

How to Negotiate and Finance Major Medical Equipment and Clinical Systems

Presented by:

Darren Vianueva, CRG Solutions, Inc.

Phil Lindner, Premier, Inc.

Learning Objectives

1. Identify the key components in a successful major equipment and clinical system negotiation.
2. Learn creative methods of uncovering financing options for major medical equipment and clinical system purchases.
3. Gain insights on how to develop strategic partnerships to maximize contracts for major medical and clinical systems as well as financing options.

**IDENTIFY THE KEY COMPONENTS IN
A SUCCESSFUL MAJOR EQUIPMENT
AND CLINICAL SYSTEM
NEGOTIATION**

What is a Successful Negotiation – Customer Perspective

- No Gotcha's
- No Buyer's Remorse – last year's model
- Positive working relationship after the negotiation
- Great Value

Successful Negotiations Always Begin with a Solid Sourcing Process

Key process elements

1. Defined Process
2. Cross-discipline team
3. Defined requirements
4. Equal supplier access
5. Scorecards
6. Competitive rounds
7. Executed contract

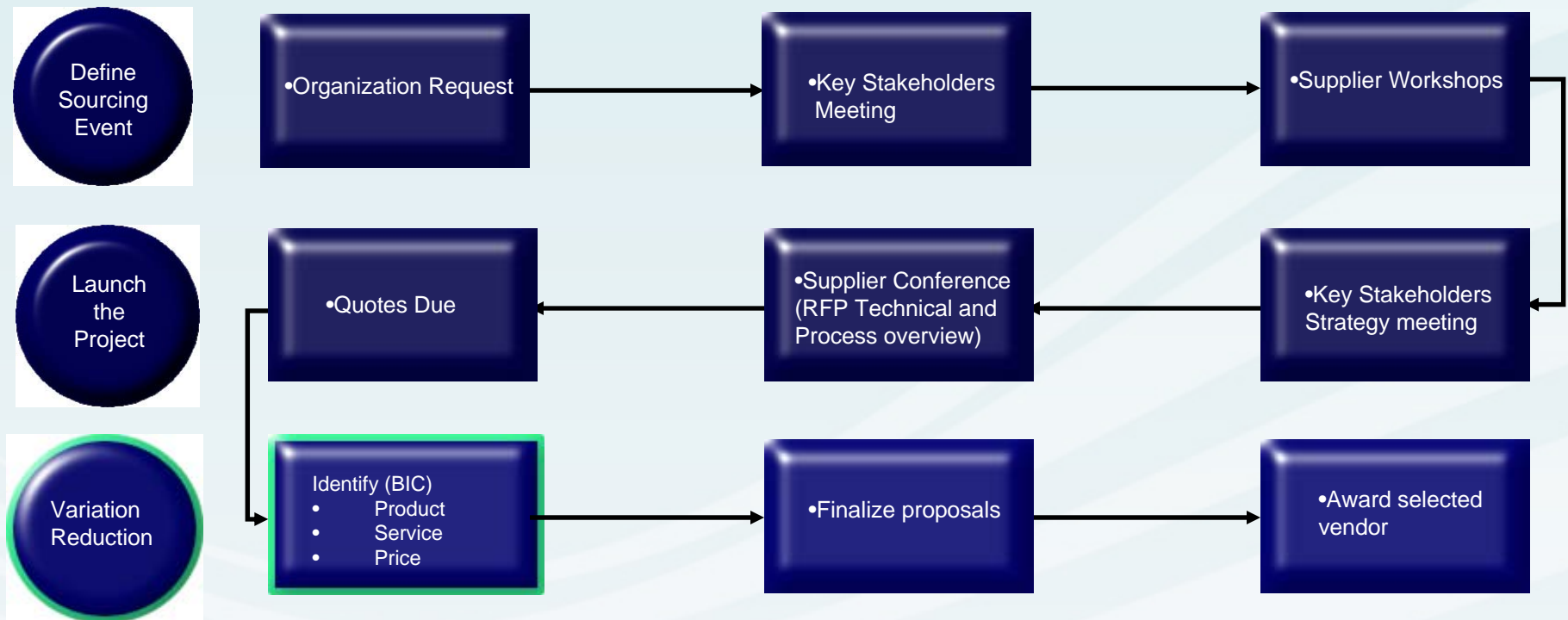
Defined Process

- Is shared at the kick-off of any major capital sourcing event
- Can be communicated and understood by both the stakeholders and the suppliers
