

**THE
UPSIDE
OF THE
DOWNTURN**



A BROADER VIEW OF FINANCIAL HEALTH LEADS TO LONG-TERM SUCCESS

BY JOHN M. BUELL

By now you probably know the distressing numbers by heart: At the depth of the recession approximately 50 percent of hospitals operated in the red; nine out of 10 made cutbacks; nearly half reduced staff and 80 percent cut administrative expenses; and one in five reduced services communities depend on, according to the Healthcare Financial Management Association (HFMA), Westchester, Ill.

In the past three recessions since 1980, healthcare organizations were able to ride any economic waves that came their way. It was assumed the industry was recession proof, but the current downturn shattered that belief.

Experts cite several reasons why this financial crisis is different for hospitals, including diminished investments, more expensive and leveraged debt, and lower income. Even though it has been reported that the recession is technically over, there remains a great deal of uncertainty about how hospitals will emerge from the downturn, particularly as the gap between financially strong hospitals and financially weak hospitals widens.

“We continue to see an expanding difference between the ‘have’ hospitals and the ‘have-not’ hospitals,” says Todd Nelson, technical director for HFMA, who adds, “Hospitals in the middle of the haves and have-nots also will struggle.”

To come out of this crisis strong, industry experts say healthcare organizations should conduct a practical reassessment of their strategy that will put them in the best possible position for sustainable success.

“Healthcare organizations’ response to the crisis should not be limited to adjustments in financing tactics; they should include a broader rethinking of strategies and priorities,” according to the article “The Long View: How the Financial Downturn Will Change Health Care,” authored by Keith Moore, Dean Coddington and Deirdre Byrne and published by HFMA.

CREATING A BOLD STRATEGY

Mark J. Dubow, senior vice president, The Camden Group, El Segundo, Calif., a business advisory firm to healthcare organizations, agrees that healthcare executives should think more broadly in their efforts to become financially healthy for the long term. He adds that for hospitals to survive and thrive in the future will require enacting bold or game-changing strategies on multiple fronts—growth initiatives, operational enhancements, etc. Identifying opportunities for a bold strategy requires seeking new

perspectives. One way to achieve this is by examining trends in technology; within and outside the healthcare industry; the political/regulatory sector; society; and economics. Dubow has observed that in those circumstances where two or more trends converge there are opportunities to enhance existing services and products, develop new ones, or do both, to better meet the future needs of customers and thereby achieve new revenue growth.

What makes one strategy bold and another basic can be confusing, according to Dubow.

“For a strategy to be bold it must simultaneously push boundaries on two dimensions: nature of change (innovation) and degree of change (innovation) and degree of change (impact),” he says. “The extent of innovation takes into account the way in which the product or service provides new ways to meet customers’ needs specific to access, information exchange, ease of use, clinical outcomes and pricing. The degree of impact takes into consideration the extent of change the product or service brings about in terms of quality, efficiency, satisfaction, awareness, preference, market share and profit. Each of these two dimensions can be viewed as a continuum extending from a low to a high level. Strategies on the high end of both dimensions would be bold, game changers, with a higher return on investment (ROI). Frequently, there is a degree of risk associated with or inherent in bold strategies. Risk takes into account the extent to which a product or service is ahead of its time, amount of investment and length of time to ROI, divergence from established patterns and partners, collaboration with competitors, and the probability and cost of failure.”

