

Eliminating the Budget: Park Nicollet Health Services

Kaizen the annual budget process; most of it is waste.

Robert W. Hall

A movement called "Beyond Budgeting" to get rid of the annual budget process appears to be gaining momentum.¹ When detailed budgets disappear, so do those accounting variances that distort lean operations and nettle lean leaders. However, only a few of the companies eliminating the budget also have a lean operations initiative. Most of them are service companies, not manufacturers. American Express is one.

While operations managers may be cheering this movement, the need for it is recognized by financial managers. They don't need lean training to see that a process that ties up half a finance staff for six months gaming a new plan is waste. Few managers actually follow the plan later. Furthermore, the financial managers who see this are more likely to see the merits of extending their lean thinking.

The first thought is that if a company did not have a detailed budget, spending would go wild. However, Guardian Industries and Sun Hydraulics have never had a budget — financial planning, but not a detailed budget. Companies that have had a budget are some-

where in the conversion process moving away from it. To see how this works, a good example is Park Nicollet Health Services, a major hospital with a lean program that has also eliminated the budget.

Getting Started

Park Nicollet entered its modern era in 2003. CEO David Wessner began to investigate the Toyota Production System for ideas that would boost operational improvements beyond the quality initiatives that the hospital already had in place. CFO David Cooke attended a seminar on "Beyond Budgeting," by Steve Player, and began to investigate how the budget process could be exorcised from the institu-

In Brief

Although small, Beyond Budgeting is a rapidly growing movement among finance departments. Park Nicollet is a large health services organization with a lean initiative that has also dispensed with the usual annual budget process. This is an overview of what Beyond Budgeting is and Park Nicollet's experience implementing it.

Park Nicollet Health Services

Park Nicollet Health Services is a non-profit serving the Minneapolis-St. Paul area, covering 96 zip codes and a population having the highest average income and the highest insured percentage of any health institution in the United States. Annual revenue tops \$1 billion, and it has 8500 full-time equivalent employees (part time work is common). The operations are integrated, but packaged into four primary sub-units:

- Methodist Hospital (426 beds; 960 doctors on staff)
- Park Nicollet Clinic (25 locations. Urgent care plus multiple specialties)
- Park Nicollet Foundation (the money-raising arm)
- Park Nicollet Institute (215 research studies in 2006, plus extensive medical continuing education)

This huge, complex operation regularly wins awards for the quality and innovation of its services. It has been cited for quality care by *Consumer's Digest* and by Solucient, a health care consulting company. However, the rating that helped with money was from Medicare's Three-Year Hospital Quality Incentive Demonstration. In Year Two, Park Nicollet scored in the top ten percent of 270 participating hospitals in three categories: heart disease, coronary artery bypass graft operations, and hip and knee replacement. Being in the top ten percent lets Park Nicollet receive an extra two percent in base Medicare payments in these areas. This is attributable to Park Nicollet's lean and quality initiatives. To even participate in the demonstration survey, an organization must keep data on how well it is performing.

Mission: "Our mission is to care for and support the health, healing, and learning of those we serve."

Vision: "Everyone caring every day, creating with the individuals we serve, optimal health and greater value."

It's obvious that the staff thinks about how to function by their vision and mission. For example, the phrase "optimal health" has a different definition for someone 75 years old with multiple disabilities, than for a stalwart youth of 25. In addition, Park Nicollet observes another precept not common among institutions, stewardship, which is "Our commitment to create ever greater value with the resources entrusted to us."

tion.² Wessner and Cooke decided that the two initiatives together might be exactly what they needed to increase the quality of health care delivery while keeping a little money to reinvest in the institution from the sums that third party payers were willing to pay.

With so large an organization, ramping up momentum took some time. Both the lean initiative and "Beyond Budgeting" center on the CFO office. Lean began first. Before cutting loose from the budget, they wanted process improvement in place with a track record of operational measurements. Key performance indicators had to replace the detailed budget reports. They set targets for improvement, and track actual performance to them, but there is no

comparison with a forecasted performance, as with budgets and variances. With that change, responsibility shifted toward the operating units; no more micro-managing or second guessing with a budget.