- Articulates one step to the next without surprise
- It defines Stakeholder roles and rules
- Communication methodology
- No verbal supplier communication
 - But I said blue.

What's the point?

- It creates One-Voice and One-Process to the supplier community

Sourcing Process



Defined Requirements

- Define upfront the minimum acceptable requirements, scope, budget, approval, release and install dates.
 - Wasted time and resources trying to define specification before touching the market
 - Let your process discover the specifications and use your requirements as the base

What's the point?

- Use all suppliers knowledge through your process for identifying what is the best in the marketplace today and tomorrow
- Know your minimum requirements

Equal Supplier Access

- Invite all available Suppliers
 - Supplier presentations
 - Demos / workshops
 - Site visits
- Do not eliminate for:
 - Past history
 - Physician / clinician rhetoric
- Eliminate when Supplier cannot meet requirement

What's the Point?

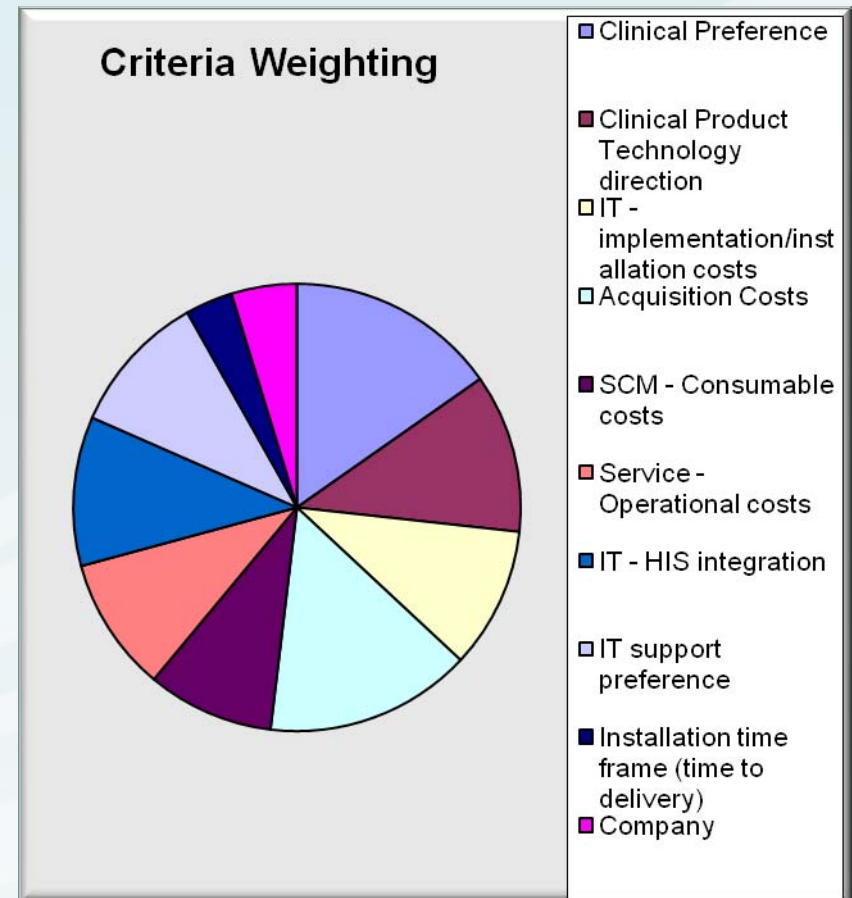
- Competition in the market place drives best economics and value
- Limiting suppliers only limits you and favors the suppliers

Scorecards

- Criteria Weighting is always first
- Use of multiple scorecards is required

What s the point?

