

Cost Reduction

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Key Findings

- Most (90%) responding executives rank cost reduction as a high or very high priority, compared to other priorities at their health systems.
- Cost reduction strategies that produce the most value for health systems include standardization of care (79%), implementing shared services/centralizing overhead functions (74%), and expanding non-inpatient services (e.g., urgent care, telehealth) (58%).
- Over half (55%) of responding executives expect cost reduction to have the greatest impact on their health system finances in the next five years, over both additional revenue generation (33%) and cost avoidance (11%).

Cost Reduction is Top Priority for Leading Health Systems

Cost reduction is a top priority for Leading Health Systems, with 90% of responding executives ranking the priority level as a 4 or 5 on a scale of 1 (Very Low) to 5 (Very High), compared to other priorities at their health systems (Figure 1).

“Been using a relentless pursuit of cost reduction. There is not a scenario I can foresee where you can allow higher cost. Everything is pushing us to be very aggressive on that.” (COO)

Almost all (89%) health systems reported cost reduction has become a higher priority in the last year, largely due to shrinking reimbursements, a focus on business transformation and operational effectiveness, and uncertainty around legislation and health policy (Figure 2).

“Efforts have accelerated slightly, partly because of the atmosphere of declining reimbursement. We are seeing urgency in reducing the cost side of the equation.” (CMO)

Those that ranked cost reduction as a lower or decreased priority cited significant success around cost reduction in previous years, as well as a prioritization of additional revenue generation and growth.

“We have squeezed out cost over many years. While we continue to focus on costs, we are trying to grow to enhance revenue.” (COO)

Figure 1. How would you rank cost reduction as a priority, compared to other priorities at your health system?

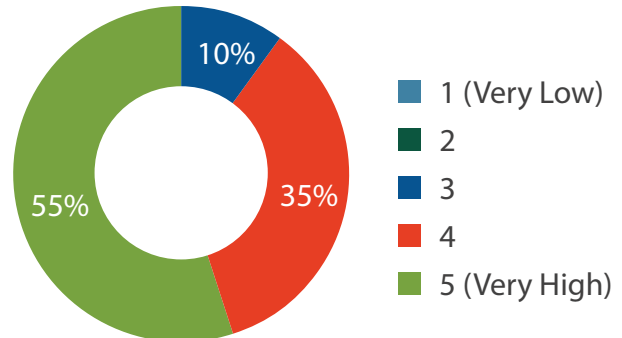
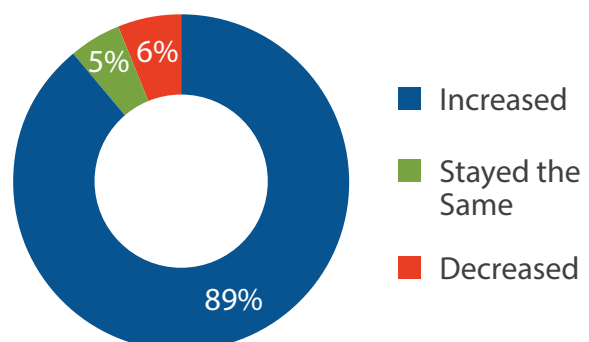


Figure 2. Has the priority level changed in the last year?



Health Systems Targeting Labor to Reduce Costs

Most health systems are focusing cost reduction efforts around areas such as labor (68%), supply chain (42%), and pharmacy (42%).

“Labor – we’ve done a lot of holding of new hires and new positions to make sure we’re not over staffing. Focused more in non-clinical and administrative areas. We do more vetting for new positions – even if the position was approved in the budget they still might not be approved to be hired.” (CMO)

Health systems are also focused on reducing costs around revenue cycle, post-merger integration, medical spend, infrastructure, system/corporate services and overhead, automation, and the physician enterprise. With EMR implementations and a major focus on cybersecurity, many health systems are hesitant to cut costs in IT.

Many health systems have made significant progress cutting costs in recent years and therefore are focused on strategies such as system-wide standardization, centralization, and clinical performance improvement. Health systems are also looking to improve hospital operations and efficiency and reduce clinical variation through care redesign and aligning interests.

