

Business Economics: The Foundation for Building Business Acumen

May 10, 2016

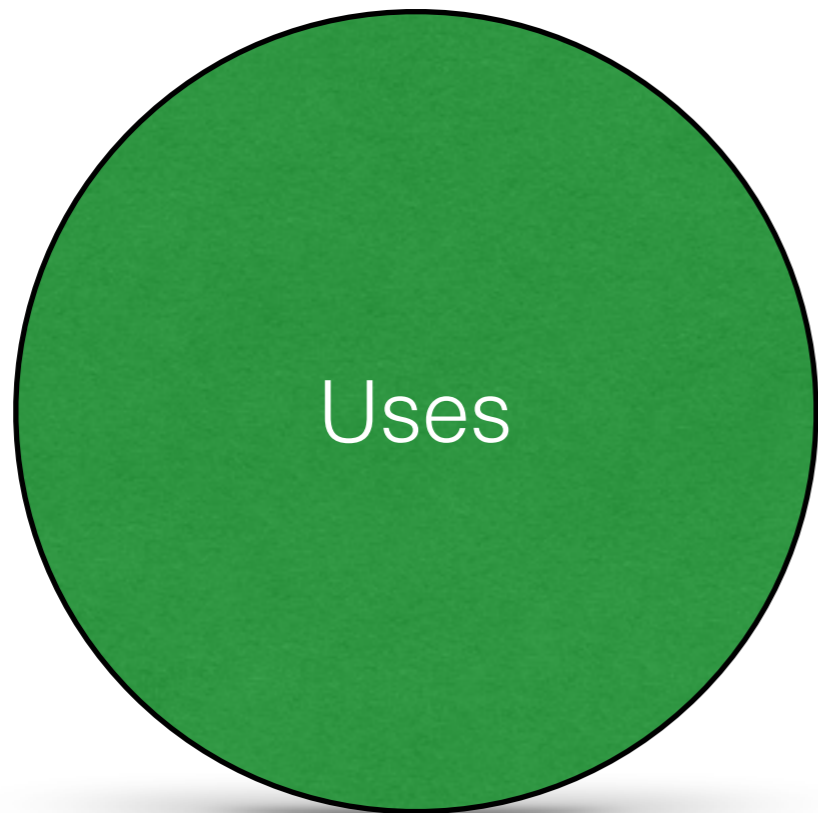
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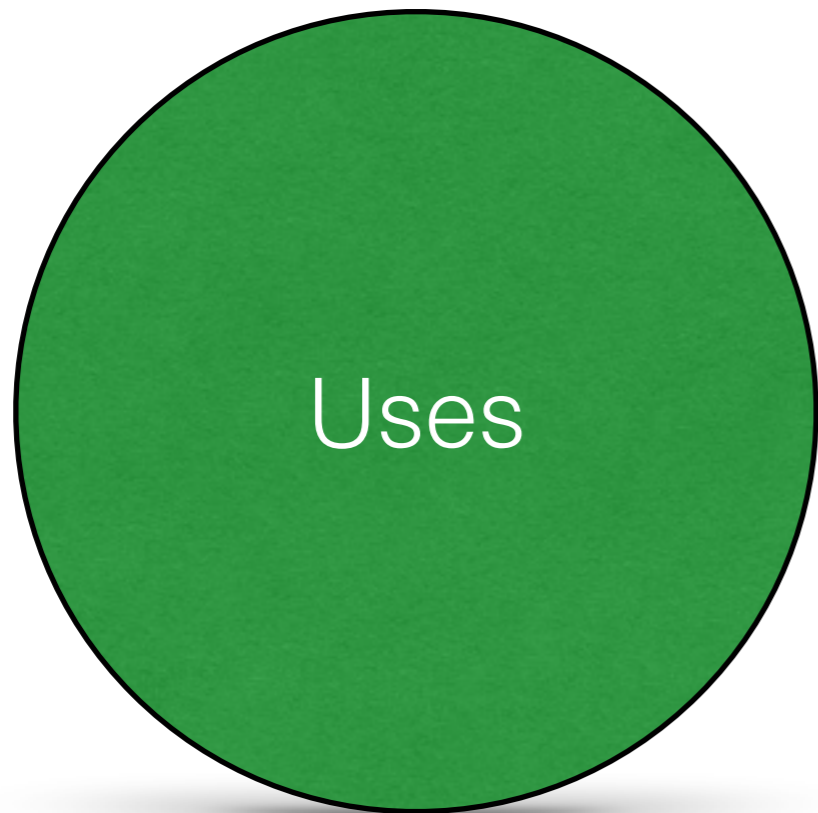
Agenda

- Business acumen
 - Definition
 - Need
- Business economics
 - Definition
 - Principles

Management Challenge: Scarce Resources



Management Challenge: Scarce Resources



Doing the Right Things



Doing the Things Right

Business Acumen Definition

Business acumen is keenness and quickness in understanding and dealing with a business situation in a manner that is likely to lead to a good outcome.

