

2009

Accounts Payable Optimization in Today's Healthcare Environment



In today's tumultuous economic and political environment, healthcare providers increasingly are struggling to balance clinical and financial objectives. On the one hand, the pressure to do more with less is forcing them to make tough decisions about where and how to cut costs. On the other, they recognize they cannot let financial pressures take precedence over their mission of providing the best possible patient care.

Faced with these competing demands, healthcare providers are discovering that changes within the accounts payable (AP) function provide promising opportunities to reduce expenses and reallocate resources to more strategic and patient-facing activities. Previously often overlooked as a source of bottom-line savings, AP automation and process improvements are quickly becoming areas of focus among hospitals, recent studies have shown.

This is the second in a series of white papers designed to provide insight into the healthcare supply chain from a financial perspective. It takes an in-depth look at AP optimization as a way in which hospitals can deal with operating expense pressure and staff reductions, cut the cost of invoice processing, manage cash flow and gain greater visibility into their accounts payable processes.

AP Optimization:

- *Helps deal with operating expense pressure and staff reductions*
- *Helps cut the cost of invoice processing*
- *Improves cash flow management*
- *Provides greater visibility into AP processes*

In this paper, GHX Business Solutions explores some of the business challenges facing hospitals today and provides advice to help financial executives lead the drive to streamline and optimize invoice processing functions to help meet those challenges. The paper describes the evolution of the AP optimization process and proposes questions that decision-makers can ask themselves as they move through the stages of transforming their AP function. It also addresses how the value of existing technology solutions can be maximized through process improvements and resource alignment and optimization.

The State of Healthcare AP Automation

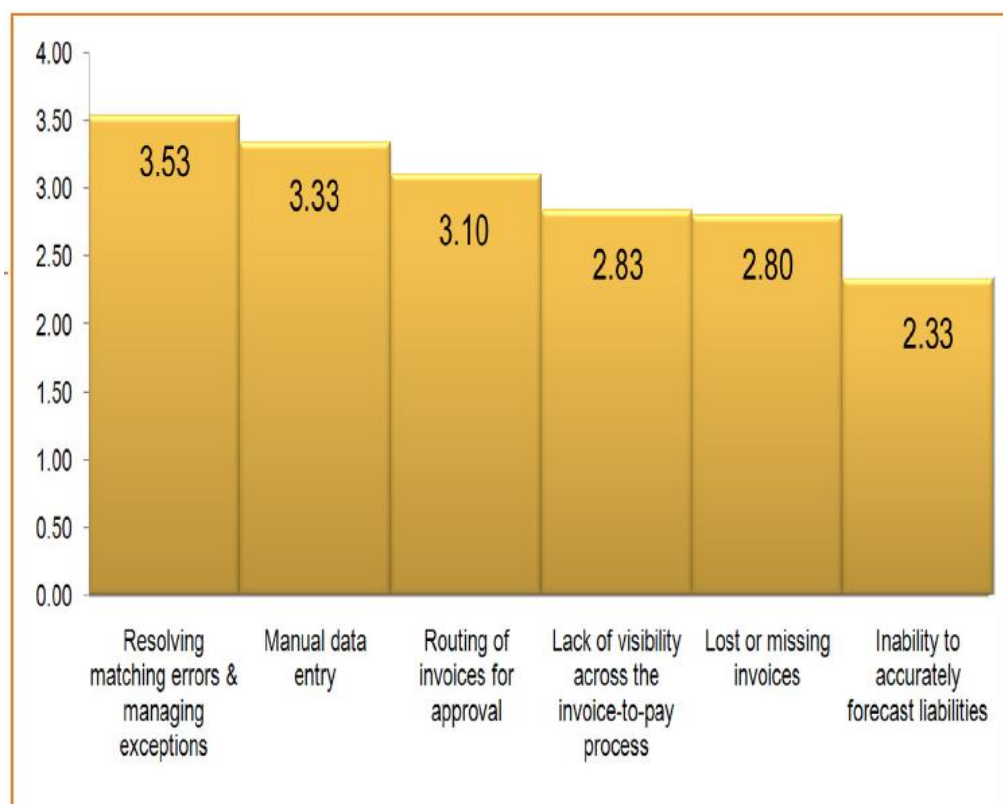
A recent study¹ conducted by PayStream Advisors provides a snapshot of the state of healthcare AP automation today. PayStream Advisors, which conducts independent research and automation assessments for financial

More than 70 percent of hospitals surveyed still receive more than 80 percent of their invoices in paper format and resolving matching errors and exceptions are their most challenging tasks.

automation technology, found that hospitals are about five years behind non-healthcare industries in terms of adoption of paperless invoice processing. More than 70 percent of hospitals surveyed still receive more than 80 percent of their invoices in paper format, and resolving matching errors and exceptions are their most challenging tasks.

