COVID-19 IS STRESSING THE FINANCES OF EVEN THE STRONGEST US HEALTH SYSTEMS

By Sanjay B. Saxena, MD; Brett Spencer, MD; Natasha Taylor; and Colleen Desmond

AROUND THE GLOBE, HOSPITALS and health systems are making heroic efforts to meet the challenges of COVID-19. To serve their communities and cope with the unprecedented clinical strain, they are canceling elective procedures; repurposing existing space and adding new beds and ICU capacity, often in advance of demand; purchasing additional equipment and supplies to accommodate the surge in patients; and reorganizing their workforce to treat more patients and limit infection.

As we learn more each day and navigate through this crisis, it is evident that hospitals and health systems face serious financial consequences as well. In the US, the federal government's $100 billion stimulus package for the health care industry is intended to help offset the anticipated losses. But this relief will not be enough to avert financial stress. Many health systems were already struggling to maintain viability, operating with single-digit margins, a lack of significant reserves, limited debt capacity, and low occupancy. Indeed, as of 2018, 50% of US hospital capacity (in terms of beds) had a negative operating margin.

Against this backdrop, our analysis finds that 20% of health care capacity is at a near-term risk of insolvency. This number will rise as the COVID-19 crisis puts pressure on systems that are already weak financially and lack a cushion to absorb the economic stress not only on their operating performance but also on their investment income (which has historically covered operating shortfalls).

There are many unanswered questions about the duration of the crisis and the details of the stimulus package. But even amid the uncertainty, it is clear that the strain on hospital economics will accelerate trends—such as consolidation and the integration of independent physicians into specific health systems—that were already driving an industry restructuring before the COVID-19 pandemic.

A Perfect Storm with Profound Implications

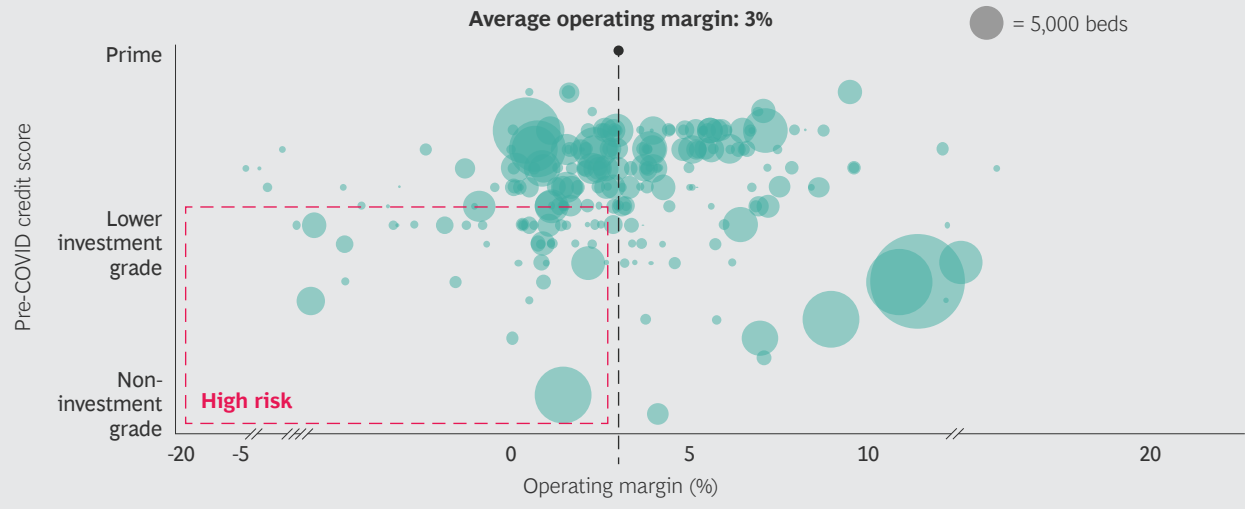
To open up capacity for the COVID-19 surge, providers have delayed or canceled high-margin elective procedures. But many are doing so without an immediate backfill of COVID-19 cases to offset lost volume from those procedures. They also face uncertainty over the extent of reimbursement for COVID-19 treatment, including treatment in nontraditional settings like hospital tents, nonhospital-based facilities, and telehealth. (Although the stimulus package requires reimbursement for services provided in nontraditional settings, the extent of offset has yet to be determined.) As the crisis unfolds, systems will see step-change growth in uninsured and Medicaid patients because rapidly increasing levels of unemployment will shift populations away from commercial coverage. And they must cope with these revenue challenges while incurring high incremental setup costs to address the COVID-19 surge.

