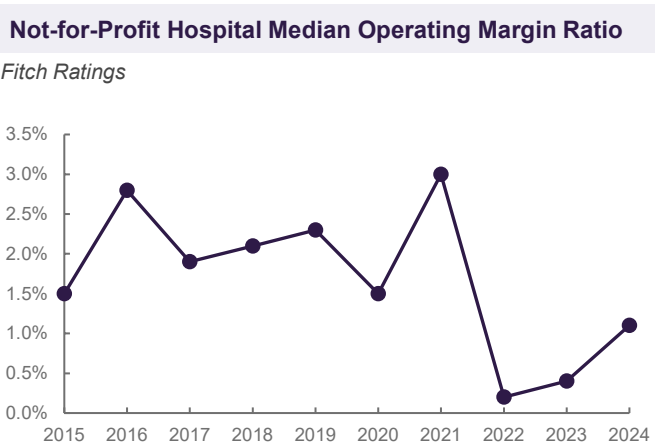


Industry Update

The Unstable State of Not-for-Profit Healthcare

Not-for-profit hospitals are experiencing uneven financial performance right now. On the surface, things seem to be looking up. Recent data from industry sources like Fitch Ratings and Kaufman Hall shows that after a few tough years, median operating margins have turned positive, rising from (0.5%) in 2023 to 1.2% in 2024.



But this overall recovery hides a troubling reality: the financial gap between top-performing and struggling hospitals is getting wider. While some providers are performing strongly, others continue to face significant challenges.

Why Does This Matter?

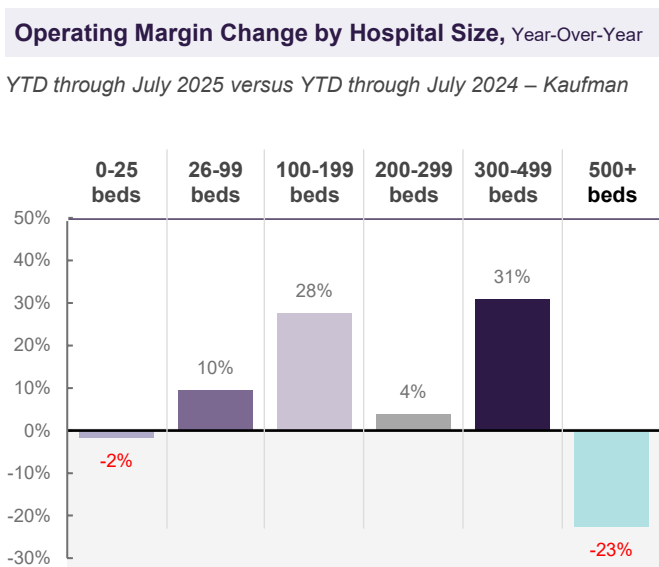
A hospital's financial health isn't just about the bottom line. Despite changes in care delivery, not-for-profit hospitals remain the "lifeline" of our healthcare system. Financial struggles lead to service cuts, staff shortages, and in the worst cases, hospital closures, leaving communities without a place to turn for care.

This article breaks down some of the key factors driving this divide and what struggling hospitals can do to not just survive but thrive.

What's Driving the Divide?

The conventional wisdom says that larger hospitals are better positioned than smaller providers because of operating scale, market share, and broad service line diversification. Interestingly, the data suggests that some of that advantage may be waning.

The data from the Kaufman Hall National Hospital Flash Report for July 2025 shows that hospitals with over 500 beds saw a year-to-date operating margin *decline* of 23% compared to 2024 while smaller hospitals (26-99 beds) experienced a significant margin increase of 10%.



Note: This bar graph represents the data compiled by Kaufman Hall showing the *change* in operating margin year-to-date through July 2025 compared to YTD July 2024. In general, larger hospitals have higher operating margins so this represents the change; not that larger hospitals are necessarily losing money. The graph shows that operating margins have improved year-over-year for hospitals with between 26-499 beds while the smallest and the largest hospitals have seen margin erosion.