¹ PayStream Advisors, *Healthcare ePayables: A Buyer's Guide to Paperless AP in the Healthcare Industry*, 2009.

Hospital pain points related to AP processes rated on a scale of 1 to 5 where 5 is the most painful



Source: PayStream Advisors

Another recent study of acute-care hospitals in the U.S.², by HIMSS Analytics, provides more insight into the state of invoice automation in healthcare. Respondents ranked invoice processing as one of the areas where automation provides the most value, yet 62 percent receive less than one-quarter of their invoices electronically as 810 EDI transactions. The median response was just 10 percent.

But significant change is underway, according to PayStream Advisers. That change is being fueled by a growing recognition among healthcare providers of the value of transforming AP from a tactical, back-office function to one that delivers strategic and bottom-line benefits.

PayStream Advisors' research indicates that hospitals are about five years behind non-healthcare industries in terms of adoption of paperless invoice processing.

²HIMSS Analytics, *The State of eCommerce in the Healthcare Supply Chain* 2009, 2009.

Business Challenges Facing Today's Hospitals

A recent study³ by Thomson Reuters of the impact of the current recession on U.S. hospitals concluded that the financial situation has improved dramatically. In its first analysis of hospital economic health in the fall of 2008, Thomson Reuters found that hospitals were facing unprecedented economic stress, with a median profit margin of 0.17. That number rose significantly to 3.1 percent in the first quarter of 2009, an increase that Thomson Reuters attributed to a combination of aggressive cost controls and overall improvement in the economy.

But the same study also found that while total margins and liquidity have increased, 30 percent of hospitals still remain unprofitable, and it remains to be seen whether the recovery hospitals are beginning to see is sustainable.

To address these challenges, hospitals are looking for ways to reduce administrative costs and maximize revenue by focusing their attention on staff productivity increases, as well as reductions in the labor force. Unfortunately, many of them find themselves in the position of needing to *add* AP staff to meet the volume of paper invoices that flow through their organizations. When one to two new AP staff members are needed at each hospital, the result can be a significant increase in operational expense. In addition, hospitals may be so focused on the immediate task of paying the invoices that they don't even have the time or tools to take advantage of savings opportunities such as early-pay discounts. Many of them, therefore, spend a great deal on AP staff expense, while leaving hundreds of thousands of hard-dollar savings on the table every year.

Especially in this era of declining reimbursements, GHX has found that leading hospitals are looking for, and finding, ways to remove labor and hard-dollar expenses from their cost structures, and invest those savings in strategic initiatives that more broadly benefit the hospital. These hospitals realize that the supply chain, including the AP function, can have a big impact on their financial health, since every dollar saved goes directly to the bottom line.

Technology Enables Change

The AP departments at most hospitals today are engulfed in a sea of paper invoices and manual processes. Hospitals often are unable to process invoices in time to qualify for early-pay discounts. This can have a negative impact on a hospital's cash flow, expenses and ability to maintain a good credit status.

A highly manual AP operation also limits visibility. Some hospital finance departments don't have any visibility into which vendors or contracts offer early-pay discounts or how much they are spending on freight and special charges. Although contract terms may exist on what type of freight can be charged by vendors, many hospitals are unable to monitor whether those terms are being adhered to properly.

With the increased prevalence of e-commerce in the healthcare supply chain, healthcare organizations have worked to increase the number of electronic invoices they receive from their suppliers. For example, the number of

³ Thomson Reuters, *Hospital Operational and Financial Performance Improving*, 2009.

electronic invoices processed via the GHX Exchange has grown considerably in recent years, doubling from 2006 to 2007. But, as mentioned previously, the overall percentage of electronic invoices at hospitals is still relatively low, especially compared to the percentage of purchase orders (POs) and confirmations received electronically—70 and 60 percent, respectively.⁴

Electronic invoicing allows hospitals to eliminate manual invoice processing and reconciliation tasks, cutting the average time it takes to process an invoice from 25 to 60 days to two to five days while also reducing keying error rates. By shortening the invoice-to-payment cycle, hospitals can take greater advantage of early-pay discounts, maximize labor efficiencies and reduce hard-dollar costs.