The stimulus package will not provide enough relief to protect health systems with already precarious finances from the impact of COVID-19, nor will it be sufficient to offset losses by stronger systems that are better positioned to weather this storm. Our analysis finds that net revenue losses for hospitals will exceed the $100 billion stimulus amount within 16 weeks into the COVID-19 crisis. The expected capital expense for ventilators alone represents approximately 5% to 15% of the total relief package.

The consequences of the shortfall are dire. Looking at operating margin and access to investment income (using credit rating as a proxy), we find that the near-term solvency of up to one in five health systems is at risk. (See Exhibit 1.) As an indication of the scope of the solvency issue, Standard and Poor's has revised its investment outlook for the entire health system sector (both for-profits and nonprofits) from stable to negative.

No health system is immune. Even those that remain resilient in the near term face a dangerous threat. The medium- to long-term impact on key financial measures such as days cash on hand will limit health systems' ability to shore up defenses against a potential second wave of COVID-19 infections, a slower than expected return of elective procedures post-COVID, or other surge events. Health systems will also be challenged to secure the lines of credit required to continue much-needed investment in infrastructure

EXHIBIT 1 | Even Before COVID-19, 20% of Top US Health Systems Were at High Financial Risk



Sources: Moody's, Fitch, and S&P ratings, 2019; hospital financial statements, 2018; BCG analysis.
Note: Data for approximately 230 of the largest US health systems, with a total of approximately 450,000 beds.

modernization, digital capabilities, and innovation.

What We Know—and Don't Know

For an individual system, the potential nature and size of the impact will vary greatly depending on a set of known knowns and known unknowns.

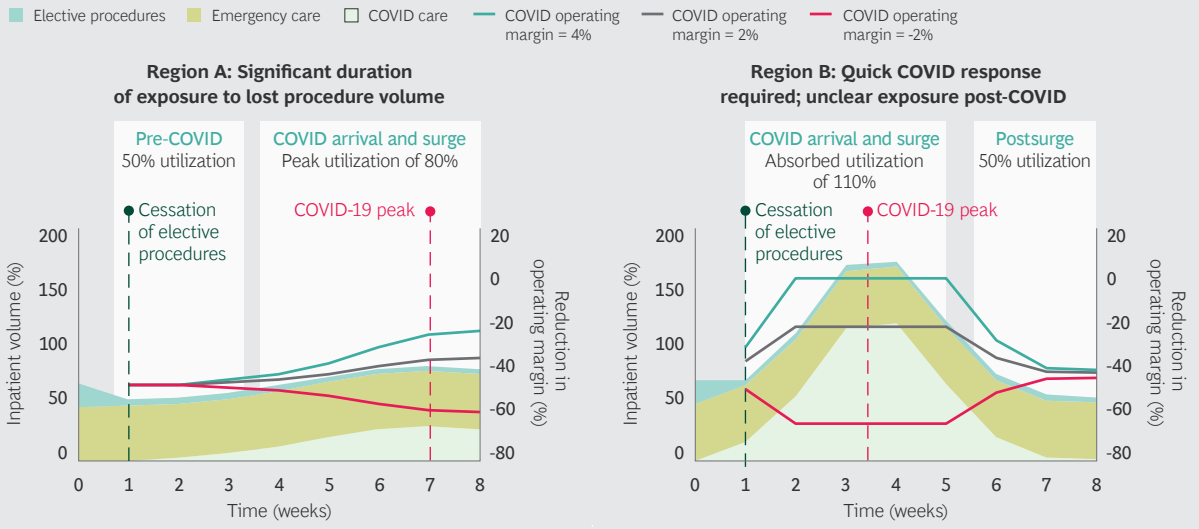
We know how a system's starting point with respect to the following three factors will affect its outcome:

- **Financial Strength.** As discussed, for provider systems operating with slim margins and without significant reserves or debt capacity, a sharp decrease in the volume of procedures is especially problematic in the short term. And the sharp downturn in the financial markets means that systems will have less investment income to cover the shortfall.
- **Cost Position.** Systems that have proactively invested in addressing their cost structure and can therefore cover their costs at Medicare reimbursement levels (or below) are less exposed. In contrast, less efficient systems that rely heavily on commercial reimbursement to subsidize their costs are more exposed, particularly as rising unemployment shifts more volume to uninsured and Medicaid patients.
- **Outpatient Exposure.** Systems with a larger proportion of outpatient volume (including those with a sizable physician enterprise) will more rapidly experience the immediate and long-term effects of delaying higher-margin procedures. In a significant departure from steady-state economics, this will disproportionately impact financially stronger health systems in which outpatient sources have traditionally accounted for a large share of revenues.

