Accelerated Operations Improvement

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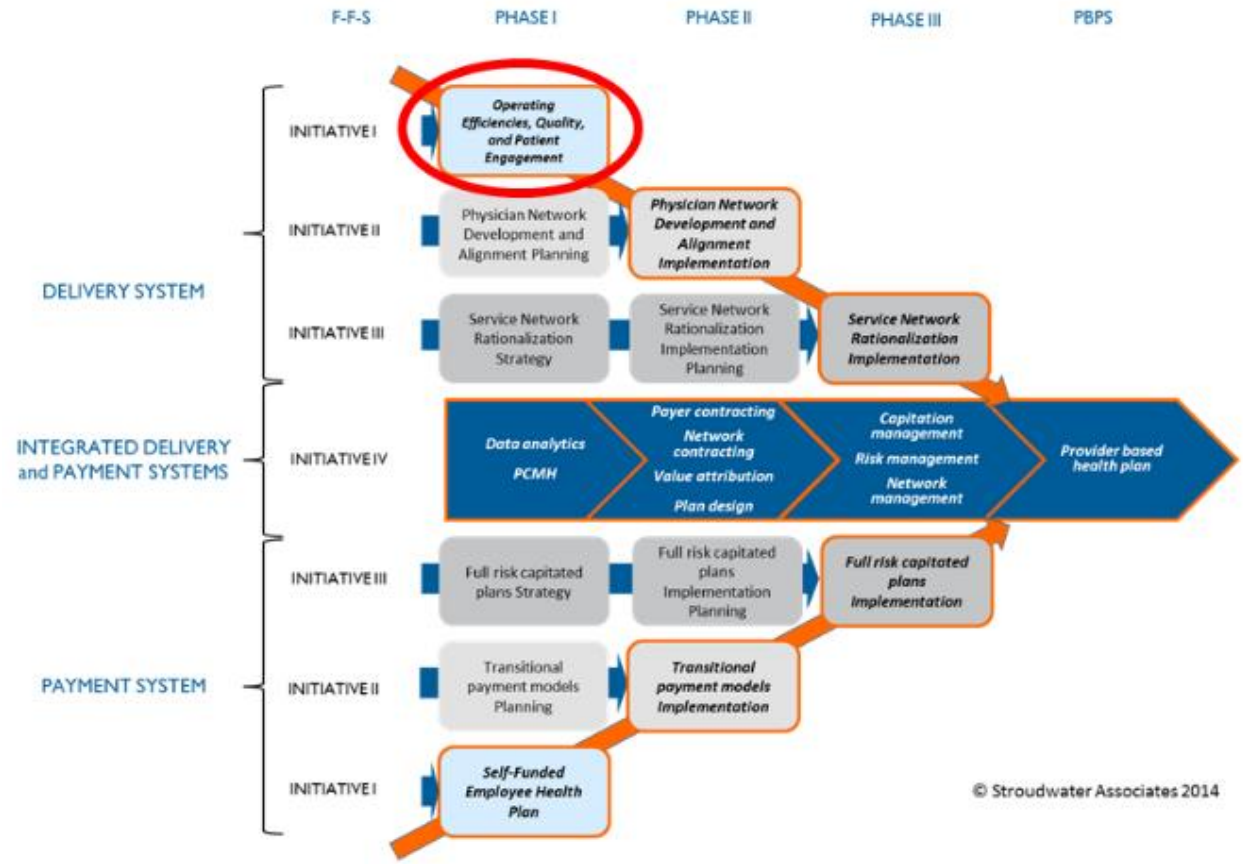
Healthcare consulting firms have been offering Operations Improvement ("OI") support to hospitals for decades. Typically, these engagements are long, and depending upon the size of the organization and the magnitude of the improvement required, will often last for years. The engagements can also be expensive, largely because the process of identifying, and then implementing, the execution of cost-reduction strategies is so labor-intensive. In large organizations, it is not unusual for a bevy of consultants to be on site for years identifying opportunities and supporting the full implementation of significant initiatives. Some hospitals have undergone repeated OI engagements with various consulting firms using different approaches so that the organization is trapped in a cycle of expense reduction-execution-plateau-expense creep-expense reduction-execution, and so on.

