5 Strategies for Transformative Cost Reduction

By Lance B. Robinson, Todd W. Fitz, Kristopher M. Goetz, and Daniel Sargeant, Dr.P.H.
Introduction

The Healthcare Environment: Pressures accelerated for the nation’s hospitals and health systems during the past year. Multiple forces, including competition, consumer expectations, payment pressures, and regulation, are expected to cause a decline in demand and revenue for core inpatient services. This trend increases the imperative to reduce costs to alleviate shrinking hospital margins. New approaches to care delivery, such as retail clinics and telehealth, have emerged to offer consumers high-volume services at lower prices and more conveniently than hospital outpatient facilities. Powerful new players, such as the venture formed by giants Amazon, JPMorgan Chase, and Berkshire Hathaway, are on the scene, with the intellectual and capital investment capabilities to overhaul significant pieces of the health/healthcare business.

Such forces have the potential to minimize or eliminate the role played by legacy healthcare organizations. “The specific future for legacy hospitals and health systems may be hazy, but we know its direction,” notes Kenneth Kaufman, Chair of Kaufman Hall. “Meaningful actions can and must be taken immediately.”


About the Report

This report presents results of an online survey completed in 2018 by senior executives of U.S. hospitals, health systems, and other healthcare organizations.

The goal of the 2018 survey was to gauge where industry participants stand with regard to transforming the cost of care.

- **Nearly 190 senior executives** from hospitals and health systems participated in the 2018 report.
- **70 percent** of participants were in executive leadership or finance roles; the remaining 30 percent were individuals in operations, strategy, quality, clinical management, and other areas.
The Cost Transformation Imperative

The forces driving the need for significant cost reduction are both strategic and financial.

70% of executives cite the need to be proactive in lowering the organization’s cost structure during the transition to a value-based payment model.

67% of executives cite the need for their organizations to remain competitive amidst traditional and non-traditional competitors.

61% of executives cite the need to generate capital/capital capacity to fund strategic growth initiatives.

A smaller (but still large) proportion of respondents cited preparation for the value-based model as a factor driving their cost-reduction efforts. Many organizations might have made investments that are longer term, and achievement of expected targets related to such investments may remain a goal. Competition and funding for growth initiatives are motivating a greater proportion of executives to lower their organizations’ cost position.

Factors Driving the Need for Cost Transformation

<table>
<thead>
<tr>
<th>Factor</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>To refine our cost structure as we transition to the value-based model</td>
<td>70%</td>
</tr>
<tr>
<td>To remain competitive in our service area</td>
<td>67%</td>
</tr>
<tr>
<td>To generate capital to fund strategic growth initiatives</td>
<td>61%</td>
</tr>
<tr>
<td>To close the gap between our financial plan and current operating performance</td>
<td>59%</td>
</tr>
<tr>
<td>To participate in making care more affordable</td>
<td>59%</td>
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Takeaway:
The cost-transformation imperative is driven more by strategic needs/forces than financial needs/forces in most organizations.

Note: A “check all that apply” option was available.
Top 5 Strategies to Initiate Progress

1. Set comprehensive targets to ensure organization-wide engagement.

2. Hold leaders accountable for setting and achieving transformative cost-reduction goals.

3. Focus on all initiatives that can contribute to transformative cost improvement.

4. Focus on the physician enterprise.

5. Use high quality data, analytics, tools, and processes to improve decision-making and track progress.
Strategy 1. Set comprehensive targets to ensure organization-wide engagement.

The Cost Transformation Imperative

Lessons from Amazon, retail, and other disruptors apply in healthcare today and tomorrow. These competitors seek to carve out the segments of healthcare with the lowest fixed costs and the highest volume and pass on the savings of operational efficiencies as lower prices for customers.

Takeaway:

Executives should be transparent about the need to reduce costs with all key stakeholders, including physicians, staff, and the community at large. Transparency of processes, responsibilities, and targets helps ensure communication and dissemination of relevant cost-reduction information.

Strategy 2. Put in place the structures and processes required for cost transformation accountability, and hold leaders accountable for setting and achieving transformative cost-reduction goals.

The structures and processes required to transform costs organization-wide need to be built and strengthened

Financial realities make cost transformation an imperative for healthcare organizations and their leaders. Significant improvement is needed in organizational commitment to goal setting that will build organizational agility through more extreme lowering of costs (beyond 1 to 5 percent) and into double-digit levels that can transform cost structures.

