A new world order for health system margins

As health system leaders look to the future, it is clear they face a different kind of challenge to financial sustainability. Multiple factors — growing Medicare enrollment with marginal rate increases, declining commercial rates and shifting of care from inpatient to outpatient locations — are converging to usher in a new era of slower revenue growth. In addition, the forces driving higher costs — investment in physician practices, escalating pharmaceutical prices and shortages in nursing labor — will likely continue for years to come. These structural changes have brought the industry to a tipping point of financial decline.

Projected operating margin absent intervention

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<table>
<thead>
<tr>
<th>Year</th>
<th>Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>4.0%</td>
</tr>
<tr>
<td>2020</td>
<td>3.3%</td>
</tr>
<tr>
<td>2021</td>
<td>2.5%</td>
</tr>
<tr>
<td>2022</td>
<td>1.8%</td>
</tr>
<tr>
<td>2023</td>
<td>1.0%</td>
</tr>
<tr>
<td>2024</td>
<td>0.3%</td>
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“This year, we need to reduce our costs by $50 million to meet our budget. Then each year going forward, we need nearly $40 million just to stay on pace.”

— CFO, multi-hospital integrated delivery system

*$ Moody’s Investors Service. Not-for-profit and public healthcare – U.S.: Preliminary medians – Profitability holds steady as revenues and expenses converge. April 25, 2019. Projections based on national three-year average growth rates of 5.23% annual revenue growth and 6.03% annual cost growth, plus Optum modeling of typical hospital with 4% margin and $1 billion in operating revenues.

$130M per $1B of revenue

Average amount of cumulative cost reduction required to maintain a 4% operating margin through 2024*
Build a path to financial sustainability

In order to meet future margin targets, leaders will have to bring a new level of focus, resources and structure to achieve deeper cost reductions on a recurring basis. Experienced executives have likely engaged in short-term cost-cutting campaigns in the past, but future financial sustainability requires a more expansive — and sustained — approach to cost avoidance and reduction. At Optum® Advisory Services, our seasoned team of health system operators and clinicians brings industrywide perspective to help clients uncover and assess both current and emerging opportunities for improved cost performance. We work side by side with health system leaders to develop a comprehensive, customized roadmap of cost strategies.

Drivers of sustainability

<table>
<thead>
<tr>
<th>Traditional</th>
<th>Transitional</th>
<th>Transformational</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Labor productivity</td>
<td>• Avoidable utilization</td>
<td>• Strategic growth</td>
</tr>
<tr>
<td>• Supply-chain efficiency</td>
<td>• Coordinated care management</td>
<td>• Service rationalization</td>
</tr>
<tr>
<td>• Revenue cycle optimization</td>
<td>• Optimal coding and documentation</td>
<td>• Provider enterprise optimization</td>
</tr>
<tr>
<td>• Corporate cost control</td>
<td>• Service line profitability</td>
<td>• Strategic partnerships</td>
</tr>
<tr>
<td>Implement radical operating discipline</td>
<td>Eliminate clinical care inefficiencies</td>
<td>• Business process outsourcing</td>
</tr>
<tr>
<td></td>
<td>Drive non-hospital value</td>
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</tr>
</tbody>
</table>

Easier and quicker
Moderate margin impact

More difficult and longer
High margin impact

Align and equip health system leaders

We believe that achieving and sustaining financial performance across a complex organization begins with a centralized approach in which system-level leadership comes together to play a key role in planning and guiding prioritized initiatives. Equally important is an infrastructure that supports and enables both leaders and teams to achieve transformational change. At Optum, we partner with our clients to design and implement these systems so that leaders can pinpoint critical margin objectives and successfully deploy and manage teams against them. Key elements of our approach include:

- Coordinated leadership structure
  - Senior leadership team accountable for achieving results
  - Prioritized set of initiatives with clear objectives and timelines
  - Clear processes and decision-making

- Transformation infrastructure
  - Comprehensive analytics to monitor progress and results
  - Execution support and project management
  - Organizational culture alignment
Sample client successes

Comprehensive margin sustainability program
Seven-hospital health system, including employed medical group, MSO and ACO:

- Assessed strategic margin priorities and designed multi-year sustainability plan to target key priorities: revenue cycle efficiency, cost restructuring and organizational realignment
- Established centralized governance structure to guide sustainability plan, assigned accountability

Systematic clinical care redesign
Five-hospital health system, including 800+ bed regional tertiary medical center:

- Identified high-impact opportunities to reduce care variation and improve quality and cost performance
- Developed and implemented a coherent program of clinical standardization via interdisciplinary teams in key areas: cardiovascular, sepsis, blood, medical, physician preference items and pharmacy

$70M margin improvement implemented in year one
$40M savings target for each of following two years
$10M+ in excess clinical costs eliminated in year one
$20M in new clinical cost reduction targets for each of following two years

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