Business Economics: Economic Way of Thinking

- Urges comparison of benefits and costs of decisions to create value.
- If benefits exceed the costs, then value is created and the decision is a good one.
- The bigger the difference the better the decision.
- The difficulty is knowing how to identify and measure the costs and the benefits accurately.

Five Business Economic Principles for Astute Decisions

- Principle of opportunity cost
- Principle of perspective
- Principle of maximum net advantage
- Principle of relevant costs
- Principle of cost-effectiveness



Remember the path not taken

Two roads diverged in a yellow wood. And sorry I could
not travel both . . . Robert Frost

Definition

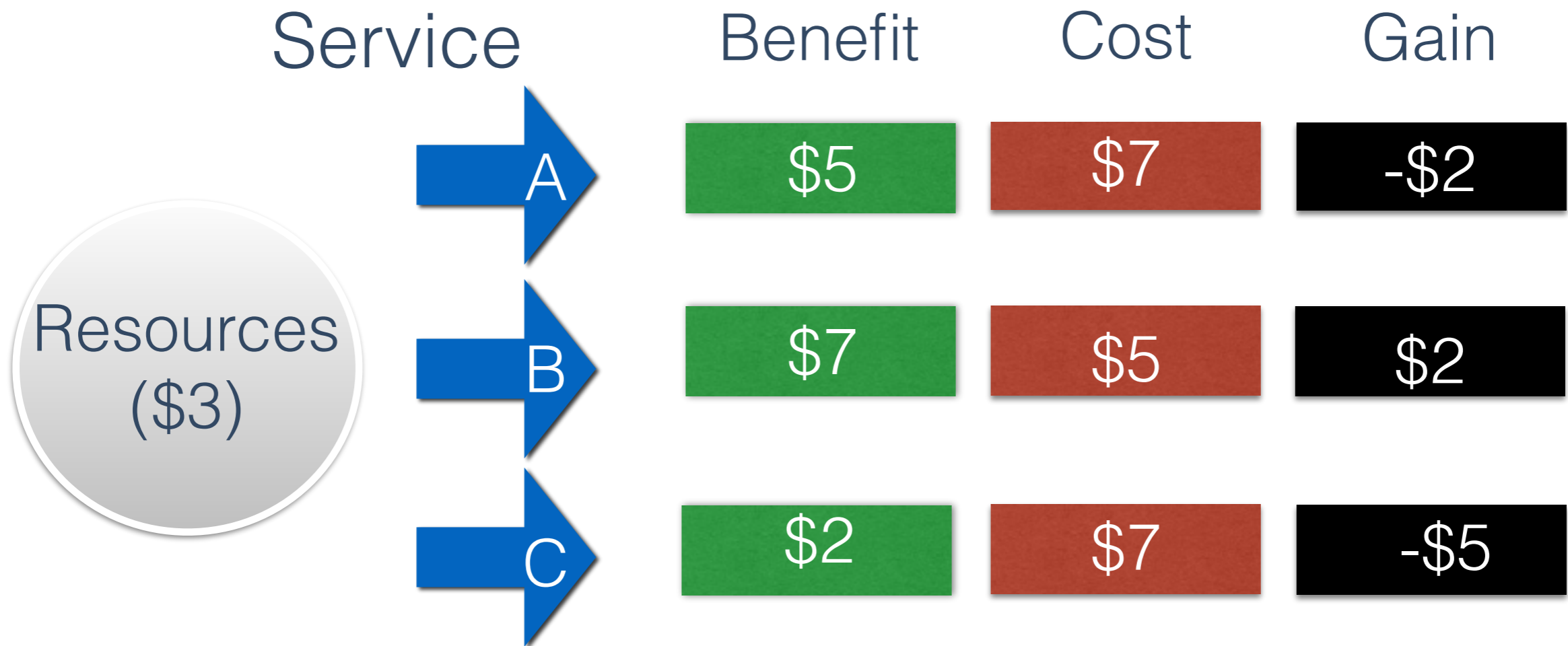
Dictionary

opportunity cost

noun *Economics*

the loss of potential gain from other alternatives when one alternative is chosen: *idle cash balances represent an opportunity cost in terms of lost interest.*

Example: Consider All Options



The diagram illustrates a resource allocation problem. On the left, a grey circle labeled "Resources (\$3)" is connected to three blue arrows labeled "A", "B", and "C". These arrows point to a table with four columns: "Service", "Benefit", "Cost", and "Gain".

