

Recession proof no more
The five pillars of performance
improvement for health care
providers: A durable blueprint to
inspire operational excellence



The recent economic downturn has spared few industries or institutions. The notion that health care is immune to fluctuations in the broader economy has fallen by the wayside. Over the last 18 months, health care providers have been feeling the effects of the recession and the fallout of the credit crisis in their margins. The average total margin for hospitals fell to -7.8% in the fourth quarter of 2008 from 4.6% in Q4 of 2007.¹ Margins are under increasing pressure as a result of a number of trends that have combined to create a perfect storm for providers:

- Demand for elective services has decreased as employers have shifted more costs to employees, and consumers, as a result, have become more cost-conscious and price-sensitive;
- Levels of bad debt and charity care are growing rapidly as the ranks of the unemployed and uninsured are increasing;²
- Increases in the Medicaid population³ are shifting the payor mix to lower (or negative) margin payors;
- Decreasing income from non-operating sources (investments and donations) and limited access to credit have removed the bottom-line 'buffer' providers historically relied on to close their operating gaps.

Even amidst this turmoil, we believe there are opportunities for health care providers to look ahead, take action and plan for the future. To counter these challenges, providers should consider adopting a cross-functional approach to operations management that encompasses five specific focus areas, or "Pillars."

The five pillars of performance improvement

1. Lead by example
2. Tighten the core
3. Drive 'fixed' costs to become more variable
4. Leverage shared services in traditional and non-traditional ways
5. Manage your demand, not just your costs

We believe a multi-dimensional approach that incorporates these Five Pillars of Performance Improvement can provide a sustainable path forward to help promote long-term operational enhancements, revenue growth and asset efficiency.

Pillar 1: Lead by example

Leadership effectiveness is perhaps the key differentiator between higher- and lower-performing provider organizations. This Pillar focuses on confirming that the organization has leaders who are rallied around a cohesive vision and who have personal accountability for its success.

Lead by example: Key strategies to consider

- Establish a culture where each member of the leadership team feels personal accountability for achieving and maintaining favorable margins
- Replace leaders who do not perform, operate in 'silos,' or resist change
- Link the achievement of performance improvement targets to the organization's strategy and set measurable goals; build focus around these goals throughout the organization

Building a truly effective organization begins with a leadership team that is aligned with the overall goals of the organization and who are not focused solely on the results of their individual 'silos' within the organization. Effective organizations establish a culture which allows for open and candid debate around ideas, but expects everyone to be "on-board" once a direction has been established. When an individual cannot be brought along, their position within the leadership group should be reconsidered.

¹ AHA. "The Capital Crisis: Survey of Impact on Hospitals." January 2009.

² Trendwatch Chartbook 2008: Chart 1.15, Chart 1.17 and Chart 7.1

³ Trendwatch Chartbook 2008: Chart 1.15, Chart 1.17 and Chart 7.1

Effective leaders guide their organizations with crisply articulated performance expectations and then bind their strategies and actions to those expectations (e.g., “achieving a six percent margin is necessary to fund the acquisition of health information technologies which will enable important quality and patient safety improvements”).

Pillar 2: Tighten the core

A focus on tightening core operations has the potential to pay immediate dividends. While most hospitals and health systems have begun some form of operations improvement, a surprising number of organizations still have not implemented (or have allowed to slip) many basic practices that can reduce unnecessary costs, drive revenue growth and establish accountability within core operations.

Tighten the 'core': Key strategies to consider

- Establish rigorous labor/position control protocol and promotion practices
- Remove barriers to throughput in high-revenue clinical areas, particularly CT/MRI, cardiac surgery, and orthopedic surgery
- Establish a budgeting process that embeds personal accountability for attaining monthly targets to everyone in the organization with a management title

Hospitals that review and rationalize their hiring and pay practices, focus on throughput in high-revenue clinical areas, and instill accountability into the budgeting process have the potential to gain significant and ongoing margin enhancement.

Pillar 3: Drive 'fixed' costs to become more variable

For many years, providers have leveraged systems and processes which 'flex' clinical department staffing and costs to reflect demand. Most providers, however, have not instituted similar discipline in their management of administrative and clinical support function costs (frequently called 'fixed' costs). As a result, many providers can operate at their budgeted margins only if volumes meet projections—so these targets are almost always missed if volumes fall short of projected demand.