As community hospitals struggle with their approach to health reform, the sheer magnitude of the change and the complexity of implementation can be daunting. The affordability imperative is driving community hospitals—particularly because they lack economies of scale—to focus on cost reduction and outcome improvement. However, most OI consulting approaches are too detailed, lengthy, and expensive to work for community hospitals. The engagements are neither scaled nor scheduled to improve financial performance rapidly and effectively.

Meanwhile, declining hospital financial performance has driven community hospitals to seek partners to ensure their own sustainability. According to leading hospital industry sources, hospital transaction volume levels in 2015 are expected to be similar to those of 2014. And yet, community hospitals are not well positioned to select the ideal merger or affiliation partner because they are not offering their prospective partners efficient care delivery processes. Before considering an affiliation strategy, community hospitals must be able to demonstrate financial accountability, a focus on process improvement, and the ability to streamline operations.

Stroudwater Associates employs a health reform model to transform healthcare organizations. The model focuses on the themes of improving the delivery system, improvement the payment system, and implementing a population health approach to position the hospital for success. The first phase of improving the delivery system and payment systems is to employ a rapid laser-focus on Operations Improvement.



Healthcare Operations Improvement Developments

Four recent developments have changed the tenor and heightened the importance of Operations Improvement. First, the risk of dramatic declines in revenue as payers shift volume within newly defined narrow networks has raised the stakes. The potential severity, pace of operating margin, and balance sheet deterioration caused by these shifts make proactive operational improvement an imperative. Second, the trend of physicians aligning with hospitals and hospitals aligning with systems consolidates services in regional markets, and can change the market position of a provider organization overnight. Third, the focus on population health has forced systems to think about managing large populations, thus changing the business models that have defined service delivery to large geographic regions.

Fourth, the imperative to measure outcomes has enabled healthcare organizations to see clearly the impact of expense reductions, both organizationally and within service lines and processes. Consumers and employers now have access to comparative quality and cost information that drives comparison shopping.

Today, hospitals are less likely to view Operations Improvement as an exercise to improve the bottom line; instead, they understand OI as a critical approach to managing strategic risks and as an important step in positioning the organization to achieve an ideal affiliation agreement with a preferred partner. Boards are shifting their thinking about their governance roles from assuring hospital sustainability to promoting health and ensuring access to quality care for the population they serve.