But we don't know the timing of the COVID-19 surge in specific locations or how long the crisis will last:

- **Timing and Magnitude of COVID-19 Backfill.** Hospitals and health systems that have made space available by canceling elective procedures several weeks before an anticipated COVID-19 surge have prolonged exposure to depressed margins. (See Exhibit 2.)

EXHIBIT 2 | Hospitals and Health Systems With a Later COVID-19 Peak Have Prolonged Exposure to Depressed Margins



Sources: American Health Association; Ambulatory Surgery Centers Association; BCG COVID Preparing Localities for Action Against Novel Coronavirus (PLAN) model.
Note: Margin impact includes inpatient and outpatient revenues.

- **Shape of the Recovery.** The shape of the downturn and recovery curve for standard procedures—whether L-, V-, or U-shaped—is unknown, as are the implications of that curve for an action plan going forward. Are health systems facing a hit that lasts one or two quarters? Or do they need to fundamentally rethink their operating model to prepare for a new normal?

The Emerging Imperatives

Despite the uncertainty, we are gaining some clarity regarding the actions that health systems can take over different time horizons to shore up their positions. Many systems have already focused on short-term actions. They are quickly pulling all levers of active cash flow management. To manage cash flowing out, they are stopping all nonessential spending (such as on marketing and special projects), extending the timeframe for accounts payable, and freezing positions and salaries. To manage cash flowing in, they are extending lines of credit, closely monitoring the health of the revenue cycle, and repurposing assets. On a cautionary note, however, health systems should be careful to consider the potential unanticipated consequences of such measures as across-the-board reductions in administrative and clinical support staff. Too often, these actions reduce clinical productivity, create operational challenges, and exacerbate reimbursement challenges.

At the same time, hospitals and health systems should take medium- to long-term actions to find advantage in adversity and emerge stronger from the crisis. To prepare for advantage and build resilience, organizations should:

- Accelerate and expand telehealth and virtual medicine capabilities.
- Prepare for the immediate ramp-up of elective procedures and a potential surge of patient demand by readying consumer-friendly solutions (for example, marketing campaigns to win back consumer trust, online scheduling, and expanded hours) and the required operational elements (for example, designating select locations for specific service lines and adding more clinicians to meet demand).
- Accelerate efforts to expand and diversify their portfolio, including strategically adding physician groups and ambulatory assets interested in aligning with a well-capitalized health system partner.

Envisioning the Postcrisis Landscape

Looking beyond the current emergency, we believe that the COVID-19 crisis will promote a fundamental restructuring of the health care landscape. In many respects, the crisis is likely to accelerate existing trends that had not yet achieved a step-change in momentum.

- Small independent systems face an ongoing and more acute threat, especially those in rural areas. These systems are not positioned to shore up their financial strength and benefit from the backing of a well-capitalized asset portfolio.
- Independent physician practices and small, independent ambulatory surgery centers may become less viable as they find themselves marginalized and highly exposed to a decrease in the volume of elective procedures.
- Virtual health and telehealth, which have struggled to find their footing for years, may finally become more commonplace. Because these services are now playing a frontline role in managing the crisis, providers and patients will likely become more comfortable with them going forward.

In the wake of the crisis, individual hospitals and health systems will have opportunities to take actions that improve the strength of the overall health care ecosystem. The strongest systems are the ones that are best positioned—because of more mature assets and greater financial stabili-

ty—to deploy sophisticated capabilities and dynamically respond to resource requirements. While the specifics of the end state are still unpredictable, it is possible to envision a stronger, more resilient system. In this system, health care delivery coalesces around the strongest players and most efficient types of care delivery, resulting in a more sustainable and efficient approach to steady-state operations as well as to future crises.

About the Authors

Sanjay B. Saxena, MD, is a managing director and senior partner in the San Francisco-Bay Area office of Boston Consulting Group. He is the global leader of the firm's health care payers, providers, and services sector. You may contact him by email at saxena.sanjay@bcg.com.

Brett Spencer, MD, is a managing director and partner in BCG's Denver office and a core member of the Strategy and Health Care practices, focusing on health care delivery systems and their evolving interactions with the rest of the health care industry. You may contact him by email at spencer.brett@bcg.com.

Natasha Taylor is a managing director and partner in the firm's Denver office and a leader of the health care payers, providers, and services sector. You may contact her by email at taylor.natasha@bcg.com.

Colleen Desmond is a partner in BCG's Chicago office and a member of the health care payers, providers, and services sector. You may contact her by email at desmond.colleen@bcg.com.

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