“We already did a good job in pharmacy, supply chain, and labor. Now we are more focused on clinical redesign – really taking unnecessary services out of the equation without impacting quality. Looking at driving down length of stay, OR utilization, utilization of blood products – things like that.” (CFO)

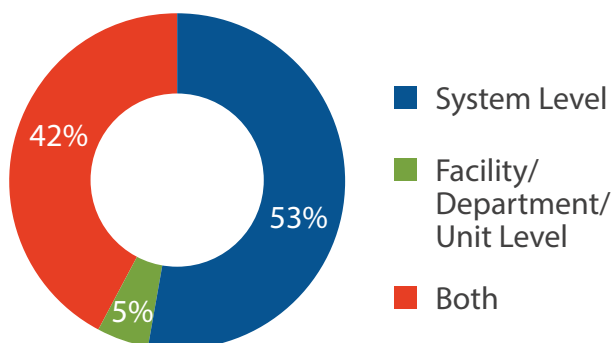
Cost Reduction Targets Commonly Driven from the System Level

A majority (53%) of health systems set overall cost reduction targets at the system level, with financial targets commonly driven from the top and cascading down to the entity, department, functional area, or unit level (Figure 3).

“Targets are set at system level and cascaded down to a department level. We are flexible in that if one area has less opportunity we will be flexible in the design of the cascade.” (COO)

Some health systems have targets set at both a system and facility/departmental/unit level, with each level receiving specific targets depending on the metric.

Figure 3. Are cost reduction targets at your health system set at a system level, department level, or both?

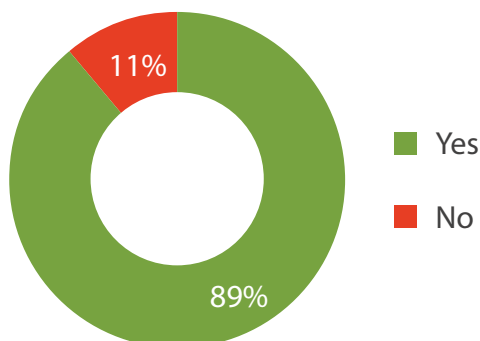


Responsibility for Cost Reduction Lies with Senior Leadership Team

As the focus on cost reduction continues to increase for Leading Health Systems, many health systems have integrated cost reduction into their overall culture to ensure all employees prioritize and feel responsible for meeting cost reduction targets.

While all employees work to achieve these financial targets, ultimate responsibility for achieving cost reduction goals commonly rests with the entire executive team or senior leadership, with leadership at every level responsible for meeting specific financial goals.

Figure 4. Is meeting goals around cost reduction tied into your health system’s incentives?



“The executive team – it’s not just one person; the whole team is accountable for making sure we hit those goals.” (CFO)

“Operating margin goal is a big part of our incentives and we can’t hit this without meeting our cost reduction goals, so it is all tied in.” (CMO)

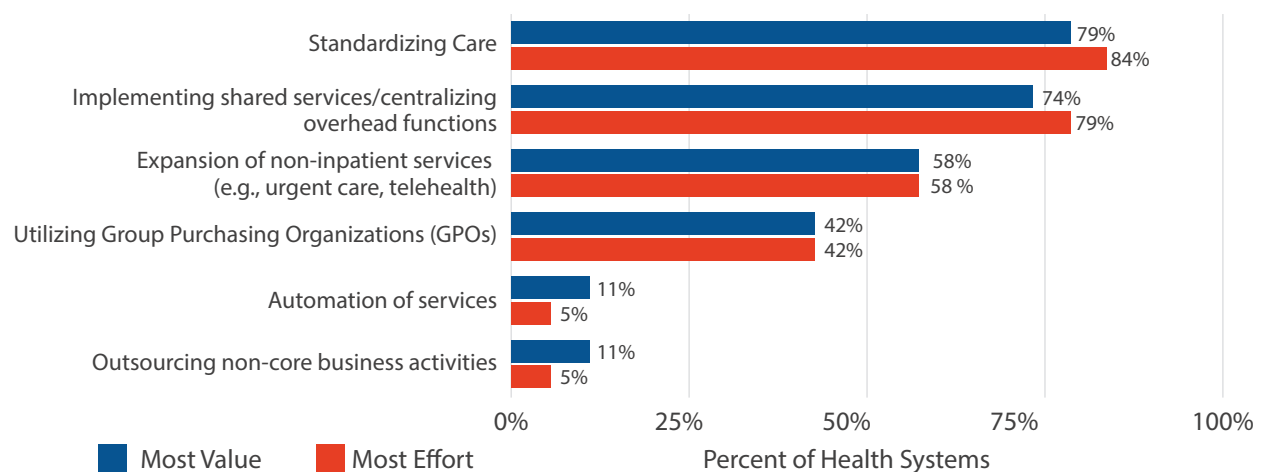
Almost all (89%) health systems tie meeting cost reduction targets to their incentives, either directly through specific cost goals or indirectly through operating income or margin (Figure 4).

