BDO USA

ARTICLE

October 20, 2023

Healthcare Under Pressure: Financial Risk Factors and Steps for Mitigating Them

The healthcare industry is facing serious financial risk. While many organizations were already struggling under financial pressures before 2020, the COVID-19 pandemic exacerbated the issue. Now, healthcare organizations are facing mounting challenges from inflation, outdated vendor and payer contracts, and reimbursement rate reductions compounded by the sunset of COVID relief funding that has reduced access to direct help from the government.

Generally, several signs of financial risk span all industries, including healthcare, such as:

- **Tight liquidity**. Organizations may be experiencing insufficient cash on hand, inability to obtain new financing, and inability to pay debts when due.
- **Degradation of market share**. As the market becomes more saturated with new entrants and the cost of acquiring new customers continues to increase, many organizations are

seeing their market share decline.

- **Labor shortage**. A lack of available talent across industries and at various experience levels poses a threat to organizations' abilities to produce goods or deliverables or provide services.
- **High inflation and cost of goods**. Even as inflation begins to ease, the cost of goods remains high, causing consumers to rethink their spending habits.
- **Evolving consumer preferences**. Because of elevated inflation and high costs of goods, consumer discretionary spending is changing. Consumers are sensitive to price, foregoing non-essentials, purchasing less, or pivoting to generic brands to save money.

In addition to these industry-agnostic risks, healthcare faces unique financial risks and considerations. In this insight, we look at the specific challenges facing the entire healthcare industry, as well as select subsectors that are at a high risk of financial instability.

Healthcare's Financial Risk Landscape

For healthcare providers, regardless of subsector, threats to financial stability include:

- **Reduced access to capital**. Between rising levels of debt, tight liquidity, being fully drawn on credit facilities, and declining margins, healthcare organizations have less capital to work with.
- **Declining reimbursement rates**. Healthcare payers continue to reduce reimbursement rates for several services, including a proposed physician rate cut of more than 3% for 2024.
- **Loss of referrals**. Patients are increasingly attracted to flexible coverage options rather than relying on employer-sponsored healthcare coverage. Reasons may include lack of patient engagement, ineffective patient retention strategies, physician retirements, or lack of expertise on the part of individual physicians.
- **Rising supply and labor costs**. Supply costs continue to rise amid inflation, and so does the cost of labor in the healthcare industry — particularly contract labor.

In addition to these threats, individual healthcare subsectors face unique financial challenges. At

the same time, some financial risks impact specific subsectors more than others. Executives in these industry segments should understand which threats may pose risks to their organizations, and what adjustments to operations or capital structures may help their businesses improve or maintain financial stability.

In the next sections, we look at each specific healthcare subsector and examine the primary factors — which are already impacting these organizations — and the secondary factors — which may be starting to impact these organizations.

Physician Groups

Primary Factors

- **Decreased liquidity and access to capital**. Access to capital and high levels of debt are continuing to impact physician groups. This places an additional burden on physicians and practices that require capital to invest in key infrastructure, technology, and talent.
- **Inability to modernize technology**. Without access to capital, physician groups are struggling to modernize their facilities. This includes optimizing electronic health record (EHR) systems and other technologies that improve the patient experience or streamline administrative burdens, such as vendor payments and billing/collections.
- **Lack of medical school applicants/students**. There are

Secondary Factors

- **Physician retirement or exit from industry**. Clinicians are retiring or exiting the industry more quickly than they can be replaced. In physician groups, not having enough practitioners to see patients creates an impact on the overall revenue of the practice. At the same time, losing those physicians and ineffective patient retention practices may cause patients to seek care at another physician group.
- **Lack of succession plan**. Physician groups must have a succession plan for business continuity. It's important to create a strategy for another physician(s), hospital, practice, or investor to take the reins when the head of the practice exits or retires. Having a plan and sharing it with other clinicians and

currently not enough students or applicants to medical programs to meet the demand for family medicine, and this challenge is expected to become even more pronounced by 2030. Physician groups may be able to mitigate this issue by expanding the scope of responsibilities of Advanced Practice Registered Nurses (APRN), Physician Assistants (PA), pharmacists, and other staff members with advanced clinical training.

staff in advance can help ensure employees feel secure and understand the next steps.

