In “Getting Serious about Costs” in the summer 2017 issue of this newsletter, Ken Kaufman noted that fundamental change in organizational cost structure has not yet occurred, and that most cost reductions to date have been incremental at best.

Our newly released cost survey of 150 senior executives, *2017 State of Cost Transformation in U.S. Hospitals: An Urgent Call to Accelerate Action*, confirms these observations. More than half of survey respondents have no cost control goals in place for the next five years or have a goal of only 1-5 percent, which is far below the 25- to 30-percent reduction over a five-year period that Kaufman Hall recommends (Figure 1). “Average” to “below average” is how 75 percent of respondents rate their cost transformation success.

To achieve the recommended levels of transformative cost reductions, Mr. Kaufman suggests that healthcare leaders pursue three initiatives: reconfigure the portfolio, redesign the care model, and reconfigure use of labor.

This article offers additional report findings, examines the first initiative, and provides guidance on how to get started on portfolio reconfiguration and rationalization.

### Awareness Not Translating into Results

Consolidation in the healthcare industry during the last decade was projected to produce economies of scale and other efficiencies that would lower costs. Consolidating overhead

![Figure 1. Cost Reduction Goals Identified by Survey Respondents](image-url)
functions typically is tackled first in merger or acquisition situations. The more difficult and politically charged process of relocating services from one facility to another, or eliminating them, often is postponed indefinitely, resulting in duplicative and costly clinical services in overlapping markets.

Our 2017 cost survey results bear this out. Service line rationalization, which has been broadly identified as having substantial potential to contribute to cost transformation efforts, was cited as a key focus by only 18 percent of survey respondents, while traditional cost-cutting measures, such as labor costs and supply chain, were the dominant cost reduction activities among respondents (Figure 2).

Healthcare organizations routinely examine strategic questions such as what businesses and services are core to our mission and vision, where can we most effectively invest our limited capital to meet community needs, and can we be all things to all people? When strategic questioning moves into goal setting and tactical implementation, however, the hard choices often are avoided.

Reconfiguring the portfolio means selling, consolidating, and closing clinical programs, business lines, and facilities that do not have sufficient volume or cannot perform at necessary financial or clinical standards. It means ensuring that patient care is delivered in the most appropriate place by providing routine care and simple procedures in ambulatory facilities instead of directing large volumes of outpatient services through high-cost medical centers.

By closing or consolidating services with diminishing volume, below average or declining patient outcomes, and increasing costs, resources are freed up to launch new or expanded service lines and facilities that better meet community needs in a more cost-effective manner.

Reconfigured Portfolios: The Time is Now

Reconfiguring portfolios must now move to the forefront of the cost transformation strategies being pursued by executives. Anthem’s recent announcement that it will direct patients away from hospital-based outpatient imaging services toward lower-cost freestanding centers is an example of an unsettling development indicating what is at stake as value-based care moves from theory to practice. For hospitals and health systems that are already contending with lower volumes and thinner margins, this announcement has triggered a heightened level of concern about their

**FIGURE 2. BUSINESS AND SERVICE LINE COST REDUCTION INITIATIVES**

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Initiative</th>
</tr>
</thead>
<tbody>
<tr>
<td>41%</td>
<td>cite service line efficiency as a key focus</td>
</tr>
<tr>
<td>38%</td>
<td>cite physician enterprise management as a key focus</td>
</tr>
<tr>
<td>18%</td>
<td>cite service rationalization as a key focus</td>
</tr>
<tr>
<td>Yet &gt;60%</td>
<td>think their delivery networks are not highly efficient or aligned with the needs of the populations served, or are neutral on this issue</td>
</tr>
</tbody>
</table>

bottom line, as well as questioning about what longer-term strategies will best position their organization to thrive. Right-sizing and right-placing services and facilities will require commitment and fortitude by leadership teams and boards as they balance cost reduction efforts with payer restrictions and community needs. Some degree of disruption, such as closures and staff reductions, often is unavoidable, but the longer-term goal of delivering the highest quality care in accessible and affordable settings must be the top priority.