- Scorecards quantify the moment, the perception, the facts
- It enables you to measure



Competitive Rounds – Variation Reduction

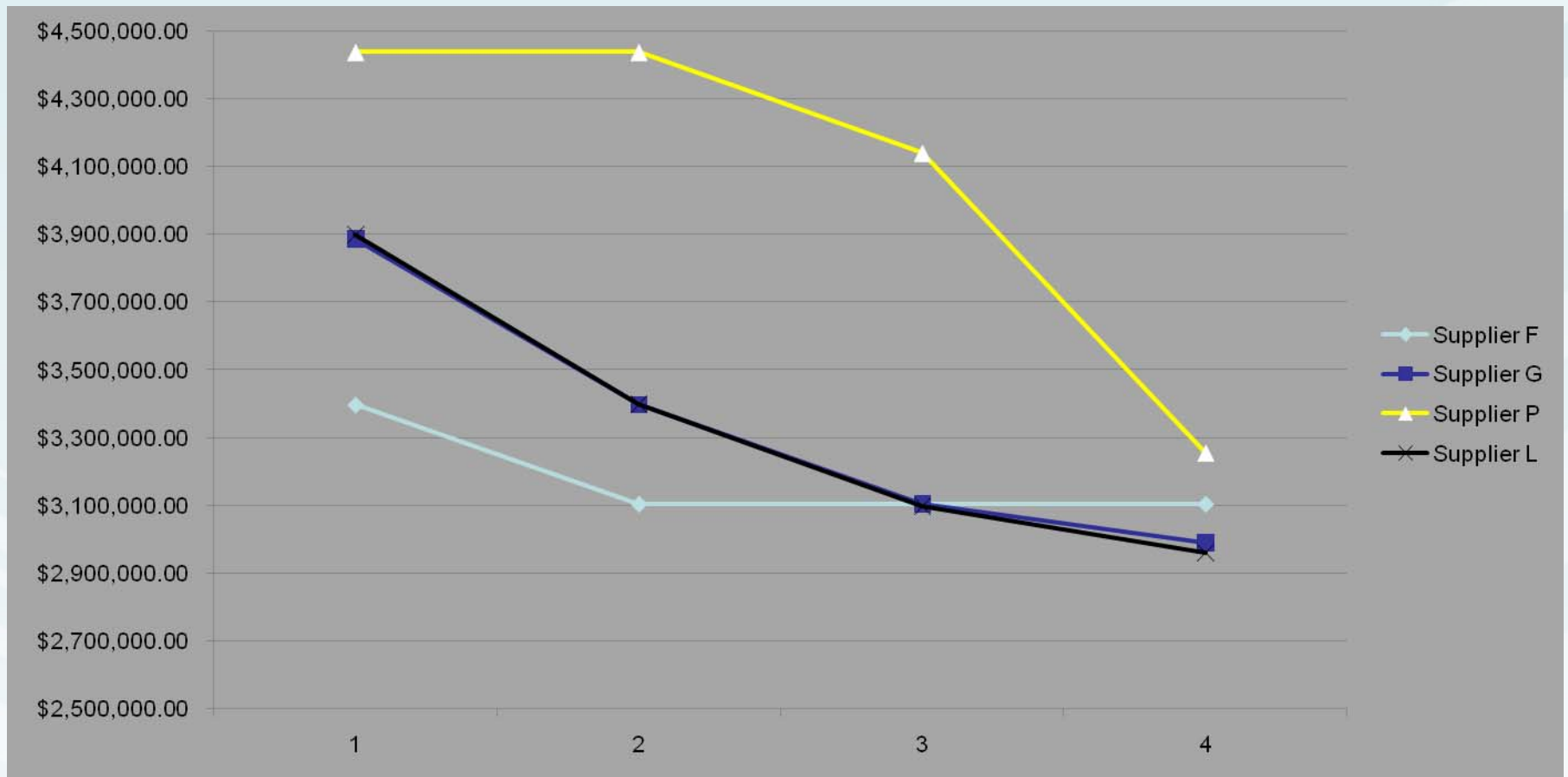
GOAL of competitive rounds:

- Reduce total costs and value-add variation to less than 5% between all suppliers

What's the point?

