

How Do Your Numbers Stack Up?

Math can actually help you make good business decisions!

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A key function of successful practice administrators is making good strategic decisions. Many critical business decisions can be made easier and more accurately by using math. Now, I know what you are likely thinking... "oh no...I hated math!" Well from a scholastic perspective, so did I. But from a practical and business perspective, I love math!

In business, numbers never lie to you. They never try to sell you anything. Numbers are simply unbiased, genuine, and real. And there are a host of ways that numbers and formulas can guide you toward the right decisions... once you understand how to use them.

This month's column highlights a useful calculation known as The Indifference Point and demonstrates how to use this formula to assist in making practice decisions.

The Indifference Point, sometimes referred to as the Cost Indifference Point, is typically used in situa-

tions where a business is comparing two or more alternatives and trying to determine the most cost-effective option. The Indifference Point is the point where the total cost of the two alternatives is equal. Some examples of its use include:

- Capital Budgeting: For example, when a company is faced with a decision to invest in a new project or expand an existing one.

to decide whether to lease or buy equipment.

- Outsourcing: Your medical practice may be trying to decide whether to outsource a particular function such as billing or to keep it in-house. The indifference point can be used to compare the costs of different options.

As an example, whether or not to outsource billing is a practical il-

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- Marketing: Businesses may use the indifference point to compare the costs of different marketing strategies.

- Capital Structure: a business may use the indifference point to determine the optimal level of debt in their capital structure.

- Lease or Buy decisions: Companies can use the indifference point

to decide whether to lease or buy equipment.

You may have read many past articles or blogs that discussed the advantages of outsourcing billing. Many authors frame their argument to outsource based on factors such as specialization of labor, lower op-

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portunity costs, lower rejection and denial rates, better returns, etc. Let's completely ignore all those very important yet somewhat intangible advantages and discuss the pure mathematical formula to easily help you understand the tangible economic factors using the Indifference Point.

As it applies to the decision regarding outsourcing your billing, the indifference point would represent the level of production activity (revenue) at which the cost is the same under either a fixed (in-house) or variable (outsourced) cost arrangement. In order to demonstrate how the indifference point calculation can help guide you in your decision to outsource, let's start with some assumptions.

Assumption #1: The cost associated with the option of outsourcing is based upon a percentage of revenue (6% for this exercise).

Assumption #2: The cost associated with performing billing in-house is a fixed cost (\$65,000 in annual salaries and benefits allocated towards billing for this exercise).

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The indifference point computation will help identify the practice's revenue needed to make each choice (outsource versus in-house) equal (indifferent), as well as which option becomes more or less costly as revenues deviate from the indifference point.

$$\begin{aligned}\text{Revenue at Indifference Point} &= \text{Fixed Cost/Variable Rate} \\ &= \$65,000/.06 \\ &= \$1,083,333\end{aligned}$$

The indifference point in this exercise tells us that when the practice is generating \$1,083,333 in annual revenues, the variable cost associated with outsourcing versus the fixed cost of performing billing in-house are equal. Phrased differently, if the practice generates less than the indifference point revenue, the variable option of outsourcing becomes more attractive (less costly option) and the fixed option becomes less attractive (more costly option).

Conversely, if the practice generates more than the indifference point revenue, the variable option of outsourcing becomes less attractive and the fixed option becomes more attractive. Remember that the numbers used in this exercise are purely hypothetical and for demonstration purposes only. You will need to work with accurate numbers in order to compute your indifference point.

And remember that the indifference point and its

associated math will help you understand the best option based only on the tangible cost associated with the choices. But as discussed in many articles and past blogs, it's the intangible costs that could be very meaningful... and sometimes even approach or exceed the tangible costs!

According to the Society of Human Resource Management (January 2023), economists are predicting a continued slowdown in labor market activity in the

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U.S. in 2023 due to a likely recession, a continued battle with inflation, and more layoffs. But data also shows a shifting of demographics with an aging population, which means we could experience an ongoing shortage of workers with hiring remaining a challenge for years. Furthermore, wage growth in businesses has slowed down but is still very strong. The labor shortage naturally drives up wages, which has been eroded by inflation. Even with inflation set to moderate this year, wage growth will need to remain robust.

As a result of intangibles such as a stressed labor market along with higher wages, outsourcing specialized tasks such as billing is now more appealing than ever.

Additionally, patient volume may start to be adversely affected by inflation as consumers begin to scale back. Payroll, being more fixed than variable, then slowly becomes a much larger percentage of collections. This presents a huge advantage to outsourcing since outsourced payroll is 100% variable (usually based on a percentage of collections). Aside from reaping the benefits of experts in the ever-changing world of podiatric billing, when a practice's economy suffers, outsourcing becomes a better alternative.

So, as you can see, there's more to making a good business decision than just relying on economic formulas. While the indifference point is a great indicator of tangible financial factors and results, many other intangible factors need to be considered during these economically challenging times. But the indifference point is a great starting point.

Learn to love math, my friends! **PM**



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