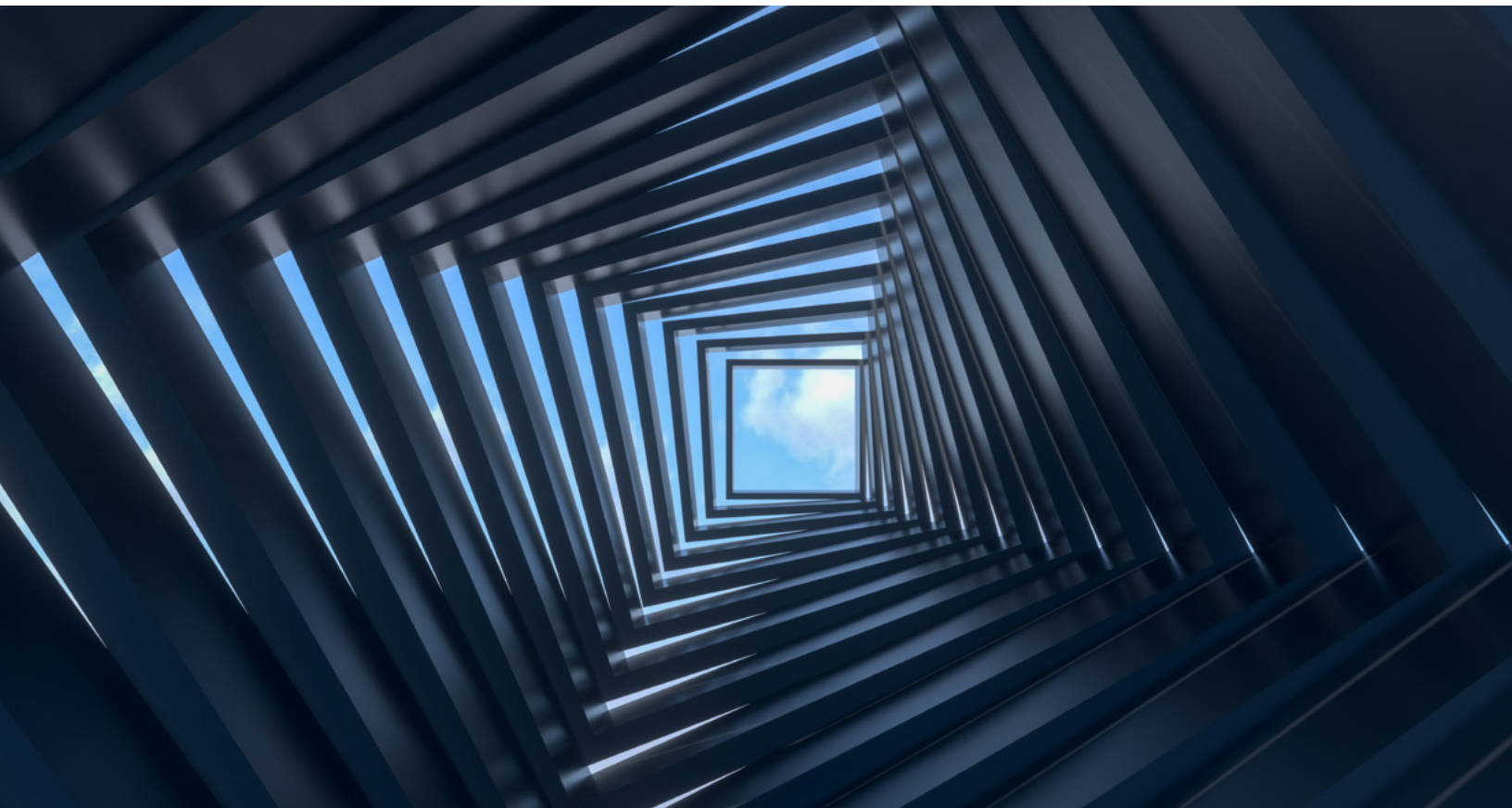


Healthcare Practice

2024 health systems outlook: A host of challenges ahead

Health systems may face a challenging year ahead, with increasing competition from nontraditional players, workforce shortages, and demands for new capabilities. However, these challenges also present opportunities for leaders to focus on resilience, find efficiencies, and take a multilever approach to growth.