- **Risks associated with refinancing**. Refinancing and/or restructuring debt may help stabilize the business and provide the organization with more financial flexibility. At the same time, physician groups need to be aware of the negotiated debt service payment obligations, financial covenants, and any other loan agreement triggers, such as defaults, which could lead to a loss of investor interest and confidence.
- **No Surprises Act**. The No Surprises Act (NSA) eliminates the leverage some providers had to dictate pricing for out-of-network billing, which could reduce contracted premiums in some specialties. Poor preparation and challenges around the appeal process have significantly restricted cash flow, which could put some organizations at risk of bankruptcy.

Hospitals

Primary Factors

- **Tight liquidity**. Reduced access to

Secondary Factors

- **Loss of key revenue**

capital and liquidity are driven by multiple factors including labor expenses, interest rates, inflation and high cost of goods, and the evolving economy. Many hospitals are struggling with days of cash on hand, high operating and salary expenses as percentages of net revenue, and low margins on some service lines. This can impact an organization's ability to make capital investments or upgrades and fund salaries for contracted labor. Hospitals experiencing financial stress are also correlated with worse patient experience.

- **Outdated technology**. With decreased access to capital, many hospital systems do not have the funds necessary to modernize technology throughout their facilities. Without a streamlined EHR system, hospitals may find it more challenging to optimize their patient engagement and revenue cycle performance, and may put them at risk for cybersecurity issues. Modern technology also can improve staffing and reduce administrative burdens.
- **Decline in medical school applicants/students**. Hospitals are not immune to the sector-wide labor shortage. Medical school **producers/referrals**. Physicians are retiring or exiting the industry at rates higher than they can be replaced. This creates ongoing threats to staffing, patient experience, and may potentially cause patient referral leakage, all of which can negatively impact revenue.
- **Absence of a succession plan**. While it may not seem necessary for organizations with groups of executive leaders, owners, or investors, hospitals should have a leadership succession plan, and many do not. It's important to determine how responsibilities will evolve to ensure that losing a leader — whether it's the owner, CEO, or department head — doesn't impact the culture and performance of the organization. Other consequences of insufficient succession planning include exacerbating existing challenges, impacts on reporting structures, and rushing to fill roles with an external hire who is not aligned with the organization's culture or strategic initiatives.
- **Decreased enrollment in primary care and research specialties**. The decline in the number of medical school students and applicants is

applicants for the 2022-2023 school year were down by nearly 12% compared to the year prior. Increased admissions selectivity, cost of medical school tuition, and lack of tuition reimbursement are major barriers to entry. These challenges also extend to non-physician staff. For example, the number of applicants to and students enrolled in nursing programs decreased in 2022, ending 20 years of enrollment growth. As a result, hospitals are paying higher rates for contract labor in these roles, without permanently filling essential staffing gaps.

- **Declining reimbursement rates**. Critical service reimbursements, particularly for emergency care services, are being declined or lowered by provider groups or payers, especially Medicare. The No Surprises Act is also challenging reimbursement for emergency care services, including radiology and anesthesia. As a result, the cost of services is being funded by specialties with higher reimbursement rates.
- **Site-of-care migration**. Many procedures that could only be performed as inpatient procedures exacerbated by shortages in certain critical specialties. Many matriculated students choose more lucrative specialties in the hopes of offsetting debt incurred by their degrees, bypassing primary care and the research specialties most in need of new practitioners.
- **Lack of students/applicants in nursing, medical assistant, and medical technician programs**. Low application numbers and enrollment rates in these programs contribute to fewer specialty certifications. Organizations that have these roles with specialty certifications often report better patient outcomes, increased clinical outcomes, and higher job satisfaction.
- **Growing adoption of remote patient monitoring technology**. Many post-acute patients who previously needed to be seen or monitored in the hospital can benefit from in-home monitoring. While this may positively impact hospital bed capacity and length of stay, it also requires clinicians who are dedicated to and familiar with remote monitoring to oversee patient care. Expanding the scope for APRNs, PAs, and pharmacists could reduce the burden on

are now available as outpatient procedures or at ambulatory service centers. While the site-of-care migration offers many benefits for patients, including the same or better quality, it represents a reduction in profitable services for hospitals.

