While the shape of health care reform is far from clear, several broad themes will influence reform efforts going forward. These themes already indicate how hospitals can best position themselves to function effectively in a reform environment. They also suggest where hospitals may be at risk.

**REFORM THEMES**

REDUCING HEALTH CARE costs is a key goal of current reform initiatives. Reductions in Medicare and Medicaid, and increases and decreases in reimbursement from other payers—as well as government efforts to recover billions of dollars through Medicare Recovery Audit Contract audits—will increase pressure on providers. Methods to address the more fundamental causes of high health spending, such as shifting from payment based on service volume to reimbursement tied to quality outcomes, efficiency and coordination of care, will likely be implemented over time.

The state of Massachusetts is out front with payment reform initiatives, and early experience shows that fundamental change is a costly and complex process. Believing that the fee-for-service payment system was a major contributor to rising costs and inconsistent quality, the state formed a Special Commission on the Health Care Payment System to recommend fundamental changes in the way health care would be paid for in Massachusetts. Payment system changes included covering only the cost of care that is efficiently provided. Additional payments would be based on high-quality care that conforms to evidence-based guidelines and results in superior outcomes. The new payment model, to be phased in over five years, provides for a set payment that covers care for a full year for each patient.

As health care strategic and financial advisor Nate Kaufman suggests, the Massachusetts experience is a cautionary tale that should be heeded by the rest of the country. So far, the costs of the state’s payment system reform are twice the original estimate, with a state budget deficit that is expected to exceed $5 billion. More than a third of the state’s family practitioners are not accepting new patients, and patients wait on average 50 days for an internal medicine appointment. Hospital emergency departments are reported to be overused by patients who have become recently insured. Hospital operating margins have been declining since 2006, and the median operating margin for community hospitals was .04 percent in 2008.

Time will tell whether national health care payment reform will result in outcomes across the country similar to those in Massachusetts. Meanwhile, reductions in reimbursement are a given, and hospitals clearly will be asked to do more with less. To help deal with declining reimbursement, hospitals must take waste out of the system by focusing on standardization of work processes and best practices.

Increasing access to care is a second goal of current reform initiatives. Various reform proposals have sought to ensure greater access to care by requiring coverage for most or all individuals,

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**Trustee Workbook**

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*Health Care Reform: What’s on the Horizon for Hospitals?*

The recent attempt at comprehensive federal legislation to address health care reform was only one step in a longer process of transforming health care payment and delivery. Payment system reform will be the focus over the next several years and various approaches, such as bundling payment for hospital and physician services and moving from volume to value-based payment, are likely to be tested.

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BY JAMES E. ORLIKOFF AND MARY K. TOTTEN

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including uninsured and underinsured populations. Large-scale coverage would necessitate an infusion of money into the system, most likely from expanded Medicare and Medicaid eligibility. How and at what level such expanded coverage will be paid for by these government programs has yet to be clarified.

While increasing coverage would have the positive impact of reducing the level of uncompensated care for hospitals, it may pose risks as well. One concern is that decreasing the level of benefit hospitals provide to their communities in the form of uncompensated care may threaten not-for-profit hospitals’ tax-exempt status.

Greater coverage also could result in large numbers of new patients flooding the system. Some experts believe this is unlikely because many uninsured or underinsured patients already receive care through hospital emergency departments. However, if a significant number of patients who are not now receiving care elect to do so if they obtain coverage as a result of health reform initiatives, shortages of physicians and other resources could result. The recent trend toward hospitals and health systems employing physicians and owning physician practices will likely accelerate as providers prepare for the impact of reform.

Moving toward a value-based system of health care payment and delivery means hospitals will need to optimize the balance among cost, quality and access to the health care services they provide. Measuring patient outcomes and tying improvements in quality and safety to reimbursement for care and service is already the cornerstone of many pay-for-performance initiatives. Broader application of these initiatives could stimulate more significant improvement than hospitals have achieved over the past decade.

The challenge will be to manage costs at a level that does not compromise clinical outcomes, the quality and safety of care and service, and overall patient satisfaction. Holding patients accountable by rewarding healthy behavior and penalizing unhealthy behavior, and increasing and addressing end-of-life care and clinical effectiveness are also critical to improving quality and patient outcomes. However, little has been done in these areas, thus creating more pressure on providers.

It is important for hospitals to understand that the current legislative focus on health care reform only addresses a subset of these broader themes (see sidebar below).

**Questions for Discussion**

1. How well-positioned is our hospital to function effectively in the emerging environment of health care reform?
2. Where do we most need to focus to optimize the balance among cost, quality and access to services that our health care organization provides?
3. How might a reduction in our hospital’s level of uncompensated care affect the overall level of community benefit our hospital delivers?
4. What resources might our hospital need to acquire or utilize more efficiently to treat significant numbers of new patients that might seek care with the expanded coverage envisioned under health reform?