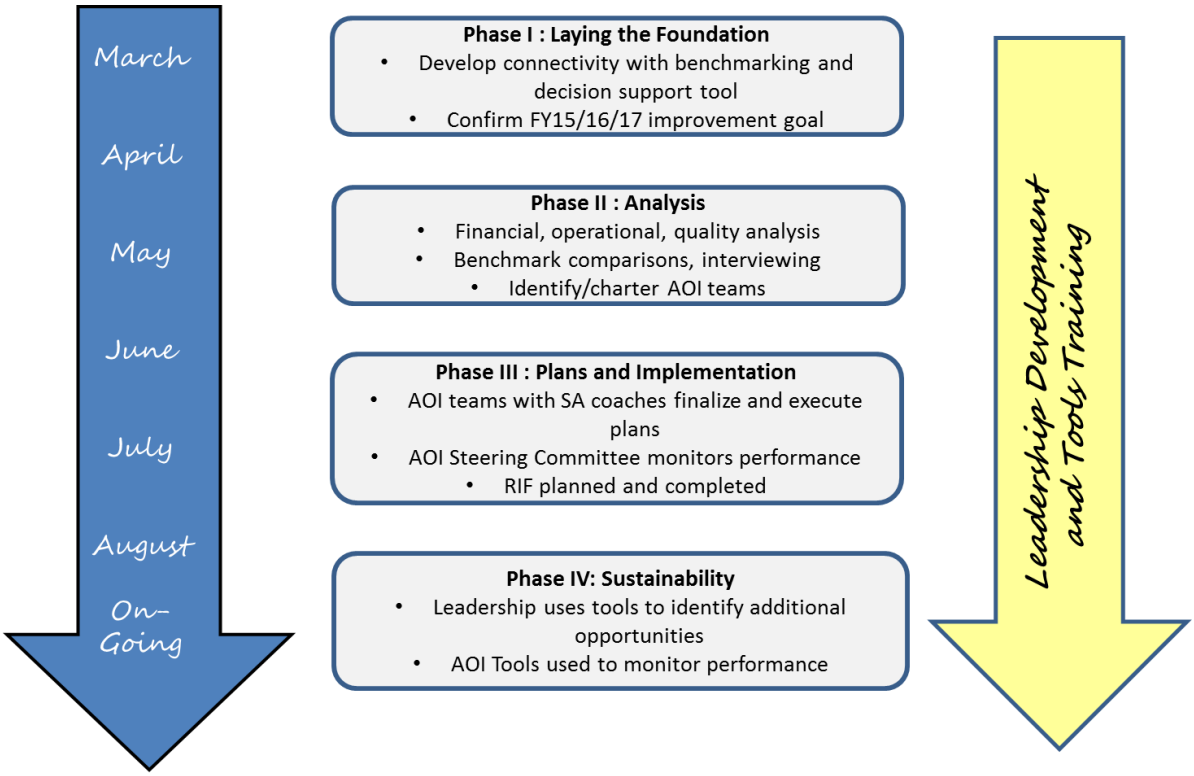
The good news is that tools for analyzing performance to identify opportunities, support execution planning, and enable performance monitoring have become increasingly sophisticated and user-friendly. Many companies can now readily benchmark performance against identified peer institutions and quickly illustrate both the possible types of expense reduction and their relative magnitude. While the power to see opportunities for more efficient operation is an accelerant to the change process, the challenge is how to redesign the value streams to eliminate waste and streamline processes.

Stroudwater's Accelerated Operations Improvement approach rapidly streamlines operations, reduces operating expenses, improves revenue cycle, and enhances patient outcomes.

Five Principles of Accelerated Operations Improvement

The Accelerated Operations Improvement is based upon five principles. **First, the hospital leadership—not the consultants—needs to own and drive the improvement process.** The Stroudwater consultants work in the background serving as coaches to leadership who are the visible force making decisions and communicating the plans to the hospital and community.

Second, the consultants' job is to **diagnose the culture and performance barriers** so that a plan can be crafted with the right information, resources, tools, and leadership development strategy to achieve organizational sustainability. For example, the lack of a culture of fiscal accountability and community responsibility for affordable healthcare can be the major factor contributing to a hospital's poor financial performance. Though leadership will state that they want to preserve aspects of the current culture but strengthen others, hospitals invariably have not used a tool to measure



culture. Therefore, there is no objective measure of the operational improvement initiatives' effect on the hospital's culture. Just as measurement is essential to improving quality, measurement is equally important to improving culture.

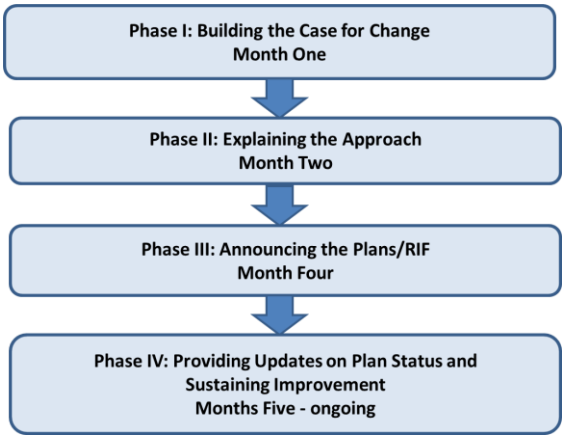
Third, **the operations improvement approach needs to be customized to the hospital**, recognizing that unique and specific market forces and organizational history need to be understood so that the improvement plan is realistic and executable under health reform. It is critical to connect the Accelerated Operations Improvement approach with the hospital's strategic plan, financial forecasts, performance improvement program, and leadership development program so that the overall plan makes sense to staff.

