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making the tough choices for cost control

sustaining a market-based healthcare system

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election 2004: implications for providers

COVER STORY

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AT A GLANCE

To prioritize cost savings, providers can benefit from following a fundamental approach that involves using easily attainable small-scale initiatives (less than $50,000) to support larger-scale projects (typically over $250,000) that can realize improvements in six months. Increases in capital that result from these efforts can then be used to focus on equally important opportunities where the organization has less control, or payoff may take longer.

Although identifying opportunities to cut costs can be relatively easy, the true test is prioritizing these opportunities in a way that optimizes use of capital and maintains the organization's strategic focus.

The habit of saving is itself an education. It fosters every virtue… cultivates the sense of order, trains to fore-thought, and so broadens the mind.
—Thorton T. Munger, American scientist

These days, financial managers have become all too familiar with this type of education. In an environment of largely fixed payments, expense management is one of the keys to having a financially optimal hospital. Almost daily, healthcare executives must decide which cost savings initiatives have the greatest likelihood of success and will provide the greatest benefit.

Although most financial executives find identifying savings opportunities relatively easy, finding an effective way to prioritize these efforts continues to be a significant challenge. Factors to consider when evaluating cost-management strategies should not only include potential savings, ability to implement, and desired timing of implementation, but also long-term significance to the organization.

A fundamental approach to prioritization that allows for these considerations and that typically proves successful is to first focus on the largest-dollar, recurring expenses where management has the greatest control and accountability, such as staffing patterns. Focus should then shift to areas such as supply expense and care management, where less direct control and accountability are possible.

As competing opportunities are presented, some low-dollar, high-difficulty initiatives are continuously pushed down on the list. It is important that a regular review be performed to ensure that all opportunities are addressed, allowing nothing to slip through the cracks.

To ensure your hospital incorporates these principles, consider the following three steps during your next review of cost-savings opportunities.

Step 1: Start Easy

Cost-reduction initiatives should first target small, easily achievable projects that offer between $2,000 and $50,000 in annual cost savings for which one to two executives will be held accountable (projects over $50,000 typically have operational or strategic impact and need to be reviewed before imple-

menting changes). It's best to choose three to 10 initiatives that require less than three months to implement. Projects selected need to be ones that the hospital has control over, that an individual can be held accountable for, and that will generate momentum through quick successes. Examples of these types of projects can be found in nearly every department.

> Raising prices in the cafeteria and eliminating free food at meetings
> Evaluating the rates for parking at the hospital, and whether the collections justify costs
> Renegotiating lease arrangements for administrative space off campus
> Reducing training and orientation time and/or implementing an on-line training program
> Consolidating the telecommunications and bio-medical services departments in order to increase efficiencies

Step 1: First target small, easily achievable projects that offer between $2,000 and $50,000 in annual cost savings for which one to two executives will be held accountable.

Step 2: Think Big (and Fast!)

While one to two executives focus on the easily attainable small-scale opportunities, others, such as the chief nursing officer, chief operating officer, and those with similar levels of responsibility, should undertake broader projects that can realize more significant savings—although still in a relatively short time. These projects should range from $200,000 to over $5 million in total benefit. Three major areas to concentrate management's attention on initially that should attain a goal of realized improvements within six months are staffing, benefit structures, and supply expenses.

Staffing. About 50 to 60 percent of a hospital's expense is in personnel cost. Consequently, this area is where the bulk of cost savings will come from. By the start of 2004, most hospitals had begun focusing attention on staffing issues and keeping staffing patterns low. Today, it is less common to see a hospital that warrants the 5 to 15 percent across-the-board reductions in force that were accomplished in the late 1990s. However, most hospitals still need to examine current staffing procedures, the monitoring tools available, the role of information technology, and whether the budget methodology employed supports the goals of the organization.