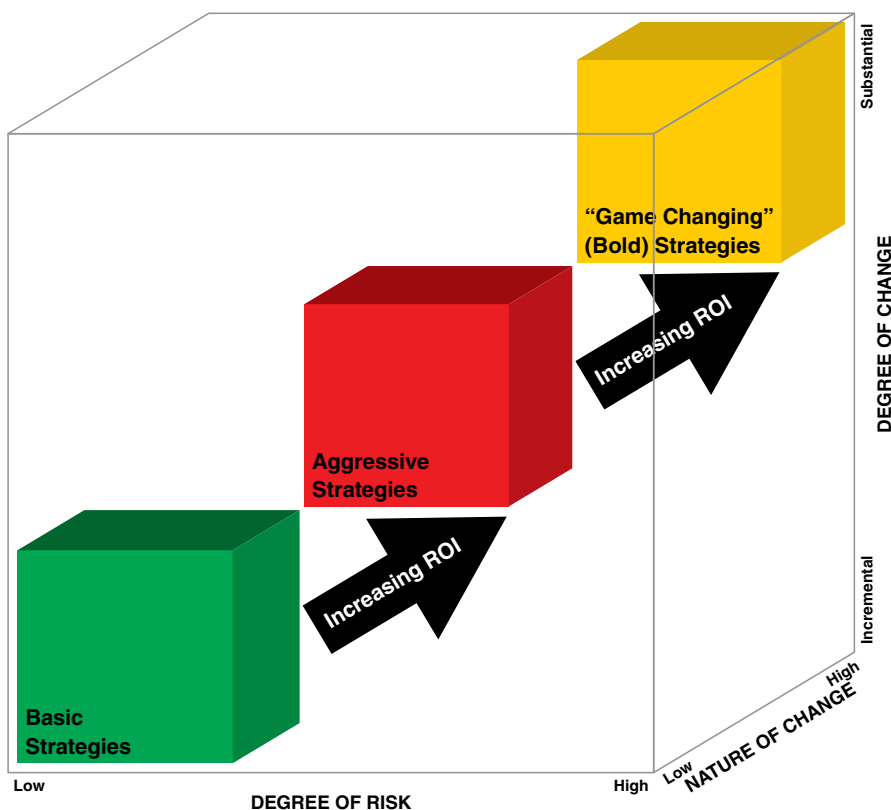
If an organization’s initiative has a high degree of innovation and impact and risks are managed, then the organization has a strategy and action plan that are game changing and bold, adds Dubow.

Reflecting on an array of case studies from other industries, Dubow says

Three Dimensions of a Bold Strategy

The chart illustrates how a bold strategy fits within a three-dimensional landscape composed of these three characteristics—innovation, impact and risk.

Source: Mark J. Dubow and The Camden Group



previous recessions and depressions have provided an environment in which companies willing to be bold have leveraged innovation in product and service design, marketing, pricing and strategic partnerships to leapfrog over competitors and achieve competitive and financial success. Examples include companies such as Apple, General Electric, Hewlett-Packard, Kellogg's, Microsoft and many others.

EL CAMINO HOSPITAL

Dubow points to El Camino Hospital, with campuses in Mountain View and Los Gatos, Calif., as an example of a healthcare organization that used a bold acquisition and merger growth strategy during the current recession. The nonprofit hospital is located in a competitive hospital market in the heart of Silicon Valley. It accelerated its entry into a neighboring target market by acquiring the facilities of Community Hospital of Los Gatos, a 143-bed for-profit competitor, and then reopening it as El Camino Los Gatos. With the addition of the Los Gatos campus, El Camino Hospital now has 542 licensed beds. Dubow explains that innovation was being pursued through alignment with local physicians, differentiation via the development of niche services and the successful unification of the clinical team and support systems across multiple providers. The hospitals are in the process of achieving significant impact in increasing residents' awareness of each organization and in patient volume and



"The risks to our hospital of simply maintaining the status quo are high. We have a duty to the community to be here for the long term and deliver the highest quality care possible."

— Kenneth D. Graham, FACHE
El Camino Hospital

income in the target market. Furthermore, the hospitals' initiative was managed within an environment that had a high degree of risk associated with four factors: the management team had no prior experience operating a multihospital system; the closure and reopening of the acquired entity had to be expedited to avoid significant loss of physicians, clinical staff and patients; the market entered was highly competitive; and a large investment was required during a recession.

"Although El Camino Hospital was in the middle of its own \$460 million replacement project and began the

fiscal year with a \$63 million capital budget, its existing business strategy allowed flexibility to relocate capital and operating funds midyear to capitalize on the strategic opportunity," says Dubow. "As a result, in the course of six months it is now a multihospital system. The purchase was a bold move, and El Camino Hospital is now poised to achieve an increase in market share."

