480. Some covered entities compensate contract pharmacies based on a percentage of the revenue generated from each prescription, in addition to a flat fee.

3 CMS. 2024 Medicare Parts A & B Premiums and Deductibles. https://www.cms.gov/newsroom/fact-sheets/2024-medicare-parts-b-premiums-and-deductibles. CMS attributed the increase in the 2024 standard Part B premium and deductible in part to the repayment for 340B-acquired drugs under the Hospital Outpatient Prospective Payment System; MedPAC. https://www.medpac.gov/document/http-www-medpac-gov-docs-default-source-reports-june-2015-report-to-the-congress-medicare-and-the-health-care-delivery-system-pdf. MedPAC has noted that, although 340B hospitals are able to purchase outpatient medicines at a steep discount, beneficiary cost sharing in Medicare Part B is based on the default payment rate, typically ASP plus 6 percent; Conti R, Bach P. Cost consequences of the 340B drug discount program. JAMA. https://jamanetwork.com/journals/jama/fullarticle/1680369.

of nearly 21% - almost identical to the performance of the top quintile of non-340B hospitals, and significantly higher than the average operating margin for non-340B hospitals of approximately 6%.

- One important determinant of financial health is commercial pricing power. While 340B hospitals are likely to treat a lower share of commercially insured patients than non-340B hospitals, we test whether this potentially weaker commercial position translates into inferior pricing power. Using commercial pricing data collected by Turquoise Inc., we examine a list of "shoppable services" as defined by the Centers for Medicare and Medicaid Services (CMS) and find that 340B hospitals, on average, are not at a disadvantage despite their relatively lower commercial revenues; in fact, we find that commercial prices at 340B hospitals are somewhat higher than at non-340B hospitals, with the most profitable 340B hospitals enjoying a commercial price advantage of over 5% compared to their non-340B counterparts.

- We also compare charity care for 340B and non-340B hospitals. Charity care is the share of hospital revenue devoted to covering some or all of the cost of care for patients who meet the hospital's financial assistance policy.[4] Consistent with prior research, we find that 340B participation is not associated with any increase in charity care for 340B hospitals, on average.[5] In fact, the top quintile of 340B hospitals based on operating margins earn $9.92 in profit for every dollar they spend on charity care compared to $7.51 for the top quintile of non-340B hospitals.

- The most profitable 340B hospitals provide roughly the same amount of charity care as bottom performing 340B hospitals. That is not the case for non-340B hospitals, which exhibit a linear relationship between operating margins and charity care. We find that the top quintile of 340B hospitals by operating margin generate 85% of all 340B hospitals' profits, but only provide 24% of all charity care provided by 340B hospitals.

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4 CMS. Medicare Provider Reimbursement Manual, July 28, 2023, https://www.hhs.gov/guidance/sites/default/files/hhs-guidance-documents/R21P240i.pdf.

5 Ho V, Jenkins D. "Nonprofit Hospitals: Profits and Cash Reserves Grow, Charity Care Does Not." *Health Affairs*. https://www.healthaffairs.org/doi/10.1377/hlthaff.2022.01542.

- The contrast between the financial performance (in terms of operating margins and pricing power) exhibited by many 340B hospitals and their undistinguished charitable care performance should raise significant questions about whether the benefits of the 340B program are being directed to the intended recipients, i.e., low-income patients.

340B: Policy Context

The 340B Drug Pricing Program (340B) was created by Congress in 1992 and requires that all drug manufacturers participating in Medicaid and Medicare Part B sell covered outpatient drugs to 340B "covered entities" at significantly discounted prices. 340B is administered by the Health Resources and Services Administration (HRSA), part of the US Department of Health and Human Services.

Drug manufacturers provide deeply discounted 340B covered outpatient drug inventory and the covered entities are reimbursed by private payers at whatever price the market will bear, frequently through contract pharmacies.[6] Payers may or may not have visibility into whether a particular prescription is filled with 340B inventory. The program is generally invisible to patients, who may be 340B-eligible if they have had an existing relationship with the 340B covered entity and other requirements are met. These relationships are often identified retrospectively by increasingly sophisticated software algorithms after the prescriptions are filled.