Drive 'fixed' costs to become more variable: Key strategies to consider

- Transition shared services and clinical support functions to 'flex budgets' which align their resource consumption with demand
- Create flexible administrative/corporate department budgets that baseline a portion of the estimated total spend and trigger an increase once specified volume/income targets are reached
- Confirm that vendor contracts flex with volume and that the organization is not obligated to pay a fixed rate if demand decreases; link price escalators in contracts to metrics aligned with revenue growth vs. inflation (e.g., Medicare reimbursement increases) to maintain desired margins

Shifting costs from 'fixed' to variable starts with a management philosophy that acknowledges that, at least in part, all departments and functions need to be able to respond to changes in volume. It is simply not realistic to maintain predictable levels of performance when health systems, even those with relatively strong variable cost structures, have one-third to one-half of their costs not linked to revenues or demand.

Pillar 4: Leverage shared services (in traditional & non-traditional ways)

Leveraging shared services effectively can help an organization to achieve significant cost efficiencies, rapidly deploy effective practices and provide greater service consistency to both internal and external customers.

Leverage shared services: Key strategies to consider

- Develop principles that guide decisions about when to centralize and when to leave support functions decentralized that include both economic and value-oriented considerations (e.g., quality, responsiveness and innovation)
- Seek opportunities to develop shared service-type functions in non-traditional clinical support functions (e.g., laboratory services, medical staff office, case management)
- Maximize purchasing leverage to drive prices down and realize economies of scale savings (e.g., reduce variation in contracts for a common vendor which may exist across the enterprise, standardize purchasing, reduce off-contract spend)
- Establish and document internal service level agreements between shared service functions and operating units to help facilitate operational alignment and maintain customer-service focus of centralized functions; link compensation of shared service leaders to performance against service level metrics

While revenue cycle and materials management offer demonstrated models of shared service efficiency, an increasing number of organizations are also creating shared services in clinical support functions, including laboratory services, case management, and medical staff office organization. Leveraging shared services in these areas can offer a value proposition as compelling as traditional focus areas, such as resource efficiency, quality improvement and greater consistency in experience.

Pillar 5: Manage your demand, not just your costs

As discussed earlier, fluctuations in demand often present one of the greatest external barriers to success for providers. Many executives often rationalize their

organization's performance by saying, "If our volumes hadn't been off last month, we would have made our budget." While taking steps to align a greater share of costs to demand represents an important step forward, many organizations are far too passive when it comes to managing their volumes.

Manage your demand, not just your costs: Key strategies to consider

- Develop and implement operational "scenarios" based on fluctuations in volume and develop contingency plans to be prepared to respond promptly to declines in demand
- Gather and actively analyze volume by service line, specialty, physician and group in real time (at least weekly) to understand and respond to negative trends
- Move beyond traditional patient satisfaction scores and embrace more progressive tools/practices which help to evaluate the actual 'experience' of these stakeholders as 'customers' of your organization

Enhancing the organization's intelligence around trends in demand not only can create an earlier awareness of issues, but also inspire a more proactive orientation towards managing demand. Additionally, a more sophisticated approach to gauging patient and physician satisfaction can provide better insights into how to position the organization as the provider of choice in its market.

Conclusion

In our view, operational excellence begins with a strong, cohesive leadership team. A high-performing leadership team will maintain a laser-light focus on core operations while embracing non-traditional strategies which will allow it to maintain a lean, flexible cost structure while aggressively pursuing strategies to expand demand for its services.

While the Five Pillars may not be revolutionary, it is remarkable how many providers struggle with the fundamental concepts they embody. Given the likelihood that the provider sector will remain highly bifurcated from a performance perspective for the foreseeable future, successful execution of the Five Pillars should allow strong organizations to further solidify their position and support the efforts of underperforming organizations to move to the next tier.



Five Pillars in Action: St. Vincent Health's Opportunity Assessment Initiative

St. Vincent Health (SVH) is a \$1.7B health care system in Indiana, comprised of four acute care hospitals and 13 other health care entities, and is a member of Ascension Health, the nation's largest not-for-profit Catholic health care system. While the organization has not been confronted with the imminent threat of financial distress that many organizations currently face, the executive team at SVH recognized the need to proactively prepare for knowable challenges on the horizon, including increased competition in each of its markets, increased cost pressure for key payors and employers and impending governmental reforms.

The organization's position of financial strength provided the opportunity to view and prioritize potential improvement opportunities from a strategic perspective in their discernment process, focusing tactics on longer-term transformation initiatives, such as their upcoming national ERP implementation.

In January 2009, St. Vincent Health began its Opportunity Assessment Initiative (OAI) by benchmarking its administrative and support services and hospital-specific clinical operations against national peers. The gap between baseline and target performance was then used to drive the identification of financial and operational improvement opportunities.

