



**SERVICE LINE DEVELOPMENT BEST PRACTICES:
GROUNDING GROWTH IN FINANCIAL AND
OPERATIONAL REALITIES**

June 10, 2026

LEARNING OBJECTIVES

1

Understand key data elements required for an effective service line pro forma

2

Understand how different data elements impact each other when running scenario analyses

3

Determine what key assumptions need to be made when developing a pro forma

4

Identify key stakeholders needed to contribute to a pro forma

5

Develop an effective communication process around the results of a pro forma

6

Identify common pitfalls in pro forma development



FUNDAMENTAL ECONOMICS

POLLING QUESTION

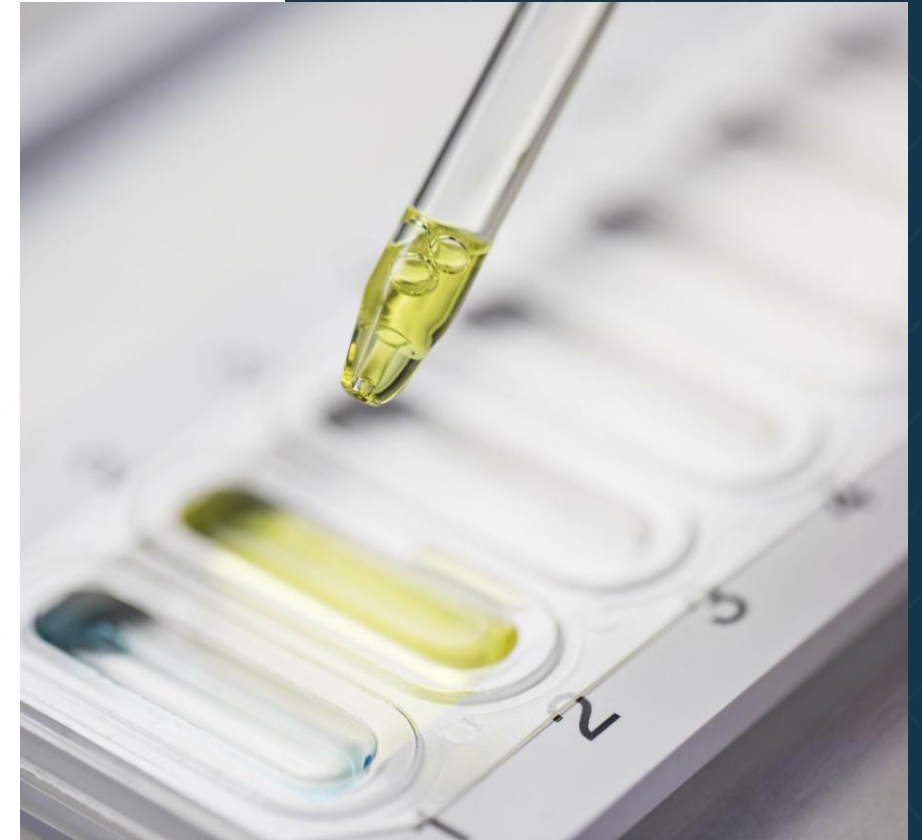
Does your organization have a system in place to evaluate a potential service line?

- Yes
- No
- Somewhat
- Unsure



ECONOMIC PHILOSOPHY

- Understand the difference between contribution margin and profit on fully allocated costs
 - **Variable Cost**
 - Definition: Expenses that change with changes in activity and remain the same on a *per unit* basis (i.e., per unit costs *will not increase* if the number of units *increases*)
 - Examples: *Pharmaceuticals, reagents, film, food*
 - **Fixed/Step-Fixed Cost**
 - Definition: Expenses that do not change with changes in activity; will decrease on a *per unit* basis (i.e., per unit costs *will decrease* if the number of units *increases*)
 - Step-fixed costs will not increase unless a certain volume amount is achieved, at which point they will increase by a fixed amount
 - Examples: *Salaries and benefits, rent, utilities*



ECONOMIC PHILOSOPHY, CONT.



