Healthcare Providers under Pressure: Make the Most of Challenging Times

By Scott B. Davis, Partner, and Phillip J. Robinson

Introduction

Between the slowing economic recovery, tight credit markets, increasing costs, and the uncertainty surrounding healthcare reform, the healthcare industry faces some sizeable challenges. These factors have put considerable strain on the industry’s traditional financing options that the industry has relied on in the past—bonds, banks, finance companies, private equity, venture capital, Real Estate Investment Trusts, private philanthropy, and grants. At the same time, providers are dealing with rising costs, lower reimbursement rates, shrinking demand for elective procedures, higher levels of charitable care and bad debt, and increased scrutiny of tax-exempt hospitals. Providers face these challenges against a background of uncertainty created by healthcare reform.

While the current challenges are numerous, healthcare is a dynamic and growing industry that currently commands 17 percent of U.S. gross domestic product (GDP) and is expected to increase to 19 percent over the next ten years (see Figure 1). The opportunities in the U.S. healthcare industry are nearly limitless when you consider the high demand and prioritization for healthcare in the U.S.

Healthcare providers must take a strategic and forward-looking approach to these obstacles and challenges to be successful. What follows is an overview of the major challenges facing the industry and recommendations for positioning your organization to survive the current downturn and capitalize on potential opportunities.

Figure 1: Healthcare Expenditures as a Percent of GDP

Source: Centers for Medicare and Medicaid Services, Office of the Actuary, March 2010.
working closely with organized labor to maintain a compensation model and working conditions that are fair but do not unduly stress the system; establishing and adhering to staffing grids that properly staff medical departments; and encouraging the use of new medical or administrative technology that helps to minimize labor cost.

Malpractice liability is also a significant cost. High insurance premiums, potential crippling malpractice settlements, and the high cost of practicing defensive medicine add up fast.

Access to capital is a growing issue for many providers. Limited access to capital severely restricts many providers’ ability to update aging facilities and upgrade information technology and medical equipment. Failure to improve technology makes it more difficult to compete. At the same time, the new regulatory mandates require healthcare organizations to invest in electronic health records and data security.

In the face of these financial pressures, stand-alone healthcare facilities find it very difficult to compete with multi-state and multi-hospital systems. Consolidation of healthcare providers is a growing trend, driven by limitations on access to capital, mandates on quality-of-care and survival due to pressure on the bottom line. Future consolidation will likely be driven by pressure to reduce costs that cannot be passed along to payers, as well as higher capital investment requirements and continuing economic uncertainty.

**Uncertainties Related to Healthcare Reform**

Healthcare reform has created a great deal of uncertainty, which is contributing to difficulties among healthcare providers. The major effect of the enacted legislation for providers is that 32 million Americans who previously did not have medical insurance will soon be covered. It is far from clear if quality health care services can be delivered to these added enrollees given that, arguably, the existing facilities, medical professionals and systems are inadequate for the existing level of patients.

There is little doubt that the increase in access to healthcare services will significantly reduce uncompensated care and charity care. However, the estimated $1 trillion cost of healthcare reform will be paid, in part, from anticipated reductions in the cost of healthcare delivery and reduction of current reimbursement rates to providers and insurers. Accomplishing this will be difficult. Healthcare reform also places a major emphasis on pay-for-performance and quality-of-care initiatives that will likely come with a high price tag. Whether the positive impact of having more insured patients will offset the effect of reduced reimbursement rates and the added strain on the already stressed healthcare delivery system remains to be seen.

Major healthcare policy changes always create winners and losers, as the Balanced Budget Act of 1997 demonstrated. The impact of healthcare reform will be much broader and will have a lasting impact on every provider.

**What Should Your Organization Be Doing Now?**

Given the many changes and pressures, what should your organization be doing now to address these challenges and position itself effectively for the future? The following are recommendations you should consider:

**Self-Evaluation**

Now is the time for a close and forthright evaluation of where your organization stands relative to the competition. Ask questions including:

- What is our current position in the marketplace?
- Where do we want to be?
- How do we best serve our community given our local demographics, competition and mission?
- What will it take to get there?
- Do we have the management depth, access to capital, and infrastructure that we need to succeed?
- Can we achieve these objectives alone or should we consider a joint venture or consolidation?

**Strategic Planning**

Given the uncertainties, now is the time for effective strategic planning at the board and senior-management levels. It is essential to establish a plan and communicate it throughout your organization. Obtaining buy-in from employees, physicians, labor unions and community leaders is also critical.

The board and management should update the organization’s strategic plan to ensure that it is appropriately focused on service structure, local conditions, payer mix and cost structure. The plan should also address issues including quality of care, patient flow, management effectiveness, communication plans, the

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**Figure 2.**

*Operating Margins for Nonprofit Hospitals and Healthcare Systems*

*Source: Fitch Ratings.*
governmental/political environment and financial strength. Monitor and modify the plan periodically and as regulatory and economic conditions change. Also, monitor healthcare reform developments closely since these affect strategic planning.

Seek Out Opportunities for Synergistic Consolidation and Joint Venture

Smaller systems are seeing that their very survival may be dependent on merging with or being acquired by another system. Consolidated systems generally have better access to capital and also tend to have higher bond ratings than stand-alone systems. In the current environment, consolidation can be an opportunity for healthcare systems, large and small, to be better positioned to fulfill their mission and deliver quality, cost-effective care.

If you don’t have strong market share, dedicated medical staff, and easy access to capital, consider consolidation options, strategic partnerships, or joint ventures with other providers in your marketplace such as physician practices, ambulatory care centers, surgery centers, and imaging centers. Also consider public-private partnerships whereby government funding is combined with private provider healthcare delivery expertise to meet local challenges. A strong partnership with a primary care physician organization will be important as healthcare reform adds 32 million new patients into the system, who are expected to primarily use traditional entry points rather than emergency rooms.

