Industry Insights: Financial Challenges for Hospital CFOs: Increasing Capital Efficiency while Transitioning to Value-Based Care

July 2015

CHG-MERIDIAN USA Corp.

The Alta Group℠

Efficient Technology Management®

Top Challenge: Cost Control

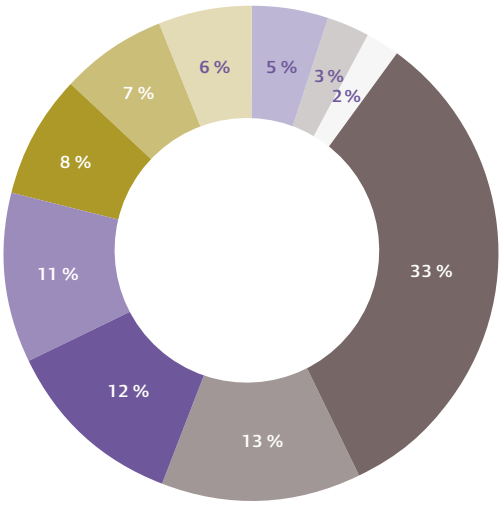
The United States spends more on health care than any other country in the world, at an estimated 17.7 % of Gross Domestic Product (GDP) in 2013. U.S. health care spending is outstripping revenue as a percentage of GDP and projections show continued growth averaging 4.9 % a year in 2014 – 18, increasing to 17.9 % of GDP by 2018.
Containing and reducing these persistently high health costs is currently the biggest challenge facing U.S. health care providers and other industry stakeholders[1].

Although spending growth slowed during the recession and has remained slower than historical averages, demographic and economic factors that are the root cause of this situation are forecast to remain unchanged for the foreseeable future.
Driven primarily by new mandates and legislation, there exists a wide variety of additional drivers affecting healthcare costs that are difficult to control, requiring aggressive and creative solutions by hospital management.

[1] **Source:**
Deloitte, 2015 Health Care Providers Industry Outlook

Operating income down at Memorial Sloan Kettering as labor costs grow: **With admissions and labor costs ticking upward, Memorial Sloan Kettering Cancer Center in New York City ended the first three months of the year with operating income down 9.3 % from the same period last year, the cancer center said in its first quarter financial filing.**
Mayo Clinic feels the pinch of rising costs: **The Mayo Clinic, which had been diligently cutting expenses over the past year, has started to see those costs creep up again in the first quarter of 2015.**
NYC system's deficit to balloon without federal aid: **The New York City Health and Hospitals Corp. will face an operating deficit of $ 1 billion in two years and dwindling cash reserves as the Affordable Care Act reduces supplemental funding to hospitals that historically offset the cost of care for the uninsured, the New York City comptroller said in a report released May 11, 2015.**

Drivers of current healthcare costs



- 33 % Healthcare legislation and mandates
- 13 % Overutilization of products and services
- 12 % Labor costs
- 11 % Lack of clinical coordination of care
- 8 % Misalignment of quality and payment incentives
- 7 % Health information technology
- 6 % Patient demand for healthcare services
- 5 % Pharmaceuticals
- 3 % Medical devices
- 2 % New clinical technology/equipment

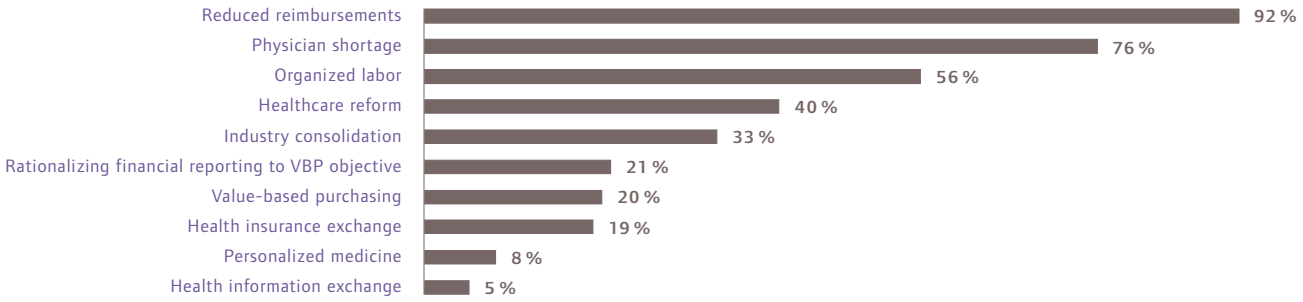
Source:
Premier Healthcare Alliance Spring 2015 Economic Outlook

