HEALTHCARE MANAGEMENT ADVISORS

Should Your Hospital Remain Independent? 5 Key Considerations

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COVID-19 delivered a gut punch to the outlook for not-for-profit hospitals in 2020, moving from a "stable but delicately balanced" outlook this past January to a negative outlook in late March due to the rapidly evolving pandemic.

While independent hospital leaders have always needed to keep a careful eye on their organization's ability to remain independent—typically conducting a formal analysis every two to three years during periods when they are not experiencing financial duress—COVID-19 obliterated hospital budgets, significantly decreased operating margins and increased expenses.

"These added constraints are coming at a time when organizations were already under some revenue and expense pressure related to industry dynamics, and balance-sheet strength had been a stabilizing factor," S&P Global Ratings stated in a March 25 report.

While many rated organizations will be able to manage through this turmoil, S&P says, "We believe there are certain hospitals and health systems that may not be positioned to hold their ratings and outlooks primarily due to weak pre-COVID-19 credit characteristics." That's especially true given that the investment market quickly deteriorated and remains volatile amid the pandemic, which could pressure the credit quality of not-for-profit hospitals and health systems.

How can independent hospitals weigh their ability to remain independent during the pandemic and afterward? There are five questions leaders should consider.

Question No. 1: Is your hospital experiencing a financial event? Clearly, all hospitals are experiencing a financial event during the surge stage of the coronavirus pandemic, whether due to extremely low volumes for elective procedures, the costs of caring for COVID-19 patients, or, in areas that are still waiting for a surge to occur, weeks of severely low census. But an economic event also could include competitor encroachment, such as the opening of a new hospital in the market area, or regulatory changes that leaders fear their organization will be unable to adapt to on its own. All of these scenarios can prompt healthcare leaders to ask, “Do we need a partner?”

Question No. 2: How much does your organization have in cash reserves? In FY18, median days cash on hand among not-for-profit hospitals totaled 209.7 days, down from 213.7 days in FY17, according to Moody’s Investors Service. The more days cash on hand a hospital has, the better positioned the organization will be to weather a financial storm. For example, during COVID-19, days cash on hand and other indicators of balance sheet strength enable hospitals to navigate increases in operating costs combined with reduced revenue.

Question No. 3: Do you have sufficient capital to invest in your future? In 2019, demand for healthcare bonds was extraordinarily high, and health systems issued bonds at a feverish pace. Today, investment market volatility has challenged hospitals’ access to short-term and long-term borrowing, and healthcare organizations are experiencing significant constraints on cash and working capital, including liquidity challenges. The need to gain increased access to capital is a common reason that independent hospitals seek a partner, whether through a merger or an affiliation.

Question No. 4: Does your organization face difficulty attracting new talent? For example, has the hospital experienced challenges in recruiting new physicians at a time when older medical staff are retiring? Does your organization have the clinical expertise needed to support critical service lines? Are there new clinical programs needed within your community that might benefit from the support of a more experienced system? Each of these factors might point to the need for an affiliation or partnership to meet the healthcare needs of the community.

Question No. 5: Is your organization prepared to accept risk under value-based payment models? In many markets, the best opportunity for improving revenue from commercial payers is in value-based contracts. COVID-19 is unlikely to change this trend toward value-based contracts. While a risk contract may have seemed unattractive in a pandemic, it turns out that traditional fee-for-service contracts were the most damaging financially as service volumes declined. Success in value-based contracts requires investment and technology and expertise. Independent organizations may find they need the support of a larger system to succeed under these contracts.

EVALUATING YOUR OPTIONS

One way in which independent hospitals can assess their ability to remain independent is through a rapid independence assessment. This type of assessment, conducted in just a few weeks, enables leaders to evaluate their organization's capacity to remain independent, identify the benefits they hope to gain from partnership, and determine the type of partnership model that would best meet the organization's needs.

Veralon offers rapid independence assessments to independent hospitals that are interested in exploring their options. For more information, contact us.