In 2010, the Patient Protection and Affordable Care Act (ACA) expanded the categories of hospitals eligible to participate in 340B and also sharply increased Medicaid's role in health coverage.[7] One important way hospitals can qualify as a 340B covered entity is by treating a certain proportion of Medicaid inpatients, so many hospitals became eligible either by treating more newly-eligible Medicaid inpatients or by meeting expanded 340B eligibility criteria under the ACA. As a result, the number of 340B hospitals increased sharply. Between 2010 and 2023,

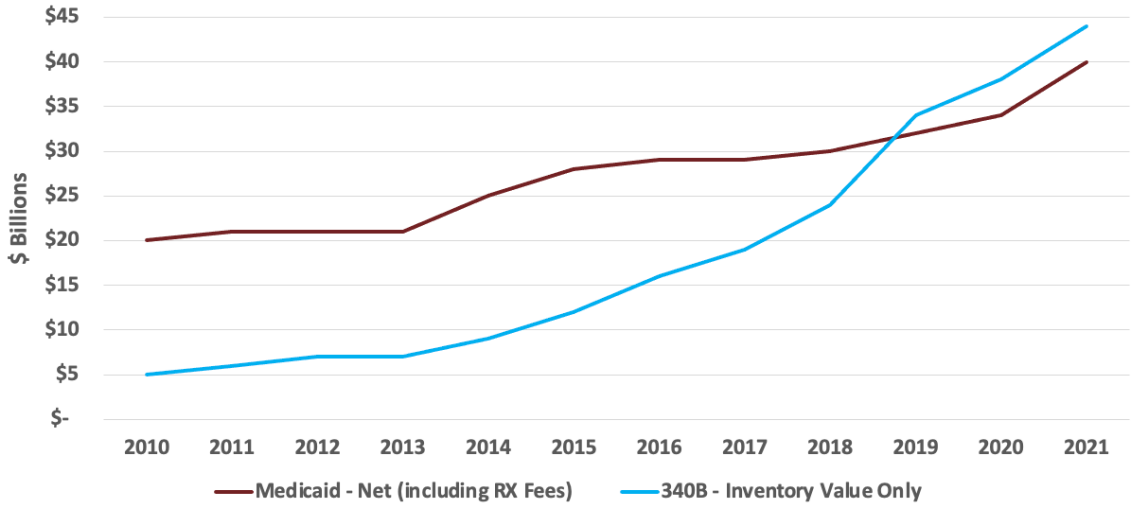
6 Medicare Part B reimburses at ASP plus 6 percent for 340B drugs. Medicaid fee-for-service reimburses for 340B drugs at acquisition cost.

7 In 2010, the Patient Protection and Affordable Care Act expanded 340B eligibility and drug discounts to children's hospitals, freestanding cancer hospitals, rural referral centers, critical access hospitals and sole community hospitals. 42 U.S.C. § 256b(a)(4)(M)-(O); See Office of the Legislative Counsel. Patient Protection and Affordable Care Act (Public Law 111–148). Published online May 2010. https://www.hhs.gov/sites/default/files/ppacacon.pdf.

the number of 340B hospitals rose from 1,365[8] to more than 2,600.[9] The majority of non-profit hospitals are now 340B hospitals.[10]

As the number of participating entities has risen exponentially over the past decade, the sale of inventory at 340B prices has similarly grown exponentially, reaching $54 billion in 2022.[11] 340B retail sales are now significantly higher than net purchases to the entire Medicaid program. Figure 1 shows the extremely rapid growth in 340B inventory purchases in recent years, even compared to rapid spending growth in Medicaid (due largely to increased Medicaid enrollment).

