

Determining Independent Hospitals' Future Post-COVID-19: Key Insights for Boards

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As the fallout from COVID-19 strains the financial health of independent hospitals, leaders face a critical need to evaluate their financial positions and determine their strategic options, both in the months ahead and long term.

Before the coronavirus pandemic, not-for-profit hospitals and health systems had been performing well. Extraordinary investment returns in recent years bolstered the financial positions of numerous hospitals, and low-cost capital enabled many providers to invest in growth projects. As a result, the not-for-profit sector entered 2020 in a stronger financial position than it had been in many years.¹ While Fitch and Moody's expected continued consolidation in this sector, they anticipated consolidation would be driven largely by a desire to increase size and boost revenue.

The emergence of COVID-19 this spring changed everything. By mid-March, rating agencies had revised their outlooks for the not-for-profit

Key Board Takeaways: Evaluating a Hospital's Financial Sustainability After the Pandemic

What should board members consider in assessing their organization's financial sustainability following COVID-19? Key questions include the following:

- What is your bandwidth for evaluating a path forward?
- How have hospital volumes improved following the return of elective surgeries—and what does post-COVID-19 demand for the hospital's most profitable services look like?
- How long will it take the hospital to recover losses from delayed surgeries and COVID-19 care and expenses?
- To what extent will the hospital's pre-COVID-19 financial position as well as federal emergency assistance and changes to the organization's cost structure support a return to financial health?
- Are there specific services that are dilutive to the hospital's financial health, both before and after COVID-19?

hospital sector to "negative."² Even after the outbreak is contained, expected pressures include:

- Lower cash flow due to unprecedented financial pressures, including delayed elective procedures and higher operating expenses (the estimated impact, according to the American Hospital Association, is \$50.7 billion per month nationally³)

- Reduced value of hospital investment portfolios
- Debt risks, including the risk of tripping financial covenants in existing debt agreements
- The potential for a prolonged recession and the impact on unemployment levels, state budgets/Medicaid funding, and potential pressure on Medicare funding

These challenges—coupled with pressures hospitals have long confronted, such as the costs of caring for Medicare and Medicaid populations relative to reimbursement—demand that independent hospital boards continually explore new and

1 Ricky Zipp, "[Fitch, Moody's Upgrade 2020 Outlook for Not-for-Profit Hospitals to Stable.](#)" S&P Global, December 11, 2019.

2 Jack O'Brien, "[Ratings Agencies Change Healthcare Outlook to Negative Due to Coronavirus.](#)" *HealthLeaders*, March 19, 2020.

3 "[Hospitals and Health Systems Face Unprecedented Financial Pressures Due to COVID-19.](#)" American Hospital Association, May 2020.

innovative ways to maintain financial viability. The immediate actions taken by leaders and boards in response to the pandemic, such as deferred capital expenditures, employee furloughs, and salary reductions, are necessary in a crisis environment, but are likely not sustainable and do not lead to long-term viability.

After the Outbreak: Evaluating Next Steps

The general disruption from lockdowns further exacerbates pressures on hospitals, and previous strategies to manage through a downturn may no longer be readily available. While government stimulus efforts could provide short-term relief for stressed balance sheets and diminished working capital, it is unlikely that government assistance alone will support a return to financial health once the crisis subsides. The financial impact of COVID-19—which will vary depending on the severity of the outbreak locally and the ways

in which hospital volumes are affected—will require boards of independent hospitals to reassess their organization’s position and potential options.

To achieve and maintain financial stability following COVID-19, operational efficiency is key. Unexpected declines in cash and investments will take time to rebuild, so mitigating other areas of weakness will be crucial to generating the strong returns required to rebuild an organization’s balance sheet. For independent hospitals with strong balance sheets, significant changes may not be as urgent; however, all organizations should routinely evaluate the efficacy of their business model, especially in an uncertain economic environment.

