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Better Management is Better Medicine®

Budgets: Easy As A, B, C – 2009

Are you feeling the pinch of not enough revenue and too much expense? Don't wait until you hear crunching bones to make a move. There's no better time than now to start charming your practice to better financial health.

The first step's an easy one: as the year comes to a close, think about what you'd like to achieve next year. Then figure out how much it will cost to reach your goals.

The next step is to find a way to make it happen. Many of you likely use your income statements to track your practices' progress, which can leave you frustrated. Income statements can't measure cash flow – which is the lifeblood of a practice. Instead, we recommend using a more comprehensive tool, called a Management Statement™, to measure cash flow and develop a practice budget.

Wait! Don't stop reading because I mentioned the b-word. A budget is simply another diagnostic tool that helps ensure practice health and success. Think of it as a treatment plan for the business side of your practice. Without it, you can't know when your practice's financial health is in jeopardy.

Not sure where to start? First, simplify the budget process by creating a Management Statement™, which will clearly show the sources and uses of cash in your practice. Once you organize your revenue and expense numbers, developing a budget will be much easier.

Tracking your sources and uses of cash

Figure 1 shows a sample Management Statement™ summary. Take these steps to develop your own summary.

1. List total practice revenue. If you operate a mixed animal practice, itemize revenue by companion animal, beef, dairy, and equine practice separately.

2. Group practice expenses into eight categories, defined by their impact on revenue:
   - **Variable expenses** – expenses directly affected by the number of patients seen, including drugs, supplies, lab fees, and vehicles.
   - **Fixed expenses** – expenses that exist regardless of the number of patients seen including phone charges, consulting services, health insurance, and office supplies.
   - **Staff compensation** – Salaries, retirement contributions, and employer payroll taxes for nondoctor staff members.
   - **Facility expenses** – expenses to maintain your facility, such as utilities, repairs, and rent or mortgage payment if you're a sole proprietor.

- **Nonowner veterinarian compensation** – salaries, retirement contributions, and employer payroll taxes for nonowner veterinarians.
- **Owner veterinarian compensation and owner management compensation** – salaries, retirement contributions and taxes for owner veterinarians and management compensation.
- **Reinvestment funds** – money reinvested into medical equipment or other technology.
- **Owner distributions** – payments to owners, other than veterinarian and management compensation.

3. Calculate cash-basis profit. The first measure of profit is the cash available for veterinary and management compensation (owners and associates), after paying all operating expenses. The target range is 36 percent to 42 percent.

   The second measure of profit is the cash available for reinvestment. To calculate this, subtract associates' and owners' veterinary and management compensation from the total cash available for veterinary compensation. This amount represents the owners' return on investment and is available for reinvestment into the practice or other distributions.

4. Format your Management Statement™ by practice type to include:
   - Revenue and expenses for the current month and year-to-date
   - Percentage of total revenue each practice expense represents
   - Target, or budget column, and the difference between actual and budgeted amounts in dollars and percentages

5. Create a revenue summary by practice type to include:
   - Productivity by veterinarian, including total revenue, number of transactions, and average charge per doctor transaction
   - Number of active and new clients and client visitation and retention rates for 12 and 24 months

To calculate client visitation, divide total medical transactions by the number of active clients. To calculate your retention rate, divide active clients by your total number of new clients.

Developing a budget
Before you sit down to create your budget, you need to gather some data. Start with the information you already know – your current year-to-date revenue and expenses. Also consider any additional goals you want to achieve. Holding a strategic planning meeting will help you identify what's important. Lastly, look at benchmarks set by other practices to get an idea of spending levels (See Benchmarks 2009). Keep this data handy as you plan your revenue and expense changes for the coming year. Here's what you should consider.

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1. **Revenue.** How much will revenue grow next year? Consider:
   - Fee changes. For example, implementing a 5 percent increase in your exam fee and value-based services and a nominal increase in your average markup on medications will increase revenue by 5 percent to 6 percent.
   - Additional services. Modify your reminder protocols, focusing on proactive scheduling, and enhancing client education to improve compliance with recommended health care will increase the number of services that you provide – and will affect your revenue.
   - New services. Are you adding a doctor or new technology, such as laser or ultrasound, in the coming year? Or perhaps you're planning to offer new services, such as behavior consulting, rehabilitative therapy, or acupuncture. If so, estimate the number of times you'll provide the service and multiply that by the proposed fee to determine how revenue will change.

