William J. Doherty
Michael Connell
Kimberly Neese
Gavin McDermott

REPRINT June 2017

hfm

healthcare financial management association hfma.org

exploring opportunities for transforming cost structure

A performance improvement process undertaken by a northeastern health system exemplifies fundamental principles that should characterize all such efforts.

Most healthcare organizations are feeling the pressure to get to a "new normal" cost of care while continuing to improve the quality, patient experience, and outcomes of services they deliver in their communities. Three categories of performance-improvement activities typically are required:[a]

> Margin improvement through optimizing labor, nonlabor, revenue cycle, and other "core" costs
> Business and service-line right-sizing and right-siting to optimize the delivery network
> Clinical transformation to enhance care delivery efficiency and quality

Effective cost transformation invariably begins with a systemwide assessment of current performance in these areas. This initial phase provides the fact base upon which the organization can begin to quantify savings opportunities. It also sets the stage for the core cost-restructuring phase, during which the organization acts on the assessment findings by creating and implementing the structure and processes for realizing the savings opportunities.

The approach taken in 2016 by two-hospital Hallmark Health System (Hallmark), based in Medford, Mass., exemplifies an effective cost transformation initiative. Here, we describe how Hallmark used a four-step strategy based on assessment findings to develop a target for performance improvement and then organized,

AT A GLANCE

An effective cost transformation initiative comprises four strategic steps:

> Assess cost-saving opportunities and use findings to set the stage for improvement.
> Establish oversight and identify the overall performance improvement target.
> Engage division leaders in setting targets and identifying how best to meet them.
> Gain consensus on the initiative's importance and its overall financial goal.

a. For a related discussion, see Hill-Mischel, J., Morrissey, W.W., Neese, K., and Shoger, T.R., "The Path to Cost Transformation," *hfm,* June 2016.

Hallmark In-Brief

Hallmark Health System (Hallmark) is a two-hospital system serving communities in the northern suburbs of Boston. It has outpatient facilities, physician practices, and community-based services, including urgent care, home care, and hospice. Effective Jan. 1, 2017, Hallmark became the third founding member of Wellforce, a health system formed by Tufts Medical Center and Circle Health in 2014

Hallmark has approximately 2,800 employees, 270 hospital beds, 650 nurses, and 700 affiliated physicians, providing care and facilities related to 150,000 office visits, 53,000 emergency/urgent care visits, and 15,000 hospital admissions and observation discharges.

Source: Hallmark Health System. Used with permission.

designed, and executed a structured approach for achieving the target.

Hallmark was guided in this effort by a road map for strategic cost transformation that is applicable to all health systems (see the exhibit on page 3).

1. Use Assessment Findings to Set the Stage for Improvement

In early 2016, Hallmark leadership articulated the goal of driving long-term organizational performance improvement and growth by identifying and pursuing strategic and financial opportunities. Like many community hospitals, Hallmark had been experiencing a challenging operating environment. Facing stiff competition, reductions in payment, and other financial challenges, Hallmark recognized the need to proactively improve financial performance. The health system determined that improving performance by $25 million to $35 million over a two- to three-year period would enable it to lower its cost of care and establish sustainable financial performance in the communities it served going forward.