- Drive decision making away from economics and to a clinical decision
- Remove subjectivity and analyze only the facts
- Itemized pricing and added value is an imperative

Example – Economics Rounds



Cross-Discipline Team

Typical Team Composition

- Finance, Supply Chain Management, Clinical Engineering, Facilities, IT, Clinical, Physician, Technologists
- Effective internal team leadership is necessary to success

Controlled Communication

- All correspondence facilitated through SCM
- All SCM correspondence blind copy your team

What's the point?

- Use the team to your advantage
- Validation of what was presented, heard, described
- Keep your team aligned and unified or the suppliers will divide and disrupt

Executed Contract

- Do not award until you award
 - Nothing worse than “bended knee” negotiating
- Verify all:
 - Discussions, email, exhibits, responses are included

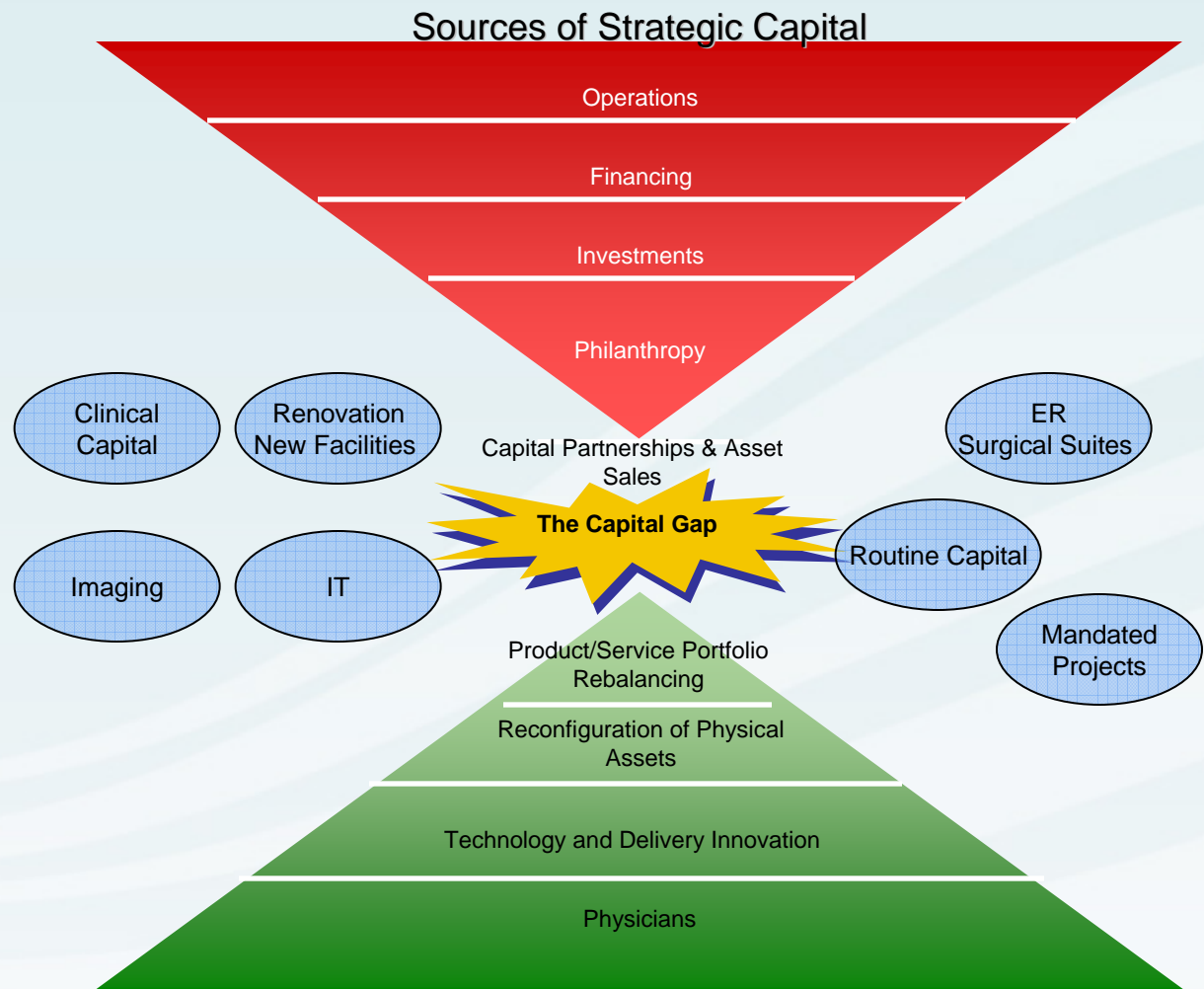
What's the point?

