WittKieffer

Finding Financial Stability in an Unstable Healthcare Environment

Brian Krehbiel and Adam Burns

We've experienced a significant uptick recently in requests for interim finance leaders among our healthcare clients. What we have seen – and heard from speaking with numerous hospital and health system executives these past months – is that the present operating environment has become dizzyingly complex and challenging, creating a dire need for experienced finance executives who can address quickly what seemingly are intractable problems.

The Covid-19 pandemic stretched the operating model of hospitals and health systems. Nursing shortages and labor costs trends accelerated at fearsome rates during the pandemic, with little relief in sight in the current post-pandemic environment. Pile on the broader inflationary environment and slow-to-catch-up reimbursement models, and financial deterioration has been unavoidable even for the most expertly run organizations. The systemic decline of hospital finances over the last few years has created a situation where leadership teams, particularly experienced CFOs and finance leaders, face difficult choices and intense pressure to combat financial crisis while managing the typical urgencies of providing accessible, high-quality care at manageable costs.

The result: Despite intense efforts many finance teams have neither the capacity nor the capability to navigate what are clearly uncharted waters.

An Unprecedented Environment

Let's dig deeper into the current operating environment which, we'll be the first to admit, led to most hospitals' and health systems' financial woes. Many organizations spent the pandemic simply staying afloat, aided by government support (such as designated protection for Medicaid) that is no longer available. Skyrocketing labor and supply costs, combined with the macroeconomic headwinds of recession and inflation, made 2022 one of the worst on record. Half of all hospitals experienced negative margins last year, up significantly from 2021, as growth in expenses outpaced revenue gains. Median days of cash on hand for providers was just 202, according to S&P, a drop-off from 250 in 2021.

2023 could be worse. Expenses for drugs, supplies and labor are as high as ever. In addition to shrinking margins, Deloitte identifies inflation and affordability among the most conspicuous obstacles for healthcare in 2023. More than three-quarters of health system leaders in that company's recent survey believed inflation would have a significant impact to their bottom lines in 2023. This comes to an industry that was once thought mostly resistant to inflation—healthcare is essential, after all. As it turns out, today's healthcare "consumers" are much more cost conscious than in the past. As the cost of living increases, families are delaying or forgoing even routine and preventative care, not just high margin elective procedures.

The bleak picture might make some healthcare executives yearn for 2008, believes Kenneth Kaufman, managing director of KaufmanHall. The 2008 recession created woes for healthcare – from investment portfolio declines to liquidity constraints to defaults on debt covenants – but labor was relatively plentiful and expenses remained in check. What we are witnessing today is much worse than 15 years ago. According to Kaufman, "The simple truth is that the pandemic and accompanying inflation have upended the longstanding relationships between hospital revenues and expenses. As a result, the pandemic cost structure of the hospital industry is operationally unsustainable."

Recognizing this, both Fitch Credit Ratings and Moody's Investors Service recently assigned "deteriorating" and "negative" outlooks, respectively, to the not-for-profit hospital and healthcare sectors. Coupled with rising interest rates, these outlooks place an additional burden on the cost of funding already strained operations and further limit access to capital for investment in facilities and care innovation that contribute to growth and quality of care.

Experience Handling Uncertainty Is at a Premium

The current environment requires more than traditional cost reductions. Such actions, which typically rely predominantly on lowering staffing levels, create an unsustainable conflict between quality of care, provider wellbeing, and cost. Rather, cost structure transformation is required to deliver a sustainable approach to what likely is a more persistent challenge in labor and other costs, which reimbursement rates will be slow to address. Such transformation means rethinking fundamental operating and business models, while continuing to deliver on the urgencies of the present.

This is where interim finance executives enter the picture. As noted, we hear from many clients that they do not have the capacity and capability in-house to address the required transformation while delivering on immediate priorities.

Interim executives can be ideally suited for these challenging times. Often in the latter portions of their careers, these executives experienced prior market dislocations, wrestled with ambiguity, and navigated the inherent conflicts that some choices present. While not relishing a crisis or an economic slump, they can contribute to existing executive and financial leadership teams the confidence and ability to undertake cost transformation, yet not sacrifice delivering on the core mission of their organizations to provide quality care to their communities.

