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Intensive Care

By Steven Wang

A Pulse Check on the Health Care Industry

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As economic conditions continue to stabilize in the health care industry from the volatility of the past few years, more health care entities are transitioning from recovery to growth mode. According to a recent 2024 Healthcare CFO Outlook Survey, 79 percent of chief financial officers (CFOs) reported that their profitability improved in 2023.[1] However, while this article mainly focuses on health care service providers, (*e.g.*, hospitals, ambulatory surgery centers, senior-care facilities, etc.), this outlook might not turn out to be as rosy for the industry as a whole.

Industry-wide obstacles such as stagnant reimbursement rates and increasing operating expenses remain persistent, and are pushing operating such margins to razor-thin levels and leaving little to no room for error. In fact, 2023 saw health care companies account for a disproportionate share of leveraged loan defaults: Despite health care companies representing only 12.5 percent of issuers, they represented more than 20 percent of default value.[2] In addition, the number of large health care chapter 11 cases increased by 72 percent in 2023, with 79 new chapter 11 cases compared to just 46 in 2022.[3]

Symptoms: Signs of Distress

As leadership continues to navigate the complex health care landscape, there are signs of financial distress that should be watched closely. Spotting these symptoms early requires a thorough understanding of the entity's financial and operational conditions, and identifying these symptoms could pave the way for prompt corrective actions and present an opportunity to avert an existential crisis down the line.

There are several financial metrics and operational key performance indicators (KPIs) that should remain in focus. Reporting of these metrics are typically covenants required by lenders or bondholders as part of the credit agreement or bond documents. Deterioration in these metrics — either compared to historical periods or industry benchmarks — often raises concerns about the entity's financial health.

Some financial metrics, including days of cash-on-hand, debt-service-coverage ratio, operating-margin ratio and days in accounts receivable (AR), can reveal a great deal about the entity's liquidity situation. For example, an increase in days in AR, if not managed on a timely basis, could result in a depletion of operating cash, which is the backbone of the business for maintaining its day-to-day activities. Depending on the entity type, such operational indicators as occupancy rate and in-patient days offer great insights to management that allows them to make informed decisions, address inefficiencies and improve quality of care.

Diagnosis: Root Cause of Financial Issues

There are several factors contributing to the margin decline and financial distress of health care entities. Over the past few years, reimbursement rates have not kept up with the cost of health care. While costs are on the rise, payors continue to reduce reimbursement rates for several services.

In November 2023, the Centers for Medicare & Medicaid Services finalized a 3.4 percent decrease

1 "2024 BDO Healthcare CFO Outlook Survey," BDO USA (Feb. 13, 2024), *available at* insights.bdo.com/2024-BDO-Healthcare-CFO-Outlook-Survey (unless otherwise specified, all links in this article were last visited on May 21, 2024).
2 "Q4 2023 Health Care Services Report," *Pitchbook* (Feb. 8, 2024), *available at* pitchbook.com/news/reports/q4-2023-healthcare-services-report.
3 "Record Bankruptcy Filings in the Health Care Sector in 2023," Gibbins Advisors Research Report (Jan. 25, 2024), *available at* gibbinsadvisors.com/record-bankruptcy-filings-in-the-healthcare-sector-in-2023.

in the conversion factor in the physician fee schedule, representing an overall payment rate cut of 1.25 percent for 2024 compared to 2023.[4] These low and unstable reimbursement rates have been a contributing factor to a number of recent hospital closures across different regions.[5]

There have been positive trends in prior-authorization requirements from some payors, with the aim of reducing the administrative burden and expediting patient care and services. For example, Blue Cross Blue Shield of Massachusetts removed more than 14,000 prior-authorization requirements for home care services effective early 2024,[6] and other insurers have made similar announcements regarding reductions in requirements.

