TOP 10 REASONS WHY: HEALTHCARE PROVIDERS PAY **WAY TOO MUCH** FOR IT

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PREFACE

With all the focus on reducing healthcare costs, it may surprise you to learn that of the 30 industries we recently sampled, healthcare organizations actually pay more for technology than any other industry. Our analysis shows healthcare organizations pay an average of 17% more, than that of the other 29 industries we sampled, and 33% more than the industry with the lowest average costs (food service).

We do expect an information intensive industry like healthcare to demand considerably more technology investments from every dollar spent to power critical patient care as well as manage organizational decisions. We do not expect the difference at this level or at this scope. Healthcare organizations pay more for all types of technology from Lawson financial applications, to Microsoft desktop productivity licenses, to Cisco networking equipment, to IBM servers, to Dell/EMC storage arrays, and so on. These overpayments extend to the vertical applications for healthcare like those provided by Epic, McKesson, Cerner (Oracle), and others. The breadth of scope of this “healthcare premium” indicates that this is not an industry specific difference for one type of technology unique to healthcare, but rather a general premium that applies to all technology.

In this whitepaper, we outline the top 10 reasons why we believe healthcare providers pay way too much for information technology.

HEALTHCARE ORGANIZATIONS FOCUS ON PATIENT CARE AND SAFETY

When it comes to investments in information technology for healthcare, there is a lot on the line. Produce the wrong information, and a patient may have the wrong leg amputated; dispense the wrong medicine and someone has an allergic reaction; conduct the wrong procedure and someone dies. Therefore, most healthcare initiatives focus on improving patient care and mitigating risk. The priority is to get the right information to the right doctors in the most convenient manner possible, within all regulations and policy parameters. Healthcare organizations require extremely high performance and reliability of the equipment and software of the information systems. As a result, the total costs of these initiatives often pale in comparison to the potential liability of a wrongful death lawsuit. Clients easily justify these types of investments. If the justification is high, there is less focus on the costs.

We see organizations in the healthcare industry paying significantly more for technology than other industries. Big monetary justifications and a strong focus away from the market value of the technology towards the organizational value to improve patient care enable technology suppliers to charge significantly more to healthcare organizations.

HEALTHCARE ORGANIZATIONS OFTEN LACK A PROFIT MOTIVE

While an increasing number of providers are for-profit, many healthcare providers remain not-for-profit organizations. Regardless, most, if not all healthcare organizations are now focusing on revenue generation. The requirement for financial performance in quarterly business cycles, often seen in traditional publicly traded organizations, can be less intense.

Most healthcare organizations believe they are cost conscious. The reality is that when technology costs go up, healthcare providers usually just factor increases in technology costs into the total costs of service without much of an awareness of other, less costly methods to achieve the same result. Without the profit motive, the measurement of success is often different. In comparison to for-profit business, another dollar of profit might equal another ten dollars of market capitalization value, and that will likely translate to an increase in stock price. Financial executives keenly focus on these areas in for-profit business and much less so in healthcare.

Healthcare organizations do not often view significant investments in technology as a competing value to an in-quarter financial target, and therefore are often more willing to make those investments when for-profit companies may delay or even eliminate technology projects for the sake of making their quarterly numbers. In addition, with multiple parties and constituents involved in making decisions, the alignment to financial concerns is often a secondary, if not an outright tertiary, objective. In these organizations, few if any in the management team are directly accountable for optimizing costs.

3

HEALTHCARE SYSTEMS ARE OFTEN INEFFICIENT AND DIFFICULT TO AUTOMATE

Healthcare is often highly subjective, making it difficult to automate, yet the industry is also highly regulated. Healthcare organizations cannot always implement processes the way they are in other, less regulated, or highly automated industries. In addition, healthcare processes are often more intense due to the necessary verification and re-verification of data and the multiple departments involved. Many times, the enhanced processes require more technology and automation than processes in other industries. When you consider how patients with urgent care needs can sit waiting in emergency rooms for four hours, and how the full burdened cost of a single administered aspirin can be $150, there is no question that some processes in healthcare organizations are highly inefficient, and therefore costly. This is no different with technology.

Most healthcare organizations see technology as a means to an end and do not always have a good handle on their technology spending. In some cases, they do not know what they are spending where and for what reason. They may not know whether they could reduce costs with better business processes or a more organized approach to technology spend management. In other cases, they do not have a good handle on their contracts, and therefore generally do not know what they own. Still in other cases, they do not generally understand what they have deployed where, and how they use it, and whether that use is appropriate.

Because of the distributed buying patterns, decision patterns, and fragmented management and accountability in some cases, there are generally very significant savings opportunities in healthcare organizations. This includes even simple business process improvements to contract and IT asset management initiatives. Healthcare organizations also have opportunities for further improvements to understanding the alignment between the organizational need and the required technology enablement.

