A LOOK INSIDE

Is Healthcare Headed for Best of Times or Worst of Times?

Synthesis of 2022 Citi/AHA/HFMA Not-for-Profit Healthcare Investor Conference

Full Report Inside

By Edward Chadwick, President of Integrated Healthcare Financial Strategies LLC
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Citi, The American Hospital Association (AHA) and the Healthcare Financial Management Association (HFMA) recently hosted the 22nd annual Not-for-Profit Healthcare Investor Conference. The event was in person, after being virtual in 2021 and canceled in 2020 due to the pandemic. Leaders from over 25 diverse health systems, as well as private equity and fund managers, presented in panel discussions and traditional formats. The following summary attempts to synthesize key themes and particularly interesting work by leading health systems. The conference title was “Refining the Now, Reshaping What’s Next.”

Clearly the pandemic showed how essential and adaptive the US healthcare industry is, and especially how incredible healthcare workers continue to be. It also exposed and accelerated many underlying dynamics, such as impact of disparities, clinical labor shortages and supply chain challenges. On balance, at this year’s conference presenters remained quite optimistic about the future, and felt that despite enormous pain, the pandemic has helped to accelerate positive transformation across healthcare.

At the same time, almost all presenters referenced future headwinds from labor and supply inflation, concerns about increasing payment pressures, and the continued need to address disparities and social justice. That being said, there was not much disclosure at the conference about just how bad things could get in the future given accelerated operational and financial risks.

As usual at such a conference, there was much passion, creativity, sharing and celebration. While each organization and market differ somewhat, the following are common themes discussed.

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SUMMARY

Key Themes

Enormous Workforce Challenges – Every speaker referenced workforce as being THE key issue they are facing, specifically retirement, recruitment, retention, well-being and cost. We have talked for years about a future caregiver shortage, but this reality was accelerated by the pandemic. The majority of health systems saw single-digit turnover rates grow to 20-30%, and the cost of temporary labor such as traveling nurses decimate operating margins. The many strategies discussed at the conference went beyond simply paying more to attract and retain staff. A key question is whether organization-specific strategies will be enough, or whether we need a broader societal and industry-wide collaborative effort to dramatically increase training slots for nurses and other allied health professionals.

Pandemic Stressed Organizations and Accelerated Transformation – At the 2021 virtual Citi/AHA/HFMA conference, many posited that the country was past the worst of the pandemic. (In fact this author's summary of last year's conference was titled "Sunrise After the Storm"). That was before the Omicron wave hit hard in Q1 2022. First-quarter 2022 operating margins were negative for most but not all healthcare systems due to cumulative impact of Omicron, temporary labor and supply costs, especially since the governmental support that partially offset those costs in 2020 ended. Organizations and their teams remain resilient, but highly stressed. Risks and challenges associated with future waves continue, as well as high reliance on foreign drug and supply manufacturing. While highly distracting and painful, many organizations discussed how the pandemic actually accelerated the pace of transformation. Necessity drives required action, and at least temporarily overcomes political and cultural barriers to change.

Growing Pursuit of Scale, Including through M&A and Partnerships – All health systems continue to be highly complex with multiple competing "big-dot" priorities. Multiple systems described their current M&A and growth strategies, pursuit of scale, as well as how these strategies were impacted by the pandemic. While the provider community remains highly unconsolidated on a national basis, mergers are more frequent, including between non-contiguous markets. Systems said that larger size, coupled with disciplined management, can reduce cost structure and improve quality and patient experience. While some pursue scale through organic growth initiatives or M&A, others described success in creating scale by leveraging partnerships with "best-in-class" niche organizations and other outside expertise.

US healthcare costs as a percentage of GDP increased from 18% in 2019 to almost 20% in 2020

Health Equity, Diversity and ESG as Core to Mission – Consistent with last year, most speakers discussed their efforts to address health equity, social justice, diversity, and Social Determinants of Health. Many health systems have developed robust strategies quickly as the pandemic spotlighted the impact of existing disparities. There is increasing interest in Environment, Social and Governance (ESG) initiatives, including environmental stewardship to improve the health of their communities and the world by reducing their carbon footprint and medical waste.

