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Case Study

Non-Labor Cost Reduction Strategies for Rural Providers – Labette Health

Key Takeaway(s): As margin pressure increases on rural healthcare organizations, they must realize cost reduction opportunities that have traditionally been difficult to identify and act upon.

Margin Pressure Compounds for Rural Hospitals

Between 2018 and 2022, 45 rural hospitals closed across the U.S.[1] According to the Center for Healthcare Quality and Payment Reform, another 700 are at risk of closure.[2] The causes of the margin pressure driving rural hospital closures are well documented.

Lower volumes resulting in high fixed costs remain a challenge for rural providers. This challenge is compounded by a greater reliance on governmental payors[3] that do not cover the cost of services and increasing uncompensated care resulting from the shift to high-deductible health plans in the commercial market. Facing expense inflation that outpaces revenue growth, many rural hospitals are struggling to generate the margins necessary to survive and thrive.

Congress and state legislatures are aware of these issues. While Congress passed the Rural Emergency Hospital model and has consistently extended the Medicare Dependent Hospital (MDH) and Low Volume Adjustment (LVA) programs, a legislative package that comprehensively addresses the challenges facing rural hospitals remains elusive given federal fiscal challenges. The story is similar for many state legislatures. Considering persistent margin pressure that is likely to increase in the coming years, rural hospital leaders must continually find and realize new cost reduction opportunities to preserve access to care in their communities.

Labette Health's Opportunity

Labette Health is a 99-bed hospital in Parsons, Kansas that staffs 49 beds, with approximately $85 million in net patient revenue and 1,300 discharges annually. Coming out of the pandemic, it had a strong balance sheet and a break-even margin. Like many rural hospital leaders, Labette Health's CEO Brian Williams saw the opportunity to improve access in an adjacent, underserved community by continued investment in an off-campus emergency department, rural health clinic, and specialty care. Leadership viewed margin improvement, achieved by reducing non-labor expenses, as the best mechanism to finance the service expansion. Labette Health then launched a non-labor cost reduction project and enlisted the help of Forvis Mazars to advise throughout the process.

Overcoming Challenges of Tackling Non-Labor Costs

Labette Health, like most hospitals, faced several major challenges when attempting to tackle non-labor costs. Nick Fleer, Labette Health's controller, noted that hospital staff were aware of and had historically discussed many of the potential opportunities for savings the non-labor cost project ultimately targeted. However, they lacked the data and the internal bandwidth necessary to conduct the analysis to determine the size of the opportunity and develop strategies that would achieve cost savings. Another consideration is that many organizations overestimate the amount of behavioral change a health system can sustain within the short period necessary to realize cost reductions. It is important to both lessen the amount of disruptive change required and create a culture that supports necessary disruption. Below is a discussion of each of these factors.

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Access to Data & Expertise: While staff at Labette Health believed they had opportunities in non-labor areas, they lacked the benchmark data to validate the opportunities and determine which to prioritize. Without understanding how much a given opportunity will yield relative to the effort to achieve it, it is difficult to build urgency to act when hospital staff already have full plates. Further, many of these opportunities require negotiating new contracts with vendors. Rural hospitals can tackle this challenge by working with advisors who have access to industry benchmarks and experience negotiating and realizing non-labor cost savings so they can provide realistic estimates of potential opportunity yields.

Bandwidth: Many hospitals struggle to generate non-labor cost savings because they lack a dedicated project lead who has sufficient time to manage the project. At Labette Health, Fleer was being onboarded as the project began, which, in retrospect, was lucky timing. This provided a project manager with the bandwidth to clearly communicate between the Labette Health staff and Forvis Mazars, hold internal staff accountable to deadlines, and help provide the consultants with necessary internal data and access to key personnel. While it is difficult to free up someone to play this role, Fleer notes that this should be viewed as a necessary investment in the success of the project.

Limit Behavioral Change Required: Non-labor savings opportunities that require behavioral changes are harder to achieve and sustain. Therefore, at Labette Health, most of the opportunities—particularly those prioritized early in the project—required a "low-change pathway." These opportunities typically required renegotiating vendor contracts to better align the incentives between the hospital and its business partners. For each of these instances, the incumbent vendor was offered the opportunity to preserve the relationship. Contracts were only rebid if the vendor wasn't willing to partner with Labette Health to create a relationship with aligned incentives.

