

**The Challenges and Opportunities in Today's Healthcare Industry:
The Turnaround Operator's Perspective**

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The healthcare industry is comprised of numerous sectors, including hospitals, nursing homes, assisted living facilities, independent living facilities and home health agencies. In today's economic environment, the healthcare industry, as a whole, is not immune from the financial challenges facing nearly every sector of the economy. In fact, the healthcare industry may be even more challenged due to its dependence on governmental funding, namely Medicare and Medicaid. Medicare and Medicaid monies are the lifeblood of the healthcare industry, and without these monies, the healthcare industry cannot succeed. With the budget constraints facing many states and the competing attention for federal funding, the healthcare industry has experienced, and likely will continue to experience, significant challenges over the next several years.

However, even with the daunting economic challenges, the healthcare industry presents some interesting opportunities for growth. The government has placed a spotlight on the healthcare industry by pushing forward with healthcare reform and targeting the healthcare industry as a recipient of monies under the stimulus package. With the aging population, the demands placed upon the healthcare industry are expected to increase exponentially. As a result, this industry is expected to create opportunities for new business, growth and job expansion.

This article explores the business challenges facing the healthcare industry, how best to weather the financial storm and, most importantly, how to survive in the short term in order to take advantage of expected growth opportunities.

The Challenges Facing the Healthcare Industry

Since the enactment of Medicare and Medicaid legislation in 1966, the healthcare industry has experienced dramatic growth and challenges. The Medicare and Medicaid programs were designed to provide *cost-based reimbursement* with little or no incentive to demonstrate efficiencies or encourage investment capital. The healthcare provider often received reimbursement monies that were not sufficient to cover the provider's costs in delivering the healthcare services. Moreover, there were little to no excess monies that could be

invested in capital improvements. Typically, healthcare providers would attempt to structure their operations to (a) provide those healthcare services generating the highest Medicare or Medicaid reimbursements and (b) maintain sufficient patient mix to achieve these reimbursements. However, the government would, at times, modify reimbursement rates leaving the healthcare facilities with significant underpayment issues and insufficient time to alter their services and patient mixes to adjust to the changed reimbursement system. As a result, over time, the healthcare industry has cycled through several restructurings to address the changes implemented under Medicare and Medicaid.

Today, the healthcare industry is plagued by the many of the same challenges experienced over the past several years. Each of these challenges is discussed below. Each of these challenges goes directly to the “bottom line” and impacts the facility’s revenue and cashflow.

Fiscal Constraints Due to Reductions in Reimbursement – Legislative or Lack of State Budget Availability. As discussed above, because of dependence on Medicare and Medicaid funding, healthcare facilities have fixed cash inflows that can be changed at any time by the government. Moreover, given the challenges facing many state governments today, there is both a significant delay in Medicaid funding and an overall lack of funding available. For example, the State of Illinois is five to six months behind in Medicaid payments unless a facility qualifies for expedited payment. In Illinois, the federal government’s stimulus package allocates \$2 billion to pay Medicaid providers with the requirement that the State’s payment cycle remain within 60 days for all providers by June 1, 2009. Because of the lack of funding in Illinois, it is likely that this one time stimulus money will be used only to pay past due Medicaid payments. The State may again delay Medicaid payments to the facilities.

Rising Acuity Levels and the Impact of “Service Creep” or “Cost Creep.” People are living longer. As a result, patients require more care, for a longer period of time at increased expense. Healthcare providers must be vigilant in re-evaluating a patient’s or resident’s needs to ensure that the healthcare provider is being appropriately compensated. For example, in the assisted living arena, providers typically re-evaluate a resident’s care requirements every quarter. The healthcare needs of a resident constantly change and providers are leaving money on the table by failing to obtain proper reimbursement for the care provided if they are only reviewing quarterly or less frequently. As a result, many healthcare facilities are providing care to patients or residents for which they are not being compensated leaving the facility with increased costs and lack of cashflow.

