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The Plan Takes Shape

Monday afternoon, Wes met with Nathan Stocks to develop a plan that would put the hospital at breakeven within ninety days. "Hospitals lose money by generating too little revenue or incurring too much cost," Wes said. "Let's focus on our costs first."

Nathan brought to the meeting comparative productivity and cost information from the Utah Healthcare Association. Of special interest were comparative data on average cost per patient day for labor and materials for hospitals approximately the same size as Peter Brannan Hospital. The data clearly showed that Peter Brannan Hospital had higher costs than any other primary-care hospital in its size category in the state. For the next two hours, Wes analyzed the data in an attempt to understand why.

As manufacturing consultant, Wes had relied on standard cost accounting systems that provided cost variances on production. A *variance* is the difference between what a product *should cost* and what it *actually cost.* Variances can help managers *understand the reasons* for cost overruns. The most common reasons for an unfavorable labor or material variance are (1) the company paid too much for the resource or (2) the company used too much of the resource.

The manufacturing industry had been using standard cost accounting since the late nineteenth century. It was still a relatively new concept in healthcare, however, although a number of hospitals were attempting to install systems since the advent of prospective payment.

Establishing a standard costing system at Peter Brannan Hospital was one of Wes's primary objectives. Since labor consumed 30 percent of his hospital's total budget, he decided to focus on labor standards first.

That afternoon, Wes called Karisa Holyoak. She gave him the name of Dr. Alma Cowdrey, a professor of management at Weber State University who had helped some of Holyoak's clients establish fair and competitive labor rates. This would be the first step in designing a standard cost accounting system.[4] A

[4] Standard costing determines variances. To calculate a labor variance, Wes will need four pieces of information: (1) the standard labor rate, (2) the standard labor quantity, (3) the actual labor rate, and (4) the actual labor quantity. Alma Cowdrey will help establish the standard labor rate.

meeting with Cowdrey and Don Yanamura, the hospital's human resource director, was established for the following day.

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"Your problem is similar to that of a number of other clients of mine," said Alma Cowdrey. Cowdrey was a fifty-year-old college professor who consulted regularly in compensation. He had thinning brown hair and an open face that impressed Wes with its sincerity

"Your compensation system was developed over a number of years on an ad hoc basis as the hospital added new positions," he continued. "There were no guidelines—no governing philosophies. As a result, your salary schedules lack *internal consistency* and *external validity.*"

"What does that mean?" Don Yanamura asked.

"Internal consistency means that the system is *fair—employees get equal pay for equal work.* External validity means that a firm's salaries are *consistent with the market*. Utah Healthcare Association data indicate your salaries are neither."

Yanamura gave Wes a side-glance. "I suspected that was the case," he said. "I inherited the present system. I've never had the resources to fix the problem."

Cowdrey smiled sympathetically. "That's a problem many personnel directors face," he said. "They're often so busy with the daily operation of their departments that they don't have time to design proper systems."

"I'd think most hospitals would be ripe for the service you offer," Yanamura said.

"That's true. Technology keeps changing the content of hospital jobs, and that creates problems with recruitment, training, and performance evaluation."

Wes was pleased that Yanamura was receptive. "If we hire your firm, how long would it take you to design a market-based compensation system for the hospital?" he asked. "A system that would provide standard labor cost for a new cost accounting system?"

Cowdrey retrieved a calculator from his briefcase and punched in several figures. "You have about two hundred employees—about 125 different job descriptions," he said. "My firm completed a similar project for Memorial Hospital in Colorado Springs. I think we could finish your study in about six weeks."

Yanamura nodded at Wes, who turned to Cowdrey. "I wish we could get the data faster, but if six weeks is your best estimate, that'll have to do. Keep me posted on your progress."