

## Utilizing Strategic Cost Management to Achieve Long Term Sustainability

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Health care continues to move toward a value-based reimbursement model as governmental and commercial payers limit payments to a greater degree while demanding improvements in quality outcomes, care, and access. In order to stay relevant in this complex environment, health care systems have to look holistically at more efficient ways to deliver care. Strategic cost management is the sustainable answer.

### What is Strategic Cost Management?

Strategic cost management is defined as reducing cost to the lowest possible levels while maintaining or improving quality or customer service to patients, as well as achieving the organization's strategic goals and objectives. Within a health care system, a strategic approach to cost management focuses on six areas:

- **Purchased service costs.** Includes contracted services and is the easiest category to reduce.
- **Supply costs.** Constitutes clinical and nonclinical materials.
- **Management costs.** Includes administrative labor.
- **Labor costs.** Includes nonadministrative labor.
- **Clinical management costs.** Includes costs related to clinical decisions.
- **Physical space usage costs.** These are costs related to the location of services within the health system's buildings.

These cost areas are presented in order beginning with the most difficult to implement. The easiest category to reduce is purchased service costs, while supply and labor costs present the largest opportunity for cost savings and efficiency increases. While these areas are reviewed independently, the relationships and their impact on other cost areas should be looked at collectively.

### Getting Started

The strategic transformation of a health system's cost structure involves thoughtful consideration of services offered, rigorous cost management to reduce costs of current operations, and a redesign of clinical operations to improve the quality and effectiveness of care. This transformation starts with the chief executive officer, who's responsible for driving cost reduction, efficiency improvements, and the cultural transformation process.

At its most basic level, strategic cost management will require significant

cultural change. Executive leaders must create a culture of results and accountability, which needs strong support from the board. You'll also need support and active participation from management, physicians, and employees throughout the organization.

Before undertaking cost-reduction efforts, leaders must understand their organization's sensitive areas and outline priorities and outcomes they want to achieve. Cost-reduction targets without specific improvement initiatives won't produce significant cost savings. Likewise, improvement initiatives without cost-reduction targets may support organizational activities, but won't produce significant cost savings.

While you'll likely need to address all the cost areas as part of a master plan, it isn't practical to pursue all areas at the same time. What your master plan should include is the order of cost review and reduction efforts as well as milestones. The plan's priorities will depend on the health care system's financial position, market, and clinical resources. To keep the initiatives moving and their impact real, divide the plan into four-month increments.

## **Implementation**

Once the plan is developed and communicated, success is dependent upon middle management driving the cultural changes needed to achieve results. Don't underestimate the power of attitude. Employees will read cues from middle management and base their thoughts and actions on this. If managers are indifferent to the transformation, no financial control

system will succeed; however, if employees take the initiatives to heart, then excellent results can be achieved.

Physician leaders and practicing physicians are also a critical component when it comes to achieving strategic cost-reduction goals. Like middle management and employees, physicians can help drive dramatic results by offering the system labor, time, and supply use, but they must be on board with the changes.

Finally, when cost-reduction efforts are realized, the organization should have periodic reviews to understand how its cost structure has evolved and whether additional opportunities exist to more efficiently use resources to support the strategic goals and quality of care. With a focused and well-coordinated effort by all, health systems can achieve reduced operating costs while maintaining or improving quality of care.

## **Is Your Health System Ready?**

Before preparing a master plan, it's important to undertake a deep and detailed analysis of the organization's current readiness for this effort—consider the strength and management of clinical teams, political will, and your culture of accountability. Success will be elusive if your organization isn't ready to implement these changes.

The following questions should be answered prior to starting this strategic cost-reduction effort:

- Is the health system's CEO personally committed to leading a cost-reduction transformation?

- Will the board support this major effort?
- Can the CEO make a compelling case for changing the organization's culture through the process?
- Does the rest of the executive team support this transformation?
- Will middle management teams be committed to the plan and process?
- Are physicians and employees willing to participate in developing cost-reduction initiatives?
- Is the health system able to implement and sustain cost-reduction efforts to achieve cultural change and long-term goals?

## **Other Cost-Reduction Approaches**

Some of the more traditional cost approaches are more successful than others, but none of them alone fundamentally drive sustainable cost improvement in the long-term:

- Budget cutting

This is a reactive approach to an immediate financial problem. However it isn't self-sustaining in driving future performance.

- Across-the-board cost cutting

These cuts are usually done using a fixed percentage throughout the health system's departments. This technique may be an immediate fix, but it won't solve the fundamental issues of balancing costs, quality, and access.

- Supply chain management

This approach starts to address the

problem of supply costs, but does little to address the issues with usage and selection of supplies.

- Benchmarking

While this may be a useful tool to begin understanding costs against other health systems, benchmarking doesn't address the differences in community needs and contract requirements.

While these annual tactical cuts might offer a quick fix, they aren't sustainable. Your organization will be better served with strategic cost management that includes truly sustainable, long-term cost reductions for a more successful—and competitive—outlook.

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