The first step in developing an efficient and effective staffing system is to implement an annual review of the nursing plan of care. Compare your plan with clinical, financial, and satisfaction performance before the budgeting process begins. By doing so, you can help ensure the plan is used to build daily staffing grids and patient care budgets. A staffing grid based on your nursing plan typically includes the following three components:

> The staffing mix as it relates to the nursing plan of care for each unit
> Projected utilization or average daily census
> Benchmark or target hours per patient day

By designing a staffing grid based on the nursing plan of care and a master schedule that corresponds with the budget, a hospital can achieve internal consistency and accuracy. Such data will dramatically improve the manager's ability to produce a budget to which staff can be held accountable.

Because of the amount of analysis, benchmarking, buy-in, and tool development required, it can easily take a hospital two to five months to implement a new staffing plan and more than six months before it begins to realize the financial rewards of doing so.

Recognizing this delay is why it is important that other, easily achieved cost savings are taking place on the front end. As the benefits of these efforts are accruing, you will have increased capital available that can be used to provide for flexibility in staffing strategies (for example, paying severance packages, if needed). Also, having spent the previous six months watching other cost-cutting initiatives executed around the hospital (and seeing executives both being held accountable for the results and achieving the goals), employees are likely to be more

THE ANSWER? ACCOUNTABILITY

An organization's ability to hold executives responsible for implementing changes is one of the most important factors in a successful strategic plan. Unless one person can be identified as being responsible for a specific cost savings, you are typically better off pursuing other opportunities. Having a CEO who is willing to champion change, to assign this level of responsibility, to hold people accountable, and to keep them focused on one to two key points can make cost-savings initiatives a success.

THE CFO'S ROLE

Ideally, the CFO's role should be one of support staff and cheerleader during planning and implementation of cost-cutting initiatives, rather than change agent. Even today, there is a chasm separating clinical and operational departments from finance, with neither side able to fully appreciate the other's point of view. Motivating clinical and operational executives to lead the charge for cost-saving initiatives typically has a much better chance for success.

A CFO (paired with a strong CEO promoting cost savings) can often best serve the organization by providing analytical support to other executives and partnering with them to examine opportunities. In some hospitals, the CFO hires a specific person to be available full time to the chief nursing officer or chief operating officer to help track down savings. CFOs that provide objective information to empower others and celebrate the successes they achieve will be doing their hospitals a great service.

Over time, helping the organization to direct efforts on areas where it has the greatest control over cost can lead to significant economic improvement. Employee accountability for savings will pave a solid road for future successes and create the best economic outcome. By applying constant discipline to ongoing expense-management initiatives, CFOs and other healthcare financial managers can help their organizations become better focused and have a higher success rate in achieving their goals.

prepared when announcements of staffing changes are made.

Step 2: Undertake broader projects to realize more significant savings from $200,000 to over $5 million in a relatively short time.

Benefit structures. Changing the health insurance benefits of a hospital is also a common strategy. However, time and care need to be taken when deciding where to cut. If a hospital is already struggling with a shortage of nurses while paying at or below market rates for services, dramatically cutting benefits can hurt the bottom line. Taking two to three months to review the marketplace and the benefit plans that competing hospitals offer can be useful in this regard.

Also, keep in mind some of the other changes to benefits that can save money.

> Consolidating to a single health plan for economies of scale
> Using a tiered insurance plan that sets copayments and deductibles based on salary
> Defining FTEs as working 80 hours every two weeks
> Moving from a defined-benefit to a defined-contribution plan

Supply expenses. Anywhere from 15 percent to 30 percent of a hospital's cost typically resides in the supplies it uses. Although the hospital does not have absolute control over this area (obviously, vendors and physicians play significant roles), it does have enough influence to generate substantial cost savings. Several types of actions may be valuable to undertake:

> Reconciling the financial item main master (FIMM) and supply item main master (SIMM) with the actual inventory
> Identifying and fixing the number of duplicated items in the item master
> Quantifying the number of orders that are placed for items not on the item master and targeting repeated purchases
> Benchmarking prices
> Enforcing contract compliance
> Finding areas (such as orthopedic implants) where limiting selection to just two or three vendors can generate cost savings
> Designing custom surgical packs for high-volume physicians to lower pack waste

