What to consider when making capital investments for your practice

Medical practices can gain significant benefits from investing in new medical equipment. Whether a practice leases or buys, it's important to determine the investment level and strategy that make the most financial sense for its particular circumstances.

Key takeaways

New equipment can improve patient care, sharpen a competitive edge and add revenue streams.

Practices should weigh increased revenue against costs for labor, space upgrades and increased utilities.

A range of purchase and leasing options can accommodate a variety of scenarios.

Equipment needs come from all directions.

There are many reasons a practice might consider investing in new equipment. Expanding your services or growing the number of offices in your group may require new machines to fill 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. Medical practices should look at the market around them to find out if competitors are providing similar services. Equipment that offers patients a wider array of services or allows physicians to deliver care in a better way can be a differentiator in a tight market. It can provide a competitive edge and provide additional revenue opportunities by attracting referrals into the practice. Current equipment should not limit the practice from moving forward.

Upgrades and replacements may also prove necessary if an office 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to discover they've fallen behind competing providers as a result, or that upkeep and other costs associated with outdated equipment have become untenable. For example, old X-ray methods relying on wet processing, a time- and cost-intensive method, have been replaced by digital imaging.

The X-ray equipment would require an initial outlay of capital to stay current, but a practice using the newer digital process will 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 prompt a practice to evaluate new equipment options. Favorable economic conditions make capital more readily available, not to mention more attractive. While interest rates on bank loans are historically low right now, we can anticipate in the near future that interest rates will go higher, and on a long-term purchase the interest paid on that loan adds up. Simply put, when rates are low, financing is often easier to get and is less expensive.

Is your practice ready 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. Practice leadership should look at what its case load has been and ask how many times someone may have been referred out for a service because the practice lacked the equipment in question. 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, a practice can begin a meaningful cost/benefit analysis.

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, 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? Financial reports showing the practice's cash positions, profitability and debt ratios will help identify the current financial status and what the picture will look like with the additional costs of new equipment.

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Other data will also be useful, including a statement of earnings, tax returns and a balance sheet. Depending on the group's financial picture and the type and value of equipment under consideration, these analyses may be extensive. It's not uncommon for doctors to attempt the process alone, but speaking with professionals who have targeted expertise can be worthwhile. And even when a trusted advisor is part of the team evaluating a purchase or lease decision, due diligence is wise. Just like in medicine, a second opinion is always a good option when making a major investment decision. When multiple discussions yield similar insight and opinions—with a CPA or other financial advisor, a banker or leasing agent, for example—the practice is likely on the right track.

Determining ROI

When it comes to determining ROI, the most important element is the equipment's benefit to the practice in the form of financial return or 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 a practice is replacing an essential system, it might add opportunities to enhance patient care or improve the services provided to your patients.

The equipment's reliability, ongoing service needs and maintenance costs are also important parts of the ROI calculations. The vendor's reputation and ability to service their equipment will similarly influence how much value is returned to the practice.

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Lease or buy?

When weighing whether leasing or purchasing makes more sense for your practice, one factor to consider is how heavily you plan to utilize the new machine. 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. So if you are planning to use the equipment all the time, it might make sense to buy it rather than entering into a very short-term lease.

If you do lease, figure out how much of the equipment's useful life you're going to use and only pay for that. 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.

Coupled with expected usage patterns, cash flow is another issue that must be added to the equation. An honest assessment needs to be made about the amount of cash that's available on day one to fund any purchase. If there isn't much, 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 with no down-payment more attractive. There is also 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. 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.

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. For example, an orthopedic surgery practice that offers X-rays 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 to support added operational complexities that arise when the new equipment is added to the mix, such as special billing requirements for reimbursements. 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.

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. 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. A financial professional can help assess your options, 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.

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Understanding a lease's return provisions is one factor to consider during the initial assessment among many important considerations in determining how attractive the lease really is. 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—things that can be difficult to chase down in a busy practice over a long lease period, forcing you to buy the equipment if terms can't be met. 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.

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. There may be legal matters to hammer out in such an arrangement, but if it's a large investment and you're concerned about how you'll operate and manage it, having a conversation with the 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.

> The end-of-term options are what practices should review carefully, That's where you need to look at the return provisions. 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?
>
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Is your building ready for new equipment?

Before making a final decision to invest in expensive equipment, your practice needs to consider if you have the space to support everything that device requires. Build-out costs can add significantly to the total price of the equipment—you might need to rebuild part of the room, expand the space or upgrade utilities. 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 utility expenses that could affect the long-term cost of the equipment, such as power, water, heating and cooling, even internet connectivity and bandwidth requirements that may drive monthly expenses up. Your practice should be able to get reliable information from manufacturers, architects and construction companies about costs and timelines to plan accordingly and avoid major surprises during implementation.

Conclusion

New equipment can be instrumental in moving your practice forward, 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? With the support of experienced advisors 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.

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