Service	Benefit	Cost	Gain
A	\$5	\$7	-\$2
B	\$7	\$5	\$2
C	\$2	\$7	-\$5

Other Applications of Opportunity Cost

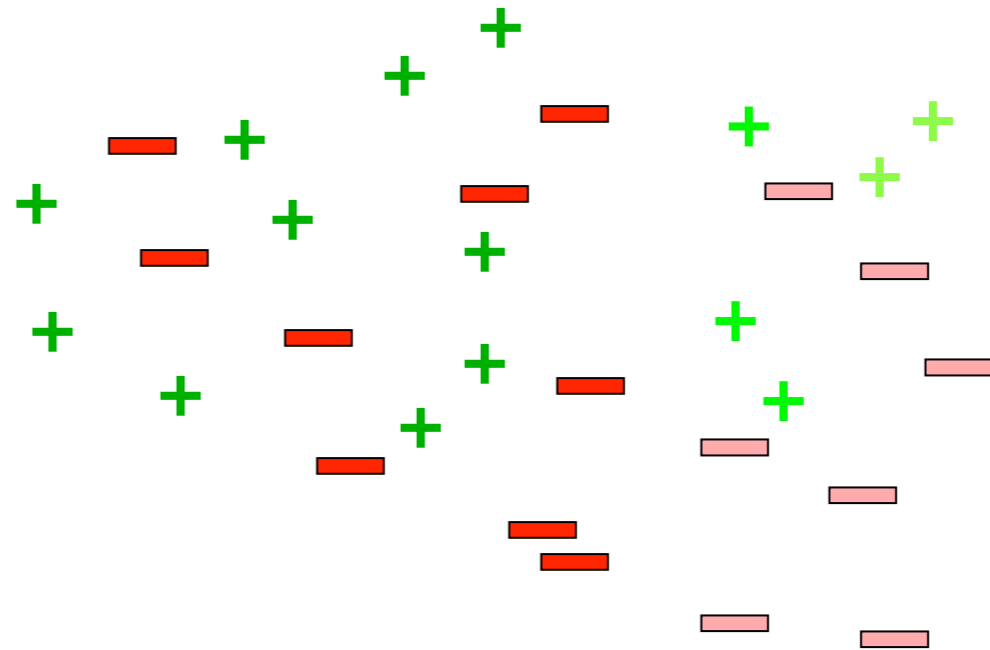
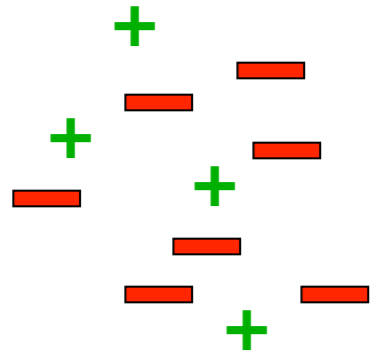
- Delegation: Comparative advantage versus absolute advantage
- Uncompensated informal care provided to dementia patients
- Recruitment of key staff: must cover their costs

Principle of Perspective Explained

Costs & benefits of a decision often accrue to different people

- Decision-makers may consider only internal costs and benefits
- Decisions may not be optimal from a broader perspective
- Need for systems thinking to achieve broader objectives

Principle of Perspective



External and devalued (if not disregarded)

Internal and considered

In decisions, internal consequences are weighed more heavily.



Parable

The 10 Diners

Perspective: Accountability in Health Care

- Bundled payments (Comprehensive Care for Joint Replacement (CCJR))
- Medicare spending per beneficiary (MSPB)
- Hospital readmissions reduction act (HRRRA)
- Accountable care organizations (ACO's)



Lab Book Exercise

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Principle of Maximizing Net Advantage: The Context

Where you choose not only whether the program, activity, or process is worthwhile or not, but also its size, extent, or scale.