- Too often verbal communication leads to sour relations
- LOI's, MOU's, LOC's all lead to one-on-one negotiations

**CREATIVE METHODS OF
UNCOVERING FINANCING OPTIONS
FOR MAJOR MEDICAL EQUIPMENT
AND CLINICAL SYSTEM PURCHASES**

Resource Constraints: “The Capital Gap”

Capital access has become tighter for most health care providers, particularly so for those with marginal credit



Key Uses of Strategic Capital

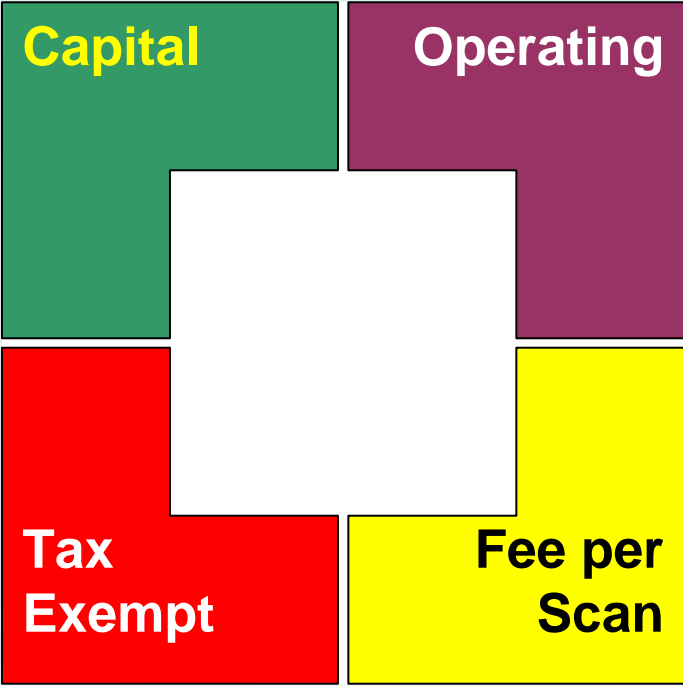
Sources of Capital

- ✓ Cash from Operations
- ✓ Tax-Exempt & Taxable Bonds
- ✓ VC Capital and Public Equity Offerings
- ✓ Sale of Assets
- ✓ Banks/Other Financial Service Companies
- ✓ **Leases**
- ✓ JVs/Partnerships
- ✓ Real Estate Investment Trusts (REITS)
- ✓ Private Philanthropy
- ✓ Public Grants
- ✓ Letters of Credit
- ✓ Bond Insurance
- ✓ FHA Section 242 Mortgage Insurance
- ✓ Local Taxes