During 2004, the lean measurement system was put in place and data began to collect. From January 2005-January 2006, they ran dual systems. The budget still existed, but the CFO office test ran the new system twice, tweaking it after each trial. For 2006, they prepared no annual budget. Late in 2005 a few managers asked if they had missed a deadline — budget planning requests were overdue. A few others never realized that the budget was gone until 2006 and reports against budget were no longer issued.

Lean Management and KPIs

Park Nicollet has many locations varying greatly in size. Attached to the CFO office is a staff of 65 lean advisors, trainers, and kaizen leaders (for 8500 people). However, responsibility for steady process improvement has been pushed out to "service line" units and their leaders. They call kaizen a Rapid Process Improvement event. Just tracking improvement is an activity in itself. Data are collected weekly and posted on a wall board, divided into Park Nicollet's main service units (Figure 1) representing 55 separate service lines altogether. The board replicates in summary form data that is mostly hand-generated and posted in the gemba throughout Park Nicollet. Several people keep busy updating this big wall in Park Nicollet's "waste war room."

At the work level, just training people is an ongoing effort. Training concentrates on 5S, visibility, Value Stream Mapping, spotting the seven wastes, and standard work. Like all the hospitals with serious improvement efforts, Park Nicollet stresses elimination of patient errors and improvement of the care experience for all patients and their families. An example of a process measurement different from manufacturing is a key "inventory," the number of patients waiting. That is to be minimized, of course, and to do that, they work on patient communication. For example, on the web site, www.parknicollet.com, the wait times at their six urgent care facilities are updated every half-hour. If in trouble, go on line and head for the shortest queue.

Standard work is a problem everywhere, but non-standard practices among physicians doing the same procedures exacerbates the variance in other people's work. Park Nicollet is taking on that problem a bit at a time. Just having doctors compare their practices looking for improvement helps. For example, a one-hour meeting of six urologists allowed them to standardize some of the tests prescribed and equipment used without any of them giving up clinical pathways that they thought worked best for their patients.

Every Tuesday morning things come together at a stand-up meeting of the Kaizen Operating Teams (KOT) from all operations within Park Nicollet. The meeting convenes next to the big wall board in Figure 1, and runs by a standard format. With only eight minutes for every team to report; they have to spit it out in six minutes, leaving another two minutes for Q&A. All presentations cover progress versus targets for the past week; the kaizen plan for this week; and any barriers to progress that others may have to help deal with. The first item at every meeting is patient safety, but operations are so complex that there is a different emphasis on topics for each week in a four-week cycle; then they start over. The standard work chart for these meetings is posted at the end of the wall board where the meetings are held (Figure 2).

One of the performance indicators tracked is "Creating a Caring Experience" (Figure 3). Not many finance departments track that one.

The Park Nicollet Performance Wall Board



Figure 1. This board in the lean "war room" is about 50 feet long, divided by service lines. Comparable data is in the same layout for each service line, but each one may also have unique performance measures posted.