2. **Variable expenses.** This category increases in direct proportion to revenue – more patients equals more revenue, equals more use of drugs and supplies. Non-medical variable expenses, such as pet food and over-the-counter retail, will vary from practice to practice, depending on how much is sold. Medical variable expenses – including drugs and medical supplies; heartworm, flea, and tick products; and lab supplies should be consistent at about 17 percent of revenue. Overall, variable expenses should remain consistent as a percentage of revenue from year-to-year at about 24 percent. If your expenses are well-managed, multiply your current expense ratio by your revenue target for the coming year.

3. **Fixed expenses.** These expenses stay relatively stable over a range of revenue. For example, office supplies will likely remain consistent year-to-year, unless you plan to print new brochures, letterhead, or overhaul your client-education materials.

   Areas where you might see significant increases include continuing education – if you're planning additional meetings – and health insurance. Review your current costs and determine which fixed expenses will remain the same and which will increase and by how much.

4. **Staff compensation.** Include cost-of-living and merit increases for current team members. Depending on the economics of your community, you'll need to plan a cost-of-living increase of 2 percent to 4 percent and a 2 percent to 6 percent merit increase for a total increase of between 4 percent and 10 percent.

   Your revenue targets also will affect staff costs. For example, to attain higher doctor production, you may need to hire more staff members. Doctors in Well-Managed Practices℠ generate about $535,000 of medical revenue with a staff-to-doctor ratio of about 4.4 to 1.

Will you need additional staff members to achieve your revenue targets? If so, add the estimated total cost of the additional position(s), including wages, payroll taxes, and other benefits.

5. **Facility expense.** Does your lease agreement call for a rent increase in the coming year? What repairs and maintenance projects do you foresee next year? Do you want to project cost-of-living increases for utilities or property insurance? Decide whether you think your spending in this category will remain consistent with current expenses or increase in certain areas.

6. **Associate compensation.** If doctors are paid on production, apply the established percentages to the revenue targets for the coming year to determine the budget. If associate veterinarians receive a fixed salary, use the same process described in the staff-compensation section.

7. **Owner compensation.** If doctors are paid on production, apply the established percentages to the revenue target for the coming year to determine the budget. If owners receive a fixed salary, plan a cost-of-living increase. Management compensation is based on total revenue, so apply your management fee to the revenue target for the coming year.

8. **Reinvestment.** This category includes loan payments for equipment purchases in prior years and any new equipment purchases planned for the coming year.

9. **Owner return.** Don't forget to plan to have something left. Owner return is whatever's left after paying all operating expenses, veterinary and management compensation, and reinvestment.

Enjoy your improved financial health
Tracking your revenue and expenses and developing a budget provides you with an organized, systematic approach to efficiently measure and analyze your financial performance. The benefits:

- You'll understand which revenue and expense items are important for short-term cash flow.
- You'll know which items are crucial to long-term sustenance and growth.
- You'll be knowledgeable about your cash flow, so you can create action plans to respond to problems or opportunities.
- Most important, keeping the financial aspects of your practice under control helps you stay on track with your goals and gives you freedom to move forward in other areas.

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Figure 1 – Management Statement™ Summary

	Dollar value	Percent of revenue
Revenue	**$1,000,000**	**100%**
Operating expenses		
Variable	$220,000	22%
Fixed	$90,000	9%
Staff compensation	$250,000	25%
Facility	$80,000	8%
Total operating expenses	**$640,000**	**64%**
Amount available for veterinary compensation	$360,000	36%
Veterinary and management compensation		
Non-owner veterinarian	$93,000	9%
Owner veterinarian	$93,000	9%
Owner management	$30,000	3%
Total veterinary and management compensation	**$216,000**	**21%**
Amount available for reinvestment	**$144,000**	**15%**
Reinvestment into practice	**$40,000**	**4%**
Owner distributions	**$100,000**	**10%**
Undistributed remaining amount	**$4,000**	**1%**
		5.9%

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