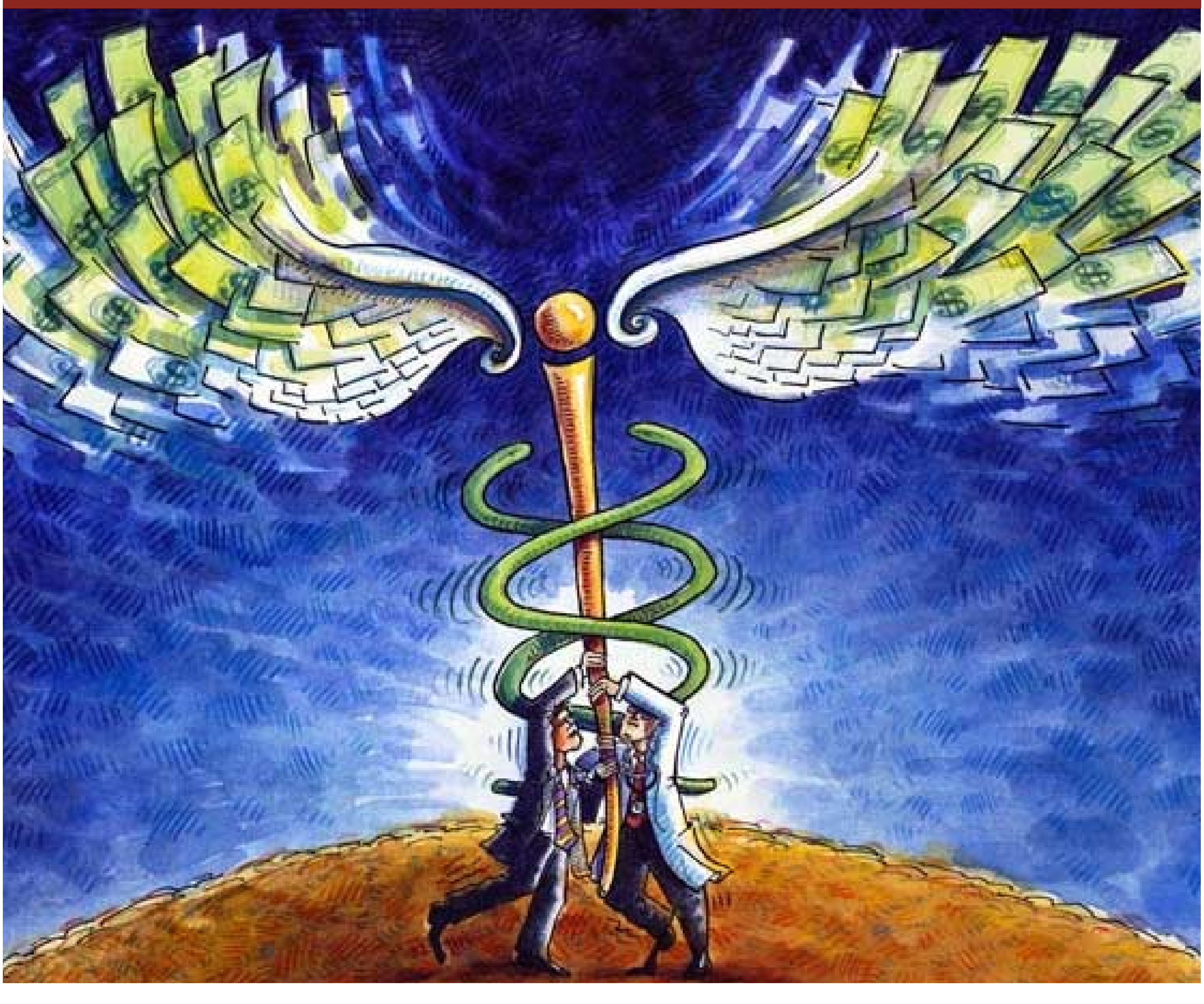
How the Cost Center Mindset is Costing Hospitals Million$.