Enterprise Risks

The chart below is a rank-ordered list of threats to hospital long-term viability identified in a survey of hospital CFOs conducted by a leading industry research firm:

Financial Shift Insight

Which of the following does your organization consider to be a threat?



Base = 823, Multi-Response

Source:
HealthLeaders Media Intelligence Report, "Industry Survey: Strategic Imperatives for an Evolving Industry", 2013

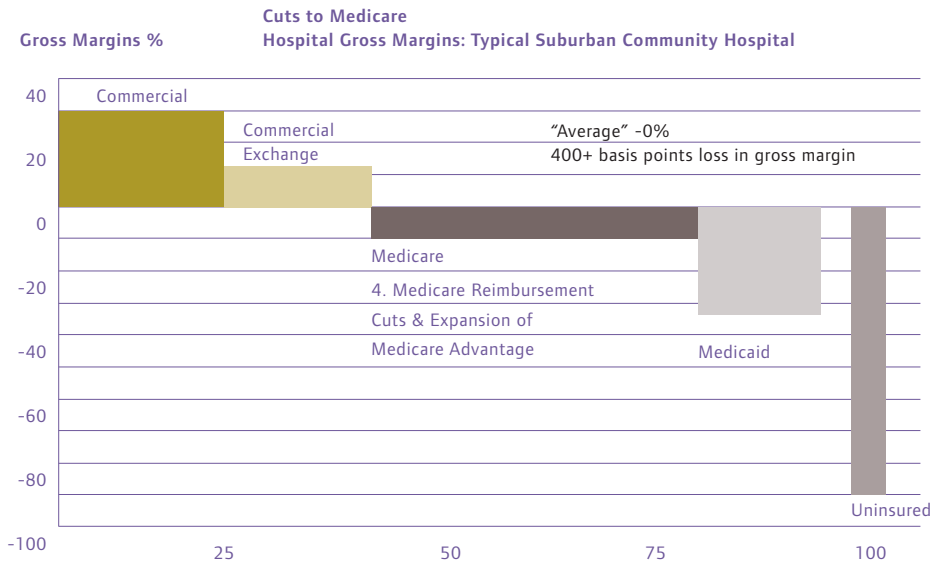
Reduced Reimbursements Top Concern

Not surprisingly, executives identified the impact of reduced reimbursements as their top concern. Several issues are driving reimbursement declines:

- Ten thousand baby boomers turn 65 every day, creating a major demographic age shift resulting in more baby boomers on Medicare. Historically, hospitals have lost money on low Medicare reimbursements and continued shrinking reimbursements only exacerbate this situation.
- A new category of healthcare insurance, "Exchanges," based on practices from other market segments such as fire and mortgage insurance. Individuals covered by a Healthcare Insurance Exchange have proven to generate lower reimbursements for hospitals when compared to conventional insurance.
- The number of patients who rely on Medicaid for healthcare coverage continues to rise. These increases put additional financial pressures on hospitals since Medicaid reimbursements typically generate net losses for hospitals.
- Government reforms and spending cuts at both state and national levels have also negatively affected hospital reimbursements. Many states have chosen not to expand Medicaid programs even as reimbursements for indigent patients decrease. At the federal level government cost cutting mandates such as The Budget Control Act of 2011 ("Sequestration") have directly impacted Medicare and other programs funded by the federal government.

Illustrating the negative impact of declining reimbursements in the current economic and regulatory environment, the following chart clearly illustrates how low reimbursement rates put pressure on margins.

Revenue Mix of a Typical Hospital in Post ACA Era



% of Total Hospital Revenues, by Payer Type
Indicative and Illustrative:
Each facility in each market achieves unique outcomes and financial results.

