



HEALTHCARE INDUSTRY GROUP

# Healthcare Market Perspectives: Quarterly Podcast

## Transcript

**[00:00:00] Martin McGahan:** The economic headwinds and the reality of what's going on right now in your labor market, in your services you provide, but still providing access to care is, I think, an unprecedented place where we are in this country and for our clients. It's new decisions that have to be made very, very quickly by healthcare leadership that they really haven't faced before. That's a challenge. The boardrooms are feeling that. That's going to be a really, really tough landscape to navigate over the coming years.

[music]

**[00:00:47] Stu McClain:** Welcome to A&M's *Healthcare Market Perspectives Quarterly Podcast*. I'm Stu McClain, a managing director and leader of our health systems practice. In this quarterly podcast, we will discuss and cover the latest in healthcare trends, changes, and what we are seeing on the horizon. For this our inaugural episode, I'm delighted to be joined by my friend, my colleague, and the managing director and co-head of our healthcare industry group, Martin McGahan. Thanks, Martin.

**[00:01:20] Martin:** Honored to be here, Stu. I'm honored that you have included me in your podcast series, let alone being the inaugural one of your podcast series, so thanks.

**[00:01:30] Stu:** Wonderful. Let's get to it. With the recently turbulent environment stemming from really the financial and economic fallout from the pandemic still really rippling across the industry, challenges remain in many areas. We're also seeing perhaps some optimism about transformation ahead. Let's start with the challenges. Financial performance of health systems has been really decimated in some regards and, in many regards, just hurt over the course of these last several years. Observations, comments about where we are and where we're going.

**[00:02:14] Martin:** There's a tremendous amount to comment about. Obviously, the last three years going through the COVID-19 pandemic has challenged the healthcare system in the US and worldwide more so than it's probably ever been challenged. Even before the pandemic started, there were basic infrastructure challenges that were being addressed, but really, a couple of things. First, COVID put a tremendous amount of stress on a already fragile system. To the credit of the system, and I think this should not be lost in all of this, is the performance of the healthcare workers, the physicians, all of the clinicians really was one of the better things that came out of what was a really tough situation.

As a result of that, coming out, though, let's not lose the fact that probably nurses, clinicians, physicians were well overdue for the recognition that they long deserved. You go back to those early days of the pandemic where they were appreciated and people were cheered coming out of their shifts. That was great to see. I wish we could go back there, but those days are over. I think what we've come out of is you've got a tremendous amount of financial



distress inherent in the system that's reflected both on the income statement and the balance sheet.

You've got the sunset of government support first through the CARES Act, but then also throughout the system. It could be through Payroll Protection Act. That helped, but really, while the clinicians and healthcare system were focused on patients and treating the pandemic, which they 100% should have been, a lot of those structural problems that needed to be addressed going into the pandemic have gotten worse. That's just the reality of it, and so you're seeing hospitals, large health systems carrying extra burden of additional debt, lower patient volumes, and increased wages out of a pandemic which is putting the system under incredible strain.

**[00:04:35] Stu:** Thanks, Martin. As our listeners know, we spent our time on the frontline supporting our health system clients. We've noticed in 2022, as most have, that almost half or even more than half of the health systems in the country are now losing money. A big driver of that has to do with the clinical staff, which you've already commented on. Any further comments on the inflationary pressures that we're dealing with?

**[00:05:05] Martin:** Yes. The labor market I think has been in turmoil throughout multi-industry. The interesting about healthcare is healthcare, when you have wage inflation, which has happened during this and trying to get clinicians in place to support critical services, that wage inflation in healthcare is incredibly sticky. Not so much if you go to hospitality, maybe you're paying immediate, but that can actually rebound.

The stickiness in the healthcare wage inflation is just a reality and a new normal coming out of this pandemic. I've seen stats saying obviously temporary staff, those rates were 20%, 30%, sometimes even 40% higher than normal. Overall wage inflation has increased I think probably in some cases 9%, 10%, 12%. That's now here to stay. That stickiness of wage inflation as well as the wage inflation itself is really the thing that's driving the cost inflation throughout the industry.

**[00:06:13] Stu:** We really are seeing that at the front lines, and it's interesting, where our health system partners, our health system clients I think are taking a really forward-thinking approach to this where they recognize that without the nurses and without the doctors, there is nothing. Therefore, they are trying to meet the market, set the market, understand what that market looks like. You are seeing double-digit increases.

I think you're right, those are going to be sticky. It sets a new cost structure which then raises the question around revenue streams and the importance of government payers. It's too soon from my perspective to tell what the impact of the changes in Medicaid might be, but do you have some thoughts on that?

