American Express Study of Health Systems’ Payments
An Analysis of Healthcare Expense Management
Healthcare companies are rapidly transforming in order to maintain profitability, optimize limited resources, and contain costs without compromising the quality of patient care. These objectives, combined with legislation passed in March 2010, have contributed to the industry’s continuous evolution and have brought groups such as Accounts Payable, Treasury, and Procurement to the forefront. Given these challenging yet exciting mandates, tasks such as managing cash, preserving strong supplier relationships, and maintaining visibility into spend are top of mind within Health Systems.

At American Express, we understand these opportunities and challenges and we want to help you successfully meet your short- and long-term objectives. To support you in this journey, we prepared this report with a specific focus on the Healthcare industry. We assessed the industry and analyzed the expense data for 15 Health Systems across the United States. We have identified trends and insights into Health System spend patterns and behaviors that will help you understand how your organization compares to your peers. In addition, through this study, we hope to help you discover cost-saving opportunities and ways to drive maximum efficiencies that positively impact your bottom line.

We think you will benefit from the insights and information in this study. For over 40 years, American Express has worked directly with businesses of all sizes to assist them in achieving financial benefits through enhanced processes and improved efficiencies. For more information, please visit americanexpress.com/hospitals or contact your account representative.

Sincerely,

Darryl Brown
Executive Vice President, U.S. Commercial Card
Methodology
An Approach to Analyzing Health System Expenses

This study analyzed over $1.6 billion in Accounts Payable spend from 15 Health Systems across the United States, not specific to one region, city, or state. This data represents 12 months of Health System payments on either check, card or ACH. Health Systems encompass hospitals and surgical centers, hospices and assisted living, and other healthcare facilities.

**Customer privacy:** American Express takes customer privacy very seriously. All data collected for this study has been aggregated on an industry level and is not company-specific. Per American Express policy, information collected at the individual or company level for this study is confidential and will be not be revealed by American Express to others unless a customer’s permission is expressly granted. Customer permission was received prior to the compilation of this study.

**Data analysis parameters:** The same input criteria were utilized with all Health Systems to collect the Accounts Payable files. The data collected was assessed for completeness and incorporates 12 consecutive months of spend. The data elements were normalized, consolidated, standardized, and cleansed.¹ Calculations were applied to determine Days Payable Outstanding, Invoice Counts, Average Invoice Size, and Supplier Counts. Spend categories were assigned based on proprietary industry code matching.² Specific profile information related to goals and policies was gathered through client consultations.

## Industry Overview

### Pressures on the Industry Today

The healthcare industry is transforming. Health Systems have always faced the challenge of balancing costs with quality of service to maintain their economic viability. Today, the pressures of increased technology needs, staffing costs, and competition are driving a trend toward network affiliation. Impending federal regulatory reform will not only require a change to the servicing model, but will also impact the overall business model and drive operational overhaul.

> “Healthcare organizations today are **struggling to maintain profitability** during a period of lowered reimbursements, nursing shortages, and a changing healthcare insurance system.”
>
> —“Healthcare Accounts Payable Automation,” PayStream Advisors, 2010

---

¹ Invoices associated with the following spend categories were removed: Financial Institutions, Securities, Tax Payments, Insurance, Petty Cash, Internal, Payroll, and Individual Payments including court costs, fines, and garnishments.

² Supplier industries are characterized by spend categories. A spend category is defined by a Merchant Commodity Code (MCC) which is a four-digit number assigned to a business when it starts accepting credit cards as a form of payment. The study data includes 255 spend categories or individual MCC codes that are also grouped into 26 spend categories consolidating related industries together.
Day to Day Operations
Advancing Procurement and Accounts Payable Processes

Not surprisingly, Health System Procurement Departments are focused on maximizing controls, with many having policies to drive spend through a pre-approval and purchase order process. Adherence to these policies can prove difficult when suppliers gain access to their end customer (such as physicians) and provide goods directly, necessitating after-the-fact reconciliation and paperwork.

Managing spend also represents a challenge for Accounts Payable (AP). Improperly documented supplier invoices can make it difficult to validate pricing or confirm receipt of goods, resulting in extra work for the AP staff and delays or non-payment to the suppliers.

“An insight that delays shipment of a clinical product could literally postpone a medical procedure.”

—Large North American Health System Network

Insight: Unlike other industries, Health Systems still pay by check
Healthcare Accounts Payable Departments lack back-office automation. Our study reveals that Health Systems lag behind most other industries in regard to office process automation with nearly 91% of payments settled via paper check.

<table>
<thead>
<tr>
<th>PAYMENTS SETTLED IN ELECTRONIC FORMAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>BEST IN CLASS*</td>
</tr>
<tr>
<td>ALL OTHERS*</td>
</tr>
<tr>
<td>HEALTH SYSTEMS</td>
</tr>
</tbody>
</table>

*“The CFO’s View of Accounts Payable: Cash is King,” The Aberdeen Group, 2009
Of the Health Systems profiled in the study, 87% want to drive processing costs down by eliminating paper checks. At a conservative cost of $2.00 per check, switching just 60% of invoices to electronic payments could yield $500,000 in savings.

