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**BECKER'S
HEALTHCARE**

Healthcare's Hidden Savings

Expert Insights on Rethinking Hospital Cost Structure



Participants Include:



S. Dawn Bulgarella
Chief Financial Officer
University of Alabama at
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System



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Expert Insights on Rethinking Hospital Cost Structure

By **Brian Zimmerman**, Senior Writer/Reporter, Becker's Healthcare

Hospital and health system executives are wrestling with an uncomfortable reality: Expenses are outpacing revenue and margins are shrinking. The factors fueling this trend are varied and complex, ranging from merger and acquisition activity to provider shortages and regulatory changes. While these external pressures are largely outside of leadership's control, health systems are not without recourse.

For the second consecutive year, expenses exceeded revenues for nonprofit and public hospitals in fiscal year 2017, according to [sector medians](#) from Moody's Investors Service. Moody's analysts predicted hospital

margins would continue to be suppressed through 2018, attributing the trend of low revenue growth to "lower reimbursement rates, [a] shift to outpatient care, increased merger and acquisition activity and increased ambulatory competition."

Results from a Becker's Healthcare and Bank of America Merrill Lynch survey of financial leaders conducted in August 2018 further elucidate the trend of rising costs. More than 87 percent of survey respondents said their organization's operational spend had increased in recent years.

The sharp rise in costs has precipitated a shift in

priorities for hospitals' top ranks. In a nationwide survey of healthcare C-level executives [conducted by the Advisory Board](#) between December 2017 and March 2018, more than 60 percent of respondents identified "preparing the enterprise for sustainable cost control" as their top concern, making it the most universally shared priority in the survey. In the previous year, a similar pool of respondents identified revenue growth as the area of most concern.

Leading hospital and health system CFOs are responding to external financial pressures with internal reassessments of their organization's cost

structure. This e-book takes a closer look at hospital and health system cost structures to discuss opportunities for savings, the role of data in identifying savings, and how organizations balance cost structure realignment efforts while maintaining a focus on innovation. The content is based on results of the Bank of America-Becker's survey and a roundtable discussion with two hospital and health system CFOs and one healthcare strategy expert.

Discussion participants included:

- **S. Dawn Bulgarella**
CFO of the University of Alabama at Birmingham Health System and Senior Associate Dean for Administration and Finance at UAB School of Medicine (Birmingham, Ala.)
- **Tim Cashman** *CFO of Estes Park (Colo.) Health*
- **Kerri Schroeder**
Commercial Credit Executive with Bank of America Merrill Lynch

Uncovering hospitals' hidden savings

For hospitals, a realigned cost structure is a destination. The route there varies from organization to organization based on specific challenges and past cost saving efforts. Some avenues will yield savings, but the question is whether those savings are sustainable and supportive of hospitals' strategy. Other avenues can lead to dead ends by actually incurring costs versus reducing them.

Cost management is not new to any hospital or health system today, meaning some opportunities for savings have been realized or exhausted. For example, while reducing labor costs by outsourcing certain functions may still be viable for some organizations, others may have already maximized labor efficiency or cannot take further action without jeopardizing patient care. These institutions need to look to other branches of their cost structure to control.

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savings, I do think that [labor as a savings opportunity] has been pushed hard for many years [and] I'm not sure there's much left there," Ms. Bulgarella said.

During the roundtable discussion, Ms. Schroeder said one thing that makes or breaks cost management is whether the team deciding which changes to make has an intricate knowledge of operations. Knowing the ins and outs of a hospital's strategy, operations and clinical outcomes can help leaders identify cost saving opportunities that may not be obvious to the plain eye. Sustainable cost cutting targets need to be tailored, not applied indiscriminately. Working to achieve a predetermined benchmark not based on deep operational knowledge is less likely to have a lasting effect on cost.

"When we think about hidden savings, [those] opportunities come from a really deep understanding of operational processes within the health system," Ms. Schroeder said, offering a parallel to what she's seen at

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her own organization. “[It’s] a little bit like an ongoing effort that we have here at [Bank of America Merrill Lynch] that’s focused on operational excellence. ... At every level of the organization [we ask] our managers to understand and own each of the processes that their employees are responsible for executing. And we’re evaluating all those. Making sure that we’re rooting out duplication and redundancy.”

Ms. Schroeder said Bank of America Merrill Lynch rewards employees who identify processes that are broken or in need of streamlining. Savings from improved operational efficiencies are then reinvested in the organization in the form of human capital, technology

or returning capital to stakeholders.

“It’s hard work, and it requires that ground-level, deep understanding of everything we are doing within the organization,” Ms. Schroeder said.

This emphasis on improving operational efficiency is supported by the results of the Bank of America-Becker’s survey. Seventy-five percent of respondents selected operational efficiencies as an area of the cost structure with opportunities for cost savings, making it the most-identified portion for savings opportunities. The second-most identified area was supply chain, with 66.7 percent of respondents citing this segment of the cost structure.

Hospital leaders looking to reduce supply chain spend may want to consider working collaboratively with a group purchasing organization. According to findings [published](#) by the Healthcare Supply Chain Association in August 2018, GPOs are projected to save the healthcare system between \$392.2 and \$864.4 billion between 2013 and 2022, which amounts to an average savings of 10 to 18 percent per member organization across most expense categories.

According to the HSCA report, one hospital realized \$3 million in annual savings after tapping a GPO to evaluate its cardiac rhythm management purchasing and utilization patterns. The GPO analyzed data comparing the facility’s pricing models to that of other hospitals only to find the models weren’t optimized to yield the best prices possible. Armed with this information, the hospital and GPO renegotiated purchasing contracts to transform cardiac rhythm management into a profitable service line.

