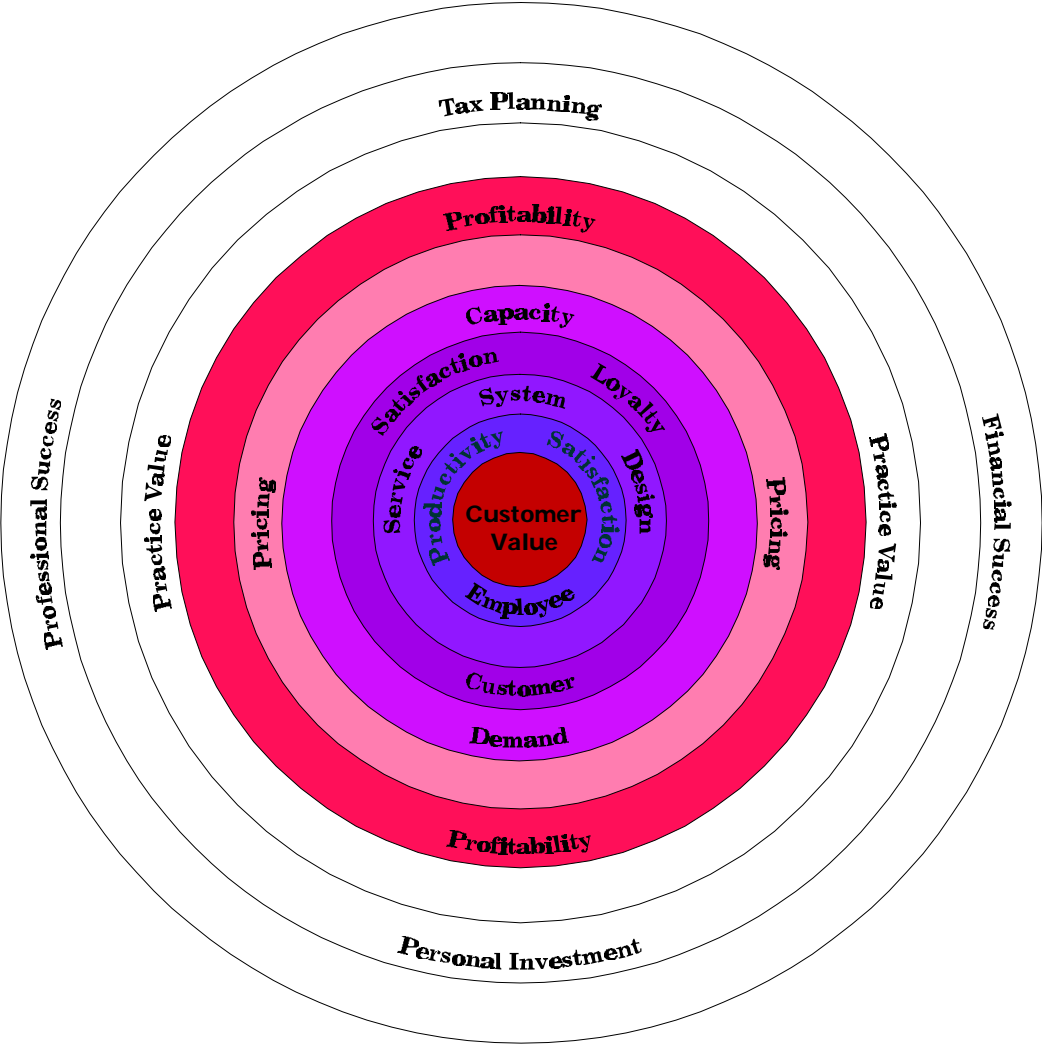


Practice Profit





Practice Profit

The preceding articles have made several references to profit. Like most other service businesses, there are three major drivers of profitability in small animal veterinary practices:

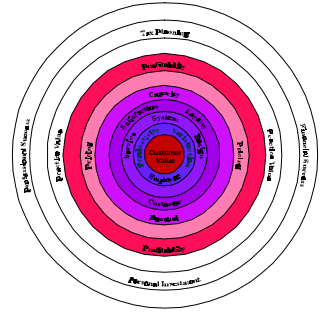
1. Customer Value (service quality)
2. Pricing
3. Matching Capacity to Demand

Each profit driver has been discussed at length in previous articles. Familiarity with the concepts and principals discussed in the related previous articles is imperative before proceeding. These profit drivers are key to the financial success of a small animal practice. Lack of attention paid to any of the three profit drivers will have a negative impact on the bottom line.

