The Compound Effect: Medicare Cuts Meets Staffing Shortages

QUADRIGA PARTNERS

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While the physical therapy industry stands at the cusp of significant growth, driven by demographic shifts and evolving healthcare needs, it grapples with the dual challenges of Medicare payment cuts and persistent staffing shortages, signaling a pivotal moment for the future of independent practices

Preface

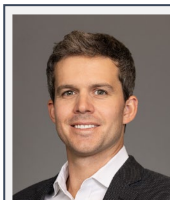
The role of physical therapists in public health is rapidly evolving, driven by demographic shifts and a changing healthcare landscape. As the population ages, there is an increased demand for physical therapy (PT) services to address age-related ailments. Moreover, with the rise in health expenditure and expanded insurance coverage, PT is becoming more accessible. This accessibility, combined with a growing health and wellness movement, positions PT as both a proactive solution for preventive care and a reactive measure for age-related issues.

Despite the potential for growth, the COVID-19 pandemic introduced significant disruptions to the industry. In 2020, patient volumes dropped sharply. However, the industry's resilience was evidenced by a quick recovery in patient encounters. Looking ahead, demographic changes will continue to shape the industry. The aging population will place additional burdens on the healthcare system, with PT serving as a potential relief. The growing preference for in-home care and a consumer-driven approach to PT will further influence industry dynamics, with revenue projected to expand at a compound annual growth rate (CAGR) of 3.2% over the next five years, reaching $57.1 billion (see *Figure 1*).

However, amidst these growth prospects, the PT industry faces significant challenges: ongoing Medicare payment cuts and persistent staffing shortages. The intricate regulatory and payment environment, intensified by these Medicare cuts, challenges PT practices' profitability and independence. These financial pressures, combined with staffing challenges exacerbated by the pandemic, have pushed smaller clinics towards consolidation with larger health systems, public companies, or private equity backed groups. While the market remains fragmented, the trend indicates a decline in the number of independent private practices.

About Quadriga Partners

Quadriga Partners is a premier healthcare investment bank, providing merger and acquisition advisory and growth and debt capital raising services exclusively to healthcare companies. Quadriga has a particular emphasis on several key sectors, including provider services, and is among the most active advisors for physical therapy and orthopedic transactions. Quadriga begins by obtaining an intimate understanding of its client's short and long-term objectives.



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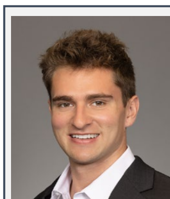

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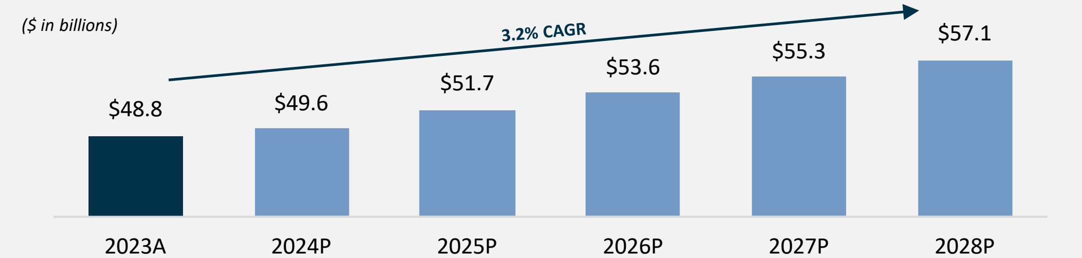
Figure 1

The United States Physical Therapy Market Size



Source: IBIS World

Deep Dive into Medicare's Revenue Challenges

The Centers for Medicare & Medicaid Services (CMS) continually assesses and revises the Medicare Physician Fee Schedule (PFS) to ensure appropriate reimbursement for healthcare services. Over the years, the PFS has undergone numerous changes, reflecting the evolving needs of the healthcare system and the challenges it faces.

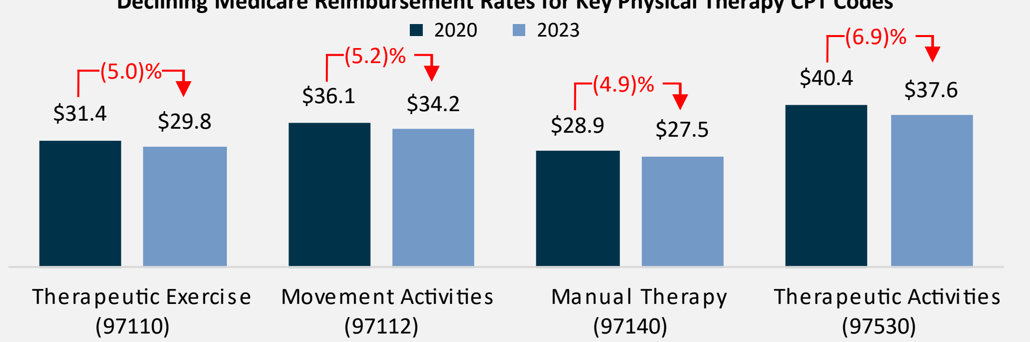
Declining Conversion Factors – One of the significant challenges that has emerged in recent years is the declining Medicare conversion factors. In 2024, the amount Medicare pays per relative value unit, known as the conversion factor, will decrease to $32.7, marking a 30-year low. This decline directly impacts the revenue of healthcare providers, as the conversion factor determines the reimbursement rate for services. The trend of decreasing reimbursement rates for key physical therapy CPT codes between 2020 and 2023 is illustrated in *Figure 2*.