by Rupal Malani



As health systems emerge from the COVID-19 pandemic, their focus has shifted from near-term challenges such as demand fluctuations to longer-term implications: an acceleration of secular trends leading to expenses exceeding revenue. Health system revenue rose 12.5 percent from 2021 to 2022 as operating expenses rose 17.2 percent in the same period, according to an S&P Global analysis. This imbalance stems from several industry trends that are putting pressure on inpatient utilization and reimbursement, driving up labor costs, and requiring acquisition of new capabilities.

Key trends in the industry

Health systems are confronting a host of challenges. Among them are increasing competition from nontraditional players, including digital natives, that have more access to capital than incumbents do. These players are cherry-picking attractive patient segments and earning margin by reducing total cost of care, with a primary focus on inpatient utilization. This exacerbates continued pressure from payers on health systems to reduce inpatient utilization and reimbursement.

Also, clinical workforce shortages continue to weigh heavily on health systems. By 2025, we estimate the United States may face a shortage of 200,000 to 450,000 nurses available for direct patient care, equating to a 10 to 20 percent gap.¹ Wage growth for nonclinical roles and inflation more generally are putting additional cost pressure on health systems.

At the same time, stakeholders are demanding new capabilities from health systems. For example, consumers' experience with retailers is forcing health systems to deliver omnichannel experiences, including digital tools such as self-scheduling. Meanwhile, payers are encouraging health systems to move toward value-based care (VBC) arrangements. We estimate that VBC lives will grow from 80 million to 100 million in 2022 to 130 million to 160 million in 2027.² This would require health systems to upgrade their risk-bearing capabilities.

Health systems are also closely monitoring regulatory issues, including price transparency requirements and the direction of initiatives such as the US government's 340B drug program.

How healthcare providers are responding

Over the past few years, health systems have focused on managing the pandemic. As the demand on health systems from the pandemic subsides, financial performance of players is diverging. Those that are seeing marked improvement in performance are tightly focused on resilience, including finding efficiencies and taking a multilever approach to growth. These levers range from ensuring the basic blocking and tackling of in-market growth (for example, clinical program development and care continuity) to diversification of revenue streams (such as investing in ambulatory surgery centers) and monetization of best-in-class capabilities (for example, data and analytics and revenue cycle management).

At the same time, health systems are paying close attention to costs. And they must be intentional about where and how to deploy capital, given the pressure on their balance sheets: S&P Global analysis shows that median days of cash on hand fell from 250 days in 2021 to 209 in 2022 for nonprofit systems. The cost of capital is also rising, which has exacerbated the outlook for health systems: in 2022, ratings actions by the major rating agencies skewed negative by almost 2:1. In 2021, they were essentially even.

Many health systems have undertaken extensive cost transformation programs. While health systems have optimized traditional levers such as commodity supply pricing, they are also focusing on clinical operations (for example, length of stay and throughput in procedural areas such as the operating room), patient access, and talent attraction and retention. As they look for efficiencies, health systems are taking a more holistic view of technology deployment. Many are

¹ Gretchen Berlin, Meredith Lapointe, Mhoire Murphy, and Joanna Wexler, "Assessing the lingering impact of COVID-19 on the nursing workforce," McKinsey, May 11, 2022.

² Zahy Abou-Atme, Rob Alterman, Gunjan Khanna, and Edward Levine, "Investing in the new era of value-based care," McKinsey, December 16, 2022.

pursuing end-to-end improvement of processes that drive value for patients and for the business while selectively deploying technologies to promote efficiency and patient experience.

The industry is also in the throes of the biggest M&A wave in more than a decade, with healthcare deal

activity having grown 42 percent since 2010, according to our analysis. Unlike past deal waves, this one is characterized by a marked increase in cross-geography deals aimed at shared investment for platform capabilities to weather the turbulence facing the industry.

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