

Healthcare FINANCIAL MANAGEMENT

Leveraging Strategic Planning for Improved Financial Performance

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Healthcare providers increasingly are relying on strategic planning to guide the allocation of capital and other resources. Strategic planning helps identify and prioritize opportunities for financial improvement, particularly revenue-generating initiatives, which offer the greatest opportunity for significant long-term benefits. New revenue usually can be generated in one of five ways: increase market share, expand service area, fill gaps in the continuum of services, develop niche services where needed in the service area, and repackage existing services to address specific market segments. Once a strategic plan is implemented, it should be reviewed periodically and modified as necessary.

In recent years, strategic planning has become a commonly used management tool in the healthcare industry. When thoughtfully carried out, strategic planning can help a healthcare organization clarify its direction and the goals for its primary business units, ensure more effective and consistent decision making, better understand the future and the forces driving the need for change and innovation, and improve organizational coordination and communication. Even more importantly, strategic planning can help a healthcare provider improve its financial performance.

Yet healthcare organizations have been somewhat slow to adopt strategic planning. With the demand for health care growing through the 1980s, healthcare executives simply had to cope with what appeared to be unlimited growth. Decisions had to be made about the timing and phasing of all reasonable initiatives, rather than choosing from among competing alternatives. Because most providers were enjoying strong financial performance, strategic initiatives general-

ly fared well when handled within the traditional financial planning process.

During the 1990s, however, increased market competition, excess capacity, managed care growth, and Medicare payment reductions have challenged the effectiveness of traditional financial-planning techniques. As a result, healthcare providers are turning to strategic planning to identify innovative approaches for minimizing costs and increasing revenue.

The Strategic-Planning Process

Strategic planning involves a four-step process. First, it is necessary to assess the organization's current circumstances. This step begins with a review of the organization's mission, philosophy, and culture to establish a basis for decision making throughout the strategic-planning process. The assessment of current circumstances also should include an evaluation of the structure and dynamics of the organization's market and the organization's internal situation and financial capabilities. The results of this evaluation will point to specific strengths, weaknesses, opportunities, and threats for the organization and help to identify the potential for revenue enhancement or cost repositioning.

The second step involves making a determination, based on the results of the analysis of current circumstances, regarding what the organization's direction should be and the amount of resources that can be allocated to strategic initiatives. Depending on their circumstances and the areas of focus, healthcare organizations must direct their strategic efforts toward expansion, stabilization, or contraction. For example, the first strategic-planning step may reveal tremendous opportunities for an organization, but the organization also will need to consider the degree to which it can capitalize on those opportunities. A financially strong organization

Healthcare providers have been absorbed with cost restructuring. Now they can benefit from turning their attention to selective revenue-growth initiatives identified through strategic planning.

may be capable of pursuing an aggressive growth strategy to do so, whereas a weaker organization may need to take a more measured approach, focusing on stabilization, or seek to merge with a stronger organization that has the requisite resources to take advantage of the opportunities.

The third step involves identifying which opportunities are most compatible with the organization's chosen direction. This process should begin with an evaluation of each potential strategic initiative and its ramifications for the organization's future in light of the organization's mission, vision, culture, and overall capabilities. As part of the evaluation, initiatives are assessed for their financial viability, including potential for return on investment. At this point, the organization also may wish to consider whether to outsource or develop in-house capabilities to launch an initiative. Then, the organization should set priorities regarding which initiatives should be pursued and articulate the organization's long- and short-term goals for those initiatives.

Finally, to effectively implement the strategy, the organization must develop a comprehensive implementation plan. This plan should include a time line for completion of each initiative, and identify the type and amount of resources that will be allocated to each initiative.

Although the foregoing steps outline the basic strategic-planning process, strategic planning does not stop with implementation. The plan and the organization's circumstances should be reviewed periodically to ensure that the plan remains on target and to make revisions as necessary to accommodate changing market conditions. Moreover, the organization should track the results of each initiative to evaluate its effectiveness. Businesses outside of health care have long used growth in market share and improvement in financial performance to track the success of strategic planning. To date, however, only a few providers have used these indicators to measure the effectiveness of their strategic initiatives.

Strategic Opportunities for Providers

During the past few years, nearly all healthcare providers have developed and carried out ambitious, successive cost-reduction initiatives in an attempt to improve their financial position. Some also have mounted significant efforts to optimize payment for healthcare services, such as revising coding procedures, implementing more thorough charge-capture mechanisms, reviewing financial terms of their managed care contracts, and ensuring payer compliance with these contract terms. While providers have focused their energies

on cost reduction, for-profit niche enterprises have sprung up to capitalize on—and coopt—opportunities that providers would not or could not pursue.

Now, more aggressive and innovative providers are using strategic planning to pursue new sources of revenue. New revenue-generation opportunities for healthcare providers generally fall into five categories:

- Increase market share by expanding the breadth and depth of existing services (eg, add new surgical capabilities such as surgical oncology or neurosurgery);
- Expand service area by establishing new delivery sites (eg, a new ambulatory care center) and develop highly specialized services with broader market appeal;
- Fill gaps in the continuum of services by partnering with other providers or developing new services not currently provided by the organization (eg, physical medicine and rehabilitation, occupational medicine);
- Develop niche services that are not sufficiently available in the service area (eg, wound care, headache clinic, and pain management); and
- Repackage existing services to address specific market segments or diseases (eg, women's health center, breast center, and stroke center).

In the recent past, these opportunities often were seen as lacking the immediate benefits demanded by healthcare organizations that were preoccupied with cost reduction. Today, however, increasing numbers of providers are pursuing all five types of revenue-enhancement strategies, but to varying degrees and rarely in a systematic and purposeful manner. Some organizations are beginning to realize the advantages of pursuing growth and revenue opportunities within a strategic-planning framework that provides a more focused and organized approach to setting priorities among competing opportunities and demands.

