The Value Available Through Group Purchasing Organizations

Buying supplies at a discount leads to a healthier bottom line.

BY JON A. HULTMAN, DPM, MBA

Group Purchasing Organizations (GPOs) present a unique opportunity for small/medium sized practices to obtain significant discounts on medical supplies and DMEs—discounts usually available only to institutions and very large medical groups. Even though there is no fee for joining most GPOs, many doctors have yet to utilize them. A common justification is that they feel saving "only" ten to twenty percent on supplies and DMEs offers too little financial return for the effort necessary to participate. The fact is that using a GPO requires no more effort than ordering from other options, and as you will see, "doing the math" trumps the reasoning that the savings are not worth the effort.

When considering the option of ordering through a GPO, it is important to first ascertain that there will be no joining fee (i.e., membership is free) and that discounts will be based on quality items as opposed to cheaper substitutes. A podiatric-specific GPO can be a plus because it will be likely to have more of the supplies and products that a DPM regularly uses. Once these pre-conditions have been established, there are three important financial considerations to weigh in order to appreciate the full value that can be achieved through the use of a GPO: 1) the relative values of cost-cutting and revenue enhancement, 2) the often-overlooked, magnified impact of cost-cutting on net profit, and 3) the value achieved from offering supplies for sale on site.

The Relative Values of Cost-Cutting and Revenue Enhancement

A significant advantage of cost-cutting is that, unlike revenue dollars, the money captured through cost-cutting drops directly to the bottom line. A way to appreciate this advantage is to establish a "test" scenario. We can compare the dollar savings from ordering supplies at a 22% discount (the average achieved through the use of GPOs) with the revenue that might be achieved by performing additional Medicare bunionectomies at $950 per procedure. A typical mid-sized group practice on my database paid an average of $32,000 a month for supplies, and those that utilized a GPO saved an average 22% of that cost, or $7,040 a month. This equates to an annual savings of $84,480—notably, as stated earlier, an amount that drops directly to the bottom line.

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Achieving this increase in profit generates no additional costs and requires no more work for the doctor or staff. In comparison, performing each bunionectomy will require several hours of work out of the office, completion of detailed medical records and reports, billing a third-party payer, seeing the patient at multiple post-operative visits as well as documenting those visits (requiring both doctor and staff time), and possible treatment of a post-op complication.

This example practice would have to perform 89 bunionectomies at $950 each to produce $84,480—the cost savings to be gained from ordering

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through a GPO. When considering the lost productivity that results from 1) taking time away from the practice to perform this many surgeries, 2) the mountains of extra paperwork generated, and 3) the utilization of doctor, staff, and treatment room time to provide post-operative visits, the cost of lost productivity is significant. In addition to this additional workload, the practice's 60% overhead must be taken into account. Doing so technically cuts the actual bunionectomy revenue by 60% ($950–$570 = $380)—unless the bunionectomy performed increases the number of bunionectomies for the year to more than the number that were performed the previous year. If this bunionectomy does increase the previous year's number, the new service would be spread over the same fixed costs and would add only the marginal variable supply costs to the visit—as would each additional procedure thereafter. The point of this comparison is not to suggest that a practitioner perform fewer bunionectomies; rather, it is to point out that a doctor should want to do both—perform any necessary surgeries *and* save money on supplies. A practitioner should want to do both—cost-cut and enhance revenue.

The Magnified Impact of Cost-Cutting on Net Profit

Physicians often do not fully understand the concept of profit. Many believe that it is the amount of money that is "left over" after paying the overhead—with their salaries being part of the "left over" money. In reality, profit is the money that is left over after paying the overhead—including the physicians' salaries. Doctors who are incorporated have a better understanding of this concept because they declare their salaries, and profit is what is left over after paying all of the overhead along with all physician salaries. The bigger the group, the more important profit becomes, because this is what creates value for the group and value for ownership in the group.

