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Health system margins show improvement, but long-term financial sustainability is uncertain

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The Buzz This Week

After several years of unprecedented operational and financial challenges, many health systems now report positive financial performance in the first quarter of 2024, suggesting a possible inflection point in the provider market.

A recent STAT report examined Q1 2024 financial disclosures for 20 large not-for-profit health systems, finding that the majority reported substantially higher operating and net margins as compared to Q1 2023.

The positive trend is seen across all geographies in the US, at both not-for-profit systems like Banner Health in Arizona, BayCare in Florida, and Henry Ford in Michigan, as well as for-profit health systems like HCA Healthcare based in Tennessee. HCA CEO Samuel Hazen stated on the company's Q1 2024 earnings call, "We had the best portfolio performance, I think, I've seen in my experience in the company with 56 of our hospitals [or over one-third] growing greater than 10%."

The primary drivers for the uptick appear to be attributed to increased inpatient and outpatient volumes, as well as demand for pharmacy and ancillary services. This has been particularly true for patients with Medicare Advantage, as new legislation requires their inpatient stays to be reimbursed at a higher rate if doctors predict a stay beyond two midnights will be needed. The "two-midnight rule" has been in place for patients with Medicare since 2013, but only went into effect for Medicare Advantage this past January. However, the new rule wouldn't explain the increase in outpatient visits or use of many ancillary services. Added volume due to COVID-19 cases also doesn't seem to account for the growth, perplexing some in the industry. Per the recent STAT report, "Early on, insurers pointed to pent-up demand following COVID-19, but some say the levels they're seeing are higher than before the pandemic."

Why It Matters

The positive news from recent health system financial filings brings a welcome change after several years of intense headwinds. Some are cautiously optimistic about the future. [A Fitch Ratings representative stated](#), "While this is still below pre-pandemic levels, margin improvements fueled by positive labor indicators, volume diversification, and efficiency initiatives lead us to believe that margins could return to near historic trends around 2025-2026."

However, these are still early days, with the broad nature of the trend seen for only one fiscal quarter. Staff shortages, while perhaps not at crisis level compared to the peak of the pandemic, are still an issue and continue to elevate labor costs. Supply costs are up due to inflation and supply-demand imbalance. Prudent health system executives continue to pursue cost containment measures, efficiency advances, and revenue growth, focusing intensely on financial performance.

It is unclear whether the unusually high growth in utilization will endure, and growth strategies will remain important to increase revenue. Medicare Advantage as an outlier in the recent trend may indicate that it is worth reexamining patient cohorts and building a better understanding of patient demand to maximize future growth potential.

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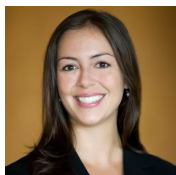
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