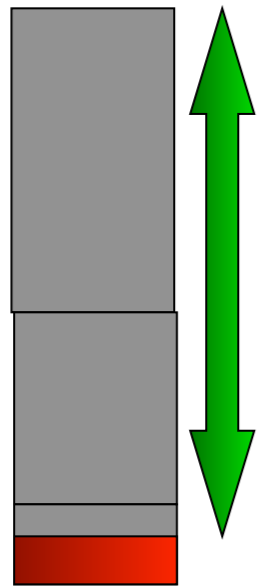
- Which patients do we offer this expensive intervention to?
- How often should we visit clients in their homes?
- Should a client receive a telephone or at-home assessment?

Principle of Maximum Net Advantage Explained

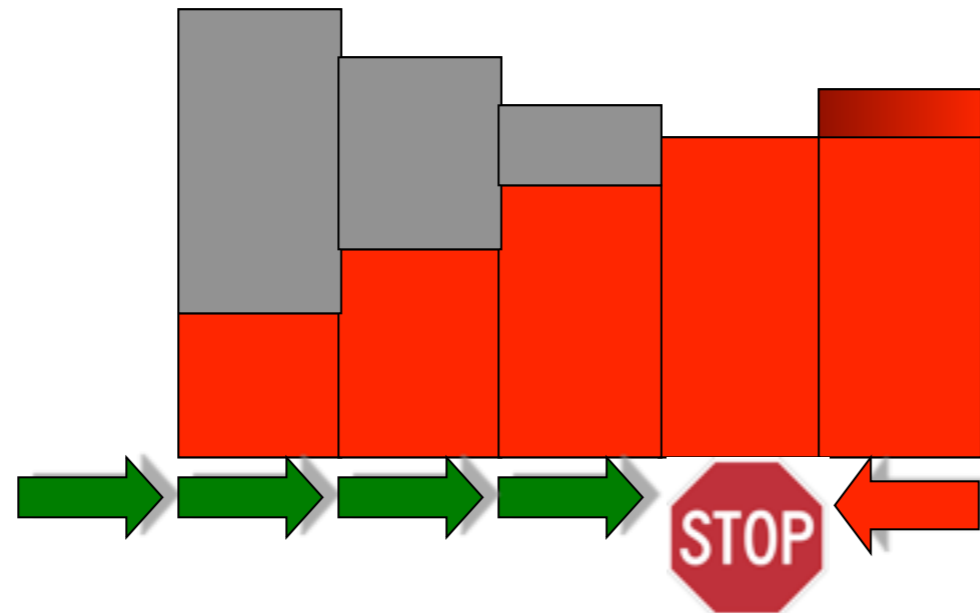
- Marginal analysis is required.
- Measure the marginal benefit.
- Measure the marginal cost.
- Stop where the marginal benefit equals the marginal cost.
- At that amount of activity, net benefits are maximized.

Principle of Maximum Net Advantage - Marginal Analysis

Net
Advantage



Maximum Net
Advantage





Lab Book Exercises
Pages 9 & 10

Calculations

$$MC = \frac{\Delta TC}{\Delta L} = \frac{6 \times \$80,000 - 5 \times \$75,000}{6 - 5}$$