Changes in mindset will be required. Health system leaders who have long relied on the hub-and-spoke model—where community hospitals funnel patients to the flagship facilities—are having to change their thinking to adapt to the notion that both high-tech and high-margin services can be packaged and delivered in more convenient locations, with nontraditional amenities that interest patients.

For example, Orlando-based Florida Hospital has pursued a deliberate strategy to invest in smaller hospitals that offer a limited number of service lines. One of these facilities, Winter Park Memorial Hospital, allows women to design their birth experience with a selection of pillows, musical soundtracks, in-room massage, and other comforts. While one might conclude that this specialty environment comes with a high price tag, many organizations are finding that not to be the case. When facilities focus on a smaller set of services, they become ultra-efficient and their physicians and staff tend to be very engaged and focused on efficient, quality care.

Since 2012, Hoag Orthopedic Institute, a partnership between Hoag Memorial Hospital Presbyterian and physician owners, has posted its quality data on its website and as a 45-page annual Outcomes Report. The data include readmission rates, surgical site infections, and other complications. More recently, the institute has begun also publishing patient pain scores from before surgery to nine months post-surgery. When quality issues are identified, Hoag is transparent about revealing what remedies are being undertaken, and whether solutions have been identified. Transparency also is evident with pricing. Consumers may view cash rates for procedures that include global pricing for facility fees, implant costs, an overnight stay, and surgeon, assistant, and anesthesiologist costs. Hoag’s high national ranking among orthopedic facilities is evidence that the organization’s “focused factory” approach substantially improves outcomes and reduces costs.

**How to Get Started**

Leading healthcare organizations have started to reconfigure and rationalize service lines as part of their care and cost transformation initiatives. Here’s guidance on how they’ve moved initiatives forward.

1. **Conduct a top-to-bottom review**

The mission, market/competitive position, financial performance, operations, current and anticipated demand, and other concrete criteria must be used to evaluate all services. Rethinking of service lines as cost centers, rather than points of care that must be protected, will help bring the objectivity needed to thoroughly examine all services on a level playing field.

Critically, in addition to a focus on costs, volume and quality must be scrutinized using the best data available. How does current usage compare with historical and projected numbers? Have outcomes or quality been impacted? Do outcomes and quality meet regional and national benchmarks/expectations? What services are shifting from inpatient to outpatient settings? In particular, minimum

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**Incorporating both quality measures and cost reduction potential into the top-to-bottom review ensures that decisions regarding the portfolio are more than just a cost-cutting exercise.**

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continued on page 4
thresholds recommended for keeping a procedure at a facility must be factored in as executive teams and boards make decisions about service lines. The highest quality of patient care is achieved through volume, repetition, and specialization. Reducing unnecessary clinical and technology duplication, and right-placing and right-sizing facilities help maximize use of limited capital and human resources. How organizations rationalize clinical services to meet patient needs across a geographic region must keep these concepts at the core as strategies are crafted and implemented.

In some cases, healthcare leaders fear loss of reputation if their facility doesn't offer a service, but struggle to acknowledge that delivery of subpar patient care will threaten the organization’s reputation as well. When leaders of one health system that performed 600-700 open-heart procedures a year across four separate hospital sites examined the program’s mortality rates—which were average for an average-sized program—candid discussion was needed to determine the program’s future. Concerns about community pushback and potential damage to individual hospitals’ reputations contributed to a stalemate. Yet, when looking around the room at each other, hospital executives, physicians, and board members admitted that they would be hesitant to have open-heart surgery at one of their own hospitals.

Executives in another facility discussed the ramifications of closing their low-volume (250-300 births annually) obstetrics unit that had significant locum tenens coverage, C-section rates that were higher than expected, and average outcomes. One individual asked, “Will mothers and babies die if we close the unit?” Another candid stakeholder responded, “Will mothers and babies die if we keep the unit open?”

Incorporating both quality measures and cost reduction potential into the top-to-bottom review ensures that decisions regarding the portfolio are more than just a cost-cutting exercise. If conducted in a fair and balanced way with physicians and hospital/system leadership asking important questions and engaging in full discussions of benefits and risks, these reviews support the ultimate goal of better care at lower costs, and provide the objective framework for reconfiguring and rationalizing services.

