How to Make Your Practice More Profitable

Mark T. Reilly, DVM, Diplomate ABVP (Equine)

During good times, high business volume can often overcome poor business management. During volatile economic times, the bottom line of the equine practice becomes even more important. Understanding business mechanisms and planning for profit allows equine practices to thrive even in down economic times. Author’s address: South Shore Equine Clinic and Diagnostic Center, 151 Palmer Road, Plympton, Massachusetts 02367; e-mail: mtreilly@ssequineclinic.com. © 2009 AAEP.

1. Introduction

During volatile economic times, the importance of management of any small business becomes obvious and critical. Successful management strategies undertaken during these times will allow borderline practices to stay afloat and enable profitable practices to continue to prosper. If systems are put in place and continue to be followed once the economy responds, profits in the properly managed business will only climb.

Before changes can be made, a basic understanding of business mechanisms and planning is essential. There are many sources of information to get baseline understanding. Some of these sources include online courses or webinars, instructional DVDs, and journal articles. More formal education is available at local colleges and universities, as well as some adult education night courses at high schools. It would behoove the reader to undertake one or more of the aforementioned studies and pursue conversations with practice analysts, financial advisors, and accountants.

2. Definitions

Profit is defined as the monetary surplus left to an employer after deducting wages, rent, and the cost of materials. Simply put, profit is any surplus remaining when all expenses are deducted from revenues. Without profit, there is no possibility for the practice to survive and advance, to pay its staff reasonable salaries and benefits, to buy new equipment, and to be able to eventually sell the practice for a reasonable price that would reflect all the effort that went into it.1

With practice valuations now based on excess earnings (or profit), it has become nearly impossible to sell a practice that shows no or little profit. Practices showing a profit <10% of gross income after paying the principals a fair wage are not attractive investment opportunities to today’s buyer.

Fixed costs are business expenses that are constant for a company regardless of the production level. Fixed costs are those costs that remain constant within a range of business activity, e.g., salaries, rent, insurance, equipment leases, utilities, telephones, and licenses. These are the expenses incurred by the business on a daily basis regardless of the number of patients seen.

By adding up all the practice’s fixed costs per month and dividing it by the total number of hours the practice is open for business (excludes emer-
Emergency visits/calls), one can now calculate the average fixed cost per hour to do business.

For example, a practice with three or four vehicles on the road and a small clinic may have fixed expenses of approximately $60,000. If the practice answers the phones and staffs the clinic from 8:00 AM to 6:00 PM weekdays and 8:00 AM to noon on Saturdays, it would have 54 hours of business per week. The fixed cost per hour of this practice calculates to $258. This would calculate to $4.30 per minute. In other words, the practice needs to produce $4.30 per minute (or $258 per hour) of billable time to pay its fixed costs, without calculating anything for practice profit.

Variable costs can be defined as the cost of labor, material, or overhead that changes according to the change in the volume of production units. Variable costs fluctuate directly in proportion to the level of business activity and include X-ray film, medical and surgical supplies, office supplies, pharmaceuticals, laboratory supplies, etc. This number will vary with the number of horses treated, number of staff members necessary to perform such treatments, and types of drugs and supplies used to do so.

For example, variable costs incurred when performing a Coggins test include the cost of the needle and blood tube to harvest the blood, the time to fill out the test request form, the fee charged by the laboratory to run the test, any shipping fees to transport the sample to the laboratory, staff time to package and label the sample properly, staff time used on receipt of the completed test to file appropriately and to forward the copy to the client, and the envelope and stamp used to send the test to the client. One must also add any salary paid to the veterinarian by the practice for performing the test. Although the laboratory may “only” charge the practice $8.00 for running the test, the other variable costs could easily add up to an additional $12.00 to $15.00.

Combined with fixed costs, variable costs make up the total cost of production. Although the total variable cost changes with increased production, the total fixed cost stays the same.

By adding the variable cost to the fixed cost per hour, we can calculate the cost of providing any particular service. If we look at the costs incurred in injecting one joint (excluding call fees), we find both fixed and variable costs.

Fixed costs include vehicle payments, fuel and vehicle maintenance, insurance, clippers and bucket for water, tray for carrying medications, tinfoil for restraint, facility costs for phone, HVAC, storage location, insurance, receptionist wage, computers, and internet.

If calculated on a time basis for the practice, the fixed costs may total $43.00 for a 10-minute procedure.

Variable costs include cotton, scrub, alcohol, exam gloves for assistant to scrub, sterile gloves for veterinarian performing injection, syringe(s) and needle(s) used in procedure, vial of amikacin, vial of intra-articular medications (hyaluronic acid, triamcinolone), wage for assistant for travel time, prep time, and clean-up, wage for inventory staff member to order, process, and stock medications and supplies, and wage for veterinarian performing procedure.