$$MC = \frac{\$480,000 - \$375,000}{1} = \$105,000$$

Marginal Analysis: Risk Stratification for Care Transitions

Transitions & Readmissions Averted

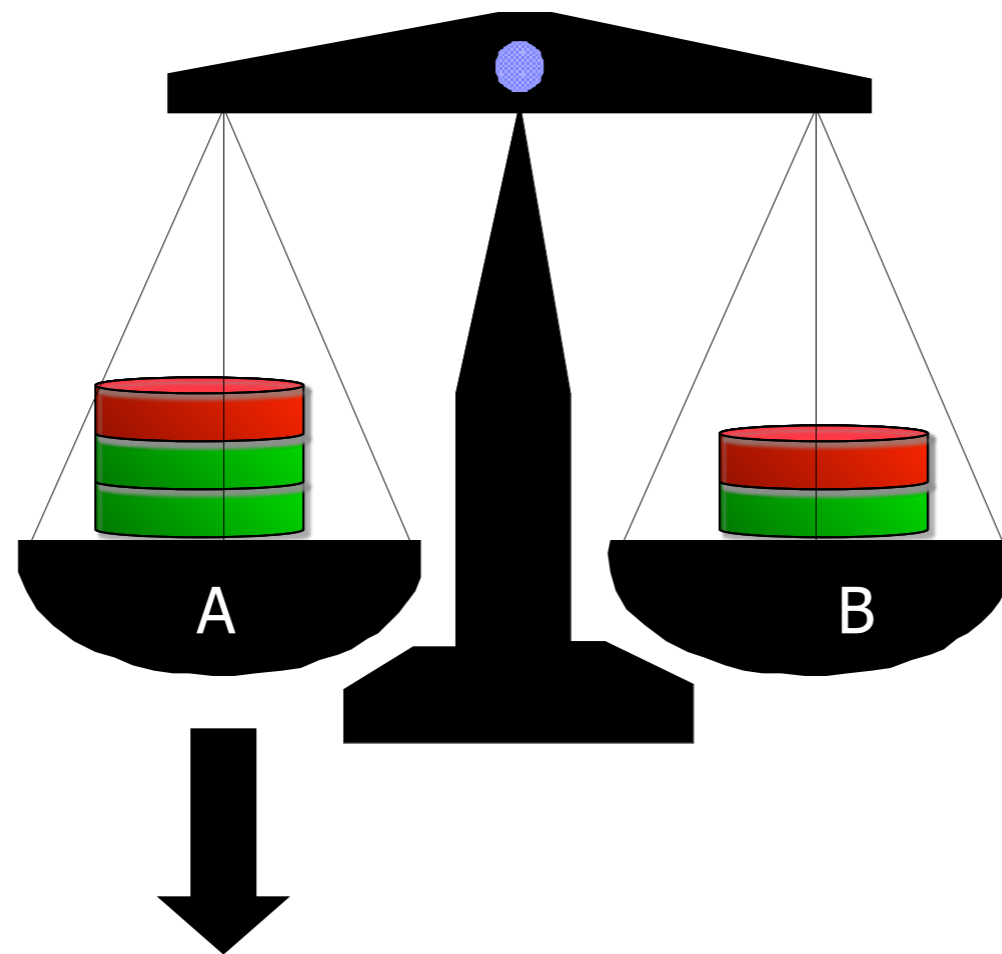
Service Costs

Transitions	Readmissions Averted	Δ Gain	Total Cost	Average Cost per Readmission Averted	Marginal Cost per Readmission Averted
100	40	40.000	\$40,000	\$1,000	\$1,000
200	70	30.000	\$80,000	\$1,143	\$1,333
300	90	20.000	\$120,000	\$1,333	\$2,000
400	100	10.000	\$160,000	\$1,600	\$4,000
500	105	5.000	\$200,000	\$1,905	\$8,000
600	107	2.000	\$240,000	\$2,243	\$20,000

Suppose the benefit of an averted re admission is \$5,000. How deep would you go?

Principle of Relevant Cost: Graphically

A cost that is common to all alternatives is not going to affect the choice of the best one.



In weighing the alternatives, the fixed cost does not affect the balance.

Relevant Costs: Sub Capitation to a Hospital

	Original	Proposed
Payment	\$800 per diem	\$1.50 PMPM
Population	10,000	10,000
Admissions	50	50
Length of Stay	5 days	4 days

