WHITE PAPER

THE NEW IMPERATIVE: WHY HEALTHCARE ORGANIZATIONS ARE SEEKING TRANSFORMATIONAL CHANGE AND HOW THEY CAN ACHIEVE IT

BY JEFF JONES, MANAGING DIRECTOR, HURON

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Adapting to change has always been a leadership imperative in healthcare, especially in the years since the marking of the new century. Executives of hospitals and healthcare systems have dealt with wide-ranging change consistently and successfully during this period, as in previous years.

What is different today is the increased scope and rate of change in the continually evolving healthcare environment. The increasing digitization of medical and financial information and the passage of the Affordable Care Act are just two of the forces bringing both innovation and disruption. As a result, today's challenges are not incremental, but transformational; across the country, many CEOs and executives in healthcare see the need not merely to improve traditional ways of doing business, but to map out new ways – in effect, to transform, realign and in some cases reinvent their organizations to align with fundamental changes in how healthcare is delivered and reimbursed in the United States.

Although every market is different, nearly all face common trends and challenges, which have combined to accelerate and intensify the pressure on healthcare organizations.

COMBINED PRESSURES

Reimbursement Compression

Volume Compression

Information Technology

Regulatory Challenges

COMBINED PRESSURES

Most significant among these trends is **reimbursement compression**. Nationally, growth in hospital prices is at record low levels, growing at just 2.0 percent in 2013.[1] Further, Huron's experience with clients nationwide shows that, in some cases, actual year-to-year payments for the same care are decreasing. Much of this is driven by Medicare and Medicaid, which account for 58 percent of all care and which reimbursed 89 cents and 86 cents, respectively, of actual costs for every dollar spent by hospitals in 2012.[2]

Other payers, notably the public and private health exchanges, are or will be following suit, negotiating for similar reimbursement levels. The end result is that healthcare systems now face the imperative of operating and thriving on rates that are at or near Medicare/Medicaid levels.

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The rise in consumerism places additional pressure on reimbursement and is seen by most experts as an increasingly disruptive force in the years ahead. The effects of high deductible health plans are already felt by hospitals and health systems as consumers shop more carefully based on price, since they are paying more of the costs themselves. As these plans proliferate, the impact will increase. Simultaneously, the advent of health and fitness apps will accelerate the pressure from consumerism, as offerings from major players, including Apple, Google, Walmart and others, increasingly threaten to supplant traditional episodes of care.

A second major force affecting the industry is **volume compression**. The strategy of relying on inpatient volume growth to achieve or improve margin is no longer sufficient in today's environment. Many organizations now forecast flat volume levels, with outpatient revenues surpassing inpatient revenues. While growing nationally, outpatient volume may not be sufficient for revenue growth in every market. At the very least, the trend toward outpatient care – bolstered by Medicare policies and private payers seeking lower costs – creates new competitive risks, such as stand-alone surgery or imaging centers not owned by the hospital or health system.

This double whammy of revenue and volume compression would be challenging in any environment. On top of this, however, healthcare leaders must also deal with significant pressures in other areas, most critically involving **information technology** and **regulatory challenges.**

With few exceptions, healthcare systems are making major investments in information technology. Healthcare IT spending in North America is projected to exceed $34.5 billion in 2014,[3] as hospitals invest in technology to raise quality levels and manage care across the continuum, manage risk, increase productivity or meet regulatory requirements, such as converting to ICD-10.

At the same time, the regulatory environment continues to impose new challenges and is likely to become an even greater factor from both financial and quality perspectives. Regulatory requirements such as the two-midnight rule, readmission penalties and Hospital Acquired Infections penalties all have significant potential to influence quality and affect the bottom line.

MEETING THE CHALLENGE

The combination of these market, infrastructure and regulatory forces could be viewed as a daunting challenge for healthcare leaders. But feedback from executives at Huron's healthcare recent annual CEO Forum confirms that C-suite leaders are optimistic and energized about the future. Many CEOs feel that these forces present an opportunity to make significant improvements in the healthcare system in the United States by breaking the unsustainable cost growth curve.