Impact on Independent Practices – Independent practices play a pivotal role in the healthcare ecosystem, often being the primary touchpoints for patient care in many communities. However, they face mounting challenges due to consistent reductions in the Medicare fee schedule, particularly the declining conversion factors. These reductions stem from Congressional mandates for budget neutrality and the expiration of supplemental funds from the previous year. Notably, therapy providers, including occupational therapists and their assistants, bear the brunt of these cuts. They have been hit harder than most due to specific rules of the PFS, such as the Multiple Procedure Payment Reduction and the absence of inflationary updates. Such financial pressures have prompted many to explore mergers or acquisitions as a means to endure.

In the face of these financial challenges, while these practices have historically operated on lean margins, the recent cuts further test their adaptability and resourcefulness. The reductions impact their ability to reinvest in advanced equipment, offer comprehensive services, and attract top-tier talent. But it is not just about adjusting to reduced revenues. The evolving regulatory landscape demands a level of administrative agility that can strain the resources of smaller practices. Despite these challenges, many independent practices are finding innovative ways to adapt, whether through operational efficiencies, strategic partnerships, or exploring alternative revenue streams. The goal remains clear: to continue providing quality care while ensuring financial stability.

Figure 2

Declining Medicare Reimbursement Rates for Key Physical Therapy CPT Codes



Source: CMS

Staffing Shortages and Cost Pressures

Current Staffing Situation and Causes – The physical therapy industry has consistently faced staffing shortages, with the Alliance for Physical Therapy Quality and Innovation warning of a potential shortage of 27,000 physical therapists by 2025. In 2021, about 22,000 physical therapists left the healthcare workforce. The Bureau of Labor Statistics (BLS) anticipates approximately 15,400 openings for physical therapists each year over the next decade. High levels of student debt, burnout, and economic pressures such as lagging wages (refer to *Figure 3*) contribute to these challenges. Adding to the strain, the rehab therapy industry's 2021 turnover rate was roughly 9.0%, significantly higher than the healthcare industry average of 3.7%. To navigate these shortages, many clinics are resorting to traveling therapists. While they offer a temporary solution, their higher costs further strain clinic budgets, intensifying the financial challenges faced by the industry.

Burnout and Administrative Burdens – Burnout, driven by high patient workloads, extended work hours, and administrative burdens, is a significant factor pushing professionals out of the industry. Electronic health records (EHRs), while essential, have become a source of stress for many. About 60% of healthcare professionals attribute their burnout to bureaucratic tasks associated with EHRs.

The ripple effects of Medicare cuts and staffing challenges feed into each other, creating a cycle that, over time, can influence both the financial viability of practices and the caliber of patient care

The Interplay Between Revenue and Staffing

A Delicate Balance – The physical therapy industry is caught in a challenging cycle where revenue and staffing intricately influence each other. Medicare cuts directly impact practice revenues, making it increasingly difficult for clinics to offer competitive salaries and benefits. This financial strain, in turn, hampers their ability to attract and retain skilled therapists. The result? A diminished staff that not only restricts patient intake but also potentially compromises the quality of care.

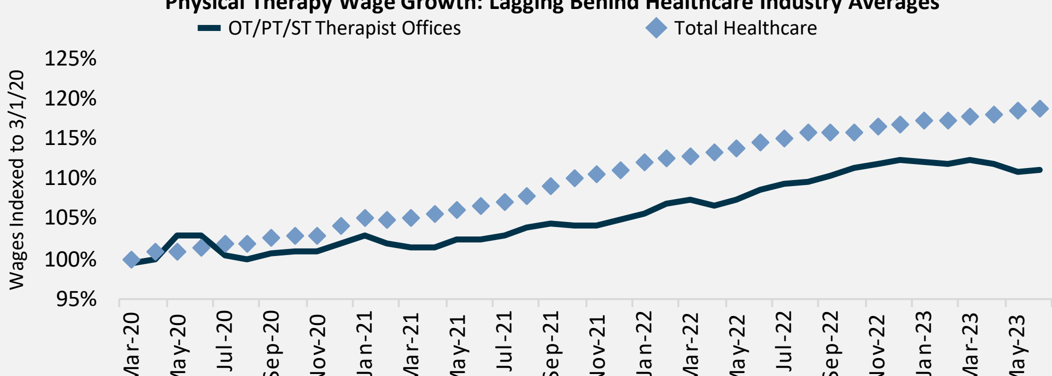
Consequences of the Cycle – As the quality of service dips, patient satisfaction and retention suffer, leading to further revenue losses. This feedback loop, intensified by the combined challenges of Medicare cuts and staffing shortages, places immense financial strain on practices, threatening the very sustainability of the industry.

Concluding Remarks

Despite the resilience and adaptability demonstrated by independent PT practices, the mounting challenges from revenue cuts to staffing shortages are making strategic partnerships increasingly attractive. These alliances, whether with larger healthcare entities or private equity backed groups, offer not just a buffer against current challenges but also avenues for growth and innovation. As the industry landscape evolves, such partnerships are gaining traction, providing independent practices with the resources, capital, and enhanced negotiation power they need. While the road ahead will have its hurdles, the focus remains on delivering quality care, and with the right strategies in place, independent PT practices can thrive in this new era.

Figure 3

Physical Therapy Wage Growth: Lagging Behind Healthcare Industry Averages



Source: BLS