Patient-Centric Care Transformation Continues as a Priority – The pandemic significantly accelerated the shift to telehealth and virtual care. Many health systems are increasing their efforts to design care around the patient instead of the traditional provider centric focus. While the need for inpatient care will always continue, more care is taking place in settings closer to or at home, with digital enablement. Expansion of personalized medicine, genetic testing and therapies, and drug discovery are transforming how healthcare is provided.

Affordability and Value-Based Care – US healthcare costs as a percentage of GDP increased from 18% in 2019 to almost 20% in 2020, mainly driven by the pandemic. There remains a dichotomy between reliance on fee-for-service payment and commitment to value-based care. Although only 11% of commercial payment is currently through two-sided risk arrangements, almost all presenting health systems discussed their strategies to continue moving to value-based care and to improve affordability. Some systems are leveraging their integrated health plans and/or expanding risk-based contracts. Many are trying to reduce unnecessary care through adoption of evidence-based models and to shift care to less costly settings.

Inflation and Accelerating Financial Pressures – Health systems are facing unprecedented increases in labor and supply costs, that are likely to continue into the foreseeable future. At the same time, commercial payment rate adjustments are "sticky low" as insurers and employers push back on rate increases. Governmental payment rate increases are less than cost inflation. In addition to current cuts like the re-implementation of sequestration, longer-term cuts to provider assessment programs, provider-based billing, disproportionate share and Medicaid expansion may severely impact many organizations over time. Benefits like 340b discounts are also experiencing pressure. Post-pandemic clinical-volume trends remain unclear, and additional governmental support associated with future pandemic waves is unlikely. Adding to these challenges, declines in stock and bond prices are negatively impacting currently strong balance sheets.

Conclusion: Best or Worst of Times in Healthcare?

Time will tell, in retrospect, if the next five years will be the best of times, worst of times, or both in healthcare. Optimists point to the resiliency of healthcare organizations; enormous opportunity to reduce unnecessary cost through adoption of evidence-based care and scale; pipeline of new cures and technology; and opportunities to address social and health equity. Pessimists point to likely unprecedented financial pressures and operational challenges due to endemic labor and supply shortages; high-cost inflation vs. constrained payment rates; and future uncertainty about the pandemic, the economy and investment markets.

The situation will undoubtedly vary by market and organization as reflected in conference presentations, but all systems will likely face substantial pressure. As one speaker noted "humans have a great ability to respond to pain," so this may be the inflection point where more healthcare systems radically accelerate necessary change to improve health, make healthcare more equitable and affordable, with higher quality and better outcomes. Some health systems are clearly doing that, with pace, nimbleness and passion. Can the industry as a whole accomplish it successfully?

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ABOUT THE AUTHOR

Edward Chadwick, Founder of Integrated Healthcare Financial Strategies, LLC. wrote this report. He has historically drafted a summary of both the annual JPM and Citi/AHA/HFMA Healthcare Investor Conferences, and routinely presented at both. Mr. Chadwick has been system CFO of a national Catholic System (Trinity Health), a top-20 academic health system (Wake Forest), and a fully integrated plan/provider (Henry Ford Health System), and has served as a senior consultant and thought leader. He holds an MBA from the University of Chicago Booth School of Business. If you have any questions or comments about this write-up, please contact him at edward.chadwick@ihfstrategies.com or linkedin.com/in/edward-chadwick.

Read Edward Chadwick's summary of key themes from the 2021 JPMorgan conference and his full report of that conference here.

DETAILED DISCUSSION

The following provides a more robust discussion of key themes and innovative approaches discussed at the conference.

Workforce Challenges and Opportunities

It is widely acknowledged that front-line healthcare workers were the great heroes during the pandemic. Many are suffering PTSD and other challenges from their commitments and sacrifice. When we discuss "workforce" it is both relative to labor resources required to provide care to patients, but also to the people who individually and collectively devote their passion, and often their own well-being, to help others.

