What the $1T Cut in Medicare Mean for US Hospital Finances

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There are about 6,000 hospitals in the US. About 5,000 of them are community hospitals which are short-term, non-federal, general and specialty hospitals that are open to the public. Here, for the sake of simplicity, we will consider a hospital which has an annual revenue of about $1B and with an average profit margin of 3% which translates to $30M in annual profits.

Medicare accounts for about a quarter (25%) of spending on hospital care. As a result of new legislation, the annual Medicare payments are projected to be reduced by about 10%. Thus, for our hospital, the lost revenue would be around $25M. It is difficult to estimate the exact impact of Medicare funding change on hospital profits, however as our simple analysis indicates, the extent of lost revenue is similar in magnitude to that of the annual profit. This implies that US hospitals will need to find millions of dollars in savings in next 6 months just to make the numbers work and stay profitable.

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Next, let us analyze the operating expenses of our hospital. There are 3 major operating expenses for US hospitals. Like many other service businesses, by far the largest contributor to operating expenses is the cost of labor (roughly 50% of total). The other, and rather minor, cost contributors are medical consumables and pharmacy operations, which contribute around 10% each. Thus, we can identify two major priorities for US hospitals within the next 12 months. First, workforce optimization will play a major role in optimizing expenses. Second, optimization of purchasing and streamlining the operations related to consumables and pharmacy will be another major focus.

We have a long tenure in workforce optimization and optimization of operations and purchasing. We should also mention that our approach to workforce optimization does NOT prioritize headcount reduction, however it does prioritize staffing budget reduction. If you are interested in learning more about our work in the healthcare industry & workforce optimization and about how we can help you, please contact us at sei-partners.com

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