For simplicity, let us assume an example practice—one with two physician owners, collections of $1,000,000 and an overhead of $600,000—excluding their $180,000 salaries. When we include these salaries in the overhead, we see that it is actually $960,000. This leaves $40,000 in net profit. Since the doctors are equal owners, they would split the $40,000 profit. If we assume that the supply costs of this practice are 12% of revenue, or $120,000 annually, achievement of a 22% reduction in supply costs would result in $26,400 in savings, which drops to the bottom line as profit. This increases profit from $40,000, to $66,400—a 66% increase in net profit. Most physicians perceive a 22% savings on supplies as being relatively "small." They reason that with a $600,000 overhead, saving $26,400 on supply costs creates "only" a 4.4% reduction in total expenses. In reality, this "small" reduction in supply costs has a magnified impact on net profit; increasing it, in this example, by 66%.

While the numbers in the previous example are simplified to make a point, the actual savings on supplies and DMEs seen by practices ranges from a low of 17% to a high of 42%, with the 22% used in our example being a reasonable average. Again, even in a growing, busy practice, a doctor would want to adopt this costless strategy to increase his/her net profit by a similarly sizable percentage.

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The Value Achieved from Offering Supplies for Sale

A majority of potential patients with foot problems initially opt for self-treatment. This often involves the purchase of an over-the-counter medication or product. If we were to recommend any one of these products to a patient, believing it to be beneficial, it makes sense that stocking that particular item would provide a valuable service to the patient. Having products or medication available at the doctor's office not only offers convenience to patients, but it also offers the doctor and staff the opportunity to instruct patients on product use in a way that is likely to achieve better compliance and optimum results. Patients can also be steered away from "self-treatment" medications or products that may be either unsafe or ineffective.

It is important to consider that all companies have multiple sources of revenue and that these sources are not equally profitable. In competitive industries, the "core" business of many companies is typically their least profitable revenue source. U-Haul is representative of such a company in the industry and can be used as a model with which to compare physician groups. We can learn by studying U-Haul's strategy for its U.S. consumer truck-rental business. According to a 1998 paper published in *Harvard Business Review* by Orit Gadish and James L. Gilbert, in the early 1990s, U-Haul, Ryder, Hertz-Penske, and Budget waged a battle for market share. U-Haul was considered to be at a disadvantage because it charged the lowest prices and had the oldest fleet of trucks. Even though it barely broke even on its rental business, U-Haul was the most profitable company in the industry—and by a wide margin. The industry's average operating margin was less than 3%; yet, U-Haul's was 10%!

How was this possible? Significantly, U-Haul's greatest source of profit was its ancillaries, not its core truck rental business. This company understood something about the business that its competitors had missed. According to the authors of the *Harvard Business Review* piece, "All the ancillary products and services that consumers need to complete the job have only begun when they rent a truck." When consumers rent a truck, they need products and services such as boxes, insurance, trailers, and

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storage space. Margins in the truck rental business are low with consumers shopping for the best rates, and U-Haul offered this to customers. Because they were in this truck rental business and were competitive, they were also able to offer multiple ancillary truck-rental services. Their success in delivering these high margin services is what made them #1.

Comparatively, a physician's core business is patient care, but higher margins are potentially available in healthcare-related ancillaries—especially those that have synergies with this core business. As with the U-Haul model, physicians can pursue these higher-margin, ancillary services because they are already in the business of healthcare delivery. If you decide to offer medical supplies and DME products to your patients, a GPO can enhance your profit. It makes good business sense to save from seventeen to forty-two percent on the purchase of those supplies and products. This will also increase patient satisfaction—saving them the time needed to go elsewhere and purchase the same products at the same prices.

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Fortunately, there are no-cost GPOs available to every practitioner—vehicles that immediately cut practice expenses in an area that provides leverage for higher profit margins as volume increases. The range of savings and leverage possible depends on a practice's size and focus, but given that no additional staff or doctor work is required to undertake this action, who would not want to avail him/herself of this readily available opportunity? **PM**

Dr. Hultman is Executive Director of the California Podiatric Medical Association, practice management and valuation consultant for Vitera Healthcare Solutions, and author of The Medical Practitioner's Survival Handbook (available at www.mbagurus.com).