Displacement of the Private Pay Population. Due to today’s economic circumstances, many people have lost their investments and benefits. More people are resorting to Medicaid coverage which is a lower reimbursement rate for the healthcare facilities. Healthcare facilities must constantly monitor their patient or resident mix to evaluate the number of private pay, Medicare and Medicaid patients at the facility. This patient mix translates directly into cashflow and the timeliness of cashflow. As private

pay patients decrease, the healthcare facility has to be more creative in order to attract new private pay patients or otherwise drive up revenue.

Labor Challenges – Nursing Shortage and Agency Utilization. There is a nationwide nursing shortage. As a result, many healthcare providers must resort to agency usage which is more expensive and does not provide the continuing stable, quality of care due to changing temporary/agency workers. This is an industry wide problem that must be managed.

Risk Management – Litigation and Insurance Costs. Healthcare facilities are experiencing high incidents of lawsuits against them by patients and families. As a result, insurance costs for healthcare providers continue to sky rocket. At times, malpractice insurance is just not available. Many healthcare providers, including hospitals and nursing homes, are self insured for a certain amount of malpractice coverage and have excess insurance coverage above that. Many healthcare providers find themselves unable to pay the self insured portions of their malpractice insurance. Some healthcare providers have used the bankruptcy process to shed these malpractice claims, which exposure can be significant.

Escalating Cost of Care. Healthcare providers are experiencing significantly higher operating costs for such things as food and medicine due to, for example, surcharges for increased gas and transportation costs. Unlike other businesses, these increased costs cannot be passed through to patients and residents because the Medicaid and Medicare payments are fixed. As a result, the providers' revenue has been adversely impacted.

The Push to Home Care. The government has increased reimbursements or funding to the home health industry. This increased funding is based upon the perception that people can be cared for at home on a less costly basis. By increasing the home health reimbursements, the home health industry has flourished with the creation of new jobs, new businesses and expansion into home care by other industry segments. Because of the increased focus on treating people at home, other sectors of the healthcare industry, such as hospitals and nursing homes, have seen reduced patient populations (or reduced patient census). With reduced populations, revenue declines.

Aging Facilities. The average age of many healthcare facilities is increasing. As a result, these facilities are in need of capital to sustain and improve their facilities. In the absence of improved facilities, these healthcare providers will need to locate and develop new facilities. Currently, the funding for most healthcare facilities does not provide sufficient monies for capital improvements (and certainly not for acquisitions of or development of new facilities).

Rural Dilemma. Rural healthcare facilities have struggled over the past several years with many of these facilities closing and leaving rural communities underserved. As a result, residents of these rural communities travel miles to the nearest urban center for treatment. In order to address this problem, there is a renewed focus on improving the

delivery of healthcare to rural communities. For example, in Illinois, the State has increased the timeliness of funding for rural facilities. As with any change in the reimbursement system, the healthcare industry will focus on opportunities in rural communities. Existing businesses may expand to rural communities. New businesses may be created. However, the nearby urban healthcare facilities will suffer as they lose patients or residents in these rural communities.

Demographics. Demand is driven by demographics. In the past several years, new facilities and services were offered due to the demand and easy access to capital. Many of these new facilities and services were offered in communities springing up around the country as the housing industry was booming. Now, with the changed economic circumstances, many of these facilities are failing or closing due to lack of ongoing demand, capital and cashflow.

Each of the above challenges represents a strain on the healthcare providers' cashflow and revenue and arguably supports the need for a complete overhaul of the healthcare industry, in particular the reimbursement system. Given the current reimbursement system in place for healthcare providers and given today's turbulent economic times, the healthcare facilities' operators must aggressively manage their business to ensure survival and maximize the ability to take advantage of expected opportunities within the industry.

How to Survive in the Short Term

In order to survive in today's economic circumstances, the operator of the healthcare facility must aggressively manage every aspect of the business, including costs, billing, patient/resident census, marketing and revenue generators. Below, we address certain methods by which revenue and/or cashflow can be managed.

