Podcast Transcript

Making Sense of Dollars and Cents:

Developing a Return on Investment

Episode 1 – Three Initials with Power: ROI to Prove What You Need, Part 1

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Transcript

FAITH ROBERTS, HOST: Welcome, everyone. My name is Faith Roberts, and I am your host for this Elite Learning podcast series Making Sense of Dollars and Cents: Finance, Budgeting, and Staffing Skills for Nurse Leaders. Throughout the course of the episodes, we'll discuss building skills that are central to a nurse leader's success, including return on investment; staffing; capital; employee engagement and retention; and, of course, patient safety.

In this episode, we will be discussing developing an ROI, a return on investment. And we need to remember that this is a great way or method for a nurse leader to be able to validate a request and be able to show and demonstrate to other leaders why this particular process is needed.

Finance is such a huge topic. It may not sound exciting to a lot of us, especially when our whole background really pushed us on clinical knowledge. And yet, as a leader, it's the very area that frustrates many of us the most.

In my own practice as a nurse leader, manager, director, and executive director, I understand business-related topics like these can make us feel less than. I think it's because for decades nursing leaders were isolated from the actual development of a budget and monthly reports, how to view them, how to understand them. And that end result, unfortunately, was that, too often as nurses, we weren't even at the table when the decisions were made. So no matter what your background is, if it's working for a state entity or the detailed specifics of a donor grant, if you work in a procedural area, ambulatory, a school district, wherever you work with your clinical practice and you have been named – and I would say earned your place at the table as a nurse leader – the elements of finance have to be part of your skill set. So, a solid knowledge base of finance helps every nurse leader obtain what their area needs, as well as being open to creating different staff mixes based on their understanding of how a budget works.

So regardless of your circumstances or motivation, it's clear that we have to – to be a well-rounded and effective leader, finance and budgeting are among the tools we need to have. We can show that we can master them.

Our speaker today is Pamela Hunt. And Pamela and I first met at a national conference for nurse leaders, and it was about 20 years ago. When I entered the auditorium, she had an audience listening to every word while she was speaking about a budget.

Think about that. Her knowledge and understanding of what she was teaching, just like any great teacher, drew the audience to her because they wanted to soak it in. And she was taking the complex language of finance and interpreting it to people who, at most, had a bare minimum of understanding at the beginning of that conference. Since then, Pam and I have traveled to many conferences and have enjoyed to this day a close friendship.

Pam is a frequent presenter at national organizations, state and national nurse leader workshops, conferences. She's seen as an expert on finance in healthcare. She's authored articles and co-authored books about finance in healthcare industry.

And in 2020, Pam was named a fellow of the American Academy of Nursing. You can read more about her background and education and experience in the notes that accompany this episode. So, let's get started.

(SOUNDBITE O MUSIC)

ROBERTS: And we want to welcome you, Pam. And I want you to know that I'm looking forward to talking with you today. Before we get into the topic or dive too deeply into it, I would love to know where people get the term ROI and how long before people really understood what those three letters stood for in that.

It's always been an acronym that's made me smile. When we hear we're going to a meeting and they're going to discuss an ROI, and you see some of your peers, the look on their face. And you're cracking up

because you're like, I don't even think they know what that means yet. So whether it be a new nurse, novice nurse leader that is listening to our podcast today, I would hope you will explain that to us. Welcome, Pam.

PAMELA HUNT, GUEST: Well, thanks, Faith. And yes, in healthcare, we are famous for using all sorts of acronyms, aren't we? And sometimes we just assume that everybody understands what we're talking about. So yes, today we are going to talk about a return on investment, which means that if I put out a large amount of money, a capital outlay initially, at what point am I going to make enough money on that investment to cover my initial expenses, and then hopefully moving forward in the future, actually realize some revenue?

And there are steps to that. We're going to talk about identifying fixed, variable, and total cost, so really understanding the cost that goes into a project like this. We're going to distinguish what expenses and revenues should be considered in developing the ROI. And last but not least, we're going to evaluate and choose which departments should be involved when we're talking about a new procedure or a new product in order to make a smooth transition.

So, when we talk about an ROI, or a return on investment, there we first of all have to talk about cost. And there are all sorts of types of expenses. There are fixed expenses, or a fixed cost. And that's a cost that doesn't change over time. It doesn't change as the volume increases.

So, let's think of – and really, you might be asked as a nurse leader to look at what is the return on investment for purchasing a new piece of equipment. Then you could also be asked what the return on investment is for something such as a process change. So, it's not always about a piece of equipment, although that's what our mind goes to most of the time.

So, when we talk about fixed, there's fixed costs that are associated with the piece of equipment. Now that would be, like, your piece of capital equipment. If I have to buy a monitor, that monitor is going to cost the same whether I use it one time or whether I use it multiple times. The cost of the monitor doesn't change as volume increases.

The next cost that we're going to talk about is a variable cost. The variable cost is a cost that is uniform per unit, but it fluctuates according to the volume. So, let's think about this.

