

Outside factors challenging healthcare providers today

Transcript

DERRICK MCGROW: Hello, I'm Derrick McGrow, an audit partner in Grant Thornton's Philadelphia office. And I'm talking with Brian Bonaviri, a managing director in our advisory practice out of the Charlotte office. We're here to talk about the healthcare industry and what sorts of external pressures are affecting hospitals and health systems now and how those pressures need to be figured into strategies to stay resilient in the near future.

There are a bevy of economic pressures all companies are facing right now, first being inflation. So Brian, while the pace of inflation has lessened, partly through the recent Fed interest rate hikes, January's inflation rate was still a high 6.4%. What are the most critical ways this has challenged healthcare providers?

BRIAN BONAVERI: Thanks, Derrick. The short answer is that it has challenged healthcare providers because of their inability to pass along cost increases to consumers. And, by that, I mean their patients or their residents. In most other industries — think about when you go to out to a restaurant, a retailer, a grocery store — as the costs of labor and materials rise, organizations can pass that cost on to the consumer when they feel it's necessary. In doing so, those companies are able to maintain a positive margin.

However, in the healthcare world, reimbursement, as you know, doesn't change quickly or dramatically. And if it does, it's going down. In other words, the cost side of the equation is increasing far quicker than revenue even when volume is maintained. Medicare, Medicaid, commercial rates aren't increasing at the same pace as costs are. And to be a little more specific, the cost of supplies, medical devices and even food has really risen dramatically without accommodating rises in revenue.

And of course, we could talk about labor all day. We've all heard about the increase in wages for nurses in particular, and an increase in a reliance on traveling or so-called agency nurses. This is having the most negative impact on healthcare provider margins. Because of the increased demand for nurses, there are even technology companies trying to disrupt this market. I've heard of apps out there, for instance, trying to be the “Uber” or “Lyft” for nurse hiring, where providers can use the app to seek out nurses in a pinch. I've heard some success stories, but I've also heard instances where [with] the lack of communication between affiliated

healthcare providers or networks, they're creating the equivalent of surge pricing in their own backyard.

So for instance, if you need a nurse and I need a nurse, we're both on the app demanding it, and it's just increasing the cost. So it's a tricky problem to solve.

Derrick, I want to pivot. It seems like everyone is always talking about inflation and interest rates. We just talked about inflation. What are your thoughts about increasing interest rates? Does that impact healthcare providers?

DERRICK MCGROW: It absolutely impacts healthcare providers in several ways. First, there may be a reduction in M&A activity. So M&A has been pretty constant throughout the space over the past 10-20 years as health systems merged together and form mega-systems.

So with the rising interest rates, it becomes less attractive for those systems to borrow money to acquire other systems or other providers. This isn't 100% tied to interest rates, though. For example, health systems need to focus on their own internal operations and financial conditions to make sure that their ship is right, before they go out and acquire other entities to bolt into their already existing structure. The increasing rates are impacting M&A because it's making it more expensive to borrow money. Furthermore, providers are going to struggle to refinance debt or raise capital.

So for any organization, healthcare or otherwise, that has variable rate or other debt that is maturing in the near future, their interest expense is increasing dramatically. Healthcare providers have to factor this into their budgeting process and future financial plans.

Let's pivot back to staffing for a moment because I was really intrigued by that comment that you made regarding staffing. The shortage of nurses in the workforce has been an ongoing challenge where little immediate help seems apparent. Are there any reasons for hope long term?

BRIAN BONAVERI: There is hope, but you're right that the solutions that I'm aware of are long-term in nature. For instance, in talking with higher education leaders, a lot of higher education institutions are investing in nursing programs. Higher education could be a whole other podcast, but they're really investing in nursing programs, and it's great for the long-term outlook of providing a supply of clinicians. However, to your point, this won't resolve the labor shortage overnight. Those programs have to get stood up, they need curriculum, they need students to enroll, students to matriculate, and then eventually you'll have a nurse or clinician down the line. It takes a long time. And in the meantime, healthcare providers need to find creative ways to reduce their reliance on agency staffing and reduce their labor expense to generate positive margins.

But we could talk about staffing shortages all day. Let's move on. And one of the dramatic hits to the industry recently that I'm reading about is the termination of pandemic, funding primarily related to the CARES Act funds that were released several years ago. Talk about the impact of that and how healthcare companies can respond.

DERRICK MCGROW: So the windfall of funding that appeared in all of the healthcare providers', or a majority of the healthcare providers' banks and bank accounts, early on in the pandemic, certainly helped in providing and some liquidity to those organizations. It was given to them to help keep the doors open and provide services during the pandemic. However, over the past two years, certain funds, like the Medicare Advance Payments have been repaid, and it ultimately resulted in all that extra liquidity declining. Now providers need to look at other programs available such as FEMA, there is also the Employee Retention Credit Program, there are other opportunities to obtain cash now that is outside of the scope of them just providing services.

There are other programs also available. The states have been provided funds through the American Rescue Plan Act, but those funds are being distributed by the states based on their own requirements. Some are focusing on healthcare while others are giving it to other industries within their state. Those are just some examples of other funding that's available. But it really comes down to the fact that there was this really strong liquidity early on, but that's dwindled and now, with the rising costs and kind of stagnant revenue that we already talked about, that's becoming very challenging for organizations to really generate cash.

So Brian, given all the challenges that we've discussed — cost outpacing revenue, labor and supply chain challenges, the termination of the stimulus funds — are there any signs of hope?

BRIAN BONAVERI: Well, as I tell my clients, Derrick, hope is not a strategy. However, in this instance, there are signs of hope, though I wouldn't rely on that alone. You're right that there are a lot of challenges facing this sector, but there is hope. First of all, there will always be demand for healthcare services. Providers just need to find a way to provide those services to the right patient in the right setting for the right cost. And obviously this is easy for me to say and much harder for healthcare organizations to execute upon. But there is hope because of that demand.

Beyond demand, there are other reasons for hope. For instance, several states, including mine, North Carolina, are considering Medicaid expansion. This would relieve pressure on some providers. However, it's not a silver bullet to solve what really plagues the industry.

Derrick, this has been a great discussion. Thank you so much for your time and for participating. We've seen how these outside factors have influenced our healthcare clients and we think we have some answers to help create a successful future.

DERRICK MCGROW: Thanks Brian.