Kenneth D. Graham, FACHE, CEO, commented, "We saw the potential for the long term, and because of thoughtful strategic, financial and contingency planning during the prior fiscal year, we were prepared to move quickly and confidently to reposition our market despite the efforts of at least six other proposals. Hospitals that are going to thrive in this environment of recession and likely vast industry structural change have to look at the big picture, manage their businesses prudently and continue to innovate. The risks to our hospital of simply maintaining the status quo are high. We have a duty to the community to be here for the long term and deliver the highest quality care possible. Actions such as this acquisition, various partnerships and ongoing investment in technology are ensuring our foundation for the future is solid."

HURON MEDICAL CENTER

Located in Michigan's Thumb, Huron Medical Center, Bad Axe, Mich., is a long way from Silicon Valley. The recession has hit

Michigan particularly hard with two of the Big Three automakers filing for bankruptcy and the state experiencing the highest unemployment in the nation at 15 percent. Even prior to the recession, Huron Medical Center faced many challenges. Janet C. Sternberg, RN, FACHE, president and CEO of the 64-bed hospital, was hired shortly before the economy collapsed more than a year ago.

“I remember thinking while I was still unpacking that this was not going to be good,” recalls Sternberg. “I was going to have to jump in with both feet.”

One of the challenges the organization needed to address was strengthening its leadership and generating a team environment. It changed leadership several times in a short period, and it was Sternberg’s mission to gain the confidence of employees. On the financial end of things, Huron Medical Center was among the 50 percent of hospitals operating in the red, and Sternberg knew something had to be done. While she had a plan to get the hospital back in the black, the recession hastened Sternberg’s strategy. She ordered an immediate top-down review of every area of the organization to examine where additional revenue could be gained and where cuts could be made.

One of the first areas reviewed was the hospital’s revenue cycle, beginning with its coding procedures. An assessment of records found the hospital wasn’t coding effectively.



“The rapidity of our actions was driven by the economy, but we looked at these steps as good management measures and good use of resources.”

—Janet C. Sternberg, RN, FACHE
Huron Medical Center

“With the help of a key physician, we recognized areas where doctors could improve their documentation and make sure our staff was capturing codes correctly,” says Sternberg.

Another area reviewed was supplier contracts. “We looked at our food service, information technology (IT)—everything was up for grabs,” says Sternberg. Some contracts were renegotiated; the remaining were canceled as new suppliers were hired.

The savings were immediate. Huron Medical Center saved some \$14,400 per year by going with a new food service vendor; it saved more than \$150,000 per year by renegotiating

office supplies and pharmaceutical supplies contracts. Another \$60,000 per year was saved by renegotiating its IT contract.

To date, Huron Medical Center’s bottom line is \$1.4 million better than it was a year ago, and it is on a path to reach profitability within the next 12 months. Sternberg was adamant that the clinical staff remain, and additional staff have been hired.

“Providing excellent quality care is foremost in our minds,” she says. “Our steps to date don’t mean we can rest on our laurels. We still have a lot of work to do. We are facing 8 percent cuts in state Medicaid reimbursements. We need to constantly be cost efficient.”

Huron Medical Center now has a strong foundation on which to build, adequate resources to maintain facilities and the ability to purchase needed equipment, pay staff wages and provide services the community expects. It also has plans to develop new services and recruit more staff.

“The rapidity of our actions was driven by the economy, but we looked at these steps as good management measures and good use of resources,” says Sternberg.

NORTHEAST GEORGIA HEALTH SYSTEM

While the recession was the catalyst for some healthcare organizations to

THE UPSIDE OF THE DOWNTURN

speed up efforts to get their financial house in order and find opportunities for strategic growth, others took steps prior to the recession that put them in a good position to weather the current downturn.

In 2004, Northeast Georgia Health System in Gainesville was at break-even, which was something the hospital hadn't experienced much of in the past. The health system, which has 461 inpatient beds and 261 skilled nursing beds and serves 700,000 people in more than 13 counties across northeast Georgia, had been under the leadership of the same CEO for nearly 40 years and saw great success. When the CEO retired in 2004, Northeast Georgia Health System needed to reinvent and reinvigorate itself. James E. Gardner Jr. was hired as the new president and CEO.

