Background Information: Fee Policies

The fees that you charge are one of the most important management decisions that you make. Fees dramatically affect practice profitability and patient perception. A profitable practice can only be attained by careful attention to the financial details of both income generation and management of practice cost. The dentist’s self-esteem is closely tied to fees, both as a cause of low fees (the dentist must believe that the fee is fair and valuable) and in the resulting practice profitability. The fees that the practice sets have obvious and important implications for income generation.

Basic Objectives of Fee Setting Policy
As a practitioner, you should initially determine what you expect to accomplish with your practice fees. Those objectives may include, depending on the type and style of the practice, market skimming, satisficing, and market penetration. Various strategies accomplish these alternative profit objectives.

Market Skimming
Skim pricing occurs when a business prices goods or services so high that only a few consumers can afford them. In the automotive world, Porsche and Bentley autos are sold on this basis. Dental practices that make large profits from a few patients by charging high fees employ skim pricing.

A paradoxical value of high fees is that consumers may use them as an indicator of quality. A patient who perceives the quality of dental care as high is not as concerned about the cost of that care. For these patients, treatment decisions are based on non-fee considerations, such as aesthetics, image, treatment outcome, or personal interaction with the dentist and office staff. Often then, high fees paradoxically may lead to higher patient satisfaction.

Market skimming has limitations for use in a dental practice. The number of patients who will buy dental services without regard to the price is not large. Only a few practices in an area can use this skim pricing. Each of those practices must offer something unique for which the patient is willing to pay a premium price. A practitioner must be sure to differentiate themselves from other dentists in the area. In that way, a patient who becomes dissatisfied with the fee will be less likely to leave, since they have no (or few) other substitute or comparable providers. Patients with dental insurance may question a procedure fee when their insurance carrier notifies them that the charged fee exceeds the carrier’s UCR (Usual, Customary, and Reasonable) fee schedule. When other practices in the area discover these higher fees, they may provide similar services, market the service similarly and charge fees similar to the practice that originally adopted a market skimming strategy.

Satisficing
Many dental practices may not emphasize extreme profitability, either in the short or long run. These practitioners may exhibit behavior that produces satisfactory, rather than maximum, profit. Satisficing behavior is an economic idea that emphasizes attainment of a desired level of something without maximization of anything. Ford Motor Company “satisfices” in its mid-sized line of autos. They produce adequate numbers of autos, charging a reasonable price, paying their workers a satisfactory wage and earn a satisfactory profit. They could maximize profits in the short run by charging more, but in return
might lose satisfied customers or workers. A dental practice that uses the satisficing strategy structures its fees so that everyone is “fairly happy.” The practice meets current expenses and allows the dentist to live comfortably and to reward the staff adequately. (“Comfortable” and “adequate” obviously have different meanings for different people.)

Creating this perception of satisficing behavior helps the practitioner to earn a reputation of being fair and equitable. Studies on dental consumer satisfaction suggest that the attributes of professionalism, quality, and reputation are significant determinants for consumer selection and retention of a dentist. Patients who perceive that their dentist is satisficing rather than maximizing may assume a higher level of satisfaction in the doctor-patient relationship. The cost of care alone does not lead to satisfaction, but can be significant in exacerbating patient dissatisfaction. (Patients won’t become more satisfied if they believe the fee is fair, but will certainly become dissatisfied if they believe that the fee charged is too high.) Therefore, a satisficing fee strategy is a helpful component in developing patient satisfaction.

Market Penetration
Fees may be set at a low level to attract new customers or “penetrate” into a new market. Many stores have “Grand Opening Sales” to develop markets for new outlets. Auto makers also uses this strategy in pricing their entry line of autos. The hope is that the low price will lure initial buyers who will then, in later years, upgrade to larger, more expensive (and more profitable) autos in the line. In dentistry, the price or fee may be set below that of similar services offered by other dental practices to attract potential patients based on lower fees and, hopefully, keep them in the practice. It is often used for such services as initial exams, cleanings, economy dentures, or even orthodontics.