Pandemic-Accelerated Workforce Crisis — For years there has been discussion of current and future anticipated shortages of physicians, nurses and other allied health professionals. The pandemic accelerated these challenges dramatically, including with nonclinical support staff. This had enormous negative impacts on caregivers, patients and families, as well as health systems. Every presenting organization highlighted workforce issues, and the importance of their teams. At a conference Workforce panel presentation, the AHA reviewed their Taskforce initiative and sharing of best practices.

During the pandemic health systems took various approaches to staffing depending on their resources, philosophy and local market issues. Some systems furloughed or otherwise downsized staff when elective volumes plummeted early in the pandemic. This was often necessary to maintain financial viability of the organization, particularly before CAREs Act funding was available. Others decided to maintain full employment. Many have offered pay increases and bonuses, both out of necessity and in recognition. As the pandemic progressed, turnover and vacancy rates quickly increased from single digits to 20-30% for many organizations.

Widespread Nursing Shortages — In order to continue to be able to treat COVID and non-COVID patients, many health systems were forced to engage "traveling" nurses. This was often at a cost five times higher than normal staffing. In addition to the enormous economic burden, this created quality of care issues, and significant discontent for directly employed nurses. To help mitigate this, health systems created or expanded their own floating pool structures, and have aggressively tried to reduce the use of travelers. It is unclear what will happen in this space in the long term.

Clinician Pipeline — At the conference there was much discussion of improving the "pipeline" of future clinicians, including nurses, physicians and allied health professionals. Leaders noted that there are almost 100,000 qualified applicants per year who apply to nursing school but cannot get into a program due to shortage of accredited teaching slots. 100,000 people who want a good paying, rewarding role, but who cannot help fill a critical need. This is due to a shortage of PhD prepared nurse educators, preceptors, clinical rotation opportunities and ultimately accredited nursing school slots.

In part due to the pandemic, more health systems are proactively working on expanding training opportunities. Some, like Rush System for Health that have their own healthcare-oriented universities, are scaling overall enrollment. Multiple presenting systems are providing grants and clinical support for expanded nursing class size in local or affiliated universities. A key question is whether individual efforts by health systems to improve pipeline is adequate, or whether more coordinated societal or industry-wide efforts will be required, including both training and addressing immigration constraints for non-US caregivers.

Another aspect of education discussed was relative to front-line clinical leaders. Some feel that the empathy and leadership skills of front-line leaders is the most critical leverage point in retaining nursing staff, and have increased training accordingly. Multiple presenters described the need to recognize clinical rotations as an opportunity to "treat potential team members like gold." Increased flexibility for nurses and others was also emphasized, recognizing that traditional staffing schedules may need to be replaced with "five-fives" or whatever other schedules may be desired by subsets of the workforce.

Care and Work Redesign — Many presenters discussed how they are better leveraging limited nursing staff by ensuring RNs "work at top of license" and delegating tasks to other team members. Efforts to allow more patients to be treated by a care team continue to be facilitated by reducing length-of-stay and improving throughput, as well as shifting care to nontraditional settings, adopting evidence-based best practices, and addressing overall population health. These efforts create a "two-for" in both reducing costs and leveraging limited clinical staff.

Increasing Productivity through Technology — Annual productivity gains in healthcare have significantly lagged most other industries and exacerbated staffing challenges. Expanded use of technology will be essential to increase productivity and allow limited clinician staff to treat an aging population. Improvements will come directly from reducing staff time spent on documentation and leveraging BOTs (software applications that can replace human tasks), robotics, and indirectly through using Artificial Intelligence (AI) applied to large data sets and individual patients to better understand unnecessary variation and design care accordingly.

Focus on Employees — Continuing a trend seen in recent years, more health systems talked about the importance of the "whole person" relative to their associates. Well-being of caregivers is essential if they are going to be able to care effectively for patients. This is why commitment to the traditional Triple Aim has evolved into focus on the Quadruple Aim, adding workforce well-being as a fourth aim. Some have called for a fifth aim of health equity. Multiple presenters referenced the recent US Surgeon General report on caregiver burnout. Compensation and benefits are important, but many health systems believe it is critical to ensure their associates are connected with purpose. For many associates, this includes organizational commitment to diversity, social justice, decarbonization, etc.