**PREPARING FOR REFORM**

According to Huron Consulting Group’s health care practice, regardless of whatever specific changes reform efforts may produce, the business climate created by those reform efforts will yield winners and losers. Health care organizations best positioned to function well in a climate of health care reform will:

**Achieve solid hospital-physician alignment.** High levels of integration among hospitals and physicians will be necessary to drive efficiency across the care delivery system and accommodate the possibility of new payment approaches, such as global reimbursement. Effective and efficient revenue cycle processes that span both hospital and physician services are critical.

“Successful integration will require hospitals to effectively manage the labor and nonlabor costs associated with owning physician practices and employing physicians,” says Gordon J. Mountford, vice president of health care operational consulting at Wellspring Partners, a Huron Consulting Group practice. “This has been a challenge for many hospitals in the past and will likely increase. Managing labor productivity based on best practices, staffing according to patient and service volume, and ensuring effective management of

**Impact of Federal Health Care Payment Reform**

Even without comprehensive reform, the government is likely to:

- Expand eligibility for Medicaid
- Reduce payment per unit for hospitals and specialists and tie payment to “value”
- Increase reimbursement for primary care physicians
- Explore alternatives to fee-for-service payment such as episodic, bundled and population-based payment
- Reduce Medicare HMO premiums
- Phase in reform incrementally over three to five years

Health care reform is not likely to:

- Change basics of fee-for-service payment system for three to five years
- Address lifestyle issues
- Significantly reform malpractice
- Require clinical effectiveness
- Address end-of-life care
- Address access to capital or capacity for hospitals
- Address physician shortage or backlash
- Fix payers’ monopolistic practices
- Factor in impact of new technology and treatments

**Source:** Kaufman Strategic Advisors, 2010
supply cost and use will be keys to success.”

The current climate of reform requires new relationships between hospitals and physicians. These relationships cannot be based simply on economic transactions. Instead, they must be founded on cultural transformations that create new and meaningful systems of care. New roles for physicians will be part of this transformation, and they will include greater participation in leading health care organizations and serving as coordinators and integrators of care delivery.

Measure, report on and deliver superior outcomes. In an environment that requires doing more with less, hospitals must further optimize revenue cycle performance to ensure they receive all payments to which they are entitled, according to West Johnson, vice president of health care revenue consulting at Stockamp, a Huron Consulting Group practice. “Identification and effective collection of patient-responsible amounts—both preservice and at the point of service—aggressive denials management, timely and accurate billing and coding, and effective managed care contracting are just some of the revenue cycle activities hospitals must perform effectively,” he says.

Ensuring optimal patient flow, with patients receiving the right care at the right time in the right setting, will also help hospitals optimize the cost/quality balance. Metrics and reporting systems that provide timely feedback to effectively manage patient flow and operational efficiency will be essential as hospitals provide more care and service with fewer resources and share performance outcomes with the communities and stakeholders they serve. Taking a comprehensive, systemic view of process improvement and putting in place a strong foundation to achieve and sustain results will differentiate strong performers.

Attain a favorable cost position compared with competitors. Achieving optimal operating efficiency, establishing pricing for services that is fair and transparent, and having sufficient scale and flexibility to absorb decreases in reimbursement without severely affecting financial health are characteristics of hospitals most likely to fare well as reform efforts unfold. Redefining competitors to include providers outside of a health care organization’s local market as well as emerging retail clinics and others outside of the traditional health care industry will be critical for hospitals and health systems to achieve strategic advantage in a more crowded marketplace.

Hospitals likely to do well in a reform environment will develop a geographically dispersed delivery system with an optimal supply of providers and services—capacity will trump everything,” Kaufman says. “They will integrate and coordinate care throughout the provider community and deliver inpatient care that is highly efficient, safe, protocol-based, patient-oriented, appropriately documented and metric-driven. They also will operate with a sustainable cost structure driven by high-performing information technology that helps reduce variation in the revenue cycle and within clinical systems.”

Hospitals need a guiding strategy to help navigate the twists and turns of health care reform. “A guiding strategy should clarify the organization’s purpose and help it invest resources today to position itself to deliver desirable, measurable and sustainable results in the future,” Kaufman notes. “It also gives the organization a sense of meaning and direction during uncertain times.”

“A useful guiding strategy for a hospital or health system today will be based on predictions that anticipate future states, such as what the regulatory environment or the supply of primary care physicians is likely to be in the next three to five years,” he adds. “The strategy will distinguish the organization by describing how it will provide outcomes for a given cost that represent ‘differently better’ value for patients. Perhaps even more importantly, it will also address the activities the organization will no longer undertake because they do not support or are inconsistent with the guiding strategy.”

