



Hospitals -- A Complex New World

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For hospitals the challenge of health reform isn't figuring out how to comply with a complex new law. It's figuring out how to do business in a complex new world. Allelexian is working on operational improvements to drive hospital profitability. Hospital margins now average 2.5% and 34% of hospitals report negative margins. We wanted to share in this month's newsletter the unrelenting pressures hospitals are facing on profitability. In later newsletters we'll share our approach and improvements.

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Declining reimbursement and under-payment per patient

- In the last 10 years payment to cost ratio for Medicare reduced from 100% to 91% (i.e. hospitals are paid 91¢ on every dollar spent on a Medicare patient)
- For Medicaid, payment to cost ratio is lower at 89%
- Percentage of uncompensated care increased from 5.4% in '02 to 5.8% in '08

Access to capital is constrained

- 31% of hospitals reported (Aug 09) a reduced ability to secure tax-exempt bonds (most important source of external financing)
- 71% of hospitals reduced capital spending (e.g. facilities upgrades, clinical technology)
- Reduction in capital spend, specifically in IT, makes complying with 'Meaningful Use' and the potential for increased Medicare and Medicaid reimbursement difficult

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Loss of non-operating income and shrunken investment resources

- Stock market and charitable donation declines from '08 highs have turned reserve gains (used for capital projects) into losses and reduced investment income (used to support underfunded operations)
- Margins in '08 for community hospitals reduced to 2.5% from an average over the last 18 years of 4.5%

Unemployment and economic woes put pressure on operating margins

- Drop in the number of elective procedures and an increase in the number of unprofitable Medicaid and Medicare patients is driving margins down
- 45% of hospitals reported a moderate increase in uncompensated care and 24% a significant increase
- 34% of hospitals in H1 '09 had a negative margin

Allelexian delivers operational improvement and strategy focused on bottom line and value creation.

Cutbacks in expenses have helped stabilize financial performance

- 80% of hospitals have cut back on administrative tasks but...
- Days cash on hand and debt service coverage have declined

As former CEOs we assist health care companies with planning and execution.

Demographics and PPACA (health care reform)

- PPACA adds 30 million new patients to the health care system – 15 million likely will be Medicaid reimbursable and unprofitable to hospitals
- Aging population adds new patients and increases Medicare burden

We are experienced in performance improvement, strategy, M&A due diligence, interim management and technology planning and organizational change.

Competing short and long term pressures on physician compensation and hospital payroll

- 75% of hospitals show an increase in physicians seeking employment thereby reducing upward wage pressure, but...
- Physicians are seeking compensation for services previously given away e.g. on-call coverage

Increasing medical technology costs

- Diagnostic imaging, cardiovascular procedures and in-vitro diagnostics are the bulk of technology costs and are all increasing

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