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Pandemic Impact on Healthcare Systems

US healthcare providers solidified their importance and role as the trusted organizations in their communities as they stepped up to respond to the pandemic. Many presenters at the conference celebrated their caregiver heroes, including support staff.

Financial Impacts — CAREs Act funding and other support was absolutely essential for maintaining financial viability of most healthcare systems early in the pandemic. Those with health plans saw advantages of diversification as sharp declines in non-COVID clinical demand lowered medical loss ratios at their health plans, creating financial gains that offset declines in hospital profitability. While CAREs Act funding and other support provided a critical lifeline for many health systems, this support only partially offset the economic hit. There remains widespread concern that future pandemic-related financial challenges will be solely born by healthcare systems in the absence of future governmental support.

Longer-term financial impacts of the pandemic on health systems are unclear, specifically related to inflation, potential recession, and ultimately federal budget and governmental payment cuts. Enormous deficit spending and ballooning of the Federal Reserve's balance sheet prevented deep recession, but combined with supply chain problems also triggered the highest inflation in 40 years. This will clearly continue to impact healthcare operations and financial performance, and rising interest rate and declining bond/stock prices will challenge health system balance sheets.

Impact on Care Models and Volumes — Telemedicine and home/remote care grew enormously during the pandemic. There has been some moderation, but clearly virtual care is here to stay and will grow with time, technology, and hopefully regulatory/payer support. There was clearly substantial deferred healthcare during the pandemic, which challenged the well-being of communities. Future patient volume trends are uncertain, although ambulatory care will certainly continue to grow. Demographics, deferred care during the pandemic, and long COVID or COVID-related disease burden should drive growth in patient volumes. Conversely, inpatient care will decline due to accelerating shift of care to lower-cost settings, as well as decreased service demand that would have been required by the one million that died of COVID, many of whom were aged and/or had chronic disease.

Disruption and Acceleration of Transformation — Multiple presenters discussed how the pandemic actually accelerated their strategic efforts. While some merger discussions and initiatives were derailed by the need to focus pandemic response, some systems found that necessity and crisis allowed initiatives to move more quickly. The elimination or mitigation of political and cultural barriers helped push progress, and need forced action that otherwise may have been deferred. Some presenters noted that the pandemic forced a shift into becoming stronger "learning organizations." Other systems, such as Ohio Health and Palomar Health, described how they were able to effectively manage through the pandemic by being nimble and quickly course correcting. Northwell Health called for health systems organizations to "Dream Big" as they continue to define their key role in the community and proactively prepare for major exogenous risks at the same time they address multiple big challenges and opportunities.

Pursuit of Scale and Accelerating Merger and Acquisition Activity

Value of Scale — The US provider community remains highly unconcentrated on a national basis vs. the insurance industry and most any other industries. While care is local and individual community needs vary, much about healthcare delivery and population health can benefit from scale. Larger healthcare organizations have demonstrated that they can get better access to and lower costs for supplies, even against the backdrop of Group Purchasing Organizations. The cost and functionality of technology and back-office services such as revenue cycle can be spread further for large organizations, provided that unnecessary variation is avoided. Larger organizations have demonstrated that they can accelerate the adoption of best practices, including care redesign. Credit rating agencies have long said that larger and geographically-diversified organizations have lower risk profiles, which reduces debt cost and enhances long-term financial viability. And during the pandemic larger organizations were often better prepared to more effectively flex resources across geographies or secure limited resources like PPE.

Barriers to Scale — There have traditionally been many barriers to consolidation by healthcare providers. This includes regulatory constraints, boards perceiving their organizations as "local assets," CEO career aspirations, risk aversion, perceptions that "we can do it better ourselves," and insufficient pain to drive need for action. Many of these barriers will likely continue to exist, but increasing financial pressure may help accelerate consolidations, both in regional and noncontiguous markets.

