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Not-for-profit hospitals can expect ongoing margin pressures through 2024

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The Buzz This Week

After not-for-profit hospitals endured their worst operational year on record in 2022, ongoing weak margins are projected through 2024, according to reports from Moody's Investor Services and Fitch Ratings. Fitch has reported that "the negative associated pressures have lingered longer than expected." While some hospitals like Mass General Brigham and Kaiser Permanente are stabilizing financially—driven by increased patient demand, operational efficiency, utilization management, and cost management—others continue to face significant challenges, citing persistent difficulties in the post-pandemic healthcare environment.

Earlier this month, Moody's released its annual Not-for-Profit and Public Healthcare median financial report, indicating that operating margins fell to "unsustainable levels," driven by labor challenges and fluctuating patient volumes. The median operating cash flow margin was 4.9%, and the median operating margin was -0.3%. The median expenses growth rate increased to 8.9% in 2022, primarily due to labor costs and inflation, while revenue growth dropped to 5.1%—a significant decrease from 11.3% in 2021, reflecting the end of federal pandemic relief and stabilized patient volume.

The Moody's analysis also spotlighted varying performance across hospital segments in 2022. Children's hospitals emerged as the top performers, surpassing their adult counterparts in several key metrics, such as revenue growth, cash flow margin, days cash on hand, and operating margin. Their success was attributed to strong patient demand recovery, substantial inpatient revenue streams, and a favorable payer mix. Meanwhile, academic medical centers (AMCs) outperformed non-AMCs in terms of inpatient volume recovery, bolstering revenue growth. However, both of the latter health systems continued to face challenges as operating cash flow margins declined.

The report also highlighted that in 2022, Medicare and Medicaid, which provide lower reimbursement rates than private insurers, constituted a larger proportion of total revenue for hospitals, reaching 5-year highs. This shift reflects a growing reliance on government-funded healthcare programs within the industry. Notably, children's hospitals are more dependent on Medicaid reimbursements, making them particularly vulnerable to potential cuts to the program.

Why It Matters

While some segments of the healthcare industry, such as children's hospitals, have shown resilience, many 2022 metrics remained below pre-pandemic levels, raising concerns about ongoing vulnerabilities. Many not-for-profit hospitals are now adapting to evolving dynamics and pursuing innovative solutions to mitigate ongoing financial pressures. For example, Mayo Clinic has adopted a collaborative approach to healthcare supply chains. Instead of competing, the health system has established commercialized business ventures for functions like purchasing and freight services, which generate revenue to offset a portion of that department's operating expenses.

The labor environment for healthcare organizations is expected to remain challenging, but some organizations are taking proactive measures. They are broadening their recruitment efforts by collaborating with community colleges, engaging with younger students to spark interest in healthcare careers, and concentrating on roles in high demand. For instance, IU Health offers training programs to upskill current employees for high-demand positions like medical assistants.

While some organizations are concentrating on internal operational enhancements, others are actively exploring partnership opportunities due to these financial hardships. Fitch observed that, given the sustained weakness in margins, many healthcare organizations might pursue mergers and acquisitions (M&A) as a strategic move. However, the current regulatory and legislative environment could restrict M&A activity among health systems operating in the same market, potentially incentivizing more out-of-market mergers.

The financial health of not-for-profit hospitals is crucial, not only for the viability of the institutions themselves but also for continued provision of services to surrounding communities and for a strong healthcare ecosystem in general. These organizations must find ways to meet patient needs while growing their revenues, implementing new efficiencies, and exploring innovative options that will help chart a path to financial health for the future.

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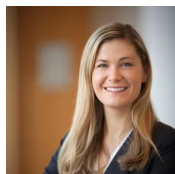
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Emily Nevarez

Research Manager