Standardizing Care Requires the Most Effort, Produces the Most Value for Health Systems

Cost reduction strategies that produce the most value for health systems include standardization of care (79%), implementing shared services/centralizing overhead functions (74%), and expanding non-inpatient services (e.g., urgent care, telehealth) (58%)

(Figure 5). Most executives reported overall alignment between the strategies in which they expend the most effort and those that produced the most value for their health system.

Figure 5. Please rank the three strategies on which your organization expends the most effort (e.g., time, resources, etc.) and the three that produce the most value for your organization.



Other cost reduction strategies reported as high effort and high value for Leading Health Systems include reducing inappropriate medical spend, post-merger integration, clinical and operational improvement, supply chain management, and efforts to impact utilization of services.

Across health systems, standardizing care was the top cost reduction strategy in both effort and value, with 53% of health systems ranking it number one in effort (average rank: 1.44) and 47% ranking it number one for value (average rank: 1.60). However, other strategies did not align as neatly. Some strategies,

such as implementing shared services/centralizing overhead functions, were reported to be higher in effort (average rank: 1.87) than in value (average rank: 2.15). Other strategies, such as utilizing Group Purchasing Organizations (GPOs) were reported to have lower effort (average rank: 2.57) but higher value (average rank: 2.13).

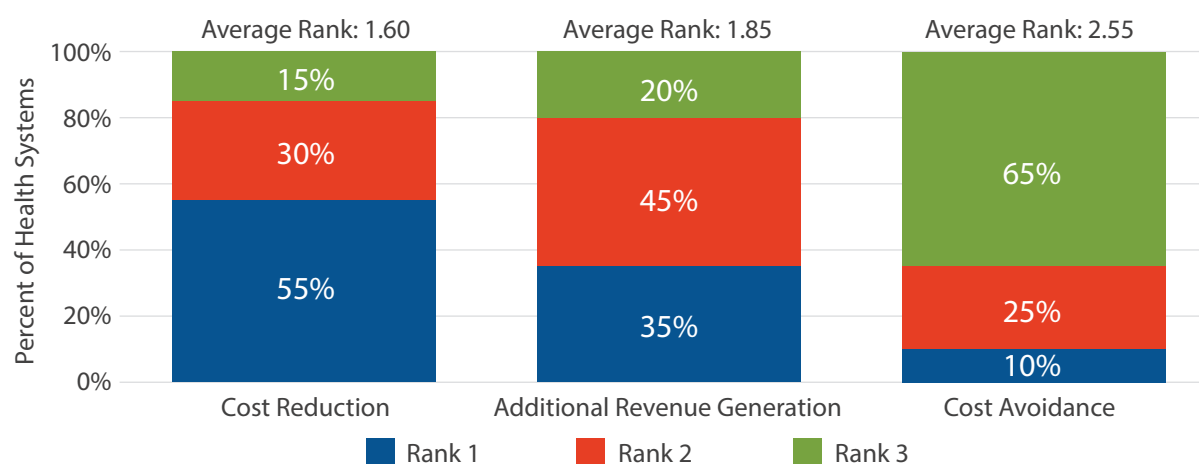
“A lot of work that goes into the telehealth-type work, but there’s not a lot of value in terms of financial reward. It’s more of a consumer strategy.” (CMO)

Health Systems are Focused on Cost Reduction, Revenue Generation

Over half (55%) of responding health system executives believe cost reduction will have the greatest impact on their health system finances in the next five years, over both additional revenue generation (35%) and cost avoidance (10%) (Figure 6).