Noncontiguous Market Mergers — At the Citi/AHA/HFMA conference the CEOs of Advocate Aurora and Atrium discussed the newly-announced merger of their strong, noncontiguous health systems through a JOA structure. Noncontiguous market mergers are a relatively new approach in the non-Catholic tax-exempt healthcare space as many preceding mergers had some element of regional market consolidation. Advocate Aurora and Atrium have very similar values and strategic priorities. While the merger will not create any local market synergy opportunities or increase in market relevance, the merger creates the potential for significant back-office savings and may accelerate system-wide adoption of best practices, technology etc. The new organization will have dual CEOs for 18 months but will appoint a unified leadership team quickly.

It will be interesting to see if this merger becomes a catalyst for others to replicate the JOA and/or noncontiguous market model, and whether this particular platform can grow quickly with other health systems joining them. The new Advocate Health anticipates FTC approval since the legacy organizations are in noncompeting geographies, although there remains heightened industry sensitivity to FTC "Second Requests" and decision making due to the recent appointment of a 5th FTC Commissioner.

Leveraging Best Practices across More Markets — Intermountain, which has long been viewed as a successful "Model Health System," discussed its recent mergers/acquisitions, particularly SCL. Leaders hope to also grow in noncontiguous markets through mergers, and referenced successful East Coast partnerships during COVID for mutual support. Intermountain has been effective in driving high quality, improved health and 30% lower costs in Utah through leveraging evidence-based medicine, and believe they can demonstrate that in other states. Other high-performing, nationally-recognized organizations are similarly hoping to grow well beyond their existing geographic footprint.

Growing Integrated Plan/Providers — BHSH, the recent merger of Spectrum Health and Beaumont Health, discussed potential leverage for value-based-care on a statewide basis. Spectrum Health was historically the dominant plan and provider for the western side of Michigan, while Beaumont Health was the largest provider on the eastern side of the State. Together they are by far the largest provider system in Michigan, and have the third-largest, provider-sponsored health plan in the country. BHSH is committed to leveraging their integrated plan and provider assets to drive value-based care across Michigan.

Virtual Strategies to Achieve Scale — In addition to large-scale mergers, many organizations are pursuing scale through virtual (non-asset-based merger) strategies. Multiple heath systems described how they have curated a portfolio of partnerships with high-performing niche firms that can bring virtual scale and accelerate access to expertise. For example, Rush System for Health discussed how they are using an "asset-light" partnering strategy to drive scale and value on a regional basis. While they are leveraging their unique assets like Rush University, they have also partnered with Select Medical to create a large rehab and long-term care network, and have driven growth through other similar partnerships.

In another conference presentation a panel of private-equity fund leaders discussed the advantage of health systems using niche partners to bring expertise, focus, technology and capital leverage to grow much more rapidly or to address critical priorities. For highly-complex organizations with many competing

priorities, this approach can allow increased focus and attention to more levers and initiatives. Partnering can take the form of contracts or joint ventures with niche firms, and some health systems are taking ownership interests in the entities. Leveraging expertise from consulting firms is also growing as another approach to accessing scale, as well as further expansion of the scope of group purchasing organizations.

Health-System-Sponsored Niche Entities — Some task-specific scale organizations sponsored by health systems continue to gain traction, such as Civica Rx, which is focused on increasing availability and reduce cost for generic drugs and biosimilars. More organizations are moving into this space. Many health systems are taking equity interests in or incubating service, technology or other support enterprises to provide services beyond their own organization. An example was a presentation at the conference by Navitus, a majority owned subsidiary of SSM Health, which has an 8.5-million-member PBM that achieves lowest net costs while providing complete transparency and pass-through of all fees and rebates.

Pandemic Impact on M&A — While the pandemic disrupted some M&A activity, a number of presenting systems described how their merger and integration efforts were actually accelerated by it. For example, Beth Israel Lahey Health, which was formed 12 months before the pandemic, was able to achieve 78% of their five-year targeted merger synergies to-date, well ahead of plan. That is because the urgency of the pandemic at least temporarily broke down traditional political and cultural barriers to change. Others noted that they took advantage of a crisis to make hard decisions.