To meet these challenges, most healthcare system leaders believe that they will need to improve performance significantly – by 20 percent to 40 percent over the next three to five years. This vision, which requires an integrated, enterprise-wide approach, is also reflected on hospital boards, which have increasingly expanded their areas of focus from fiduciary matters to broader issues of quality and performance over the last five years or more

The level of change needed to respond to this challenging environment is not incremental. The strategies and actions required to achieve an additional 20 percent to 40 percent performance improvement are fundamentally different from past efforts. A focus on efficiency alone – or, for that matter, a focus on any single area – will not be sufficient to achieve the level of improvement needed. Rather, changes in the revenue model will dictate corresponding changes in the way care is delivered and where it is delivered. In turn, new models of care delivery will lead each organization to re-examine issues of scale and integration. Taken together, these changes amount to a transformation in clinical care – a top-to-bottom rethinking of the clinical enterprise.

EVERY MARKET IS UNIQUE

Hospitals and health systems are at various points on this performance improvement journey, depending on unique factors such as competition in their market, their mission and past initiatives. Individually, these differences are meaningful and significant. Regardless of these differences, Huron forecasts that all organizations are likely to fall within the 20 percent to 40 percent range of improvement needed over a three- to five-year time span.

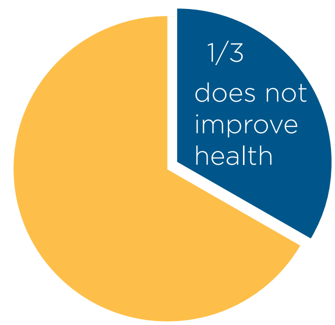
One reason for this can be found in a comprehensive national study of costs by the Institute of Medicine (IOM). That study concludes that one-third of health care expenditures does not improve health – a percentage that annually represents $750 billion of National Healthcare Expenditures (NHE).[4]

The IOM study finds that "Pervasive inefficiencies, an inability to manage a rapidly deepening clinical knowledge base and a reward system poorly focused on key patient needs, all hinder improvements in the safety and quality of care."[4] The study lists factors such as unnecessary services, inefficient care delivery, excess administrative costs and prevention failures as being spread widely throughout the healthcare system.

Collectively, hospitals represent approximately one-third of the NHE. Thus, on a macro level, it is clear that hospitals and health systems must make significant and dramatic improvements to the clinical enterprise. Those that fall below the 20 percent to 40 percent target – that is, those that make cost/revenue improvements of less than 20 percent over the next three to five years – may face risks to the sustainability of their missions in the new healthcare environment.

On the other end of the scale, improvements targeting more than 40 percent of cost and revenue may risk going too deep, creating unintended consequences of too much change, too fast. Caregivers can only manage so much change in a given period of time as they cope with new demands from IT, regulatory requirements, staffing levels and other challenges.

TOTAL HEALTHCARE EXPENDITURES



Represents $750B of NHE annually

Finally, firsthand reports from Huron's clients and from executives attending Huron's annual CEO Forum confirm that healthcare leaders are looking to levels of change that are unprecedented in the healthcare field.

A MODEL FOR TRANSFORMATION

To help organizations achieve this change, Huron has developed a transformation model that addresses key components in an integrated manner. Each organization will have its own strategy, based on its own priorities, strengths, market and capabilities. The main pathways of the strategy, however, will be largely the same.

THE TRANSFORMATIONAL MODEL IS COMPRISED OF FOUR KEY ELEMENTS:

Revenue Transition

Moving from traditional models that were primarily fee-for-service to value-based payment models will affect top-line revenue and its impact on the bottom line in complex ways. Organizations will need the ability to predict, plan for and manage revenue flow with much greater granularity than in the past. Tracking and understanding this transition will be essential to an organization's ability to time the change from volume to value.