It is necessary to be able to measure the financial effects of manipulating and massaging the principal profit drivers. The old adage “what gets measured, gets done” is appropriate to this need for measurement. Previous material has centered around measuring the effects of delivering value to clients. Value equates to client satisfaction which can be measured subjectively by perceptive staff and objectively by intermittent surveys. Other measures of high levels of customer satisfaction and loyalty are the number of annual transactions per client, average transaction per client, average annual revenue per client, and client longevity.

The success of managing the price and capacity profit drivers can be measured by a chart of accounts. A chart of accounts tracks revenue and expense details that allow a post-mortem evaluation of the practice performance. A chart of accounts is a measure of what has happened in the past. An analysis of the chart of accounts will induce a reactive managerial response based on historical data. Although the past is often an indication of the future, more forward thinking is appropriate.

A cash budget is a tool that attempts to forecast the future and the response to managerial actions. A cash budget allows managers to be proactive and to sculpt the future of the business to some extent.



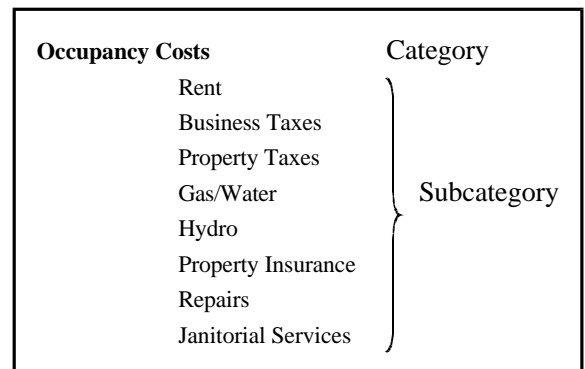
Developing and Using a Chart of Accounts

Maximizing profit is a matter of optimizing revenues and costs. If the process was simple, every business would be much more profitable. Fortunately, the process can be made simpler when revenue sources and expenses are broken into small components that are more readily comprehended.

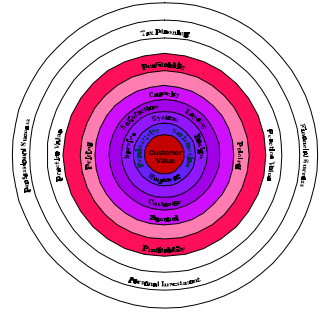
Essentially, a chart of accounts subdivides revenues and expenses into components that intuitively make sense and into components that are known to be important to the subject business.

In a chart of accounts, revenues and expenses are divided into small constituent components (subcategories) that collectively comprise a larger major component (category). This organization simplifies the process of identifying changes that occur within a given practice over time as well as simplifies the comparison of one practice to another.

If discrepancies are noted in overall expenses or revenues, one can first scan the appropriate categories. Once discrepancies are identified in a given category, one can scrutinize the smaller subcategories. For example, one may note that overall the expenses of a practice have increased over those of the previous year. On examining the expense categories of the chart of accounts, it is noted that occupancy costs are up significantly. Upon examining the subcategories of the occupancy costs, it is easy to identify where expenses have changed.



Although detailed charts of accounts of expenses have been maintained for many years through manual systems, computer software packages greatly simplify the process. Accounting software can easily subdivide expenses into categories and subcategories. Practice software can track revenue sources.



The chart of accounts can be subdivided into two sectors:

1. Revenue-independent
2. Revenue-dependent

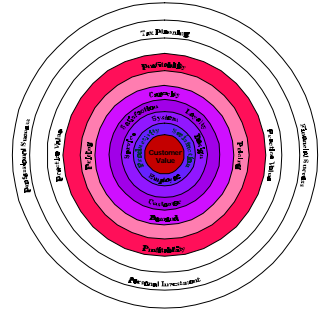
Revenue-Independent

The revenue-independent sector consists of expenses that are normally identified as the operating expenses on the practice income statement. A revenue-independent expense is one that will not change within a given level of business activity. This defining characteristic is easy to identify in some expenses such as rent and utilities. However, the characteristic is less obvious in other expense components such as staff salaries. For a given volume of business, salaries are fixed. One cannot easily alter the level of staffing if the month was busier or slower than anticipated. Yet the expense of salaries can be altered over the long-term much easier than that of rent or other revenue-independent expenses. