



# Workforce Prescriptions

An unincorporated division of CKD Enterprises, Inc.

**Evidence based consulting, outcomes focused and customer driven**

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Pay Practice Audits \* Length of Stay Audits \* HR Audits \* Financial Opportunity Audits \* Forms Automation \* Workforce/Manpower Planning

## The Economics of labor in Not-for-profit healthcare, 2007

Prepared 12/02/2007

## Purpose of the Report

With shrinking reimbursements, aging workforces and creeping acuity, reducing expenses is fast becoming a required leadership competency. As a result, each year since 2005, Workforce Prescriptions has compared data on up to 1300 not-for-profit adult acute hospitals in order to better understand the impacts of labor costs on overall financial performance. Hospitals studied, each report between 100 and 1043 staffed beds and are non-government not-for-profit facilities who update their publicly reported data by 11/15 of each year (MedPAR, OPSS, Cost reports, CMS and other publicly reported data). In 2006, 1043 hospitals were sampled and in 2007, 1292.

Workforce Prescriptions then completes deep internal audits on a random sampling of them (24 in 2007) in order to gain a better understanding of the factors impacting changes in labor costs.

### General Trends

- For the first time in 3 years, year-over-year growth in net revenue per bed outpaced labor growth
- For the first time in 3 years, labor as a percentage of net revenue held firm (instead of rising)
- Nursing productivity (the number of nursing hours utilized for each adjusted patient day) slipped slightly
- "Premium pay" as a component of labor experienced its largest ever increase (in the 3 year study period).

	2006	2007	Annual Change
<i>Premium pay as a % of Net revenue</i>	4.8%	5.6%	16.7%
<i>Premium pay as a % of Gross labor (with benefits)</i>	11.8%	13.2%	11.9%
<i>Recap % of Net Rev</i>	2.50%	2.79%	11.6%
<i>Labor/Net Rev</i>	51.2%	51.1%	-0.2%
<i>Nursing Productivity (nursing hours/Adj Pat Day)</i>	10.9	11.3	-3.7%
<i>Labor /staffed bed (160-1000 beds)</i>	\$372,804	\$379,204	1.7%
<i>Revenue /staffed bed (160-1000 beds)</i>	\$742,390	\$762,773	2.7%

### Specific Findings

- Growth in net revenue per staffed bed (2.7%) has allowed studied hospitals to slightly improve the financial results of operations even though access to nursing labor has declined and the cost per hour of that labor has increased.
- This has masked an increase in the use of overtime, agency and other "premium" components of labor.
- Hospital staff are working harder than ever to meet volume and acuity needs.

### Data by facility size

Over time, we have recognized that facilities of disparate size experience unique challenges in labor. In small facilities, the % of fixed labor resources is less than in large facilities where 24 hour infrastructure requirements and deeper layers of management infrastructure create heavier relative burdens. As a result, we compare organizations of similar size in order to ensure the equity of operating conditions.

Workforce Prescriptions calculates a "Pay Practice IQ" for each studied facility. This algorithm adjusts for cost of living, payor and volume differences and then compares the efficiency of labor dollars spent in meeting volume needs.

Based on in-depth onsite audits and recapture programs completed in 2007, Workforce Prescriptions has been able to assess which components of labor spend are "reducible" without requiring FTE cuts. Both calculations for each category appear to the left (by facility bed size):

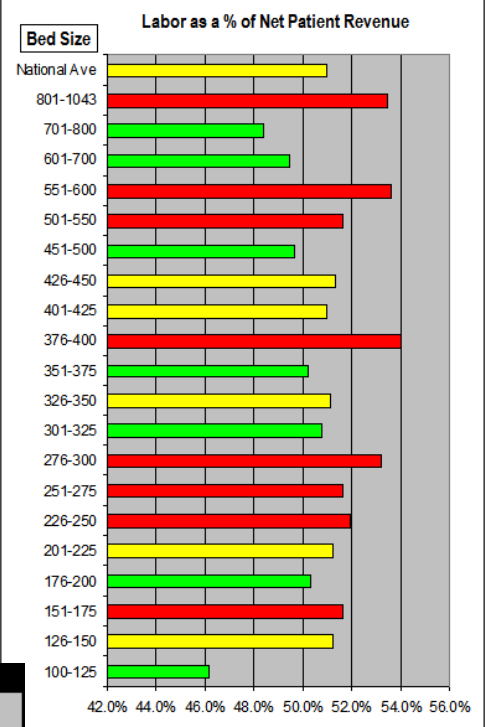
Bed Size	Labor/Net Revenue	Pay IQ	Recapture % of Net Revenue	N
701-800	48.4%	108.9	2.4%	36
551-600	53.6%	108.6	2.7%	34
801-1043	53.4%	108.5	2.6%	24
426-450	51.3%	108.2	2.7%	44
501-550	51.6%	107.6	2.6%	39
601-700	49.5%	107.6	2.3%	41
276-300	53.2%	107.3	2.8%	82
201-225	51.2%	106.9	2.8%	110
451-500	49.7%	105.7	2.6%	41
326-350	51.1%	105.6	2.8%	62
<b>National Ave</b>	<b>51.1%</b>	<b>105.4</b>	<b>2.79%</b>	<b>1292</b>
251-275	51.6%	104.8	2.8%	86
151-175	51.6%	104.7	2.9%	110
301-325	50.8%	104.6	2.7%	68
226-250	52.0%	104.5	2.9%	83
376-400	54.0%	104.4	3.0%	47
401-425	51.0%	104.4	2.7%	52
126-150	51.2%	104.0	3.0%	101
176-200	50.3%	103.7	2.9%	129
351-375	50.2%	103.3	2.7%	61
100-125	46.2%	101.8	2.9%	42

