

## EMR 201: A Beginner's Guide to Financing an Electronic Medical Record System

The electronic medical record (EMR) is emerging as a powerful new tool for ambulatory medical practices. When successfully implemented, the EMR is one of the few technologies that can positively affect both the clinical and administrative side of a practice. However, the EMR also represents a major capital investment in hardware, software, and services that many practices are not prepared for. This white paper serves as an introduction and resource to the various options available for financing a technology investment like an EMR. We will explain four specific options available, and within each option we will provide some of the pros and cons so that you can evaluate the best method of financing for your practice. The following categories are as follows:

- Cash
- Traditional bank financing (loan or line of credit)
- Lease
- Application Service Provider (ASP)

### Cash

Cash is by far the simplest of all methods of financing, and it has many benefits. The practice owns the software and pays no monthly installments or interest. The financial transaction is quick and easy; there are no third-party arrangements, credit applications or transaction fees – you simply write a check.

But purchasing the system with cash may not be the best option. Many practices do not have excess cash to finance capital purchases. Cash may not be an option simply because the practice does not have it. While larger practices often establish capital budgeting processes designed to earmark funds for major purchases, such processes are uncommon in smaller practices.

All practices should seek to conserve cash. Cash is necessary to meet the routine requirements of payroll, facilities, and supplies that make it possible to practice. When cash is used to finance technology, it is no longer available to meet these needs.

*How to decide.* First, assess your available cash resources. How much money do you have? Do you have enough funds to cover potential emergencies and fluctuations in your practice's business? Do you have borrowing capacity on demand (i.e., line of credit) to cover potential cash shortfalls? Second, assess your current or projected cash flow from your practice. If your cash flow is significantly positive (more cash is coming in than is going out) and you have significant cash reserves, cash may be the best financing option. However, if your cash profile does not meet these criteria, an alternative method of financing is the best bet.

## Leasing

Leasing is a unique form of financing that is perhaps the most widely used method of purchasing technology in healthcare. Leases can be used as either a type of unsecured loan, (a finance lease) in which the technology is owned at the end of the term, or as a type of rental (a true lease). The benefits of leasing include:

**Easy application and quick approval process.** The lease application is typically simple and rarely exceeds one page for transactions under \$50,000. The approval process for leases of this size is typically less than 24 hours (and often within a few hours of receipt of the application). Transactions more than \$50,000 may require additional information (i.e. a tax return or financial statement) and may take longer to approve.

**100% financing with no down payment.** Most leasing companies will allow you to finance the entire technology package (which typically includes hardware, software, annual support and services) with no down payment. 100% financing helps preserve capital which is especially important for cash sensitive new practices.

**Flexibility.** The structure of the lease is variable depending on the requirements of the practice. Payments can be made either monthly, quarterly or yearly; and the lease term can range anywhere from 12 to 60 months (the longer the term, the lower the payment). Additionally, monthly payments can be lowered by establishing a residual buyout payment at the end of the term. Establishing a buyout payment may make sense for growing practices that anticipate a steadily increasing cash flow over the term of the lease.

**Preserves other borrowing options.** Using leasing to fund technology helps a practice optimize other financing tools, such as a bank line of credit, to meet operational cash flow needs.

**Tax advantages.** Depending on the type of lease that you use, the entire monthly payment can be expensed to minimize your tax burden. Consult your tax consultant to determine what is optimal for your practice.

## Explain the financial lease vs. true lease. How do I decide what is right for me?

As noted above, a financial lease is simply a way of purchasing software or equipment. It makes sense for technology, such as software, that has a long useful life.

A true lease is a form of rental. At the end of the lease, the customer may return the equipment to the leasing company, or purchase it at the fair market value. This type of lease makes sense for equipment, such as hardware, that may significantly depreciate over time. In a true lease, since it functions as a type of rental, all payments can be expensed. Additionally, the payments on a true lease - since it is a type of rental - are lower. Bundling the entire transaction into a financial lease or mixing and matching

financial and true leases will be a function of your financial objectives and the dollar value of the technology (hardware and software) that is being purchased. This method should be carefully discussed with your leasing agent.

### What is the disadvantage of leasing?

When leasing, the effective interest rate may be higher than conventional bank loans or lines of credit. Additionally, a lease agreement commits the buyer to make a series of payments over time. In contrast to a conventional loan, there is no compelling financial advantage (i.e. reduced interest expense) to paying off the balance of the lease prior to the end of the term.

### Traditional Bank Financing

Bank loans and lines of credit are widely used traditional methods of financing business purchases. For organizations that have established a good working relationship with a financial institution, bank financing may be an advantageous way of purchasing an EMR. However there are also potential drawbacks associated with bank financing that should be considered before proceeding. The two main forms of bank financing, bank loan and line of credit, are discussed briefly below.

#### Bank Loan

The basic premise behind a bank loan is simple – a borrower is given a set amount of funds from a banking institution at a fixed interest rate. When the loan is paid in full, the borrower owns the system outright and is free of all payments. The length of the loan term can vary, but loans for technology and equipment are typically set at three to five years (depending on the types of products purchased). The advantages of a traditional bank loan include:

**Lower interest rate.** While interest rates charged on bank loans vary according to the specific needs and resources of both the lender and borrower, bank loans typically offer lower interest rates than leasing. The best rates will be received from a bank with an operating history with the practice. Startup businesses, for example, often pay high interest rates (especially when they have little collateral) because banking institutions classify them as high-risk investments.

