Dental Competitive Strategy: Cost Leadership or Differentiation?

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Dental practices compete on the basis of cost leadership or differentiation, or some combination of both. This article deals with the various factors that affect a dentist's ability to increase profitability through cost-leadership or differentiation strategies.

Dental practice profitability varies according to the gap between prices and costs. This gap depends on the practice's competitive strategy (**Fig. 1**). For the average dental office there is a reasonable gap (margin) between what patients are willing to pay (i.e., the prices charged) and average practice costs. A practice that uses a successful differentiation strategy has higher average costs but can charge more, so its margins are higher. A practice with a successful cost-leadership strategy will also have higher margins because average costs are much lower, even though prices may also be slightly lower than average. A successful mixed strategy, which is harder to implement, will result in both higher prices and lower costs.

Cost-Leadership Strategies

A cost-leadership strategy focuses on lowering service or practice costs. It is important to emphasize that cost leadership need not necessarily lead to lower than average prices. A practice which adopts a cost-leadership stance can charge lower prices (**Fig. 1**), or it can charge the same prices as other dentists in the neighbourhood and enjoy superior profits. Since most dentists comply with their provincial fee guide, focusing on costs is the primary way for dentists to earn superior profits. However, this does not mean that dentists should not pursue a differentiation or mixed strategy, because referral rates and switching costs are intrinsically linked to quality.

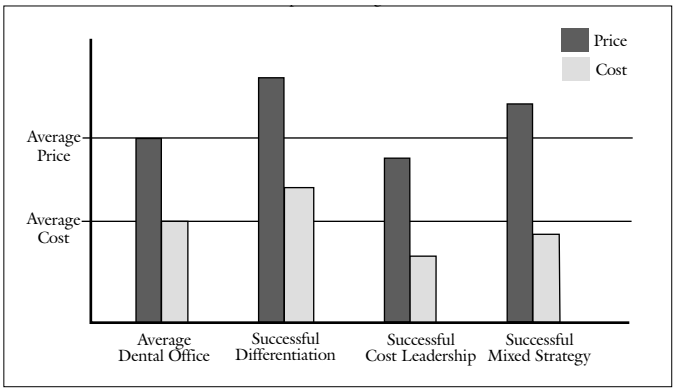

Figure 1: Alternative competitive strategies

Dentists can reduce costs by capturing economies of scale, achieving economies of scope, capitalizing on economies of learning, lowering coordination and organization costs, reducing input costs and, perhaps most importantly, improving operational efficiency.

Capturing Economies of Scale. Economies of scale pertain to the relationship between the size (i.e., the scale) of the practice and average costs. Average costs equal total costs divided by the number of patients. Economies of scale exist when average costs decrease as the scale of the practice increases. Typically, the relationship between average costs and scale is represented either as a U-shaped cost curve (**Fig. 2**) or as an L-shaped cost curve (**Fig. 3**). An efficient scale is one at which average costs are minimized. The smallest efficient scale is called minimum efficient scale, or MES. For the U-shaped curve this occurs at only one size. For the L-shaped cost curve, many scales are efficient.

It is important for a practice to achieve at least MES. Over the past 30 years, the scale at which MES can be achieved has been lowering, such that MES can now be reached with a three-chair office (although it can vary from two to four chairs depending on productivity). Beyond four chairs, managerial difficulties make it hard to benefit from increased size.

Achieving Economies of Scope. Economies of scope are total cost reductions achieved from providing different services in the same practice rather than in separate practices. Most dentists actually enjoy the benefits of economies of scope through the use of auxiliaries, whose services are different from the ones dentists provide. Economies of scope can also be achieved in a two-dentist practice, where one dentist does all the endodontic procedures while the other does all the periodontal and oral surgery procedures. Both dentists would deliver preventive, restorative, cosmetic, and crown and bridge procedures. By keeping the patients in the same practice, average costs are lowered.