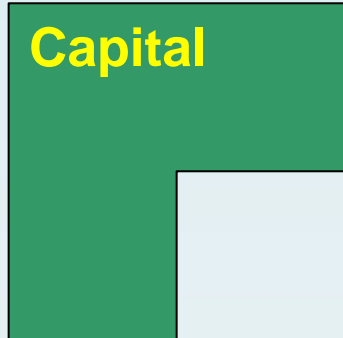
Leasing 101

- ✓ A means of using an asset owned by someone else for a specific time and for a sum of money
- ✓ An alternative method to acquire an asset
- ✓ A financial instrument that allows for the acquisition of equipment:
 - With lower upfront costs;
 - May be paid out of operating funds; and
 - Can be useful tool to support a technology leading position.
- ✓ Provides some protection from technological obsolescence – when technology changes, the lease may be amended to incorporate the new technology
- ✓ Conserves cash – while initial cash outlay with a purchase is 100% of the equipment price, initial cash outlay with a lease is minimal (usually one payment or about 2% on a five-year lease) and payments are spread over the useful life of the equipment
- ✓ Payments are lower – because you only pay for the *use* of the equipment, can be lower than traditional financing

Leasing Types

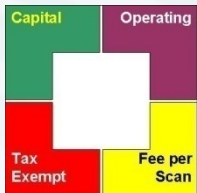


Leasing Types



Commonly known as a “\$1 out lease”

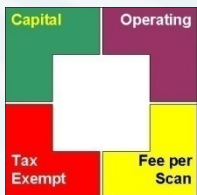
- ✓ This structure is disclosed on the balance sheet (as an asset and corresponding debt) and the interest cost and depreciation are shown on the P&L statement
- ✓ Normally paid out of capital budgets
- ✓ Used to acquire equipment that will be owned
- ✓ Requires little cash outlay (usually one payment)
- ✓ Title transfers at the end of the lease for \$1
- ✓ 5.0% 7.5% depending on credit rating



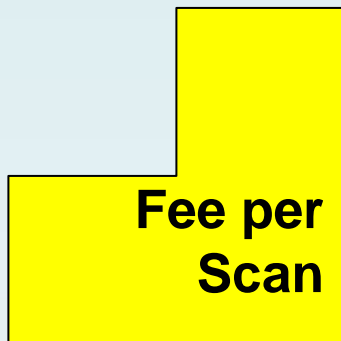
Leasing Types

Operating

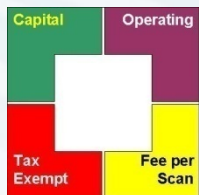
- ✓ Fair Market Value Lease that meets FASB-13 tests
- ✓ Is not shown on the balance sheet and the entire lease payment is expensed on the P&L statement
- ✓ Normally paid out of operating budgets
- ✓ Term of lease is tied to technology useful life
- ✓ Interest rate varies by equipment modality and residual value
- ✓ 0% - 3% range (rates can even be negative)
- ✓ At end of lease, may:
 - Purchase for fair market value
 - Renew the lease
 - Return the equipment



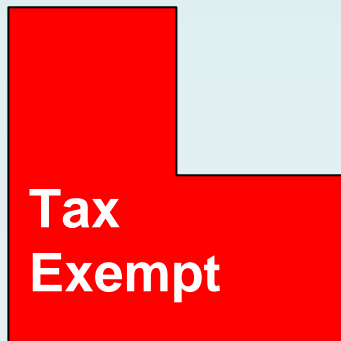
Leasing Types



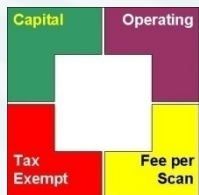
- ✓ Fee Per Scan has been most effective in acquiring information systems
- ✓ Companies that are IT, IS, PACs providers use this form of financing to place expensive, non-revenue producing programs into hospitals that need to upgrade their systems.
- ✓ The Fee Per Scan is tied to a reportable measurement and vary with use.
- ✓ The FPS normally includes service and software upgrades but does not include upfront installation costs which are usually capitalized.
- ✓ FPS have been tried with imaging equipment but the cost is higher and administratively cumbersome
- ✓ When used with imaging equipment, a conversion option to a traditional lease is included and often exercised as soon as possible.
- ✓ 6.5% - 8.5% interest rate due to admin costs / risk depending on credit type