**Early payment option.** Early payment toward the principle can save the borrower interest fees; once the principle of the loan is retired, there is no obligation to make monthly payments. In contrast, a lease represents a commitment to make a series of lease payments; there is no compelling advantage (in terms of saved interest) to early payment.

### What are some disadvantages of bank loans?

Bank loans require a down payment. Having to pay an upfront down payment is a distinct disadvantage for practices that are conserving capital. The amount of down payment needed for loans can vary according to the loan terms. As an alternative to offering a down payment, businesses can use collateral in lieu of a down payment. Collateral may include personal assets, private real estate, and market investments. In contrast, leasing, in most

cases, does not require upfront cash or collateral to complete the transaction.

**Longer and more difficult approval process.** Understanding a bank loan is simple but acquiring one can be difficult. The application and approval process is time consuming because the lender requires extensive credit reports, financial statements, and paper work. For start-up practices that have not established a relationship with a bank, the loan process can take weeks or longer.

**Less flexibility.** Bank loans do not offer the same full range of payment options and structural flexibility as leases. Variability is typically limited to the term of the loan.

**Technology obsolescence.** Depending on the useful life of the hardware, a bank loan may not be advantageous for purchasing. "Renting" hardware, via a lease, allows one to upgrade to the latest technology at the end of the lease term.

## Line of Credit

Lines of credit are revolving loans that are typically used to finance short-term or seasonal expenses. A line of credit operates on the same principle as a credit card – the borrower only pays interest on the outstanding balance. And like a credit card, the borrower can "charge" up to a pre-defined amount. Typically, a practice will pay the line of credit down from cash flow, so that additional borrowing capacity is available when needed. A line of credit is an important financing tool for the following reasons:

**Flexibility.** A line of credit is ideal for businesses that make purchases throughout the year but are uncertain as to the amount needed for financing. The money is available should you need it, but interest will not accrue until funds are actually borrowed. Typically, banks define minimum payments; however the practice can pay off the balance in full without penalty. Having an established line of credit is particularly useful for financing unexpected expenses or helping balance variations in cash flow.

**No down payment.** Like a credit card, a line of credit allows you to finance purchases without a down payment. The only constraint is the size (the total amount that can be borrowed) of the line.

**Lower interest rate.** Interest rates on lines of credit are virtually the same as bank loans. As noted above, borrowers who have a well-established relationship with a lender typically have access to a low interest rate.

However, a line of credit is not recommended for major technology purchases. A line of credit is an important financial tool for medical practices to help cover natural variations in cash flow and the day-to-day cash needs necessary to finance operations. It is not optimal for large lump sum purchases like technology, unless the practice has sufficient cash flow to quickly pay down the line. Example: Dr. Johnson applies for and receives a \$50,000 line of credit. He uses \$45,000 to finance a software and hardware purchase.

Unless he makes large lump sum payments against the line, he only has \$5,000 of borrowing capacity left.

### How do I know if traditional bank financing is the right method for me?

Bank loans offer the potential advantage of lower interest rates and early payment options. However, a loan for a technology purchase will be much more difficult and time consuming to receive and will probably be less flexible in its structure than a lease. It will also typically require some level of down payment. As noted above, we would not recommend using a line of credit for a major capital purchase like an EMR; it is better to preserve this financing capacity for daily operational needs.

### ASP

The Application Service Provider (ASP) is a new Internet-based model that offers a different way of financing an EMR because it allows users to access the software as a service without the costs associated with ownership. Using the ASP, a practice can finance an EMR (and other software) through monthly fees.

The ASP works through the connection provided by the Internet. Users simply log on to the Web and access their records through a connection to a secure data center housed and maintained by the ASP provider. Because the ASP is a service, many of the capital expenditures and labor associated with traditional client-server applications are reduced or eliminated. These savings include:

**Reduced hardware investment.** Because most processing is done at the data center, ASP users can use relatively less powerful workstations or laptops and simple peer-to-peer networks that do not require a powerful server. By utilizing less powerful workstations and servers, overall hardware and networking expenses are reduced. An ASP also helps extend the useful life of workstations, reducing the need for replacement as applications increase in complexity.

**Reduced administrative expenses.** With an ASP, hardware and software system administration is also reduced. ASP vendors purchase and maintain all server-related functions, including software installation and set-up, routine maintenance, back-ups, updates, and troubleshooting. Given the current shortage and expense of dedicated IT personnel, organizations can help lower labor costs by outsourcing some of these functions to the ASP. For small practices that do not have dedicated IT personnel, an ASP system can make the entire process of utilizing complex applications easy and affordable.

Another advantage of the ASP from a financial perspective is its simplicity. Practices are charged on a per physician basis, and monthly fees include software technical support, software upgrades, and IT support (backup and basic administration). Having a predictable monthly fee makes budgeting easy.

The monthly ASP fee also provides a tax benefit, as these fees can be written off on your taxes as an operational expense.

## Summary

Electronic medical record systems are the inevitable next step in healthcare. Implementing such a system is a major undertaking for any practice, involving an expenditure of both human and financial capital. The benefits of such an implementation are far reaching, touching on every aspect of the practice. From increasing administrative efficiency to improving clinical workflow, an EMR not only enhances practice operations, it also leads to healthier patients.

While an EMR is a significant investment, the methods mentioned above can make it affordable for most practices. In the end, you will have a more profitable office, a more efficient staff, and a healthier patient population thanks to your EMR system.

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