**[00:07:03] Martin:** Complicated and multi-part question there. Before we leave wages, first, I think wages and overall clinical rates and employment wages, they're varied, right? They vary by geography, they vary by market. I think overall, we've seen the trend. One stat that I saw that was particularly alarming was somewhere over 333,000 clinicians left the profession during the pandemic, and that's nurses, that's physicians, that's other clinicians, that's techs. As you and I and our clients know, recreating that labor base, it can't happen overnight. You can't create more nurses or create more physicians. That will have to be solved over time, further contributing to the stickiness.

What then happens, as you totally pointed out, is who pays for that? How do you pass that along? Quite candidly, to provide care, it's going to fall to ultimately insurers, but that's sticky as well. You're not going to see that reflected in rates, so the gap is going to fall to government programs and most likely state and Medicaid programs if you want those

services to continue, which quite candidly, they have to continue. You're going to see increasingly burden on the states to fill that gap, and that's going to be, I think, a real flashpoint for our clients probably over the next two to three years of how that gap in funding care falls out in each of these communities.

You're going to also see it within communities, there are going to be winners and losers, unfortunately. It's a really dynamic time as you and I know in the hospital space right now, especially in the large healthcare system place because these are complicated questions and questions that can't get answered pretty easily. Long answer to your question, but hopefully that was something that-- [crosstalk]

**[00:09:18] Stu:** Super helpful. Just to add to that, the challenge, I think, that some of our clients on the front line are having is that there are services that they provide in their community that are profitable and there are services that are simply not, and so those services that are not are also, to your point, important with regard to access. Because of that funding gap, there are questions being raised in boardrooms and in C-suites around whether they can continue to provide the full range of services. That sort of disruption is a really powerful question that we as a nation are facing.

**Martin:** Yes. Going back, you're exactly right because the health system and healthcare services system in large hospitals, they're economic beings but they're also public health beings. They have a duty to provide services for their community. I think that's something that is remarkably unique, and in a lot of ways, special about what we do. It's, yes, this is a business, but you're providing really critical health services for your community.

Being caught between the economic headwinds and the reality of what's going on right now in your labor market, in your services you provide, but still providing access to care is, I think, an unprecedented place where we are in this country and for our clients. It's new decisions that have to be made very, very quickly by healthcare leadership that they really haven't faced before. That's a challenge and the boardrooms are feeling that. That's going to be a really, really tough landscape to navigate over the coming years.

**[00:11:22] Stu:** The question becomes, again, from the perspective of the boardrooms and the C-Suites, how do we respond? I think what we're seeing is a movement in a couple of directions, certainly in the direction of ambulatory care, virtual care, but also the application of technology. Comments on any of those just in terms of the change in the way care is delivered, perhaps.

**[00:11:49] Martin:** Yes. Heading into the pandemic and really I'll say over the last 15 years, you would even know better than I, there has been a significant movement to shift patients in care out of the high-cost environments into more economically-driven care environments. That's been great. I think the pandemic accelerated that more than probably any payer probably has. It was more effective in doing that.

You're going to see movement toward those outpatient and ambulatory care services. You're going to see different treatments in how you clinically treat patients in those areas too. You saw the emergence of telehealth. I think that's interesting. I think that's here to stay, but it's more than that. It's how do you deliver care, how do you change the footprint of large hospital systems, and what does the hospital 25 years from now look like? It's going to be very, very different.

**[00:12:48] Stu:** Yes, agreed. I read a study recently, I want to say it was a Kaiser Foundation study but I'm not sure, that noted that for a hospital and health systems, that in this year 2023 for the first time, in total, outpatient revenue would equal and outstrip inpatient revenue. That's been a long time coming, and I think you're right, has really accelerated over

the course of recent years. It just speaks to a really dramatic change in the way care is organized.

**[00:13:23] Martin:** To make that shift, Stu, it requires different application and different sourcing of capital. It's not a shift that happens quickly, it's not a shift that happened. There's some planning that you have to get in order to drive what the strategy for care is and the clinical care is going to be. You put that also in an environment where most of large health systems are capital, they're running into just the overall market of capital constraint. Access to capital is more expensive and it's more limited. To make that shift in this environment becomes almost doubly hard.

You have a capital system with rates that are higher. You have a debt burden on a legacy system that you're going to have to somehow service. You're going to have to make that shift in what's going to be a pretty tough economic environment, at least for the near term. We're starting to see that. You're starting to see bond rates and bond defaults increase. I saw in the first quarter of '23, there were more bond defaults than there had been since, I think, this time in 2011. That is almost like that's a 12, 15-year life cycle of capital that you've had low cost of capital that's now shifting to more expensive capital.

You're starting to see a higher cost of inflation. I think the supply chain issues that plagued us during the first part of the pandemic have loosened, but they're still complicated obviously. Especially it's going to be complicated with access to international medical products. All of these things make it a really, really, I think, unique and complicated time for a hospital leadership at this point.