Fourth, and most important, the engagement is not about designing a performance improvement initiative that is time-limited, but rather, it is about **permanently changing the way the hospital does business**. Embedding the new tools and processes within the hospital's leadership structure, goal setting process, performance measurement systems, and language is key to assuring that the organization stays on a trajectory of financial improvement.

Fifth, **the crafting and execution of the communications plan must be customized to the organization.** Many creative tools can be employed to ensure that the plan is actually a dialogue with staff and the community. A four-phase communication plan parallels the OI process. First, a case for change must be made by senior leadership with all key stakeholders. Second, the approach used to identify cost reduction and revenue enhancement opportunities needs to be explained, with a clear plan for fully engaging the staff. The third step is to explain the decisions made and their impact on patient care and processes, patient access, staffing, pay/benefits, and partnerships. Finally, the plan will outline a regular means of listening and providing feedback as plans are implemented.

Accelerated Cycle Operations Improvement

Stroudwater's Accelerated Operations Improvement (AOI) approach has four phases. **Phase I: Laying the Foundation** begins with the establishment of an AOI steering committee that meets at least every other week to design and drive the process. At the first meeting, the AOI steering committee develops the improvement principles, communications plan, schedule, and work plan. A structured assessment is conducted of the hospital's financial, human resources, information, human capital, patient care delivery, and performance improvement systems. Also, a reliable culture instrument is employed to aid in understanding values and behaviors within the organization. Concurrently, the performance of the market is analyzed to identify opportunities and risks. Market performance is assessed with rapid benchmarking. This market assessment is juxtaposed against the hospital's current five-year financial forecast to illustrate potential disparities. If needed, a proven, nimble, and affordable decision-support system is connected to the existing IT platform to examine the underlying cost structure, while



industry-proven benchmarking tools identify and quantify the magnitude of the opportunity.

Human Resources begins planning for a reduction in force with reviews of severance policies, position control systems, and staffing plans. While a reduction in force may not occur in some instances, leadership must plan for an organized staff reduction in anticipation of plans that require less staffing. With salaries and benefits typically comprising about 50% of a hospital's budget, it is rarely possible to reduce expenses significantly without affecting staff numbers, pay, and benefits.

At the conclusion of Phase I, the improvement goal has been established and Accelerated Operations Improvement (AOI) teams with specific goals have been created. For example, the hospital might identify an $8M goal of improving performance through revenue enhancement and expense reduction. Accelerated Operations Improvement teams in supply chain, facilities management, or nursing would be established, pairing a hospital leader with a Stroudwater consultant and assigning each pair a specific financial target.

During **Phase II: Analysis,** the AOI teams delve into the data, brainstorming opportunities and contacting benchmarking hospitals to transform their thinking about the most efficient ways to deliver care. Understanding key care processes (such as rigor around the discharge process, the scheduling of outpatients, or bed management) is essential, as the downstream impact of inefficient processes drives costs across the organization. Technology options that would enable efficient care delivery are thoroughly investigated.

The AOI teams are expected to develop ideas and plans *exceeding* their targets, and to present those plans to the Steering Committee. Since the AOI teams typically have only four weeks, the analysis and identification of opportunities is an intense process that becomes a top priority of the organization. The Stroudwater consultants serve as coaches to the teams, helping to generate ideas and challenge thinking about new ways of doing business.