- **Capacity issues**. Despite the declining volume of inpatient procedures, hospitals still do not have enough acute or post-acute beds available. Longer patient stays result in higher costs for the hospital, and inadequate bed capacity negatively affects revenue.

clinicians.

- **The rise of new-age longevity/lifestyle centers**. New-age assisted living facilities aim to improve the quality and length of life. Many of these organizations are planning to create on-site acute care medical facilities, potentially reducing patient volume and revenue for hospitals. Hospitals should seek opportunities to be the preferred provider organization within these facilities where possible.
- **More aggressive collection tactics**. With healthcare debt on the rise, lenders are more aggressive than ever before, including accelerating loan payments, and hospital systems' credit ratings are being downgraded.
- **Lack of affiliation with a broader network or hospital system**. Hospitals that are not part of a well-funded academic institution or an integrated delivery system may not have access to capital to reinvest in the upkeep of the physical property, or for maintenance and upgrades of necessary equipment.

Post-Acute Facilities

Primary Factors

- **Labor challenges**. Like physician groups and hospitals, post-acute facilities are also struggling with the labor shortage, especially when it comes to recruiting and retaining skilled nurses. The cost of contracted labor is also putting a strain on financial health.
- **Capacity issues**. Post-acute facilities face a shortage of beds due to challenges in moving patients to the next level of care. Whether a patient will receive in-home care with a visiting nurse or move to assisted living, delays in transitioning to the next stage of care often result in a longer stay and excess spending by the facility.
- **Access to capital impacting ability to modernize**. Because the high costs of labor and goods are creating financial strain on facilities, investments in technology are not always feasible. This may mean being left behind when it comes to streamlining operations, improving patient access, and enhancing the overall patient experience.

Secondary Factors

- **New competition**. Lifestyle/longevity centers present a serious threat to post-acute facilities and payer mix, especially as privately insured patients may look to these care centers as an alternative to post-acute care. Organizations that are able, should look to partner with these centers as the on-site medical providers.
- **Exclusion from referral networks**. As insurers/payers continue to limit reimbursements and as physician groups and hospitals try to keep as many patients in-network as possible, post-acute facilities may find they are increasingly losing referral opportunities.

Home Care

Primary Factors

- **Development of competencies**. Because in-home care is a new workforce area, many physicians, nurses, and medical technicians do not yet have the training for this type of care. This limits the opportunities for the expansion of in-home/home care until more practitioners have completed specialized training.
- **Social determinants of health**. Some populations that would benefit most from home care may have limited access to this service. They may struggle with greater challenges in the home environment — for example, lacking the right family support system to facilitate at-home care. At the same time, family caregiver reimbursement often fails to provide enough income to care for a loved one full-time, and many family caregivers cannot afford to give that care independently.

Secondary Factors

- **Lack of infrastructure**. Underserved populations that would benefit greatly from home care may not have the necessary technology to access this type of care. This includes access to high-speed internet, a Wi-Fi-enabled computer, tablet, smartphone, adequate beds and furniture, or other essential equipment. Infrastructure challenges go beyond the home as well and can include limited broadband access in rural areas, lack of access to new remote monitoring equipment, and lack of integrated EHR systems.

Retail & Urgent Care

Primary Factors

- **Lack of growth model**. The current infrastructure for retail and urgent

Secondary Factors

- **Absence of KPIs**. Urgent care and retail facilities cannot demonstrate

care facilities does not appropriately support a growth model. While private equity and venture capital investors are continuing to acquire, aggregate, and then sell these organizations, payers are not reimbursing these facilities adequately to support the care model that's being delivered.