Assume per diem cost of \$1,000

Case Analysis

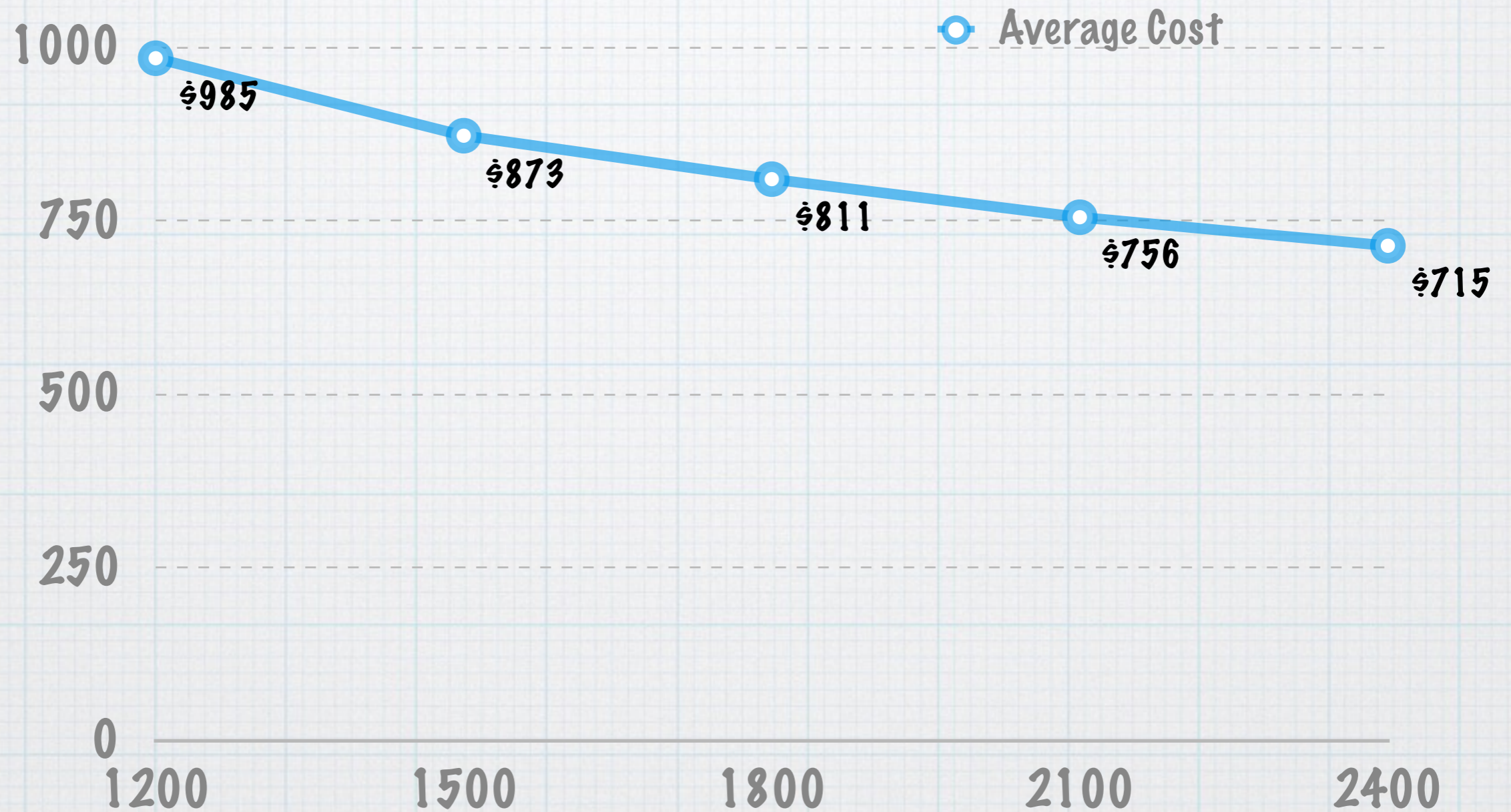
	Conventional	Economic Way of Thinking
Decline in revenues	\$20,000 (\$200,00 - \$180,000)	\$20,000
Decline in costs	\$50,000 (50 x \$1,000)	\$12,500 (50 x \$250*)
Change in net income	\$30,000 (\$50,000 - \$20,000)	(\$7,500) (\$12,500 - \$20,000)
Decision	Convert to capitation	Retain per diem