It seems the advantages of size & scale are being offset by several key factors:

- **Non-labor expenses** are rising faster than revenue at many larger hospitals & systems. While large systems benefit from economies of scale in areas like purchasing, they also face cost pressures from rising supply and drug prices. Per the July Kaufman Hall report, hospitals with 500+ beds saw their supply expense per calendar day increase by 14.5% year-over-year. This rapid growth in non-labor costs is disproportionately affecting larger institutions.
- Large hospital systems are also inherently more complex to manage, which can lead to higher overhead and administrative costs. In contrast, smaller and mid-sized hospitals often have leaner operational structures.
- While all hospitals face labor shortages, very large hospitals tend to have greater reliance on specialized, expensive staff, which can drive up labor costs more significantly.
- We continue to observe a significant shift of patient care from an inpatient to both outpatient and ambulatory settings. Larger hospitals have traditionally relied on high-acuity inpatient services for revenue, however smaller hospitals—particularly those in the 26-99 bed range—are often nimble enough to adapt and pivot to higher-margin outpatient services and specialty programs, providing a more consistent revenue stream.
- While larger systems generally have a more diversified payer mix, they often operate in more competitive urban markets with a high volume of lower-reimbursing government payers like Medicare and Medicaid. Smaller hospitals often have a more stable patient base which can lead to favorable local contracts or to securing additional supplemental funding.

In short, while scale and size offer advantages, they are not a guaranteed path to financial success. The data suggests that large hospitals are currently more exposed to the significant challenges of expense growth outpacing revenue growth and the complexities of managing massive systems, which can erode some of the benefits of their scale allowing smaller, more agile hospitals to outperform.

So, what separates the strong performers from the others?

- **Diversified Revenue:** High-performing hospitals aren't just relying on inpatient care—they're making smart shifts to new revenue sources like outpatient services and taking on risk contracts. For example, a hospital that created a remote patient monitoring program was able to reduce hospital readmissions within 30 days resulting in savings.

- **Cost Control and Efficiency:** The most successful systems are laser-focused on keeping costs down. The new battlefield for profitability isn't just about labor, but all the other expenses. This means getting smarter about things like the supply chain and administrative processes. For instance, one health system implemented a system-wide pharmacy network across its 53 facilities which led to \$8.5 million in savings on drug costs alone.
- **Leadership and Payer Mix:** A hospital's financial health is also tied to its community. Markets with more commercially insured patients have a built-in advantage because those plans pay better. Conversely, hospitals that serve a high number of Medicaid patients can face serious financial challenges that are difficult to overcome. This makes strong and strategic leadership all the more important.

The Path Forward

The financial struggles many not-for-profit hospitals face have real consequences: service cuts, difficulty retaining skilled staff, and an inability to invest in technology. The record number of partnerships and affiliations among financially distressed hospitals shows that many are seeking a lifeline.

This divide will not be permanent. Successful turnaround stories prove that there is a way forward. Hospitals can:

- **Team up:** Forming collaborations, joint ventures or clinical partnerships with larger systems can provide access to better negotiating power and to capital for crucial investments.
- **Get smarter about operations:** Adopting shared services for things like IT, supply chain, and HR can create major cost savings and efficiencies.
- **Embrace new revenue streams:** Investing in outpatient care and telehealth can create more resilient financial models that aren't solely dependent on inpatient volume.
- **Use data to make decisions:** Utilizing data analytics to streamline workflows, improve billing, and monitor performance is no longer a luxury—it's a necessity for survival.

Ultimately, a not-for-profit hospital's ability to generate a positive margin is about more than just staying in business; it's about having the resources to fulfill its mission to the community. By making smart strategic choices and focusing on operational excellence, struggling hospitals can ensure they can continue to provide essential care for years to come.