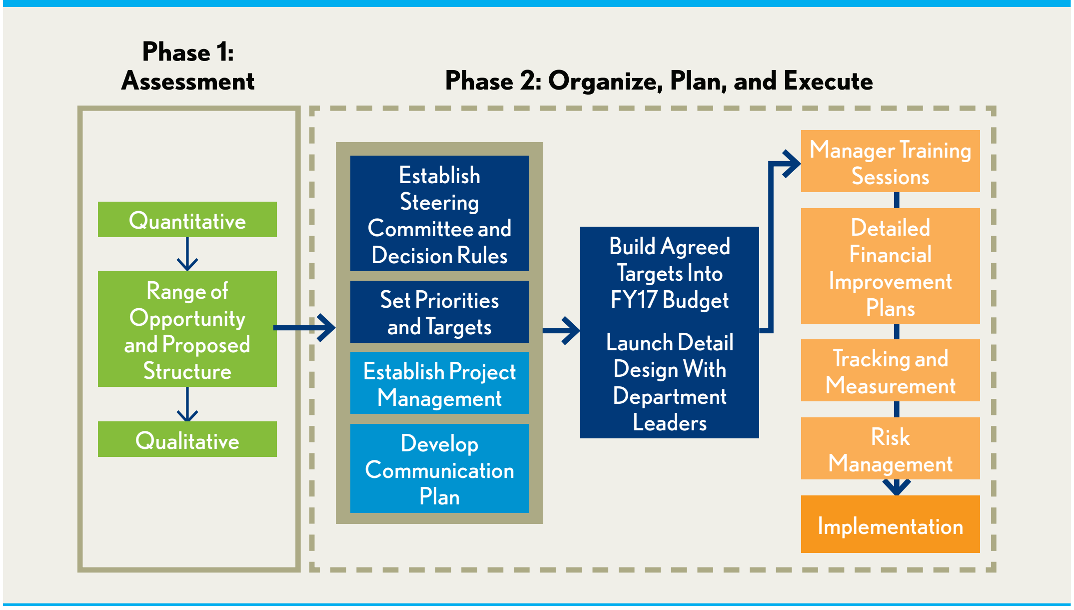
As Hallmark was setting these goals, it also was finalizing a merger that would make it the third founding member of Wellforce, an alliance initially composed of two other health systems—Tufts Medical Center in Boston and Circle Health in Lowell, Mass.

Hallmark's decision to join Wellforce had no bearing on its proactive performance improvement; the health system was committed to pursuing the effort with or without the affiliation. Hallmark's leaders believed it was imperative to achieve its own performance enhancement goals, independent of the additional benefits it would realize from the partnership. As an additional benefit of achieving meaningful financial improvements on its own, Hallmark would be optimally positioned to become an equal founding member in January 2017 within Wellforce's high-performance partnership.

To identify the range of savings opportunities it could realistically achieve, Hallmark undertook a thorough cost and revenue-yield assessment consisting of comparative quantitative analyses and interviews with key stakeholders for qualitative input. The three-month assessment, conducted from April through June 2016, covered the following areas:

> Enterprisewide global costs, viewed through entity-level benchmarking with external peer groups
> Labor productivity and nonlabor expense levels, compared with Hallmark historical trends
> Department-level functional areas, benchmarked with external peer groups
> Organizational management span of control (i.e., the ratio of overall management by job level to frontline staff), compared with best practice
> Revenue cycle management performance, compared with key performance indicators such as payer yield, documentation and coding

A ROAD MAP FOR EFFECTIVE COST TRANSFORMATION



Source: Kaufman, Hall & Associates, LLC. Used with permission.

related to denials, point-of-service collections, and others

To deepen their understanding of how key stakeholders viewed the state of the enterprise, Hallmark's leaders started the process by arranging for interviews to be conducted with more than 40 stakeholders. Interviews involved physician, nurse, and other clinical leaders across services and entities, including the employed medical group and visiting nurse and hospice program.

An important goal for Hallmark, prompted by declining inpatient utilization, was to increase its ambulatory market share. An important point of focus for the assessment, therefore, was on determining the right size for the Hallmark delivery network and the best sites for the health system's various services.

Overall, the assessment identified an opportunity to improve core-cost financial performance in the Hallmark enterprise by $8.3 million to $33 million. Significant opportunities existed to improve labor productivity and span of control, among other expense areas, despite these costs having been trimmed in the past. Hallmark's leaders also saw that financial improvements could be achieved through operational and productivity gains within the physician enterprise, service line development and growth, brand strengthening, and strategic partnership opportunities. Pursuit of these opportunities was beyond the scope of the assessment described here.

2. Get Organized at the Leadership Level

Following the assessment phase, in August 2016, Hallmark established a steering committee of about 20 members charged with identifying the improvement target and beginning the work necessary to achieve it. Members included

Hallmark Steering Committee Principles

Hallmark Health System (Hallmark) established the following rules of engagement and responsibilities for the steering committee that it established to lead its performance improvement initiative.

