Is There Such a Thing as An Irrelevant Cost?

Can the cost of something actually be LESS than zero?

BY JOHN V. GUILIANA, DPM, MS

Editor's Note: *This is the second installment of a new regular series of articles by Dr Guiliana. PM welcomes him into our family of respected contributors and columnists, and we are excited that Dr Guiliana will be sharing insights based upon his extensive experience within the profession and his wide knowledge of healthcare practice management.*

Can the cost of something actually be LESS than zero? The answer to the above question is…Yes! And it's related to the Price versus Value distinction. One of Warren Buffett's favorite quotes is, "Price is what you pay; value is what you get." It's a philosophy that guides his investment decisions and has allowed him to achieve enormous wealth.

You see, price is arbitrary while value is fundamental. What exactly does that mean? Price is an arbitrary amount chosen by the seller of a good or service determined by factors known only to them. Ideally, a seller's price is where supply and demand settle at an equilibrium. On the other hand, value is the fundamental importance, worth, or usefulness (utility) derived by the purchaser. Price and value are indeed entirely different.

Let's look at a practical example. The price of gasoline at my corner gas station is currently $2.99 per gallon. But the value of that gasoline far exceeds $2.99 per gallon for those who purchase it. For example, that gasoline gets them to and from work each day. That same gasoline enables their children to get to soccer practice or allows them to visit their loved ones. The value of gasoline far exceeds the $2.99 price.

Now let's look at how this same concept might apply to business decisions and how the marginal utility or value (additional value achieved) must be considered over and above the price of something considered an alternative. As consumers, we frequently get "hung up" on the price of something. Instead, by focusing on the marginal value that the decision might bring, the actual cost of an item could be muted... and, in fact, could even approach a cost of less than zero!

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One of the most critical decisions physicians face involves selecting the best technology for their practice. Technology is essential to run a medical practice and assists in reducing human capital burdens and errors. But technology needs to be modern and up-to-date. If you think archaic technology might be sufficient, just recall what happened to Southwest Airlines earlier this year due to their 30-year-old technology. They brought air traffic to a screeching halt.

Providers often make technology decisions based solely on price, not value. As a result, the price and cost frequently approximate each other since marginal value or utility are often ignored. This is a common cause of software frustrations. When we ignore value, the cost of the software provides no additional benefits over another competing choice. The software perceptually becomes a fungible commodity, with one choice being equal to another. But in today's world of advanced technology, that's simply not the case! You MUST evaluate marginal value.

No two technologies are the same. Instead of focusing solely on price, it's essential that you ask yourself some questions when evaluating a purchase or change:

1) Will the change allow for less, very costly resource exhaustion? An affirmative answer will allow you to redeploy staff towards more revenue-generating opportunities, or perhaps even streamline your payroll.

2) Will the change allow for more efficiency in the charting or billing process? An affirmative answer will allow you to spend more focused time with the patient or will allow you an improved quality of life.

3) Will the change provide the opportunity for better charting compliance? This added value will potentially protect you during an audit.

4) Will the change allow for incorporating other important processes for which you are currently missing or paying separately? This added

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value directly impacts your practice since it eliminates some of your current costs or allows for missing tasks that can improve your revenue.

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Unlike price, understanding costs is crucial to making prudent business decisions. So now let's take a closer look at costs and begin to understand the types of costs that are involved in the decision-making process:

• ***Relevant Costs***—If you have two choices, and you choose A instead of B, relevant costs are those costs that will be different from those associated with choice B. These costs directly affect cash flow—the money coming in and going out of your practice.

• ***Differential Costs***—these are relevant costs that make up the difference between your available choices. If your costs are $150 for choice A and $325 for choice B, your differential costs are $175 ($325— $150).

• ***Irrelevant Costs***—are those that will not change in the future when you make one decision versus another. They are costs that will continue to happen. For example, if the payroll needed for choices A and B are the same, payroll is an irrelevant cost.

• ***Sunk Costs***—A sunk cost is an irrelevant cost that has already occurred and cannot be recovered. Sunk costs should not be considered when making decisions.

So much like purchasing a gallon of gasoline, think through the perceived price of a good or service and focus on its value. You might indeed find that the marginal price that you pay for a good decision can lead to a cost that is neutral or perhaps even less than zero! **PM**

Dr. Guiliana is a nationally recognized speaker and author on topics pertaining to medical practice management. He is a Fellow of the American Academy of Podiatric Practice Management and holds a master's degree in Healthcare Management. He has authored numerous columns in various journals and is the co-author of *31½ Essentials to Running Your Medical Practice*, as well as *The Million Dollar Practice…Keys to Success*. Dr. Guiliana is currently a Medical Director of Podiatry for Modernizing Medicine's award-winning technology. He can be reached at John.guiliana@modmed.com.