- Rural hospitals have inordinately high fixed costs relative to revenue (e.g., ER standby, acute care nursing costs, etc.)
 - Unit contribution margin
 - The amount from each unit of service available to cover fixed costs and provide operating profits
 - Example: If Department X's unit service price is \$200 and its unit variable cost is \$30, the unit contribution margin is \$170 ($\$200 - \30)
 - A rural hospital is made up of 1000s of Unit Contribution Margins
- For a CAH, service price (i.e., reimbursement) per unit *changes with volumes* for cost-based payers such as Medicare



COST-BASED REIMBURSEMENT OVERVIEW



CAHs receive cost-based reimbursement for inpatient and outpatient services provided to Medicare and, in some states, Medicaid patients

What cost-based reimbursement **does**:

- **Partially** insulates hospitals from the financial impacts of significant volume fluctuations
- Provides an advantage for financing capital projects (i.e., depreciation)
- Helps hospitals to operate in communities with inherently low populations

What cost-based reimbursement **does not** do:

- Protect the hospital from all financial woes
- Negate the need for prudent cost management strategies



The Medicare cost report is a crucial part of ensuring a CAH maximizes reimbursement from cost-based payers





ELEMENTS OF A PRO FORMA

POLLING QUESTION

How confident are you in your organization's ability to understand market demand before launching a new service line?

- Very confident
- Somewhat confident
- Neutral
- Not very confident
- Not confident at all



BEGIN WITH THE END IN MIND

Important to ask the following questions *before* developing a service line pro forma:

- What am I trying to solve for?
- What is driving the desire to complete a pro forma?
- How does the proposed service line align with organizational goals?
- What is my time horizon?
- What is my current financial position?
- What is going on in the market, both locally and nationally?



BEGIN WITH THE END IN MIND

Crucial to begin with an understanding of your market

Before spending significant time and resources on a pro forma, it is best to:

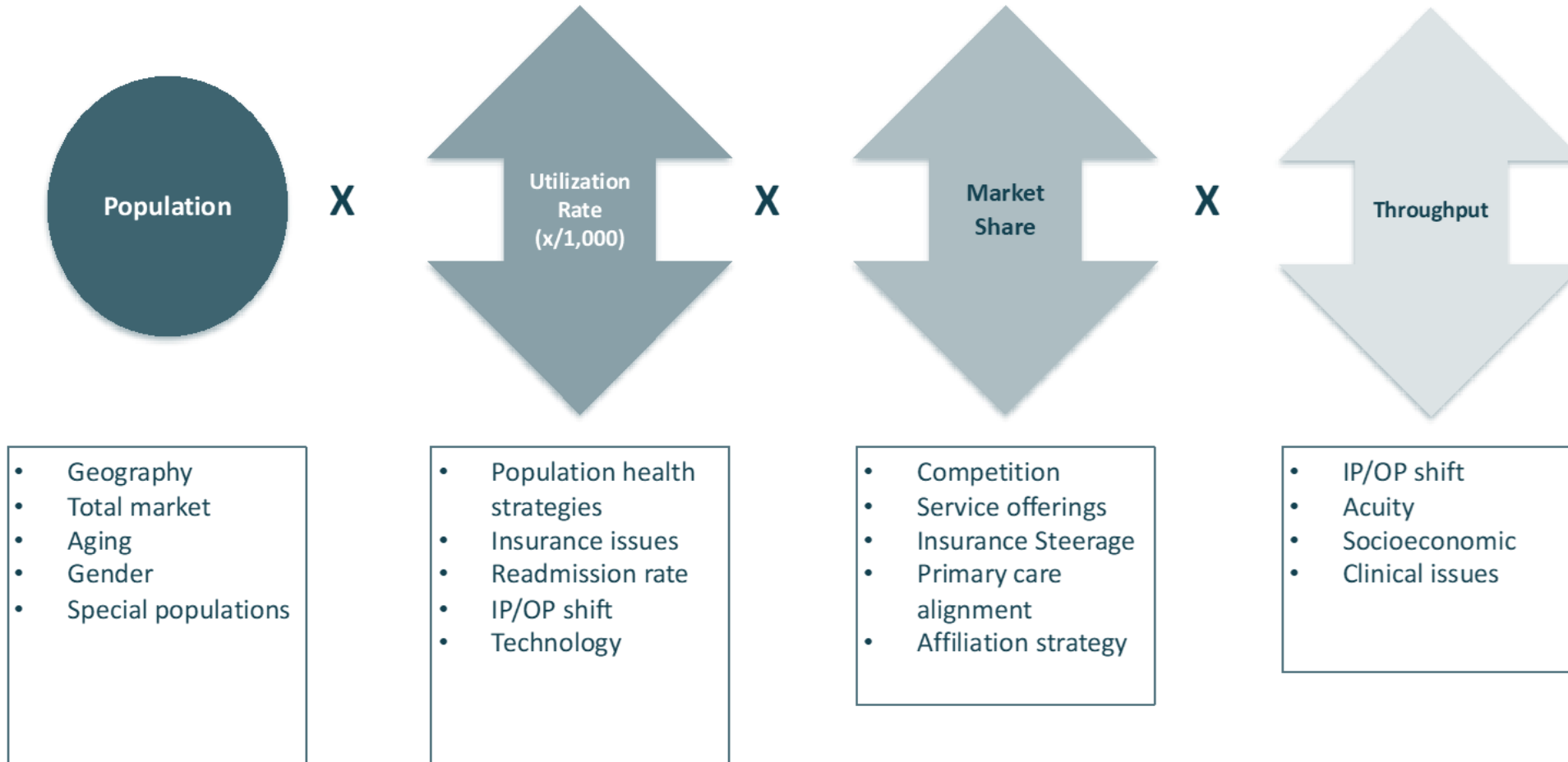
- Define your service area
- Understand patient demographics in your service area
- Evaluate trends in utilization in your service area
- Understand historical volumes for your organization
- Estimate future volume changes in your service area for whatever service you are intending to evaluate

