

The Healthcare IT Market: As Opportunities Emerge, Lessors Should Proceed With Caution & Clarity

As opportunities emerge in the healthcare information technology market, lessors are well advised to pay special attention to the complexities involved. In addition to an understanding of the general market, finance professionals must also have a strong background on the issues that impact healthcare from a global perspective. Merely assuming an "I can do it too" attitude is a sure road to disaster.

By Alan N. Frankel

"One of the major reasons that the healthcare industry has had to occupy a reactive position is the absence in this country of a national health policy. We are the only major nation in the western hemisphere that has not, in a formal way, come to a conclusion on what basic level of health care we propose to provide for the members of our society and whose responsibility it is to provide this basic level to the various groups, such as the aged, the unemployed and the disadvantaged. Yet because we have not developed this basic policy, health care today is being driven primarily by economics, rather than moving forward in a logical manner toward the fulfillment of national health policy objectives."

This statement could easily be read in today's newspaper or heard on the evening news. Yet, it was made in 1985 by Herman H. Kohlman, National Chairman of the Healthcare Financial Management Association.

Unfortunately, little has changed in the two decades since Mr. Kohlman's assertion. The United States still spends an increasingly large proportion of its Gross Domestic Product (GDP) on healthcare — much more than any other industrialized nation. In fact, estimates point toward a future where an untenable 25% of our GDP will be required to support our healthcare infrastructure.

As noted in a recent issue of Health Affairs, "Many of the same issues that bedeviled America's troubled health system in the 1990s and well before remain unaddressed: an uninsured population that numbers some 45 million people and, by most accounts, is very likely to increase; high overall expenditures that continue to grow at two to three times the economy; and accumulating evidence that the quality of care delivered in many instances is well below optimal."

What is even more startling, according to the report the United States compares unfavorably with other industrialized countries in life expectancy, infant mortality, patient satisfaction and number of doctors per capita. Our per capita healthcare costs, meanwhile, are more than 250% higher than the other countries.

The urgent need for healthcare reform is also being driven by the business sector. Decades of promises to provide virtually unlimited healthcare coverage for active and retired employees by GM, Ford and other large

corporations have resulted in extraordinary competitive burdens today. In 1999, for example, GM insured 1.2 million people at a cost of \$3.6 billion. During 2005, the number of insured decreased to 1.1 million, but the cost increased to \$5.3 billion. GM's per-employee medical costs have been reported at \$1,500 annually.

To date, Congress and the administration have essentially ignored the coming healthcare cost crisis. The administration is aggressively pursuing, however, the development of a highly sophisticated computerized network to provide for electronic billing, electronic patient records, patient outcomes reporting, electronic physician order entry for medications and patient records portability.

The implications for improved efficiencies and decreased costs through the implementation of a Health Information Technology (HIT) system are immense. To be sure, the costs and complexity to establish this system are daunting. Opportunities for equipment lessors will be great as its implementation will amount to the largest segment buy within healthcare in history. But, there will be risks that could undo lessors that do not understand the complexity of the market or who are careless in their due diligence.

In April 2004, President Bush created the post of National Health Information Technology Coordinator within the Department of Health and Human Services (HHS). The coordinator's job is to lead the creation of an interoperable and automated health information technology infrastructure to ensure that each patient's accurate medical information would be available at all times.

Once this is in place, there will be great cost savings through the elimination of inefficiencies and medical errors. Another benefit will be the wider availability of medical outcomes reporting, permitting patients to become smarter consumers in the selection of doctors and choice of medical care.

It is estimated by RAND that over the next 15 years, assuming a 90% adoption rate, the country will enjoy an annual net savings of close to \$78 billion. This matches up with the second exhibit and, in my view, still makes the point and provides a time horizon. The same study estimates there

could be a potential prevention of 2.2 million medical errors. This may ultimately lead to a significant reduction in the estimated 44,000–98,000 unnecessary deaths in the United States each year from errors in medical treatment — more than the number of fatalities from automobile accidents, AIDS and breast cancer combined. Many of these deaths occur from the administration of incorrect medications and play a large role in the \$8 billion annual financial cost of medical errors.

The mandate to create such a HIT infrastructure led to a 10-year plan by HHS, introduced two years ago. Both houses of Congress responded by pursuing legislation, but the process has been slow. The Senate has passed its official “Wired for Healthcare Technology” bill but, as of this writing, a House bill has still not been reported out of committee.

When a law finally does go into effect, the cumulative costs for adoption are estimated in a September/October 2005 article in *Health Affairs* at \$98 billion for hospitals and \$17.2 billion for physicians, providing lessors with a golden opportunity. The average yearly costs for hospitals and doctors over a 15-year period are \$6.5 and \$1.1 billion, respectively. A study of the costs of implementation for a physician practice reported in *Health Affairs* last year said that initial average implementation costs would amount to \$44,000 per full-time equivalent provider, with an ongoing cost of \$8,500 per provider per year. This study estimated the average practice would recover their costs in 2.5 years.

The federal impetus has already created a whirlwind of activity in the technology marketplace. At the 2006 Healthcare Information and Management Systems Society conference, there were 863 exhibitors — 225 new this year. Among the exhibitors were long-time information technology providers McKesson, Cerner and Eclipsys, as well as many others that were basically start-up companies. Industry consolidation has already begun to take place. This includes the case of IDX Systems Corporation, a major player in the business that was acquired by GE for \$1.3 billion in cash.

The impact of outcomes reporting is reflected in the plan by the Centers for Medicare and Medicaid Services (CMS) for changes in both the methodology for reimbursement and reporting requirements for hospitals beginning in 2007.