Despite these advancements, the challenge of high claim denials persists, with a significant percentage of health system leaders reporting an uptick in the rate of claims denials over the past year.[7] The process of appealing these denials imposes further delays in payments and adds pressure to the revenue cycle. A recent industry survey highlighted that health systems are incurring almost $20 billion annually in costs associated with contesting denied claims. Furthermore, only a little more than half of these denials were successfully overturned and paid by commercial insurers after going through several rounds of appeals.[8]

Specific plans, such as Medicare Advantage (MA), can also pose significant challenges to a health care entity's liquidity. MA enrollments have been growing at a steady pace, with an expected enrollment of 33.8 million in 2024.[9] This represents more than half of the total eligible Medicare population. However, several providers have announced their plans to go out of network with MA due to several concerns, including continued reimbursement decreases, excessive coverage denials and burdensome paperwork requirements.

For example, Scripps Health opted to discontinue MA plans in January 2024 for its integrated medical groups. Scripps' president and CEO Chris Van Gorder suggested that the San Diego-based health system incurred an annual loss of $75 million on MA contracts in 2023.[10] In fact, 16 percent of health systems intend to stop accepting one or more MA plans in the next two years, and another 45 percent also are considering doing so, although no final decisions have been made, according to the Healthcare Financial Management Association's 2024 Health System CFO Pain Points Study.[11]

Operating expenses have also increased at a rate that exceeds revenue and patient volume growth during the past few years. Labor costs, representing more than 50 percent of total costs in a typical health care setting (and up to 70 percent if external contractors are used), continue to erode margins. Staffing shortages, especially in nursing, remain one of the top concerns for management since COVID-19. Managing staff turnover and retention requires an understanding of the current market dynamics. Other factors such as high drug and supply costs fueled by inflation also contribute to the financial distress of a health care entity.

Unexpected external events, such as cyberattacks, often send shockwaves through the whole industry and can delay the financial recovery of health systems. Ransomware attacks can expose more than personal health information. In some cases, billing and collections processes might also be disrupted, leaving providers unable to submit claims or receive payments and claim information. Cash-posting might not be finalized until the data between the claims and the cash deposited can be matched. As a result, companies hoping to regain access to collections and liquidity could experience lengthy delays that could create significant uncertainties and financial risks for health care providers.

Noncompliance with regulatory requirements and union contract terms could also lead to costly penalties and serve as another root cause of financial distress. For example, hospitals might be ordered to pay millions of dollars in fines for understaffing nurses and violating the safe-staffing ratio. In addition, risks arising from changes in laws should not be overlooked. Although the Federal No Surprises Act, introduced in 2022, is still facing legal challenges, it has the potential to eliminate pricing levers for some providers over out-of-network billing for emergency care services. Health care leaders need to assess the financial implications of these events and come up with game plans to proactively monitor and mitigate risks.

Treatment Plan: What Management Can Do

How can management tackle liquidity constraints and financial issues? Cash is king in any distressed scenario, and leadership should have a tight grip on overall liquidity. Tools such as a 13-week cash-flow analysis offer an overview of the entity's short-term cash-flow situation. To improve cash inflow, such operational KPIs as the net-collection rate should be reviewed regularly. Sufficient resources must be allocated to manage payor relations and focus on revenue-cycle functions, specifically collection efforts. In some cases, special operating groups can be set up to negotiate with payors and accelerate cash collections from aging ARs.

In addition to expending collection efforts, more than one-third of health care CFOs are also planning continued strategic cost reductions, including labor cost containment, based on the 2024 BDO Healthcare CFO Outlook Survey. Health care entities are coming up with out-of-the-box solu-

4 "Calendar Year 2024 Medicare Physician Fee Schedule Final Rule," Ctrs. for Medicare & Medicaid Servs. Press Release (Nov. 2, 2023), *available at* cms.gov/newsroom/fact-sheets/calendar-year-cy-2024-medicare-physician-fee-schedule-final-rule.

5 Madeline Ashley & Alan Condon, "The Reasons Behind 14 Hospital Closures," *Becker's Hosp. CFO Report* (Dec. 14, 2023), *available at* beckershospitalreview.com/finance/the-reasons-behind-14-hospital-closures.html.

6 "Blue Cross Blue Shield of Massachusetts Removes Prior Authorization Requirements for Home Care Services," Blue Cross Blue Shield of Massachusetts Newsroom (Nov. 6, 2023), *available at* newsroom.bluecrossma.com/2023-11-06-blue-cross-blue-shield-of-massachusetts-removes-prior-authorization-requirements-for-home-care-services.