Optimize Cost Structure and Improve Margins

Knowing where to cut expenses is key to maintaining efficient and stable operations since cost reductions typically provide quicker results than revenue-enhancement efforts. Focus on expenses with the greatest impact. Labor and medical supplies are generally the two largest cost centers of healthcare organizations’ operating expenses. Analyze these categories of spending thoroughly to get the highest potential savings impact. Examine your administrative expenses, such as use of consultants, temporary staff, and managerial salaries, as well as your entire indirect cost structure to ensure that it links directly with patient services. Take the view that all costs are variable, particularly administrative costs, and then justify their value by linking them with the revenue-generating activities that the cost supports. Also, take this opportunity to implement metrics and benchmarking to evaluate service lines that either need to be fixed or dropped.

Explore All Available Financing Strategies

Given that many healthcare lenders have exited the market and access to the tax-exempt bond market has been interrupted in the last two years, many healthcare organizations are scrambling to secure financing. Commercial lending activity is on the rise but terms and covenants are more restrictive than before. Stronger systems can pursue tax-exempt bond financing but weaker ones typically cannot, which puts them at a distinct disadvantage due to the higher cost of capital.

View all assets—tangible and intangible—and activities of the hospital as potential sources of capital or financing. If structured properly, you can maintain quality and operating control via a sale/leaseback or some other contractual arrangement. Aggressively access nontraditional financing sources including: sales of assets, joint ventures, public and private grants. Facility capital spending demands are so large that they leave less capital for equipment spending, which is needed to remain competitive. Employ all available leasing/financing options for the smaller equipment purchases. Equipment leasing continues to grow as a means of financing smaller transactions. Focus on how each capital asset acquired or leased will improve financial performance and meet organization goals.

Now is also an ideal time to negotiate with suppliers for consignment opportunities, extended terms, and larger, early-pay discounts. If your healthcare system has multiple facilities, consider opportunities to consolidate its buying power into a centralized purchasing department in order to purchase more for less.

Protect Liquidity

In the past months, many healthcare organizations have found out the hard way that cash matters more than earnings. A slower economy puts additional pressure on cash flow because payers are likely to pay more slowly, third-party reimbursement rates may be reduced, revenues and profitability diminish, and banks are less inclined to lend against insufficient or aging collateral. If not monitored closely, liquidity can become constrained very quickly and without warning.

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Establishing a cash-flow projection and then closely monitoring adherence to that projection is essential for healthcare organizations. These steps will give advance warning of points at which cash may not be sufficient to maintain existing operating levels or maintain compliance with loan covenants involving cash balances. As such, this discipline will also give you the ability to aggressively manage cash as necessary under the circumstances.

Minimize Collection Risk and Maximize Revenues

The staggering high rates of unpaid medical bills are growing quickly as more patients lose employment, insurance coverage, and their ability to pay for care. To minimize the impact of collection risk to your liquidity and your bottom line, strengthen your registration and admissions process, verify data inputs, and maintain accurate and complete medical records. These efforts will allow you to avoid costly payment deferrals and denials.

Analyze clinical documentation to ensure all reimbursable complications or co-morbidities are captured in order to maximize revenue. Stay ahead of third-party contract renewals, and realign incentives when possible. In many hospital failures a major contributing factor has been the inability to capture and bill for all the charges that are being incurred.

Update the organization’s strategic plan.
It is also a good idea to speed up the collection process. Create an atmosphere of zero tolerance for significant delays to collect. After patient care, managing the revenue cycle is the most complex process in provider management. Seamless operational integration and flawless execution are essential to maximize net-revenue realization.

Consider An Integrated Healthcare Model

Many healthcare systems are moving toward an integrated healthcare model, in which there is a high degree of collaboration and communication among healthcare professionals and their patients. In this model, physicians, hospitals, ambulatory care centers, system management, and primary health plans are coordinated with common goals and incentives, both financially and as they pertain to quality of care.

Integrated healthcare will be highly dependent on IT capabilities because of the required sharing of data among various constituents including the patient. Providers that are able to adopt this approach effectively undoubtedly will be better-positioned for the future than those who do not.

Future View

The forces competing for quality patient care, patient access and affordability, combined with the uncertainties surrounding healthcare reform and a challenging economic environment, exert a tremendous amount of pressure on the healthcare industry. Such pressure demands a back-to-basics approach that embraces sound business practices and requires healthcare executives to aggressively address issues and respond to signs of danger. You need to consider a range of strategic options and seek help as needed from outside advisers, before your hospital or health system experiences significant distress. Organizations that do so effectively will not only have a greater number of options and alternatives available to them, but also will be ready to capitalize on opportunities in the future. NP

Authors

Scott B. Davis is a partner in Grant Thornton’s Corporate Advisory & Restructuring Services practice, and is located in the Charlotte office. Scott has over 25 years of consulting experience assisting underperforming businesses, and in the areas of strategic change, litigation, and forensics. Scott currently serves on the team that holds the role of Chief Restructuring Officer of Saint Vincent’s Catholic Medical Center in its Chapter 11 bankruptcy, and is responsible for the disposition and sale of all assets.

Phillip J. Robinson is a Director in the Corporate Advisory & Restructuring Services practice of Grant Thornton LLP, and is located in the Phoenix office. Phil’s focus is the healthcare industry where he advises hospitals and other providers who are experiencing financial and operational challenges. He is a Certified Public Accountant and is a member of the Healthcare Financial Management Association, Turnaround Management Association and American Bankruptcy Institute.