Organic Growth — For many health systems inpatient volume growth has flattened, with continued growth in ambulatory activity. Some systems have continued to grow through organic initiatives or M&A or strong market demographics. For example, Ohio Health described strong population growth in the Columbus Ohio area, with metrics more like sunbelt cities than Midwest trends.

Health Equity, Diversity and ESG

As noted by many speakers at the conference, the pandemic highlighted great disparities in health, the critical impact of social determinants of health, and bifurcated access to healthcare. Disparate COVID mortality and vaccination rates layered onto many historical health metric disparities.

High Focus on DEIJ — For a number of years, health-system investor conference presentations have expanded their discussion of diversity, equity, inclusion and social justice. The killing of George Floyd and others and Black Lives Matter protests accelerated the need to address equity, diversity and ESG. The Allina Health presentation at this year's Citi/AHA/HFMA conference occurred exactly two years after George Floyd's killing. Allina's flagship hospital is blocks away from where he was killed. Allina's CEO discussed their $1.5 billion reinvestment in that facility, their $30 million social investment in that community, as well as their efforts to focus on both healthcare value and Allina's employees.

Moving from Community Benefit Reporting to Proactive Initiatives — For many years health systems have filed 990 reporting on their community-benefit expenditures, and developed Community Health Needs Assessments and action plans in partnership with others in their communities. At many organizations the required reporting and action plans have evolved into deeper focus on health equity, addressing social determinants of health, and concrete efforts to address diversity. Initiatives include recruitment, minority-supplier targets, expanded/embedded behavior health services, addressing food deserts, gun safety, affordable housing, education and transportation. Health equity has become a central element of mission statements. As an example, Norton Healthcare described its commitment to reducing disparities inside and outside of their organization, and their decision to build a new hospital in an underserved community.

Increased Attention to Environmental Justice — An expanded commitment to environmental equity, decarbonization and reduction of waste is another related trend. Healthcare accounts for 8% of greenhouse gases, is the largest part of the economy, and healthcare systems value improving health. The reality is that the economically disadvantaged are disproportionately hurt by global warming. One conference panel discussion focused on decarbonization in healthcare. Kaiser Permanente has gone carbon neutral, and others have achieved or are committing to such a transition.

While these efforts require strong CEO and CFO support, organizations have demonstrated that in additional to addressing a moral/social imperative, many decarbonization initiatives by health systems can have a positive financial ROI. Initiatives can vary from reducing energy consumption by replacing all lighting with high-efficiency LED lighting, to ensuring green focus on new construction, to sophisticated Power Purchase Agreements (PPAs) to shift source of energy consumed by the health system. A material portion of our health system associates feel the commitment to decarbonization is very important. In a time of staffing shortages, organizational commitment to environmental justice can have a positive impact on employee engagement.

Expanded ESG Focus — At this year's conference there was more discussion of ESG (Environment, Social and Governance) than in previous years. While Europe has a much higher focus on ESG than in the US, expanded SEC disclosure and heightened interest by investor-owned firms are increasing interest in tax-exempt healthcare. Multiple health systems described their expanded ESG focus. It is now more common for health systems to consider ESG in the investment of their financial assets, including through social impact funds. While generally not with the robustness of SEC firms, more health systems are including ESG disclosures in their external financial reporting.

Patient-Centric Care Transformation

Growing Emphasis on Patient-Centricity — Progressive healthcare systems continue to aggressively redesign themselves to become more patient centric instead of provider centric. This is reflected in heavy investments in ambulatory and home-based services, telehealth and other digital and technology enablers. Integrated behavioral medicine is now a common strategy. The pandemic lockdowns opened the telemedicine floodgates, and many patients and clinicians now prefer remote care over traditional in-person care. Several presenters discussed the digital transformation of chronic-disease management. The promise of virtual care has undoubtedly pushed some health systems to want to grow into noncontiguous markets and bring renowned specialty and best-in-class care to markets that previously had geographic barriers to entry.

