Hospitals Need a New Playbook on Margin Improvement

By Eric Themm

Running a hospital is a daunting proposition. Is it possible that only those who have done it can truly appreciate the complexities and challenges? Or maybe some have studied the model and can objectively see what can be done versus what is being done. Note the great sports coach who was a pedestrian player or the excellent sportswriter who never played at a professional level.

While hospital margins have improved post-COVID, roughly 40% of the hospitals in the United States are losing money on operations. These are indeed challenging times, and there is a myriad of issues for the hospital management to contend with – aging facilities, poor reimbursement for Medicare and Medicaid, difficult payers, provider shortages and turnover, rising costs, challenges navigating new technology and innovation, and others. However, many hospital leaders are struggling with margin improvement and continue to use an outdated playbook for how to reimagine and financially improve their organization.

In order to "get out of the box" and begin the paradigm shift to becoming a more viable hospital organization, leaders will need to examine some new ideas to be true to their fiduciary responsibility to the Hospitals that they serve versus making decisions to protect someone's job, maximize that bonus, or diffuse responsibility. Here are some of the moves that hospital leaders need to make.

1 Stop Waiting for a Handout

More dollars for hospitals are not going to magically appear anytime soon. Last time I checked, we had a huge federal budget deficit, and most states do as well. Medicaid cuts, particularly related to the One Big Beautiful Bill Act (OBBBA) will impact reimbursement and hospital financial performance leading to service reductions, downsizing, and facility closures. Other traditional funding streams (e.g., disproportionate share, IGT, etc.) have shrunk with more delays in payments. There will be few hospitals that can just rely on supplemental funds to survive financially.

2 Avoid Instantly Going to Traditional Places to Cut

In the traditional playbook, hospital management will often go to the usual suspects – reduce workforce (usually without the proper assessment), cut programs (some of which are actually needed to remain viable), decrease physician compensation, and look to outsource

functions. In my experience, there are several places to look for improvement that could avoid some or all these steps, which can often lead to a hospital closure or bankruptcy. These include:

1) **Revenue Cycle**. Most hospitals are doing mediocre at best in areas such as coding, managed care rates, ensuring that you are getting paid what you should, preventing denials, etc. Our team has routinely found a 10-15% opportunity for revenue improvement. That, in and of itself, could be the difference between financial loss and good profitability.

2) **Automated Solutions**. Hospitals are very complex, with disparate systems, and have complicated tracking needs (financial, materials management, etc.). There are now AI-driven solutions for areas like revenue cycle, materials management (e.g., operating rooms and other procedural areas), denials management, tracking consumer market research, and others. In our experience, these solutions can improve efficiency dramatically and make a significant impact on the bottom line.

3) **Pharmacy** – rapid (retail, 340B, supplies, revenue cycle, and pharmacy benefit manager. Experience has shown that most hospital C-suites do not have a very good handle on the opportunity in this area, and most self-funded hospitals are being taken advantage of by their PBM, on the order of $500-$800 per member per year. For a hospital with 5,000 lives (employees and dependents), that would equate to $4,000,000 per year. On a recent hospital margin improvement project (independent hospital in California), we found over $30M per year in opportunity, with $8 million of that in pharmacy. I don't believe that many hospital leaders would imagine that to be possible.

4) **Non-Labor Cost Centers** including supplies/materials management, support services, equipment maintenance, energy, emergency department, and hospitalists. We have seen opportunities in all these areas, which, individually, are probably not as impactful as labor, pharmacy, or revenue cycle, but with operational/functional improvements, can yield $1M-$5M of annual savings each, depending on the circumstances. In the aggregate, there is tremendous opportunity to improve efficiencies and margins in these areas.

5) **Labor/Workforce**…but done properly. Our team focuses on reimaging labor, including the education of department managers, examining cross-training opportunities, and utilizing automated solutions. Yes, usually 40% to 60% of hospital costs are in labor, but a more progressive approach is needed to deploy and manage this vital area successfully going forward.

3 Don’t Solely Rely on the CFO to Identify and Implement Changes

First of all, it is impossible for a CFO to do his/her standard functions and be able to objectively identify ways to improve the organization. You need an expert(s) to truly do an objective assessment and identify comprehensive solutions that will be in the best interests of the organization. In addition, from my experience, some CFOs go into “self-protect” mode when a margin improvement initiative is considered/proposed. Identifying opportunities to improve or save tens of millions of dollars per year does not necessarily reflect well on an incumbent (some believe), and CFOs can block change in lieu of self-preservation. In my several years in healthcare, I have found that the best CFOs are open-minded and know that it’s not possible for them to have comprehensive knowledge of all areas impacting performance and margin and that expert help is needed. It is important to know what you don’t know; don’t be afraid to investigate.

4 Include Margin Improvement Initiatives in Your Strategic Plan

The traditional strategic plan includes components like market/competitor analysis, internal review of performance (volumes, financial, medical staff, etc., but at a high level), SWOT analysis, review of vision, goals and strategies across facility, programs and services, physician enterprise, HR, and a few others. I know this because I have done over 100 of these in my career. Going forward, a more robust vision of the hospital and workforce of the future is imperative, including the concepts that have been identified herein. Revenue/volume growth needs to be linked to revenue cycle, staffing/performance, and non-labor cost strategies. Driving incremental volume/revenue is possible in some situations but has never been more challenging. Becoming more efficient and margin savvy is critical to overall financial viability.

5 Do an Assessment

You can avoid the traditional approach of hiring a big, branded consulting firm, which will try to charge $500,000 to $1 million to do an assessment and then $5 million to $10 million or more to implement. Most hospitals cannot afford this anyway. Assessments can be done much more modestly and can consider the areas that actually need improvement versus “looking at everything.” Many hospitals have already done some very good work to find improvements in areas that can be identified (versus those that are complex and require a more knowledgeable team to glean opportunities). Revenue cycle, labor, and pharmacy (the “Big 3” as I call them) can be looked at prudently within 60-90 days, usually with dramatic opportunities identified. Do not discount some of the others identified here, though. For some institutions, if you can find $1 million of opportunity in a single area, that can be very impactful.

6 Prioritize Performance Improvement Areas to be Able to Move Forward

In my experience, it can be very difficult for hospital leaders to do their "day jobs" (the important work of taking care of patients) and balance margin improvement initiatives. Things just move slower in a hospital setting than in most other businesses based on the complexity and mental duress that hospital leaders must deal with. Some of my clients can only do 1-3 things at a time, and that is their reality. It is better to try to prioritize a few key initiatives and do others later than to try to do too much and deal with burnout and excess stress. It is usually much easier to diagnose the problems than to implement the solutions.

7 Be Mindful of Change Management and Look for a Model to Implement

This area may be the most difficult of all, given human nature and how hard it is for us to change. The idea of trying the same approaches and expecting different outcomes is the definition of insanity. Change management can involve tools such as executive coaching or more formal team approaches. For many organizations, this essential step could be the difference between long-term success and failure. Our team recommends this for most larger performance improvement initiatives.

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Zephyr Healthcare Advisors, a healthcare management advisory firm, works with organizations to help determine if a business combination makes sense, identify proper processes and criteria for evaluation, and avoid the pitfalls identified above in pursuing a transaction.

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