Interim leaders can help healthcare providers tackle the most pressing financial issues that 2023 will present. Increasingly, clients are asking us to provide interim finance executives to supplement the in-house team. The table on page 3 illustrates the varied strategic and operational actions that interim finance leaders often champion. Any of these initiatives can provide a rapid and high return on investment in an interim hire. Often it takes an outside set of eyes (sharpened from years as an executive) to see solutions to structural problems that may have persisted for years, or an extra set of hands to address chronic issues or strategic imperatives that the finance team simply lacks time to address.

At a time when contract labor spend is under intense scrutiny, some might hesitate to raise the question of adding an interim finance executive. However, we suggest that is not the question boards, CEOs or CFOs should be asking. The real question is, "What will happen to our care quality, communities, providers and broader team members if we do not take action to transform our operating model and cost structure?" In other words, "How do we invest in finding and implementing solutions that deliver both rapid and longer-term value?"

A vacancy in the CFO office raises the stakes on this question, because that vacancy puts both the future state and the current state of an organization at risk. When a CFO leaves, there must be a finance leader at the helm who can assess the current health of the organization and provide constructive suggestions for improving its financial outlook. An interim CFO can, for example, optimize cash conversion cycles, protect the balance sheet, expertly manage revenue cycle, orchestrate reductions in average length of stay for patients, provide stability during a merger or acquisition, and address multiple other challenges that, if left unattended, will significantly impede the ramp and success of a permanent CFO hire.

Furthermore, a CEO needs an experienced finance leader to support the board of directors and its finance committee in assessing the near- and long-term viability and risk profile of the enterprise. This includes situations in which the CEO previously may have been the CFO. Even in such cases, the chief executive still needs a steady, informed partner to speak granularly and plainly about the current state of affairs and future strategy.

Opportunities for Interim CFOs

DIRECT COST-CUTTING, EFFICIENCY AND REVENUE ENHANCEMENT MEASURES

- Execute a comprehensive annual audit and root out line-item excesses
- Institute measures to ensure charge capture to reduce the likelihood of insurance denials
- Spearhead negotiations with payors to ensure reimbursement rates keep pace with inflation, create more effective attribution methods, and agree on uniform quality and cost measures
- Identify areas for justifiable price increases and revenue gains

VALUE IMPROVEMENTS

- Conduct an in-depth assessment of the current finance team structure and assess the capability of leadership/staff
- Conduct a strategic assessment of existing operating assets (e.g, real estate, non-core assets, service line evaluation) to recommend sales or restructurings
- Assess the value proposition of employed and aligned medical groups (maximizing group size, strength, and the system's investment in each)
- Reassess the organization's debt portfolio and taking other measures to shore up bond ratings

STRATEGIC INITIATIVES

- Provide expert consultation into organizational imperatives toward value-based payment and increased risk profiles
- Collaborate with the CEO and CFO to grow, partner or start health plans to diversify and capture greater revenues
- Coordinate a major technology implementation that contributes to improved patient and provider experiences
- Strategize ways to finance digital initiatives to enter into new, desirable markets and increase access

Glimmers of Hope

A good interim finance executive will document their work streams and, therefore, value contribution. "I have an Excel spreadsheet that I start the first few weeks that I'm at an assignment," shares Jeff Mullis, a former industry finance leader and current interim executive. "It has 30 to 40 different line items across the gamut of all the different things in a hospital that I need to be doing as a CFO. With it I'm able to track my recommendations, progress and accomplishments. At the end of my engagement, I'm able to go through the spreadsheet with the CEO and board and show them my accomplishments and what still needs to get done. It shows my worth and my value-added. The proof is in the pudding."

There are pathways to better operating performance for healthcare organizations this year, McKinsey believes. "The U.S. healthcare industry faces demanding conditions in 2023, including recessionary pressure, continuing high inflation rates, labor shortages and endemic COVID-19," it states. "But players are not standing still. We expect accelerated improvement efforts to help the industry address these challenges in 2024 and beyond, leading to an eventual return to historical average profit margins."

From our perspective, one of the levers available to hospitals and health systems – to keep them moving forward rather than standing still – is interim finance executives. These leaders bring ideas and insight to leadership teams that can be the catalyst for lower costs, better margins and a more promising and sustainable financial outlook.

Brian Krehbiel is managing partner and practice leader of Witt/Kieffer's Interim Leadership Practice.

Adam Burns is a principal in the practice.