**There are 3 groups that are doing better than ave:**

- Hospitals with beds between 426 & 450
- Hospitals with beds between 551 & 600
- Hospitals with beds above 700

**There are 3 groups that are suffering:**

- Hospitals with beds between 350 & 375
- Hospitals with beds between 176 & 200
- Hospitals with beds between 100 & 150



## Data by State

(\* on chart denotes where new facilities were added to the study group in 2007)

Performance by state pointed to clear regional market trends. Knowing that the Pay IQ calculation adjusts for differences in reimbursement rates (private, Medicare and Medicaid), acuity and cost of living, it is interesting to note that the gap in labor performance is widening as some states improve their performance while others have slipped:

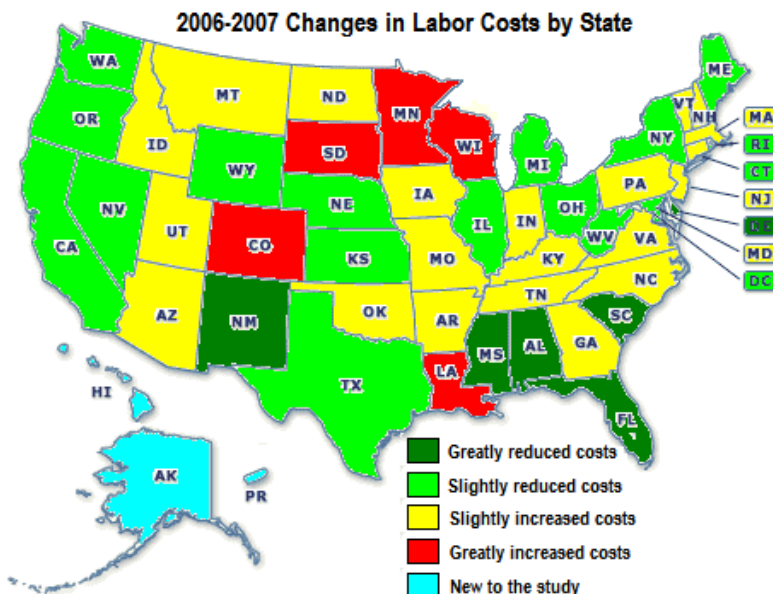
### Mitigating Factors to changes in year-over-year labor performance of states

- Many markets benefited from payor adjustments (Medicare, Medicaid and Private). Of firms completing detailed onsite audits, 36% were recipients of such adjustments during fiscal year 2007.
- Several States saw their Labor/Net revenue and Pay IQ drop. This occurs when enhancements to revenue outpace increases in labor costs. The pay IQ number reflects efficiency in labor utilization even when ratios like "labor/net revenue" appear to have improved (IE labor costs can be rising but are masked by higher revenue).
- The overall hospital workforce has continued to age (mean of 43.6 yrs in 2007 of audited facilities). Aging workforces tend to have heightened tenure driving up the cost of non-productive labor components (PTO, Sick leave, vacation, etc . . .)

### Root Causes of overall increase in labor costs in 2007 – "WHY" costs are rising

Knowing "what" is occurring is only half of the battle. Understanding "why" and more importantly "what to do about it" are the other half. All organizations audited (onsite audits included detailed payroll data analysis, staff & leader interviews and custom surveys) reported the following as reasons for escalation in labor costs:

- Labor costs on a per hour of care basis have risen.
- "Premium Pay" is the fastest rising component of paid labor.
- Current productivity measures are masking rising hourly costs (often productivity is measured as FTE's per A.O.B. instead of as cost-per-output).
- Workforce flexibility is diminishing as workforce age rises. As a result, staff scheduling is becoming increasingly complex.
- 83% reported plans for FTE reductions to combat rising labor expense.
- Productivity (output per hour of labor) was declining in proportion to workforce aging.
- All struggled with declining reimbursement rates.