The AOI teams are expected to consider the eight significant Operations Improvement Opportunities (OIOs). The teams are challenged to answer the sample questions identified as follows:

- Workflow Processes – How can workflow be streamlined? Is there waste or duplication? Can technology expedite work? Can demand be smoothed so that peak staffing is not required? Have cycle times been measured and goals established?
- Programs/Services – Can some services or programs be eliminated? Can services or programs be redesigned or reorganized for greater efficiency? Has a capacity analysis been conducted to reduce excess capacity?
- Staffing – Is work evenly distributed across staff? Can management span of

control be increased? Are staff working at the top of their license? Is skill mix appropriate for the work to be done? Can some services be outsourced?

- Wages/Benefits – What is the hospital's wage philosophy and how does that compare with benchmarked data? Has the health plan be redesigned to incentivize healthy behavior and effective utilization by the staff?
- Supplies – Have supplies been standardized across the organization? Is purchasing centralized to ensure volume discounts? Are materials received, distributed, utilized, and disposed of effectively?
- Contracts – Have major contracts had an annual review and been renegotiated? Have preventive maintenance and information systems contracts been updated?
- Facilities – Has a facilities/properties audit been conducted recently? Has an energy audit been conducted and recommendations fully implemented? Have selling and leasing options been considered for all properties? Can some practice locations be consolidated for staffing efficiency?
- Physicians Relations – Do the physician contracts include productivity expectations? Is productivity by physician monitored and staffing adjusted accordingly? Is patient leakage monitored?

At the conclusion of Phase II, the AOI teams present their plans to the Steering Committee for endorsement and cross-functional planning. Plans for a reduction in force are finalized, with staffing, communications, and scheduling defined. Senior leadership needs to be convinced that there has been equal rigor across all segments of the hospital. The consultants' job is to challenge leadership to make sure there are no "sacred cows," and that every possible avenue for performance improvement has been explored. The communications principles developed during Phase I drive the frequency, vehicles, and messaging in Phase II and Phase III. An AOI tracking system is utilized to track and monitor execution during Phase III and IV by the AOI Steering Committee.

During **Phase III: Implementation,** the AOI teams continue to play a role in tactical planning and execution of all improvement initiatives. The significant operational improvement experience of the Stroudwater consultants empowers them to be valued partners in planning the implementation of the endorsed ideas. Stroudwater consultants bring both implementation experience and moral support to assure leadership that the change is possible. Typically, a large part of Phase III is managing the Reduction in Force so that staff are treated with humanity and dignity, patients and families remain central, and the medical staff supports the process.

The most important element of Operations Improvement is **Phase IV: Sustainability.** The right decision support tools and processes have to be embedded in the management structure to ensure performance is rigorously monitored. The leadership development plan needs to focus on developing competencies in financial accountability and process improvement. The availability of a "before" culture assessment allows the organization to measure the impact of the AOI initiative on the staff with an "after" assessment. Within six months of engagement launch, the goal is to have built internal tools

and leadership capability to sustain improvement over time.

The Stroudwater Associates Accelerated Operations Improvement process is best understood with a community hospital case study.

Operations Improvement Case Study

Oaklawn Hospital is a 94-bed hospital with an ADC of 40 patients, located in south central Michigan in the town of Marshall. A sole community provider, the hospital has the dual mission of providing access to quality patient care and being the economic engine for the community by creating high-paying jobs. Like many community hospitals, Oaklawn Hospital is the largest employer in the community. The hospital's vision is to strive for perfect care every time. Oaklawn's strategic plan focuses on quality and safety, comprehensiveness of services, and physician alignment, but not on affordability of care.

With a $117M operating budget in FY14, the hospital had enjoyed fairly stable financial performance over the years. The FY 2012 operating margin was $1.1M, and with approximately 125 days cash on hand, the hospital had adequate liquidity. However, 2013 brought significant challenges for Oaklawn Hospital. In January of that year, Ginger Williams, MD, was internally promoted from CMO to CEO, succeeding a 36-year CEO. During February and March, the hospital experienced significant declines in volume that resulted in monthly losses of almost $1M. Then, in June, the FY13 audit (Oaklawn's FY ends March 31) found that the hospital had failed to account for contractual allowances appropriately, resulting in FY13 operating losses of $2.3M. The contractual allowances error carried forward to the FY budget. The hospital had its first RIF in October 2013, but an operating loss of almost $5M was projected for FY14. While Oaklawn's market share was steady, utilization of both inpatient and outpatient services was declining. With community population projected to decline and admission rates expected to drop significantly, the board and leadership realized that the existing five-year financial forecast for Oaklawn was of little value, as the underlying volume assumptions were unrealistically high.

