On the 2023 healthcare board agenda

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Healthcare boards can expect their oversight and corporate governance processes to be put to the test by a spectrum of ongoing and emerging challenges in the year ahead—economic volatility; an acute talent shortage; supply chain disruptions; cybersecurity risks; increased scrutiny of organizations' ESG and DEI postures; and a slowly reviving deal market. The increasing complexity and interconnectedness of these risks and issues require a holistic approach to oversight and governance.

Drawing on insights from our latest research and interactions with business leaders, we highlight six issues to keep in mind as healthcare boards consider and carry out their 2023 agendas.

1

Economic risk

The healthcare industry is still struggling to regain its pre-pandemic economic stability, with many hospital systems endeavoring to get out of the red through cost-cutting measures.

2

Talent shortage

Although many industries are struggling with attracting and retaining talent, healthcare organizations need to surmount a particularly acute talent shortage stemming from burnout from the pandemic; an aging workforce; and waning interest in the profession, particularly by nurses.

3

Supply chain disruptions

Starting during the pandemic, hospitals and health systems were compelled to find work-around solutions for many critical supplies. Now, as these organizations continue to care for COVID patients while simultaneously rescheduling elective procedures, minimizing the risk of supply chain disruption is more critical than ever.

4

Cybersecurity

Healthcare is a prime cybersecurity target due to its elevated profile during the pandemic and the fact that health data is worth 10 times as much as credit card data on the black market.

5

Diversity, equity and inclusion (DEI)

Although healthcare has historically been more mature in terms of diversity than other industries, organizations are still subject to scrutiny from various activists and potential federal and state diversity mandates.

6

Reviving deal environment

Although mergers and acquisitions were relatively light during most of the pandemic, there has been an uptick in hospital deals in recent months. Larger entities are seeking to merge to gain greater negotiating power with payers and vendors, while some smaller, rural hospitals seeking are looking to acquisition by larger health systems to secure their survival. Furthermore, there are many non-traditional healthcare entities (disrupters) entering the healthcare market through startups, partnerships, or acquisitions with the goal of improving the patient experience.

Maintain focus on how management is addressing economic risk

The business and risk environment has changed dramatically over the past year, with greater geopolitical instability, surging inflation, and the prospect of a global recession added to the mix of macroeconomic risks healthcare organizations will face in 2023.

There has been a rise in the percentage of hospitals with negative credit ratings in the past year. The number more than doubled, rising from three percent in 2021 to seven percent in 2022, according to Fitch Ratings.[i]

This environment will call for continual updating of the healthcare organization's risk profiles and more scenario planning, stress testing strategic assumptions, and analyzing downside scenarios. Leaders will need to assess the speed at which risks are evolving, their interconnectedness, the potential for multiple crises at the same time, and whether there is flexibility in the organization's strategy for pivoting.

For example, inflation and higher interest rates have heightened consumers' concerns about where they spend their healthcare dollars, thus elevating the importance of making real progress toward value-based care and avoiding the risk of raising prices. Instead, hospitals are looking at a variety of cost-cutting measures, including circumventing staffing shortages with robotic process automation where possible, offshoring information technology and other back-office services, transforming the revenue cycle, and other measures. That said, there will be some cases where raising medical costs will be inevitable, such as fulfilling pent-up demand for elective procedures. (More than 32,000 COVID-19 patients are being treated in hospitals, according to The Washington Post, while hospitals are seeing more patients who delayed treatment for other health problems during the pandemic.)[ii]
In these cases, health systems will need to move negotiations with payers to the top of their agendas.