State	2006 Labor/Net Revenue	2007 Labor/Net Revenue	2007 Pay IQ	Yr-over-yr Labor/Net Rev
DE	66.1%	49.2%	101.0	-25.6%
NM	55.1%	48.2%	110.5	-12.5%
MS	43.7%	39.6%	92.9	-9.5%
AL	47.1%	43.4%	94.5	-7.9%
SC	48.0%	45.3%	101.7	-5.6%
FL	47.7%	45.8%	99.9	-4.0%
CA	53.4%	51.7%	106.1	-3.2%
TX	45.8%	44.3%	97.4	-3.2%
IL	49.3%	47.9%	103.5	-2.9%
OR	55.0%	53.6%	116.7	-2.5%
WA	48.9%	47.8%	110.0	-2.2%
MI	53.2%	52.0%	107.3	-2.2%
NV	44.4%	43.4%	103.2	-2.2%
NY	65.2%	64.0%	111.9	-1.8%
DC	51.3%	50.6%	106.6	-1.4%
CT	58.3%	57.5%	117.7	-1.4%
RI	61.2%	60.4%	118.3	-1.3%
ME	50.6%	50.2%	109.9	-0.9%
NE	47.5%	47.2%	100.2	-0.6%
WY	44.3%	44.1%	103.2	-0.5%
KS	46.1%	45.9%	100.3	-0.5%
OH	48.3%	48.1%	100.9	-0.5%
WV	47.6%	47.5%	98.4	-0.2%
IA	50.3%	50.4%	101.6	0.2%
GA	47.8%	47.9%	100.8	0.3%
ND	54.2%	54.5%	110.1	0.5%
NC	49.3%	49.8%	103.4	1.0%
MA	58.8%	59.5%	119.0	1.1%
TN	44.0%	44.5%	97.0	1.2%
OK	46.5%	47.1%	97.5	1.3%
AZ	48.1%	49.0%	108.9	1.8%
NJ	56.8%	57.8%	109.1	1.8%
MT	47.9%	49.0%	105.8	2.2%
MO	48.1%	49.2%	102.2	2.2%
UT	49.6%	50.9%	108.3	2.7%
KY	46.2%	47.5%	100.9	2.7%
IN	47.7%	49.2%	103.1	3.1%
NH	48.1%	49.6%	113.3	3.2%
PA	48.6%	50.3%	102.1	3.5%
VT	50.3%	52.2%	121.6	3.8%
ID	52.1%	54.2%	114.7	4.1%
MD	49.9%	52.0%	106.8	4.1%
AR	43.7%	45.7%	96.9	4.7%
VA	45.1%	47.3%	102.4	4.8%
LA	44.9%	47.5%	100.3	5.9%
SD	51.5%	55.5%	103.4	7.9%
CO	43.2%	46.9%	109.1	8.6%
MN	53.8%	58.8%	111.0	9.3%
WI	49.3%	53.9%	117.0	9.4%
AK	No Data	54.8%	112.8	N
HI	No Data	52.6%	107.6	N
PR	No Data	44.9%	91.0	N

### Big Winners:

Florida, South Carolina, Alabama & Mississippi who each drove their labor costs as a % of net revenue DOWN by over 4%!

### Big Losers:

South Dakota, Minnesota, Colorado & Wisconsin who each saw their labor costs (as a % of net revenue) INCREASE by over 8%

## Lessons from the field – “WHAT” is being done about it

Across America, facilities we audited were actively pursuing labor expense reductions as a means of improving overall financial performance (yet many noted that their larger issues were actually rooted in known revenue challenges). Those that pursued FTE reductions as their primary method of reducing labor costs in 2007 discovered that:

- Turnover/hiring/orientation costs and the use of premium pay all rose by an average of 9.4% following FTE reductions
- Employee engagement and access to productive labor fell following FTE reductions
- Productivity fell following FTE reductions by an average of 19.7%

### Organizations that were most successful in reducing labor costs pursued operational opportunities such as:

- The effects of L.O.S. on labor costs
- The impact of scheduling practices on labor costs
- The cost of staffing shortages (budgeted & approved vacancies) in premium program spending
- The effect of current business processes on labor costs
- The impact of “premium pay” programs on labor costs and the reason for their use
- The cost of failures in policy & governance on labor
- The opportunities for variable workforce strategies to drive efficiencies