Figure 1. 340B Inventory Value vs. Net Medicaid RX Spending, 2010 - 2021



Source: NHE files; Drug Channels Institute; Health Capital Group LLC analysis

There is no question whether 340B generates profits for covered entities. Commercial payers, Medicare, Medicaid managed care plans and uninsured patients are all potential sources of profit for covered entities and their contract pharmacy partners. The 340B program does not

8 MedPAC. Report to the Congress. Overview of the 340B Drug Pricing Program. May 2015. https://www.medpac.gov/wp-content/uploads/import_data/scrape_files/docs/default-source/reports/may-2015-report-to-the-congress-overview-of-the-340b-drug-pricing-program.pdf.

9 GAO. 340B Drug Discount Program: Information about Hospitals That Received an Eligibility Exception as a Result of COVID-19. May 2023. https://www.gao.gov/products/gao-23-106095.

10 MedPAC. Report to Congress: Medicare and the Health Care Delivery System. June 2022. Table 3-4. https://www.medpac.gov/wp-content/uploads/2022/06/Jun22_MedPAC_Report_to_Congress_v4_SEC.pdf. 57% of hospitals are now 340B.

11 HRSA. 2022 340B Covered Entity Purchases. https://www.hrsa.gov/opa/updates/2022-340b-covered-entity-purchases.

restrict how covered entities use these direct financial benefits.[12] While 340B is often referred to as "costless" to taxpayers,[13] it is often taxpayers who are reimbursing 340B entities for profit-generating prescriptions through reimbursements from Medicare, Medicaid managed care or other programs.[14] To the extent that such reimbursements could have been lower had they been made based on the 340B acquisition price, taxpayers are subsidizing hospitals' 340B profits. In addition, 340B profits may change prescribing behavior or other healthcare utilization factors which may in turn drive more demand for and spending on taxpayer-funded services.

While one of the original purposes of 340B was to assist safety-net hospitals and clinics serving large populations of low-income and otherwise vulnerable patients, little systematic research has examined the financial performance of 340B hospitals. Our research uses commercial pricing data combined with hospital cost report data to explore the financial strength of 340B hospitals and their non-340B counterparts along with their charity care expenses.

Methods and Data

Since 2021, hospitals have been required to post their negotiated prices for a list of "shoppable services" as defined by CMS.[15] We accessed data collected from roughly 1,000 hospitals by Turquoise, Inc. in Q4 of 2022 and combined that data with annual hospital cost report data for 2021, the most recent year generally available to us. After combining these data sources, we had commercial pricing, operating performance, and detailed characteristic data (e.g., system affiliation, charitable care, 340B status, payer mix, etc.) for just under 1000 hospitals. Table 1 provides some key characteristics across our sample of 340B and non-340B hospitals.

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12 US Government Accountability Office. DRUG DISCOUNT PROGRAM: Federal Oversight of Compliance at 340B Contract Pharmacies Needs Improvement. GAO-18-480. Published June 2018. Accessed February 1, 2021. https://www.gao.gov/assets/700/692697.pdf.

13 See for example, https://www.aamc.org/news/340b and https://www.340bhealth.org/newsroom/becauseof340b.

14 See www.americanactionforum.org/research/the-340b-drug-pricing-program-challenges-and-solutions.

15 See https://www.cms.gov/hospital-price-transparency for details.

Table 1. Sample Characteristics of Hospitals in Our Analysis, 2021

Hospital Type	Count	Avg Operating Margin	Avg Charity Care as % of Rev	Avg Beds	Avg Net Patient Revenue	Avg Share of Revenue from Commercial Payers
Non-340B	372	5.9%	2.5%	168	$ 261,296,530	69.8%
340B	604	5.7%	1.9%	177	$ 346,850,154	63.3%
Total	**976**	**5.8%**	**2.2%**	**174**	**$ 314,241,601**	**65.8%**

Source: Turquoise Inc., CMS Cost Reports, Health Capital Group Analysis

About 62% of hospitals in our sample participate in the 340B program, which aligns with the national average share of hospitals enrolled in the 340B program. Overall operating margins in our sample are similar for 340B and non-340B hospitals, but charity care is lower for 340B hospitals compared to non-340B hospitals. These differences are similar to those found in earlier research.[16] We also note that the average share of revenue from commercial business is 63% for 340B hospitals vs. 70% for non-340B hospitals; this is not surprising given the eligibility criteria for 340B program participation rely partially on the share of Medicaid inpatients treated.