Software tools that provide real-time visibility to purchase order discrepancies can also reduce costly and time-consuming invoice exceptions. Purchasing and AP staff can work together to proactively address discrepancies. “Managing by exception” has been shown to reduce invoice discrepancies by up to 50 percent, GHX has found.

Today, hospitals have access to electronic invoicing tools to automate up to 100 percent of their invoices, even from suppliers that are unable to send invoices electronically. This includes both PO and non-PO invoices. The ability to automate non-purchase order invoices enhances AP efficiencies by improving communication and approval workflow with other departments that are responsible for approving non-PO invoices. The labor costs to scan invoices and the hard-dollar costs of scanning equipment or leases also are eliminated by using a third party to convert paper invoices into electronic invoices.

Lost invoices become a thing of the past with electronic invoice capture. This can reduce the time necessary to reconcile vendor statements by 50 percent or more.

These new invoicing processing tools also address the need to have the proper audit trail and store paper copies of invoices. Software tools also provide the ability to see invoice details, electronically archive invoices and print paper invoices on demand for auditing purposes.

More sophisticated invoicing tools provide hospitals the ability to identify early-pay deadlines; in this way, finance departments can pay specific vendors earlier if they want to recognize the discounted savings. At the same time, they have the analytical tools to be more proactive in managing expenses such as freight and special charges.

With AP automation, healthcare organizations are finding that they can do more than just save money: they can transform their AP function into a source of competitive advantage, supporting business planning and decision-making. Using an AP automation solution from GHX, UPMC, an \$8 billion integrated global health enterprise, now receives 100 percent of its PO invoices electronically, even from suppliers who do not currently support electronic invoicing. This has enabled UPMC to redirect resources for five data-entry positions to two senior sourcing positions, each of whom is charged with saving UPMC \$1 million per year.

⁴ *Ibid*, HIMSS Analytics

Return on Technology Investment

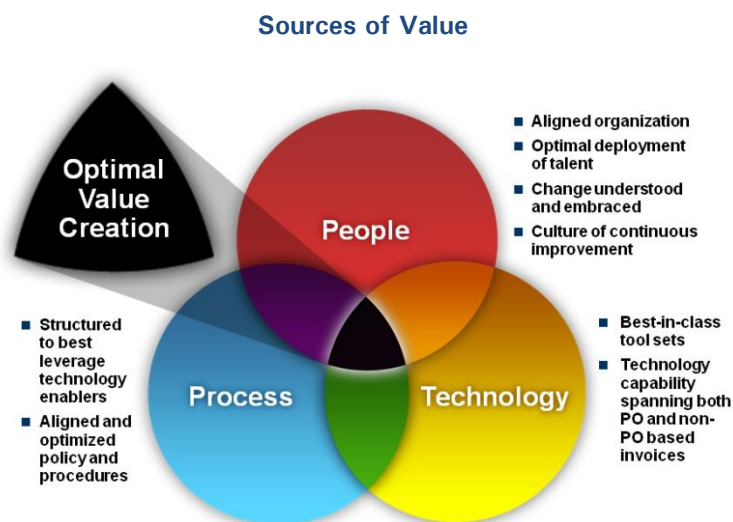
Automating invoices to reduce manual processes results in both hard-dollar and labor savings. Hard-dollar savings are achieved in a number of ways, including the following:

- Early-pay discounts
- Fewer late payment penalties
- Elimination of scanning equipment costs
- Elimination of storage and microfiche costs
- Reduction in freight and special charges because of visibility, reporting and analysis provided by the technology
- Elimination of value-added network fees if an organization is doing electronic invoicing on its own through direct EDI

Labor savings are achieved by eliminating or automating steps in the process, which can result in an average time savings of 60–80 percent. The average labor cost to process a manual invoice ranges from \$5 to \$10 per invoice, compared to \$0 for a touchless electronic invoice to \$5, depending on whether there are invoice errors.