Variable costs for injecting one joint with one vial of hyaluronic acid, 125 mg of amikacin, and 6 mg of triamcinolone may total approximately $90.00, including the veterinarian salary for performing the procedure. Injecting additional joints would increase variable costs but not in a linear fashion. Some items (gloves, vials, and wages) would be conserved when injecting multiple joints in the same patient.

Now by adding in a profit margin to each aspect of cost (one for fixed costs and one for variable costs), one can arrive at a fee to be charged for any service. In the single joint injection scenario, adding 25% to fixed costs and 25% to variable costs would add $10.75 to fixed costs and $22.50 to variable costs. Therefore, the client would be charged approximately $165.00 for injecting the one joint. Although it seems like a lot of work initially, the data are already available to you from your accounting software (fixed costs) and practice management system (variable costs).

In the example of the Coggins test, we can arrive at a client fee by adding a profit margin to a test fee charged to you by the laboratory plus a profit margin for your efforts in submitting the test (staff and doctor time, materials used, and time to process). By adding 25% to the variable cost of $23.00, we arrive at $28.75. Then, adding a fee for fixed costs of the practice and a profit margin, the client fee will now total approximately $35.00.

### 3. Methods

To increase profits, we are faced with increasing revenues and/or reducing costs. We will first cover a few aspects of reducing costs.

#### Reducing Costs

By managing your costs, you can help improve the profitability of your practice by limiting losses caused by excesses. The two most easily controlled (and largest) costs include payroll and inventory. Managing (or reducing) other costs include effective use of equipment, review of leasing arrangements for equipment, and review of loans. Refinancing and/or restructuring short- and long-term notes is something business owners should be reviewing when interest rates change and become attractive enough to realize a difference. Consolidating lease payments and short-term notes into one practice loan may also be a great opportunity to free up cash flow on a monthly basis.

Benchmarks are available for appropriate allocations (budgeting) of expenses to payroll and inventory. There is much greater agreement from our small animal counterparts on payroll and inventory than there is on the equine or mixed animal side.
On the small animal side, it is typical to see payroll at 18–22% of revenue and to see inventory at 15–18% of revenue.5

On the equine side, there is quite a bit of variability in business structure. Ambulatory only, hospital only, and some mix of each at many different levels exist in equine practice. Ambulatory-only practices will have larger inventory percentages and slightly less payroll numbers. Ambulatory practices should keep inventory costs <25% of revenues and non-veterinary payroll at 17% of payroll. Those practices with a hospital component should be keeping inventory <19% of revenues and non-veterinary payroll at 23% of revenues.4

By monitoring inventory costs monthly as they relate to gross production, it becomes easy to see if proper amounts are being spent. A three-doctor, mostly ambulatory practice grossing $80,000 per month should be keeping inventory below $20,000. Charting historical and actual revenues in a spreadsheet will allow the practice to project revenues for future months. Therefore, budgeting inventory expenses can also be projected and budgeted. Unless unusual or anticipatory seasonal purchases are incurred, discrepancies should be easy to uncover if monitored on a monthly basis.

Similarly, payroll can be budgeted based on historical revenue figures. Keeping monthly payroll below $13,600 for the above-referenced practice would be ideal. Seasonal increases and decreases in revenue should also be represented in a similar fashion in the column for wages. Seasonal and/or part-time employees may prove to be a good option for many ambulatory practices.

Concentrating on inventory by instituting controls, using practice management software capabilities to calculate inventory needs and pricing, and minimizing loss of capture does take diligence. Adjusting payroll may involve difficult conversations with inefficient staff members and budgeting bonuses and pay raises based on practice revenue centers. To be effective, your budget needs to be updated and reviewed regularly (at least once a month) to keep it under control and make any necessary adjustments to keep it on track and achieve your goal for the year.5

It is much harder to make changes that affect other fixed costs without investing considerable time and finances (e.g., energy efficiency, vehicle fuel efficiency, and maintenance). Electric supply companies will perform free energy audits and make recommendations in increasing energy efficiency. Updated fixtures can be installed by the energy provider and paid for over time at no interest. Energy savings are typically recognized within a year. Updating inefficient HVAC units or updating fuel-guzzling vehicles should be considered when maintenance costs start to escalate with older equipment and vehicles. At our practice, we have cut our facility energy costs by 50% within the last 2 yr and are constantly looking for more ways to decrease expenses and reduce our carbon footprint.

Also, one can take advantage of slow times to further educate the staff. One can instruct receptionists on correct methods of giving prices or estimates by first collecting information about the patient, detailing the service requested, and relaying the price as it appears adapted to the patient and its owner. Office staff should directly proceed to scheduling an appointment.6 Holding staff education seminars over lunch or breakfast is a perfect opportunity to help your staff become more productive and valuable to the practice. Information concerning equipment necessary to perform certain services and care for such equipment also reduces the equipment replacement and repair expenses. Helping the staff to understand some of the complexities involved in the costs and decisions will help them to understand and empathize with concerned and emotional horse owners. Staff members will also be able to convey the importance of particular services to clients.