The Five Pillars in Action: Examples from St. Vincent Health

Pillar 1: Lead by example

- The Steering Committee worked together to develop a singular vision and set of guiding principles for the opportunity assessment project so that communications to the organization were consistent and expectations were clearly articulated.
- One of the key concepts for project success was the idea that ‘everybody plays.’ Representatives from each function performing unfavorably against the established benchmark threshold were tasked to identify an improvement plan and present recommendations to close the gap.

Pillar 2: Tighten the core

- The organization designed and implemented a standard system-wide position control process to monitor position replacements, changes, and additions, enabling improved labor expense management on an ongoing basis.
- Several teams in high-revenue areas were charged to outline strategies to improve throughput, rather than only focusing on cost reduction.
- The highest proportion of proposed initiatives fell into the category of ‘rationalization,’ or reducing redundancies embedded within the functions across multiple entities.

Pillar 3: Drive ‘fixed’ costs to become more variable

- A disproportionate share of approved cost reductions (>50%) will be generated from savings and corporate administrative and clinical support functions, rather than from clinical departments.

Pillar 4: Leverage shared services (in traditional & non-traditional ways)

- As part of the proposed initiatives, several areas (including Revenue Cycle, Finance, Human Resources and Medical Affairs) took advantage of opportunities to create shared service centers within the organization, working within the context of defined strategic goals and aiming to create ‘world-class’ service and processes
- Teams proposed several oversight committees aimed at integrating efforts across the organization (e.g., Surgical Services and Community Health/Benefit)

Pillar 5: Manage your demand, not just your costs

- Rather than focusing only on cost cutting measures, several teams developed plans to grow volume through specific recruitment, physician relations, or marketing strategies.
- The Steering Committee discussed the impact of each proposed initiative on client experience and value as part of the discernment process. Standards required by different hospital markets were considered prior to accepting or rejecting these initiatives as well.

Results

After weeks of brainstorming and research on effective practices, the teams ultimately developed a plan that, in total, comprised 156 different initiatives that could drive an increase in margin of almost 2%. The proposed initiatives ranged from relatively simple changes in staffing practices to more complex changes in the way departments fundamentally operated. While not all of the proposed initiatives were ultimately selected as part of the future vision for the organization, the effort and thoughtfulness

around the plans equipped the executive team with the options necessary to develop a broad portfolio for improvement across a variety of functional areas.

Incorporating the fundamental tenets of the Five Pillars into the planning and execution of the process, St. Vincent Health was able to identify and implement sustainable improvements to the organization that they expect will have a net benefit to both the bottom line and the future operational infrastructure of the system.

Five Pillars of Performance Improvement "Scorecard"

While no single litmus test can identify all of an organization's operational ills, honest answers to the following questions may help an organization prioritize its focus as it endeavors to maximize its potential relative to the Five Pillars of Performance Improvement.

1. Lead by example

Does your organization have specific performance expectations for the current fiscal year that are tied to its strategic plan and can be articulated in 3 sentences or less?

Can members of senior, middle and lower management articulate the organization's performance expectations and do most understand how they relate to them?

Are there members of your organization's senior leadership team who frequently are obstacles to change, but remain in their positions due to tenure or political clout?

2. Tighten the core

Is it difficult to get a new position approved within your organization?

Do leaders within your organization feel as though missing their budget is an action that will have serious individual consequences for them?

3. Drive 'fixed' costs to become more variable

Are your administrative/corporate functions growing while your volumes are flat or decreasing?

When budget gaps arise, do clinical areas bear the brunt of most cost reduction exercises, while corporate/support functions are allowed to make minor adjustments without putting any material 'skin-in-the-game'?

4. Leverage shared services (in traditional & non-traditional ways)

Are there obvious areas to better leverage economies of scale and reduce duplication of services within your organization?

Do you feel as though the functional leaders within your organization have the objectivity to see beyond the 'four walls' of their department and critically analyze opportunities for consolidation without it being thrust upon them?

Is there significant variation in the performance of similar support functions across the organization (e.g., cost, quality, service levels)?

5. Manage your demand, not just your costs

In the last period that your organization missed its projected volume, did you know by the mid-point of that month exactly where and why demand was down?

If you were to create an analog of the 'customer' experience that physicians and patients have at your facilities, would it be more like a high-end luxury car (well honed and responsive) or a mid-priced minivan (serviceable, but not flashy)?

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