A close study of survey data indicates organizations that hold leaders accountable for targets are more likely to report progress in most cost-reduction priority areas.

Takeaway:
A structured, comprehensive approach to cost transformation is paramount. The approach includes clearly defined roles, accountability and reporting, goal setting, and ultimately, incentives tied to sustainable cost control. While financial incentives are helpful, they aren't sufficient without an engaged management team.

Use of Incentives to Improve Operational Cost

- Progress toward individual/department goals is built into the performance review process: 59%
- Leaders can earn financial rewards for the attainment or improvement of individual/department goals: 40%
- Leaders report on their progress regularly in front of their peers: 38%
- No incentives are in place: 19%
- Other: 6%

Note: A “check all that apply” option was available.
Where Are Organizations Focusing?

Traditional priorities dominate attention for cost reduction, with 72 percent of executives citing labor cost/productivity and supply chain and other non-labor costs as a key focus area. Areas that will contribute to changing foundational cost structure, such as service rationalization and physician enterprise management, are not being addressed at a similar pace (29 percent and 45 percent, respectively). Physician engagement in cost-transformation efforts appears limited. The top-cited strategy to engage physicians in cost transformation is to regularly deliver to them reports on quality, cost, and patient experience, but this was cited by less than half of respondents (42 percent).

Takeaway:

A new mindset is required for the kind of extreme shift and lowering of costs that will distinguish an organization into the future. That frame of mind is characterized by a willingness to focus on the full cost transformation agenda. This will require overcoming entrenched incrementalism and political sensitivities to make progress with the hardest cost-reduction work—namely business and service line rationalization, physician enterprise management, clinical redesign, and workforce redesign.

4. A “check all that apply” option was available.

Engagement of the physician enterprise in cost transformation is limited, at best

The top-cited physician engagement strategy is to regularly deliver reports on quality, cost, and patient experience, but this was cited by less than half of respondents.

In our experience, organizations that are able to engage their physicians typically are the organizations with stronger strategic and financial performance. Most physicians want to improve their performance. Regularly providing physicians with relevant data and enabling a view of their performance in the context of peer performance helps them to identify improvement opportunities that can be pursued.

Takeaway:
The identification and engagement of strong physician sponsorship in a chief medical officer or other physician leader are critical to obtaining buy in from other physicians in the organization. Benchmarks provided to clinicians should be directional in nature (i.e., normalized based on an understanding of the relevant operations) and applied in the context of the system as a whole. Reporting on progress should occur regularly in medical staff meetings. All of the surveyed engagement strategies, as presented in the graph, should be used by organizations.

Strategies to Engage the Physician Enterprise

- Reports (quality, cost, patient experience) delivered to physicians regularly: 42%
- Physician leaders are members of cost transformation steering committee: 39%
- Physician advisory council: 25%
- None of the above: 22%
- Cost improvement targets built into physician contracts: 17%
Strategy 5. Use high-quality data, analytics, tools, and processes to drive improved decision making in clinical and business domains, and the tracking of improvement progress across transformation areas.

Data, analytics, and important processes or tools are absent or not reliable at many organizations

To succeed in reducing an organization’s cost structure, executives need a rich set of accurate data that gives them insight into their current costs and allows them to make informed decisions on how to reduce costs going forward. The data and analytics must extend beyond financials to include clinical and other operational data sets. Reporting of cost and profitability trends should be broad to support strategic decision making. Less than 30% of executives have a high degree of trust in their existing cost accounting solution; consequently, most executives want to do more to leverage data and analytics to improve insights and decision making. Reliable cost data, analytic insights, decision making, and monitoring are required to transform costs in a sustainable way.

Takeaway:
A reliable cost-accounting tool is critical to cost transformation. Such a tool offers robust data and analytics, is integrated with the organization’s strategic-financial planning software, and delivers the right information in an actionable format.

Survey data indicate executives that have confidence in the accuracy of their cost accounting data are more likely to report progress in areas such as labor costs and clinical variation reduction.
CONCLUSION

Moving to a Transformed Cost Structure

As noted in this report, core strategies for achieving transformative cost improvement include the following:

- Ensure all top disruptive forces facing the nation’s healthcare organizations are on leaders’ radar screens and driving cost transformation.

- Put in place the processes and structures required for cost transformation accountability, and hold leaders accountable for setting and achieving transformative goals:
  - Set specific and ambitious goals and distribute targets enterprise-wide
  - Put in place incentives for achieving cost-transformation targets
  - Hold leaders accountable for the achievement of performance-improvement goals

- Focus on initiatives that can truly yield transformative improvements: physician enterprise management; inappropriate clinical variation reduction; service rationalization; service line efficiency; and redesign of the clinical workflow/model and workforce. Physician engagement is critical to these more transformative initiatives.

- Use high-quality data, analytics, tools, and processes to drive improved decision making in clinical and business domains and the tracking of improvement progress across transformation areas:
  - Ensure access to information through broad report distribution and other approaches

To reconfigure their businesses for a much more cost-competitive future, healthcare leadership teams must ensure a “profound refocus” on lower-forever initiatives as well as traditional initiatives and their enablement through reliable data, analytics, processes, and tools. Lower-forever initiatives permanently remove or reshape capital-intensive structures, models, and processes. They do so by redesigning care, rationalizing/right-sizing services, and reducing unwarranted clinical variation to continually remove utilization from the system.

Leadership teams must be willing to tackle the more politically sensitive opportunities. The core strategies above require strong resolve, but they are necessary to truly bend the cost curve. If implemented correctly, organizations will begin to see the year-over-year benefit sustained over time.

About the Authors

Lance Robinson is a Managing Director of Kaufman Hall and leader of the firm’s Performance Improvement practice, which includes individuals with deep expertise in labor, non-labor, productivity, supply chain, contracted services, overhead, clinical service mix, and revenue cycle management. Mr. Robinson works with hospitals and health systems nationwide to redefine the way healthcare leaders view performance improvement by providing data-driven insights and solutions for achieving widespread and sustainable results.

Mr. Robinson has more than 25 years of experience in healthcare, working on both the provider and consulting sides of the industry. Prior to joining Kaufman Hall, he was a Partner at Berkeley Research Group (BRG). Mr. Robinson earned an MBA in Accounting and a Bachelor of Science in Health Care Management and Accounting from the University of Alabama. lrobinson@kaufmanhall.com

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Prior to joining Kaufman Hall, Mr. Goetz held numerous leadership positions at Northwestern Memorial Hospital in Chicago, including Director of Operations, Manager of Performance and Innovation, and Process Improvement Leader. Mr. Goetz holds a Master of Arts in Clinical Psychology and a Bachelor of Arts in Psychology from Eastern Illinois University. kgoetz@kaufmanhall.com

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Prior to joining Kaufman Hall, Dr. Seargeant served as the Chief Financial Officer of a large non-profit outpatient community health organization and a for-profit statewide managed care organization. Dr. Seargeant holds a Dr.P.H. from the Health Policy and Management Department at the Fielding School of Public Health of the University of California, Los Angeles, an M.B.A. with an emphasis in Finance and Information Technology from UCLA, and a B.A. in Accounting and Finance from the College of Idaho. dseargeant@kaufmanhall.com
About Kaufman Hall

Kaufman Hall provides management consulting and software to help organizations realize sustained success amid changing market conditions. Since 1985, Kaufman Hall has been a trusted advisor to boards and executive management teams, helping them incorporate proven methods into their strategic planning and financial management processes and quantify the financial impact of their plans and strategic decisions to consistently achieve their goals.

Kaufman Hall services use a rigorous, disciplined, and structured approach that is based on the principles of corporate finance. The breadth and integration of Kaufman Hall advisory services are unparalleled, encompassing strategy; financial and capital planning; cost transformation; treasury and capital markets management; and mergers, acquisitions, partnerships, and joint ventures.

Kaufman Hall software includes the Axiom® Healthcare Suite, providing sophisticated, flexible performance management solutions that empower finance professionals to analyze results, model the future, and optimize organizational decision making. Solutions for long-range planning, budgeting and forecasting, performance reporting, capital planning, and cost accounting deliver decision support, reporting, and analytics within an integrated software platform. Kaufman Hall’s Peak Software empowers healthcare organizations with clinical benchmarks, data, and analytics to provide a higher quality of care for optimized performance and improved patient outcomes.

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