

# Plugging the Leaks: How to Save Millions in Labor Costs Without Staff Reductions

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Given the extraordinary demands on senior-level hospital executives, the time and effort many spend micro-managing labor issues is alarming. When a hospital's chief operating officer, for example, has to regularly approve or deny staffing decisions based on nothing more than an impassioned plea from a harried supervisor, you know that the hospital's labor cost management process is broken. Unfortunately, this is too often the reality. This is why, each year, so many hospitals spend millions more than they should on labor.

By necessity, hospital labor is a huge expense. According to the American Hospital Association, a hospital's labor force — from nurses to technicians, food service personnel, maintenance and clerical — represents 52.5 percent of total expenses for hospitals nationwide, or *over \$360 billion in 2008*. Payroll at a mid-sized hospital tends to reach about \$100 million per year, and for large hospitals it's considerably more. In light of such numbers, making labor-related decisions without reliable staffing and budgeting data creates significant and expensive issues for senior leadership.<sup>1</sup>

It happens, however, because few hospitals have a consistent, in-depth understanding of their overall personnel needs. They have even less of an understanding as to whether the hours and shifts people work — or their pay rates — are in line with budgetary and regulatory constraints.

The good news is that most hospitals already own the tools to gain detailed, accurate insights into their labor situation. Using these tools correctly can save between 2 and 5 percent of labor costs, which translates into \$2 million to \$5 million in savings at a mid-size hospital — or between \$1,300 and \$3,300 per employee. In many cases, the savings can be achieved without cutting workforce or reducing hours.

## Identifying the Problem

The biggest driver of unnecessary labor costs is the inability of many hospitals to consistently see a complete and reliable picture of their workforce in the context of market and regulatory demands facing every institution.

Most hospitals already possess the necessary technology within their enterprise resource planning (ERP) and/or legacy systems to create that picture. But too often, they either do not tie together key pieces of the systems and/or the components are improperly set up.

The result is that hospitals wind up with tangled processes that cause them to over-hire and over-staff specific shifts. They also improperly pay employees or invest too much time and energy in maintaining their systems. Even when these systems accurately capture labor problems, it is often far too late to make a difference. Consider just three examples with costly consequences:

- Improperly setting up the position control component in most ERP systems and failing to integrate it with financial planning components results in the delivery of an inaccurate picture of current staffing needs and its relationship to the budget. Consequently, there is no clear trigger for when a new hire is warranted and when it is not. The result is that despite budgeting for a certain number of full-time employees (FTE), many hospitals exceed that number on a regular basis — without being aware until they are reconciling numbers at the end of a budget period. By then, it is too late.

<sup>1</sup> American Hospital Association. *AHA Hospital Statistics*. Chicago, IL, 2010. Print.

- Miscalculating pay, especially overtime pay, is a common occurrence. For example, a nurse who works the night shift might receive a \$2 differential on top of the base hourly wage, but no one is tracking the fact that when the nurse works overtime they receive time and one-half for the entire hourly wage, including the differential. In most cases, this is a clear overpayment. Even if it is not, calculating pay correctly is necessary for compliance with the Fair Labor Standards Act (FLSA) — as are accurate audits.
- Many hospitals fail to tie contract labor into their systems, such as agency nurses. Consequently, the costs associated with contract workers are not recorded, even though keeping total labor costs under control is an absolute necessity.

## The Solution

Correcting these problems is not an expensive, complex project. Rather, an effective labor cost management (LCM) process is relatively easy to design and implement and usually does not require significant investment in new systems.

For the most part, LCM uses existing systems but integrates a number of business processes to allow the chief executive officer, chief operating officer, human resources and shift managers to view their workforce *holistically* across the hospital enterprise. This allows all of these key decision makers to quickly understand the hospital's hiring needs, effectively manage employee shifts and pay rates, and consistently monitor all of these areas so they can address problems in a timely way.

At the core of LCM is "position control," which is a standard component of most ERP systems. This component measures labor costs by tracking the number of approved FTEs as a proxy for actual labor costs while connecting the FTEs with the hospital's budgeting, workflow and general ledger processes.

