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What to Consider When Making Capital Investments

Costs, considerations, and resources to help you make the best decision for your practice. Here's what you need to know about investing in equipment.

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This whitepaper will help practices determine whether or not they should invest in expensive medical equipment at their practice. It will look at the financial reports a practice should run before making the investment, determining the return on that investment, and ways a practice can explore the advantages and potential disadvantages of both leasing and buying. With this insight, the practice can then determine what investment level and strategy makes the most financial sense for its particular circumstances.

EQUIPMENT NEEDS TO COME FROM ALL DIRECTIONS

There are many reasons a practice might consider investing in new equipment. Expanding your practice or growing the number of practices in your group may require new machines to fill in the gaps, for example. A 2016 survey from The Physicians Foundation found that 20 percent of physicians practice in larger groups of 101 doctors or more. That figure was just 12 percent in 2012. Changing strategic direction of the practice, on the other hand, could mean different types of equipment are needed to support the transition.

The competitive landscape may also influence the need for new or updated devices. "What's going on in your practice's market?" Victoria Terekhova, vice president of sales at Key Equipment Finance, says is one question to ask. "Are there other competitors providing similar services in your market?"

Equipment that offers patients a wider array of services or allows your physicians to deliver care in a better way can be a differentiator in a tight market. "The primary reason is survival," Terekhova says. "Do you want to pursue additional revenue opportunities by attracting referrals into the practice? You don't want to be in the position where your current equipment limits the practice from moving forward."

Upgrades and replacements may also prove necessary if a practice hasn't kept up with technology. Physicians are likely to discover they've fallen behind competing providers as a result, or that upkeep and other costs associated with outdated equipment have become untenable. "How do you stay clinically relevant?" asks David Gans, MSHA, senior fellow of industry affairs at Medical Group Management Association (MGMA) in Englewood, Colo. He points to old X-ray methods that relied on wet processing, a time- and cost-intensive method. "Now it's digital," he says. The equipment investment in the X-ray example required an initial outlay of capital to stay current, but a practice using the newer digital process likely find the time saved creates a better patient experience and allows busy staff to focus on other tasks.

Market forces outside healthcare may also sometimes prompt a practice to evaluate new equipment options. Favorable economic conditions make capital more readily available, not to mention more attractive. "Right now we have historically low interest rates on bank loans," Gans says of the current financial environment. "We can anticipate in the near future that interest rates will go higher, and on a long-term purchase the interest you pay on that loan adds up." Simply put, when rates are low, financing is often easier to get and is less expensive.

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IS YOUR PRACTICE RIPE FOR NEW EQUIPMENT?

Certain areas of a practice are more likely to be candidates for new machinery than others. Radiology is one specialty often cited for its use of expensive equipment. Devices are becoming more advanced and integrated setups such as an MRI-guided linear accelerator can easily run several million dollars. Other operational areas, from IT infrastructure to a building's heating and cooling systems, may also require expensive equipment from time to time.

No matter the discipline or area of the practice, experts say the process for evaluating any large capital investment is largely the same. When it comes to medical equipment, much of the focus should be on usability and the machine's anticipated impact on the bottom line.

"The practice should look at what its case load has been and ask, 'Without this equipment, how many times was someone referred out for this service?'" says Mark Hoffmann, vice president at Key Equipment Finance. If it's an X-ray machine that's under consideration, by looking at the income associated with doing that service in-house rather than sending patients elsewhere for X-rays, your practice can begin a meaningful cost/benefit analysis. "How much income will be generated from the projected number of X-rays that we will perform and how much will the equipment cost?" Hoffmann says. "Does it make sense?"

RUNNING THE NUMBERS

Medical groups typically focus on conserving cash and optimizing their distributions at the end of the year. With those issues in mind, Terekhova says, "Physician practices need to think through how this equipment is going to impact their daily cash flow." Liquidity will be a primary concern as the practice examines its position. "Is there enough cash coming into the practice, and will it increase over time by investing in this equipment?" Terekhova asks. Financial reports showing the practice's cash positions, profitability, and debt ratios will help identify where you stand and what the picture will look like if you choose to take on the additional costs of new equipment.

