ToneyKorf Partners LLC

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# Unemployment Impacts Hospital Margin and Sustainability

By PETER YEH and JAMES PORTER

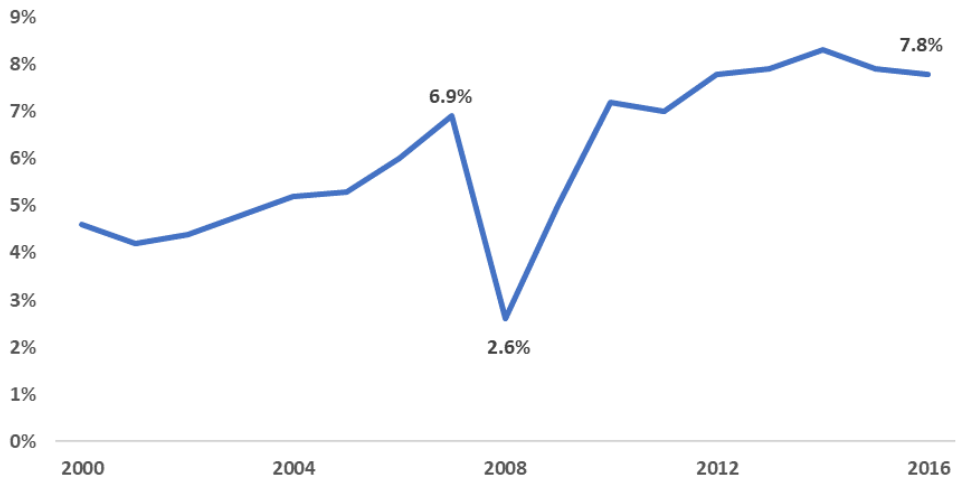
A recent article in the New York Times written by Reed Abelson stated that, *"The twin risks in this crisis — potential infection and the cost of medical care — have become daunting realities for the millions of workers who were furloughed, laid off, or caught in the economic downturn. It echoes the scenarios that played out after the 2008 Great Recession when millions of Americans were unemployed and unable to afford even routine visits to the doctor for themselves or their children."* [1]

On March 19, 2020, California was the first state to issue “stay at home” orders to help flatten the curve and fight the COVID-19 pandemic. That same week, 3.3 million Americans filed unemployment claims. Since the beginning of the pandemic, unemployment has risen to levels unseen since the Great Depression with a reported 52.7 million filing for unemployment benefits, as of July 18th.[2] Under normal circumstances, unemployment is often immaterial to a hospital budgeting process. However, in times of prolonged economic downturn, through the loss of employer-sponsored health insurance ("ESI") and cautious consumer healthcare spending, unemployment has a significant impact on financial performance. Therefore, management must understand how COVID related unemployment and its impact on ESI will alter a hospital's financial forecast. This factor, along with the infection rates in geographical regions, recovery rates by populations, and other related elements, require accurate projections and thoughtful planning to mitigate the related financial risk.

On June 10, 2020, the Chair of the Federal Reserve, Jerome Powell, predicted that unemployment will remain as high as 9.3% through the end of 2020 and that the U.S. economy, now in recession, will not recover to pre-COVID levels until the end of 2021. Historically, high numbers of layoffs during major recessions result in significant shifts of ESI from private insurance to government payers or uninsured, which often pay less than the costs of treating patients. These historical behaviors often result in decreased hospital admissions and profit margins.[3] While unemployment is not perfectly aligned with a provider's bottom line, we can

approximate the effect based on the shift of ESI. **Diagram 1** below shows the historical impact of the Great Recession on hospital profit margins, which accounted for approximately a $30 billion erosion of profit to the provider community from 2007 to 2008, or the equivalent of a $50 billion in profits in 2018.[4] [5] To counteract the impact of the Great Recession, The American Recovery and Reinvestment Act of 2009, including the Affordable Care Act, was enacted to provide direct and indirect stimulus to the most impacted hospitals, safety nets and nonprofits.[6] These stimulus plans succeeded in helping financially distressed hospitals rebound from the challenges caused by the economic downturn.

