CHAPTER 6

SPECIAL COST TECHNIQUES IN HOSPITALS

It is recommended that certain special cost techniques should be applied in hospitals. These are special purpose techniques which serve the hospitals in the areas of decision-making, comparison and control of hospital costs. These techniques undoubtedly help the hospitals to improve their overall efficiency.

6.1 APPLICATION OF MARGINAL COSTING IN HOSPITALS

There are many important areas in hospital where principles of marginal costing can be applied effectively. The analysis and presentation of cost data under the marginal costing principles help the hospital management in a number of ways. Following is given a brief sketch of the purposes for which these principles should be applied as an integral part of the Cost Accountancy System in hospitals:

1. COST CONTROL

Since segregation of cost into Fixed and Variable is a fundamental requirement in marginal costing, cost control is facilitated. All variable costs are fully controllable while each item of fixed cost can be subject to careful analysis and control. It can be observed that no additional effort is required for hospitals for cost control from this point of view due to the fact that all costs are analysed and presented as Fixed and Variable categories.

2. EVALUATION OF PERFORMANCE

The revenue earning potentialities of each Revenue-producing departments in hospitals can be accurately evaluated and the performance in terms of
costs and revenue can be assessed. The efficiency and the performance of each Revenue-producing department really determines the success of a hospital. Marginal contribution analysis is the most useful technique for this purpose.

3. **DECISION-MAKING**

Hospitals have to take many vital short-term decisions which affect their profitability. The following three decisions merit special consideration in this context:

a) **PRICING DECISIONS**

It is usual in all hospitals that certain speciality services are greatly demanded by the patients, while certain others are unable to attract an expected volume of patient turnover. Although many reasons can be attributed to this feature, the most significant factor is the stiff competition among hospitals. The situation should not be allowed to persist for a long time since it may eventually lead to suspension of such speciality services. Such a situation can be saved if the prices are lowered equal to, or in exigencies, below marginal cost. This action can be justified for obvious reasons. As and when things change for the better, the situation should be reviewed and proper decision should be taken.

Patient fees should also be charged less when a new speciality department is opened and certain types of patients genuinely deserve concessions. In other like cases also, hospitals should resort to reduction in prices of services which in the long run will be beneficial in many respects. Here also marginal contribution aids the management in determining the extent of price reduction.
b) OPTIMISING THE SERVICE MIX

Service Mix highly influences hospital cost. Every hospital would like to provide the widest range of services consistent with its objectives. It should be admitted that there is a great need for good general hospitals with good facilities for General Medicine, Obstetrics, Gynecology care, Paediatric care and clean, safe and efficient General Surgical facilities. Sub-specialities like Eye, ENT and Dental clinics can also be added to the hospital system. The departments rendering these services can be made highly efficient and cost effective due to comparatively larger turnover of patients. Supportive services like Laboratory and X-ray can also be made cost effective if there are facilitates for conducting clinical, routine and general investigations.

However, the modern trend in most hospitals is to provide supra-specialisation such as Cardiology, Cardio Thorasio Surgery, Urology, Nephrology, Oncology, Neuro-Surgery, Plastic Surgery, Genito Urinary Surgery and the like. They also prefer to have Histo-pathology and Scanning facilities. Modest facilities of these nature of good standard require unusually large investment in investigations, operations, critical care facilities and a good team of doctors, nurses and para medical personnel. The ultimate result will be that these specialities raise the costs to the maximum level without providing commensurate benefit to patients.

Adding modern specialities definitely bring good reputation for the hospitals. However, resources being limited, because of economies of
scale, it is generally advisable for the hospital to restrict its service mix up to a limit for higher workload results in both higher quality and lower cost per case. The greater work load of different specialities, within limits, account for greater competence as the staff are geared to that higher level of performance. Further costs are minimised as fixed costs on physical infrastructure, equipment and specialists are shared by a larger patient base. Thus there is a strong case for restricting the service mix and also for finding out the most profitable and optimum service mix.