Steps toward automation are observed with the use of procurement cards, ACH/EFT, and wire transfers. Card transactions are traditionally used for low-dollar purchases averaging less than $2,200 per invoice. Wire is used primarily for invoices associated with higher dollar purchases, averaging slightly less than $17,000 per invoice.

According to a 2010 PayStream Study, budgetary constraints are a primary obstacle to the adoption of automated AP processes. Health Systems need to look for solutions that enable automation at a low financial cost and minimal IT resource commitment.

"Accounts Payable departments in most industries are rapidly transforming as electronic methods of receiving, processing, and paying invoices are eliminating manual processes and increasing the efficiency of operations. These organizations are leveraging innovative technology to reduce the number of AP staff, increase processing efficiencies, improve vendor relationships, optimize cash flow, and enforce purchasing policies and practices."

—“Healthcare Accounts Payable Automation,” PayStream Advisors, 2010
Commodity Overview

Insights into Industry Spend

Twenty spend categories comprise 80% of total spend. Not surprisingly, Dental/Lab/Medical Equipment and Supplies is the largest spend category constituting more than 25% of total spend, more than three times larger than the next commodity class, Medical Services and Healthcare Providers. This spend group has an average Days Payable Outstanding (DPO – the number of days between the supplier invoice date and the payment clearing date) of 45 days, constitutes 41% of total invoices, and is predominantly paid via check.

The 1,780 suppliers in this category comprise the majority of all electronic payments with 72% of total ACH/EFT payments and 53% of total wire payments.

**Insight: Speed of pay can depend on product purchased**

The top 5 spend categories with the slowest payments (the highest average DPO) comprise 26% of total spend and 14% of total invoices. Three of these five spend categories are more generic in nature, allowing an opportunity for the buyer to dictate or negotiate better payment terms. For example, in the Education group, the DPO for individual spend categories ranges from 26 to 73 days, with the average at 50 days and a standard deviation of 16 days. The Physicians group, which includes commodities such as nursing care facilities, health systems, and physicians, shows a range of 14 to 104 days with a standard deviation of 28 days.

Industrial Chemicals is the fastest-paid spend category at 24 DPO on average. In this spend category, 89% is paid via check and 11% via wire. A discounted payment term is associated with 1% of spend. In addition, 54% of spend has a payment term of less than or equal to 10 days, and 79% of spend has a payment term of less than or equal to 15 days.

Drugs, Drug Proprietors, and Druggists drive the most spend within Industrial Chemicals. These suppliers often provide

<table>
<thead>
<tr>
<th>TOP 5 AVERAGE DPO</th>
<th>SPEND CATEGORY</th>
<th>AVERAGE DPO</th>
<th>NUMBER OF SUPPLIERS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ELECTRICAL SUPPLIES &amp; EQUIPMENT</td>
<td>53</td>
<td>302</td>
</tr>
<tr>
<td></td>
<td>COMPUTER EQUIPMENT &amp; SERVICES</td>
<td>50</td>
<td>643</td>
</tr>
<tr>
<td></td>
<td>EDUCATION†</td>
<td>50</td>
<td>1,301</td>
</tr>
<tr>
<td></td>
<td>PHYSICIANS†</td>
<td>50</td>
<td>2,950</td>
</tr>
<tr>
<td></td>
<td>RETAIL ESTABLISHMENTS†</td>
<td>47</td>
<td>768</td>
</tr>
</tbody>
</table>

\[ \text{TOP 5 AVERAGE DPO} \]

\[ \left\{26\% \text{ OF TOTAL SPEND} \right.\]

\[ 14\% \text{ OF TOTAL INVOICES} \right\]

<table>
<thead>
<tr>
<th>BOTTOM 5 AVERAGE DPO</th>
<th>SPEND CATEGORY</th>
<th>AVERAGE DPO</th>
<th>NUMBER OF SUPPLIERS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>GOVERNMENT &amp; LEGAL</td>
<td>30</td>
<td>366</td>
</tr>
<tr>
<td></td>
<td>PREPARED FOODS &amp; GROCERIES</td>
<td>28</td>
<td>196</td>
</tr>
<tr>
<td></td>
<td>AIR / GROUND DELIVERY SERVICES</td>
<td>27</td>
<td>41</td>
</tr>
<tr>
<td></td>
<td>TELECOMMUNICATIONS</td>
<td>27</td>
<td>205</td>
</tr>
<tr>
<td></td>
<td>INDUSTRIAL CHEMICALS</td>
<td>24</td>
<td>104</td>
</tr>
</tbody>
</table>

\[ \left\{7\% \text{ OF TOTAL SPEND} \right.\]

\[ 6\% \text{ OF TOTAL INVOICES} \right\]

†These spend categories are more generic in nature and may allow the buyer to better negotiate payment terms.
very specific products. Thus, buyers may have a limited ability to shift to other suppliers or negotiate longer terms. Health Systems also may be dependent on particular suppliers with specialized products.

Air Ground Delivery Services is not only one of the lowest DPO groups (27 days on average), but also one of the most consolidated industries with only 41 unique suppliers.

“Maximizing cash flow should be a key objective of any Health System CFO, and automating accounts payable to meet business objectives can be a crucial part of achieving that goal.”

— “Healthcare Accounts Payable Automation,” PayStream Advisors, 2010
Insight: Spend rationalization can identify savings opportunities
84% of the industry’s invoices average less than $2,500; this accounts for only 11% of total spend. With such a high number of invoices attributed to such low overall spend, the opportunity exists for staffing cost savings by eliminating low dollar invoices and driving process automation and electronic payments.

Higher dollar invoices, those ranging in size from $2,500 to $100,000, comprise 56% of spend and only 16% of invoices. Invoices in this category require a greater number of touch points and controls prior to authorizing payment, but can still yield significant improvements in electronic payment automation.
Cash Management Strategies

Maximize Cash On-Hand, Minimize Interest Expenses

Working capital management has become the phrase of the day as companies in all industries focus on how to manage cash effectively. Accounts Payable and Treasury Departments are aligning with Procurement to develop strategies to maximize cash on-hand and minimize interest expense.

This can be especially important for Health Systems faced with mitigating costs associated with uninsured or underinsured patients, making capital investments in innovative technology to remain competitive, and overcoming the rise in salaries driven by personnel shortages. Maintaining a strong bond rating is also of primary importance to ensure access to low interest rates and to help offset the unpredictability of receivables.

The supplier is an integral partner in any successful working capital strategy. Consideration should be given to the impact on their Days Sales Outstanding (DSO – the number of days from when a good is shipped or service provided to when payment is received). Forcing suppliers to accept long delays in payment can adversely affect their ability to manage cash and remain economically viable.

Insight: Health Systems can manage cash flow better

Health Systems in this study paid at 39.5 days on average and optimizing working capital is a goal of 93% of them, with more than half currently considering payment term extension.

One third of those studied are holding on to cash upwards of an additional 25 days, extending 52% of spend beyond 60 days and 33% of spend beyond 90 days. Innovative cash management solutions provide an opportunity for these Health Systems to maintain their DPO without extending their suppliers’ DSO.

One Health System, with a fast 10-day average DPO, leverages discounted payment terms for 1% of their total spend. All Health Systems with an average DPO of less than 30 days indicated that discounted terms are available; however, the terms do not appear to be highly leveraged, with less than 1% of total spend eligible for discounts.

“Another goal is to maintain and strengthen relationships with key suppliers, because sourcing is limited for many medical and pharmaceutical products. An uninterrupted supply of goods and services is crucial to patient care. Therefore, it is important to forge stable relationships with prime suppliers. But at times that goal conflicts with the need to maintain a safe margin of days cash on hand. Suppliers want to be paid more quickly, and buyers prefer to hang on to their cash for a longer float period.”

—“Healthcare Accounts Payable Automation,” PayStream Advisors, 2010

DAYS PAYABLE OUTSTANDING BY HEALTH SYSTEM

- Days Payable Outstanding (DSO) is the number of days from when a good is shipped or service provided to when payment is received.

- Health Systems in this study paid at 39.5 days on average and optimizing working capital is a goal of 93% of them, with more than half currently considering payment term extension.

- One third of those studied are holding on to cash upwards of an additional 25 days, extending 52% of spend beyond 60 days and 33% of spend beyond 90 days. Innovative cash management solutions provide an opportunity for these Health Systems to maintain their DPO without extending their suppliers’ DSO.

- One Health System, with a fast 10-day average DPO, leverages discounted payment terms for 1% of their total spend. All Health Systems with an average DPO of less than 30 days indicated that discounted terms are available; however, the terms do not appear to be highly leveraged, with less than 1% of total spend eligible for discounts.
American Express Global Business to Business Payments

Driving Savings for Health Systems

Now more than ever, Health Systems are looking for automation as a means to reduce manual touch points, manage working capital, and transform the back-office into a profit center.

Eliminating the manual printing, stuffing, and mailing of paper checks can be a worthwhile place to start the automation process.

American Express solutions enable payment automation, delivering strong ROI with minimal IT resource commitment. This can transform the overlooked back-office into a profit center, while helping both the buyer and supplier to maintain a strong cash position.

Our consultative approach to business-to-business spend management can help simplify your payment processes and reduce your costs. Put our team of payment experts to work for you and open up new opportunities to look at payments differently – everyday.

To optimize your payments strategy, contact your American Express representative or visit americanexpress.com/hospitals.