Source:
L.E.K. Consulting / Executive Insights,
"Hospital Economics and Healthcare Reform:
No Free Lunch", Vol XV, Issue 10, 2013

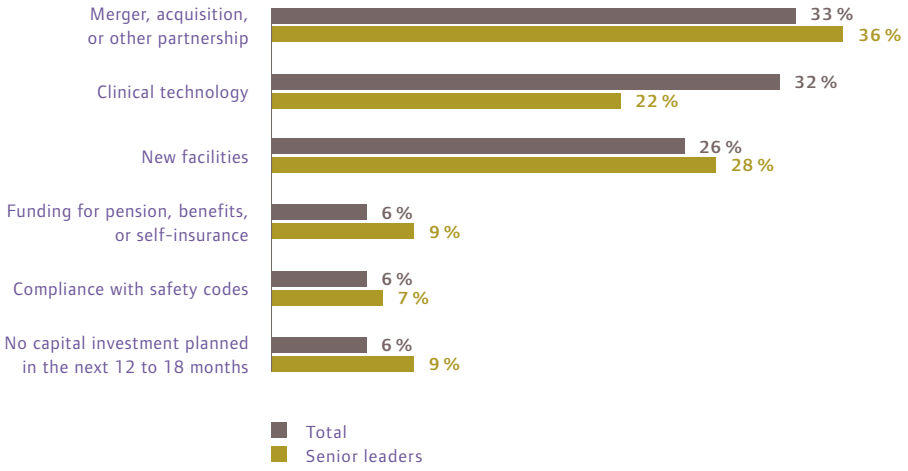
Allocating Scarce Capital

Pressure increases on CFOs amid fundamental changes in the industry's capital structure. Healthcare industry issues and challenges place hospital CFOs in an especially difficult position. Declining revenues coupled with demands on hospital finances to sustain quality care, implement EMRs, improve IT interoperability and security, Meaningful Use, improving outcomes and managing changing patient mix call for increased focus on financial management.

IT spending, already a high priority, has seen additional increases as major data breaches of healthcare providers, insurers, retailers and financial services providers have occurred. And the elusive goal of implementing EMR's while maximizing Meaningful Use rebates has necessitated unexpected and increased funding for projects that are already far beyond their initial implementation timelines.

Identifying Priorities for Capital Expenditures. Healthcare CFOs voted for their priority ranking of capital expenditures with results shown in the following chart:

Healthcare Providers Prioritize Uses of Capital



Source:
HealthLeaders Capital Finance and Industry Consolidation Survey, 2013

Expenditure Priority #1: M&A

Capital allocations need to address the bigger picture — especially issues related to long-term viability. Typical for a revenue-constrained environment, economic forces push participants to seek economies of scale through M&A. This basic survival impetus is closely matched by the push for investment in technological resources to improve patient care, safety and efficiency, as well as to save costs.

Expenditure Priority #2: Evolving Medical and Information Technology

Federal EHR directives to completely digitize and integrate systems certainly propel this priority to a high position on the list. Important ancillary requirements affect areas beyond technology: the ever-increasing pace of new medical technology has increased infrastructure needs in buildings. As an example, the ability to sequence individual patient genomes will provide more accurate diagnoses and treatment plans — but implementing this capability will require rows of sequencing devices and large increases in laboratory space beyond the traditional blood/gas analysis lab footprint. Result — more capital requirements for devices, increased consumables costs for reagents and more or vastly re-allocated square footage.

Patient-centered home care to prevent readmissions requires significant investment in a category that was not previously material enough to receive its own budget line item. Focus and expenditures both are growing quickly as providers routinely send home patients with in-home monitoring devices such as telemedicine units, Wi-Fi scales, blood pressure, heart rate and respiration monitors, for specific conditions such as diabetes, COPD or CHF, to name a few. These units are very consumer oriented, making them subject to rapid change, depreciation, loss and theft — ideal candidates for rental or FMV lease treatment.