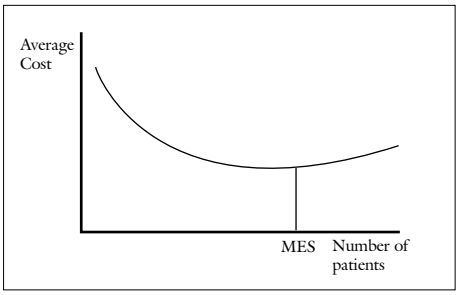

Figure 2: U-shaped average cost curve

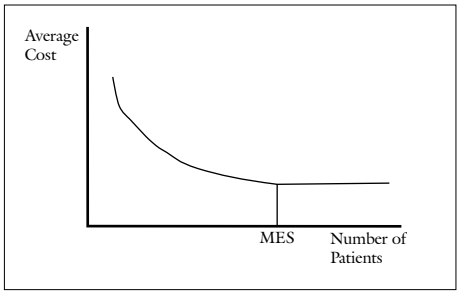

Figure 3: L-shaped average cost curve

Capitalizing on Economies of Learning. In many areas of dentistry, the real (inflation-adjusted) average cost of services has declined over time. Cost reductions can occur as a result of technological and treatment innovations. These cost reductions can be significant. For example, a plasma arc curing light allows dentists to decrease the curing time of composite restorations by 75%. Keep in mind, however, that the early adoption of "new technology" is unlikely to be successful unless it is accompanied by strict cost control.

Reducing Input Costs. The three main input costs are staff, rent, and equipment and dental supplies. Dentists can reduce these costs by:

- bargaining with staff, landlords and suppliers (e.g. negotiating volume discounts)
- buying cheaper (basic or second-hand) technology
- substituting their time with auxiliaries' time.

Lowering Overall Coordination and Organization Cost. The dentist is responsible for the overall structure of the practice, assigning responsibilities and setting up the coordination mechanisms between receptionists, dental assistants, other dentists and hygienists.

- Dentists must drive productivity, not auxiliaries. The faster and more productive the dentist is (i.e., higher levels of dentist-delivered procedures per hour), the larger the staff that can be supported.
- For each hour of dentist and hygienist time scheduled, you need about half an hour of reception/administration. Underestimating the need for reception time results in unfilled cancellations and a poor recall system.
- Hygienist hours are a two-edged sword. Too few or too many hygiene hours are serious strategic mistakes. Generally, it is hard to manage more than 1.5 hygienists (in a practice with a large gross) before queuing generates significant scale diseconomies.
- Office design makes a big difference in efficiency. Some dentists overbuild. Design for a three-chair operatory can vary from 750 sq. ft. to over 1,800 sq. ft. Practice size affects both variable costs (monthly rent) and fixed costs (cost of construction).
- Profit depends on capacity utilization. Unused capacity cannot be stored and is therefore wasted. Dentists underestimate the potential capacity of their dental offices if they ignore the use of extended hours and staggered shifts. The average dentist works approximately 1,600 hours a year. A chair can potentially be filled 14 hours a day, six days a week, 50 weeks a year, which amounts to 4,200 hours a year. Thus, one practice could easily accommodate two dentists who never overlap. The potential benefits to each dentist over a 30-year practice amounts to about $1.6 million.

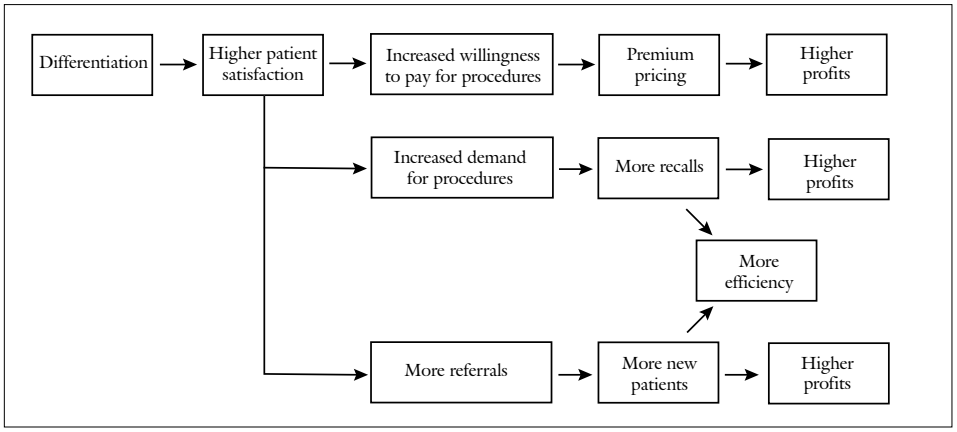

Figure 4: The benefits of differentiation

Improving Operational Efficiency. Dexterity and stamina significantly affect average costs. Dentistry is a physically demanding profession. It is important to be able to perform 'wet-fingered' dentistry quickly. Improving the average dentist's productivity by one procedure per hour increases a practice's gross revenue by almost $96,000 per year. This change represents an improvement in the practice's margin from 30% to 42.5%. The most efficient practitioners can do procedures in less than half the time of less efficient dentists and can produce 112% more dentistry in each hour.