According to Huron Consulting Group’s health care practice, while some hospitals have begun to position themselves to succeed under health care reform, others face significant challenges. Health care organizations likely to be at risk in a reform environment are those that:

• have not kept pace with implementing process redesign and technology to support performance improvement
• have continued to rely on cost shifting and other “yesterday” techniques for getting by, rather than tackling fundamental issues of revenue, quality and cost efficiency
• have less contracting leverage due to market position, service offerings or scale.

Freestanding hospitals with medical staffs composed of independent physicians will also be at great risk. The traditional medical staff model will not be adequate to deal with anticipated changes in payment and care delivery. Hospitals with this model are likely to experience the greatest sudden shock under health reform.

Questions for Discussion

1. What is the level and nature of our hospital’s alignment with physicians? Is the relationship characterized by legal arrangements such as joint ventures or as collaborative partnerships based on mutual expectations and goals?
2. Do we adequately measure, report on and deliver superior performance and outcomes? Have we established metrics and reporting systems that provide timely feedback on revenue cycle and patient flow performance and that clarify overall operational efficiency and effectiveness?
3. Who are our hospital’s current and emerging competitors? What is our cost position relative to these competitors?

4. Where is our hospital’s greatest level of risk exposure? Is there a failure to implement adequate process redesign and technology to support performance improvement, an overreliance on cost-shifting and other techniques rather than addressing fundamental issues of cost and quality, or poor contracting leverage with insurers and other payers?

A JOURNEY, NOT AN EVENT

THE AMERICAN HOSPITAL
Association’s Hospitals in Pursuit of Excellence strategic platform identifies several areas of focus to help hospitals operate more effectively under health care reform. Short-term efforts in this campaign include facilitating improvement in hospital quality and cost savings through use of best practices in preventing infections and improving patient safety. Longer-term initiatives focus on improving care coordination, implementing health information technology, promoting efficient resource use, expanding quality and safety efforts and reducing supply costs.

While passage of federal legislation may provide initial direction, most experts agree that reform will not happen overnight or be limited to an act of Congress, and it will require a new level of governance and leadership expertise to guide transformational change and maintain accountability to communities and other stakeholders. They also acknowledge that hospitals no longer have the luxury of time and should position themselves today for an environment that will increasingly expect high performance with fewer resources.

To achieve and sustain success under health care reform, Huron Consulting Group’s health care practice says, hospitals will need assistance from partners who:

- demonstrate both the depth and breadth of knowledge and experience necessary to improve hospital operations.
- understand hospital operations at a level of detail that enables assessment of opportunities for improvement and implementation of a strong foundation to drive significant, sustainable performance gains.
- have a proven track record of facilitating rapid, transformational change.
- share a commitment to achieving the organization’s mission and strategy through improving effectiveness, efficiency and quality.

Boards can take several steps to help their organizations fare well in an environment of health care reform. These include:

- understand that health care payment system reform is only one of several fundamental changes now under way to improve our nation’s health care system.
- ensure that their hospitals assess and address areas (such as cost, quality, efficiency and access to care) where they may be vulnerable in a reform environment.
- focus on ways to strengthen hospital-physician relationships and pursue opportunities for greater integration.
- work with other organizational leaders to revisit the hospital’s current strategy and goals and establish a guiding strategy that describes how the organization will deliver “differently better” value for patients and other stakeholders.

Sample Statement of a Guiding Strategy for a Hospital or Health System

- To consistently provide measurably superior care, centered around the needs and preferences of the patient. Use rigorous attention to the process design and achieve optimal levels of quality, safety, efficiency and compassion using Medicare as a target for breakeven.

- Care and service will be delivered by a sufficient supply of digitally connected, highly productive, motivated, engaged and highly compensated providers—both employed and community-based—working together as a clinically integrated team to deliver care based on applying the best science to the practice of medicine.

- Our work will be driven by a culture that includes:
  - Uncompromising commitment to this guiding strategy
  - The use of metrics as the primary determinant of performance
  - Significant participation of physician leaders in management
  - Safe, open dialogue
  - Recognition of the need to consistently achieve top tier financial benchmarks
  - A willingness to sacrifice some short-term gain for mutual success and our higher purpose

Source: Kaufman Strategic Advisors, 2010

CONCLUSION

It’s time for hospitals to begin the journey toward achieving success under health care reform. Doing nothing or adopting a “wait and see” attitude is not an option. While some hospitals have already begun to position themselves for the fundamental changes looming on the horizon, others face significant risks.

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