Some questions healthcare boards may want to ask themselves as they oversee management's reassessment of the organization's processes for identifying and managing these risks and their impact on the company's strategy and operations include:

- Is there an effective process to monitor changes in the external environment and provide early warning that adjustments to strategy might be necessary?
- Is the company prepared to weather an economic downturn? Are stress tests sufficiently severe?
- Help management keep sight of how the big picture is changing: connecting dots, thinking differently, and staying agile and alert to what's happening in the world. Disruption, strategy, and risk should be hardwired together in boardroom discussions.
- Challenge and question management's crisis response plans. Are they robust, actively tested or war-gamed, and updated as needed? Further, do they include communications protocols to keep the board apprised of events and the organization's response, as well as to determine when/if to disclose matters internally and/or externally?

Finally, aim to have business continuity and resiliency as part of the discussion. Organizations need to assess their ability to bounce back when something goes wrong and the ability to stand back up with viable strategic options for staying competitive and on the offensive in the event of a crisis, such as ransomware, a cyberattack, or another health crisis like the COVID-19 pandemic.

[i] Ron Southwick, Hospitals should brace for difficult 2023, but there's 'light at the end of the tunnel,' analysts say, Chief Healthcare Executive, January 12, 2023.

[ii] AHA

To better manage the talent shortage, focus on human capital management and the employee value proposition

Most companies have long said that their employees are their most valuable assets. Across industries, the aging workforce, a dearth of prime-age employees, and the departure of many employees who are currently suffering from long COVID from the workforce have raised the difficulty of finding, developing, and retaining talent. It is arguable that no industry has faced a more challenging talent shortage than healthcare: Many healthcare professionals are suffering from burnout from working on the front lines of COVID for the past two years. Some are leaving the industry altogether, while others are interested in moving into less risky administrative positions. Overall, there is a less positive view of the healthcare profession, as can be seen through declining medical school and nursing school enrollment, as well as burgeoning employment opportunities at non-traditional healthcare entities.

According to the Bureau of Labor Statistics, healthcare occupations—including nurse practitioners, physical therapists, and home personal care aides -- are supposed to be the fastest growing occupations between 2020 and 2030 due to the aging of the population. However, low wage rates are a deterrent, particularly since healthcare is competing with other industries for a shrinking labor pool. Ultimately, the industry is facing a shortage of one million to two million nurses, according to Fitch Ratings.[iii]

Against the backdrop of the Great Resignation, employees are demanding competitive pay and benefits; work-life balance, including flexibility; interesting and meaningful work; and opportunities to advance.

Regarding compensation packages, there is a lot of upward pressure on wages. Although labor costs moderated a bit in the second half of 2022, the expectation is that they will remain elevated for the foreseeable future. In other words, it continues to be an employee's market—particularly for hard-to-fill positions. Health systems are certainly being mindful in their contract negotiations, since close to half of their expenses are currently going toward labor.[iv] Many are looking at tradeoffs to continual salary increases, such as job sharing, shorter shifts, and tuition reimbursement, and other incentives in lieu of continual salary increases.[v]

When it comes to recruiting, companies in all industries are rethinking their employee value propositions. Healthcare organizations should remember that tying their brand to not only the consumer experience, but also the employee experience is becoming increasingly critical, particularly for larger healthcare systems with more vacancies to fill. In general, today's healthcare talent is more educated about the landscape of potential employers, so branding should be based on how an organization and its culture are different than the competition. Younger employees in particular want to work for a company with values that align with their own—including commitments to DEI and ESG. Finally, some health systems are broadening their recruitment strategies to target potential talent from outside of their geographic areas, including internationally.

[iii] Ron Southwick, Hospitals looking at 'very bumpy 2023', Fitch Ratings analyst says, Chief Healthcare Executive, December 9, 2022.

[iv] Ron Southwick, Higher costs, tough negotiations: KPMG's Ash Shehata looks at hospitals in 2023, Chief Healthcare Executive, December 16, 2022.