Oaklawn has a strong tradition of commitment to quality and safety. In 2014, Consumer Reports identified Oaklawn Hospital as the second safest hospital in the US. The quality improvement framework had incorporated Lean principles about seven months earlier, which yielded impressive results from two value streams. Nursing was recognized with Magnet status in 2011, with redesignation scheduled for 2014.

The FTE complement of 795 was operating well below the FTE budget of 850. The hospital had a decade-long effort to align with physicians, and the FTE complement included 55 physicians and extenders employed by Oaklawn Medical Group. The leadership team was aware that the hospital was overstaffed compared to benchmarks, and expected that a significant reduction in force was necessary and would affect inpatient, outpatient, and administration. However, the leadership team reported that they lacked the analytics to locate the greatest opportunities, the tools and skills to redesign the work effectively, and consequently, the confidence to execute. The CEO estimated that Oaklawn needed to reduce operating expense by about $20M, or 20% of the budget, over three years. Therefore, in early 2014, Oaklawn

sought consulting assistance for Accelerated Operational Improvement.

Stroudwater Associates was selected by Oaklawn Hospital based on its significant community hospital experience, operational improvement approach, and reasonable fees for the engagement. The aspect of Stroudwater's approach that Oaklawn found most appealing was the rapid deployment of senior consultants with deep operational expertise, who would partner with leadership over the six-month engagement.

Oaklawn Hospital identified the following goals:

- **Quantify the scale of financial performance improvement required** to overcome future reductions in volume and revenue, and to achieve an operating margin sufficient to provide adequate investment capital for Oaklawn Hospital over time
- Identify specific opportunities, approaches, skills, and tools for performance improvement by applying a combination of **expense reduction and revenue growth strategies**
- **Develop analytic and performance improvement competencies** in the administrative and physician leadership
- **Embed a set of tools and leadership/management skills** that will allow the performance improvement trajectory to continue beyond the timeframe of this engagement

Stroudwater's engagement with Oaklawn Hospital launched in March 2014. During the eight weeks of Phase I of the engagement, a communication plan was finalized; the OI Steering Committee was established; benchmarking was conducted with peers nationwide and for community hospitals within Michigan; the hospital financial target was established; and AOI teams were created.

Stroudwater had been engaged recently to work with a dozen Michigan community hospitals, so benchmarking with peer institutions was readily available. In addition, the project team used a national benchmarking tool that allowed Oaklawn leadership to select peer hospitals from across the United State for comparison. Employing both tools, the annual improvement opportunity for Oaklawn was identified to be as much as $24M in operating expenses. This exercise was necessary to illustrate Oaklawn's high costs, and therefore the degree of unaffordability of Oaklawn's care. Oaklawn's AOI steering committee established the goal of reducing yearly operating expenses by $8.9M annually. Significantly, Oaklawn lacked a decision support system to provide leadership with timely financial information for OI decision-making. Installation of a decision-support suite of tools, with accompanying training, provided the OI teams with reliable financial information to drive decisions.

Also during Phase I, preliminary plans began for the Reduction in Force projected for June 2014. The Reduction in Force policy was revised and principles were established by the AOI steering committee. The severance plan was revised to provide more significant financial support for the staff to be reduced. The AOI steering committee determined that they wanted to offer voluntary severance to staff in targeted departments, a step that required extra planning. The HR communications plan and schedule were drafted. In addition to the internal meetings with management, physicians, the board, and employees, the CEO held community meetings to explain the case

for change at Oaklawn Hospital and to share the goals and process.