Maximizing the Value of Technology

While automating the invoicing process is an important part of the AP optimization equation, technology alone is never the complete solution to a business problem. To transform a function like accounts payable from reliance on paper-based processes plagued with errors and inefficiencies to a well-tuned, efficient and highly automated operation, best-practice enterprises combine technology with process improvement and resource alignment. The following illustrates how people, processes and technology come together to provide optimal value creation during AP optimization.



Process

The right technology solution provides a powerful lever to do things differently in the AP process. Invoice automation removes steps from the process, but true AP optimization involves designing work processes to make the best use of the technology solution.

For example, one of the most common sources of invoices not matching is freight, since it is very hard to know ahead of time what freight charges will be for a given requisition. While most requisitioners have little or no idea how to determine what the freight charges will be, buyers are better able to figure this out. But since most requisitions are automatically turned into purchase orders, buyers are touching POs less and less. That means there may be a perfect PO and a perfect invoice, but \$27 for freight on the invoice does not match the PO.

Leading healthcare organizations ask themselves key process questions to help decide which process to use in this situation: Do we just add freight to the header of the invoice? Call the buyers to add a line for freight? Or have the vendor bill a separate freight distribution once a month and then have an internal team analyze freight charges to determine proper billing and/or cost savings opportunities?

People

As with any significant business transformation undertaken by an organization, AP optimization requires change. To ensure success, best-practice hospitals align their organizations to ensure the right people are doing the right jobs. As individuals move from being transaction processors to exception analysts, a different skill set and different tools are required, and hospitals that are successful at AP optimization create innovative training and change management programs to help people be successful using the new processes.

GHX Business Solutions has found that there are a number of questions hospital executives need to ask when addressing the people part of the AP optimization equation. What are the key issues to be resolved? Who owns the process? Who is involved in the process? Are they committed to improving the process and working together and, most importantly, are they prepared to do the work to make the new process successful?

Change management can play a big role in mitigating the pain of AP optimization as it relates to people. From its work with hospitals around the country, GHX Business Solutions believes the following are the key ingredients of an effective change management strategy:

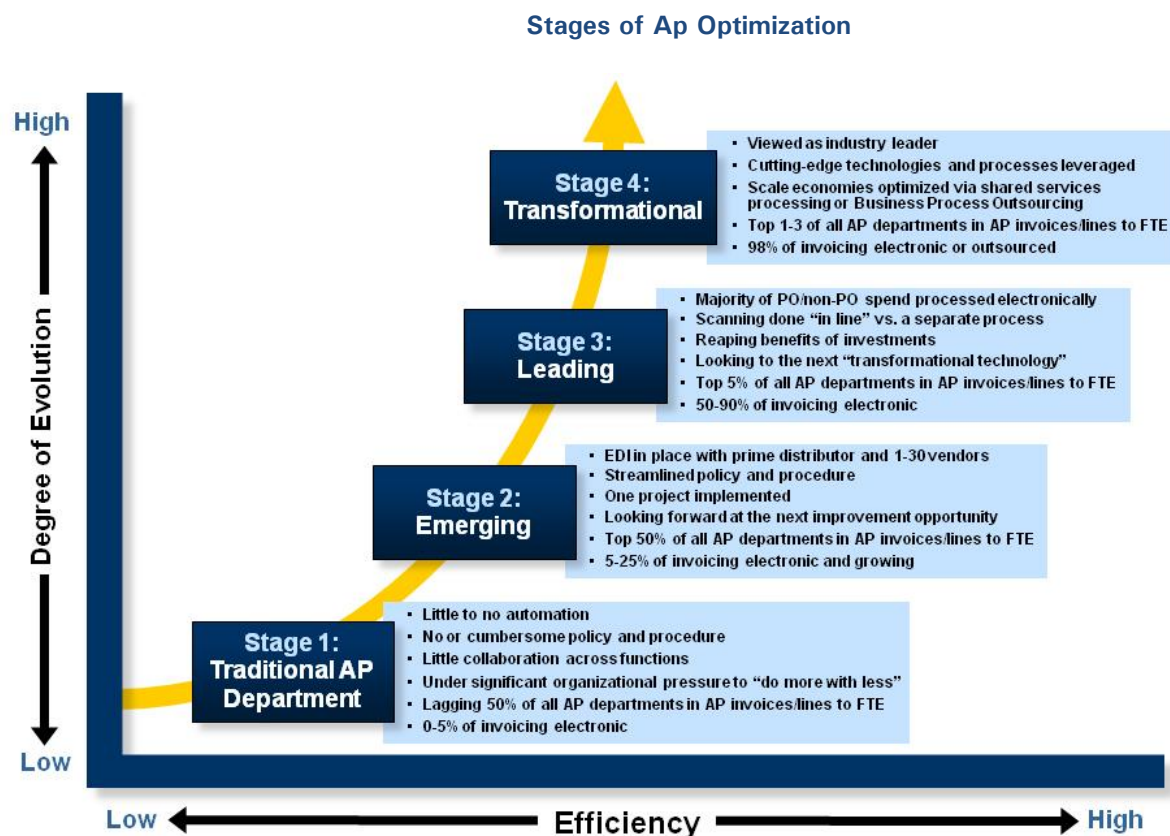
- Helping employees understand the need for change
- Aligning people to the need for change
- Creating champions for the change
- Training people on new systems
- Training people on policies and procedures
- Creating client "super users" who carry on the message