Given that most hospital types qualify for 340B in part based on the share of Medicaid and low-income Medicare inpatients they treat, and given the importance of commercial revenue to profitability, it is somewhat surprising that profit levels at 340B and non-340B hospitals are similar. It appears that 340B hospitals make up for whatever profits they lose due to less favorable inpatient payer mix with a combination of reduced charity care, significant 340B profits and more profitable outpatient care. Since 340B eligibility for most hospital types is based on an inpatient metric, the provision of outpatient care in wealthier areas does not impact a hospital's 340B eligibility. One recent analysis found that 340B hospitals serve a smaller share of safety net populations on an outpatient basis.[17]

[16] See Health Capital Group White Paper, "Measuring the 340B Drug Purchasing Program's Impact on Charitable Care and Operating Profits for Covered Entities," available at https://www.healthcapitalgroup.com/340b-profits-and-charity-care.

[17] See ADVI. Medicare Patient Demographics at 340B Covered Entities. https://www.advi.com/insight/medicare-patient-demographics-at-340b-covered-entities.

Operating Performance for 340B and non-340B Hospitals

We have previously shown that 340B participation increases hospital profits holding constant other factors that influence margins like health system affiliation, payer mix, the local uninsured rate, patient revenue per bed, teaching status and similar factors.[18] In that research, we found that 340B's excess impact on hospital margins in 2019 was 2.7 percentage points.[19] For this study, we first sorted 340B and non-340B hospitals into quintiles based on their respective operating margins in 2021 to examine whether high performing and low performing 340B hospitals look or act significantly different from their non-340B counterparts. We examined charity care as a share of total operating expenses, net patient revenues, share of revenue coming from commercial patients, and the average commercial price for hospitals across the list of shoppable services defined by CMS under the hospital transparency rules that took effect in 2021. Not every hospital in the sample posted prices for every procedure. To calculate the average "price" per hospital, we first calculated the average price for each procedure across all hospitals that posted a price for that procedure. The price we used was the median price charged to the five largest national insurance carriers across a range of services as calculated by Turquoise, Inc. For each hospital we calculated the price for each procedure compared to the average price across all hospitals for that procedure. We eliminated procedures (e.g., simple blood draws) with an average price of under $100. This resulted in nearly 40,000 price observations across 976 hospitals in our data set. To establish a single "price" for each hospital we calculated the average premium or discount across all of the procedures for which that hospital published a price. Table 2 presents the key statistics for each performance quintile in 2021/22.

[18] Health Capital Group, Ibid.

[19] Ibid.

Table 2. 340B Hospital Operating Characteristics, By Operating Margin Quintile (n = 604)