Gardner says he was not overly concerned at the outset about the hospital's financial status. The economy at the time was relatively good, and the operating metrics were stable. There was no reason for alarm. But he knew that for the hospital to successfully position itself financially for the long run, and more importantly execute a new, bold strategic plan, the status quo was not an option.

In 2005, more than two years before the recession hit, Gardner and the board of trustees agreed on a plan to improve the hospital's finances by approaching the goal strategically

instead of merely incorporating the latest financial techniques.

"Financial improvement is not a strategy; it's an outcome," says Gardner. "We focused on simultaneously improving patient satisfaction, employee morale and leadership accountability. The goal was an empowered work force and trusted leadership that could push the organization's performance to a new level."

A driver of the strategy was the hospital's need to access \$500 million in capital during the next 10 years. To achieve this objective, the leadership team knew that operating costs would have to be reduced by at least



"Financial improvement is not a strategy; it's an outcome. We focused on simultaneously improving patient satisfaction, employee morale and leadership accountability."

— James E. Gardner Jr.
Northeast Georgia Health System

\$20 million annually to provide a healthy operating and cash flow margin.

To accomplish this would require a fundamental commitment by all involved, including the board of trustees, says Gardner. Nine teams that included more than 100 hospital leaders were formed to identify where \$20 million in strategic cost improvement would occur. Each team was given a certain percentage to improve. For example, if the surgery service's cost structure was 20 percent, then it would be responsible for 20 percent of the \$20 million. Within five months, each team achieved its objective and implemented expense improvements totaling \$26 million annually. The bottom line immediately improved by \$2 million per month, the 2006 fiscal year operating margin exceeded 7 percent and earnings before interest, depreciation and amortization was more than 17 percent.

"What I'm most proud of is we have sustained those numbers for four years in a row, enabling the addition of \$250 million of new services and critically needed facilities," says Gardner.

By getting its cost structure under control, the organization has been able to endure the current recession relatively unscathed. It didn't lay off a single person. The health system went into the recession with 4,200 employees and came out of it with 4,200 employees. "We trust our leaders and staff to be accountable for the results of their departments, and

KEYS TO SUCCESS

The Healthcare Financial Management Association has identified four keys to success to help hospitals manage the effects of the recession and weather future downturns in the economy.

Manage service lines effectively. This can be accomplished by defining service lines. The easiest way to do this is using diagnosis-related group methodology, but this definition approach is not all-inclusive. Instead, use International Classification of Disease, 9th edition, Clinical Modification (ICD-9-CM) and Current Procedural Terminology (CPT) for a more comprehensive approach. In addition, gauge your financial system and internal readiness for growth using standardized units of analysis and standardized service line definitions.

Form strong relationships with physicians. This can be done by:

- Creating a sustainable physician strategy that engages physicians in strategic decision making
- Carefully considering employing physicians, especially in high-demand, low-supply specialties
- Developing age- and specialty-specific arrangements
- Giving priority attention to arrangements with primary care physicians
- Developing a formal engagement plan that commits capital to achieving the plan and allows you to begin purposefully implementing that plan

Collaborate (finance, clinicians, payors, vendors). Fostering a collaborative culture between financial and clinical areas is key to a stronger hospital-physician relationship. This can be accomplished by:

- Maintaining visibility of finance personnel in clinical areas
- Holding regular meetings with clinical departments to review financial performance and their ideas for improvement
- Providing necessary resources to accelerate improvement and the deployment of clinical initiatives that enhance value
- Deploying financial personnel in clinical areas where large value opportunities exist, such as the operating room, cardiology and pharmacy
- Providing departments and clinicians with cost and comparative data that support clinical changes, including physician preference items, and involving physicians in negotiations
- Using standing meetings with payor representatives to resolve outstanding billing and administrative issues
- Developing payor report cards based on key performance indicators
- Sharing results with payor representatives on a regular basis
- Agreeing to an alternative dispute resolution process to circumvent costly litigation

Engage staff in efforts to improve efficiency and reduce costs. You can empower your staff by providing education, data and analytical tools. In addition, you should:

- Use benchmarking dashboards to help frontline employees reduce waste and inefficiencies in operations
- Create integrated, cross-functional teams to identify cost-reduction opportunities
- Seek input and ideas from staff to eliminate labor and other costs

they consistently rise to the occasion,” says Gardner. “In our experience, improved leadership, teamwork and accountability have led to better financial outcomes.

