Cutting Costs

By Karen Moore

What can you do to improve your operational and financial performance? Have you looked at all key areas to identify potential cost savings? Consider product acquisition, labor, and general operating costs such as office and warehouse rental and vehicle expenses. At the same time, set goals to increase your gross margins. Do you have equipment or supplies in which the reimbursement rate is lower than your acquisition cost? If so, this negatively affects your bottom line, particularly after your operating costs are factored in. Some companies may excuse this by saying it was necessary to make sure they didn't lose referrals, or they were required to provide these services to maintain an exclusive supplier agreement. Or they say, "What we lose in margin, we make up for in volume."

If you are concerned about losing a referral or keeping an exclusive supplier contract, find a company that specializes in that product and is able to provide it profitably. The most commonly outsourced items are wound care, ostomy, urological, TENS units, insulin pumps and wound vacs. These specialty companies usually don't compete with you for your bread-and-butter products. In most cases, you can structure an arrangement so that you provide the items that you are able to, and pass the remainder of the referral on to the specialty provider. In cases where you have an exclusive contract, find out if the specialty provider can supply their products and bill the insurance company directly. (If you do structure such an arrangement, be sure to comply with all Medicare fraud and abuse and HIPAA requirements.)

As you review your product mix, remember that the higher your ratio of rentals to sales, the higher your gross margin and profit margin are likely to be. Lincare, which specializes in oxygen and respiratory equipment, is a prime example of a company with a favorable product mix. Lincare's sale items are primarily accessories for their rental equipment. These items are inexpensive to ship, which keeps down delivery costs. In addition, labor costs for rental items such as stationary oxygen equipment, CPAPs, BIPAPs, beds and miscellaneous respiratory equipment are typically low. After initial set-up, the biggest labor expenses associated with these units are related to reimbursement activities and the cost of pickup once the item is no longer needed.

When examining your product mix and margins, you should also pay attention to your inventory acquisition costs. Small and independent suppliers might be able to save 15-20% on some items by joining a buying group such as VGM or the Med Group. If a particular product or product line accounts for a significant percentage of your company's revenue, your volume may allow you to negotiate better pricing directly with the manufacturer. (If you don't ask, the manufacturer isn't likely to volunteer it.)

Large distributors like McKesson or Cardinal, or local or regional distributors that offer just-in-time inventory, can also be of value. You might pay a little more for your inventory, but it may be worth it, particularly for slow moving items or when equipment or supplies are needed immediately; next day delivery can be a lifesaver.

Having the proper mix of vehicles for your geographical area is also important. Weigh fuel mileage versus relocating the warehouse, or consider larger vehicles as "moving warehouses." A vehicle that can carry extra inventory could cut the cost of delivery tremendously, especially in rural areas. It is both frustrating and expensive when a service technician is 50 miles from the closest warehouse, and just blocks away from a new patient's home without the needed equipment on the truck. The cost of a couple of 100-mile round trips adds up quickly. A large vehicle, properly stocked, could be the answer. When dealing with a large volume of deliveries with a short distance between stops, your employees' time is more of a consideration than the cost of operating the vehicle. It is usually more cost efficient for your service technicians to make 12-15 stops without having to return to the warehouse to pick up additional equipment. GPS technology is a great tool, helping to reduce mileage and keep track of your service technicians and respiratory therapists to make sure that they are using their time efficiently. Efficient routing saves time, reduces personnel expense and decreases fuel costs.

Companies like UPS Logistics provide software and routing tools that both large and small HMEs can use to significantly increase their efficiency and reduce their fleet mileage, leading to more timely deliveries and less employee overtime. The typical HME supplier using this technology will usually see both mileage and labor savings of 25% or more. Overall delivery expense is often reduced by 15% within the first six months, making the breakeven point for most companies approximately nine months. In addition to the cost benefits, this system raises customer satisfaction by increasing the number of on-time deliveries. You will also receive objective data to track the individual productivity of each of your service technicians and respiratory therapists on a daily, weekly or monthly basis.

For many companies, the hours between 3 to 5 p.m. are the busiest for their customer service department. Depending on your referral source patterns, a high percentage of orders could be for same day service. When all of your service techs work from 8 a.m. to 5 p.m., this usually translates into overtime. A better alternative would be to establish a mid-day to early evening shift. Respiratory companies should also weigh the cost of using an oxygen home fill or portable concentrator against a stationary oxygen concentrator and portable gas system with a conserving device. Selecting the correct system for your patient's needs will have a profound impact on your profit margin.