The way hospitals make a profit has changed. The way hospitals have responded to this change has not.

According to Rick Jackson, Chairman and CEO of Jackson Healthcare, the cost-plus reimbursement mentality over the past 50 years is still written in the DNA of hospital financial management.

"Profits were almost guaranteed and expenses were passed through to payers," Jackson says. " Financial systems were put in place to measure what mattered most: costs."

Times have changed, explains Jackson, but unfortunately, hospital accounting has not.

So he challenges hospital CEOs and CFOs to consider: "What if today's hospitals were managed as a collection of profit centers, instead of cost centers? How would this enhance the viability of our hospitals?"

According to Jackson, the implications of this shift in thinking are immense. "It positions our hospitals to thrive, rather than survive," he says. "And it positions hospital executives to be stewards focused on both the short and long term contributions of their organization."

Where We Must Go

For this shift to happen, suggests Jackson, CEOs and CFOs should transform their organization's financial management philosophy. This solution, he says, is a bargain and the rewards are huge.

He illustrates his point by recalling a recent experience:

I *once asked a hospital CEO, if he could only make one phone call to the most important surgeon that affects his bottom line, who would he call? He thought for a second and said he would call Dr. Smith (a cardiac surgeon). He was confident he knew who the largest generator of revenue was for the hospital. I then proceeded to give him a list of the top 20 Surgeons based on revenue and, as expected, Dr. Smith was on the top of the list.*

Then I gave him another list. This list reported the top 20 profit producers for the hospital. Dr. Smith was 17th on this list. The top physician was an orthopedic surgeon who provided a $10 million profit contribution to the hospital. I then asked him who he was going to call now?

Of course he changed his answer.

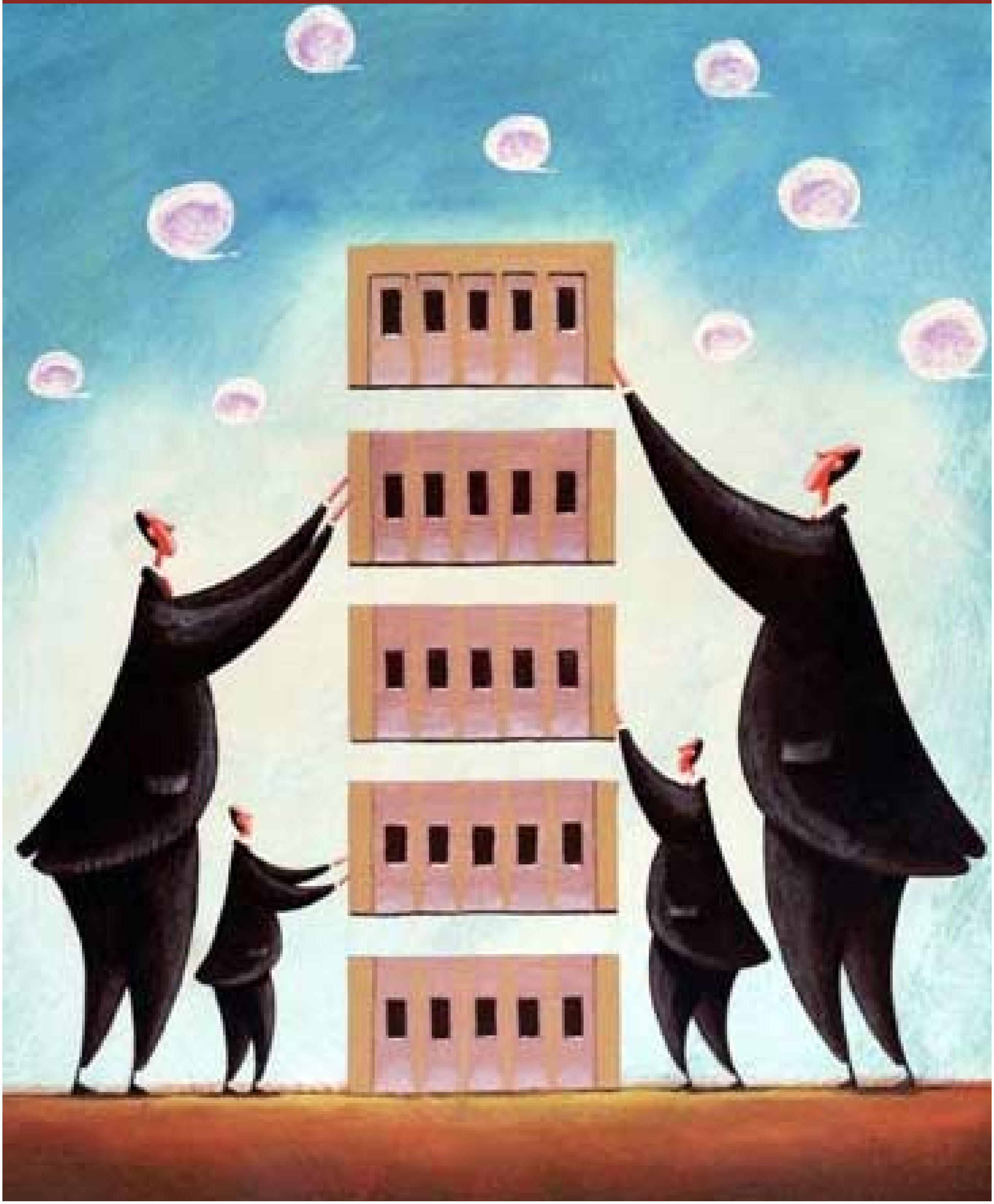
Looking at contribution through the profit-center model, we discovered that the cardiac surgeon was, in fact, losing money for the hospital and the CEO didn't know it. This meant that every surgeon that ranked lower than 16th was losing money.

