THE OFFICE

Should You Do This Deal?

BY MARK NEEDHAM, M.D.

If you've ever wondered whether you should buy a DXA machine or start offering botox in your practice, read on: Learning how to calculate the net present value of that venture would go a long way toward helping you figure out if it's truly a good move.

For all their training and experience in clinical decision making, physicians are no better than anyone else at making business decisions if they lack the necessary quantitative tools.

And yet, I've seen plenty of my colleagues invest their time and money in significant practice-changing ventures without first rigorously evaluating them, only to wonder a year later why they aren't making any money.

The most common mistake is making decisions, not blindly, but partially blindly. I'm referring to the physician who decides to buy a dual-energy x-ray absorptiometry machine because the age and demographic profile of his or her patient population would seem to make the purchase a no-brainer. But there are a lot more factors to consider besides the ideal patient population.

Why do I recommend using a net present value (NPV) equation in particular? Because it's a fairly straightforward way to take into account the risk and opportunity costs of any venture.

The first step is figuring out cash flow. For example, say the DXA machine you're eyeing costs $100,000 and is good for 10 years of use before it needs to be replaced. Let's say that payers will reimburse you $100 for each scan. And based on your patient population, you may estimate that you will be performing x number of scans per year.

Next, figure out what the cost of each of those scans will be. If you have to hire a technician, factor in his or her salary and benefits, the cost of that person's training, and the cost of any supplies. In addition, consider what the marketing costs will be.

The second step is figuring out opportunity costs. Will be you be giving up time or space, or both? Reading DXA scans doesn't take much time, but space may be an issue. If you place the machine in an exam room, what is the opportunity cost of giving up that space? Will it reduce the number of patients who can be seen each hour?

Go online, learn about net present value. Crunch the numbers yourself, or hire someone to do it for you. But be aware of all the tools at your disposal.

Sometimes the opportunity costs may not be as obvious as you think. Take the example of a colleague of mine who is considering adding colonoscopy to his practice.

Let's assume that, on average, Medicare reimbursement is $225, and that he can perform two colonoscopies per hour. Factor in the time that it takes to travel to and from the colonoscopy center—as well as the inevitable no-shows—and it may appear that the opportunity costs of providing colonoscopy are too great.

That would certainly be the case if his time could instead be spent seeing four patients per hour at $110 each, without the travel time. On the other hand, when he is away at the colonoscopy center, perhaps an exam room is freed up for a colleague to see more patients, a factor that may shore up the deal, at least in a large practice.

The third step is to evaluate what that cash flow is worth to you over time. Let's say you expect $20,000 in income from the DXA scanner each year for the next 10 years. Ask yourself: Is $20,000 a year worth $100,000 to me now? Calculating the discount rate—which is your estimate of the risk of your project—can help answer that question. So let's say much of your practice's patient population comprises postmenopausal women. But there are 10 other physicians in your area, as well as a few hospitals, that offer DXA scanning, so there is no shortage of competition. In this case, the discount rate is quite high.

The fourth step is doing a sensitivity analysis, which is a way of testing your estimates.

After you've made estimates in good faith, you may then discover that your discount rate is 12%. In other words, you're not super confident, but the venture isn't a flier either. Based on that estimate, you find that your NPV is $200,000, which is more than what you expect to pay for the machine, a favorable finding. The higher the NPV is over the initial cash investment, the more confident you can be that you will make money. The beauty of this NPV number is that it can then be used to compare projects, say one that may last 3 years versus another that will last 10 years.

You can also go back and change your assumptions and see how the changes alter the NPV. If Medicare reimbursement for DXA scans is reduced by 10%, for example, or if the number of scans you expected to perform each year is cut by 10%, what does that do to the NPV? If it veers into the red, don't do the deal.

A low NPV may give you bargaining power. In negotiations with the DXA machine vendor, a low NPV will substantiate why you're will to pay only $70,000 for the machine, or you may more clearly see the wisdom of purchasing a lightly used, refurbished machine instead.

Physicians don't tend to calculate NPV because it's time consuming, and it's not as challenging or as exciting as a clinical problem. But a lot of money may ride on it and it will help you know if your financial intuition is correct.

My advice: Go online, learn about net present value.

Crunch the numbers yourself, or hire someone to do it for you. But be aware of all the tools at your disposal before you cut that check. ■

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