Key questions:

- Is there enough volume currently to justify the desired service?
- Are volumes projected to *decline* or *grow* for this service?
- If there is enough volume, how much can we capture?



FOUR LEVERS TO CALCULATING MARKET DEMAND



Operating Parameters	<i>Random vs Scheduled</i>	<i>Confidence Intervals vs Occ %</i>	<i>Distinct Unit Types</i>
	<i>Universal vs Specialty</i>	<i>Observation</i>	



NEXT PHASE

Collect data necessary for the pro forma

Develop or “borrow” financial model

Scenario analysis

Draw conclusions based upon stated goals



KEY DATA ELEMENTS

Internal volume statistics

Financial statements

Medicare cost report

FTE counts

Current payer mix

Reimbursement rates for non-cost-based payers (e.g., fee schedule, DRG, APG, percentage of charge, etc.)



KEY ASSUMPTIONS

Future volume growth

**Gross charge per unit
of service**

**Estimated payer mix
for specific service
line**

**Expense growth
specific to proposed
service line**

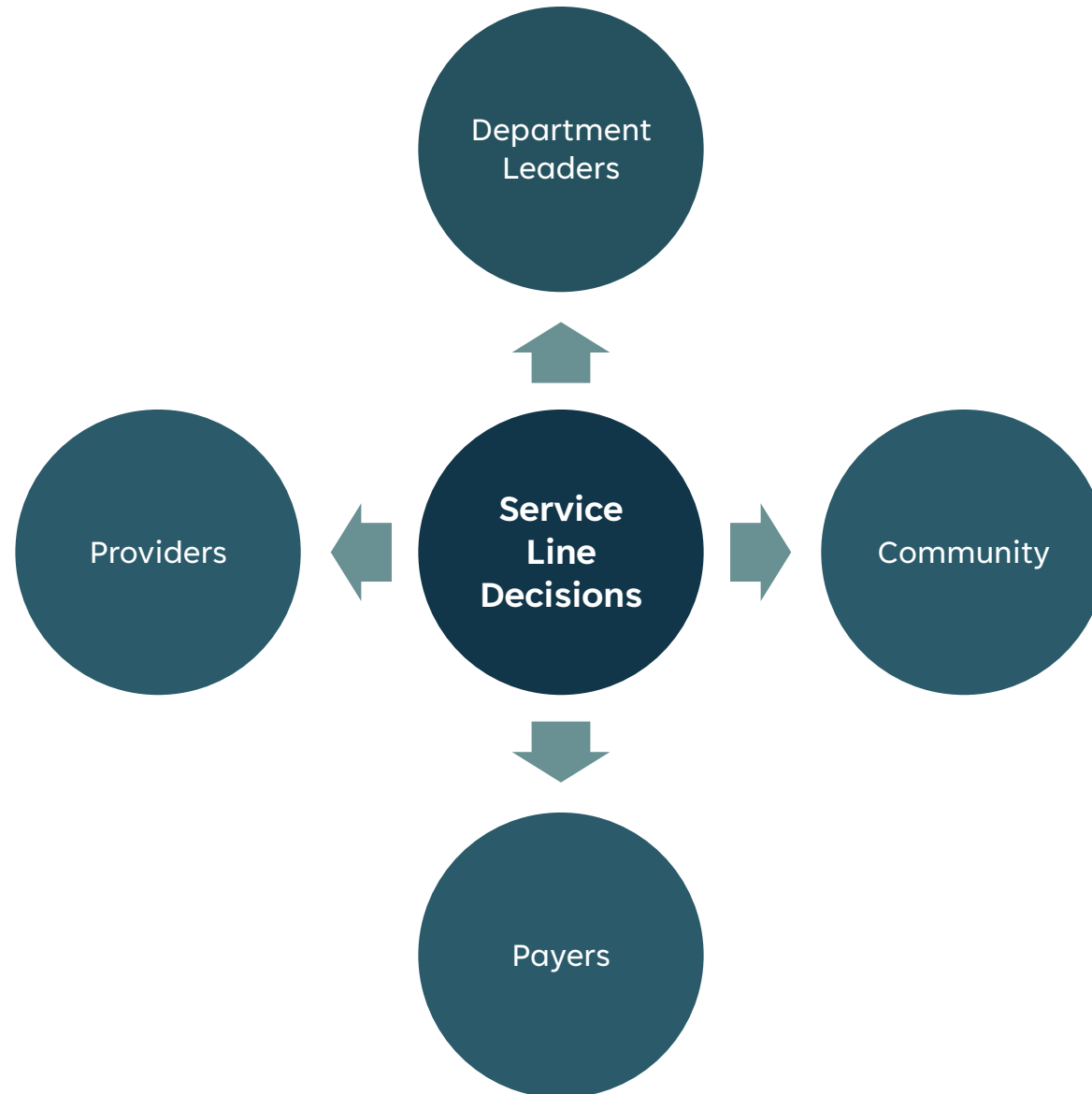


KEY STAKEHOLDERS

- 
- ✓ CEO
 - ✓ CFO
 - ✓ Providers
 - ✓ Department manager(s)
 - ✓ Revenue cycle team



EFFECTIVE COMMUNICATION





COMMON PITFALLS

POLLING QUESTION

What is the most common reason your organization considers adding a new service line?

- Community need (e.g., CHNA)
- Competitive pressure
- Physician/provider interest
- Financial opportunity
- Donor or external funding



