

The Health of Rhode Island's Hospitals, 2005

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Rhode Island's 13 non-profit community hospitals are a \$2.6 billion dollar economic driver in the state, comprising over 8% of the Gross State Product. The hospitals' payroll approaches \$1.5 billion, and they invest more than \$164 million annually in new capital construction and equipment. Because of their importance to healthcare delivery, their impact on the economy, and the large public investment they represent, the Rhode Island Department of Health tracks the performance of this industry to monitor financial trends, to inform healthcare policy, and to identify financial problems. This article is excerpted from a 2006 Report¹ similarly titled.

Methods. The Department of Health compiles an annual dataset² from the audited financial statements of the 13 community hospitals in the state, comprising 1,700 separate data elements. The financial performance of the hospitals is appraised using ratio analysis. This technique uses the audited data to calculate eight measures that are grouped into four categories: profitability, leverage, liquidity, and activity. To benchmark statewide performance, the aggregate statewide values were compared to equivalent national data for 2004.³ To gauge performance over time, three years of data were examined (2003-2005). Finally, to assess the individual hospitals, the eight measures over the three years were aggregated into a composite, standardized index,¹ with higher values indicating better financial performance.

Results. Table 1 presents the eight statewide ratios with their desired trends. Profitability measures examine the generation of net income and the creation of wealth. Profitability is critical to a hospital's long-term survival because it provides the means to replace aging plants and to invest in new technologies. Rhode Island's 2004 statewide profit margin trailed the national benchmark (2.4% versus 3.3%) and was the 15th lowest in the country. However, in 2005, the state's hospitals posted a 33% increase, from 2.4% to 3.2%. Hospital equity or net worth also improved over the period. Together, they posted a 12% equity gain in 2004, the 3rd highest in the nation. There was a further 11% growth in equity in 2005 (from \$1.47 to \$1.64 billion).

Leverage measures define the importance of debt in financing the hospital, and the ability to fund additional borrowings. Leverage is important because it has a direct bearing on a hospital's creditworthiness and, ultimately its

Ratio	2003	2004	2005	Desired Trend
Profitability				
Profit Margins	-0.3%	2.4%	3.2%	up
Equity Growth Rates	-2%	12%	11%	up
Leverage				
Debt to Capitalization	27%	26%	24%	down
Debt Service Coverage	2.3	3.6	4.0	up
Liquidity				
Current Ratios	1.41	1.40	1.37	up
Days in Accounts Receivable	51	50	46	down
Activity				
Total Asset Turnovers	\$0.94	\$0.91	\$0.90	up
Fixed Asset Turnovers	\$2.81	\$2.63	\$2.63	up

ability to fund future capital projects. Statewide financial leverage in 2004 was similar to the national benchmark (26% versus 27%), and just below the median of all states. In 2005, Rhode Island's financial leverage improved from 26% to 24%. The hospitals' ability to service the debt exceeded the national benchmark in 2004 (3.6 versus 3.1), and was the 17th highest in the country. This measure further improved from 3.6 to 4.0 in 2005.

Liquidity measures assess the ability of a hospital to pay its short-term obligations. Deterioration in liquidity usually indicates cash-flow problems when an organization experiences financial difficulty. Rhode Island's current accounts were weaker than the national benchmark in 2004 (1.4 versus 2.0), and ranked 2nd lowest in the nation. In 2005, these account balances remained essentially unchanged (1.40 to 1.37). Hospitals' collection of receivables, however, was much more favorable. In 2004, the statewide value was below the national benchmark (50 versus 55 days), and was the 6th lowest in the U.S. Rhode Island hospitals further improved their performance in 2005, reducing the collections period from 50 to 46 days.

Activity statistics examine how productively hospitals use their assets to generate revenue. Higher values indicate a more efficient use of resources, all else being equal. Rhode Island's 2004 total asset turnover trailed the national value (\$0.91 versus \$1.06), and its measure was essentially flat in 2005 (\$0.91 to \$0.90). The 2004 fixed asset turnover, however, bested the national benchmark by 7% (\$2.63 versus \$2.46), and was the 17th highest in the U.S. Two factors may help explain the apparently conflicting relative performances on these measures for the state's hospitals. First, they are older than their national counterparts, on average (12.1 versus 9.8

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years), which tends to inflate their fixed asset turnover value because of understated historical costs on the property, plant and equipment. Second, Rhode Island hospitals may hold more financial assets (i.e., investments) than hospitals elsewhere, and this would depress their fixed asset turnover value because the income generated from the underlying securities is not booked as revenue, but as a below-the-line net gain.

In addition to benchmarking the statewide performance of the state's hospitals to others across the country, individual hospitals were also evaluated against each other using a composite index of the eight calculated ratios. Figure 1 presents those results. Newport (1st), Miriam (2nd), and Bradley (3rd) showed the strongest overall financial performance in the state, while Westerly (13th), Kent (12th), and Landmark (11th) exhibited the weakest overall performance, respectively.

Discussion. Generally, the financial prognosis for RI's hospitals is favorable. Compared to their national counterparts, in 2004:

- RI hospitals were less profitable (2.4% vs. 3.3% *profit margins*), but ...
- Their net worth(s) grew faster (+12% vs. +8% *equity growth rates*).
- RI hospitals had similar financial leverage (26% vs. 27% *debt to capitalization*), but ...
- They had greater capacity to service additional debt (3.6 vs. 3.1 *debt service coverage*).
- RI Hospitals had weaker liquidity (1.4 vs. 2.0 *current ratios*), but ...
- They had better collections of their outstanding accounts (50 vs. 55 *days in accounts receivable*), and ...
- They used their fixed assets more productively (\$2.63 vs. \$2.46 *fixed asset turnovers*).

In addition, in 2005, RI hospitals' performance improved, as:

- Profitability increased from 2.4% to 3.2%.
- Net worth grew 11%.
- Financial leverage decreased from 26% to 24%, and ...
- Debt capacity increased from 3.6 to 4.
 - Liquidity remained the same, but ...
 - Collections improved from 50 to 46 days.

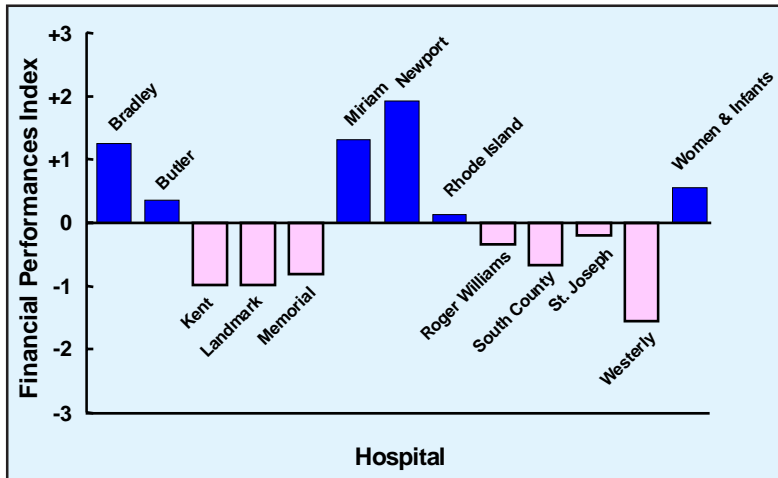


Figure 1. Hospital Financial Performance Index, by Hospital, Rhode Island, 2003-2005.

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