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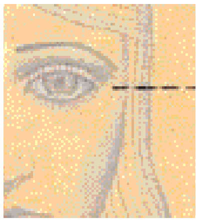
Looking Outside: Using External Capital Sources to Overcome Budget Constraints

The most significant barrier to implementing information technology is the lack of financial support. A partner who understands health care, and who can arrange the best funding package available, can help health care organizations not only improve their core business processes, but also integrate disparate systems to improve patient safety.

By Dan Morse, GE Healthcare Financial Services



Health care organizations have never needed information technology more than they do to survive in today's competitive market. Faced, however, with static capital budgets, higher operating costs, regulatory demands, and reduced reimbursement from Medicare and other insurers, organizations may find reliable hardware and mission-critical software more difficult to finance than ever.

Every organization faces its own set of challenges. Some need to upgrade or replace aging systems developed 20 years ago for a single-structure hospital rather than a multi-facility enterprise. Some need to find connections and compatibility among the disparate systems of merged or acquired institutions. Others need to create an enterprise-wide patient data repository to increase efficiency and improve accountability. Still others need to replace the lingering paper files of specific departments or clinics with electronic systems that interface with the overall hospital information system. What's common about all of these is the budget challenge.

Meeting Market Challenges

Security upgrades on IT systems to meet requirements of the Health Insurance Portability and Accountability Act (HIPAA) topped the list of health care leaders' IT priorities for today and the next two years, according to the 2002 HIMSS Leadership survey conducted by Superior Consultant Company. About 72 percent of respondents listed HIPAA-compliance as the business issue they believe will impact health care the most over the next two years.

However, meeting HIPAA requirements will mean changes in IT systems and in processes that may be both time-consuming and costly. Keeping patient records secure leads to consideration of systemwide measures such as firewalls and data encryption, as well as biometric technologies and other secure sign-on methods to ensure that records can be accessed only by appropriate staff – and that a complete audit trail reflects each time a record is viewed or changed.

Integration of systems in a multi-vendor environment and implementation of technology to reduce medical errors and promote patient safety ranked second and third on the IT priority list for leaders responding to the HIMSS survey. While integration across systems has been an ongoing concern for health care organizations, reduction of medical errors is a more recent development, coming in response to the Institute of Medicine's reports in 1999 and 2001.

Citing a minimum goal of reducing medical error by 50 percent over the next five years, the Institute of Medicine urged health care organizations to create a culture of safety, including the use of computerized physician order entry (CPOE) systems to reduce medication errors. Yet at the time of the HIMSS survey, less than one-third of responding executives said their organizations had reached implementation of systems to improve patient safety. Some 43 percent were either in the development or discussion phases, and 67 percent said their organizations planned to implement CPOE software.

And so the organization's list of "must" IT projects grows from the systems needed for day-to-day business operations to the electronic infrastructure to bring systems together and a comprehensive patient data repository, HIPAA-compliant security, CPOE, and other systems to ensure patient safety.

Add to that the fact that the price of information systems and services has risen significantly over the past 10 years. Patient accounting systems, for example, cost $50,000 to $100,000 a decade ago, according to "Trends in Healthcare & Healthcare Systems," a vendor report by R.L. Johnson and Associates. Today, those systems cost $200,000 to $350,000 – and installation and training costs have quadrupled, according to the report.

Finding the Right Partner

The result is a costly list of projects that compete during budgeting with the organization's other financial needs. The most significant barrier to implementing IT is the lack of financial support, according to responses to the HIMSS Leadership Survey. And the IT dilemma for health care leaders is to find a source of capital to allow these projects to proceed instead of being shifted onto the priority list for next year or the year after.

The first step may be to plan a capital budget strategy to balance the organization's financing needs for various projects with sources of funds for each of them. IT represents a big piece of the capital pie. In fact, the average IT budget for hospitals in 2002 was $1.6 million, according to GE Medical Systems' 13th annual Capital Budget Study. That's even more than the average $1.3 million each hospital budgeted for diagnostic imaging equipment.