Standard Work for the Stand-Up Meetings

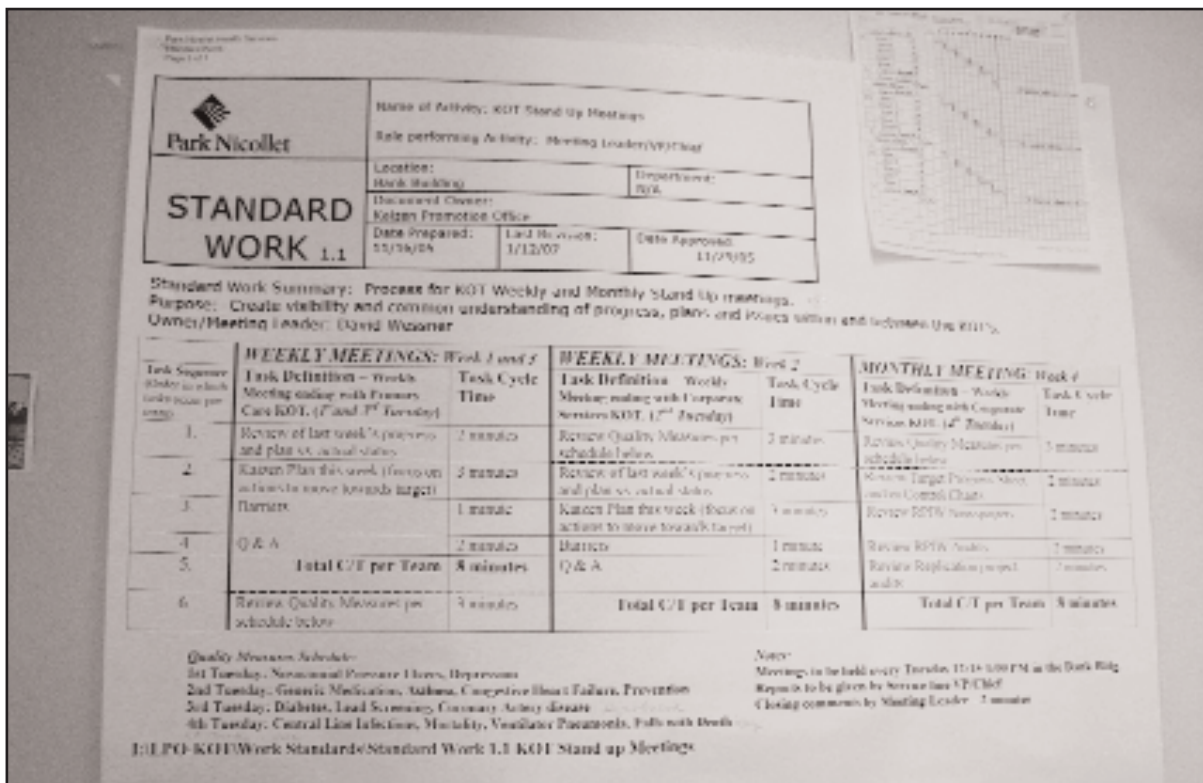


Figure 2. This photo is hard to discern, but it outlines the format for each meeting of Park Nicollet's Kaizen Operating Teams (KOTs) every Tuesday morning. With many people giving reports, the sequence is of presentations is pegged by a tact time.