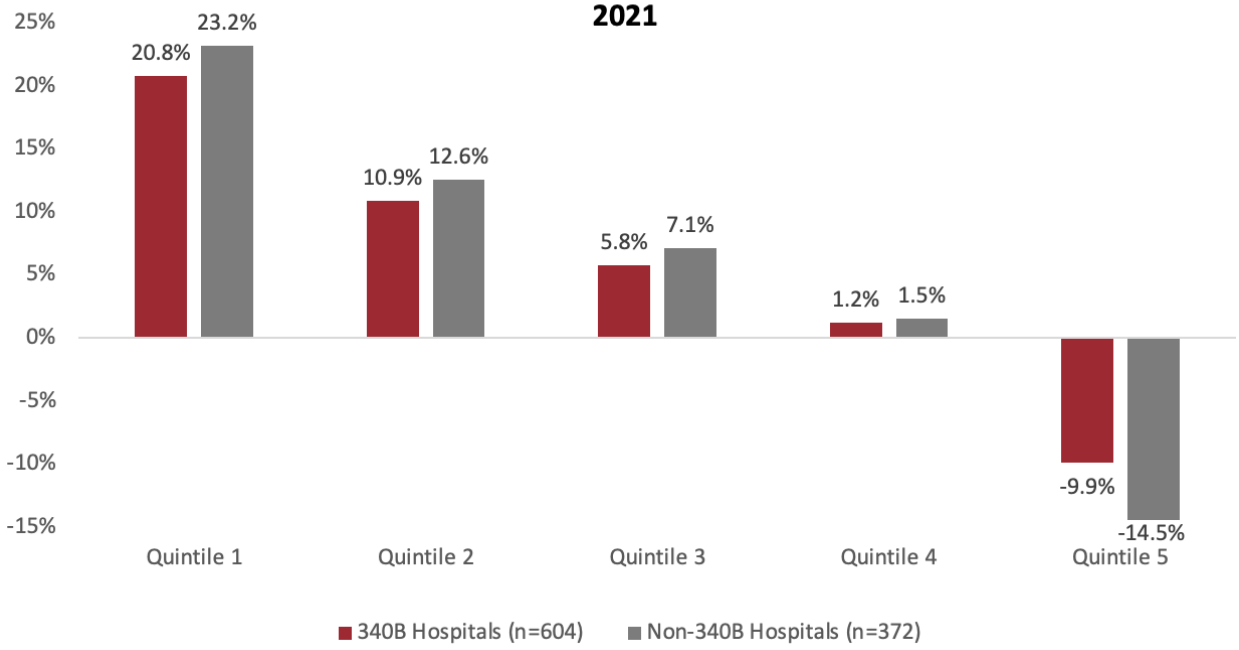
340B Operating Margin Quintile	Average Operating Margin	Average Charity Care %	Average Net Patient Revenue	Avg Commercial Revenue Share	Avg Commercial Price Premium
1	20.8%	2.1%	$ 381,832,072	65.4%	5.2%
2	10.9%	1.6%	$ 244,775,917	63.9%	3.1%
3	5.8%	1.7%	$ 293,214,686	62.8%	1.8%
4	1.2%	2.0%	$ 456,158,238	64.0%	-1.4%
5	-9.9%	2.1%	$ 358,558,967	60.5%	0.5%
Total	**5.7%**	**1.9%**	**$ 346,850,154**	**63.3%**	**1.8%**

Source: Turquoise Inc., CMS Cost Reports, Health Capital Group Analysis

Table 2 shows that the top quintile of 340B hospitals had average operating margins of nearly 21% in 2021,[20] with more than 65% of revenue coming from commercial customers and generating, on average, a 5.2% price premium for "shoppable services" with major commercial insurers. The second quintile also had robust operating margins of nearly 11% and garnered a 3% pricing premium on average. The worst performing 340B hospitals had average operating margins of nearly -10%, significantly lower commercial revenues and lower commercial prices than their higher performing peers. Figure 2 compares the operating margins for the performance quintiles for 340B and non-340B hospitals.

[20] Operating margins in 2021 were increased somewhat by the timing of COVID-19 relief funds; by contrast, we calculate that in 2019 the average operating margin in the top quintile of 340B hospitals was 18%.