Cost Control. If a business can eliminate expenses or costs from the organization, this savings will generate an increase in cash flow over time or immediately. As a result, it is imperative that the operator of a healthcare facility be vigilant in constantly reviewing and questioning all expenses and costs in order to identify possible savings. These savings might result from eliminating unnecessary expenses, reducing reliance upon agency or temporary staffing, renegotiating terms with existing vendors or identifying more cost effective vendor alternatives.

Revenue Enhancement. Healthcare facility operators must also constantly look for revenue opportunities. These opportunities might result from changing the patient mix to more private pay patients, more Medicaid patients or more patients requiring certain services with higher reimbursement rates. When these revenue opportunities are identified, they must be implemented through aggressive marketing to the community, physicians, hospitals or the appropriate audience.

Watch Your Cash. During troubled economic times, cash is the key to survival. In the healthcare industry, managing cash is very difficult given the lack or infrequency of Medicaid payments from the states, due to budget constraints. Therefore, operators

should watch and manage cashflow very carefully. Operators must anticipate and plan for any unexpected cash shortfalls. For example, you don't want to figure out, on the day payroll is due, that there isn't enough cash.

Vendor Management. Most businesses are struggling in today's economic environment. For the healthcare facility, this means two things -- you need to monitor the financial health of your vendors and you may not be able to stretch payments to the same extent as in past years. With respect to the financial health of vendors, the healthcare facility must identify their critical vendors (*e.g.*, those vendors who are essential to the operations of the facility such as food vendor, therapy vendor, etc.). The facility should monitor the financial stability of these critical vendors by reading news reports, staying in touch with others in the community and talking to these vendors. The facility must also have alternatives in place. So, if, for example, the food vendor is critical to a healthcare facility and the food vendor goes out of business, the facility must have a back-up plan in place to obtain food from another vendor immediately.

Supply Management. Healthcare facility operators must also actively manage supplies. Supplies impact the expense and revenue side of the business. With respect to supplies as an expense, the facility should only order those supplies necessary and not have standing orders to purchase supplies every week or month. With respect to supplies as revenue, the facility must have adequate policies, practices and procedures in place to promote the accurate billing of chargeable supplies.

Billing. As noted numerous times, most healthcare facilities are dependent on Medicare and Medicaid monies. As a result, accurate and timely billing is critical. This requires accurate and fully developed charts so that the billing department can obtain the maximum reimbursement rates based upon the services provided.

Strong Financial Controls. In order to succeed with the above cost control and revenue enhancement opportunities, the operator must monitor the facility's financial performance through a budgeting process. The operator, working with appropriate staff, must develop, monitor and update the budget. The operator should measure the facilities' performance against that budget and look for continued areas of improvement. Without the financial discipline of preparing and maintaining a budget, monthly financial statements and the like, the operator cannot adequately monitor the healthcare facility's financial performance.

Vest in the Community. If the healthcare business is rooted in the community, community loyalty will be a key to the success of the healthcare business. Community or customer loyalty is important to any hospital, nursing home or other healthcare facility. Moreover, in troubled times, not for profits in the healthcare community struggle raising donations and maintaining funding. Strong community ties typically lead to success.

You Must Have a Plan. If the healthcare facility is in financial difficulty, the operator must have a plan for addressing the problem with fully developed current cashflows, projections and a business plan addressing implementation of the plan. These

documents will be key in discussing any proposed restructuring or workout of secured debt, vendor debt or the like. Moreover, these documents will be key in any discussions with critical vendors or critical employees that must be convinced to continue working with the troubled healthcare facility.

In financially difficult times, the key is to address problems head on. Without aggressively managing the situation, the financial problems will worsen and the prospects for working out of financial difficulty will diminish.

An Industry of Opportunities

With the aging population, the healthcare industry will be a tremendous growth area in this country. The government is clearly focused on re-vamping the delivery of healthcare. This is a must. In order to do so, there must be a more balanced funding of the capital and operating costs. A broader and more comprehensive government healthcare payer program must be developed. Such programs must be designed to encourage cost-effective and efficient operations in the most appropriate setting for the delivery of healthcare services. It must promote optimum levels of quality care and independence through economic incentive.