One of Park Nicollet's Standard KPIs

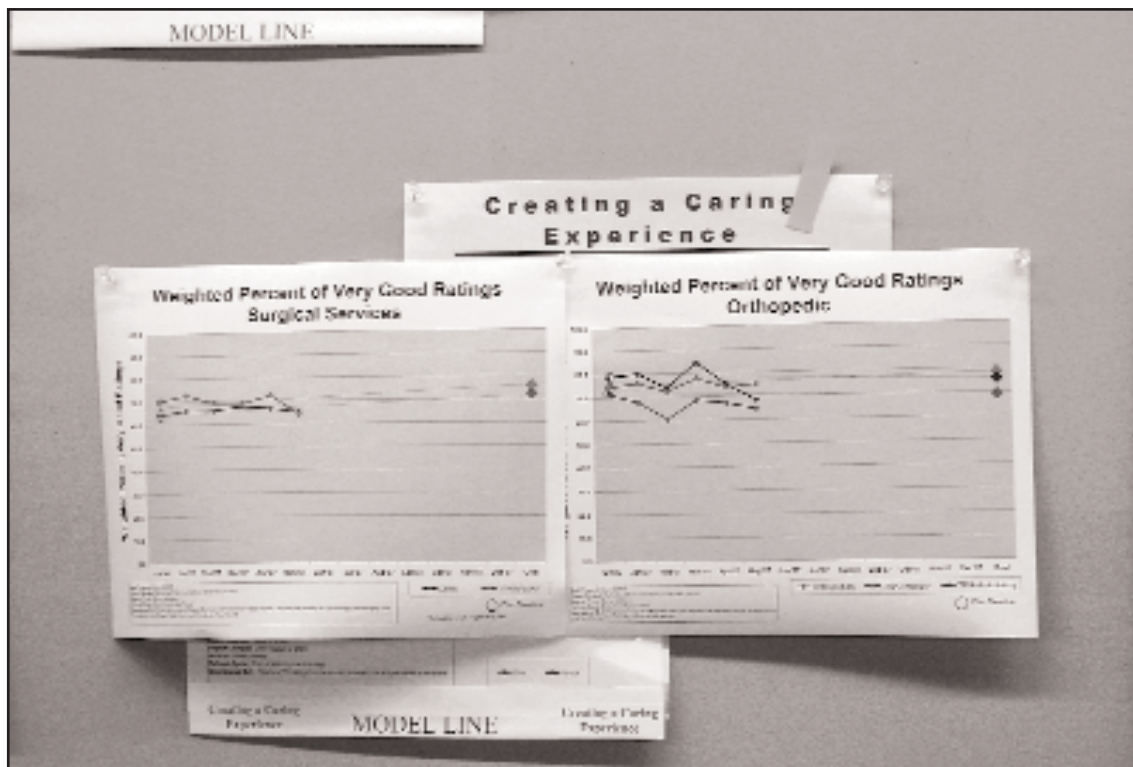


Figure 3.

Budgetless Reporting

Park Nicollet does have a financial planning process. It's important for finance, but not for health service managers. They must do whatever is needed and look at the budget later, if ever. Actual costs result from people fulfilling their mission using whatever process exists at the time. They can provide better service at lower cost only by developing better processes. That's the theory behind dumping the conventional budget.

Finance needs a handle on cash flow. That somebody is watching the money is comforting to boards, credit agencies, and bond agencies, but if everybody in operations also closely watched the money, they could not do their job. Once a quarter, the CFO's office updates a six-quarter financial forecast, called a rolling forecast. This is broken down by all 55 service lines of the hospital, but not distributed to operational leaders. An annual capital spending budget is planned based on cash flow from the prior year; the CFO can't fund major projects using money that exists only in a forecast.

Only the top operating unit managers get a financial plan, a few lines totaling around \$100 million or so each (these are big units). Senior managers must direct money wherever it is needed without budget guidance, so they have to take initiative. They measure their unit's performance by key performance indicators (KPIs; sometimes called "vital signs"), not the budget. Five KPIs monitored only at the service line level are:

- Units of service per full-time equivalent (productivity)
- Actual cost per unit of service
- Margin on units of service
- Total expenses
- Units of service per square foot.

These are financially-oriented, but the CFO's office asks no petty questions like how much is spent on copying. Park Nicollet financial analysts occasionally refer to this as "Bud Lite." If the service line organizations diligently eliminate waste, costs steadily evaporate, but performance

is measured by period-by-period improvement by the KPIs. CFO David Cooke explains how he judges overall process improvement. First is to expect positive outcomes; that patients' health will be better when they leave than when they arrive. (While usually true, in a hospital you can't win them all.) Given that, Cooke juggles a mental ratio:

$$\text{Value} = \frac{\text{Patient-centered outcomes and experience}}{\text{Price and Time}}$$

If there is a squeeze from the CFO's office, it is on improvement as measured by the KPIs, but the main pressure is from peer comparisons. The war room board is open for anyone at Park Nicollet to see. All reports issued disclose the performance of all service lines. Even the chief medical officer gets these reports. No data are secret whether regularly posted or not.

Besides the stand-up meetings, there is a top level quarterly performance review in conjunction with each cycle of the rolling forecast. The vice-presidents with several service lines look at what is changing, give their reports, and present their action plans for the coming quarter and beyond. This system gives much more flexibility than the old annual budget cycle.

For longer-term planning, each quarter top management reviews performance over the past 12 months. Johnson Chou from the CFO office prepares five year forecasts. These projections are shaky, of course, but Park Nicollet needs something for anticipating capital projects, bond issues, and giving campaigns by the foundation. But none of this is used to "drive" operations. In effect, the budget is not totally eliminated; it's constrained to a high level of aggregation.

For green-gown workers, the big change was eliminating waste by kaizen and learning more effective ways to work. When unencumbered by the contradictory system of budget measurements, senior managers had to learn to exercise more leadership for improvement, a strange new role.