2. Define the organization’s new configuration of services

Next, leaders should consider what a completely redesigned system of care would look like. Would there be more outpatient sites and fewer hospital-based services? What types of care should be delivered where? Would similar types of care be co-located?

As formal discussions advance, a well-communicated and transparent decision-making process should be in place. Stakeholders must be involved and consulted at appropriate points during the process to ensure that their perspectives are considered and that they understand the rationales for critical decisions. Physicians, in particular, and nursing staff must be informed and educated about clinical and financial data used to drive decisions. Energy must stay focused on the long-term aim of portfolio reconfiguration and service line rationalization, and the benefits it can bring to clinicians and patients, including better outcomes, increased efficiencies, and greater control of care processes. Changes that have strong clinician support should be considered as priority opportunities since they could deliver early wins and momentum for further reconfiguration activities.

3. Create a long-term implementation plan based on these insights

Discussions about reconfiguration and rationalization of services should ultimately lead to a plan that drives improved operating performance and efficient care delivery across a geographic region, without compromising quality and

Thorough and thoughtful planning must lead to outstanding execution. A documented and detailed implementation plan must be in place with clearly defined parameters, expectations, and timelines.
outcomes, and ideally, improving both. Opportunities that will improve patient outcomes and the organization’s bottom line, and that have physician support should be prioritized.

As with all initiatives that demand substantial change, thorough and thoughtful planning must lead to outstanding execution. A documented and detailed implementation plan must be in place with clearly defined parameters, expectations, and timelines. Momentum must be attended to, as political challenges and organizational resistance to change surface. Leadership oversight and commitment to continued progress will be key to advancement of initiatives.

Indiana University (IU) Health has spearheaded a multi-year, multi-phase approach to optimizing the distribution of its services, involving a transformation process that has included mergers, acquisitions, divestments, and facility turnarounds. Phase I included a strategic, financial, and facility assessment to create the fact base for further evaluation and decision making. A review of healthcare reform implications and a competitor assessment informed the foundational information as well. Next came the visionary and strategy development phase, where stakeholders created a vision of what IU Health should be as a regional and statewide healthcare provider, followed by creation of strategies that would help the organization advance toward that vision.

Over the course of the last several years, IU Health has made multiple decisions to reconfigure and optimize its portfolio of services. The organization has invested and strengthened community hospitals surrounding its downtown Indianapolis hub in order to meet community needs and keep appropriate care local. In 2014, IU Health opened its Neuroscience Center and a dedicated specialty center. In more rural geographies, the system has repurposed IU Health Morgan to serve as an outpatient hub for the region, while closing its inpatient services. Recently, IU Health announced its intention to consolidate its tertiary services from University Hospital to Methodist Hospital.

Conclusion

When cost transformation recommendations are presented, the temptation to delay will be strong, particularly when politically charged decisions about how and where healthcare services are provided are at stake. Settling for “reconfiguration lite” can be a tempting option; however, as Mr. Kaufman points out in the summer 2017 Kaufman Hall Report, one area within healthcare that will not be changing is the need to significantly lower costs. In a time of great uncertainty, dramatic cost reduction is a no-regrets strategy.

Reconfiguration and rationalization initiatives will test organizations on many levels, challenging service line stakeholders to think beyond their interests and understand that these efforts are part of broader initiatives to provide high-quality care as cost effectively and efficiently as possible. Hospitals and health systems with the leadership teams, organizational commitment, and wherewithal to implement reconfiguration and rationalization strategies will be better positioned to achieve the aggressive cost reduction goals that are no longer optional.

For more information, contact Walter Morrissey, M.D., at 847.441.8780 or wmorrissey@kaufmanhall.com.

References

This is the one event you do not want to miss this year.

The 2017 Healthcare Leadership Conference

Time is running short to register to attend this exceptional educational and networking opportunity presented by Kaufman Hall October 18-20 at the Four Seasons Hotel Chicago. This year’s conference features a rich agenda with expanded opportunities to gain valuable insights from and engage with other healthcare leaders across the country.