Figure 2. Operating Margin % By Quintile, 340B vs. Non-340B Hospitals, 2021



Source: CMS Cost Reports, Health Capital Group Analysis

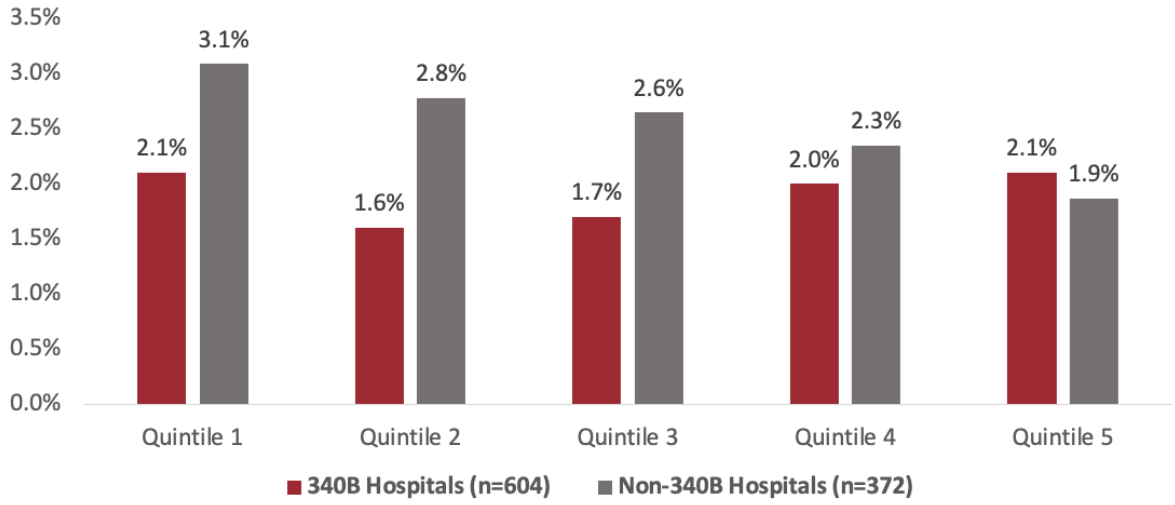
The data show that for both 340B and non-340B hospitals, high performing hospitals were *very* high performing in 2021. 340B does not discriminate between profitable and unprofitable hospitals – some qualifying hospitals have margins exceeding 20%, as do many non-340B hospitals. On the other hand, the lowest performing 340B hospitals appear to be bolstered significantly by 340B program participation, with operating margins of -10% vs. -15% for the lowest performing 340B and non-340B hospitals, respectively.

340B and Hospital Charity Care

All 340B hospitals are, by definition, "not-for-profit" entities. Not-for-profit is a tax status, not a description of whether the hospital earns a profit; most hospitals earn profits every year, and to maintain their tax status they are required to demonstrate that they provide a certain level of community benefit. Allowing hospitals which are already subsidized by taxpayers by virtue of their not-for-profit status to participate in 340B may cause additional taxpayer costs (e.g., influencing the site of care, etc.) and policymakers may wish to compare such costs with the charitable efforts of 340B hospitals. Our previous research has shown that 340B hospitals

appear to provide less charity care than their non-340B counterparts.[21] We focus here on comparing 340B hospitals with each other - specifically, comparing the charity care expense for the most profitable 340B hospitals and the least profitable 340B hospitals. We also compare charitable activities by non-340B hospitals assorted into their own operating margin quintiles. The results are shown in Figure 3.

Figure 3. Charity Care as a Share of Operating Expenses By Operating Margin Quintile, 2021



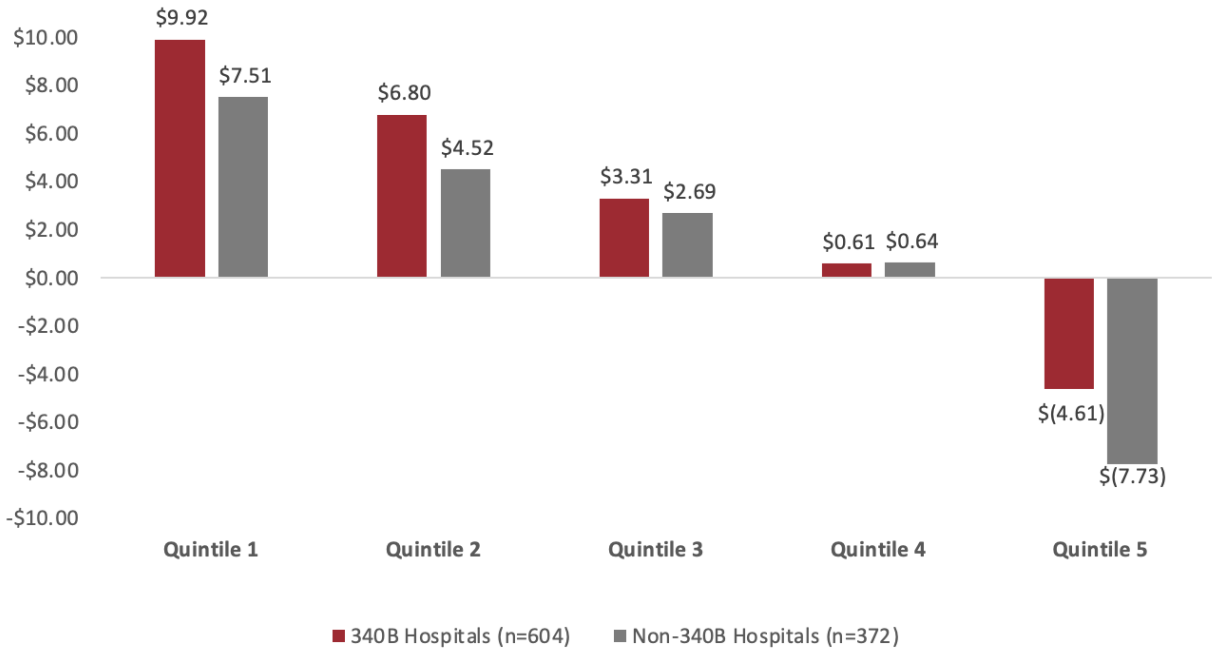
Source: CMS Cost Reports, Health Capital Group Analysis