[v] KPMG Economics

Some questions healthcare boards may want to ask themselves as they consider their organizations' human capital management strategies and employee value proposition in a labor-constrained market include:

- Does the board have a good understanding of the organization's talent strategy and its alignment with broader enterprise strategy, as well as the ability to forecast needs for the short and long term?
- What are the challenges in keeping key roles filled with engaged employees?
- Which talent categories are in short supply and how will the organization successfully compete for this talent?
- Does the talent strategy reflect a commitment to DEI at all levels?
- As millennials and younger employees join the workforce in large numbers and talent pools become globally diverse, is the company positioned to attract, develop, and retain top talent at all levels?

Finally, having the right leadership team in place to drive culture and strategy, navigate risk, and create long-term value for the enterprise is pivotal to human capital management efforts. The board should help position that the company is prepared for leadership changes—whether planned or unplanned, on an emergency interim basis or permanent. Leadership succession planning is a dynamic, ongoing process, and the board should always be focused on developing a pipeline of potential candidates.

Some questions to keep in mind include:

- How robust are the board's succession planning processes and activities?
- Has the succession plan been updated to reflect the CEO skills and experience necessary to execute against the organization's long-term strategy?
- Are succession plans in place for other key executives?
- How does the board get to know the high-potential leaders two or three levels below the C-suite?

Monitor management's progress in building and maintaining supply chain resiliency

Healthcare organizations—particularly hospitals and physicians' practices—continue to navigate unprecedented supply chain stresses and strains. Many healthcare organizations are implementing efforts to address vulnerabilities and improve resiliency and sustainability.

Most healthcare organizations struggled throughout the pandemic to access critical supplies—including personal protective equipment (PPE) for safely treating COVID patients, as well as basic supplies for across many aspects of patient care. Many were forced to find work-around solutions to mitigate the risks associated with the supply shortage. Supply chain disruption continues to stress many organizations—particularly as they continue to care for COVID patients while simultaneously rescheduling elective procedures. Organizations need to be more assertive with their regular suppliers, maintaining ongoing communication and, in some cases, using scorecards to track suppliers' reliability, while also having back-up suppliers and exploring the idea of reshoring supply sources from overseas to the Americas to mitigate rising transportation costs.

Then there's the issue of supply costs themselves: Many organizations are facing higher costs for supplies, largely driven by inflation. In fact, there has been a six percent increase in medical supply prices, a 14-16 percent increase in drug prices, and a 10-12 percent increase in the cost of purchased services. Given these elevated costs, healthcare organizations have to balance mitigating against supply disruption with the risk of hoarding.

Some questions healthcare boards may want to ask themselves as they consider their organizations' approach to supply chain resiliency include:

- Has our supply chain structure and footprint been updated to reflect current geopolitical tensions?
- Have we updated supply chain risk and vulnerability assessments?
- What steps have been taken to diversify and/or repatriate the supplier base?
- What new technologies will be employed to improve supply chain visibility and risk management?
- Are we actively monitoring emerging cyber risks?
- Do we have back-up plans for future health crises and/or supply chain disruptions?
- Have we explored renegotiating vendor contracts as a cost-cutting measure?

[vi] KPMG Economics

Approach cybersecurity, data privacy, and artificial intelligence (AI) holistically as data governance

Across all industries, cybersecurity risk continues to intensify. The acceleration of AI and digital strategies, the increasing sophistication of hacking and ransomware attacks, and geopolitical hostilities have elevated cybersecurity risk and its place on board and committee agendas. Regarding the latter, the geopolitical climate has raised the possibility of another round of cyberattacks against high-visibility industries like healthcare.

CMS is currently advocating for more stringent data interoperability requirements among payers and providers, which will help drive insights into patient care needs. Further, the pandemic spurred additional cross-institutional data sharing and collaboration on complex health issues. With multiple stakeholders and hyperconnected digital systems, there is more of a theft risk for personal health information (PHI), which is, according to current estimates, significantly more valuable on the black market than financial data. Boards should advise their organizations to endeavor to find the sweet spot between getting value from data and keeping PHI secure.