COMMON PITFALLS

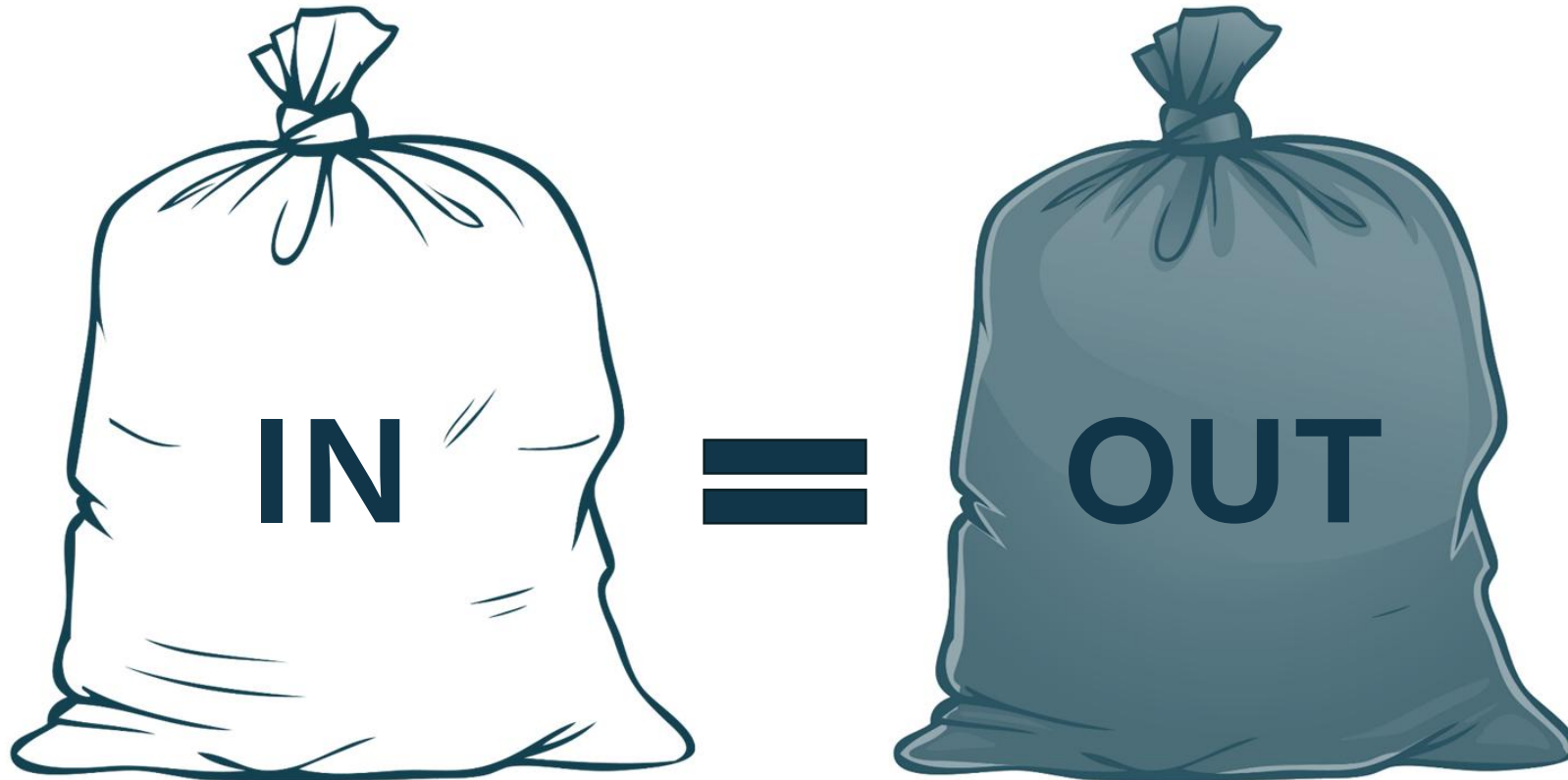
“Putting the cart before the horse,” i.e., have we looked at the market yet?

Misunderstanding true variable cost

Making assumptions that are not based in reality



COMMON PITFALLS



COMMON PITFALLS



WHAT WE
OFTEN
HEAR...

“We have a donor that has pledged to give us \$X to put in _____ service, so we should proceed.”

“Our last CHNA told us that the community wants _____ service, so we need to do this.”

“At my last facility, we provided _____ service and it did really well, so we should do it here.”

“Our biggest competitor recently started providing _____ service, and we need to be able to stay competitive.”

“I heard another hospital leader mention that _____ service is a money maker, so we should consider it.”



REALITIES

- Rural hospitals are all different
- Communities are all different
- What works well somewhere else may not work well in your community
- Any decision around service line additions or changes must be:
 - ✓ Grounded in a deep understanding of your market
 - ✓ Based on accurate and relevant data
 - ✓ Aligned with organizational goals
 - ✓ Financially sustainable





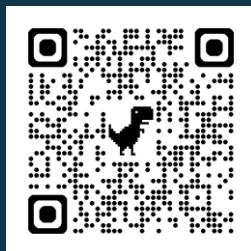
COMMITTED TO INCREASING THE IMPACT OF RURAL AND COMMUNITY HEALTHCARE.

Our team of rural and community healthcare experts support the leadership of hospitals, health systems with a rural footprint, and the groups and clinics that form an essential care network across the 97% of the US that is defined as rural.



Wade Gallon
wgallon@stroudwater.com
(T) 207-221-8270

Let's Connect!
Scan my QR Code



Cameron Smith
csmith@stroudwater.com
(T) 207-221-8253

Let's Connect!
Scan my QR Code