- **Retail reimbursement losses**. Retail clinics expect a loss from reimbursement for services and therefore rely on patients making other purchases during visits. Whether this is picking up a prescription, a pack of gum, or another item such as toiletries, there is still an EBITDA expectation for the business. However, financial performance should be based on the clinical services provided, which cannot happen until reimbursement from insurers/payers is adjusted to cover the cost of services.
- **Urgent care performance**. Urgent care facilities are meant to divert patients from the ER for non-life-threatening acute care like treating a sore throat or stitching up a minor cut but are not performing as expected. While there is a low barrier to entry for new urgent care facilities, certain social factors — patient outcomes and quality of care. Patients at these facilities typically seek acute care, do not see a specific physician, often do not return for repeat care, and usually do not visit clinics for preventative care other than vaccines. This presents challenges to measuring outcomes and validating performance.
- **Siloed patient information**. Many urgent care facilities and some retail clinics operate in siloes, with no connection to larger provider organizations or physician groups. As a result, their EHR systems are not integrated with those of hospitals or physician groups. It's important to have a unified system so that entire patient histories can be shared between these clinics and the patient's primary care physician to avoid gaps in medical history.
- **Labor costs and shortages**. Urgent care and retail clinics face the same competitive talent market as physician groups and hospitals, making it difficult to adequately staff their facilities.
- **Off-site labs**. Because retail and urgent care facilities are small, the cost of managing laboratory services on-site isn't worthwhile. As

including income, perceived threat of racial bias, geography, and access to transportation — often impact where patients seek care.

a result, patients are often given lab orders to complete blood work or imaging at third-party facilities. When there isn't a "one-stop-shop" on-site, patients do not always complete their lab orders, which can lead to negative patient outcomes.

Mitigating Financial Risk

While different kinds of healthcare organizations face different challenges, the following tactics can help providers across the industry mitigate financial risk:

- **Seek partnership opportunities**. Healthcare organizations of all shapes and sizes can look for partners whose vision, values, and strategy align with theirs. Whether the partnership is with an investor, or another facility — such as a hospital system partnering with a physician group or becoming the on-site medical services provider for a lifestyle/longevity center — mutually beneficial arrangements can help stabilize financial health.
- **Rationalize certain service lines**. Organizations should carefully consider evaluating underperforming service lines. At the same time, provider organizations should preserve service lines that are most important to their communities, even if exiting may increase financial stability.
- **Outsource non-clinical services**. Outsourcing non-clinical roles, such as IT, revenue cycle optimization and management, call centers, and supply chain management may create an immediate improvement in financial health.

Leaders at healthcare organizations need to keep in mind that while financial stability and performance are key, maintaining the confidence of the clinical staff is just as important. If clinicians lose confidence in the organization's leadership, it could impact culture, job satisfaction, and the degree to which individual employees feel valued or supported in their roles leading to staff turnover.

Proactive Strategies & Next Steps

Whether your focus is on addressing financial challenges, maintaining stability, or growing, the following steps can help your organization achieve better financial health:

- **Perform a service line evaluation**. Exiting a service line can be time-consuming and difficult. Organizations of all sizes, types, and financial health levels should prioritize and perform regular service line evaluations.
- **Evaluate and renegotiate third-party and payer contracts**. With continued inflation and the high cost of goods, it's important to continually assess supplier and vendor contracts. Look for opportunities to save money with the same or similar products or service providers. Contracted reimbursement rates should also be reassessed every 2-3 years. Organizations should review their current contracts and work with payers to renegotiate reimbursement rates for services, and where possible, encourage positive patient outcomes and quality of care.
- **Focus on your people**. It's crucial to maintain a focus on supporting clinical and back-office staff to avoid labor shortages and retain key talent. Organizational leadership should be intimately aware of and involved in all aspects of operations; walk the halls during different shifts; and regularly survey staff members about their employee experience and ensure that staff members feel connected to the vision and values of the organization. Improvements based on employee feedback such as on-site childcare and behavioral health services should be part of the conversation.
- **Understand what your patients want and need**. Leadership should routinely solicit patient reviews to aid in identifying areas for improvement. Using the feedback, create a strategy to implement changes that will satisfy patient needs and prioritize investments in technology and modernization wherever possible. This includes services such as telehealth, access to patient portals, online check-in, and other emerging capabilities.
- **Prepare for the next big challenge**. Many healthcare providers are prepared for acute events such as mass shootings or multi-car accidents but are not prepared for long-term threats like the COVID-19 pandemic. The pandemic revealed serious gaps in preparedness for enduring, evolving health events across all sectors of the healthcare industry, and organizations should create plans and a deployment strategy now — before the next crisis arises.

Contact a BDO professional today for a check-up to see if your healthcare organization’s financial stability is at risk.

Have Questions? Contact Us