**Diagram 1 – Impact of Great Recession to Total Hospital Profit Margins**

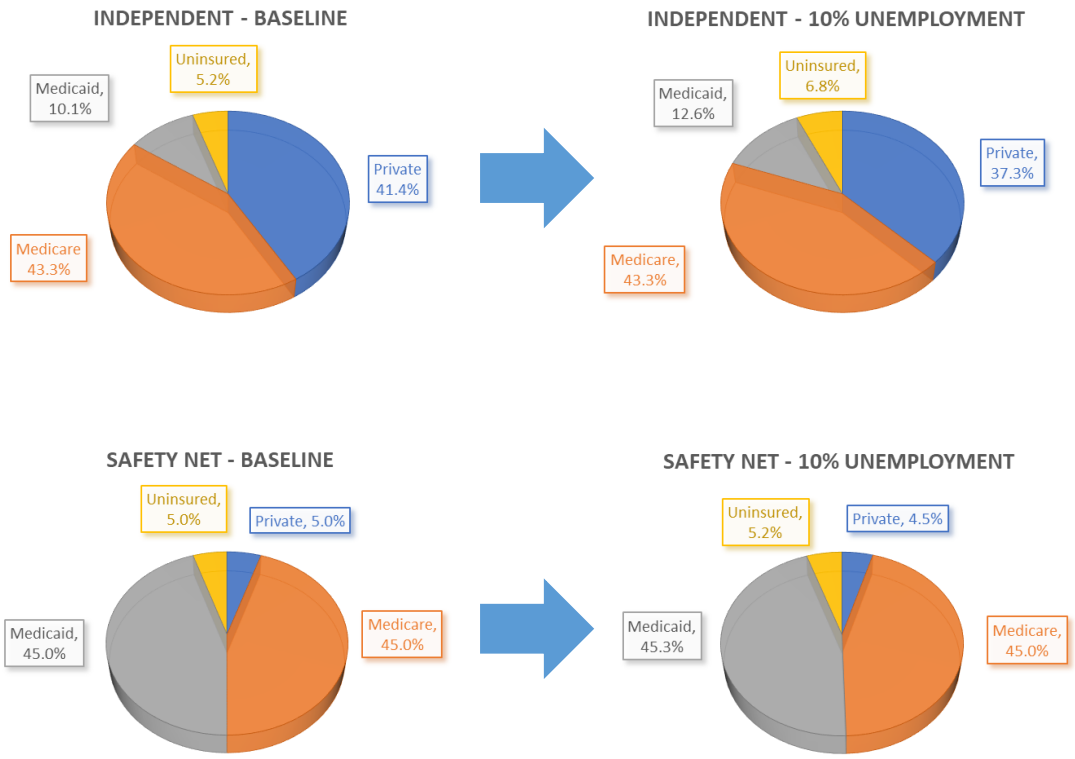



Mirroring the prior 2008-2009 stimulus, the CARES Act in 2020 has provided $175 billion of aid to providers on the front lines of the coronavirus response. According to the American Hospital Association ("AHA"), the estimated four-month cost (March – June 2020) to providers from the pandemic will be $202.6 billion.[7] Unlike the 2009 Great Recession, the AHA report implies that the additional direct and indirect costs of COVID-19 will continue to impact providers far greater than the current stimulus funding. Barring additional support, or an unlikely swift end to this recession, unemployment will increasingly burden the already distressed organizations.

## High Unemployment Drives Shift Away from Employer Sponsored Insurance

Historical studies on provider trends, profitability, and payer mix, along with more recent data points, yield estimates of the current unemployment impact to individual hospitals. Initial data projects a loss of ESI based on the unemployment rate and assigns that loss to three categories: Medicaid, Private Insurance (includes COBRA and ACA plans), and Uninsured.[8] **Diagram 2** below shows the significant impact of a 10% unemployment rate to baseline payer mix of independent hospitals in sharp contrast to the nominal shift seen for safety net hospitals.[9]

**Diagram 2 – Payer Mix Shift for Safety Net and Independent Hospitals**

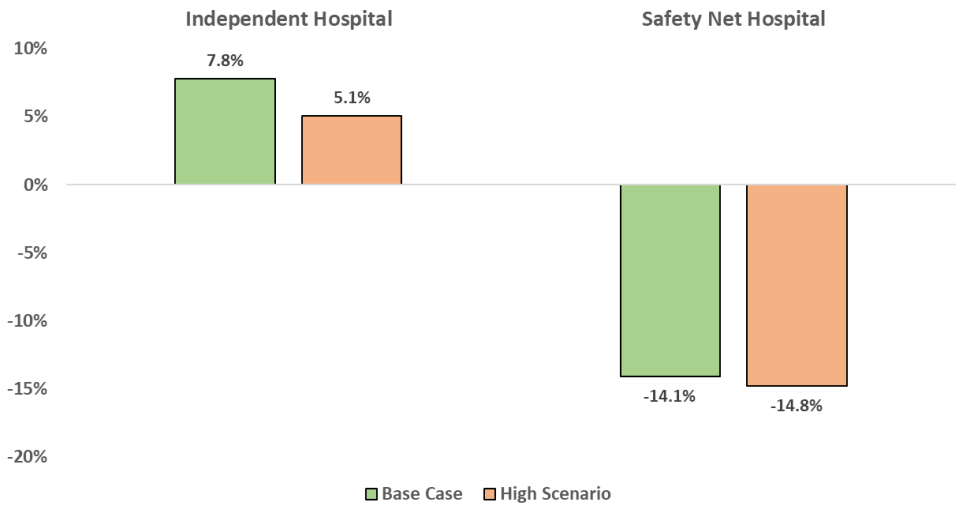



In order to quantify the financial impact of these employment-related payer mix changes, and to allow for meaningful comparisons, we utilized average revenue and expense metrics for safety net and independent hospitals.[10] [11] These financial metrics include:

- Revenue per hospital discharge by payer
- Cost per hospital discharge
- Revenue allocation for inpatient vs. outpatient
- Seasonality

Based on these metrics, the 12-month negative impact of a 10% national unemployment rate to hospitals could be as high as $35 billion. As shown in **Diagram 3**, independent community hospitals will experience the most significant impact, with up to a 2.7% decline in their profit margins. Safety net hospitals, in line with the shift in payer mix, will be minimally affected by the impact of unemployment but may still see a proportionally significant 0.7% decline in profit margin.

**Diagram 3 – Impact of Unemployment on the Profit Margins of Independent and Safety Net Hospitals**




*"We knew these numbers would be big, this is the worst economic downturn since World War II. It dwarfs the Great Recession. So it's not surprising that we would also see the worst increase in the uninsured."*[12]

## Hospital Type and Location Highly Influence Impact

On July 24, 2020, the U.S collectively reported almost 75,000 new coronavirus cases, the pandemic's highest single day on record.[13] No longer open for speculation, COVID-19 is not burning out, but rather is spreading beyond the initial epicenters impacting local, regional and state economies. These trends do not bode well for unemployment. Hard hit sectors such as retail, entertainment, and hospitality were beginning to improve as states reopened commerce under the pretense that everything would return to normal. The exploding case count tells a different story. Many state governors are now imposing new restrictions consistent with rising infection rates and plans for reopening are not progressing as smoothly as expected. With a low likelihood of an immediate cure for the virus, and the high probability of a prolonged economic recovery period, unemployment does not look poised to rebound anytime soon.

ToneyKorf Partners', through its proprietary Pandemic Impact Mitigation Strategies ("PIMS") Model demonstrates that the impact of unemployment on the hospital community will be significant but disproportionate.[14]

Geographically, 46% of the estimated 5.4 million (and counting) workers becoming uninsured resulting from the COVID-19 pandemic have occurred in five states: California, Texas, Florida, New York and North Carolina. In addition, 20% or more of adults are now uninsured in eight

states: Texas, Florida, Oklahoma, Georgia, Mississippi, Nevada, North Carolina and South Carolina.[15] Within each state safety net hospitals will be the least impacted due to their nominal percentage of private payers. Large systems, small systems, and independent hospitals with a higher private payer percentage will face greater challenges caused by the shifts in payers. However, large health systems often have large cash reserves, more in-depth resources, and sufficient bargaining leverage to weather most storms. Also, larger systems are usually located in more densely populated areas and may be less impacted by one or two employers that have massive layoffs. In contrast, independent and community hospitals, along with smaller networks, do not have deep resources and are less able to endure declines in net patient revenues. Further, smaller systems and independent hospitals generally have facilities in locations with a few critical employers for the entire region. In such cases, a large layoff can significantly impact a hospital's payer mix with very few options, if any, to offset the lost revenue.

Multiple factors influence a hospital's payer mix including location, services, quality of care, reputation, and market share. However, these factors change slowly and the changes take time to result in increased commercial insured patients. If higher unemployment rates persist for more extended periods of time, competition for patients with commercial insurance will increase further, requiring hospitals to find new ways to recoup these additional financial losses until unemployment returns to lower levels.

## Future Expectations

Rising unemployment caused by COVID-19's is an important consideration in a hospital's or system's budgeting process. The unemployment rate in regions and local communities will influence the payer mix because of the loss of ESI. Furthermore, addressing the impact of unemployment becomes increasingly important as no federal legislation signed into law during the pandemic has attempted to create a sustainable health insurance plan to combat the loss of ESI and promote economic recovery. ToneyKorf Partners' PIMS Model projects that this change alone will reduce pre-COVID profit margins at small and independent hospital systems by 35%. The altered payer mix, in combination with other factors such as lost case volume and increased labor and supply costs, will accelerate many hospitals' financial instability. Providers need to understand the impact of their local and regional economic slowdown, as well as the pace of the recovery to mitigate this impact.

## About the Authors:

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## About ToneyKorf Partners:

ToneyKorf is a management and advisory firm that specializes in complex and crisis situations. We lead organizations that are experiencing strategic, operational, or financial challenges.

ToneyKorf's distinctive approach combines experience and evidence-based interpretation of data that provides our seasoned professionals the ability to create realistic and executable options. In addition, we work to understand the various stakeholders' objectives, develop solutions that meet expectations, and avoid pitfalls before they derail the turnaround process.

We bring experience and skills to fit the situation and have the courage and perseverance to make the necessary changes for the right outcome.

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