Scheduling efficiency drives many costs — the dentist's procedures delivered per hour, dental supply costs and staffing requirements. Booking a number of patients for the same type of procedure in one block (restorative versus preventive) allows the dentist to use fewer staff at certain times. Also, performing quadrant dentistry (multiple restorations in a single sitting) decreases the seating cost per patient and improves profitability.

As mentioned above, capacity utilization is critical. The receptionist's skills at coordinating patients and the dental team affect optimal capacity utilization. The ability to fill short-notice cancellations has a huge impact on profits.

Differentiation Strategies

A differentiation strategy focuses on increasing customer satisfaction and the amount customers are willing to pay for dental services. Differentiation involves adding quality or features that are valued by patients. The three main benefits of differentiation are patients' increased willingness to pay for procedures, increased demand for procedures and more referrals (**Fig. 4**).

First, higher satisfaction means patients are willing to pay more for dental services. In Canada, however, it is difficult for dentists to price many procedures above the fee guide. Nonetheless, some opportunities exist to benefit from differentiation, especially in major urban areas where there is always room for a number of "carriage trade" practices that charge more than the fee guide (for cosmetic and crown and bride procedures, for example). Higher prices can give a practice "cachet."

Second, higher satisfaction leads to an increased demand for procedures by existing patients, especially for periodontal, hygiene and cosmetic procedures. The practice will therefore experience more recalls and more procedures per patient, which will lead to higher profits. Note that more recalls also improve the operational efficiency of the practice. Thus, differentiation may affect cost-leadership performance.

Third, there is considerable evidence that referrals are based on the quality of the patient experience and that they are a major driver of new business. Like recalls, referrals lead directly to higher profits and improved operational efficiency.

Since dental prices do not vary much, dentists compete for patients primarily on the basis of quality rather than price. Ways to differentiate your services include signalling superior competence, building an attractive office, developing relationship skills, enhancing communication and marketing activities, and emphasizing effective leadership and administration.

Signalling Superior Competence. Because patients find it hard to judge the quality of the services provided by the dental team,

they look for other cues. Dentists may signal superior competence by:

- emphasizing the reputation and quality of their graduate program
- taking extra dental training
- providing leading-edge technology in the reception area, such as Internet access or the Smile Channel
- using leading-edge technology in the operatory, such as dental loupes, intra-oral cameras, computerized patient education systems (e.g. CAESY)
- having access to the best specialists for consultation
- providing before and after photographs in the office.

Building an Attractive Office. Another way to signal quality is through the location and design of the office:

- locate the office in a good neighbourhood
- design the physical layout to high standards, especially the reception area
- place TVs/multimedia in the operatories.

Developing Relationship Skills. Recalls and referrals depend on the communication skills of the dental team. Chemistry is important. The dentist must listen carefully to patients, address their concerns and build a rapport. These skills can be developed through programs such as Toastmasters and Dale Carnegie. Good interpersonal skills by auxiliaries, especially the receptionist, also lead to greater patient commitment.

Enhancing Communication and Marketing Activities. Direct ways to enhance patients' total experience include:

- using ground floor commercial locations
- providing dental services during non-traditional hours
- leaving a range of magazines in the waiting room
- placing a telephone at the front desk for patients' use
- using a variety of comfort-enhancing technologies (nitrous oxide or electronic anesthesia, neck support, back massage pad, CD player with headphones)
- giving out carnations and hot towels at the end of appointments
- making phone calls to check on post-operative progress
- developing practice literature, such as a newsletter
- advertising in the Yellow Pages.

Using Effective Leadership and Administration. Although dentists may not like to accept assignment of patients' insurance benefits, patients value it highly. Other ways to provide patients with value include computerized billing, insurance predetermination, running on time and processing patients' insurance claims for them.

Final Thoughts

All dentists should pay serious attention to cost control. For many dentists, it makes sense to pursue cost-leadership strategies. Others, however, may wish to adopt a mixed strategy and try to reduce costs and add value to the patient experience. The rewards of adopting the strategies outlined in this article are huge: practices in the top quartile earn 434% more net income than those in the bottom quartile. ■

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