Jackson says this situation wouldn't have happened if the CEO had a surgical services manager who understood the difference between managing expenses and leading a business to profitability.

"In my opinion, the historical view of hospitals has caused managers to see the hospital as a collection of cost centers," explains Jackson. "This view of running hospitals is outdated and simply will not allow those who are spending the money (i.e. the managers) to run their units like a business."

He advises that hospitals must become profit centers, not cost centers. This is not solely about making money, but ensuring an operational and financial foundation that allows for safe, quality medical care to thrive for the long term. CEOs and CFOs should shift their financial management philosophy and provide every departmental manager with the necessary profit reports for their respective areas. This includes the training and support they need to understand and act on this information.

What If Hospitals Were Malls?



What If Hospitals Were Malls?

Jackson says that by thinking of a hospital as a mall (i.e. a house for independent, interconnected businesses), it helps reframe executive thinking to explore the profit-center argument.

Executives should see the hospital as a collection of different business units working interdependently as separate profit centers connected together as one profitable enterprise. As a hospital of profit centers, executives can realize a significant improvement in the participation and performance of managers when they release their energies toward running a business, instead of merely managing a budget.

According to Jackson, the effectiveness of managers increases when they understand they can lead their unit with profitability as their goal. “The more business leaders we have, the easier our job becomes,” says Jackson. “The good news is that instead of having only two or three people worrying about the hospital’s profitability,” he adds, “we would have dozens of managers working collectively toward this goal.”

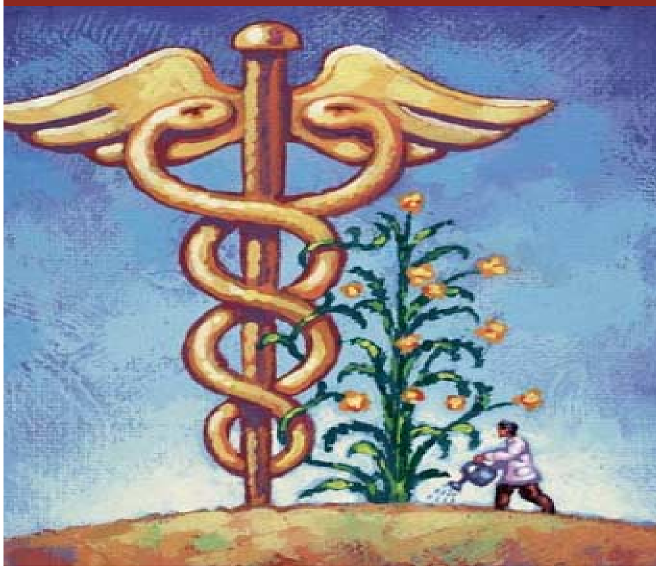
The actions of every manager in the hospital are significantly improved within the profit center model. Jackson offers this example:

A CFO calls the surgical manager and suggests reducing overhead by $2 million. The problem with this approach is that it’s assumed the decrease will net an equal increase to the bottom line. This is not necessarily the case.

What if the way the manager elects to cut the expense is to close down two ORs and the end result is decreasing revenue by $3 million? Did it achieve what the CFO wanted? Of course not. However that is exactly what will happen. Most managers do not understand the relationship between revenue and costs because they do not get financial reports connecting these two factors, allowing them to see their service line or department as a profit center.

Instead of cutting $2 million, what if the CFO defined the goal as $2 million in additional profit next year? This is a different question which leads to different solutions. The manager may come back and suggest opening another room, which would allow them to access more surgeons thereby increasing costs by $1 million and revenue by $4 million.

Time For A New Philosophy and Model



According to Jackson, the best way to move the "profit needle" is to:

1) Increase profitable revenues
2) Increase throughput (operational efficiencies)
3) Be more strategic: launch new service lines and/or divest of underperforming ones
4) Realize that customer service increases referrals which increases the bottom line
5) Develop marketing strategies that drive revenues such as concierge services for surgeons, mammogram screening, appointment reminders, etc.

In order for hospitals to be run as financially viable organizations, the financial systems need to change, says Jackson. And new accounting software and more data is not the answer. "What we need is a new financial philosophy that forces executives to change the way they look at hospitals financially." In a cost center model, the focus is negative. If managers merely cut costs, reduce payroll, terminate employees, etc., they are always a bearer of bad news. "They are in the business of 'destruction' with a scarcity mentality," says Jackson. "In a profit center environment," he adds, "our focus is on 'construction' of a business through marketing, alliances, customer satisfaction and service line growth."

The chart at right illustrates the different actions that are created by Jackson's shift in financial management philosophy.

Converting a hospital from a collection of cost centers to profit centers will influence managers in ways that will increase the organization's bottom-line.

"In order to accomplish all these elements, hospitals must work together to change such steps as the chart of accounts," says Jackson, "given the fact that forces outside of the hospital field are involved." He believes it is well worth the effort.

COST CENTER	PROFIT CENTER
• Cut labor and supplies by $2million • Reward physicians with the lowest costs *(i.e. total knee $3,700)*	• Open one more room and invest $500,000 in salaries. See revenues increase by $4 million • Reward physicians with highest profit margin per case
• Focus on process efficiencies	• Focus on throughput
• Expense control	• ROI measurement
• Image marketing	• Call-to-action marketing
• Decrease expenses	• Increase quality revenues
• Physician management	• Physician partnering
• Management Metrics: • Cost per case • Cost per service	• Management Metrics • Profit per case • Profit per service

Time For A New Philosophy and Model

What are the steps to turn a hospital into a profit center?