Continued Focus on Quality, Safety and Creating an Exceptional Patient Experience — Almost all presenters emphasized this as a core strategy and focus area. Some presenters, such as El Camino Health, attributed this intense focus as the driving factor in their organic growth and significant financial improvement.

External Disruptors to Traditional Care — In addition to transforming the structure of how and where care takes place, healthcare systems see the impending impact of both external disrupters and new diagnostic and treatment methods. Disrupters include many large and small tech firms, private equity and venture funds, as well as health systems themselves. While it was a moon-shot type effort that leveraged existing technologies, it took less than a year to develop FDA-approved COVID vaccines.

Personalized medicine has become much more common. CRISPR-Cas9 gene editing is now widespread and researchers are applying it to develop cures for many diseases. While there is not yet a playbook for addressing off-target mutations associated with CRISPR, this technology will revolutionize health and healthcare. Science, discovery and commercialization will have a profound impact on the structure and function of health systems in the future.

Affordability and Value-Based Care

US healthcare costs as a percentage of GDP increased from 18% in 2019 to almost 20% in 2020 as healthcare spending increased due to the pandemic and overall GDP declined. While these effects have moderated as the pandemic subsided and the economy rebounded, demographics and disparate cost trends will force healthcare spending to consume a greater portion of the economy over time.

Healthcare Is Too Costly — Many speakers at the conference noted that healthcare is already too costly and unaffordable. Shifting health systems and providers from reliance on fee-for-service payment to value-based payment is a priority for most health systems, although the current state of that transition varies significantly by market and organization.

Shift from Fee-For-Service Payment to Pay-For-Value — As referenced at the conference, only 11% of provider commercial payments rest in two-sided risk arrangements. For some organizations that number is much higher, while others still have payment largely on a fee-for-service basis. Some organizations have benefited from having their own health plans, while others have negotiated full-risk or partial-risk arrangements with insurance plans. In general, those health systems accepting risk fared better during the pandemic as they received fixed payment streams even as clinical volumes declined. Some presenters quantified the economic payback from focusing on value. For example, Ochsner Health averaged over $160 million of annual, value-based-contract gains in the last three years.

Medicare Advantage Growth — Medicare is another substantial area driving the shift to value-based care. On a national basis, 42 percent of Medicare members are now in a Part C Medicare Advantage Plan, and many traditional fee-for-service members effectively participate in various CMS risk payment models. However only a portion of Medicare Advantage membership translates into risk-based payment at the provider level. Multiple speakers highlighted their efforts to aggressively pursue Medicare Advantage as a vehicle to improve profitability and maintain financial viability on their Medicare populations.

Tangible Efforts to Reduce Cost and Increase Value — Redesigning care, aligning incentives and leveraging technology will be critical to addressing healthcare costs. While most health systems have tried to eliminate unnecessary care, the reality is that much more can be done across the industry to adopt clinical best practices and evidence-based care, and further move care to lower-cost settings. A number of presenters discussed how they are aggressively shifting more complex surgeries to the outpatient setting. Aligning provider incentives, including for employed physicians, has significant unrealized potential. While expanding leverage of artificial intelligence, data analytics, and medical breakthroughs may require new costs and investments, hopefully those investments will reduce long-term healthcare cost trends.

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Inflation and Accelerating Financial Pressures

Healthcare systems have perennially faced financial challenges, and somehow managed to maintain positive operating margins. It is widely acknowledged that we are not likely to return to the pre-pandemic world in healthcare. A key question is whether there will be a step-wise increase in financial pressure going forward. If so, systems must be bolder and transform more rapidly.

Widespread Operating Losses in 2022 — Q1 financial results were generally negative across the industry, although some markets and organizations didn't suffer as much. Labor and supply shortages and associated cost pressures will likely continue into the foreseeable future. Systems operate with the reality of payment rates set for multiple years and payers that are hesitant to increase rates materially. Expenses will continue to grow exponentially, and in the absence of substantial management intervention will decimate operating margins. At the same time, rising inflation and interest rates are hammering investment portfolios and impacting multiyear construction costs.