See an unmatched lineup of speakers at the must-attend event for senior health system executives and trustees:

The Undoing Project: Turning Decision Science Upside Down
Michael Lewis
Acclaimed Writer
Author of Moneyball, Liar’s Poker, and The Big Short

Transformative Leadership
James Skogsbergh
President and CEO
Advocate Health Care

Eugene Woods
President and CEO
Carolinas HealthCare System

High-Definition Individualized Medicine
Eric Topol
Prominent Cardiologist and Medical Futurist
Scripps Health

Values-Based Leadership
Harry Kraemer
Author and Business Leader
Northwestern University

Leadership Imperatives in the Internet Economy
Kenneth Kaufman
Chair
Kaufman Hall

All-New: Anatomy of a Rating Agency Review

Martin Arrick
Managing Director
S&P Global

Lisa Goldstein
Associate Managing Director
Moody’s Investors Service

Kevin Holloran
Senior Director
Fitch Ratings

Therese Wareham
CEO
Kaufman Hall

The conference concludes Friday morning with a compelling, highly interactive Rating Agency panel you won’t want to miss. Kaufman Hall CEO Therese Wareham will be joined by senior representatives from Fitch, Moody’s, and S&P Global to describe how to approach a rating agency review in today’s rapidly changing environment.

Register at www.kaufmanhall.com/hlc
The publishing arm of the American College of Healthcare Executives recently released *Strategic Allocation and Management of Capital in Healthcare: A Guide to Decision Making, Second Edition*, authored by Jason H. Sussman, CPA, FACHE. Mr. Sussman is a Managing Director at Kaufman Hall, where he directs capital planning and allocation advisory services in the firm’s Strategic and Financial Planning practice.

The book provides leadership teams with detailed guidance for making strategic investment decisions. Employing corporate finance principles, it explains, step by step, how to (1) establish a framework for standardized, portfolio-based review of capital investment opportunities; (2) identify an organization’s capital constraint; (3) assess and select the best value-enhancing projects; and (4) manage post-allocation activities, including monitoring of project investments and measurement of results.

This book will help the leadership teams of organizations of all types and sizes—from small community hospitals to large healthcare systems and physician groups—to make informed decisions for smart investments in their organizations’ future.

“I am confident you will find this book enormously helpful in moving your organization forward in a time of great challenges, yet also great opportunity,” notes Peter L. DeAngelis Jr., EVP, CFO, and CAO of Thomas Jefferson University and Jefferson Health in the foreword.

Covering new capital investment needs and decision making in a rapidly changing and uncertain environment, this edition has been updated throughout. New features include:

- Case examples with approaches, planning schedules, and reports used by high-performing healthcare organizations
- Helpful tools, such as a form for prioritizing capital investment opportunities and a sample curriculum for educating physician leaders on the capital allocation process
- Practical, on-the-ground guidance at the end of each chapter
- A final chapter on the prerequisites for a successful capital allocation and management process, including education; use of high-quality tools, communication, and transparency; and a disciplined implementation plan

For more information, visit [http://www.ache.org/Publications/product.aspx?pc=2342](http://www.ache.org/Publications/product.aspx?pc=2342) or call ACHE Customer Service Center at (312) 424-9400. Order Code: 2342, $70. Discounts are available for bulk orders of the book for boards of directors or other leadership teams. For more information, contact Nancy Vitucci at nvitucci@ache.org. For an examination copy, contact Lee Anne Elston at laelston@kaufmanhall.com.
The imperative to provide less costly, more efficient and effective care has never been more critical. However, results of a new Kaufman Hall survey report, 2017 State of Cost Transformation in U.S. Hospitals: An Urgent Call to Accelerate Action, indicate that healthcare leaders are not pushing their organizations far enough fast enough.

The survey of more than 150 senior hospital executives shows that healthcare leaders recognize the need for cost savings and the strategies that must be pursued, but urgency is lacking when it comes to setting ambitious, longer-term goals and implementing the required strategies.

Nearly 80 percent of respondents cite the need to proactively revise their cost structure to align with the transition to value-based care, and nearly 70 percent indicate they must close the gap between their financial plan and current operating performance (Figure 1). Yet, more than 50 percent of responding executives have no cost reduction targets for the next five years or only have a goal of 1-5 percent, which is far below what is required to transform cost structures, or even keep pace with inflation.