Navigating the Waters of AP Optimization

GHX Business Solutions has found that healthcare organizations working to fully optimize their AP operation go through several distinct stages as they move from highly manual, staff-intensive AP processes to a highly automated, lean AP function.

The following chart shows the stages of AP optimization and the characteristics of each stage. We'll explore these stages – including how the stages are achieved – in this section of the white paper.



Stage 1: Traditional

Most hospitals today are at the first stage of AP optimization, which is characterized by very little to no invoice automation and a diligent, hard-working staff that wants to pay invoices on time and ensure that payables activities do not disrupt the supply chain. Hospitals at this maturity level are processing up to 5 percent of their invoices electronically, and when benchmarked against their peers, have a relatively low ratio of number of invoice lines processed per person to the number of AP staff. They are taking advantage of very few early-pay discounts.

AP departments within hospitals at this maturity level may recognize the benefits of increasing the volume of electronic invoices they receive from suppliers and distributors, but they might not be able or willing to make changes for a variety of reasons, including a perceived threat to the status quo. Historically, AP staff members have

relied on paper invoices because paper is comfortable: they can see it, touch it and feel it. In addition, paper provides an audit trail and can be stored for seven years to meet government requirements. Finally, because AP operates autonomously from purchasing, relationships can be strained when AP sends discrepancies back to purchasing for resolution.

Overcoming resistance to change is one of the biggest challenges to moving from this first level in the AP optimization process to a more automated AP operation, but the payback can be tremendous. By simply increasing the volume of electronic invoices received from suppliers, organizations at this maturity level can take advantage of measurable savings.

Stage 2: Emerging

The second step in the AP optimization process involves a moderate degree of invoice automation. GHX Business Solutions estimates that healthcare organizations at this level are handling from 5 to 25 percent of their invoices electronically and are properly taking advantage of early-payment discounts, or are starting to do so. While these organizations still have a fairly manual-intensive AP operation, they are moving toward full invoice automation by continuing to increase the number of suppliers from which they can receive electronic invoices.

At this level, organizations can achieve significant savings by increasing the volume of electronic invoices, or "maximizing the pipe." At an annualized rate and assuming \$32,400 in savings per 10,000 invoices, they could be saving more than \$125,000 per year in labor alone by receiving invoices electronically from their prime vendor and approximately 30 additional trading partners. Moderate automation also opens up the opportunity for the organizations to take early-pay discounts. On average, providers can realize a .5 percent overall savings via early-pay discounts based on their invoice dollar volume. For a hospital processing \$3.5 million a month, that represents \$210,000 in potential early-pay discount savings.

GHX Business Solutions has found that organizations at this maturity level are beginning to think about how they can align their resources to position themselves for greater effectiveness and efficiency. A healthcare system that is growing, like Spectrum Health System in western Michigan, may use AP optimization as part of its growth strategy.

Spectrum Health employed AP optimization as a way to address an aggressive acquisition strategy that required minimal headcount growth. Undertaking an AP optimization project with GHX fit into Spectrum Health's strategy to increase efficiencies to enable continuing growth. The project increased the number of vendors with electronic invoices from four to more than 40, while accelerating discrepancy resolution at the same time. The project enabled Spectrum Health to keep the same size AP department even as it brought additional physician practices and a hospital into the fold.