More Short-Term Intervention Likely Necessary — Management will have to act in response to these short- to medium-term pressures especially combined with other forces like 340b pullbacks and re-introduction of sequestration. While not discussed much by presenters at the conference, as the Federal Reserve attempts to curb inflation there is now a higher probability of a recession. Fortunately, healthcare is somewhat recession-proof, as much of care demand is nondiscretionary. As unemployment increases, some former caregivers who left the industry in the "great resignation" may choose to return to work.

Increase in Long-Term Financial Pressures — Increasing interest rates and inflation will exacerbate the large annual federal budget deficit, and state budgets will be under more pressure when stimulus funds are gone. In the longer term, Congress will likely conclude that the enormous federal budget deficits will need to be addressed. This will create pressures to reduce Medicare and Medicaid payment structures such as provider assessments, provider-based billing, disproportionate share payments, and Medicaid expansion, as well as base payment rates. Looming midterm elections and then the next presidential cycle could materially impact these issues.

And on top of all that, the inability to predict future waves of the pandemic creates more uncertainty. Many presenters at the conference expressed concern that the federal government will not provide additional pandemic support to healthcare systems, so the industry will bear the disruption and costs, adding to ongoing future challenges.

Closing Comments

While it will vary by market, all health systems will face increased financial pressures that will require material and proactive transformation. Change will likely include:

- Organization structure
- Access to greater scale through mergers, partnerships and consulting support
- Substantial redesign of care, including widespread adoption of evidence-based medicine and patient centric approaches
- Effective impact on Social Determinants of Health and social and environmental justice
- Significant shift from fee-for-service payment to risk-based models that provide economic value from "demand destruction"
- Leveraging continued discovery, commercialization and adoption of new technologies, diagnostics and treatments

Many health systems have effectively migrated from traditional static annual budgets to rolling forecasts. While this has increased understanding of trends and required actions, rolling forecasts are relatively short-term tools. With increasing financial pressure and greater uncertainty, health systems must implement more robust long-range financial planning, Enterprise Risk Management (ERM) assessments, scenario testing and contingency planning to support risk mitigation and accelerate transformation.

As the title **Best of Times or Worst of Times?** evokes, health system leaders can be both optimistic and pessimistic about the future. Financial and operational challenges will most likely be more daunting than in the past, but the opportunities to accelerate transformation are vast. The industry will be watching and we'll each decide if this is the Best of Times or Worst of Times depending on how the world unfolds and how our individual and collective efforts reshape healthcare.

List of Presenting Systems and Additional Panel Discussion

Advocate Aurora
Allina Health
Atrium
Banner Health (CFO-to-CFO dialogue)
Beth Israel Lahey Health
BHSH (Beaumont/Spectrum)
Common Spirit
El Camino Health
GCM Grosvenor
Headspace Health
Luminis Health
Jefferson Health (Decarbonization panel)
Hartford Healthcare
Kaiser Permanente (Decarbonization panel)
Intermountain
Mayo Clinic
Navitus (SSM Health)
Northwell Health
Norton Healthcare
Ochsner Health
Ohio Health
Palomar Health
Rush System for Health
RWJ Barnabas Health
Sutter Health (CFO-to-CFO dialogue)
Virtua Health
Fund Managers re ESG
Private Equity Panel re Partnerships

ABOUT THE AUTHOR

Edward Chadwick, Founder of Integrated Healthcare Financial Strategies, LLC. wrote this report. Historically he has drafted a summary of both the annual JPM and Citi/AHA/HFMA Healthcare Investor Conferences. Mr. Chadwick has served as the system CFO across many parts of the healthcare industry, including a national Catholic System, a top-20 academic health system, and a fully integrated plan/provider, and has served as a senior consultant, interim executive and board member. He holds an MBA from the University of Chicago Booth School of Business. Reach him at edward.chadwick@ihfstrategies.com or www.linkedin.com/in/edward-chadwick if you would like to discuss anything in this report.

Read Edward Chadwick's summary of key themes from the 2021 conference and his report of that conference here.