Survey respondents also are continuing to rely on traditional cost improvement measures such as labor cost/productivity, supply chain costs, and revenue cycle enhancement as their primary cost transformation strategies. In most organizations, these strategies have been in place for decades and are widely acknowledged as lacking the potential to deliver the dramatic cost savings now needed. Actions with the potential to yield substantially higher savings, such as service line efficiency and rationalization, physician enterprise management, and clinical and workforce redesign, are not being pursued aggressively. As one survey respondent stated, “We are cost cutting, but not really changing the way we operate.”

**Barriers to Progress**

The absence both of reliable data upon which to focus cost reduction efforts, and of accountability for achieving cost transformation benchmarks, were the most common impediments to significant cost reduction. In particular, 25 percent of respondents cited as troublesome the lack of solid data and insights on current costs and cost-saving opportunities. In addition, cost accounting methods, processes, and tools lack credibility, with only 25 percent of respondents expressing confidence in their current cost accounting solution. Many organizations (54 percent) do not have strong processes in place to hold leadership accountable for cost transformation initiatives.

**Four Actions to Ensure Vigorous Transformation**

The report offers four key strategies healthcare leaders can use to achieve significant cost reduction. For more information, please see the full report at: www.kaufmanhall.com/2017-cost-report.
Hospitals and health systems across the country have been slow to catch up with rapidly changing consumer demands. Only 8 percent of healthcare organizations are applying successful practices to meet these new expectations, according to a recent report from Kaufman Hall.

The 2017 State of Consumerism in Healthcare report benchmarks how well America’s hospitals and health systems understand their consumers and apply effective strategies to meet their needs in areas such as access, pricing, and improving the patient experience.

Using a tool called the Healthcare Consumerism Index, the report findings are drawn from analysis of a recent survey encompassing more than 125 organizations. The Index rates survey respondents according to their organizations’ levels of priority, capability, and functionality relative to consumer-based strategies.

The analysis shows that consumerism is a high priority for most healthcare organizations, but many have been slow to build capabilities to meet core consumerism objectives:

- 90 percent of organizations identify improving the consumer experience as a high priority, but only 30 percent have built capabilities to do so
- 73 percent identify developing a diverse set of facility-based access points as a high priority, but just 25 percent have the needed capabilities
- 58 percent identify offering digital tools and information to enable consumer engagement as high priorities, but just 14 percent have those capabilities

Significant discrepancies also exist when it comes to how well organizations are meeting consumer needs and wants, according to the survey. For example, respondents were asked to rank which factors most distinguish their organizations from the competition, and then which factors they believe their consumers value most in selecting a provider.

Accessibility of care was seen as most important to consumers, followed by consumer experience (encompassing consumer interactions from initial contact through completion of care and rehabilitation)—but those factors ranked third and fifth respectively as differentiators in terms of what organizations currently offer consumers. Meanwhile, quality of clinical outcomes was cited as the top competitive differentiator for respondents, but ranked third for what respondents perceive as consumers’ priorities.

These responses suggest a general lack of alignment between what healthcare leaders see as their organizations’ primary competitive strengths, and what they perceive consumers want most.

**FIGURE 1. OVERALL PERFORMANCE: KAUFMAN HALL’S HEALTHCARE CONSUMERISM INDEX**

<table>
<thead>
<tr>
<th>Tier</th>
<th>Percent</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1</td>
<td>8%</td>
<td>Meeting consumer expectations is a high priority; several important consumer-related capabilities are being applied with some demonstrated successes, and more are in the works</td>
</tr>
<tr>
<td>Tier 2</td>
<td>29%</td>
<td>Meeting consumer expectations is a high priority, and work is underway on several new consumer-related capabilities</td>
</tr>
<tr>
<td>Tier 3</td>
<td>37%</td>
<td>Meeting consumer expectations is a medium or low priority, and only moderate activity is underway on new capabilities</td>
</tr>
<tr>
<td>Tier 4</td>
<td>27%</td>
<td>Meeting consumer expectations is a medium or low priority, and minimal activity is underway on new capabilities</td>
</tr>
</tbody>
</table>

Other key findings of the report include:

- Only 15 percent of organizations are aggressively moving to improve patient access with both diverse sites of care and digital connectivity
- Nearly three-fourths of organizations rate poorly relative to their efforts to use consumer insights for decision making
- Less than 10 percent of organizations are pursuing pricing strategies and price transparency as high priorities

The findings should serve as a wake-up call for hospital and health system leaders across the country, said Paul Crnkovich, Managing Director with Kaufman Hall.