* Marginal cost of a bed night



Lab Book Exercise
Page 11- 12

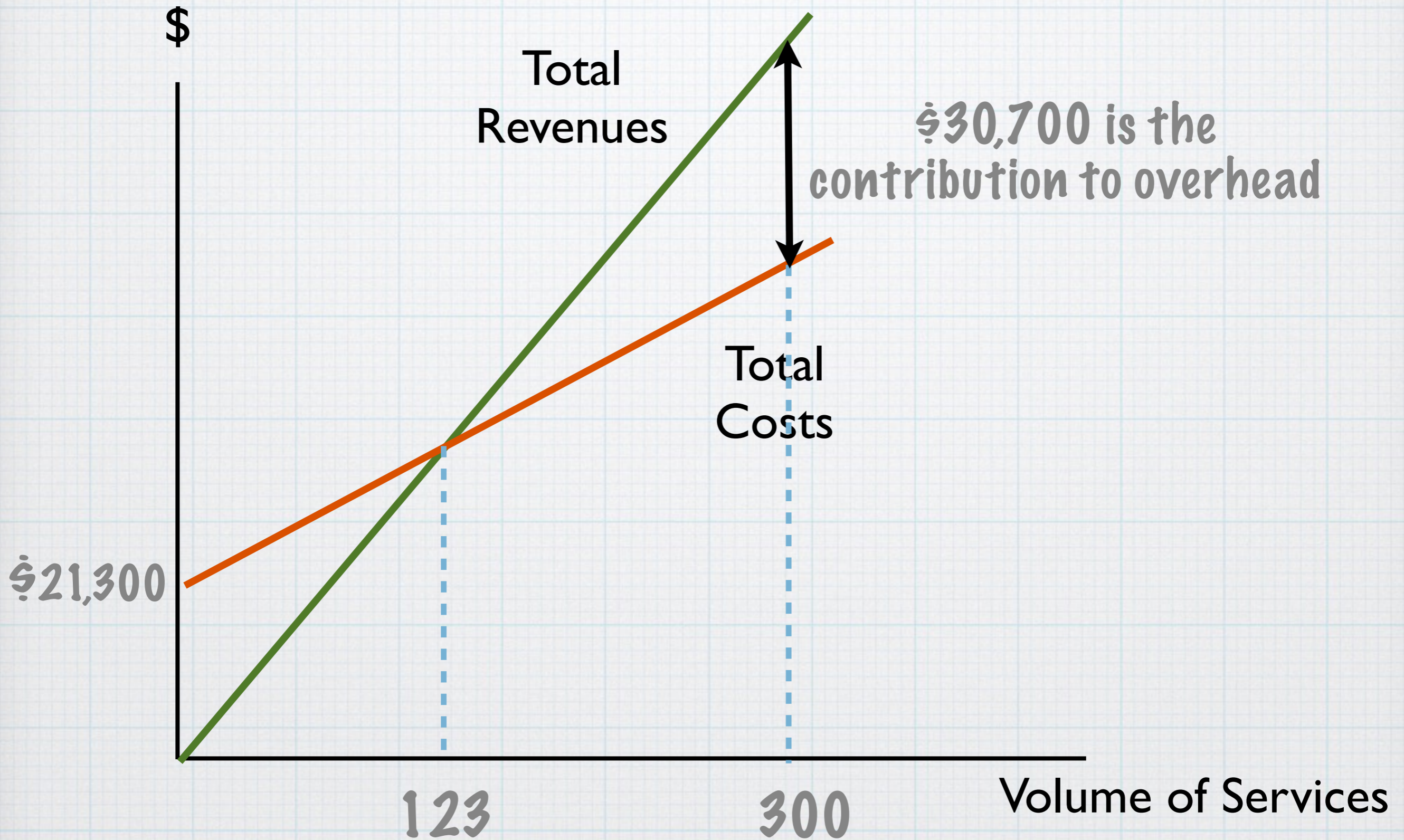
Scale Economies Result from Fixed Costs



Marginal Cost is Only \$497

* $MC = (\$1,459,000 - \$1,310,000) / (1,800 - 1,500) = \497

Financial Contribution is Positive



The Fundamentals of CEA



Arithmetic of Cost Effectiveness

- The large item contains 24 oz which is about 5 times the smaller one (5.3 oz).
- But it costs only about 3 times as much.
- Calculate cost per ounce and compare:

$$\textit{Small} = \$1.79 \div 5.3 \text{ oz} = \$0.34$$

$$\textit{Large} = \$5.79 \div 24 \text{ oz} = \$0.24$$

Comparative Cost

Effectiveness of Service B relative to A

		More	Same	Less
Cost of Service B relative to A	More		A	
	Same		A or B	
	Less		B	

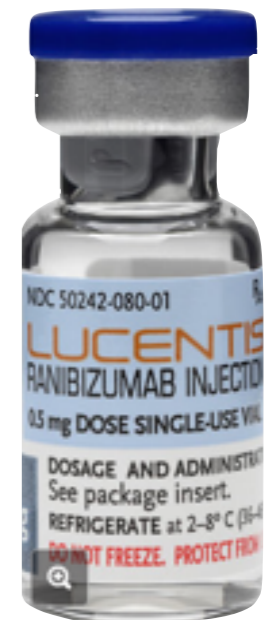
Here we are dealing with a cost-minimization problem which is a special case of cost-effectiveness analysis

Comparative Cost Example

- Studies have shown, for example, that two drugs are about equally effective in treating an eye disease, macular degeneration.



\$50



\$2,000

Medicare could save hundreds of millions of dollars a year if everyone used the cheaper drug, Avastin, instead of the costlier one, Lucentis.