Leasing Types



- ✓ Tax Exempt Leases are normally used by eligible hospitals (501(c)3) to finance capital equipment acquisitions over time.
- ✓ Because the lending institution does not pay income tax on the finance income, they can pass the savings to the hospital.
- ✓ Only taxing authorities (government owned) hospitals can issue tax exempt debt.
- ✓ 501(c)3 hospitals use conduit financing through an eligible government entity (state financing/municipal authority).
- ✓ Because of the cost to structure the tax exempt debt (upfront fees, attorney fees, etc.), tax exempt debt is normally used for multi-million dollar acquisitions.
- ✓ 3.75% - 5.5% depending on credit type

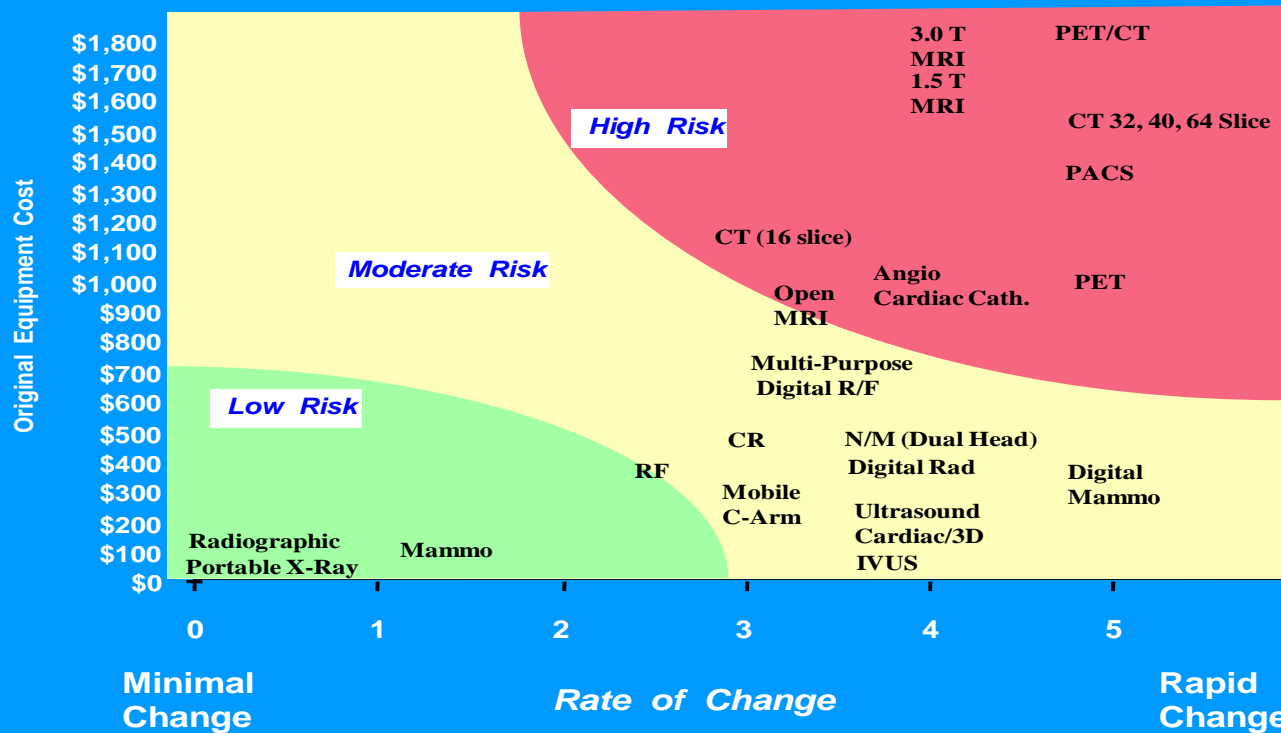


Leasing Fundamentals

- ✓ Leases can provide cash flow, tax and accounting advantages
- ✓ With hospital expansions, it can be a method to keep the balance sheet clean to maintain or improve bond ratings (consult your auditors on OBS treatment)
- ✓ Still mixed reception by financial officers looking for control and efficient management of capital programs and processes
- ✓ Centrally manage leases and treat consistently from an accounting perspective across the enterprise (again, auditor advice)
- ✓ De-link the decision on whether the investment opportunity has relative merit from the decision on acquisition methodology
- ✓ Remove mixed-incentives by reducing departmental budgets like purchased for cash, even if ultimately decide on lease
- ✓ More executives are looking at leasing as an approach to acquire and maintain the latest in technology, particularly in high-end segments, and to address life cycle cost management (see e.g.)

John Hopkins White Paper

TECHNOLOGY CHANGE RATE INDEX Diagnostic Imaging



DEVELOPING A STRATEGIC PARTNERSHIP

Developing a Strategic Partnership

- What is it?
 - Most are typically:
 - Master Agreement standardizing T&C's
 - Establishes a dollar commitment between customer and supplier for a specified duration
 - Establishes a discount rate
 - Specifies customer ancillary requirements
 - Limits choice

Developing a Strategic Partnership

- Have a clear vision:
 - Due diligence
 - What product / service offerings align strategically (your model today and tomorrow)
 - How specifically will execution improve our competitive position (cash, customers, retention)