The second step may be to find a financing partner outside the organization that can help sort through the options to find those that best meet the organization's specific financing goals – and then develop the appropriate financing package. Sharing goals such as cash flow management, balance sheet treatment, and ownership preferences with an experienced financing partner will enable that partner to develop a financial solution that meets the organization's needs.

If, for example, an organization wants to own the equipment, a term loan may be the best option. This traditional financing solution allows the organization to take advantage of the tax benefits associated with ownership. Most health care organizations would prefer to own major capital equipment outright, but a large upfront outlay of capital can strain an organization's already tight budget. Term loans can be structured as conditional time sales agreements to conserve the organization's funds and protect its cash flow.

If the organization has tax-exempt status, tax-exempt financing can make a lot of sense for larger projects and, therefore, is a critical consideration in choosing a financing partner. Tax-exempt financing can make capital available more quickly than public tax-exempt bonds while using simple, standardized forms. This type of financing usually can only be offered by large national financing firms that have sufficient assets to draw on.

If the equipment has a shorter life span, and the goal is to manage technological obsolescence, leasing may be a better solution under certain circumstances. Leasing solutions minimize the cost of acquiring equipment while maximizing cash flow. These agreements provide 100 percent financing with flexible end-of-term options such as upgrade, renewal, or purchase. However, numerous IRS and FASB requirements must be met. The residual value requirement, for example, requires that the organization have a large enough proportion of hardware, appropriate ownership licenses in place, and the ability to realistically return the equipment at the end of the lease term. Given the number and complexity of the requirements related to IT, an organization needs an experienced and creative financing partner who can develop a sound lease arrangement.

It's perhaps worth noting that, with the increased scrutiny of financial statements by the investment community, many companies have become more conservative in considering creative financial structures. They are choosing to focus more on cash flow management than on obtaining off-balance sheet status for capital assets.

Financial Capabilities – and More

While finding a partner who can offer the necessary range of financial capabilities is important, there are also other considerations, such as the partner's knowledge of the health care industry. A local financial institution may seem like the logical place to go for a loan to cover an IT initiative. But a bank won't necessarily have employees who understand the day-to-day operations of a health care organization or its unique financing needs – to say nothing of the impact of the HIPAA regulations, IT security concerns, or particular reimbursement issues.

A financing partner whose business is focused on health care will have employees who have come from leadership positions in hospitals and other health care organizations. These staff members have experienced firsthand the context of purchasing requests and the unique and complicated financing decisions that every health care organization needs to make. They're able to apply their expertise to an organization's specific needs.

Another consideration in choosing a financing partner is the value-added services that the partner can offer. For example, can the partner help evaluate departmental efficiency to improve revenue and efficiency while reducing costs? Can they not only provide funding in the right ways and combinations for the project at hand but also help the organization to accomplish its goals by managing its existing assets well?

One of the most important considerations in choosing a financing partner is their ability to expand beyond a single IT initiative to address the organization's broader financing needs. An organization that is considering a $1 million IT project, for example, probably is also looking at $5 million in other expenditures. By taking a blended approach to these projects, the organization may be able to take advantage of more advanced financing tools. And the financing partner may be able to develop more creative solutions to meet the organization's overall needs.

While finding the lowest rate of interest may seem like the best way to choose a financing partner, that may not be the most advantageous decision over the long term. Instead, look for a partner who understands the clinical, regulatory, and reimbursement issues; one who can work with you across the spectrum of your financing needs, as well as within IT; and one who can help you craft the best financial arrangements to meet those needs.

Finally, with cash flow management such a critical goal in the current environment, it is important to work with a financing partner who can provide a holistic approach to meeting this goal by employing a variety of other financial services, such as revolving lines of credit, cash flow management, and equipment financing.