In the latter case, plans are for an increase of 3.4% in the full market basket update for hospitals submitting quality data. Those that do not submit such data can look forward to only a 1.4% increase. Additionally, changes that will further refine the definition of case severity in setting DRG reimbursement rates will require that hospitals have strong HIT capabilities in place in order to both comply with CMS rules and maximize their repayment.

During development of the HIT system, technology will continue to evolve, new players will enter the scene and further consolidation and acquisitions will occur, resulting in winners and losers. The industry is not waiting for Congress, either. Farsighted entrepreneurs are taking steps to ensure they are positioned to reap the benefits of higher reimbursement rates and better outcomes.

An example of such leadership is the recent growth of the Regional Health Information Organization (RHIO). The goal of a RHIO is to increase efficiency and improve safety for healthcare processes and patients across various populations.

There are various models of RHIOs, including payer-sponsored and employer-sponsored programs. Shared Health, a payer-sponsored RHIO in Tennessee, provides access to more than one million clinical documentation and community health records by more than 2,500 users on 500 sites. A similar project called Health Mid-America is under development in Kansas City.

In the coming years, opportunities for equipment lessors will cross over all healthcare categories and leasing segments. There will be room

for small-ticket lessors, vendor-based companies, operating lease organizations and big-ticket players. In addition, some of the same drivers creating such needs in the United States are present in other countries and there is room for international lessors. For example, there are similar measures underway in the United Kingdom to automate clinical processes and digitize medical records.

Lessors here will be faced with an array of opportunities, but also with a number of daunting challenges. This entails issues related not only to those inherent in the HIT concept, such as financing large amounts of software-only transactions, but also the fact that financing will occur in a sector that is troubled, dynamic and heavily influenced by constant changes in governmental regulation and reimbursement.

A lessor interested in the HIT opportunity must recognize that leasing in the healthcare industry is unlike any other. There are a multitude of diverse industry segments, most of which rely on payment from third parties, such as Medicare and private health insurance companies. The level of reimbursement in any given segment changes for better or worse on an ongoing basis. Medicare has made revisions for 2007 that, on average, may have an impact of 4% positively or negatively on most hospitals. Some institutions, however, may be impacted by as much as 17% depending on their case mix.

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Regulations regarding reimbursement for physician fees in the outpatient diagnostic imaging sector have been radically changed, as have regulations and rates within home healthcare. Companies such as DVI, American Express and Scientific Leasing that were once household names in the healthcare leasing space are no longer in business. These firms were among the segment leaders, presumed to withstand the test of time.

A lessor considering the HIT market cannot treat it as a commodity. In addition to an understanding of the general market, one must also have a strong background on the issues impacting healthcare from a global perspective. There are some extraordinarily strong competitors, both captive and independent, in the business already.

To be successful, a lessor must have a true value proposition. Merely assuming an “I can do that, too” attitude is a sure road to disaster. Lessors must undertake a complete review of their corporate culture and capabilities to determine how to distinguish themselves from competitors. These distinctions may take the form of program, service or segment enhancements. Each company will need to determine what makes sense for them. The critical point is that simply being as good as the incumbents will not win any business.

Additionally, the breadth of healthcare equipment modalities is wider and the change in technologies is more rapid than in many other markets. This requires a strong asset management capability both on the residual setting and recovery ends. The possibilities run the gamut from small hardware or integrated OEM systems to physician offices to total multi-facility information systems. The latter, with costs running in the millions of dollars, may predominantly be software transactions.

In between are many departmental and procedure-specific systems that may have a greater or lesser impact on cost-savings and patient outcomes and greater or lesser risks as leaseable assets. These include

PACS and RIS systems for the capturing and transmission of digital images, clinical laboratory systems, pharmacy systems ranging from automated dispensing carts to pick-and-place equipment to electronic prescription writing and filling systems, electronic billing systems and financial management systems. The HIMSS website for this year's annual exhibition lists over 220 product/service categories; everything from cardiology information systems to bioterrorism prevention.

There is a multitude of potential opportunities within virtually any asset finance category. One company may dominate, with perhaps a captive leasing capability or a longstanding relationship with a major healthcare lessor. There also will also be several other companies of significance that may be potential partners for the lessor who can provide the right combination of value and service.

Unfortunately, there will not be much "low-hanging fruit" in the healthcare financing sector as the HIT initiative takes shape. The Alta Group recently conducted a survey for one of its clients in the market regarding the use of financing and leasing products to augment their sales process. The preponderance of responses indicated that the use of leasing is widespread, but so are the established relationships. A new player will find the level of sophistication regarding leasing to be relatively high.

This reality requires that the solutions will need to be equally creative and designed to meet the specific objectives of the individual vendor. **m**

Alan N. Frankel has specialized in healthcare equipment leasing for more than 37 years. He utilizes this and his executive-level expertise and management talent as a principal in The Alta Group. Frankel has served as president and chief operating officer of two publicly held companies, Copelco Leasing Corporation and American Business Leasing — involved at their origination and helping lead the design and implementation of strategic plans for their sales, marketing and operations. Prior to joining The Alta Group, he was president of Lighthouse Capital Corporation, a consulting firm to the leasing industry with special emphasis on healthcare — particularly strategic and implementation planning, residual review, and operations and systems oversight.



As an active member of the Equipment Leasing Association for many years, Frankel has served on the board of directors, as well as on the finance committee and executive committee. He also served on the government affairs committee and the membership committee and currently is on the service providers committee. Frankel has written extensively on equipment leasing, and for ten years he authored an annual article on the state of the U.S. healthcare market for World Leasing Yearbook. He is an advanced member of the Healthcare Financial Management Association.

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