**[00:15:17] Stu:** Yes. Well said. Martin, I want to say just as we wrap this up, your perspective from that is you have the benefit of really understanding the hospital and health system space, and you see healthcare from a much broader perspective as well, from the perspective of the payers, from the perspective of investors, and the like. Closing comments perhaps on the road ahead and whether or not you might see some changes perhaps in terms of the way capital structure is maybe considered or technology is delivered, or the relationship between payers and providers.

**[00:15:58] Martin:** Yes. I think you have to never lose the perspective that the business and the reason that large health systems exist is to provide patient care. Just end of story. Having that on-the-ground perspective and having that in-the-trenches perspective that you have and obviously being out in clients that our clients have can't be lost, but also it's going to require different challenges. It's going to require a broader scope and probably a shift in capital planning. It's going to require a shift in perspective. I would just encourage our clients to not ignore that and understand that this is the new reality and understand that getting at that additional perspective is going to be key.

My thought in heading into this next phase is whatever you do, it's going to require a new and bolder thinking that, quite honestly, is going to require people to collaborate a lot faster, to be a lot more integrated between the care delivery and people driving the balance sheet. That shift and speed and reactivity is going to have to increase. In order to do that, you're going to have to develop business muscles and tools that are unfamiliar and sometimes undeveloped. That's just the reality of what's going to happen and the shift that's going to have to take place.

**[00:17:47] Stu:** Thank you, Martin. Yes. The old playbook just won't be helpful. New muscles and a new pace in terms of responding to the challenges. We're seeing that.

**[00:17:59] Martin:** Your perspective I think is critical too because I'd love your perspective. This is the part where the guest gets to interview the interviewer here. The challenges

specifically that you're seeing on care delivery and probably on changes and the receptiveness I think you're seeing in the clinical hallways, is that something that you're seeing at your clients right now?

**[00:18:28] Stu:** Yes. First of all, it's against the rules for you to be asking me questions, but we'll put that aside.

**[00:18:32] Martin:** [laughs] Who makes the rule here? I don't know. This is the first inaugural podcast.

**[00:18:37] Stu:** It's inaugural. Okay, fine. That's fair. I think that's fair. Thank you for the opportunity. What I'm struck by when I spend time with our clients is, first, the earnestness with which boards and management teams are addressing these challenges, and that they really do begin with clinical staff. That they're really trying to think about a durable model for employment around clinical staff because that's just so critical, particularly given the shortages that you've described. Second, what is a durable capital structure given a financial environment that will continue to be incredibly volatile and challenging? Then, finally, really the application of technology and new modalities of care.

Those are really seismic and fundamental questions, and we're trying to ask and answer them all at the same time. This is an incredible moment, incredibly stressful, incredibly important for our clients. It's really a privilege to sit beside and walk beside these women and men as they address these challenges. We look forward obviously to continuing to walk beside and assist them in really weathering this change. Thanks for that, Martin.

**[00:20:03] Martin:** The perspective, I think, when you look at the sources of capital, you look at the strain and lack of access to capital that's driving a lot of this, I do hope that there's an appreciation for the people who have come out of this really unique time in this really unique period where, quite honestly, they have been distressed and they've gone through a tremendous amount of stress in a already stressful profession. I saw a competitor's survey of registered nurses that there was a 40% job dissatisfaction rating among current RNs right now. That is, I think, eight times higher than it was pre-pandemic.

To have these challenges that are structural unique challenges coming out of the pandemic with a high inflationary, high cost of capital, high challenge in a already, quite honestly, exhausted workforce, like you said, it's a tremendous honor to be there for that, but it also shouldn't be lost as this is a critical industry. The changes are real, but those changes in this environment need to be managed and handled in an appropriate way, or else you're going to start seeing also, which COVID shined a very bright light on the disparity of care and the impact and the access disparity.

Really it's the lack of access that a lot of our, quite honestly, people of different ethnicities, race, color, economic background face that also will be impacted as a result of these changes. That's a very complicated volatile situation to put this change into, but it also really points to the importance of getting it right. It's not lost, I know, on you. It's not lost on our clients. I'm glad to hear it's not lost on the clinicians too because they're dealing with it and they feel it. I think that's an important point to carry out of all of this.

**[00:22:35] Stu:** Thank you, Martin.

**[00:22:36] Martin:** Any other reactions that you have from what I'll say is the front lines out there?

**[00:22:41] Stu:** That's it I'm out of time.



**[00:22:43] Martin:** All right. You got other more important stuff to do. Stu, it has been a pleasure. I always love talking to you about this stuff. I would encourage you obviously and our clients and the listeners to this to reach out to smart people like yourself and your colleagues to help navigate these situations. Honored to be part of your team in delivering these tough solutions, but real important solutions.

**[00:23:08] Stu:** Thank you, Martin. It's been great to have you with us today. Martin McGahan, thank you so much.

[music]

[00:23:17] [END OF AUDIO]

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