The need for data-driven solutions

Cost structures are complicated in a \$3 trillion industry that influences life-or-death decisions. As hospitals design strategies to curb costs, every dollar must be saved in a way that supports their mission of care quality.

While variable costs do exist, the majority of a hospital's costs are fixed expenditures associated with labor, supplies and other overhead. Labor costs typically account for the largest portion of costs, roughly 60 percent on average. Supply chain costs take up nearly one-third of the average hospital's operating expense, and are predicted to surpass labor as the leading expense by 2020, according to projections by the Association for Healthcare Resource & Materials Management.

To complicate matters, many hospitals are staring at a black box when it comes to the true cost of the care delivered to patients. "I think one of the biggest challenges for a lot of

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healthcare organizations is the lack of adequate data," Ms. Schroeder said. "There are a lot of players in the industry who still have an inadequate understanding of their true cost structure and really aren't able to determine the cost of each procedure performed within the four walls of the hospital. That lack of transparency, or at least those gaps in transparency, makes it a little harder to figure out where your cost savings opportunities are."

For example, in August, [The Wall Street Journal](#) reported on La Crosse, Wis.-based Gundersen Health System's effort to determine the true cost of its knee replacement surgeries. It took the system 18 months to pinpoint an approximate cost, finally landing at \$10,550. The time

and resources needed to conduct this type of analysis for one procedure illustrates the challenge hospitals' finance leaders face.

Hospitals and health system finance leaders need to be able to accurately measure revenues and expenses, but this can't occur unless the true cost of care for a condition is documented throughout the care cycle. Investing in cost accounting and decision support technology solutions can position leaders at the starting point needed to get their arms around true costs.

Balancing cost cutting with investment in innovation

It is easy to see how financial leaders tasked to simultaneously champion cost reduction efforts and innovation investments

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feel tugged in two different directions. This conundrum is especially salient for hospitals in smaller, often rural, markets. Many of these facilities operate under razor thin margins but must invest in leading technologies and equipment to remain competitive.

As CFO of a community hospital in the town that sits at the base of Rocky Mountain National Park, Mr. Cashman is familiar with this balancing act. During the conversation, Mr. Cashman said his organization continually upgrades its medical equipment and technology to meet evolving quality standards and deliver the best possible care to patients. When looking to invest in clinical care, Mr. Cashman said his organization works

to determine which service lines have potential to achieve financial sustainability.

“If you’re not growing and investing [in innovation], then you’re dying,” Mr. Cashman said. “I’m continually working on models [to determine] what sort of investments are going to produce the best yield. Not only financially, but also [in terms of] servicing the community.”

Mr. Cashman looks to invest in service lines that produce some sort of return on investment within 18 months. To determine which lines are best positioned for consolidation or investment, Mr. Cashman’s organization examines data compiled during community needs assessments to pin down which healthcare services are in high demand.

During the discussion, Ms. Bulgarella spoke to the importance of innovation from her viewpoint at a 1,157-bed academic medical center and Level I trauma center in the South. Innovation is the hallmark of AMCs, and Ms. Bulgarella said fiscal responsibility throughout the cost structure is important so the institution can maintain continuous investments in education, research and patient care.

“We are constantly investing in innovation,” Ms. Bulgarella said. “We have to map out what the return on an investment would be — sometimes it’s a year, sometimes it’s five years and sometimes it’s never ... oftentimes you’re doing things to maintain a market share

[or] you're doing things to support your community.”

Financial leaders need to understand the health needs of their patient populations to achieve equilibrium between investments and cost savings initiatives. Collecting and analyzing big data is expensive and requires significant labor resources. Hospitals and health systems that tap an outside partner to handle this data collection and interpretation are better positioned to prioritize medical care, research and education.

The role of outside partnerships

From outsourcing technology and financial services to tapping outside consultants for health information on

patient populations, hospitals and health system leaders are increasingly looking for expertise outside the walls of their institutions to improve both care quality and fiscal health. About 98 percent of hospital leaders are considering working with third-party vendors to generate cost efficiencies in both clinical and nonclinical functions, according to the results of a [Black Book Market Research](#) survey published in May 2018.

“I think there is a significant role for outside consultants to play [in rethinking hospital cost structure],” Ms. Schroeder said. “There are partners out there that can help provide some of the services that hospitals provide in areas that are, maybe, not

the core competency [of the hospital].”

Ms. Schroeder has years of experience to draw from, including time spent working with hospitals and health systems to achieve savings through revenue cycle management. For instance, one common challenge hospitals face is streamlining the accounting process for insurer payments. This is especially the case when it involves paper-based explanation of benefits documents sent by insurers, which must be converted into files in the patient accounting system.

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your internal resources a lot of time and create a much more efficient process,” Ms. Schroeder said.

During the discussion, Mr. Cashman suggested outside partnerships provide a way for healthcare organizations to sidestep the challenges created by declining reimbursement, but he cautioned that such investments should be made discerningly and with a specific intent. Few, if not zero, hospitals today have thick enough margins to deploy outside expertise for activities that are not mission critical.

“The use of consultants, I think, can be handy,” Mr. Cashman said. “They can also be expensive. And so, we have to be very careful about when and where we employ that resource.”

Conclusion

The external pressures on hospital margins are likely to persist for the foreseeable future, largely driven by the continued uncertainty surrounding care reimbursement. With the repeal of the ACA's individual mandate set to take effect in January 2019, as well expected changes to 340B reimbursements, hospitals and health systems

must continue to operate in a landscape colored by regulatory uncertainty.

In this era, it's important for hospital and health system finance leaders to control what they can within the cost structure to maintain fiscal stability while simultaneously investing in the delivery of high-quality care. Fortunately, these two ambitions are hardly disparate. When hospitals work to eliminate operational inefficiencies and target investments toward patient needs, financial security is likely to follow. ■

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