At the conclusion of Phase I, seven AOI teams were established: supply chain, revenue cycle, wages/benefits, nursing, operations, Oaklawn Medical Group, and administration. Each team was chaired by an Oaklawn leader partnered with a Stroudwater Associates consultant. Financial and operational targets were established for each team based on the team budget and the projected magnitude of the opportunity for improvement. For example, with a budget of $20.5M, Oaklawn Medical Group was expected to reduce operating expenses by $2M. These targets were established using the data from benchmarking that identified the greatest opportunities for improvement. The decision support system was not implemented at the conclusion of Phase I, hampering management's ability to analyze opportunities fully.

The AOI teams had four weeks during Phase II to develop specific revenue-enhancement and expense reduction plans. Position control lists were distributed to all AOI chairs with the expectation that all potential RIF staff would be identified by the conclusion of Phase II. Quality improvement staff supported the teams and employed QI tools such as A3 thinking, a problem-solving approach centered on PDCA and workflow analysis to identify and eliminate waste in processes.

The eight-week Phase III began with each of the AOI teams presenting their plans to the Steering Committee. Finalization of the plans, including documentation of the staffing implications, was important so that the RIF could proceed as planned. Sixty-two FTES were reduced, though since some positions had been held vacant, only 39.8 *occupied* FTEs were eliminated. The AOI co-chairs worked closely together during this time to execute the RIF plans with minimal patient and staff impact. Plans ranged from changing the staffing and patient schedule in endoscopy to closing some practice locations to revising the Oaklawn employee health plan.

During Phase IV: Sustainability, a key goal was to embed the decision support system within the hospital as a tool for tight fiscal management. Because implementation of the decision support system took longer than planned, it was not helpful during the cost reduction process; however, full use of the system was essential to sustain the culture of fiscal accountability and performance improvement. A dozen staff from departments across the hospital were trained as super-users of the decision support system and served as resources to management and leadership.

Another goal was to strengthen management and leadership through a leadership development program. The 2014 leadership development program was designed to focus on three core competencies: improving processes, improving fiscal performance, and leading people and change. The leadership development program commenced in April, with one session on change leadership and plans to launch the full program with all senior and middle management in August 2014 after the conclusion of the RIF. The 2014 leadership development program concluded in December 2014.

The outcome of Oaklawn Hospital's Operation Improvement initiative is evident, as the operating results rebounded from a loss of $5.1M in FY14 to a projected gain of $1.2M in FY15. Patient days declined by 3% during this same time period and outpatient utilization remained steady. All quality and safety

indicators reflected either stable or slightly improved performance. In February 2015, Consumer Reports cited Oaklawn Hospital as the safest hospital in the United States. Nursing Magnet redesignated Oaklawn Hospital in 2014. Oaklawn conducted an employee engagement survey at the beginning of their Operational Improvement initiative, but has yet to repeat the survey, so the staff impact has not been measured. Oaklawn was largely confident they could sustain improvement on their own after six months, though they required an extended engagement in revenue cycle due to the magnitude and complexity of the projects identified.

First, it is important to note that Oaklawn's improvement is a result of strengthening the culture of fiscal accountability for performance, particularly at the managerial level, where staff has been empowered with tools and skills to manage effectively. Second, the turn-around occurred as a result of both expense reduction and revenue enhancement, primarily in revenue cycle as opposed to service expansion. Third, Oaklawn's commitment to employing Lean tools to improve processes has been integral to the success of this initiative. Oaklawn's culture of quality and safety remains strong, with Nursing being recertified by Magnet and patient outcomes improving during this same period. Fourth, Oaklawn leadership recognized the affordability imperative and committed to developing internal staff to sustain cost reduction and revenue improvement over time.

Stroudwater's Accelerated Operations Improvement approach provides a rapid, thorough process for improving operations and financial performance with demonstrated results.

For further information about Stroudwater's Operational Improvement practice, please contact Scott Goodspeed at sgoodspeed@stroudwater.com.