

**UNDERSTANDING
PERFORMANCE MANAGEMENT
FOR HEALTHCARE**

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AMERICAN HEALTHCARE: A GROWING BUT TROUBLED INDUSTRY

Americans spend more on healthcare than the citizens of any other industrialized country, whether it's measured in total spending, per capita spending, or as a percentage of GDP. And the rate of growth is similarly remarkable. By 2016, healthcare spending in the US is expected to double from 2 to 4 trillion dollars which equates to over \$12,600 for every man, woman, and child in the country and a whopping 20% of gross domestic product.

For many provider organizations it would be tempting to look at this projection and see business opportunity. And while a growing market certainly can create opportunities, it is also a cause of great concern for healthcare executives who know that this runaway spending cannot continue unchecked forever. Insurance carriers, patients, and employers are demanding greater accountability and demonstration of value for their healthcare dollar, and these demands will only intensify in the future. Consider the following trends:

- Health plans are shifting more and more economic responsibility to the patient in the form of higher copays and deductibles. This, coupled with greater access to information via the internet, is creating a much more savvy and engaged population of patients who are shopping around for the best physicians and hospitals.
- Employers, and other agencies, are demanding evidence of patient safety and clinical quality.
- Payers, led by Medicare, continue to offer rate increases that barely keep up with inflation, if that.
- Feeling this financial pressure, physicians and for-profit corporations are aggressively pursuing high-margin services that are increasingly being provided on an outpatient basis, forcing hospitals to forfeit much of this volume altogether or to accept weak negotiating positions in any number of joint venture arrangements.
- In light of the growing demand that comes with an aging population, many healthcare provider organizations need to expand their capacity and fund these projects out of razor-thin operating margins.

THE CHALLENGE FOR PROVIDER ORGANIZATIONS

One obvious implication of these trends is that it's not getting any easier to manage a provider organization. Margins on existing services are tighter than ever before and will continue to tighten at a time when many provider organizations need to invest heavily in facilities and information systems; reporting requirements for clinical quality and patient safety are becoming more and more taxing; and competition for profitable services is getting tougher. For most provider organizations, and especially those with a mission to provide a full range of care to the entire population, maintaining solvency while meeting community service obligations is a real and growing challenge.

In addition to this, is the sheer complexity that has to be managed. For example, when was the last time anyone saw a hospital that was just a hospital? Gone are the days when a hospital was a monolithic, freestanding organization focused almost exclusively on inpatient services. Instead, the typical community hospital is likely to include a network of employed physicians, a clinical joint venture or two, perhaps a management services organization (MSO), a community-based residency program, a long-term care facility, a health plan, and any number of other ventures. Likewise, physician group practices are branching out into outpatient surgical and imaging centers and in some cases, specialty hospitals. Increasingly, provider organizations are becoming complex networks of subsidiaries, partnerships, and other ventures, making it all the more difficult to plan effectively and manage on an ongoing basis.

Unfortunately, many provider organizations are operating with badly outdated management tools and infrastructure to accommodate the new reality. Establishing clinical and operational performance goals is often difficult because the variables that drive performance are poorly understood and/or tracked ineffectively. In many cases planning is conducted using spreadsheet models, which don't effectively accommodate multi-user environments. This seriously limits the effectiveness of the input from the operational departments, leading to a lack of buy-in and difficulty establishing accountability for results.

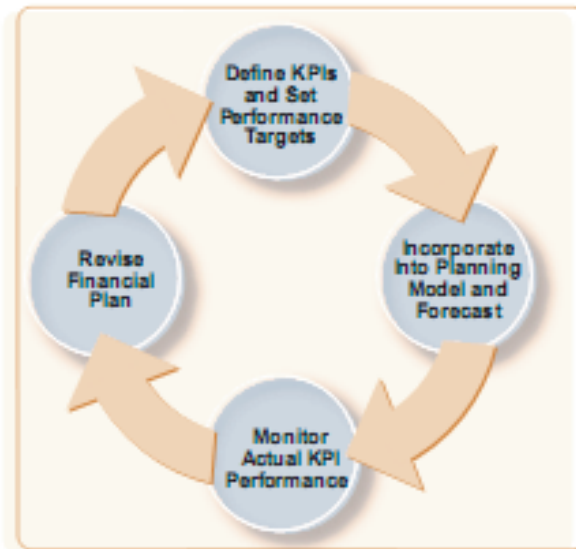
THE IMPERATIVE FOR PERFORMANCE MANAGEMENT