“The lesson I take away from our experience is organizations must constantly prepare for the unexpected,” he says. “We underwent a cost restructuring in 2005 in response to a strategic imperative, which in hindsight also prepared us for an unprecedented downturn. We now have benchmark financial metrics in place and access to capital. Our growth is slower, but we are positioned well to recover as quickly as anyone when the healthcare market inevitably changes again.”

If there is one thing Gardner can point to that has allowed the organization to remain financially healthy it is following principles of good leadership. “You never want to make decisions in crisis mode,” says Gardner.

WOMAN’S HOSPITAL

Another hospital that looked at operations strategically was Woman’s Hospital in Baton Rouge, La. It, too, underwent a top-down analysis. It began a few years ago identifying and establishing additional sources of revenue. More recently, Woman’s Hospital examined where it could cut expenses without reducing the quality of care.

The hospital identified two areas to cut costs strategically that have

helped sustain it through the current downturn and into the future. The first was in its obstetrics department, where the labor and delivery processes were streamlined.

“Two years ago we became more diligent about setting quantitative goals and measuring them,” says Teri G. Fontenot, FACHE, president and CEO. “In the past we would implement strategies but not always follow through to see if they were effective.”

With its obstetrics department, the hospital knew improvements needed to be made because the process was getting bottlenecked to the point that the department was running out of beds. Patients were being held in labor and delivery rooms after delivery because of evening discharges of postpartum patients. Using consultants, hospital staff analyzed how patients were admitted; how they were transported to the labor, delivery and postpartum rooms; and the process for discharging them. Processes were adjusted accordingly, and the result was that the length of stay for obstetric patients was shortened by eight hours. This means patients are discharged by 9 a.m. instead of in the afternoon.

“The steps we took in obstetrics were simple things that improved patient satisfaction and efficiencies and reduced costs,” says Fontenot. “We had eight fewer hours of nursing care on that last day. It made a huge difference to our bottom line. Financially it reduced operating



“Your staff has to believe and be involved in any change you make. In addition, you have to identify and create measurable goals, monitor them and be transparent.”

— Teri G. Fontenot, FACHE
Woman’s Hospital

expenses by \$1 million per year, and it allowed us to make better use of the space we had.”

Staff continues to follow established processes that they helped develop along with consultants. Those processes are “hard wired” into the hospital’s culture, says Fontenot.

“Because of that, we have lower costs, better patient satisfaction and better morale for nurses,” she says.

“Things are now planned and measured. There is more precision in our processes.

“Your staff has to believe and be involved in any change you make. In addition, you have to identify and

create measurable goals, monitor them and be transparent.”

The second area where the hospital reduced expenses is in its compensation and benefits package. With the recession taking hold and an 8 percent decline in state Medicaid reimbursement looming, the hospital reviewed how employee compensation and benefits stacked up with national norms and found its pay and benefits were on the high end.

As a result, Woman’s Hospital modified its bonus program. It now has a bonus plan based on the organization as a whole meeting patient satisfaction and efficiency goals. “The employees are still rewarded, but as a team and not individually for goals that are met,” says Fontenot. “Our cost cutting was more strategic. We really don’t look at it as cutting costs but as reducing waste and improving efficiencies in ways that don’t reduce care.”

Hospitals will most certainly continue to take short-term steps to weather the current economic environment, but the new reality means reviewing operations strategically and taking bold steps to sustain a healthy financial position.

“And successful hospitals that view their operations strategically always keep patient care first and foremost in their minds,” says HFMA’s Nelson.

John M. Buell is a writer with Healthcare Executive.