The positive potential of strategies aimed at generating new revenue can be shown by the actual experiences of two healthcare organizations, referred to here as "Community Hospital" and "Valley Health System."

Community Hospital. Community Hospital is a 250-bed acute-care hospital with \$65 million in annual revenues that operates in a populous middle-class suburb of a major U.S. city. The hospital competes with three other nearby community hospitals, none of which is dominant in the market.

Community Hospital had undergone two cost-reduction programs in the past five years. As a result, its cost indicators compared favorably with those of its competitors and others

in the region. Nonetheless, due to unfavorable payment trends, an underused physical plant, and some underdeveloped services, it had experienced persistent negative financial performance, with net operating losses ranging between \$2 million and \$3 million for the prior three years. Believing that the organization had largely exhausted the potential gains from cost reduction, Community Hospital's management initiated a strategic-planning process to identify potential revenue-growth opportunities for the organization.

An effective strategic plan is a living document that serves as a compass for guiding the organization through inevitable change.

Following an assessment of the organization's mission, market, and internal capabilities, management determined that the organization should focus on initiatives that contributed to increasing core services. Based on this determination, management identified a number of strategic initiatives that, in combination, had a potential to increase revenues at Community Hospital by more than \$20 million annually. These initiatives included the expansion of emergency services, the introduction of a new trauma service, marketing outreach to physicians in the hospitals' service area, and the addition of various specialty services (eg, a vascular center as an adjunct to the hospital's open-heart surgery program and a comprehensive physical medicine and rehabilitation center).

It was determined that the capital costs to implement the chosen initiatives would be modest (about \$2 million, excluding the trauma service) due to the availability of sufficient plant capacity and the nature of the proposed initiatives. Projected contribution margins, therefore, were greater than might be achieved through the pursuit of brand-new initiatives with high incremental direct costs or less favorable payment.^a

Efforts to expand emergency services would likely increase utilization by 3,000 visits per year, generating \$2.8 million in additional revenue and \$1.7 million in contribution margin annually. The expansion would entail a combination of marketing to ambulance service companies, reducing waiting times, improving throughput, and marketing directly to consumers.

It was determined that introducing a trauma service would attract, at most, about 500 new admissions, but that these admissions would increase revenues by \$6 million. Initial estimates of the cost of a trauma service indicated that financial performance would be roughly break-even, but that a reasonable margin could be attained if critical resources

a. The estimated contribution margins for Community Hospital's initiatives did not account for the investments that would be needed to establish and initially support the programs, including incremental capital costs, start-up costs, working capital, and marketing expenses, and thus are somewhat overstated.

were shared with the cardiovascular surgery program. Moreover, management determined that even at break-even, a trauma service would benefit Community Hospital financially by increasing ambulance transport of both trauma and non-trauma patients to the hospital's emergency department.

Regarding the physician outreach initiative, strategic planners identified eight physicians in four practices who might admit or refer significant numbers of new patients to Community Hospital. Together, these physicians could be expected to generate \$2.4 million in additional revenue and \$1.6 million in contribution margin.

Community Hospital also identified 17 other inpatient and ambulatory services that warranted serious consideration for start-up or expansion. It was determined that, together, these 17 initiatives had the potential to generate an additional \$9.7 million in revenue and \$4.9 million in contribution margins. Nonetheless, financial constraints and demands on management barred the organization from investing in all of the recommended programs.

Valley Health System. Valley Health System is a four-hospital system formed in 1997 and located in a largely rural area just outside a major metropolitan area. The four hospitals range in size from \$35 million to \$70 million in annual revenues, and total system revenues were \$200 million in 1998. The hospitals are spread out over a large county and compete with two smaller hospitals in the county and four larger hospitals in surrounding counties.

Based on an evaluation of Valley Health System's circumstances, the system's management identified four strategic imperatives regarding the organization's overall direction. Two of these imperatives—reduce patient outmigration and expand market area—had direct implications for generating significant additional revenue. The other two imperatives involved reorganization to increase board effectiveness and infrastructure improvement.

The strategic-planning process identified several market opportunities that would help Valley Health System achieve its revenue-enhancement goals:

- Reduce outmigration in general surgery from 33 percent to less than 25 percent principally by adding surgeons to existing groups;
- Reduce outmigration in orthopedics from 45 percent to less than 30 percent by adding surgeons and developing subspecialty areas (eg, hand surgery)
- Develop an invasive cardiovascular surgery program;
- Develop two ambulatory care centers—one each at the southern and eastern borders of the service area; and
- Develop an occupational health program.

Valley Health System projected that the initiatives would increase revenues by about \$8 million after three years and more than \$20 million after five years, largely based on increased patient volume. Contribution margin projections,

after accounting for capital expenses and incremental start-up costs, were projected to be \$2 million per year in year three and \$6 million plus in year five.

Conclusion

Strategic planning offers an effective means for providers to take a fresh look at opportunities for growth. Given the difficult financial challenges facing the healthcare industry, healthcare financial managers should give serious consideration to every significant opportunity to sustain their organization's long-term financial health.

Even when strategic planning does not result in implementation of large-scale strategic initiatives, it offers important benefits. One of these benefits is the shared learning that occurs as organizations reevaluate past and current strategies and agree on a future direction for the organiza-

tion. This learning leads to a better understanding of the organization's identity and purpose and provides a context for making the decisions. An effective strategic plan is a living document that, with ongoing monitoring and revision, serves as a compass for guiding the organization through inevitable change. ■

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