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NEW REVENUE GROWTH

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growing pains the difference between strategic and nonstrategic growth

Community General Hospital (a fictitious institution) is a 250-bed hospital located at the periphery of a major metropolitan area. Community General's revenues were flat for the three years ending 2001, and with rising expenses, the hospital's operating deficit increased from \$2 million in 1998 to \$5 million in 2001. The hospital's financial managers applied every measure they could think of to control expenses and increase revenue yield, but their efforts only slowed the rate of financial decline.

At the end of 2001, the board decided to replace the CEO.

The new CEO declared that the hospital had a revenue problem and embarked on an aggressive set of initiatives to expand revenue, based on the premise that with the hospital's high fixed costs, almost any incremental revenue would yield contribution margin and, more likely, net margin. Revenues grew from \$100 million in 2001 to \$125 million in 2003, but operating losses rose to \$10 million as well.

Again, the board elected to fire the CEO, this time along with the senior financial executives. What went wrong?

Lessons Learned

This fictitious case study highlights three important lessons that hospitals should keep in mind when seeking to balance new revenue growth with controlling expenses.

Start by getting the house in order and have a solid foundation on which to grow. As all good financial managers know, there's no substitute for sound fundamentals. Community General may indeed have had a revenue problem, but it also had an expense problem. The second CEO could and should have found ways to reduce costs further. Indeed, there were still significant opportunities to resize the hospital to bring cost and revenues into balance when its annual revenue level was at \$100 million. Although there may be hospitals that have successfully reduced costs to bare-bones levels, this hospital was not one of them.

The simple fact is that a well-conceived, strategic growth plan will produce significant financial benefits.

Scrutinize proposals advocating growth for their near- and longer-term financial impact. This advice applies particularly to proposals based on short-term imperatives to better use fixed costs. Hospitals are a high-fixed-cost business. Large investments in facilities, technology, and regulatory and accreditation requirements for staffing and processes create major burdens. In some instances, excess capacity can be redeployed for financially advantageous purposes, while in other instances, it is better to mothball it or eliminate it. Proposals that

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claim to generate minor incremental gains on the theory that the fixed assets will otherwise remain idle may become major headaches later (even if successful in the short term) when the new programs are made to bear their full cost base.

Make sure your growth strategy focuses only on growth that is clearly advantageous. Not all growth is good. Growth can be too slow and sometimes even too rapid. Hospitals can make the mistake of pursuing growth in businesses or markets that are not in their core competence, where the necessary competencies are difficult to develop, or in areas that have a shortage of trained or available managers. Hospitals also can experience growth in financially disadvantaged businesses, markets, and segments, or as they pursue short-term profits, which eventually evaporate. Community General's growth plan exhibited nearly all of these problems (except for rapid growth) because it was borne mostly of desperation—a last-gasp strategy to save the management team using scatter-shot efforts across a seemingly random array of services and markets. Unusual for today's health-care industry? Unfortunately not.

How to Grow Strategically

The simple fact is that a well-conceived, *strategic* growth plan will produce significant financial benefits. Effective growth strategy rests on five fundamentals:

1. *Plan.* Develop business plans for major growth initiatives and stick to them. A hospital's strategic planning

activities typically include an extensive review of the organization's situation and future issues and needs. Following such a review, make sure your organization remains committed to agreed-upon strategic priorities and avoids the temptation to stray off course.

2. *Focus.* Determine which businesses, markets, and segments have the best prospects for financially beneficial growth and stay focused on pursuing opportunities in these identified areas. In situations where this effort is not guided by already agreed-upon strategic priorities, develop a structured process to make this determination.

3. *Pace initiatives.* Hospitals too often attempt to select too many opportunities at once. Pursue those initiatives you commit to purposefully, but don't overcommit. Rather, phase in new initiatives as time and other resources permit.

4. *Provide necessary resources.* Many businesses fail because they are undercapitalized or otherwise resource poor. Make sure you have or can get the resources needed to support each initiative, and apply them as warranted to maximize the potential for success.

5. *Measure, monitor, and revise.* Track progress routinely, quantify progress and shortfalls, and revise the growth plan as needed.

Sound easy? Most of these recommendations are simple business discipline—essential for successful growth, but surprisingly lacking in today's healthcare industry. ●

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