Integrating position control with other processes is essential because it ensures all decision makers are using the same data and using it in an appropriate and rigorous way. This eases the labor management burden on high-level executives while ensuring that hiring and staffing decisions are in accordance with the hospital's budget and strategic priorities.

Another important step is ensuring that position control is set up properly so that it assigns the correct positions and captures the necessary information without requiring constant *ad-hoc* fixes every time an employee leaves or transfers and a new employee enters the system. In too many instances, the position control element was never set up properly, causing hospitals to wrestle with numerous patches that render the system virtually useless.

Another key component of an effective LCM is the ability for managers to set up appropriate views or dashboards that guide decision making. For example, a shift manager might create a tactical view that delivers insight into employee hours, pay rates and capabilities. In turn, the manager can make more informed decisions about who to call for a particular shift and who to send home. Alternatively, human resource managers might create a more strategic view that enables them to shift appropriate FTEs into open positions in one area, even as they address over-staffing in another area. In doing so, the hospital avoids the considerable expenses associated with the hiring and laying off of any employee.

## Where the Savings Occur

The savings generated by creating an effective LCM process emerge from three areas: optimized return-on-investment (ROI) in existing systems; more accurate calculations; and the creation of a single, trusted source of enterprise labor information that allows for more informed decision making.

### Optimized ROI in Existing Systems

Most of today's ERP systems have powerful labor cost management capabilities that are under-utilized by most hospitals. Optimizing these systems ensures that the hospital uses its full power to streamline labor costs and ensure regulatory compliance. For example, properly designing the position control portion of the system facilitates:

- **Improved labor analytics** — including real-time labor reporting delivered via executive-level dashboards that help identify trends and opportunities in timely ways.
- **Improved management of the entire employee life cycle** — the system provides a centralized, integrated view of the human resource function at the enterprise level. While decentralized groups can be effective at hiring and managing people on a departmental basis, a LCM system linked to the hospital's budget helps prevent upward creep in the number of FTEs. This ensures data integrity for payroll. In addition, proper position control also leads to smarter scheduling of existing employees and prevents pay and benefits from going to workers who have retired or moved to new institutions but who are still in the system for one or two pay periods.
- **Payroll savings** — a well-designed LCM system provides superior oversight and applies pay rules correctly and consistently. This saves money for the hospital and also promotes morale by ensuring that overtime rules and shift differentials are applied uniformly and accurately. In addition, by simultaneously tracking noncontract labor, hospitals have a more complete picture of their true labor costs, which can lead to further payroll savings.

### More Accurate Calculations

A LCM process typically includes a time and attendance component that automates the process of tracking time — including premium time — and applying overtime rates. When set up properly, employees only need to report *what* they are doing, and the system automatically applies the proper rate, thus ensuring the hospital is in compliance with the FLSA. Most systems also contain an audit capability, which can improve compliance.

### A Single Source of “Institutional Truth”

It has become almost cliché to talk about a single source of institutional truth, but this does not make it any less necessary. Labor cost leaks are inevitable when:

- Line managers receive their information from a multitude of sources that may or may not overlap
- Data matches only occasionally
- Managers receive conflicting reports for which they feel no sense of accountability

A properly designed LCM eliminates these problems and thereby aligns all decision makers — from the chief executive officer on down.

## A Rare Opportunity for Pain-Free Savings

The cost pressures with which hospitals constantly wrestle are only increasing under health care reform. Even today, in the early implementation stages of the Patient Protection and Affordable Care Act (PPACA), most hospitals scrape by on razor-thin margins. Yet many analyses of the PPACA's impact indicate that hospitals may see even those tiny margins shrink, or disappear, unless they can find new places to reduce costs.

Such solutions are typically difficult, painful and often complex. But preventing wasteful labor costs does not have to be any of those. Through the better use of technology that most hospitals already own, they can save millions. Few cost saving solutions will ever be so painless.