Many high-volume retail dental operations use this pricing objective. Their goal is to attract patients based on a “lower” price for a common service, such as an initial exam. By doing this, they hope to attract enough patients to “penetrate the market.” Once a patient load is established, the retailer may adjust fees upward to approximate those of other dentists in the area.

Advertising dentists who offer initial price reductions in their advertisements or coupons use a similar strategy. A free or reduced price examination, prophylaxis or radiograph attempts to penetrate a market and generate new patients for the practice. This strategy is especially effective for cost conscious dental consumers. These groups include families with lower discretionary income and poorer insurance policies. It is much less effective for consumers for whom cost is not a significant decision factor.

Managed care dental plans often use a similar strategy to become established in the dental benefits market. Their goal is to price the managed care plan at a low entry level price compared with conventional dental reimbursement plans. By doing this, they hope to attract companies or organizations as clients rapidly and, so, build market share. Once they build this share, they may eliminate the “introductory offer,” and prices may rise. Profitability to the participating dentist under this objective is small, or may not exist at all during the plan’s growth phase. Other plans may offer high reimbursement rate to gain practice participants, then lower their reimbursement over time.

The use of a low price, market penetration strategy is only advisable under certain circumstances. The markets in which this strategy is most effectively used include those that are highly sensitive to fee levels (demand for a service increases as the fee declines), in which a lower fee would discourage competition, and those in which a lower fee would not be equated with poor quality. It is debatable whether the traditional dental practice market place meets any of these criteria. Many patients may use price as an indication of quality, particularly for intangible services, such as health care. Potential patients must also be informed of the price, which means that extensive advertising costs may be incurred, but advertisements rank low as an important dental consumer decision factor. Therefore, undue emphasis on advertising of dental services may be counterproductive to the effective marketing of dental services. A market penetration strategy may be used by independent practice associations, contract dental plans or
other groups who are competing based upon price and are willing to accept low profits to build a presence in a particular market.

**Methods Used To Set Fees**

Philosophically, there are several ways to set fees. The method you use will depend in large measure on the objective you have established.

**Cost-Based Method**

One common method that dentists use to set fees (price) is based on the practice's cost structure. The dentist determines total office cost per hour, determines the time required to do each procedure and then computes the required fee for each procedure based on the time needed to complete the procedure and any additional costs (e.g., lab). A normal or desired profit (personal income) can be added to the overhead cost to decide the fee to be charged. For example, if you know that the practice must generate an average of $120.00 / hour to meet the operating costs, you want $50 per hour in profit, and you know how long it takes, on average, to do a given procedure, then you can calculate the amount required to “break even” on that procedure. If you can do the “average” two-surface alloy in 20 minutes, then you should charge $56.66 ($120 / hour overhead + $50 profit / three procedures per hour) to meet this projection. We give these numbers as examples only. Your individual practice numbers will certainly be different.

This type of fee planning is particularly important if you participate in managed care or contract dental plans. In this instance, it is critical for you to know how much a given procedure will “cost” the practice to produce. Since the practice receives a predetermined fee for any given procedure, you must know the cost structure of the practice to figure out if you will be making or losing money by participation in the program. A capitation plan may decrease the fixed costs of a practice (by supplying a monthly fixed revenue amount), but not pay a high enough fee to recover variable practice expenses. If the managed care plan fee will not cover at least variable expenses, then it literally costs you money to participate in the plan and treat patients covered by the plan. Remember. There may be reasons other than simple profit for participating in a plan. The marketing and practice growth implications of gaining additional patients for the practice may, in fact, outweigh the strict financial justifications.

Cost-based fee determination has its shortcomings. It leads to a satisficing fee strategy. Its intent is to be “fair” to all parties involved, and it accomplishes that end. However, it is not an aggressive fee strategy and does not lead to the maximum profit, or income for the practitioner. Most practitioners want to be viewed as fair and not overly concerned with money. This strategy reduces dissatisfaction of involved parties. It involves considerable calculation work. You must have excellent time records, which either involves considerable time with a stopwatch, consistent schedule records, or a good guess. This can also lead to the dentist who is clinically faster being compensated less than the slower dentist.