Marginal cost analysis helps the hospitals to select the best service mix from amongst the various alternatives available. The service mix which gives the maximum possible marginal contribution will be the optimum mix and this optimum mix is the maximum profitable service mix. The marginal contribution technique can be applied to the hospital as a whole and also to each department which render various types of mixed services.

c) ASSESSING THE CAPITAL INVESTMENT PLANS

While introducing new departments of supra-specialisation, it becomes necessary to invest huge amount in highly sophisticated and costly equipments and instruments. Among the important factors which should be considered before taking a final decision in this respect, the marginal contribution from the proposed project merit special consideration. If the increase in contribution is more than the increase in fixed cost of additional facilities, a favourable decision can be taken by the management.
4. **BREAK-EVEN ANALYSIS**

This is a very useful technique which can be applied in hospitals in a number of situations. Following are given the areas, situations and purposes for which this analysis can be applied profitably:

a) The impact of fixed costs on the profitability of the hospital can be clearly measured by analysing the capacity utilisation.

b) The profitability of new investment in new departments can be ascertained.

c) Cost-profit studies on price differentiation of the same service for different patients can be effectively carried out.

d) It indicates the point wherefrom each type of unit of services starts to earn profit. It also tells the number of patient-days which are required by the hospital to break-even.

e) It helps to forecast the cost and profit with each change in the level of patient turnover.

f) It directs the hospital how to plan its activities so as to earn a desired amount of profit.

g) The effect on total cost of an increase in fixed costs can be clearly assessed.

h) It analyses the cause of decrease in profit of each department and suggests the measures to be taken to improve the situation.

These are some of the important aspects which need the immediate application of the Break-even analysis. This analysis has great potentialities which can be utilised by the hospitals so as to save themselves from a number of precarious situations.
6.2 **UNIFORM COSTING FOR HOSPITALS**

It is suggested that the principles of Uniform Costing should be applied in hospitals after the successful installation and maintenance of Cost Accountancy System in the individual hospitals. Uniformity in the costing principles, techniques and methods practised by hospitals can bring manifold benefits to each hospital. A Central Hospital Association can organise the application and working of uniform costing principles. Areas where uniformity is preferred in hospitals include the following:

1. Computation of cost of each cost centre and cost unit.

2. Segregation of cost into Fixed and variable.

3. Cost Finding procedure to arrive at cost per inpatient-day and outpatient.

4. Procedure for computing material cost and labour cost per patient.

5. Method of valuation of inventories of medicines and other consumables.

6. Determination of cost centres.

7. Determining the bases for allocation and apportionment of costs.


9. Control techniques relating to each element of cost.

10. Service Mix

The objectives and requirements of each individual hospital should be considered while designing a uniform costing system for the hospitals. It is also essential to develop a Uniform Cost Manual which should be circulated
among the participating hospitals. The Manual should lay down the recommended Cost Accounting plan and the procedure for operating it.

The Central Hospital Association should seek whole-hearted co-operation and willingness of all the hospitals. It should educate its members about the benefits they can derive from a Uniform Costing System. It can be hoped that if the hospitals unite together under a Uniform Costing System, it is the community which can get the best quality of care at minimum price.
It is strongly recommended that an inter-hospital comparative study should be conducted at reasonably regular intervals to locate the weaknesses, inefficiencies and efficiencies of different hospitals. This study can be conducted irrespective of the size, variety of specialities, amount of investment and number of employees in the hospitals. The necessity of such a study arises from the following reasons:

1. Hospitals charge different prices for the same type of service rendered to the patients.

2. Average length of stay of a patient suffering from same illness differs in different hospitals.

3. It is necessary to ascertain the most profitable service mix suitable to the peculiar conditions in each hospital.

4. Hospitals should also find out a proper method to relate the quality of care with cost.

5. There should be the awareness of social responsibility for hospitals in a much better way.

6. Unfair competition leading to exhorbitant charges in some cases and under-recovery of costs in other cases should be avoided or minimised.

7. The sufferings and frustration of hospital employees should be given proper consideration and something should be done for their betterment.

It is quite evident from my study itself that most hospitals are not reluctant to supply the requisite data if they are ensured of the
benefits of such a study. A central hospital association should organise the inter-hospital comparison in an effective manner. It should also be seen that desirable conditions must exist in hospitals for the comparative study. The participants should decide the nature of data that should be compared. It is left to the participants to select the appropriate techniques of comparison which suit their requirements. The central organisation should provide the results of the study in the most appropriate manner. It is also recommended that the inter-hospital comparison should be done regularly each year after finalising the accounts.