Rules of Engagement

> Attend each meeting or send an approved substitute with decision-making authority.
> Determine, approve, and actively work to support the achievement of the overall financial goal.
> Work as a team to determine and approve divisional targets.

Responsibilities

> Approve the planning and implementation project goals and work plan.
> Approve, communicate, and support specific targets, including achieving the original FY budget targets and incremental financial transformation improvement.
> Consider impacts of improvement plans on quality, patient safety, and patient experience.
> Review and approve vetted and validated improvement plans.
> Resolve identified barriers and support appropriate mitigation strategies.
> Track and monitor plans and results, developing course corrections as necessary to meet goals.

Source: Hallmark Health System and Kaufman, Hall & Associates, LLC. Used with permission.

C-suite leaders, senior-level divisional executives in clinical operations, and five physician leaders.

Physician and nurse leader participation was critical on the front end because the committee's decisions would likely have a significant impact on downstream operations—and on these stakeholder groups in particular. These leaders could communicate the cost-improvement challenges to divisions across the organization and serve as ambassadors to help with the changes in specific areas.

The sidebar above outlines steering committee responsibilities and the agreed-upon rules of engagement. The committee held 90-minute meetings twice weekly at first, then weekly. Meetings were almost always attended by everyone because committee members recognized the importance of the decisions being discussed and wanted to be present to share their perspectives. The committee chair served as the final arbitrator of any disagreements.

The steering committee determined that divisional vice presidents should be accountable for achieving the targets for their divisions, and should be afforded flexibility to move only departmental targets within their divisions, *not* their overall divisional targets. The committee agreed on a review process for improvement initiatives that might have unintended impacts on other departments or on patient safety, experience, or quality of care.

3. Gain Consensus on the Financial Goal Enterprisewide and by Division

Given that September was the closing month for Hallmark's fiscal year (FY), in August 2016, the steering committee set a cost-improvement goal for FY17 by adding the following key numbers:

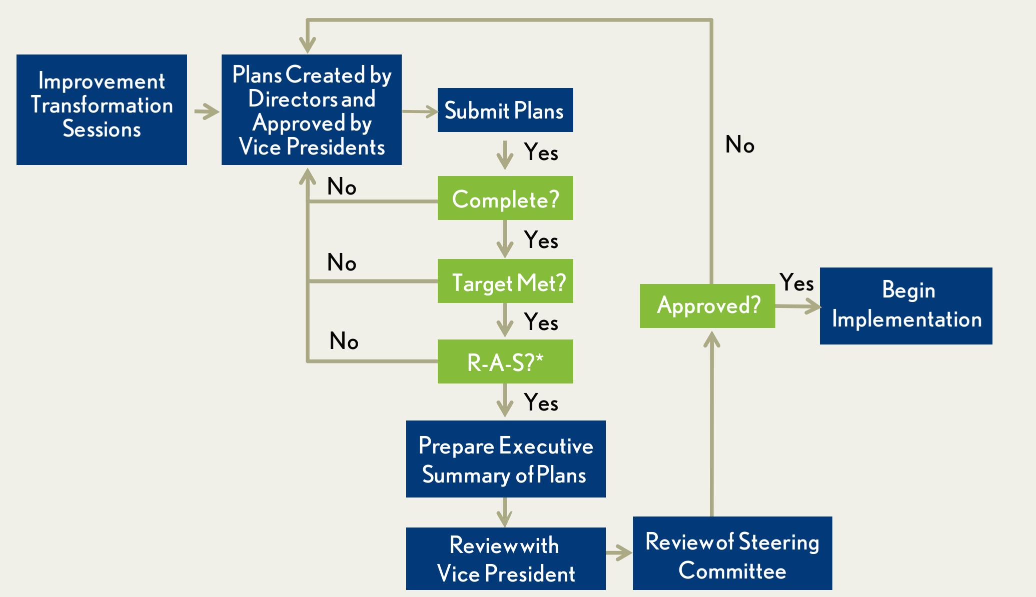
> The FY16 operating gap to the then-current FY17 budget gap
> Amounts of strategic financial improvements required to cover lower-than-expected payment and uncontrolled costs
> A board-requested improvement target over the FY16 budget

The result was a recommended financial goal of $22 million in performance improvement for the first year, about $6 million of which was to occur outside the initiative described here. The initiative's goal of about $15 million to $16 million was in line with where Hallmark wanted to be from an operational standpoint with its future affiliate partner. The steering committee approved that goal.