4

HEALTHCARE ORGANIZATIONS DON'T ALWAYS NEGOTIATE DILIGENTLY

In acute times of need, when you go to your doctor, your doctor generally treats you pervasively. Due to the professional nature of doctors in the first place, plus the potential for exposure to increased liabilities due to malpractice claims, doctors generally evaluate and treat you broadly, order comprehensive tests on expensive machinery, and otherwise design and architect a plan for your complete care. Other than the occasional generic versus branded drug, there is not much room for negotiation. As an example, we do not know of many who have successfully negotiated down the cost of an MRI, let alone whether an MRI was the appropriate test whether or not the organization needed an MRI in the first place. In fact, healthcare providers delegate this "negotiation" function to their insurance companies. As much as this insurance driven model creates issues, there is no doubt that the payers have driven a certain level of cost efficiency.

In addition, doctors want to be viewed as the experts, so when they are assessing your needs, they do not often engage in a negotiation on the solution of your care, let alone on its associated cost. This culture permeates the healthcare industry. Healthcare organizations view costs as largely a product of the solution, and added into the total consideration without so much as a second thought. This culture of trusting the experts for a solution extends to IT. An all-too-frequent scenario is:

- Healthcare organizations bring in outside experts who tell them what kind of technology solutions they need, and then work with suppliers to review those requirements.
- They then purchase what they believe they need, without awareness of the actual market price of the proposed technology solutions specific to their environment.
- They do not have the knowledge of other configurations or optimizations to produce an equal or greater organizational value proposition at a significantly lower cost.

5

SUPPLIER LOCK-IN

Most healthcare organizations have made significant capital investments in vertically integrated technology solutions. Once an organization is committed to a vertically integrated healthcare technology supplier like Epic, Oracle/Cerner, McKesson and others, those suppliers have increased organizational influence and greater account control. In fact, in many cases, the healthcare organization violates the support agreements with these

technology suppliers if they do not buy even commodity technologies (e.g. storage products) from the vertically integrated technology suppliers, as opposed to the original technology producers. There is usually a significant mark-up to the costs of these technologies, due to the supplier's certification of these technologies as part of the underlying supported solution set. Many of these so-called 'certifications' fall into one of three categories:

- ❖ not truly required,
- ❖ not fair to the healthcare organization, or
- ❖ not justified for the premium cost associated with the certification.

Once healthcare organizations lock into a vertically integrated technology supplier, they must deal with a supplier that now has monopolistic pricing controls. Technology suppliers understand this and fully leverage that added power to incrementally drive-up prices, capture greater wallet and market share in other areas of the organization, and otherwise exploit the added account control in ways that enhance their own objectives.

6

SINGLE PURPOSE PURCHASING

Most healthcare organizations purchase technology solutions that have a single purpose. Many healthcare clients will look for a total solution for a specific purpose, like radiology as an example. These clients are searching for a solution that provides all the hardware, software, and services — along with all the training, education and ongoing support. By bundling all these things together, technology suppliers can 'hide' margin that would otherwise be more easily identified.

In addition, the 'solution' is the thing that takes value, and suppliers are often granted enhanced profit margins if they can become the single functional source. Further, if the solution integrates with the healthcare organization's chosen vertically integrated technology solution, the organization perceives further enhanced value, and therefore, the technology supplier will capture even additional margin.

Finally, consider the technologies that healthcare organizations purchase for a specific need are not able to be multi-purposed for greater economies of scale. As a result, the actual utilization rates on infrastructure components like servers, storage, and networking equipment are extremely low in healthcare. Similar to what we see in government, healthcare organizations often approve funding for a specific project, rather than for an enterprise-wide infrastructure standard. As such, each specialty area has its own infrastructure, costing considerably more.

INDUSTRY SPECIFIC SUPPLIER PROGRAMS

Some technology suppliers have implemented special industry programs for industries with specific needs, like education, government, healthcare, and non-profits. Suppliers design, engineer, and market products specifically for healthcare that generally cost considerably more than cross-industry products. When our healthcare clients have conducted detailed studies of the actual differences between industry-specific offerings versus non-healthcare specific commercially available offerings, they attribute a shockingly high percentage of the value to nothing more than marketing.

Many technology suppliers use the very same technology components for industry-specific solutions for industries like healthcare as they do for other commercial business, so the reality of this premium value does not often match the reality. In many cases, healthcare clients have been able to purchase the commercial versions of these same products and have been able to use them for their industry-specific needs at lower costs and without sacrificing any organizational value.

In seven recently sampled industry-specific product offerings from various technology suppliers, we could not justify the cost premium in any of them. A few had some customized configuration options, presumably designed to offer faster deployment and integration, but side-by-side comparisons resulted in significantly less costs associated with making these configuration changes to the commercially available options versus paying the higher values for the healthcare-specific products.

8

LACK OF STRATEGIC SOURCING PROTOCOL

Many healthcare organizations buy through buying consortiums. This makes a lot of sense when purchasing commodities like cotton balls, tongue depressors, bandages, swabs, food and linen services and other items, which healthcare organizations can buy in bulk with no significant competitive differences from one product to another. Buying consortiums rarely offer sophisticated capabilities beyond volume benefits. Unfortunately, even in the commercial sector, when it comes to technology, buying consortiums have not proven to work in practice.

Technology is just too specialized and complex to be addressed on a commodity basis. In the commercial sector, the answer has been the development of “strategic sourcing” as experts in the evaluation and procurement of technology and services. Most healthcare providers lack strategic sourcing capabilities in technology. Some healthcare clients may believe the unit costs of commoditized technology components may be highly optimized (even though our research indicates that is not the case).

They can still cost way too much because they might not be the right kind of units, for the right organizational need, or there may be other units of something else entirely that could do the job as well or better for significantly less. When it comes to IT, healthcare providers can purchase very few things as commodities, and therefore strategic sourcing capabilities are highly recommended. Even such seemingly commoditized items as Microsoft licenses can have dramatic price differences if the organization configures, deploys and uses them in ways that meet the specific organizational needs, the current infrastructure, and the planned technology roadmap. Optimizing the economic and strategic value of the technology investments results in savings and benefits of 33% or greater.

9

NO INDUSTRY CENTRICITY

In commercial business, it is common to see cross-industry collaboration. Many of the user groups (as an example) have professional members that run the gamut of industries. The information sharing that goes on has a normalizing effect on the market. Professionals in one industry can easily collaborate with professionals in another industry and although they may find some differences, they discover that they share similarities in how they plan, deploy, and use information technologies. Industries outside of healthcare become quite experienced with analytics, data mining, decision support, etc. – the very same demands coming to the healthcare IT groups with increasing velocity. In addition, many of key suppliers are the same, and many of the challenges of managing those suppliers and those investments are similar.

Most healthcare providers, however, network only with other in-industry peers, and often lack the benefit of a cross-industry perspective of technology markets. When they do collaborate, they realize that their peers in retail, manufacturing, transportation, and other industries pay considerably less than they do, often, for the very same technologies. Healthcare clients tell us they usually cannot relate to the challenges in other industries. With the inability to use Federated Market Intelligence, instead having to rely on peers in the same industry, healthcare organizations often know less about the actual market value of technologies and rely only on the suppliers and/or their value-added resellers, who all share the incentives to get them to pay more for the technology.

UNPRECEDENTED CHANGE AND MANDATE FOR BUSINESS SUSTAINABILITY

Compelling events in healthcare, economically, legislatively, and through M&A activity, are driving unprecedented change in all sectors of the healthcare industry. These organizations need to make significant investments not only to achieve compliance, but also to build a sustainable business – the technology is getting even more complex than ever. To build sustainable businesses, these organizations must maximize the value of their capital investment now and in the future. Freeing up capital from existing technology suppliers to redirect to strategic initiatives is one opportunity.

Healthcare providers should focus these strategic initiatives on new market pressures (i.e., Accountable Care Organizations, meaningful use, transition from ‘fee for service’ to ‘fee for performance/outcomes’, etc.), new lines of business, and other new revenue streams. These strategic initiatives are the necessary activities for healthcare providers to create sustainability amidst this unprecedented change.

BONUS: HEALTHCARE IT IS **OVERSIMPLIFIED**

IT in the healthcare industry is one of the most complex areas of IT. Yet, healthcare organizations spend less on IT talent than other industries but have more staff due to inefficiencies. Similarly, healthcare organizations pay too much for technology, but have not efficiently automated key processes. In addition, due to suppliers' poor integration of their technology acquisitions and healthcare organizations' acquisitions of diverse technologies, real operational integration across the enterprise is elusive.

These complexities lead to gaps in experiences and competencies in many healthcare organizations necessary to navigate complexity and change. As accountability shifts from staff to suppliers in SaaS models, these gaps are compounded. Who is establishing effective Service Level Agreements? Who is managing them to ensure supplier accountability?

With a comprehensive expertise in Healthcare IT, NET(net) can improve the economic and strategic value of critical IT investments. Concurrently, NET(net) helps healthcare providers build better, more sustainable business partnerships with key technology suppliers, focused on value for the long term.

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- Federated Market Intelligence gathered from serving the unique needs of 1,200 global clients,
- Best practices refined over the course of professionally managing over 15,000 engagements, and
- Proven results of the Proprietary Negotiating Methodology mastered in the pursuit of the more than $50B of captured savings since 2002.

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Since 2002, NET(net) is the world's leading IT Investment Optimization firm, helping clients find, get and keep more economic and strategic value. With over 2,500 clients around the world in nearly all industries and geographies, and with the experience of over 25,000 field engagements with over 250 technology suppliers in XaaS, Cloud, Hardware, Software, Services, Healthcare, Outsourcing, Infrastructure, Telecommunications, and other areas of IT spend, resulting in incremental client captured value in excess of $250 billion since 2002.

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