If I purchased a new piece of equipment, and in order to use that piece of equipment – costs the same, no matter how many times I use it. But I also need a disposable, or what we would call an operational, piece of equipment to use with that piece of equipment. Let's say it's a catheter or a trocar or an operational piece of equipment, if you will – supply. As the number of cases increases, that trocar may still cost $30; but my total cost is going to go up.

And I'll show you this. We'll talk about this further as we continue this discussion. But then the total cost is the sum of the fixed cost and the variable cost together.

I'm going to give you some examples of fixed costs. So fixed costs might be administrative staff salaries. A fixed cost might be, again, a piece of capital equipment.

Oftentimes, fixed costs are things like the lawn service for your organization. The organization pays one fee. And no matter how many times the lawn needs to be serviced, that fee is a fixed cost.

Some variable costs that we might think about in our organizations are things like wages, overtime wages, supplies, medications, utilities. Those are variable costs. So those are going to vary according to the volume used in our organizations or for the procedure.

When I speak about fixed costs in your notes that are available for this session, you have a little table that shows – let's say we have a piece of equipment for the procedure that we want to start doing in our facility, and that piece of equipment costs $10,000. If we use that piece of equipment for 100 procedures, that piece of equipment still costs $10,000. If we use that piece of equipment for 400 procedures, that piece of equipment still costs $10,000.

However, the average fixed cost – which is an important component to us as we think about volume. The average fixed cost if we do 100 procedures is only $100 per procedure because that $10,000 is spread out among 100 procedures. So, we would take 100, divide it into $10,000, and that says that it cost, the average fixed cost is $100.

If we do 400 procedures, that $10,000 is now able to be spread out among 400 procedures instead of 100. So now the average fixed cost is only $25. With this demonstration that's available to you in your notes, you'll quickly see that the more procedures you do the lower the average fixed cost is for that capital equipment.

(SOUNDBITE OF MUSIC)

HUNT: Now let's talk about variable cost. Let's take those same 100 procedures, and let's say that the piece of equipment costs $10,000. But the catheter that we need to use in order to do the procedure costs $10.

Now, that catheter is going to cost $10. Whether we do one procedure or whether we do many procedures, the cost of that catheter is $10. That's the unit cost.

Now, I'll give you this. There may be inflation, that somewhere along the way, that cost of that catheter is going to increase. But the unit cost is $10.

If we do 100 procedures, and we multiply that by $10, then we're going to have a total variable cost of $1,000. If we do 400 procedures, we multiply that by $10, and so our variable cost is $4,000. So you can hear that, unlike the fixed cost, the more procedures we do, the higher the total variable cost becomes because each of those units –that disposable piece of equipment or supply – the cost increases as the number increases.

What's important to us is a table that you'll see in your notes that shows that you add the fixed cost and the variable cost together. So, for those 100 procedures, remember the fixed cost was $10,000 and the variable cost was $1,000. So that's $11,000.

If you divide that by 100 procedures, then the average cost – if you do 100 procedures, the average cost is going to be $110. But if you do 400 procedures – so that's $10,000 fixed cost plus $4,000 variable cost, $14,000. But you divide that by 400, your average cost is only $35 per procedure. This demonstration shows the value of volume when we're talking about getting to a break-even point for your business case.

The break-even point, which we talked about earlier, in the beginning, we always believe that the cost is going to exceed the revenue. So, we know that we have to cover the fixed cost. We have to cover the

variable cost. The break-even point is the point at which you've recovered enough revenue to meet the cost of that initial investment of your piece of equipment or your fixed cost, plus your variable cost.

And then ongoing, the revenue exceeds the cost, which is where your facility makes money or makes revenue. So, the break-even point is when you determine the point at which the facility expects to recover the cost of the investment. And after the break-even point, they're actually creating and making revenue that's not needed to cover the initial investment.

(SOUNDBITE OF MUSIC)

HUNT: Hey, how you doing? Have I lost you yet?

ROBERTS: Just one question. I absolutely appreciate what you just said about what break-even truly means. But the question I have is right at the end, before that, you said a word I've never heard, pro forma, and then business case. Is that one in the same, or are they two different things?

HUNT: Well, they're often referred to some synonymously in organizations. And I worked in an organization for 28 years that I'd never heard the word pro forma used. And it was always you wanted to create the return on investment, and you wanted to show the ROI if you were going forward with a proposal for a new piece of equipment or a new procedure.

Then I switched organizations. And suddenly, that word was pro forma. So those words are used interchangeably.

Oftentimes, a pro forma you can do a real quick, I call it back-of-the-napkin ROI. We can do a real quick ROI, but a pro forma, when that word is brought out, usually means a little bit more. It usually means not just the ROI, but it usually means a good description of the marketing that's went behind this, maybe description of the landscape and the demographics of the area, the patient population that's going to assess this.