The committee then worked with the divisional vice presidents to establish the targets for and within the divisions. The vice presidents identified cost-improvement opportunities in their areas, commencing with cost-center opportunity ranges based on assessment findings, and potential impacts and risks of specific initiatives. The committee reviewed and weighed these factors in its weekly meetings.

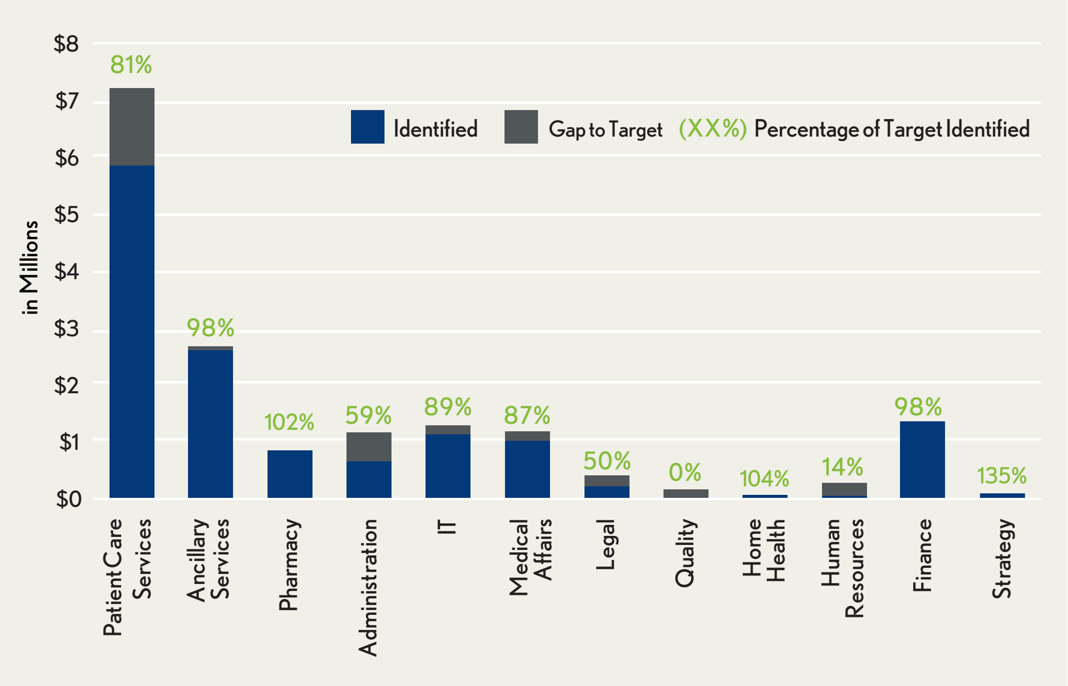
Guided by internal and external data and analytics used during the assessment process, the steering committee agreed to a final target for each division's identified opportunity, capped at 15 percent of the current department expense. Targets took into account current metrics, financial need, and actual experience in organizations similar to Hallmark nationwide. Target setting thus was neither a blind adoption of external benchmarks and performance metrics nor an across-the-board percentage reduction;

INITIATIVE PLANNING AND APPROVAL PROCESS



*Reasonably achievable, and sustainable
Source: Kaufman, Hall & Associates, LLC. Used with permission.

COST IMPROVEMENT TARGETS BY DIVISION: IDENTIFIED AND GAP TO TARGET



Source: Hallmark Health System. Used with permission.

rather, it was a process involving extensive management judgment, industry-based expertise, and full awareness that detailed plans must be developed and implemented by the leaders directly charged with oversight of the departments where the clinical or support-services work is performed.