"With the help of a full AP process review by GHX Business Solutions, we understand where we really stood vis à vis other organizations and where we could make improvements. Through our recent growth, our invoice volume has grown over 10 percent. Working with GHX has been crucial in absorbing this increase without additional labor."- John M. Rosloniec, AP Manager, Spectrum Health

Hospitals facing budget cuts may already have made personnel reductions, but they can adopt a strategy of using AP optimization to keep up with the work that did not go away when the personnel did. Other hospitals see an opportunity to redeploy personnel from AP into more value-added roles, including early-pay discount analysis or ad-hoc supply-chain improvement projects.

Stage 3: Leading

The next step in the evolution of an AP operation occurs when a hospital has automated from 50 to 90 percent or more of the invoices it receives, including both purchase order and non-purchase order invoices, even from suppliers who do not currently support electronic invoicing. Invoices are scanned automatically instead of going through a separate backend batch process, and workflow processes have been optimized for both of these types of invoices. Under this scenario, AP can provide excellent financial visibility to other internal departments.

Depending on the size of the hospital, an organization at stage 3 can expect that between 100,000 and 300,000 invoices a year will be processed automatically and that more than \$100 million in medical-surgical spending will be available for early-pay discounts.

Very few hospitals today are at this advanced level of AP optimization, but GHX Business Solutions works with an increasing number that are working to get there. Some, such as UPMC, have made significant strides. Like most IDNs, UPMC has a huge vendor pool, many of whom still only provide paper invoices. In line with its strategy to focus on strategic activities that drive value and savings to the organization, UPMC employed a turnkey, software-as-a-service solution by GHX that enabled them to move from 60 to 100 percent electronic invoicing in 90 days—a transition that could otherwise have taken years.

UPMC is now receiving 100 percent of its invoices—which can exceed 2,000 in a single day—electronically, eliminating the need for manual data entry and accelerating invoice approval. UPMC has been able to reduce its invoice processing costs to less than \$1.55 per invoice and, with the increased productivity achieved, has been able to shift resources to more strategic-based supply chain activities such as sourcing.

Stage 4: Transformational

Looking to the future, a few leading healthcare organizations are beginning to ask the longer-term question of whether they should be in the business of processing invoices at all. GHX believes there are two options for them to consider: full automation of their in-house AP processes or outsourcing the entire AP function.



The decision-making process for a hospital at stage 4 involves a close examination of a hospital's culture and core competencies. Here are some questions to ask when considering which course to take:

- Is my organization comfortable with outsourcing? Do we outsource other functions? How has that worked?
- What are my organization's core competencies? As a healthcare organization with a core competency of providing outstanding patient care, should I find a third party whose core competency is AP?
- What efficiency gains and cost reductions would result from outsourcing the payables functions?

About GHX Business Solutions

Using a variety of assessments to analyze technology, processes and people, GHX Business Solutions provides a customized approach to help healthcare providers maximize the value they get from their supply chain initiatives. This analysis process enables hospitals to identify unique problem areas and take the necessary steps to become more efficient and achieve greater cost savings.

Conclusion

Because the AP function tends to be so manually intensive, it is a business area that holds great potential for process optimization and bottom-line savings. Healthcare organizations that learn how to leverage AP optimization to better position themselves for long-term viability in today's constantly changing healthcare environment can provide high levels of service and exceptional quality while still achieving their financial and operational objectives.

The current recession has brought into clear focus the need for healthcare providers to address cost drivers and optimize the various components of their supply chains. Many organizations already have supply-chain improvement projects underway and increasingly are adding accounts payable to their project portfolio.

While most healthcare organizations recognize the need to do something about AP optimization, some may need help deciding how to proceed. Even after implementing new technology and streamlining business processes, organizations may find themselves short of achieving their supply chain goals. They may want to consider a rapid benchmarking exercise to see where their organization stacks up in relationship to other organizations on adoption of leading practices and performance against key metrics. This benchmarking exercise can help determine if an organization is at Stage 1, 2 or 3 of the AP optimization process. It can also frame the benefits that result from moving up the maturity scale and identify key projects to move the organization forward. For more information, contact GHX Business Solutions at 720-887-7187.