**Demand-Based Method**

A second method used to set a fee is based on consumer demand for a service or product. This method is represented by the adage “Charge what the market will bear.” This infers that the firm or dentist will charge the highest fee at which enough people will buy the product or service. It is important to note that there is no price at which everyone will buy dental services; nor is there a price at which no one will buy services. Demand-based pricing infers that some people will be dissatisfied with the price or fee and go elsewhere to purchase their services or simply not purchase the service at all. However, demand-based pricing also infers that the other people who value the good or service will pay the price. Demand-based pricing is a technique used for specialty and image-based goods and services. Many luxury automobiles, designer clothing, and gourmet restaurants are priced on a demand basis. The business could sell more products or service at a lower price, but not enough more to make up for the income lost from lowering
the price. Thus, these firms optimize profit, rather than maximizing the amount of goods or services produced.

As an example, assume that a dentist could “sell” 30 gold crowns a month at a fee of $800 each. If they raised the fee of a gold crown to $1,000, some people would not buy a gold crown that would have previously purchased crowns at $800. Assume that the dentist could now “sell” only 25 crowns at this higher fee. Which fee would result in a higher income for the dentist? “Selling” thirty crowns at $800 results in collections of $24,000 per month (30 x $800). Selling fewer crowns at the higher price results in a higher collections of $25,000 (25 x $1,000). If costs remain the same (disregarding the lower lab bill from fewer crowns), the dentist has increased income by selling fewer crowns at a higher price.

The obvious problem is to figure out how many people will purchase various services at the various prices. Economists determine this by estimating the Elasticity of Demand for a product or service. Elasticity is a term that describes how much “give” or “flex” will occur in purchase amounts because of a change in price. Demand is elastic if there is a large change (either increase or decrease) in the amount purchased because of a price change. An example is the purchase of soda drinks. If your favorite brand of cola raises its price, many consumers will switch to a competitor’s brand. Demand is inelastic if there is not a large change in the amount purchased because of a price change. An example of inelastic demand is the purchase of pharmaceuticals. If a particular drug gives relief of symptoms, a person will purchase the drug at virtually any price. Dental services appear to fall in a midrange of elasticity. That is, patients are not very sensitive to changes in price (fee). Increasing dental fees causes some (but not all) potential patients not to purchase the service. Elasticity of demand for dental services varies considerably with socioeconomic and demographic factors. People who have higher disposable incomes are less sensitive to changes in prices or economic conditions.

The CPI (Consumer Price Index) can be used along with estimates of disposable income as indicators of how much change in demand there may be in response to dental fee adjustments. If the CPI is increasing, then the public is generally aware of higher prices and will accept increases in dental fees as a matter of course. If, on the other hand, prices (i.e., the CPI) are stable, then the public expects slight (or only moderate) increases in dental fees. Whether or not people can pay these higher fees will be influenced more by their disposable incomes than the CPI. If income is going up faster than prices, people will have more money to spend on discretionary or optional services, such as routine dental care. They will be less sensitive to increases in fees. If the price index is rising faster than incomes, then people will have less money to spend on such services and will be much more sensitive to increases in dental fees.

Traditional dental indemnity insurance plans tacitly encourage demand-based fee determination. The insurance portion of the total fee will largely absorb any fee increase. Capitation dental plans, on the other hand, virtually eliminate demand-based pricing, since the fee is contractually determined. Interestingly, the sponsoring organization then is using demand-based pricing (in reverse) to set fee reimbursement levels. If enough dentists presently are willing to provide the needed quantity of services at the given contract price, the price will hold. However, if the market of dental providers is unwilling or unable to provide the services at the prescribed fee level, the contract plan would have to raise the reimbursement level until enough dentists would be willing to participate to provide the required number of services.

Demand based fee determination is an aggressive strategy. It leads to maximum profit for the practitioner, although many patients may be dissatisfied with the high fees and leave the practice. This is acceptable if your practice is mature and has a backlog of patient demand. If one patient becomes dissatisfied, there is another to take its place. New practitioners who are growing the practice and practitioners in very competitive markets will find it difficult to use this aggressive strategy. Managed care
plans are irrelevant to the demand-based fee practice. Since fees are high, managed care is not involved.