## Successes - Results of efforts to improve labor performance

The organizations that participated in onsite audits all shared one compelling desire: To drive down labor costs WITHOUT disenfranchising the workforce or compromising quality of care. What is most valuable to share is that all 24 organizations audited were able to drive down labor costs. Below are the results of their efforts:

- Those that pursued FTE reductions identified an average of \$1,837,447 (.74% of Net Revenue) in annual savings opportunities
- Those that pursued operational efficiencies identified an average of \$6,453,907 (2.6% of Net Revenue) in annual savings
- Those that pursued operational efficiencies had the greatest reduction in Agency and “premium program” usage (23.7% of total spend in those areas).
- Even high performing hospitals (those with efficient use of labor) were able to drive down labor costs through the reduction of use of “premium pay” programs and attention to interventional strategies for Length of Stay challenges.

	Beds	IQ	Anl Recapture	% Net/Rev Recapt'd	
<i>Upstate, NY Hospital</i>	248	129.4	\$ 5,113,954	1.8%	Top quartile
<i>Philadelphia, PA Hospital</i>	514	115.9	\$10,264,530	1.9%	
<i>Southern, FL Hospital</i>	299	106.4	\$ 5,545,825	2.3%	2nd quartile
<i>Southern, NJ Hospital</i>	385	101.7	\$ 6,895,096	2.7%	3rd quartile
<i>Central, SC Hospital</i>	251	100.7	\$ 4,356,232	2.9%	
<i>Eastern, FL Hospital</i>	523	98.7	\$ 8,967,535	3.1%	bottom quartile
<i>Central, NJ Hospital</i>	199	98.2	\$ 3,452,057	3.1%	
<i>Central, AL Hospital</i>	355	90.7	\$ 7,036,029	3.4%	
<b>Average Annual Recapture</b>			<b>\$ 6,453,907</b>	<b>2.6%</b>	
<b>Cummulative Annual Recapture</b>			<b>\$51,631,258</b>		

Of the 8 organizations participating in detailed audits during Q2 and Q3 of 2007, all were able to identify methods for significantly reducing labor costs by focusing on key operational competencies in the areas listed above.

## Conclusions

*The primary lesson learned in 2007 is that there ARE opportunities for improvements in labor costs that don't require draconian FTE reductions or the eliminations of programs by mandate. In a majority of organizations we audited (23/24), premium pay had grown to become an expected component of core compensation and therefore an entitlement. As this labor component represents an average of 5.6% of net revenue and 13.2% of gross labor in not-for-profit hospitals in 2007, addressing it has become a chief concern of executives, and addressing it they are! Organizations that pursue them are producing measurable bottom line results which appear scalable and sustainable over the long haul!*

### **About Workforce Prescriptions**

Workforce Prescriptions is an “evidence based” consulting firm headquartered in Hudson, FL that provides assistance to organizations desiring to: enhance their revenue opportunities, reduce their cost of labor, reduce their length of stay or to improve their human resource & recruiting practices. Workforce prescriptions focuses primarily in the not for profit sector of healthcare in order to “assist those organizations whose own mission requires them to take extraordinary risks in order to ensure access to quality healthcare”.

Workforce Prescriptions can be contacted at (888) 343-8403 or online at <http://www.workforcex.org>

### **About the “Pay Practice Audit”**

Workforce Prescriptions launched its detailed “Pay Practice Audit” in August of 2006 in support of its annual report “The economics of labor in healthcare”. If you would be interested in discovering more about how you can participate in an audit, please visit our website at <http://www.workforcex.org> and click on the presentation, “How to reduce labor costs through a Pay Practice Audit”.

### **About the “Pay Practice IQ”**

Each year, Workforce Prescriptions creates an “every hospital” from scrubbed data. It then factors differences in reimbursement and cost of living for each market of the country and creates template facilities for each zip code family (first 2 digits of the zip code). It then overlays actual facility performance (volumes, case types, costs, revenue, labor, etc . . .) to the appropriate zip code template and evaluates the efficiency of labor cost utilization. The Pay IQ algorithm then assigns an “IQ” score to each facility based on how effectively it used its labor expenses. IQ’s range from 182 (Einstein level genius at labor cost efficiency) to 84.7 (smarter than Forrest Gump, but needing some direction). Each December 1<sup>st</sup>, Workforce Prescriptions publishes the Pay IQ of all 1292 hospitals in its involuntary study group along with “algorithmically calculated labor cost reduction estimates” on its website!

### **To purchase the raw data**

Workforce Prescriptions will make available the raw data of its study on CD or by email at a cost of \$1,000 per study year. Currently, only 2006 and 2007 data are available electronically. For further information contact: Dean Kristiniak at (888) 343-8403 X 2.