The importance of success with this cost-reduction initiative was underscored in discussions with the vice presidents, who were part of the steering committee and understood its goals. Solidarity and alignment of committee members around the goals were critical, and the vice presidents emerged with a determination to not accept anything short of meeting improvement targets.

4. Cultivate a Deep Organizational Commitment to Operational Improvement

Hallmark wanted its initiative to help foster a culture in which a focus on operational improvement would permeate every level of the organization. Thus, with the targets established by the steering committee at the vice president level, the next step was for the vice presidents to move the divisional targets down to their cost centers.

For example, based on the initial assessment, the steering committee set the ancillary services divisional target at $2.6 million. The division's vice president distributed this $2.6 million target among the cost centers of ancillary services based on the initial assessment's identified opportunities and consultant recommendations. The latter were based on what has been achieved in comparable organizations nationwide.

To achieve savings opportunities, a structured approach would be required for designing and implementing financial improvement plans at a level of detail that could guide action. Detailed plans were defined as plans that are reasonable, achievable, and sustainable, as described later. All plans had to be budgetable at the cost-center and sub-account level. For instance, if the plan required the addition or elimination of positions and/or increases or decreases in nonlabor expenses, the impact would be built directly into the budget.

The steering committee determined that department managers and directors, who were the operational subject-matter experts in each Hallmark division, should first receive cost intelligence education and tool training that would help guide and inform their efforts. Senior Hallmark leaders on the steering committee began the training sessions that occurred from late August through September 2016 by clearly conveying a sense of urgency for cost reduction. They also described implications for the future success of the organization and stressed that everyone involved in the organization was capable of contributing meaningfully to the effort's success.

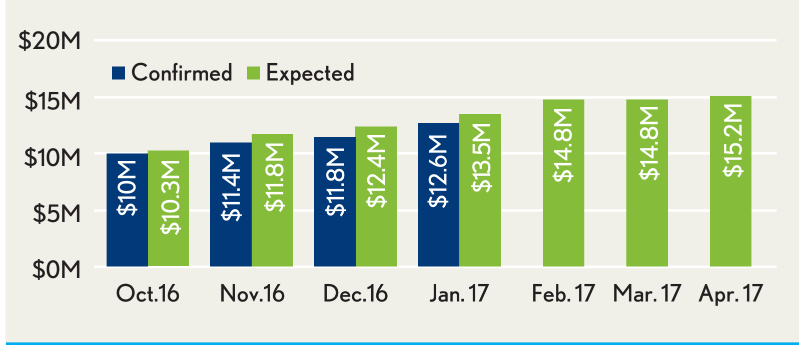
Educational sessions addressed participants' questions about why the initiative was needed, what role they would play in the process, and why that role would be important. Participants in each session received detailed information on the organization's strategic goals, budget and target numbers, and the overall process used to arrive at those numbers.

Subsequent brainstorming sessions ensured that operational managers could actively participate in the process of generating ideas and plans for achieving cost reduction goals, with the understanding that, as subject-matter experts, they are in the best position to identify and execute such plans. To support these discussions, Hallmark brought in operational consultants who could highlight industry best practices, facilitate the discussions, and provide analytical assistance and oversight. The sessions also generated ideas for improvements beyond the core cost area and into network optimization and clinical process improvement.

Small- and large- group cost-planning sessions with managers followed to launch detailed initiative planning. The steering committee had developed a planning and approval process whereby all initiatives were vetted and validated with final approval from the committee (see the exhibit on page 5). The single ground rule of planning sessions was that financial improvement at a cost-center level must be based on initiatives that are reasonable, achievable, and sustainable (R-A-S), defined as follows:

> *Reasonable* initiatives are based on real-world expectations of hospital operations and do not include shifting the burden of work to other areas.

CONFIRMED AND EXPECTED COST IMPROVEMENT TARGETS ENTERPRISEWIDE



Source: Hallmark Health System. Used with permission.

