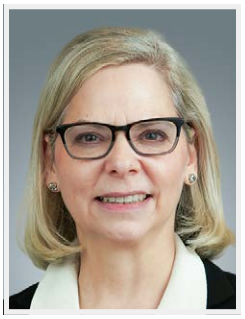
The Role of Governance in Uncertain Times

By Lisa Goldstein, Kaufman Hall



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The job of not-for-profit hospital board members has not gotten any easier over the past few years. There was some relief for many organizations over the course of 2024, as financial performance began to stabilize, but hospitals are still operating in a changed environment, with elevated expenses and a continuing migration of care to outpatient sites where hospitals face increased competition. Payer negotiations have grown more difficult, and a new administration in Washington, determined to disrupt the status quo, introduces a new level of uncertainty. Despite overall industry improvement, Kaufman Hall *National Hospital Flash Report* data indicates that 37 percent of hospitals still had negative operating margins near the end of 2024.

Hospitals have been through many challenges—including the Balanced Budget Act of 1997, the Great Recession, COVID-19, and the ensuing labor shortage—and have proven their resilience. There is every reason to be optimistic that hospitals will meet today's challenges with the same determination that has seen them through in the past. But board members and executive leaders must be aware of—and prepared to respond to—the many uncertainties that lie ahead. This article outlines those uncertainties and concludes with some thoughts on where boards should focus their energies today.

The Rating Agencies' Outlooks

The sense of growing industry stabilization was confirmed when, at the end of 2024, Fitch Ratings and S&P Global Ratings joined Moody's Ratings in moving their industry outlooks from negative to stable (or, in Fitch's case, from deteriorating to neutral). Factors cited by the agencies included:

- Anticipated steady improvement in margins, with revenues outpacing expenses
- Improved days cash on hand, with capital spending returning to a longer-term focus
- Declining covenant violations

At the same time, the rating agencies have identified several issues to watch:

- Labor and physician shortages will likely pressure performance in the coming years.
- Payer mix will continue to shift toward governmental payers, and hospitals and health systems will increasingly rely on state-directed payment funds (which bring Medicaid payments closer to commercial rate averages), the permanence of which is uncertain.
- The cybersecurity risk is growing. While a cyber event has not yet been the direct cause of a rating action, an increasing number of cyber attacks on health systems and key vendors (e.g., the Change Healthcare cyber attack in February 2024) are drawing rating agency scrutiny of organizations' response plans and preparedness for an attack.[1]

The guarded nature of the rating agencies' outlooks for 2025 is perhaps best summarized in the title to S&P Global Ratings' outlook: "Stable but shaky for many amid uneven recovery and regulatory challenges."[2] Despite the improved outlook for 2025, the number of rating downgrades in 2024 (95 across all three agencies) far exceed

››› KEY BOARD TAKEAWAYS

In these uncertain times, boards must ask and seek answers to these essential questions:

- How can we do better for our patients, clinicians, staff, and community?
- What are the decisions—which may be very difficult—that we must make to ensure our organization's long-term sustainability?
- What are the most significant opportunities for growth, and what may we have to give up to pursue them?
- Of all the changes ahead, which will be most impactful for our organization?

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1 Lisa Goldstein and Robert Turner, "Rating Agency Update: Supplemental Funding Programs, Cybersecurity, and Industry Outlooks," Kaufman Hall, December 17, 2024.

2 S&P Global Ratings, "U.S. Not-for-Profit Acute Health Care 2025 Outlook: Stable but Shaky for Many Amid Uneven Recovery and Regulatory Challenges," December 4, 2024.

the number of upgrades (37), an improvement over the prior year but still a sign of a challenged industry.[3]

Industry Trends

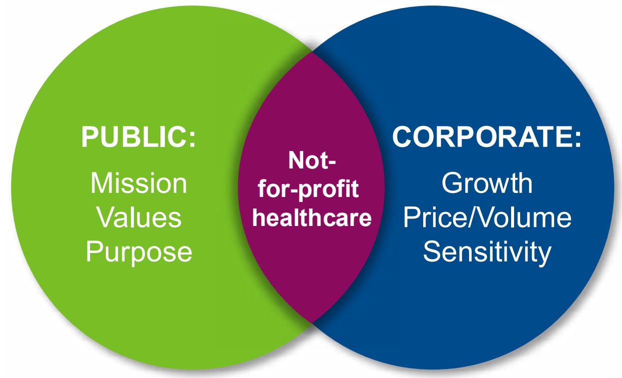
Several industry trends continue to pose significant headwinds for not-for-profit healthcare:

- **Continued growth of Medicare Advantage**: An aging population is contributing to the payer mix shift called out in the rating agency outlooks; at the same time, a growing number of seniors in the U.S. are opting for Medicare Advantage (MA) plans. MA plans can offer many benefits to enrollees—including very low or even zero-dollar premiums—but for providers, they will require navigation of a much more rigorous prior-authorization process than traditional Medicare. The number of prior-authorization determinations made for MA beneficiaries grew from approximately 37 million in 2021 to almost 50 million in 2023, driven by growing MA enrollment.[4]

> **One of the most important questions for the board remains: how can we do better for our patients, clinicians, staff, and community?**

- **The pharmaceutical "wild card"**: New pharmaceuticals could have dramatic impacts on volume, service lines, and capital. The rapidly expanding market for GLP-1 agonist weight-loss drugs, for example, could reduce the metabolic disease burden, drive down volumes for bariatric and orthopedic surgery, and lead to a rise in the diseases of advanced old age.
- **Continuing industry disruption**: Despite setbacks for several retail-based health clinics in 2024 (including Walmart, Walgreens, and CVS), Amazon is doubling down on an expansion strategy. Both established and new competitors will continue their efforts to draw market share away from legacy not-for-profit health systems in areas such as telemedicine, primary care, diagnostics, and ambulatory surgery.

Hospitals Reflect Blend of a Social Mission and Corporate Elements



Federal Policy Changes

Finally, there is considerable uncertainty around policy changes that may come from the Trump administration as it seeks to fund extension—and possible expansion—of the 2017 Tax Cuts and Jobs Act. On January 17, the House Budget Committee distributed to the House Republican Caucus a 50-page list of options, with many that would directly impact hospitals and health systems. These include cuts to the Medicaid program, removal of the tax-exemption on interest from municipal bonds, and even removal of 501(c)(3) status from not-for-profit hospitals and health systems. The likelihood of any of these options coming to pass is still very much in the air, but they merit close monitoring as proposed legislation begins to take shape.

The Role of Governance

What then is the role of governance in these uncertain times? More than ever, boards must be cognizant of the fact that not-for-profit hospitals and health systems must blend their social mission, vision, and purpose with traditional corporate elements. Like corporations, they must:

- Raise capital through public and private debt offerings.
- Provide and achieve forward guidance or budgets.
- Recruit and retain talented leadership—and have a succession plan in place for organizational leaders.
- Maintain transparency with investors.
- Build a culture of accountability and excellence.

And like corporations, they must pursue growth opportunities. In today's environment, some of the most promising opportunities lie within what I have described as a new "triple A" for healthcare,[5] with a focus on:

- **Access**: ensure that patients can easily access high-quality healthcare services and bring services to new geographies and markets.
- **Accretive**: seek accretive growth opportunities—usually in the form of acquisitions or capital projects—that can begin contributing ROI immediately.
- **Ambulatory**: meet—or beat—disruptors in speeding new ambulatory services to market, recognizing that the shift to outpatient services is unlikely to slow.

At the same time, the social mission of not-for-profit healthcare continues. One of the most important questions for the board remains: how can we do better for our patients, clinicians, staff, and community?

TGI thanks Lisa Goldstein, Managing Director in the Treasury & Capital Markets practice at Kaufman Hall, a Vizient company, for contributing this article. She can be reached at lgoldstein@kaufmanhall.com.

3 Lisa Goldstein, "Pace of Downgrades Slowed in 2024: Five Key Takeaways," Kaufman Hall, January 22, 2025.
4 Jeannie Fuglesten, et al., "Medicare Advantage Insurers Made Nearly 50 Million Prior Authorization Determinations in 2023," KFF, January 28, 2025.
5 Lisa Goldstein, "Will the Hospital Industry Finally Land Its First 'Triple A'?," Kaufman Hall, December 4, 2024.