1) Identify the profit centers in need of development. The minimum profit centers should be OR, ED, Radiology, Inpatient, OB, Rehab and Ancillary. Have sub profit centers such as MRI, CT, X-ray in the radiology profit center roll-up. In the OR have sub profit centers by service lines, such as OB, Ortho, General, Cardiac, etc.
2) Change the chart of accounts to show each profit center. Most accounts will need two to three numbers to account for the cost center. *(This will require the largest time investment.)*
3) Apply every line item revenue and cost to one of these centers.
4) Teach managers how to read a financial report. Once they understand it, they will address problems before you have to show them. It decreases time to solve financial problems.
5) Create models that allow managers to budget and forecast based upon specific strategies they believe offer the best return.
6) Create financial incentives based on profit goals and improvements.

Jackson emphasizes that as a hospital of profit centers, executives should notice significant psychological and sociological behaviors in their managers as they truly drive positive change. Managers will subtlety turn from expense managers to empowered leaders focused on the viability of our hospitals. And the more business leaders executives have, the easier their job becomes. "Hospitals must be financially strong to meet the needs of the communities they serve," states Jackson. "The profit center philosophy will help hospitals rise to this challenge and remain healthy staples of their respective communities – and that's the true goal."

If you would like to share your thoughts on the ideas in this article, please go to the link below. If you provide us with your contact information, we will send you a summary of the survey's results.

Link: *http://bit.ly/mvQHf*

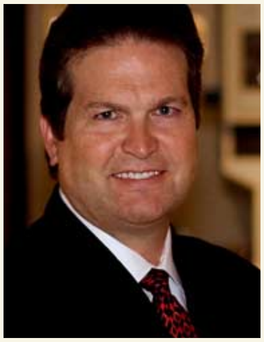
Do "Profit Centers" Apply to Nonprofit Health Systems?

Given their charitable mission, many nonprofit health systems use the term "contribution margin" instead of "profit" to demonstrate how excess revenues are reinvested back into the health system.

The ideas in this article don't change for nonprofit health systems who deemphasize profit, says Jackson. "Mission-oriented organizations, more than ever given today's environment, could benefit from this shift in thinking that looks at return-on-investment, as opposed to cost containment."

Today, communities throughout the U.S. need healthcare leaders who are investing in the long-term success of their community's health. A focus on hospital sustainability at the department level demonstrates that healthcare executives are practicing stewardship in a meaningful and measurable way.

Rick Jackson and Jackson Healthcare



Rick Jackson, Chairman and CEO of Jackson Healthcare, is an expert in healthcare trends and has been instrumental in developing more than 25 healthcare-related companies over the past 30 years. In both 2006 and 2007, Jackson was a southeast regional finalist for Ernst and Young's Entrepreneur of the Year Award. Jackson Healthcare was named to the Inc. 500 list of the fastest-growing private U.S. companies in 2004 and to the Inc. 5000 in 2007 as one of the top 100 healthcare companies. It was also on *Entrepreneur* magazine's 2007 list of the "Hot 500" U.S. entrepreneurial companies and was ranked fifth on Staffing Industry Analysts' list of "Top U.S. Healthcare Staffing Providers" in October 2008.

Jackson Healthcare has been included for the last three years on *Atlanta Business Chronicle's* list of "Pacesetters," Atlanta's fastest-growing private companies, ranking number seven on that list in 2007. In 2007 and 2008, *Atlanta Business Chronicle* named Jackson Healthcare to its annual list of "Atlanta's Best Employers" based on an independent employee survey.

Jackson Healthcare, located in Alpharetta, Georgia, is the parent company of:

- **Jackson & Coker**, a retained physician search and temporary physician recruitment firm
- **Jackson Hospital Affiliates**, owner and manager of hospitals
- **Jackson Therapy Partners**, provider of supplemental rehabilitation therapists and other allied healthcare professionals
- **LocumTenens.com**, a full-service locum tenens (temporary) physician recruitment agency
- **Parker Staffing Services**, provider of supplemental IT staffing
- **Patient Placement Systems**, a supplier of discharge planning and management software
- **Premier Anesthesia**, an anesthesia (department) management company
- **StatCom**, a supplier of patient flow logistics software
- **Travel Nurse Solutions**, the nation's largest rapid-response travel nurse staffing company

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