Other data will also be useful, including a statement of earnings, tax returns, and a balance sheet, Terekhova says. Depending on your group's financial picture and the type and value of equipment under consideration, these analyses may be extensive. Terekhova says it's not uncommon for doctors to attempt the process alone, but she encourages them to seek out professionals with targeted expertise. "When considering major capital investments, it is advisable for physicians to seek out financial professionals who can explain how the business' financials will be impacted by any future equipment investments," she explains.

Even when a trusted adviser is part of the team evaluating a purchase or lease decision, Bruce Deskin, director of healthcare finance at Warbird Consulting Partners in Atlanta, says due diligence is wise. "Just like in medicine, a second opinion is always good when making a major decision." When multiple discussions yield similar insight and opinions — with a CPA or other financial adviser, a banker or leasing agent, for example — the practice is likely on the right track.

"Whoever already has your accounts, talk with them about what they would need to consider loaning you money," Deskin says. "Get a quote from them and also one or two others."

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—Victoria Terekhova, vice president, sales, Key Equipment Finance

DETERMINING YOUR ROI

When it comes to determining return on investment (ROI), Gans says the most important element is the equipment's benefit to the practice. "Whether it's a financial return or not, the first question is, does it have clinical importance?" For instance, an orthopedic surgeon's practice would have trouble surviving without in-house imaging capabilities. The importance and clinical relevance in that scenario is clear. The same criteria can be applied to new equipment purchases as well as upgrades and replacements. "If you're replacing an essential system, what does this do clinically? Does it add opportunities to the practice to enhance patient care? Or to improve the services you provide to your patients?" Gans asks.

The equipment's reliability and ongoing service needs are also important. "What are the maintenance costs for the product? Because those need to be in the ROI calculations," Gans says. The vendor's reputation and ability to service their equipment will similarly influence how much value is returned to the practice.

"You may have the best EHR, instrument, or other [piece of] equipment, but if it can't be supported locally, it's a disadvantage," Gans says. After exploring all of these factors, the ROI should become fairly clear.

LEASE OR BUY — WHICH IS RIGHT FOR YOU?

When weighing whether leasing or purchasing makes more sense for your practice, one factor Hoffmann suggests is considering how heavily you plan to utilize the new machine. "Are you planning to use the equipment all the time?" he asks. "If so, you probably want to buy it, or you'll be in a very short-term lease before you turn it around."

Lease terms and payments are often calculated based on usage and the expected useful life of the equipment when the lease period comes to a close. From the practice's perspective, Hoffmann says, "The thing about leasing is figuring out how much of the useful life you're going to use and only paying for that; why pay for something you're not going to use?" If patient volumes create a situation where physicians anticipate using the equipment at its maximum level, a very short lease or outright purchase will likely be more financially advantageous than leasing with a longer term, he says.

Coupled with expected usage patterns, cash flow is another issue that must be added to the equation. "Cash preservation is a primary consideration," Terekhova says. An honest assessment needs to be made about the amount of cash that's available on day one to fund any purchase. If the answer is, "Not a lot," then leasing may be a better route. Even businesses with ample cash may choose to use a lease or loan when procuring new equipment. In a survey conducted by the Equipment Leasing & Finance Foundation, 78 percent of respondents said their business used at least one form of financing (leasing, secure loans, and lines of credit) to acquire new equipment.

Practices with limited capital, or those that want equipment that's expected to require upgrades every five to seven years, may find leasing more attractive. "For such practices, I would say leasing is probably a better option, because with leasing there are no down payment requirements," Terekhova says. " And, with a lease there is almost always an option to return the equipment at the end of the lease term to the lessor."

Another indicator that may influence your practice's decision to buy or lease new equipment is the vendor's position on the machine's lasting value. "Their confidence level on what the equipment will be worth at the end of the lease term might give you some indication whether or not you want to buy it," Deskin says.

Though equipment pricing is often held close to the vest during negotiations, finance experts can help you understand how close a quoted price is to the averages they see in the market. And because end-of-lease values are part of the leasing calculation, a piece of equipment that's determined to have very little value at the end of the term may not be a good candidate for a purchase. "If they don't want to buy it back that tells you something," Deskin says.

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LABOR COSTS

Though rarely considered as part of any financing package, labor costs may also need to be included in a practice's broader ROI calculations. Some equipment can fit cleanly into existing operations, but other devices will require more dedicated time and expertise. It's possible that staffing levels will need to grow to accommodate running, managing, administering, or even servicing the new equipment.