The 340B hospitals with the highest operating margins in 2021 provided significantly less charity care than the non-340B hospitals with the highest operating margins. This relationship holds true in each performance quintile except for the lowest. For non-340B hospitals, the relationship between operating margins and charity care follows a more corollary path – the higher the profitability, the more charity care. On the other hand, despite their strong operating performance, the top 20% of 340B hospitals provide roughly the same proportion of charity care as the worst-performing 340B hospitals, and a slightly lower proportion than the national average of 2.2%. Second quintile 340B hospitals, who still report very healthy operating margins, offer even less charity care – only 1.6% of total expenses.

[21] Health Capital Group, Ibid.

We used the average revenue and costs in each quintile to calculate the proportion of total profits and charity care for each hospital type that are generated within each quintile. As seen in Figure 4, the top quintile of 340B hospitals based on operating margins earn $9.92 in profit for every dollar they spend on charity care compared to $7.51 for the top quintile of non-340B hospitals. In the second quintile, 340B hospitals show $6.80 in operating profit per dollar of charity care vs. $4.52 for non-340B hospitals. After adjusting for the average revenue within each quintile, 340B hospitals generate over 85% of the total operating profits earned by 340B hospitals but contribute only 24% of the overall 340B hospital charity care.

Figure 4. Operating Profits per Dollar of Charity Care for 340B and non-340B Hospitals, by Operating Margin Quintile, 2021



Source: CMS Cost Reports, Health Capital Group Analysis

Conclusion

The 340B program has grown exponentially in recent years and now accounts for a larger share of the US prescription drug market than Medicaid[22] and Medicare Part B.[23] Our results show that more than 40% of 340B hospitals earned operating margins of greater than 10% in 2021, garnered significant commercial price premiums, and provided significantly less charity care than both the national average and non-340B hospital average. While the program was originally intended to assist safety-net hospitals and clinics providing care to large numbers of low-income and underserved patients, the benefits of the program appear to be diffused very broadly, including to thousands of entities that may not provide care to large numbers of these patients, and thus the program may not be targeted to the entities most in need. Given 340B's exceptionally rapid growth, policymakers must consider whether the excess revenue created by the program is appropriately targeting the most vulnerable Americans.

[22] MACPAC. Chapter 3 Strengthening Evidence under Medicaid Drug Coverage. March 2023. https://www.macpac.gov/wp-content/uploads/2023/03/Chapter-3-Strengthening-Evidence-under-Medicaid-Drug-Coverage.pdf. In fiscal year 2021, net drug spending in Medicaid was $38.1 billion.

[23] MedPAC. Part B Drugs Payment Systems. October 2023. https://www.medpac.gov/wp-content/uploads/2022/10/MedPAC_Payment_Basics_23_PartB_FINAL_SEC.pdf. In 2021, Medicare and its beneficiaries paid about $43 billion for Part B-covered drugs and biologics.