hfma
healthcare financial management association

HFMA's Healthcare Financial Pulse

The Financial Health of U.S. Hospitals and Health Systems

Highlights of a Survey by the Healthcare Financial Management Association

January 2009

> "One ought never to turn one's back on a threatened danger and try to run away from it. If you do that, you will double the danger. But if you meet it promptly and without flinching, you will reduce the danger by half."
> —*Sir Winston Churchill*

Reports about spending freezes, employee layoffs, and other financial fallouts at U.S. hospitals have fanned concerns about the weakening economy's effect on healthcare organizations and the communities they serve. To understand the dimensions of the situation, the Healthcare Financial Management Association (HFMA) surveyed more than 300 healthcare financial executives about the recent and future financial health of their organizations. The results show that many hospitals and health systems are struggling to access credit and are anticipating margin declines within the next six months. In response, hospitals are indicating that capital budgets will be slashed and additional cost reductions may be necessary. However, hospitals can take several actions to preserve their financial position and maintain their mission.

Survey Highlights

Investment volatility, rising unemployment, and other economic challenges are affecting hospitals across the country.

Limited capital access. The pervasiveness of the credit crisis, as revealed by the HFMA survey, is significant. It is not just the financially weak "have-not" hospitals that are struggling to access capital; almost 30 percent of respondents from financially strong, or "have," hospitals report recent capital challenges.

For instance, 18 percent of respondents from "have" hospitals and 31 percent from "have-not" hospitals report difficulty securing a liquidity facility, an essential credit vehicle that would allow hospitals access to lower cost variable rate debt. In addition, almost 30 percent of "have" hospital respondents report a substantial increase in the cost of debt, compared to 43 percent from "have-not" hospitals.

"Historically, financial health and capital position were primarily driven by operational characteristics," says Richard L. Clarke, DHA, FHFMA, president and CEO, HFMA. "A trend of public payment rates that pay less than the cost of care and the increasing uncompensated burden of the uninsured has caused some healthcare institutions to depend on investment portfolios for a significant portion of their margins. These margins are essential to the continuing health of the industry, as they are reinvested in facilities and programs that are vital to the communities that they serve. The impact extends beyond

Sponsored by

McKESSON
Empowering Healthcare

RelayHealth

the traditional 'have nots' to the 'haves.' Those who are positioned well are increasingly challenged by investment volatility. Those who struggled financially will be even more sensitive to operational shifts and patient trends."

Weakening margins. Many hospitals are witnessing declines in operating margins, resulting from declines in patient volume and increases in bad debt and charity care.

The majority of respondents (55 percent) reported that their hospitals had experienced a drop in inpatient volumes over the past six months. Respondents from mid-sized hospitals reported the largest decreases, with 38 percent saying volumes had fallen more than 2 percent.

In addition, more than 60 percent of respondents said rising charity care and bad debt expenses are negatively affecting financial performance.

While the majority of respondents anticipate declining margins, financial executives from larger healthcare organizations provided the gloomiest projections. Thirty-one percent of respondents from hospitals with 300 to 500 beds anticipate an extreme decline in operating margins, and 43 percent anticipate a decline in total margins. "Hospitals are seeing the effects of growing unemployment and high patient deductibles and copays," says Bob Broadway, FHFMA, chairman, HFMA. "Patients seem to be putting off elective tests and treatments, and the cost of necessary care for the uninsured and underinsured is being picked up by providers. Larger organizations tend to be located in more urban areas, and therefore, are more affected by changes in patient volumes."

Spending cuts. Hospitals are making difficult decisions as investment and operating losses climb. Construction took the biggest hit among HFMA survey respondents, with 53 percent reporting that their hospitals were holding off or substantially cutting back on new construction spending. About 30 percent of respondents said their hospitals also plan to freeze or severally restrict IT and medical technology spending.

"Hospital financial leaders must, once again, marshal all of their assets to face current realities and use their considerable expertise to provide what is best for their communities."

Mission in jeopardy. Individual comments from survey respondents point to the most urgent finding: Hospital cutbacks could have negative effects on patient services. For instance, one respondent's hospital is holding off on an emergency department expansion, which could further jeopardize safety net access in a community that recently lost two hospitals. Another respondent said the inability to replace an aging hospital and medical equipment could jeopardize the facility's ability to recruit physicians, and that capital constraints "could easily shut us down."

Action Needed

There is no doubt that the current economy is placing strain—in some cases, extreme strain—on hospitals. However, paraphrasing Churchill, hospital executives will only double the danger if they turn their backs on it. "Few sectors of the economy have faced—and weathered—as much continuous financial tension as the hospital sector, which must regularly adjust to payment and regulatory changes," says Clarke. "Hospital financial leaders must, once again, marshal all of their assets to face current realities and use their considerable expertise to provide what is best for their communities."

The first step: Create a sense of shared urgency among hospital executives and board members that significant change needs to occur. "Financial leaders need to work closely with all of the leadership within their organizations and their communities. They need to provide information about the seriousness of this downturn, the potential impact on their operations and communities, and possible solutions," says Clarke. "One positive note is that the fundamental outlook for the healthcare sector still remains positive, in terms of long-term demand. While there are significant issues to grapple with in terms of payment, provision of healthcare services is a critical component of a vibrant economy and society."

Second, healthcare organizations must focus on value—high quality and low cost. They must commit to systematic approaches to rooting out inefficiencies, rework, and waste with the dual goal of reducing costs and improving the quality of patient care. This will require organizationwide redesign approaches that bring sustainable improvements. The providers that will ultimately thrive in tomorrow's economy will be those that provide the highest value to patients, payers, and employers.

Finally, organizations need to preserve cash to carry them through this critical time in the economy. Tough decisions will need to be made when prioritizing capital projects, and alternative sources of funding may need to be considered. Financial executives also need to reevaluate their asset allocation strategies to help ensure a reasonable return on investments.

There is a lot of work to be done, and the jeopardy to mission is a great concern. However, "health care is a resilient industry," says Broadway. "The market challenges of today could lead to efficiencies and investments that enable hospitals to provide more value to their communities in the future."