Using the example of imaging, Gans says, "An orthopedic surgery practice that has X-ray as one set of services may also offer CT scanning or MRI in-house. It's a different level of service at a much higher cost, not only for the equipment but also for the specialized technicians to run it."

Benefits and other employee costs such as ongoing training must also be factored in, along with any certification and state licensing requirements.

In some cases, the practice might need to grow its business office staff. This may be due to added operational complexities that arise when the new equipment is added to the mix. "It could also be due to special billing requirements for reimbursements," Gans says. Where the practice's business office is already working at capacity, new equipment that leads to increased patient volumes may trigger the need for additional administrative employees. "Those staff costs should also factor into the financial decision," he adds.

NAVIGATING THE LEASE PROCESS

The financial effects of a lease stretch farther than just the monthly payments, which can typically be tailored to suit your practice's financial position. Careful planning of your investment's timing will also have a big impact on how much the lease costs in the long run. The assistance of a financial adviser can ensure the practice takes every advantage available to them.

"If you lease equipment on the first of January versus the last day in December of the same year, your tax benefit will be significantly different," Terekhova explains. "A professional will give you that type of assessment, factoring in the cost of the equipment, comparing lease versus buy scenarios, evaluating capital versus operating lease treatment, and determining the impact to cash flow depending on potential tax credits or asset depreciation."

Understanding a lease's return provisions is one area practices may not think about during the initial assessment, but they're vitally important in determining how attractive the lease really is. "The end-of-term options are what practices should review carefully," Hoffmann cautions. Some leases stipulate the equipment must be returned in the original box, for example, or that all accessories, power cords, and cables be intact and included; something that can be difficult to chase down in a busy practice over a long lease period.

"That's where you need to look at the return provisions," Hoffmann says. "Are they so onerous that you'll never be able to meet them and so you'll have to buy the equipment no matter what?" Additional lease terms should also be investigated, such as what options are open to you in the event the equipment doesn't work out. Can you give it back early? Can it be sold to pay off the lease and any residual? "As with any contract, it's important to read the details," he adds.

For practices that don't find traditional lease or purchase options suitable, other avenues may still offer promise. Much will depend on the specialty and the need for the practice's services in the local marketplace. "A lot of imaging centers are jointly owned by physicians and hospitals, for example," Deskin says. There may be legal matters to hammer out in such an arrangement, but he adds, "If it's a large investment and you're concerned about how you'll operate and manage it, having a conversation with whatever hospital system you do business with certainly makes sense." The equipment and service lines your practice plans to offer will likely determine another entity's appetite for a joint venture or other type of partnership, but it may be a practical and effective way to reduce the amount of capital your group needs to provide.

PLANNING IS KEY

New equipment can be instrumental in moving your practice forward, providing next-level patient care, maintaining your competitive edge in a crowded marketplace, and opening up additional revenue streams. But the costs to procure needed devices can be high. Are they worth it? Will you be net positive when it's all said and done? What might the ramifications be if you choose not to invest?

A range of purchase and leasing options mean most practices will be able to find a solution that's right for them. With the support of experienced advisers and some thoughtful planning, your practice can determine what value the new equipment will deliver and how to maintain positive cash flow throughout the life of your new device.

"Figure out where you want to be a few years from now," Terekhova says. "We've seen businesses wait too long and make investments too late, when they might not return as much value to the practice."

IS YOUR BUILDING READY FOR NEW EQUIPMENT?

Before a final decision is made to invest in expensive equipment, your practice needs to consider if its space is up to the challenge of supporting everything that device requires. Build-out costs can add significantly to the total price of the equipment. "Depending on the equipment, you might need to rebuild part of the room, expand the room, or upgrade utilities," Terekhova says. "Typically, manufacturers of equipment can give you a pretty good idea of what would be needed for installation."

Construction costs — plus the services of a knowledgeable architect and fees to cover any necessary permitting or licensing — should also be plugged into your ROI calculations. There may also be ongoing operating expenses that could affect the long-term cost of the equipment. Utility consumption may go up once the device is installed.

Power, water, heating and cooling, even internet connectivity and bandwidth requirements may drive monthly expenses up. "It's a project, but the practice should be able to get reliable information from manufacturers, architects, and construction companies on cost and timeline to plan accordingly and avoid major "surprises" during implementation."