FEATURE

CRISIS OR OPPORTUNITY:

Reimbursement cuts and management's response

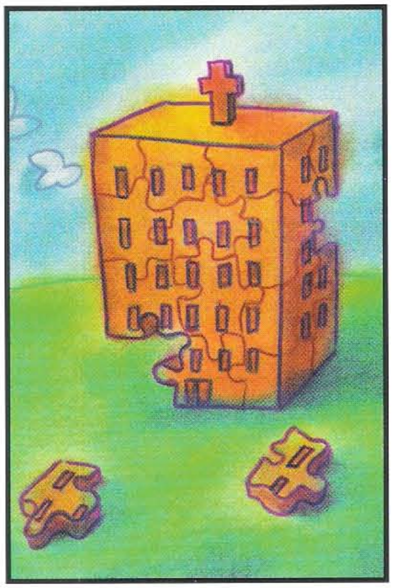
BY ROBERT D. BETKA

Health care organizations particularly experience savings in the following categories:

- **consignment agreements with vendors for high-cost, multiple SKU items**
- **just-in-time requisitions and deliveries**
- **limited inventories**
- **information system applications**
- **targeted group purchasing organization contracting**
- **product standardization and vendor consolidation**
- **reduced utilization**

The conclusions drawn from the MHA study, The Declining State of Michigan Hospitals, *are sobering. Cuts in government funding for Medicare and Medicaid have resulted in $537 million of lost revenue across the 50 hospitals surveyed. Hospitals' responses to these shortfalls have included layoffs and staff reductions, termination of health plan contracts, program and service elimination, and delays in technology and capital purchases.*

These reimbursement reductions are only the most recent in a sequence of market and regulatory changes affecting health care organizations. Hospitals are no strangers to belt-tightening, having undergone rounds of layoffs, downsizing and restructuring. But what really works in these situations? As one Michigan CFO put it, "One time cost reduction programs don't work." A brief overview of a number of actions — sustainable and of significant impact — being implemented by leading hospitals provides several lessons for health care executives.



COMBINING FORCES

Shared service centers are based on the principle that high-volume, transaction-based processes performed by separate entities can be combined into an organization whose sole function is to provide its internal customers with high-quality services at lower costs. Although typically found in multihospital organizations, shared service centers are being piloted by unaffiliated hospitals. Benefits of shared service centers include economies of scale, standardized processes, single point of contact for customers and suppliers, and leveraged business process re-engineering efforts.

While the physical consolidation and technologies of the shared services center contribute to reducing costs, most health care organizations have primarily achieved savings by standardizing and re-engineering major business processes.

Processes commonality has led organizations to implement shared services to support customer management, finance, human resources, supply and purchasing management, and information systems.

Organizations considering shared services should examine the trade-offs between central and local control. Shared service initiatives are generally high-return projects, but the impact on the business and the degree of change require careful scrutiny.

IMPLEMENTING STRATEGIC PSM

Successful purchasing and supply management (PSM) initiatives have provided two fundamental lessons. First, PSM should be viewed as a strategic process. Marketplace and regulatory exigencies have prompted health care organizations to discard the view of PSM as a back-office function in a basement location. Rather, leading organizations recognize that managing the supply chain effectively can add two to six percentage points to operating margin. Second, numerous avenues exist to achieve significant benefit. (See sidebar.)

Two fundamental principles of supply chain management should guide any PSM improvement effort. First is the focus on minimizing the total cost of ownership. This includes supply and service acquisition and delivery cost plus internal costs of consumption and asset productivity.

Experience has shown that the greatest returns are found in vendor rationalization and product standardization, particularly with respect to purchased services. Additionally, efforts to control clinical utilization, though more difficult to uncover, can generate sustained long-term savings. Second, even though health care PSM is at a rudimentary level of sophistication, there are still significant opportunities available through improving basic blocking and tackling. Large investments in sophisticated e-commerce solutions are not necessary for the typical hospital to achieve measurable savings.

APPLYING AN INVESTOR'S APPROACH

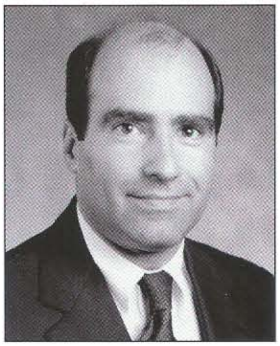
Fundamental principles of investing and portfolio management should underlie rigorous program and service evaluation. Planning for and investing in various new programs and services requires three disciplines: a solid business plan, challenging performance thresholds (including an exit strategy), and a sound management team. Evaluating existing programs for investment or divestment should address the program's financial performance, strategic importance, and relative competitive position.

Health care executives should remind themselves that true competitive advantage for any program or service is gained in three ways: low cost leadership, product differentiation or market specialization. Unless one's organization can be assured that its programs meet those criteria, the luxury of providing a comprehensive scope of services may have to be foregone.

IMPLEMENTING BUSINESS

Hospitals are emphasizing business acumen in selecting and placing executives and front line managers alike and in setting the continuing education priorities of their management teams. One reason for this emphasis has to do with the reduction in the numbers of middle management personnel as a result of years of reorganization and streamlining. More is now expected of managers who only recently were concerned wholly with clinical issues. Enlightened hospitals are transforming clinical managers to business unit managers, with responsibility for their own services' profits and losses. By doing so, organizations are moving to the logical consequence of employee empowerment by vesting responsibility and demanding accountability.

This new perspective in business management requires hospitals to provide the needed information, tools and capabilities for managers to assume these responsibilities. By investing in human capital and increasing the professional capabilities of their most prized assets, these hospitals are protecting their financial viability, thus ensuring their ongoing leadership. end



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