A significant focus of this work involves educating the vendor on Labette Health's goal and sharing data illustrating that other service providers can meet the need at a lower rate or higher level of service. Further, renegotiated contracts typically require the vendor to report data on a quarterly basis. This creates discipline and helps monitor the performance of the new contract to address emerging issues that might decrease the savings yielded. Once the project has achieved some early wins with low-change projects, the team can use that momentum to address opportunities that require changes in day-to-day behavior.

Creating a Culture to Support Change: Beyond the "low-change pathway," Fleer credits two factors for Labette Health's realization of savings from the non-labor performance improvement project.

First, CEO Brian Williams and CNO Kathi McKinney were project sponsors. Williams and McKinney have strong relationships with clinical and medical staff and helped build the case for the project. While they have been transparent about the financial challenges facing Labette Health—particularly in 2023 when this project kicked off—the messaging wasn't gloom and doom. Instead, they focused on this project as an opportunity to free up funds to reinvest in services to better serve the community and items on the physicians' capital wish list. Using this "legacy approach," Williams and McKinney engaged staff by focusing on positioning this and other projects as allowing Labette Health to meet the community's needs not only in the next year, but years from now. This framing is best embodied by the question, "Do you want your grandchildren to continue to have access to high-quality care in their community?"

Second, Fleer and the Forvis Mazars team included impacted stakeholders in discussions related to opportunities for savings. This involved sharing data with department heads, community physicians, and vendors in a transparent manner that invited them to assist in creating possible solutions. Special attention was paid to physicians' and clinicians' concerns about the clinical implications of savings opportunities. This not only improves buy-in but typically results in more durable solutions, which is crucial. As CFO Janet Soper noted, "Hospitals are like ocean liners. Changing direction requires foresight and a measured approach."

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How To Find Opportunities

Hospitals pursuing non-labor savings need to understand the unit price (inclusive of logistics) and utilization cost drivers for each of the areas under consideration. Typically, the first step is to conduct a Pareto analysis comparing the hospital's top supply and service providers' costs in key areas to benchmarks based on peer organizations. The key areas include physician preference items, other medical devices/supplies, benefits vendors, information technology and electronic health records, clinical maintenance, facilities maintenance, and utilities.

Hospitals should conduct a similar analysis by service line category to identify other variances, *e.g.*, cost per procedure is higher than market peers, which could be addressed. This not only can help identify cost reduction opportunities but also illuminate charge capture, rebate, and managed care contract improvement opportunities.

Once hospitals identify the universe of potential opportunities, they then need to prioritize them. Hospitals should consider not only the amount of change the organization is capable of bearing, but also the cost to realize the savings. As an example, Labette Health elected not to pursue a savings opportunity in biomedical when it determined that the hours required to achieve the savings would cost more than the dollars available. Labette Health focused first on projects that would have the biggest dollar impact relative to disruption to the organization. Labette Health also considered other ongoing initiatives involving key stakeholders. Where possible, the organization scheduled cost reduction efforts around the ongoing initiatives to create bandwidth for key stakeholders to fully participate in the cost reduction project.

Results

Labette Health and its leadership team used a data-driven approach that prioritized stakeholder collaboration and "low-change pathway" opportunities to reduce non-labor expenditures. This approach, coupled with the CEO's and CNO's strong relationships with clinicians and medical staff and a focus on the needs of the community, has yielded approximately $1 million in annualized savings thus far. Labette Health is redeploying these savings to capital projects that expand access to care for members of the communities it serves and address the needs of the physicians who practice at Labette Health.

Interested in Achieving Similar Results?

Learn more about the strategies and experience that helped make this possible by visiting Forvis Mazars. Discover how they can help your organization uncover cost-saving opportunities and build a stronger financial future.

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[1] "Closed, Converted, Merged, and New Hospitals with Medicare Rural Designations: January 2018-November 2022," congress.gov, April 26, 2023.

[2] "The Crisis in Rural Health Care," ruralhospitals.chqpr.org, 2024.

[3] "Medicare Advantage Enrollment, Plan Availability and Premiums in Rural Areas," kff.org, September 7, 2023.

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