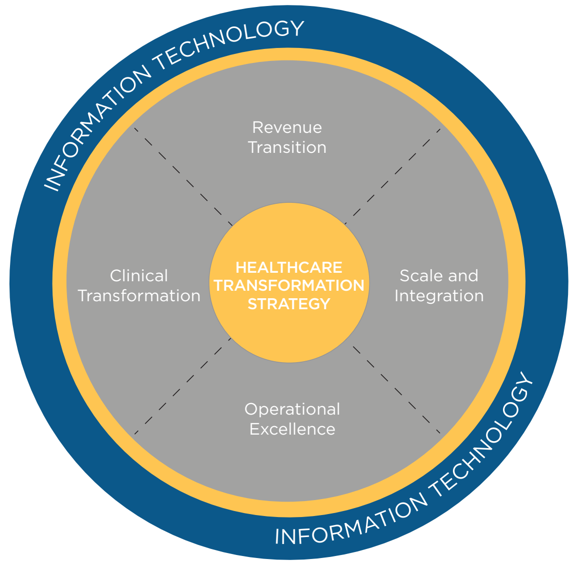
Clinical Transformation
Changes in payment models will necessitate changes in care delivery. New care delivery models will have to address all levels of care, and all facilities and delivery points, starting before the patient enters the hospital and continuing after he or she leaves. As organizations look ahead, all are making significant investments in clinical transformation, from integrating care across the system; reducing variability; or increasing quality, patient satisfaction and safety; or – as in most cases – a combination of these.

As with other elements of the transformational strategy, timing in the clinical enterprise will be crucial. Organizations face the challenge of building this new care model while continuing to prosper under the current system. It is this stress that leads CEOs to ask the important question, "How fast can we make a transition to payment incentives that are value-based and away from the volume-based system of today?"

Scale and Integration
As they assess the speed and degree of change in their market, organizations will also need to consider the appropriate scale to best deliver care under the new model. New delivery systems will require new partnerships and a higher level of coordination, both within the organization and with community partners.

Part of this effort will include strategically evaluating program and facility assets to determine how well they are matched to the market. The process of asset optimization includes understanding the market, evaluating how current assets align with new and competitive market strengths and threats and realigning assets based on a strategic understanding of the gaps and opportunities.

Operational Excellence
Nearly all organizations are continuing to focus on efficiency and operational excellence as an imperative for future success. Most have undertaken efficiency initiatives of various degrees and scope over the past ten years or more. Typically, these began as belt-tightening initiatives that harvested and then went beyond the low-hanging fruit. Operational excellence strategies now must bring new discipline, processes and structure to organizations that are already performing at high levels of efficiency – while increasing quality and patient satisfaction levels. Specific areas of focus will vary; what is uniformly true is that organizations that are able to increase efficiency and quality while reducing costs will be best positioned to thrive.



Huron's transformational strategy leverages organizational strengths and local market dynamics to deliver measurable results across four key areas.

These four elements form the basis for transformational change. A robust information technology infrastructure will be required to enable and support this change across the organization. This will require significant ongoing IT investments and improvements. This will typically involve optimizing the usefulness and the ROI of current systems – EHR and others – as well as implementing new business intelligence analytic tools.

IMPERATIVES FOR TRANSFORMATION

Putting these transformational initiatives into action requires an overarching strategy that leverages organizational strengths and local market dynamics. The strategy must then be implemented in a way that informs and integrates change across the enterprise and delivers measurable value. A demonstrated commitment from the C-suite – including relentless communication – is a major predictor and prerequisite for success.

Taken as a whole, this level of improvement has the power to transform organizations. Creating this type of change is one of the major challenges of leadership in the current healthcare environment. Part II in this series will take a deeper look at the four elements of transformational change and how your organization can operationalize them in order to thrive in the healthcare marketplace of the future.

ABOUT HURON

Huron is committed to achieving sustainable results in partnership with its clients – across the institutions, industries and communities it serves. The company brings depth of expertise in strategy, technology, operations, advisory and analytics to drive lasting and measurable outcomes for leaders in the healthcare, higher education, life sciences and commercial sectors. Through focus, passion and commitment, Huron works closely with its clients to solve their most pressing problems, providing strategic guidance in the face of the rapid change transforming their industries. Learn more at www.huronconsultinggroup.com.

1. Bureau of Labor Statistics. *Producer Price Index data, 2002–2013, for Hospitals*

2. American Hospital Association. *Underpayment by Medicare and Medicaid.* Fact Sheet. March 11, 2014

3. *SourceIT Healthcare Report.* August 29, 2013

4. Institute of Medicine. *Best Care at Lower Cost: The Path to Continuously Learning Health Care in America.* September 6, 2012

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