Step 3: Continue to Think Big

After sorting out the big-bang areas, attention should be turned to issues that tend to offer a similarly high level of savings—only where the same degree of accountability and control is less likely. There may even be an operational or strategic impact that needs to be considered before any changes are made. Typical issues that fall into this category are average length of stay and cost per case, uncompen-

COMMUNICATION COUNTS

For new cost-reduction efforts, it's particularly important to develop an accompanying communication plan. Hospital executives must be able to communicate a clear, consistent message to the physicians, employees, and community about what is happening at the hospital. The communication plan should include several basic components:

- A simple message that first explains why the hospital is in the situation it is in (most hospitals blame the Medicare cutbacks, regardless of the actual impact)
- An explanation of why it is important that the hospital regain its financial standing (including the mission and investment in new technology)
- General comments about the steps that are going to be taken, the care and consideration that will go into each decision, and the need to act quickly

For smaller or ongoing expense reductions, including two to three sentences about why the particular expense is being cut typically is sufficient.

Making sure physicians are tied in to the message is particularly important. The worst thing that can happen when trying to cut costs is to have physicians pulling out of the hospital because they are afraid that the hospital will fold. Remember: The best way to fix high expenses is to add more revenue. Engaging the physicians early on in these discussions—and asking for help—can pay off further down the road.

sated care, and nonperforming business lines and assets.

Length of stay and cost per case. Minimizing the length of time that patients spend in the hospital and the number of resources they consume reduces the direct costs incurred by the hospital and frees up capacity that can be used for incremental business. These days, most hospitals are managing average length of stay and cost per case by benchmarking their physicians internally and letting them know how they compare with their peers. Also, many hospitals are holding physicians accountable for care standards they help create.

For example, some hospitals will sort hip-implant patients into categories based on physician-supported clinical criteria. High-performance hip implants that are the most expensive, create longer recovery times, and raise other health issues are the least likely to be given to elderly patients who have other mobility issues. A physician selecting this type of implant for a patient for whom the implant appears to be inappropriate would need to make the request and provide supporting information prior to surgery.

Many organizations also have formed cross-discipline committees to tackle specific diagnosis groups and establish baseline protocols. Achieving physician input and buy-in for these strategies is always important, as is formulating early in the process the method for holding the physicians accountable and adhering to it.

Throughput issues also have a significant effect on average length of stay. Early discharge planning and access to the full continuum of post-acute services are the focuses of many hospitals today. To this end, some hospitals make it a condition of their hospitalists' contracts that appropriate patients be discharged by 11 a.m., and require case managers to work with the patient's family to ensure someone will be able to pick up and care for the patient after being discharged.

> Step 3: Turn attention to issues offering a similarly high level of savings, but lacking the same degree of accountability and control.

Uncompensated care. Many hospitals today simply accept having high levels of uncompensated care and assume it is a cost of doing business. However, those that decide to hold one executive accountable for fixing the problem and have a strong CEO serving as a champion have made great improvements. It has been shown that uncompensated care expense can be

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reduced by as much as 30.3 percent in three years by:
> Working with pharmaceutical companies to receive replacement drugs for those given out to charity cases
> Routinely transferring patients back to referring hospitals once adequate specialty care has been given
> Identifying the most common DRGs for uncompensated care and developing stricter protocols
> Adding financial counselors in the emergency department during peak times for uncompensated care patients
> Creating web sites so patients can review accounts and pay on-line

Nonperforming businesses and assets. By now, most hospitals have eliminated or fixed the integrated delivery system strategies that led to so much loss in the late 1990s and early 2000s. Fewer hospitals own HMOs that are losing $5 million to $15 million a year or physician practices losing $100,000 per physician. However, many hospitals still operate businesses that are either losing money or have marginal benefits and that function largely as a distraction to management, such as home health, acute rehabilitation or other postacute care, and outpatient dialysis.

Similarly, hospitals have spent a great deal of time purchasing land and building emergency medical services. Many of these strategies have reaped benefits such as higher volumes, lower costs, and the ability to expand services, but others have only created cost centers that consume scarce resources. Financial managers should continually assess the value of these assets and whether they impede the organization's financial performance. ●

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