To be successful, healthcare organizations need to establish a culture of performance management; that is, an ongoing process by which organizations define their strategic direction and then deploy their business processes and management systems in support of that direction. This requires establishing performance expectations through the planning and budgeting process, and then continually monitoring performance against the plan, making adjustments as necessary. More specifically, this involves:

- **Understanding the complexity of the business, what the key drivers of volume, profitability, risk, quality, etc. are, both at the departmental level and also how they roll up to the operating unit and corporate levels.**
- **Setting performance goals for these drivers (also known as Key Performance Indicators, or KPIs).**
- **Integrating these KPIs into the budgeting and planning process so that managers know what they need to manage, in order for the organization to meet expected performance levels.**

- Tracking, in real time or something close to it, how the organization is performing relative to these KPIs and taking decisive action to correct variances.
- Re-forecasting the budget/plan based on actual results and any adjustments to KPI performance that might be achieved to improve overall results.

This is a continuing, cyclical process that is shown graphically below



This process requires not only sophisticated tools and infrastructure but a strong commitment on the part of leaders to develop a performance-oriented culture. This is a special challenge for healthcare organizations that typically have a high degree of organizational complexity, diffuse lines of authority and accountability, and a culture of mission and community service that often is at odds with management discipline and rigor.

A PRACTICAL EXAMPLE

To illustrate the relevance of this approach, it is instructive to consider a hypothetical organization facing a fairly typical business challenge. After a lengthy strategic planning process, our Memorial Hospital has made a decision to become the regional center of excellence in spine surgery, which would allow it simultaneously to capture high-margin services and enhance the hospital's reputation for clinical excellence. Our Memorial hospital has been recruiting two well-known neurosurgeons to lead this program, and these two physicians would then become the nucleus of what will eventually be a five to six surgeon practice providing comprehensive spinal care, complete with physical therapy, rehab, and other affiliate services.

While this would be a major win for Our Memorial, the two surgeons are shrewd negotiators and have pushed hard for a commitment to have a dedicated OR for their use, even though it would take several years to build up sufficient spinal volume to keep an entire OR busy. This is no small matter, since the hospital already has had occasional difficulties accommodating demands for OR time, and it would not be easy to squeeze existing volume into fewer ORs.

There would be a significant political risk as well. Many of the existing surgeons have already complained about the prospect of Our Memorial giving preferential treatment to two physicians who had yet to bring a single patient to the hospital. The leader of a general surgical group, which didn't get the bariatric surgery program it wanted, has threatened to take their business elsewhere, a threat which may be credible if the hospital cannot maintain its service levels for the surgeons.

Complicating matters is the fact that Our Memorial is about to break ground on a new medical tower with the price tag of \$150 million. The debt burden for this project will be significant, and maintaining financial ratios in accordance with its bond covenants promises to be a tightrope walk. Failure to maintain these ratios would have ripple effects throughout the organization.

Given this scenario, Our Memorial has some tough decisions to make. Its existing plan and budget allowed it just barely to meet its financial obligations, and suddenly this plan has been placed into jeopardy by an unanticipated (though hardly atypical) turn of events. The spine surgery program is important to the hospital's future, but at what cost?