 - How will it enable the best technology not only today but tomorrow

Developing a Strategic Partnership

- Engage your team
 - Most likely some are very engaged already
- Always start with multiple Suppliers
 - Investigate / Engage
 - ✓ Supplier technology Road Maps
 - ✓ Explore all capabilities but diligently focus on your specific requirement
 - ✓ Existing customers in similar agreements

Developing a Strategic Partnership

- Issue an RFP
 - Specifically state your minimum requirements / product
 - Allow all suppliers capable of meeting your minimum requirements to participate
 - Allow and call out for value add service / offerings

Developing a Strategic Partnership

- Challenge areas for Strategic Partnerships
 - Defining product
 - Defining “State of the Art” technology
 - Volume commitments dollar or percent of annual volume
 - Securing and guaranteeing favorable pricing
 - Equipment service and choice
 - Financial terms / leasing options
 - Equipment performance - uptime

Developing a Strategic Partnership

What else is possible?

- Marketing support
- Employee store access
- Clinical training
- Biomed Training
- Online training
- Accessory discounts
- Consulting / work flow
- Financial penalties
- Shared research
- 90-180 application trials
- Technology Road Mapping participation
- Delayed payments
- Scheduled technology upgrades
- Free loaners

What's the point?

Supplier creativity here is always changing – NEVER underestimate what a supplier can do that you may find value in!

Developing a Strategic Partnership

- General Cautions
 - Technology changes rapidly
 - Physicians come and go
 - Price erosion happens
 - Financials change, contractual commitments do not
 - Cancellation provisions (“how do you get out?”)

Developing a Strategic Partnership

- The value adds
 - Higher sales representative commitment / response
 - No cost to low cost accessories
 - Long term loaned devices / accessories
 - Integration services provided
 - Typically less hassle factor

Summary

- Disciplined, rigorous, and effectively managed negotiation processes deliver significant savings
- Leasing arrangements can provide cash flow, tax and accounting advantages, and a buffer to the technology curve,
- Strategic partnership development requires clear vision, significant levels of due diligence, and careful attention to areas of challenge