7 "2023 State of Health Care Performance Improvement: Signs of Stabilization Emerge," Kaufman Hall (October 2023), *available at* kaufmanhall.com/sites/default/files/2023-10/KH-Report_2023-State-Healthcare-Performance-Improvement.pdf.

8 Andrew Cass, "Claims Denials Are Costing Hospitals Nearly $20B Per Year," *Becker's Hosp. CFO Report* (March 25, 2024), *available at* beckershospitalreview.com/finance/claims-denials-are-costing-hospitals-nearly-20b-per-year.html.

9 "Medicare Advantage and Medicare Prescription Drug Programs to Remain Stable in 2024," Ctrs. for Medicare & Medicaid Servs. Press Release (Sept. 26, 2023), *available at* cms.gov/newsroom/press-releases/medicare-advantage-and-medicare-prescription-drug-programs-remain-stable-2024.

10 Alan Condon, "Scripps CEO Concerned Further Losses Will Risk Borrowing Ability," *Becker's Hosp. CFO Report* (Sept. 29, 2023), *available at* beckershospitalreview.com/finance/scripps-ceo-concerned-further-losses-will-risk-borrowing-ability.html (subscription required to view article).

tions. For example, Urbana, Ill.-based Carle Health has introduced voluntary separation to employees in order to contain costs and plan for growth.[12] Somerville, Mass.-based Mass General Brigham is offering its employees buyouts to meet its workforce needs.[13]

To get ahead of the ever-increasing competition in today's labor market, management can focus on retention by optimizing employment packages and perks. Various programs and initiatives can be designed to support the workforce, improve employee loyalty and address turnover. For example, Chicago-based CommonSpirit Health recently launched a multidisciplinary residency program for nursing that aims to mitigate the turnover risk in the first year for new nursing grads.[14] The program provides nursing orientation and is designed to enhance the workforce transition experience through education, support and mentorship.

Other cost-optimization mechanisms should also be deployed, such as exploring alternative suppliers, and renegotiating anesthesia and other services contracts. Based on the 2024 BDO Healthcare CFO Outlook Survey, nearly half of health care CFOs expect to increase investment in technology implementation in 2024, and a staggering 98 percent suggested that they are piloting generative artificial intelligence over the next 12 months.

The importance of technology investment and system upgrades cannot be overstated. Operating an outdated system leaves the organization vulnerable to cyberattacks, thus putting valuable financial resources and sensitive patient data at risk. In today's consumer-centric environment, health care is no exception, as prospective patients have certain expectations regarding the patient experience. By investing in a patient portal that is easy to use, health care entities can enhance patient interaction at the first point of contact, which in turn boosts the patient consult-to-treatment conversion rate, improves efficiency and prevents revenue leakage. Investment in the mid-revenue cycle will drive the accuracy of coding, charge capture and clinical-documentation integrity, all of which directly impact cash collections and net revenue.

On top of operational levers that management can pull, there are various strategic options available to some. For example, are there any additional revenue streams to explore? Can a sale leaseback transaction be contemplated for additional liquidity? Is anyone in the market interested in consolidation, partnership or joint venture? Is there any appetite for a carve-out or divestiture, such as a parcel of land or a vacant medical office building? Is there any interest in pursuing private-equity or venture-capital funding?

Conclusion

Chapter 11 remains an effective tool for entities to seek protection and undertake reorganization and restructuring. A § 363 sale might also provide satisfactory results to the parties involved. While assessing these alternatives, management should always consider the stakeholders at play and the communities it serves. abi

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13 Mackenzie Bean, "Mass General Brigham Offers Buyouts for Digital Staff," *Becker's Hosp. Review* (Nov. 10, 2023), *available at* beckershospitalreview.com/workforce/mass-general-brigham-offers-buyouts-for-digital-staff.html (subscription required to view article).

14 "CommonSpirit Health National Nurse Residency Program," CommonSpirit Health, *available at* commonspirit.careers/Nursing-New-Grad-Residency.