Are Hospitals Prepared for a Recession?

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News coverage of a possible economic recession flared late this summer with a yield curve inversion, a bond market phenomenon that is historically associated with a financial downturn. The curve came with a 3% drop in the Dow and S&P. Healthcare-related stocks took an even larger fall. The Federal Reserve's interest rate cut failed to immediately bolster the market.

While economists can't precisely pinpoint the start of the next recession, this market volatility should serve as a wake-up call to vulnerable healthcare organizations. As we saw during the Great Recession (Dec. 2007- June 2009), an economic downturn can be particularly harmful to standalone and government hospitals and health systems currently eking out the slimmest of margins. Hospitals should be preparing now to absorb the financial impact of a recession.

The hospital business is highly subject to consumer utilization patterns. Out-of-pocket healthcare costs continue to be burdensome for many Americans with the proliferation of high-deductible health plans. Half of adults surveyed by the Kaiser Family Foundation in March 2019 said they have put off seeking medical care in the past year due to costs. This comes despite the U.S. currently experiencing one of the greatest periods of economic expansion in its history.

Increases in un- and under-employment and financial insecurity caused by a recession will only further cost avoidance by consumers, as we saw a decade ago. Elective procedures sought by insured patients are generally a hospital's best revenue-generator. During the Great Recession, scheduled inpatient hospital stays by commercially insured patients dropped 4.5% year-over-year due to coverage loss and patients with coverage seeking care at reduced rates. This resulted in a $3.7 million loss in patient revenue for the average 300-bed hospital. Patients who do seek hospital care during a recession are more likely be sicker and lack meaningful insurance. Overall, the average hospital margin fell from 6.0% in 2007 to 1.8% in 2008, the first full year of the recession, according to a study published in Health Affairs by Bazzoli et. al.

Hospitals and health systems should also brace for a significant hit to their non-operating income. A significant source of income for many hospitals comes from their investment portfolios. A recent analysis by Juniper found that many hospitals' balance sheets were bolstered by a strong stock market in 2017 and the first three quarters of 2018. Average investment income revenue represented 47.0% of net margin for 90 sampled independent hospitals across the country. The average operating margin for these hospitals was -0.8% and average net income margin was 3.7%: the positive uptick almost entirely thanks to investment revenues.

Considering Quality in a Business Combination, continued

The stock market dive in the 4th quarter of 2018 gave us a preview of a recessionary experience. Most institutions experienced notable investment income losses in that time period. (A dozen of the largest non-profit systems in the U.S. ended the year with a collective $3.7 billion loss on investments.) The hurt brought on by a full recession would be prolonged. Between 1945 and 2001, the average recession was about three and a half quarters. The Great Recession stretched on for six quarters. The impact of an extended downturn on investment income would prove devastating for many hospitals and health systems.

Hospitals that receive meaningful philanthropic or governmental support will also likely see such revenues decline. Charitable giving dropped 7.0% in 2008 and another 6.2% in 2009, the height of the Great Recession, and remained “well below the 2007 level” in subsequent years, according to the Stanford Center on Poverty and Inequality. Cash-strapped local governmental entities may be less inclined to support public-sector hospital losses, while hospitals that enjoy direct tax revenues could see those funds decline significantly.

Unsurprisingly, the Bazzoli study noted that, “operating margins for hospitals with mixed or weak initial performance generally declined throughout [the Great Recession].” The study authors also found that hospitals in systems fared better than their independent peers, theorizing that “systems may provide resources that buffer individual hospitals against local economic downturns.”

While hospitals and health systems were historically considered to be robust performers in a weak economy, they are not recession-proof. The financial strain of a recession can negatively impact a hospital’s ability to achieve optimal patient outcomes, maintain financial viability, and make necessary investments for the future.

Hospitals must develop strategies to cope in an environment with fewer adequately insured inpatients, increased self-pay, and limited non-operating revenues. Examining cost reductions is important, but likely insufficient to fully insulate an organization from a multi-year downturn. Comprehensive outpatient initiatives, service line enhancements and exploration of strategic, scale-focused partnerships should all be on the table. With forethought and planning at the Board and executive level, a hospital or system can position itself to remain a sustainable community anchor and preserve access to quality health care services in times of economic stress.

Juniper Advisory is an investment banking firm dedicated to serving hospitals and health systems, providing objective financial advice and guidance on strategic parnterships. More information is available at juniperadvisory.com.