In general, boards have made strides in monitoring management's cybersecurity posture. Some have greater IT expertise on the board and relevant committees. Other efforts include company-specific dashboard reporting to show critical risks and vulnerabilities; assessing cybersecurity talent; weighing vulnerabilities and emerging threats; war-gaming breach and response scenarios; and discussions with management on the findings of ongoing third-party risk assessments of the company's cybersecurity program.

Some questions healthcare boards may want to ask themselves as they consider their organizations' approach to a holistic approach to cybersecurity and data governance include:

- Do we have a robust data governance framework that makes clear what data is being collected; how it is stored, managed, and used; and who makes decisions regarding these issues?
- Which business leaders are responsible for data governance across the enterprise, e.g., the chief information officer, chief information security officer, and chief compliance officer?

Keep ESG and DEI embedded in risk and strategy discussions and monitor regulatory developments.

How companies address climate change, DEI, and other ESG issues is viewed by investors, research and ratings firms, activists, employees, customers, and regulators as fundamental to businesses and critical to long-term value creation. Although health systems and hospitals appear to be more diverse than other industries, there is still room for improvement.

The ESG issues of importance will vary by company and industry. Some questions healthcare boards may want to ask themselves as they consider their organizations' approach DEI programs include:

- How is the board helping to foster ESG as a priority issue for the company, and that the company is following through on its commitments?
- How is the company embedding ESG into core business activities (strategy, operations, risk management, incentives, and corporate culture) to drive long-term performance and growth?
- Is there a clear commitment and strong leadership from the top, and enterprise-wide buy-in? Are there clear goals and metrics?
- Is management sensitive to inadequate internal controls over ESG reporting?

A related issue is diversity in the boardroom. There is an increasing focus on the alignment of board composition with healthcare organizations' DEI strategies. Developing and maintaining a high-performing board that adds value requires a proactive approach to board-building and diversity of skills, experience, thinking, gender, ethnicity, and social background.

While determining the company's current and future needs is the starting point for board composition, there is a broad range of board composition issues that require board focus and leadership—including succession planning for directors and board leaders (the chair and committee chairs); director recruitment; director tenure; board and individual director evaluations; and removal of underperforming directors.

Be strategic within a reviving deal environment

On the merger and acquisition front, activity was relatively light during most of the pandemic. However, there has been an uptick in hospital deals in recent months given the need to mitigate narrow margins and the elevated costs of supplies, capital, and labor. Larger entities stand to gain greater negotiating power with payers and vendors, while some smaller, rural hospitals are looking to acquisition by larger health systems to secure their survival.

Several recent multi-billion-dollar hospital deals could serve as blueprints for similar hospital mergers, particularly when there is a desire to move into larger national markets. Larger hospital systems resulting from mergers may also gain bargaining leverage when it comes to contracting and capital improvements. In fact, some organizations may need to prioritize long-term capital needs, such as those needed to deal with aging physical plants, ERP upgrades, and cutting-edge CRM systems.

At the same time, mid-sized and smaller systems are likely to be looking for partners, either to mitigate financial difficulties or to gain access to more specialty services. Regarding the latter, the only way for some smaller hospitals to own more specialty services is to be purchased by a large health system; otherwise, they are losing out to payers and private equity companies, which are also looking to invest in this area. Others may want to follow the lead of larger health systems and partner with non-traditional entrants to the healthcare market. Such partnerships can provide health systems with access to advanced analytics and other technology tools, allowing them to offer patients a better consumer experience.

Some questions healthcare boards may want to ask themselves as they consider their organizations' deal strategy include:

- Will acquisitions under consideration give the organization access to new markets?
- Could an acquisition help the organization access talent in areas where the organization is facing acute shortages?
- Are acquisitions that provide access to specialty services being prioritized?
- Are there opportunities to merge with a payer?
- Are we paying attention to marketplace signals that will allow us to hone in on non-traditional healthcare entrants that can help us better serve consumers?

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