**Competition-Based Method**

The third major method that can be used to set dental fees is based on what the competition charges. This is the method that is traditionally used by dentists when they “casually discuss” fees. With the addition of third party payers, competition-based pricing becomes more complex. The basic problem with this system of fee determination is in verifying the source of information about other dentists’ fees.

The most common source of information is to ask other dentists in a geographical area what their fees are for given procedures. This method has several shortcomings. Besides being possibly illegal (due to price fixing), the other dentist may not accurately represent their fees. The inquiring dentist often asks friends and contemporaries about dental fees and, therefore, does not get a true cross-sectional sample of the dental community.

A second, and more accurate, source of information concerning competing dentists’ fees is the data published regularly in the dental literature. These data are often broken down by region of the country, city size, and dental specialty to make the comparisons more meaningful.

The third source is for the dentist to establish a system in the office to track insurance and other third-party reimbursements. Dental insurance carriers will generally keep fees for a very specific area or region, often to the point of establishing UCR fees for part of a metropolitan area or even an individual ZIP code. By gradually raising fees, the dental office can determine when the “cutoff” occurs for a particular plan. For example, if a plan will pay the UCR fee up to the eightieth percentile, you can detect when your fee for that procedure reaches the eightieth percentile for the area -- the insurance carrier will no longer reimburse the full amount. Since most offices see several different plans with different payment schedules, you can develop an accurate notion of prevailing fee levels through this method. You must have a detailed knowledge of each plan’s limitations and constant monitoring to make this system work.

Once you have a range of fees for your geographical area and type of practice, you must decide how you want to position your fees compared with other practitioners in your reference group. Many practitioners want to establish fees at the mean or average level. Others are more aggressive and prefer to be at the 75th or even 90th percentile. (That is, their fees are higher than 75% or 90% of the practitioners in the area.) If your fees are too high, you will be noticed like the sore thumb. If you take this approach, you should have a “name” in the community. Also, be aware that if your fees are above the 80th percentile, third party carriers may not reimburse the full amount. Here, patients may require extra education to understand their relationship with the third party carrier.

**Adjusting Fees**

Most management experts agree that dental fees should be adjusted, at a minimum, annually. Either January 1 or July 1 is the most common date, with the first of the calendar year being the most prevalent. Many practitioners time staff raises to follow fee increases closely. This has several advantages. It helps staff members to remember that their pay is tied to practice revenues. If patients question fees, they will have a more personal stake in justifying the fee charged. Staff will look forward to fee increases, since they know their salaries will soon increase as well.

Many dentists use the Consumer Price Index (CPI) to set changes in their practice fees. The CPI is an index that measures the change in prices of a hypothetical “basket” of goods and services that the “average” consumer might purchase. It is a statistical index computed by the U.S. government based on selected urban Standard Metropolitan Statistical Areas and a few sample cities. The CPI includes payments made for housing, food, transportation, and health care costs. Dentists assume that their cost
of doing business will generally rise in proportion to the CPI. (This assumes that fees are appropriate to begin with.) When dental practice costs are rising, assuming that dental fees should be adjusted in relation to that change in cost is logical. Dentists have a much better measure of their practice costs than is represented by the CPI, they have the actual costs. The CPI is valuable in determining changes in compensation levels for employees, since their costs of living are more truly reflected in the index's "basket" of goods and services. The CPI is not as useful for cost-based pricing decisions. It is, however, more useful in assessing the public's demand for services.

Some fees, such as the fee for a routine periodic oral exam or prophylaxis, are very visible to the dental consumer. Since these services are the most commonly performed, most of the patients can use these as benchmarks as comparison figures, either between practitioners or over time. One strategy to cope with this problem is to list every procedure done on the maintenance visit. Rather than simply list "Recall Exam, Prophy" on the patient's statement, be sure to list everything you did. This should include a medical history update, oral cancer exam, blood pressure check, home care instructions, radiographs, toothbrush, floss, hard and soft tissue exams and any other education or services that you routinely provide at the maintenance visit.