Increasing Revenues
After taking advantage of all cost-cutting opportunities, you may come to the realization it may be very difficult to significantly increase profit by lowering expenses. The best (and possibly simplest) way to significantly increase profit is by increasing revenues.7 Attracting new clients, expanding services, or increasing the performance of underused services within the practice or throughout the practice area should be undertaken. Dentistry is one area of practice that has long been undermarketed and underserved by equine veterinarians. Combined with complete oral exams and dental charting along with nutritional consulting will increase the perceived value of this service.

Having a presence at local shows, feed stores, or holding client education seminars will help your name fall on potential new accounts. Ask your top clients which topics they would like to hear about and learn more. Holding seminars with light refreshments, handing out practice materials, and recording the event as a link on the practice website will help to bond clients to the practice and potentially introduce new clients to the practice.

Expanding hours or offering Saturday morning appointments may be opportunities to reach more clients, especially if clients are unable to take time off from work during tough economic times. Holding a vaccine and Coggins test day on Saturday mornings at a locale to eliminate call charges may help to attract budget-minded clients. Each exposure allows the veterinarian to continue to build the relationship between doctor, patient, and client. Problems can be dealt with at the conclusion of the morning or on a future scheduled visit.

Increasing client compliance by educating clients on the value of such services can increase revenues with minimal expenditure. Using staff to service
patients from their training in laboratory work, treatments, and imaging frees up veterinarian time to provide more value to services through education and client contact time.

Apart from not making and following a financial plan, one of the biggest mistakes many veterinarians make is to not charge properly for their services. Undercharging or discounting services has the effect of reducing income into the practice, which in turn reduces (or eliminates) profits. This may mean a reduction in the ability to provide a reasonable salary for yourself after you have paid all the other costs. Discounting does not attract the sort of clients you want to have—it simply devalues your services and reduces your income. Many practice owners believe clients are attracted by low prices. Of course, if this is the only way they can differentiate between the service level in your clinic and someone else’s, this may be true. However, this is not how providing quality care and quality service develops.

In addition, undercharging because you believe this will make your clients happy simply teaches them veterinary services are not worth much and will encourage them to shop around for even lower prices. Undercharging is basically giving your clients money out of your own pocket, and this ultimately is professional suicide. Setting fair professional fees and charging properly can make a huge difference to the income generated into your practice.

We already discussed proper fee setting: costs plus profit margin. There are some fees that need to be competitive (vaccinations, castrations) and others that are cost based (diagnostic services, laboratory, internal medicine) and typically not shopped. Competitive fees are those that clients perceive no real value from their veterinarian. Of course, you do have an opportunity with every transaction to provide value to your client, reducing the competition of the fee from the client’s eyes. Fees that are not shopped are those that either the client does not have time or expertise to shop (i.e., a sick or injured horse) or those that have innate attached value (surgeries, diagnostic testing).

In 2003, AAHA reported a study that showed when clients are offered the best medical or surgical option for their animal versus an option the veterinarian believes is within the client’s financial means, 90% prefer the former. In other words, start by proposing the best options first and alternatives second.

Competition based on (low) pricing is a very limited way to compete. It restricts creativity; it creates a downward business spiral and eventually kills the business, not only the individual veterinarian’s business, but the overall veterinary business in an area or a country. A healthy price structure with competition based on product and services portfolio, quality, and of course, a responsible price structure will allow veterinarians to earn a decent profit to reinvest in the practice (staff and equipment) and allow growth. A healthy veterinary profession is in the interest of horses and their owners. Price battles among veterinarians restrict developments and limit the availability of services.

To say it another way, if it is the market that determines price, we have some control over the market. If competition is low and demand high, your practice has plenty of latitude to fix its prices. If competition is high and services appear to be undervalued, individualized and personalized service is the one thing only you can offer. It is important to notice that, in this country, the animal health market has been stagnant for the last few years; however, the needs and demand of pet owners for medical services is increasing. This author has repeatedly been told by clients that they expected the bill to be much higher once it has been presented. In fact, most clients surveyed in our clinic responded that they viewed their veterinary expenditures reasonable and of good value regardless of the total bill. This indicates that, regardless of price, clients will choose your services as long as they perceive value and a benefit to their horse.

4. Conclusion

By monitoring expenses and budgeting accurately, one can reduce the cost of doing business. By expanding services and pricing reasonably and appropriately, a practice owner will continue to be able to pay him/herself first, pay the staff competitive wages, reinvest in the practice, and provide requested and necessary service to its patients and their owners. Ultimately, the practice will show considerable profit, leading to the possibility of selling to any number of suitors.

References