> *Achievable* initiatives may be aggressive, but a group of dedicated leaders can accomplish them, and they can be budgeted.
> *Sustainable* initiatives entail the use of work plans, monitoring tools, and oversight mechanisms.

With support from the operational consultants, the subject-matter expert managers provided guidance and insight on how to reach the targets. Each manager received an example of a detailed plan and then used a thorough, comprehensive approach to develop their own plans to support targets. As mentioned previously, if cost-center managers could not achieve a target, the vice president had the latitude to change targets at that cost-center level, but overall cost-center targets had to meet or exceed the division-level target.

THE STRATEGIC COST TRANSFORMATION PROCESS

Source: Kaufman, Hall & Associates, LLC. Used with permission.

Within this framework, the cost-center managers and division vice presidents worked as a team.

For example, perhaps a specific cost center could not meet its improvement target because it was responsible for a growth initiative—as defined in the organization's strategic plan—that required a high-level resource investment on that cost center's part. In such a case, the division vice president has the ability move the dollar target shortfall to a different cost center, which would assume responsibility for achieving a higher target.

More than 300 specific initiatives were identified, vetted, validated, approved, budgeted, and launched. Hallmark's human resources, finance, and operations improvement staff provided hands-on support throughout the process and helped to identify, quantify, and implement quick wins. A sampling of initiatives includes the following:

> Improve alignment of RN staffing with demand (Emergency Department [ED])
> Change skill mix: replace clinical associates with medics (ED)
> Standardize packs for hips and knees (Surgical Services)
> Close the cafeteria on one campus at 3 p.m. on weekends (Food Services)
> Consolidate leadership responsibilities, eliminating one position (Support Services)
> Consolidate contractors (Maintenance)

Training in use of productivity and initiative tracking tools ensured regular monitoring of progress toward targets and early recognition of slippage.

The exhibit on page 6 shows budgeted targets by division and the proportion of such targets that were identified with specific initiatives through early October 2016. The exhibit on page 7 shows confirmed savings achieved from October 2016 through January 2017 and expectations forward through April 2017.

In fall 2016, as the divisions began designing specific improvement plans, Hallmark appointed an internal project manager to administer the cost transformation work. Hallmark also chartered a senior management oversight group composed of 20 members of the steering committee plus additional finance staff to review ongoing progress, address challenges, and identify and mitigate any unrecognized consequences of specific initiatives. The group meets weekly to review progress and overall organizational performance related to quality, service, growth, and people. The group has been transformative in building awareness of performance improvement organizationwide, leading to additional improvement initiatives and strengthened accountability among leaders and staff.

Cost center-derived improvement ideas and plans, an effective oversight structure, organized use of a simplified productivity tracking tool, and rigorous commitment to position control have engrained operational improvement in Hallmark's culture and DNA.

Positioned for Success

Hallmark's leaders successfully initiated a strategic cost transformation cycle, bringing operational improvement across the enterprise. Senior management identified targets and operational managers developed and executed the plans for meeting them. Comprehensive training related to cost intelligence and tracking and a thorough communication plan that provided consistent, clear messaging and support are enabling Hallmark to lower its cost structure for more efficient and effective delivery of care.

Hallmark's leaders also have embedded in the health system's culture a commitment to performance improvement and a process for achieving it. This dedication has enabled Hallmark to contribute meaningfully to the Wellforce partnership. The results have benefited not only the community Hallmark serves but also the regional health delivery system as a whole. ■

About the authors

William J. Doherty, MD, FACHE, is executive vice president and COO, Hallmark Health System, Medford, Mass. (wdoherty@hallmarkhealth.org).

Michael Connelly, CPA, FACHE, is executive vice president and CFO, Hallmark Health System, Medford, Mass., and a member of HFMA's Massachusetts/Rhode Island Chapter (mconnelly@hallmarkhealth.org).

Kimberly Neese is senior vice president, Kaufman, Hall & Associates, LLC, Skokie, Ill. (kneese@kaufmanhall.com).

Gavin McDermott, CFA, is vice president, Kaufman, Hall & Associates, LLC, Skokie, Ill. (gmcdermott@kaufmanhall.com).