Other procedures, such as posts and periodontal surgeries are less frequently done. Patients have a much more difficult time comparing the costs of these procedures. You may have more discretion when setting fees for these procedures. Routine patients become accustomed to fees for routine procedures. Often problems arise when patients are confronted with procedures that are uncommon or which they have not seen in many years. A form of "sticker shock" sets in. Like an auto consumer who has not priced cars for several years, these patients are amazed (and appalled) at the total price for the package of services. ("Why, the last crown I got in 1958 cost me $45 and it was all gold!") Your patient education skills become very important at this point.

Dental insurance plans can strongly influence your fees. Managed care plans require you to sign a contract that states that you will only charge the patient a contractually agree fee. If you charge more (and are reported) then you may be required to pay back the difference, pay penalties, and may be barred from further participation in the plan. The plans then try to hold down fee increases for their subscribers (the patient). Patients may refuse treatment if the plan doesn't cover the procedure. The reimbursement level may be so low that you do not feel that you can do the procedure profitably. This puts you (the practitioner) in a difficult position of recommending (or not recommending) a treatment that you might lose money doing.

The Effect of Fees on Patient Treatment Plan Acceptance
Price is a factor in almost every purchase decision that consumers make, although it is only one decision factor. Everyone has some price that will cause them to switch to a different brand, a different style or model, or a different health care provider. For dental consumers, that switching behavior is a result of the uniqueness of the practice, the consumer's discretionary income, third party involvement, and the consumer's attitudes about dental health care.

Consumer/Patient Fee Sensitivity
Most people shop for certain goods based solely on price. This is the basis of selling many commodity type goods, such as generic soap, paper products, or dental amalgam. Some people also buy dental services solely based on the professional fee. The patient who calls the dental office and asks about the price of an extraction or denture is "shopping" for services, and will buy primarily based on price. Some dentists are very concerned about attracting these people, and desire to use a low fee or penetration fee strategy to make them "regular customers." You should be aware that people who shop on price are often looking for specific, not comprehensive, dental care. Therefore, they may not represent a large potential source of income. Since the patient originally was "won" on price, he can just as easily be "lost"
because of price. If he finds a dentist who will do dental services more cheaply, he may leave the practice and patronize the new dentist. Therefore, the use of a low fee strategy often does not result in the establishment of a stable patient pool for the dental practice. It may, however, generate an initial patient pool that can be used as a referral base. Additionally, some of those people who were initially won by price can be converted to buy dental services based on factors other than price. While not a frequent occurrence, they may become loyal patients.

Dental consumers are concerned with the apparent, or out of pocket, fee for a service. A third party payer decreases the patient’s out of pocket expense. If a patient has dental insurance that reimburses 50% of a procedure that costs $800, the apparent cost to the patient is $400. Patients are not particularly sensitive to the price of dental services, but they are sensitive to payment options and other forms of credit. (See the chapter on Credit and Collection Policies.) A patient will balk at an $8,000 treatment plan the same as at a $9,000 treatment plan. Using the same principle as automobile leasing, if you can make the monthly payments affordable, the cash flow price for the consumer becomes tolerable. Dental consumers are also more concerned with and knowledgeable of frequently “bought” procedures. Many patients know when you raise the prices of a “Recall” exam by $1, but are oblivious to a $25 increase in the price of a crown.

The Effect of Fees on Practice Profitability
The fees that you charge affect practice profitability greatly. The greatest part of a dental practice’s costs is fixed. Once this fixed cost component has been met, then additional revenue becomes almost pure profit. The following chart illustrates this point. Assume that there are three equal dental practices, Practices #1, 2, and 3. These practices are in the same building, employ the same staff and have the same exact cost structures. Practice #2 charges the average fees for the area, in this example $100 for a procedure. Practice #1’s fees are 10% below the average for the area ($90); practice #3’s are 10% above ($110). They all do identical amounts of dentistry for the year. The chart shows the financial results from this scenario.

<table>
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<tr>
<th>Fee Effect on Practice Profitability</th>
<th>Practice #1</th>
<th>Practice #2</th>
<th>Practice #3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fee level</td>
<td>10% below = $72</td>
<td>Average = $80</td>
<td>10% above = $88</td>
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<td>Gross Collections</td>
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