“In the age of Amazon and Netflix, consumers expect more from their healthcare providers,” Mr. Crnkovich said. “For healthcare executives, consumerism should not be just another item to be checked off a list. It should be a core capability, as it is key to long-term growth.”

Organizations that fail to move forward in these areas will be left behind. Many already are feeling the pressure. As one survey respondent put it: “Several years ago, we were a mover and a shaker, but now we’re behind the industry because consumerism has moved so quickly.”

For more information, please see the full report at: www.kaufmanhall.com/2017-consumer-report

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Kaufman Hall Axiom Software Training

For the current schedule of software training sessions and to register for a class, please visit http://education.kaufmanhall.com.

Registration is limited. Class dates and availability are subject to change based on client demand.

For more information, please call 847.441.8780, or email training@kaufmanhall.com.
Contract Management Solution Empowers Payer Negotiations for Sturdy Memorial Hospital

As the healthcare industry transitions to more complex payment models, maximizing net patient revenue has become a greater challenge for hospitals and health systems. Many organizations are tapping into the power of contract modeling and analytics tools to help them better predict and manage reimbursement and leverage a data-driven approach for improved payer negotiations.

Sturdy Memorial Hospital, a not-for-profit community hospital in Massachusetts, recently received from a payer a contract that moved from percent of charges to inpatient APR-DRGs and outpatient fee schedules. With the help of Kaufman Hall’s Contract Management software, hospital staff analyzed the terms of the proposed new contract and avoided a significant loss in expected payment by renegotiating the terms of the agreement.

“In the past, performing a payer review was a very manual process,” said Jeanine Levinson, Director of Budget and Reimbursement for Sturdy Memorial. “We compared actual payments to charges and did all of the analysis in Excel. With the help of Kaufman Hall’s software, we now are able to look with ease at the whole picture.”

Visit www.kaufmanhall.com/sturdy to read the case study and learn more about how Contract Management software is empowering Sturdy Memorial.

How Reliable Cost Data Support Strategic Decision Making at ProHealth Care

Several years ago, the executive leadership team of ProHealth Care, a two-hospital integrated system based in Wisconsin, sought to develop expanded data and analytics capabilities. The goal was to strengthen fact-based decision making related to changing healthcare policies, service line delivery, and value-based management of population health across the care continuum.

Management aimed to distribute accurate and reliable costing and profitability information across the enterprise and require use of that information for capital planning, service line management, business plan development, pricing, managed care contracting, and all other key strategic initiatives, said Ron Farr, ProHealth’s Chief Financial and Administrative Officer.

Using Kaufman Hall’s Cost Accounting and Decision Support solution, ProHealth is realizing that vision and enabling data-driven decision making in several important areas of the business.

Visit www.kaufmanhall.com/prohealth to read the case study and learn about the progress the health system is making.

Calendar of Events

**KaufmanHall Report** Fall 2017

**HFMA Alabama Chapter Fall Institute**
*Capital Planning in the New Era of Healthcare*
Jason Sussman
September 25, 2017, Miramar Beach, FL

**SHSMD Connections Annual Conference**
*Strategic Planning for the Future of Healthcare: Time to Pivot*
Mark Grube and Paul Crnkovich
September 26, 2017, Orlando, FL

**First Illinois Chapter HFMA Fall Summit**
*Strategic and Financial Planning in Light of Industry Transformation*
Jeff Kilpatrick and Gavin McDermott
October 25, 2017, Oakbrook, IL

**Sigma Theta Tau International: 44th Biennial Convention**
*Nurses on Boards: Lessons from the Board Room*
Therese Fitzpatrick, PhD, RN, FAAN
October 30, 2017, Indianapolis, IN

Visit www.kaufmanhall.com for more information.