Leaders’ skill in unlocking and properly allocating value from their organization’s business assets and internal resources will prove even more critical to an independent

hospital’s success. So will factors such as:

- The hospital’s ability to recapture demand—especially given consumers’ reluctance to return to a hospital environment⁴
- The extent to which board members are actively involved in service line resource planning and willing to make the choices necessary for sustainability
- Whether the hospital gains “first-mover” advantage for key opportunities, including around partnerships, and whether positive impacts can be sustained such as virtual care delivery

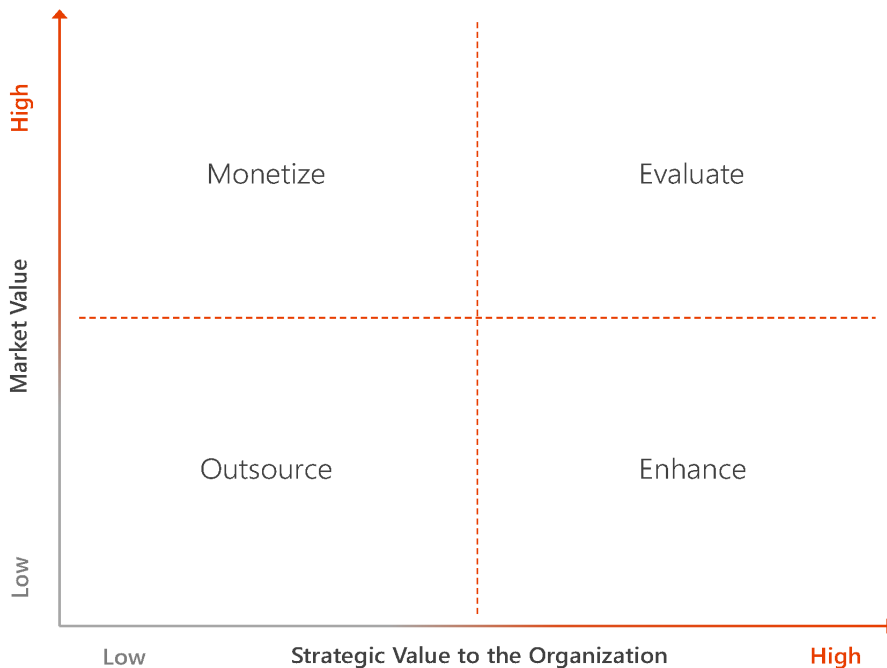
How can independent hospital boards most effectively determine their organization’s financial viability following COVID-19? Here are three actions board members should consider.

Forecast the organization’s financial position and outlook. Evaluating an independent hospital’s financial position before and after COVID-19 is a time-consuming, resource-intensive effort, but it is critical to determining the hospital’s strategic options in a post-pandemic environment.

Boards that work quickly to forecast their organization’s financial outlook and leverage the data to guide the hospital’s path forward are more likely to respond with agility to opportunities in the market. These include opportunities to restructure debt, transform the way in which care is delivered (such as via telehealth), and pursue growth or partnership.

4 [“Overall Hospital Visit Recovery Sluggish Despite Positive Upward Trends in Outpatient Visits,”](#) TransUnion, June 1, 2020.

Exhibit 1: Portfolio Optimization Matrix



Conduct a deliberate portfolio review and optimization process.

This involves assessing all of the business assets owned and operated by the hospital and then prioritizing internal resources according to which ones deliver the highest quality and strongest financial performance. Through this process, hospital boards gain a clear understanding of both the market value and strategic value of the hospital's business lines (see **Exhibit 1** on the previous page). It is a process that gives board members vital perspective regarding which core assets should remain under the hospital's control, where opportunities for partnership with core or non-core assets exist, and the non-core services that could provide greater value to the community if they were operated by another party. Understanding which assets should remain under the hospital's control and the elements of control that can be delegated to others is an important step in striking the right balance between core and non-core assets.

Depending on where the asset falls on the matrix, the hospital's strategy may vary. In some instances, small enhancements can make a

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significant difference; in others, partnering with an expert provider may improve the value of the service for the community. Not all optimization strategies will meet the hospital's primary needs, but most will accomplish at least one major goal from among the following:

- Improved balance sheet
- Enhanced service line performance
- Operational improvement
- Expanded reach
- Additional expertise

Take a fresh look at partnership opportunities in the wake of economic distress. The advantages of scale will become even more important for independent hospitals following the pandemic. However, this doesn't mean every challenged provider will need to sell or transfer control. For example, numerous opportunities exist to partner with other providers and specialty operators to boost operating

efficiency, invest in growth, and strengthen the hospital's balance sheet.

For boards that wish to consider a broader transaction, partnering with a larger organization can produce a positive outcome for a community. Systems offer scale efficiencies that can lower costs, and they often are better able to survive an economic downturn. There may be a first-mover advantage for independent hospitals seeking partnership. Additionally, while the market typically moves in the buyer's favor during periods of economic uncertainty, independent hospitals still possess advantages that can provide leverage during negotiations. By quickly identifying gaps and potential opportunities, boards of independent hospitals can more effectively chart their organization's strategic direction and craft a path to success in a post-pandemic environment.

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