Then the ROI may also include some reimbursement along with it. And it may also include, obviously, a final recommendation at the end. So good question, using those terms interchangeably, that the pro forma oftentimes has more components in it than just the back-of-the-napkin, break-even analysis.

ROBERTS: So before we go to this next section, my question is, as a nurse leader, who am I contacting to help me get some of this information?

HUNT: I'm going to give you that in just a minute.

ROBERTS: OK, sounds good.

HUNT: Thanks for thinking of that. Before we go there – so before we go there, I want to just outline for the group that's listening, and for the team that's listening, when I talk about expenses and I talk about revenue, what am I talking about? So, when you're looking at providing a new service or providing a new piece of equipment, expenses are going to be the cost of the capital – so the cost of the equipment, the cost of the supplies. It has to include the cost of any remodeling that's necessary in order to make space for this new procedure.

I know in the OR, we used to have lasers that required water. So it would include the plumbing necessary for that laser to work. It includes the cost of staff time in order to do this procedure. And it should include the loss of revenue from other sources. So let's talk about that a minute.

The best example of this that I can think of, that I like to use is, years ago, we were discussing and doing an ROI on whether we should buy the equipment to perform something called capsule endoscopy. Capsule endoscopy is in replace of a small bowel series, and the patient swallows a capsule that has a camera in it. They wear a belt that has a transmitter in it. And as this capsule travels through the patient's GI system, it takes pictures.

The capsule is discarded through the patient's GI system. It is a one-time disposable use product. I hope you're all grinning at that. It is a one-time disposable use product. But meanwhile, the pictures that capsule has captured have been downloaded to this transmitter that the patient brings back to the office.

When we were doing that proposal for the capsule endoscopy, we had to take into consideration the loss of revenue from a small bowel series because those patients would no longer need a small bowel series. So that's a good example of when maybe there's new technology out there, there's a new procedure out there. You do need to understand if we do this new procedure, will there be loss of revenue from other sources?

(SOUNDBITE OF MUSIC)

HUNT: Let's talk about revenue. We need to take into consideration the patient population. And why? Well, not just because of volume; but we need to take into consideration the patient population that will be accessing this procedure because of the payer mix and how that impacts reimbursement. And I'll talk about that a little bit more later, as well as in your handouts or in your notes for this session, there's a great example of a business plan return on investment for a procedure that really shows the difference in payer mix as it relates to the revenue for this particular procedure.

Now, they've already asked this question, and let's talk about where do I get the expenses? Where do I get that? So, the cost of the capital, you're obviously going to get from the vendor, along with your materials management team, or your capital purchasing team that helps you negotiate that.

Probably many of you are part of group purchasing organizations that may have some pricing advantages from being in a GPO. The cost of the supplies, again, you're going to get from the vendor, along with your materials management folks that are going to be able to help you negotiate those. The cost of remodeling, you're going to have to loop in maintenance and engineering, depending on what that remodeling might look like. And they are going to give you an estimate on that.

The cost of staff time is going to be something that you're going to calculate according to how long the procedure is, what skill level of staff are going to be involved in this, and what that looks like as far as their staff time. I get asked often, OK, if I don't have to hire any more staff, do I still need to take into consideration the staff time? And the answer is yes because the assumption is that the staff is not just sitting around doing nothing. So, if you're going to take them from doing something to doing this, their staff time needs to be included in this. And then I already talked about the loss of revenue from other sources and gave you an example of that.

So, the revenue – where do I get the revenue? And the patient population, I think – or whoever – if it's a particular procedure that's tied to a particular physician, I would advise you to have some conversation with that physician. What patient population are you seeing that would access this procedure, what age population, what's the most common diagnosis for this procedure – those are going to be important questions for you to ask the provider that is going to be doing this procedure.

And then you need to find someone from coding, billing, and finance. And I'm going to give you a checklist. Later on in our presentation and our time together, I'm going to give you a checklist.

When you're bringing up a new procedure, there's so many other departments that need to know about this. And especially when I'm talking about reimbursement, you need to get involved the coders, the finance department, and the billing department so that everybody knows exactly that patient population that is predicted to need this, what the CPT code or what the procedural code is that would be used is, and then what the reimbursement is for that service. And your return on investment is going to change according to those elements of the revenue.

(SOUNDBITE OF MUSIC)

ROBERTS: OK, I can guess what listeners like you are thinking: Wow, that's a lot of math. And it's a lot to take in on a podcast. But as Pam points out, the details are provided in the show notes for this episode. You can download the show notes on our web page at EliteLearning.com/podcast at any time, and you may wish to listen to Pam's explanations again while you have them in hand. Doing so could be particularly helpful during our next episode, in which Pam walks us through an ROI example. It's this kind of practical, step-by-step explanation that will help you fully understand the complexities of developing the justification for something your staff needs. I hope you'll join us.

This is Faith Roberts for Elite Learning.

(SOUNDBITE OF MUSIC)