“There’s lots of stress out there – volume is down, revenue is down – there’s no place to go but cost.”
(COO)

Figure 6. Please rank (1 – 3) what you believe will have the greatest impact on your health system finances in the next 5 years



While cost reduction is a top focus for most health systems, additional revenue generation is a close second with an average ranking of 1.85, compared to 1.60 for cost reduction. As health systems continue to experience financial pressure due to declining volumes and reimbursements, many are looking towards diversification and strengthening non-clinical revenue streams in addition to cost reduction in order to improve margins.

“If we don’t significantly increase revenue – including non-clinical revenue – even cost reduction is not going to be enough to make us thrive. We have to do cost reduction but we also have to look at other ways to generate revenue.”
(CMO)

H2C Commentary

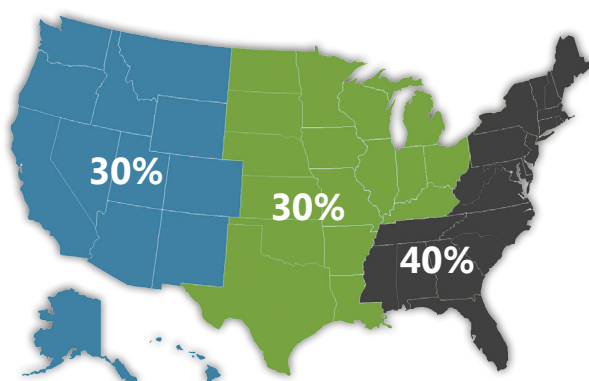
Health systems have, on average, experienced years of operating cost increases significantly in excess of GDP inflation. The causes are numerous and include lack of standardized care, the necessity to attract and retain highly-trained talent that is often in short supply, investment in IT and EHR systems, adaptation to increasingly complicated compliance and revenue collection requirements, pharmacy costs, and other factors unique to the business of providing healthcare services.

Compounding this, health plans have been encouraging physicians and other service providers to find ways to reduce utilization of comparatively expensive hospital-based services. Health systems have relied on these volumes to cover their fixed costs but find it increasingly difficult to do so. Finally, increasing government volumes and reimbursement trends that are below healthcare service cost inflation have put extreme pressure on health systems to reduce costs.

When it comes to cost management, a serious challenge many not-for-profit health systems face is their nature as mission-driven institutions with deep community service responsibilities. Unlike for-profit providers whose purpose is to generate profits for their shareholders while providing a service, the mission motive of not-for-profit healthcare providers may inhibit their ability to take necessary actions that would disadvantage certain key constituencies and potentially cause conflicts within their community to arise. This is a unique attribute of health care services delivery in the U.S. that should be recognized as creating a higher level of difficulty in achieving cost reductions.

Profile of Participating Health Systems

Representative of the various regions of the U.S.



Average Net Patient Revenue

\$3.9 BILLION

Own or operate 241 hospitals with 45,095 beds

50%
Have a Provider-Owned Health Plan

70%
Single-State Systems

30%
Multi-State Systems

Participating Health Systems



Methodology

In June 2017, The Academy conducted the tenth round of its quarterly strategic survey among 20 senior health system executives, including: CEOs, COOs, CFOs, CMOs, CNOs, and CSOs. The survey for the interview consisted of: (1) a tracking section that provides insight into trends around primary strategic areas; (2) a special topic area that allows for an in-depth look into a timely, developing issue. Innovation, consumer engagement, ambulatory and real estate strategies, physician alignment, bundling, data analytics, telehealth, pharmacy strategies, and branding were topics of previous surveys.

The Health Management Academy, "The Academy"

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