Expenditure Priority #3: Facilities

Facilities expenditures are at nearly the same priority as technology-related spending as a much more concerted effort is taking place to plan facilities to optimize reimbursement, whether inpatient or outpatient. Primarily focused on capital costs of construction and redesign projects, hospitals have little to no tolerance for scope creep unless it results in incremental revenue.

The emergence of truly disruptive technology providers such as Additaz[2] are a clear example of the growing recognition that facilities can provide additional cost savings and revenue opportunities. Additaz estimates that there is an estimated 30 % waste in the construction industry due to lack of innovation and technology adoption, and provides a proven solution to the healthcare industry.

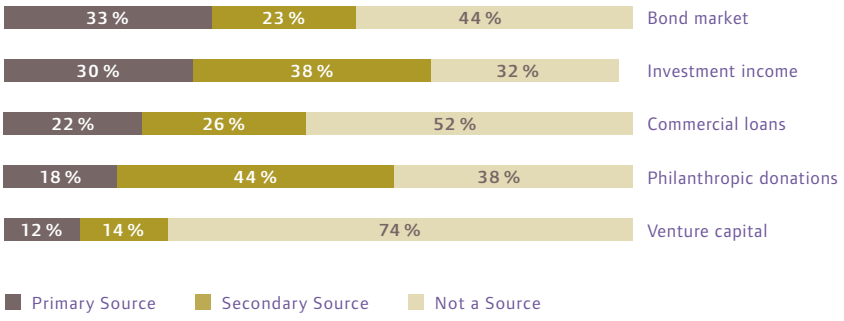
[2] www.additaz.com

Finding Capital: Bonds and Beyond

Bonds

Since the market is generally bullish on healthcare, many diverse capital sources are available, both public and private. However, as shown in the chart that follows, the bond market continues to be a favored and significant source of external capital, along with commercial lending markets.

Preferred Funding Sources of Healthcare Providers



Source:
HealthLeaders Capital Finance and Industry Consolidation Survey, 2013

Beyond Bonds: Specialized Financial Services for Management of High-Technology Equipment Portfolios

Bonds and commercial loans have certain limitations and are not always the best options, especially when used to acquire assets with high obsolescence rates. There are better solutions available from alternative financial services firms that provide a broad array of services and funding structures that go beyond equipment acquisition and management, to improve financial metrics and performance.

For example, new technologies are available to improve healthcare services and quality and safety analyses, ultimately improving hospital performance and value. However, financial commitments on older technology could put this new equipment, and its substantial benefits, beyond reach.

An alternative funding source can create a custom financial solution for new equipment acquisition that results in an even greater return for technology equipment investments.

Specialized financial services experts minimize the impact of increased technology obsolescence through a full array of lifecycle management services including:

- Creative leasing structures matching expenses to revenue streams
- Services for disposal of existing equipment
- Innovative RFID/RFLS tracking and workflow solutions
- FMV leasing
- Rentals
- Flexible trade-in terms
- Refurbished and off lease equipment management
- HIPAA-compliant data destruction

To take advantage of these substantial benefits, CFOs must seriously reconsider the requirement to "own" certain technologies versus having the right device, at the right place, at the right time acquired via an operating expense model. In the current industry environment where improved financial performance can result in significant financial benefits, a focus on equipment use vs. ownership provides a true competitive advantage.

Conclusion

Most healthcare executives agree on one thing; the state of flux in reimbursement and required changes in healthcare delivery make planning capital expenditures a challenge. Many hospitals and healthcare systems spend significant time analyzing market projections and feasibility studies before committing to capital programs. Navigating through this chaotic environment requires the right financial partner, with proven expertise, flexibility and experience.

A partner like CHG-MERIDIAN.

About CHG-MERIDIAN USA Corp.

CHG-MERIDIAN's mission is to help healthcare providers efficiently care for more patients with greater safety and improved satisfaction by providing independent advice regarding the acquisition, financing, management, and disposal of IT and medical technology assets.

CHG-MERIDIAN provides strategic support and financial structures tailored specifically to your needs. Our expertise and resources enable hospitals to make better decisions for the allocation of limited capital ensuring client hospitals not only achieve strategic objectives, but also survive and thrive in this challenging environment.

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