These are all important considerations, but when it comes to cutting costs and increasing efficiency, the elephant in the room is labor costs. The most profitable companies in the industry are those that have the highest revenue per employee ratio and report the lowest bad debt. At the end of 2009, Lincare's revenue per employee was $157,000, down from the $165K - $170K that they normally report. American Home Patient, another publicly traded company, usually reports their revenue per employee below $110,000. A well run high-tech respiratory company can achieve revenue per employee in excess of $200,000.

A company's business software is a key factor in helping to determine what the revenue per employee will be. The ideal business software is not one that only handles the essentials such as order entry, automated documentation generation and follow-up, billing, collection, cash posting, accounts receivable tracking and follow-up and inventory control, but one that can also produce the management reports that are necessary to operate the business efficiently. The system must be able to do all of these tasks efficiently and automatically. If your system is not able to handle quality assurance, CMN generation and create and log the prior authorizations at the same time the order is confirmed, your labor costs are increased. All of these functions should be fully automated with all the payer rules built into the system. If a single quality assurance and order confirmation employee cannot process a hundred orders or more per day, the system is inefficient. Commercial claims that are being submitted electronically are usually paid two to three weeks faster than those billed on paper, and efficient electronic remittance posting can save countless labor hours depending on the size of your company. For most companies, going from manual to electronic cash posting could mean a cost savings of one or more employees. Inventory utilization is also extremely important, and having a system that can tell you how often you are turning your inventory, report gross margins by product, and accurately notify you when an inventory item needs to be reordered is key.

To make the biggest impact to their bottom line, a company must be able to operate each of their departments at optimal staffing levels. If levels are too high, your labor costs will be unnecessarily high. If those levels are too low, the company's bad debt can significantly increase, or the company could be losing business due to poor service. Optimal staffing levels will be different for each company; however, the capabilities and efficiency of your software system is one of the biggest factors affecting labor costs in the order-to-cash processes. Your business system's ability to track and compile data on individual employee productivity is essential to achieving desired outcomes. Effective management is extremely difficult without key automated reports showing indicators and individual performance, including measuring and comparing the productivity of customer service representatives; and tracking and reporting open orders, held revenue and accounts receivable. For companies that require more than one employee to perform these functions, the system must be able to report productivity by employee responsibility. When your business software is unable to do this, the department manager is forced to make subjective decisions based only on observations. Using objective employee data, a manager can reward top performers, counsel subpar performers, and correctly terminate employees who are simply not able to make a contribution to the organization. Moreover, the manager is able to use objective goal setting to maximize your labor resources. What if everyone in your organization could improve their productivity by 10%? This would give you the resources to grow your company, reduce your labor force, improve cash collections and reduce bad debt.

Before making significant staffing changes, it is important to review your business model. For many companies, 50% of the total labor cost originates from order-to-cash functions. This includes the staff involved in taking and processing orders, obtaining the required documentation, billing and following up, and cash posting. Companies are able to continuously improve their processes and the staff's proficiency to realize savings in labor costs. However, you shouldn't run so lean that performance is sacrificed. For example, it may make more sense to have a slightly higher number of A/R staff until you can get your denials down, or to have staff concentrate on getting claims in and paid before timely filing. There is a balance between cost versus benefit. Why take another $150,000 in bad debt if you can avoid it by adding another employee at a cost of $40,000 for salary and benefits? However, in the long run, the bad debt should be controlled throughout the order-to-cash process by ensuring staff are proficient at their jobs, automation is optimized, and you have excellent protocols, processes and workflow.

What are your goals? Do you want to increase revenue per employee by 5%? Increase profits over the next quarter by 10%? Whatever your goals, it is critical that you and your managers be able to get objective data from your business software to review your company's performance and make the correct business decisions. This data will help you maximize assets, measure the success of your staff, and help the corresponding department meet or exceed its goals. Goals are important in sustaining employee morale; the vast majority of us want to do a good job. It is both rewarding and motivating to know that management and co-workers recognize our contributions. Setting goals, measuring them, and providing feedback will also help in reducing variability and result in improved performance.

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