UPI INTERVIEW: JOHN BOETTIGER ON HEALTHCARE

Published: May 4, 2007 at 5:54 PM

WASHINGTON, May 4 (UPI) -- United Press International interviewed John Boettiger, healthcare valuation leader at Deloitte & Touche USA, about the future of the financially tumultuous healthcare industry.

All healthcare firms are facing the challenge of higher costs and higher expectations, Boettiger says, but some sectors are coping better than others.

Q: What is the current financial state of the healthcare sector?

A: The payer sector is looking pretty good for the next year.

Managed care organizations are expecting between 15 percent and the low 20 (percent) growth in earnings. They are seeing increased revenue per covered life, they've gotten benefit from leveraging their fixed-cost investments and some of the transactions that have happened recently.

They are also large, well-integrated companies benefiting from economies of scale. Of course, the offset to that is they're seeing increased medical cost driven by consumer and quality issues.

Q: Are things less rosy for the pharmaceutical, biotech and medical device sectors?

A: The pharmaceutical and biotech companies are facing pretty stiff competition from their generic competitors and at the same time, they're looking to fill in holes in their product pipeline. As a result, some analysts expect pharmaceutical companies will have flat revenues or even earnings declines as high as 10 percent.

However, on the medical device side there are much better expectations, probably with earnings of as much as 20 percent.

Q: And how are the providers faring?

A: The provider sector -- hospitals, academic medical centers, specialty hospitals, physicians, ambulatory surgery centers, imaging centers and others -- really consists of two groups. There are those that are a little better off, and those that are having a tough time.

Hospitals have 3 percent to 6 percent profit margins, and that's not a lot of money to reinvest in a physical plant -- which is getting older and more expensive to maintain each year -- and cutting-edge diagnostic equipment to stay competitive in oncology, general surgery, neurosurgery and orthopedics. And those are the really lucrative services for hospitals.

At the same time, providers are trying to manage the increasing uninsured and bad-debt challenge they are facing.

At the high end of the range, providers are able to make those investments and look at different business models to increase their success.

The folks on the low end of the scale are having a hard time keeping up with maintaining their physical plants, investing in technology and retaining their workforce.

Q: Can you describe the unique financial challenges that hospitals face?

A: At most hospitals, for every dollar of revenue they have, about 50 cents' worth is labor cost. It's a competitive labor market right now and they're facing 5 percent to 8 percent increases in the cost of labor each year.

When you've got small margins to begin with and that kind of growth in your labor costs, margins are going to be pretty tight.

In the first quarter of this year, for every hospital that (had its bond rating) upgraded by Moody's Investor Services, they had one and a half downgrades, so 50 percent more facility managers were downgraded.

Q: From a macro perspective, what are some of the bigger forces driving change in the healthcare sector?

A: All of the sectors are facing a group of cross-sector factors.

First, there's an aging population and as you get older, your demand and need for healthcare is higher. There are a lot of new technologies and pharmaceutical products available, and seniors are aware of them and have higher expectations.

The question is, how do you deliver great quality at a competitive price to a knowledgeable group of consumers while there is also a large uninsured population you have to serve? It is a big challenge to meet those expectations while managing costs.

Q: From a micro perspective, what are some of the things that are getting hospitals and healthcare networks in financial trouble and what do smart firms do when they think that might be happening?

A: At Deloitte, when we work with clients where that is happening, we do a diagnostic and look a couple of different areas.

First, you look at how you run your business. Are you running the tightest ship you can and staying up-to-date with industry best practices?

When it's more urgent, we look beyond operational solutions to things that are more strategic to the balance sheet. What assets will the business hold on to?

First we look for non-core assets we might be able to divest for cash to help with things like renovations, or building a financial war chest. Those reserves can help a health system deal with things like a higher proportion of uninsured patients in their payer mix. It can also be a cushion while the company is renegotiating contracts and dealing with some of the operational issues.

Next, we look at core assets we'd like to hold on to in the long run, but might be a bigger source of cash. That might include selling one of your hospitals or your managed care plan. A lot of providers still have a captive insurance company.

Some might also syndicate some of their outpatient businesses like imaging centers and surgery centers to generate revenue as well. Those are businesses that are core to their operation, but they have to look at monetizing some of that asset to help manage cash-flow needs.

Q: Are there special considerations for single-hospital systems?

A: There are some situations where you have a single-hospital system with significant financial needs. Often those hospitals look at divesting the entire business or putting all of it into a joint venture with a financial sponsor or one of their competitors.

You usually have somebody exiting the healthcare business and someone else coming into the community and taking over the institution and rebuilding it.

There's such a continuum of options. Most organizations will do those in baby steps, but a smarter answer is to make decisions holistically from the beginning. The smarter organizations get to that realization quickly.

Q: In the next five years or so, what are some of the biggest changes you think will take place in the sector?

A: Big for providers is the topic of pay-for-performance as a way to incentivize physicians to provide better care. Hospitals need to look at how to embrace that. Having a strategy around integrating pay-for-performance into your business model is going to be important.

We're going to see increased joint-venturing in hospitals. If your hospital is not performing very well in an area like cancer or orthopedics, there's a lot of outside expertise you might look at partnering or bringing in help in the service area.