Learning a new leadership approach is harder than the system changes needed to

Why We Hate Budgets

In practice, the entire budget process is loaded with waste. Every manager with budget experience is familiar with the gripes below and more, voiced over a beer or two, but as a refresher here are a few:

- Budget planning takes too long, and ties up too many people.
- Game the numbers: Pad the first estimates. Deep cuts in these force estimators to plead a case. The cycles of ritual lying end only by a drop-dead due date.
- Assumptions and forecasts are almost always wrong; sometimes wildly so.
- Out-of-date budgets become more and more irrelevant.
- Budgets become an excuse for inaction: "That is not in the budget."
- Managers want to spend every dime in a budget; use it or lose it.
- Budgets create the illusion of control.
- Is missing a budget bad planning or bad performance?

The Twelve Principles of the Beyond Budgeting Model

Leadership Principles	
1. Customers:	Focus everyone on their customers, <i>not on hierarchal relationships</i>
2. Processes:	Organize as a lean network of accountable teams, <i>not as centralized functions</i>
3. Autonomy:	Give teams the freedom and capability to act; <i>don't micro-manage them</i>
4. Responsibility:	Create a high responsibility culture at every level, <i>not just in the center</i>
5. Transparency:	Promote open information for self-management, <i>don't restrict it hierarchically</i>
6. Governance:	Adopt a few clear values, goals and boundaries, <i>not detailed regulations</i>
Process Principles	
1. Goals:	Set relative goals for continuous improvement, <i>don't negotiate fixed contracts</i>
2. Rewards:	Reward shared success based on relative performance, <i>not fixed targets</i>
3. Planning:	Make planning a continuous and inclusive process, <i>not a top-down annual event</i>
4. Controls:	Base controls on relative indicators and plans, <i>not variances against plan</i>
5. Resources:	Make resources available as needed, <i>not through annual budget allocations</i>
6. Coordination:	Coordinate interactions dynamically, <i>not through annual planning cycles</i>

The principles are taken from the European web site for the Beyond Budgeting Round Table. You can find it on page 4 of the document at: www.bbbrt.org/eu/documents/BBRT_Prospectus.pdf
Beyond Budgeting originated in the United Kingdom.

Figure 4.

function without a budget. The principles of "Beyond Budgeting" were not developed specifically for lean companies, but as shown in Figure 4, they are compatible with lean thinking.

Going Forward

Park Nicollet is progressing on a major ongoing goal, four percent productivity improvement per year. Headcount is down nine percent for the same level of service. The number of prescriptions written for generics jumped into the 70 percent range, a

big decrease in drug costs. A year and a half into it, they are still picking up momentum.

David Cooke thinks that their approach to implementation of "Beyond Budgeting" set about the right pace, the cut-over did not stall in confusion. His office is now just as busy supporting lean operations and advising managers than when doing the crunch work of budgets and monitoring variances. But it is more fun, the sort of work many bean counters would like to do if they had preparation and opportunity. Leaders have had training to

better prepare them, but they want still more, and it is unusual for that training to be coming from a CFO's office.

Cooke also thinks that lean thinking will soon start to permeate all health care. The reason is that a huge amount of capital has now been sunk into health care facilities. That pace cannot be sustained, and people are demanding better care for less money, so they will not tolerate an approach to health care that racks up 5-10 percent per year increases in revenue to these institutions. They will have to start making much better use of existing facilities and reserve the investment for where it really counts improving health.

In the meantime at Park Nicollet, everyone wants more training, and they need to put more time and more effective time into process improvement. And definitely, no one misses the budget, especially not the CFO.

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References:

1. Jeremy Hope and Robin Fraser, *Beyond Budgeting: How Managers Can Break Free from the Annual Performance Trap*, Harvard Business School Press, Boston MA, 2003. This is the book that began the movement to go beyond the annual budget. The authors are British.

2. Steve Player of The Player Group is pushing "Beyond Budgeting." Most of the companies now engaged in getting rid of a detailed budgeting process belong to the Beyond Budgeting Round Table (BBRT.) There are five round tables besides the one in North America. You can find The Player Group at www.theplayergroup.com and the round table at www.bbrtna.org.

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