

Getting Cost Out—Reducing Management Costs

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One of the thorniest challenges health-care providers face is the need to reduce costs quickly. Historically, many health-care providers have “legislated” short-term budget cuts from the top down. This method is quick, but it can divert attention from important redesign opportunities and create short-term results that are not sustainable.

Cost reduction can also be an opportunity to transform the organization to be more productive and competitive. This must be done with an intimate knowledge of the organization rather than with the “hatchet man” approach. To do the work thoughtfully, middle managers must be actively involved.

Setting

Our case study was set in a large teaching hospital in the Northeast with an annual budget of \$300 million. A hospital-wide cost reduction effort had been underway for several years, including process redesign teams working to re-engineer large areas of its operation. The teams did not expect that their work would meet the cost reduction target for the fiscal year.

The hospital also wanted to create a more empowered organization in which front-line workers made more decisions and management positions could be cut. The Center for Applied Research Inc. was retained to help the top team to first establish a target for management salary reductions and then determine where the cuts would be made.

Establish a Target

The management team had rejected previous benchmarking data as irrelevant. Managers also expressed frustration with previous cost cutting efforts. Against this backdrop, we designed a retreat for the management team and developed three broad approaches to management cost reduction. Each one was intended to stimulate discussion based on real organizational data, and was presented as a “strawman” rather than as a definitive solution.

1. Cut 10 percent across-the-board. A 10 percent reduction in management positions was applied equally across exist-

ing management categories. This implied that all parts of the organization were equally efficient (or inefficient).

2. Reduce management layers. The human resources department identified the number of management layers between front-line workers and the CEO. The strawman presumed that two layers of management could be eliminated throughout the organization.

3. Increase span of control. The HR department modeled the effects of consolidating and eliminating management positions from all cost centers with fewer than five employees, fewer than 10 employees, and fewer than 22 employees.

After discussing these approaches and the estimated cost savings associated with each, the team agreed on a management reduction goal of \$2 million and an approach combining features of the two most thoughtful strawmen - “reduce management layers” and “increase span of control.”

Step One: Empowering the Team

When the team met to evaluate its progress, it reverted to a familiar set of dynamics where individual members defended their own decisions. Several people said that they had done all they could and suggested that others should be taking more action. They did not confront one another directly, and did not hold each other accountable.

We realized the team was struggling with the issue of shifting authority. Together with the chief operating officer (COO), the team created an approach that would allow him to exercise his authority and encourage the group to work in a more empowered way. Ironically, we often find that more directive authority from above succeeds in creating a more empowered team below. The COO created a deadline for identifying the management cost reductions and promised to use a “default option” if the group was unable to meet the deadline. The option gave the team the choice of either working collectively in pursuit of an organization-wide goal (new culture), or of asking for top-down decision making from the COO (old culture).

Step Two: Peer Coaching

All management team members participated in meetings in which two or three of their peers coached and challenged them. The combination of exchanging structured information and peer-coaching helped the team overcome the reluctance they had to challenge each other. An additional benefit was that the actual assembly of the information to prepare for the meeting helped some managers identify previously unrecognized opportunities. Some managers came to the meetings with new reductions, and several more agreed to make additional cuts based on the discussions.

Step Three: Final Decisions

A management retreat was scheduled a few days before the default option deadline to reach a final plan for achieving the \$2 million goal. The management team still needed to cut \$400,000 of management cost, about eight positions. We broke the participants into small groups each charged with developing an approach for identifying the remaining reductions. Several actions were proposed by all the groups, and by the end of the discussion, they had identified the remaining reductions.

Results

1. The hospital reduced nearly \$2 million of management expense.
2. The hospital’s management team

accomplished the expense reductions in a way that supported cultural change.

3. The team respected rather than undermined the broader reengineering efforts underway.

4. The process of making the management reductions supported organizational learning.

Management teams often face significant challenges during periods when old methods are losing legitimacy and new methods are not yet well developed. Short-term budget cuts frequently get made in the “twilight zone” between the old and new authority, and they are often required before long-term redesign efforts can be implemented. ■

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