Comparative Effectiveness

Effectiveness of Service B relative to A

		More	Same	Less
<i>Cost</i> <i>of Service B relative to A</i>	More			
	Same	B	A or B	A
	Less			

Here we are dealing with an effectiveness-maximization problem which is a special case of cost-effectiveness analysis

Comparative Cost-Effectiveness

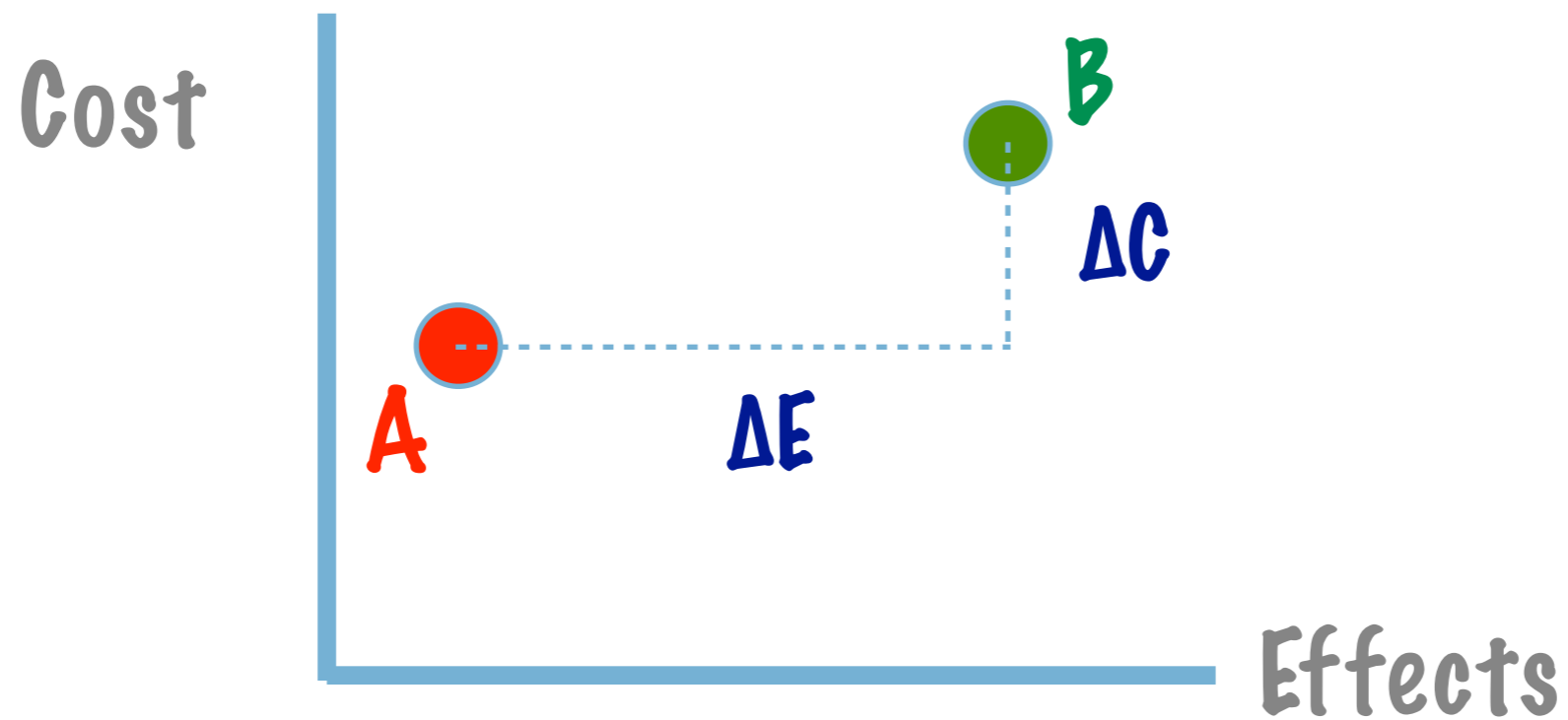
Effectiveness of Service B relative to A

		More	Same	Less
<i>Cost of Service B relative to A</i>	More	???	A	A (dominant)
	Same	B	A or B	A
	Less	B (dominant)	B	???

(A dominant modality is one that is cheaper and more effective.)

The Question Graphically

	More	Same	Less
More	???	A	A (dominant)
Same	B	A or B	A
Less	B (dominant)	B	???



Requires converting effects into dollars of benefit!



Lab Book Exercise
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Care Coordination: Analysis

Costs & Outcomes	Usual care	Coordinated Care
Program cost	\$0	\$150,000
Panel size	30	30
Baseline admissions	18	18
Post program admissions	18	4.5
Avoided admissions	0	13.5
Cost of an admission	\$15,000	\$15,000
Incremental benefit (cost savings) from CC		\$202,500
Incremental net benefit		\$52,500

YES!