- **Is a dedicated OR a realistic option?**
- **Can the existing surgical volume be squeezed into one less OR, and if so, what operational changes would be needed to make that happen?**
- **What would be the financial damage should the disgruntled surgeons move some or all of their business?**
- **Does the spine program really justify this risk?**
- **Are there operational improvements elsewhere that might offset the damage of such an eventuality?**
- **How should managers re-allocate their priorities to meet this challenge?**

COULD THIS BE YOU

Too often, when an organization is confronted with the need to make difficult, complex business decisions and do so quickly, managers are disadvantaged by their understanding of the business. They struggle to assess the various alternatives based on a solid baseline understanding of the organization's operational performance and how the proposed initiative might affect that. While the preceding example was somewhat dramatic, provider organizations face similarly complex decisions routinely, such as:

- **Determining whether, and when, to embark on a major facilities expansion.**
- **Participation in pay-for-performance contracts with Medicare and other payors.**
- **Feasibility assessments of mergers, acquisitions, joint ventures, etc.**
- **Physician recruitment and network development.**

These are all high-stakes initiatives that need to be considered within the context of available capacity, fixed and variable costs, physician productivity and referral patterns, clinical quality metrics, and other factors. While the operational and clinical managers typically understand these factors best and have access to a wealth of data describing them, they are often lacking the useful information they need to run their departments effectively. What's more, most healthcare organizations struggle to incorporate this information into their financial projections because operations and finance professionals tend to operate in silos and look at the business very differently. As a result, many healthcare organizations pay consultants large sums to gather and analyze their data, translate it into financial terms, and provide it back to them so that they can make more informed decisions. A much better solution would be for these organizations to have this capability in-house.

The challenge is really no different when conducting the planning and budgeting process. Ideally, this process is informed by a thorough understanding of activities at the clinical and operational level, and where the opportunities for improvement lie. Again, this only occurs through close collaboration between finance and operations. Unfortunately, if this collaboration does not occur, then the budgeting process resembles little more than adding a small inflation or growth factor to last year's budget, plus adjustments here or there for known initiatives. The problem with this is two fold. First, a broad-brush approach to planning can be dangerously inaccurate, resulting in unpleasant surprises when things don't work out as anticipated. Second, it tends to perpetuate inefficiencies in the system if no one is tracking and scrutinizing performance metrics.

Comments such as “We know we’re losing money on this physician network but we need it strategically, and at least we’ve budgeted for this loss.”

These statements are quite common in healthcare, and they signal an approach to management that lacks the will and/or wherewithal to drive the organization to higher levels of performance. To gain an appreciation of whether this describes your organization, take a moment to consider the following questions:

- **Can your managers describe the link between the organization’s strategy and the annual financial plan?**
- **Does the planning process involve an open exchange of information in setting expectations for the upcoming period, as opposed to one in which managers consider it a “black box” process?**
- **Do finance and operations conduct their day-to-day business using the same planning tools, metrics, and data, resulting in a “single version of the truth”?**
- **When variances to budget occur, is it clear where the variances come from?**
- **Are managers at all levels evaluated according to performance against objective, quantifiable performance criteria?**
- **When something goes wrong at the operational level, is it usually easy or difficult to isolate the problem and/or find other ways to get back on track?**

- **Is the finance department able to devote time to helping operational managers run their businesses, as opposed to spending all its time doing analysis?**

If the answers to any of these questions is “no”, your organization may be in need of better performance management. How much better do you think your organization would perform if all of these answers were “yes?”

THE JCB PARTNERS SOLUTION

JCB Partners provides healthcare organizations with the tools, techniques, and advice they need to develop a culture of performance management. JCB Partners fields a complete team of certified financial, implementation and development professionals who specialize in planning, performance measurement, accounting integration. With our help, your organization can make better management decisions quicker, and with greater confidence. Our customer list include some of the largest and best-known names in the healthcare industry. We also bring the benefit of experience with hundreds of other customers in financial services, manufacturing, consumer goods, the public sector, and other industries.

Our services include:

- **Performance management assessments and best practice gap analysis.**
- **Development of financial planning and analysis solutions for large, complex, multi-user environments.**
- **Metrics management for balanced scorecard initiatives.**
- **Business intelligence for monitoring operating efficiency/throughput, capacity management, customer satisfaction, provider profiling, etc.**
- **Data warehousing and reporting solutions.**

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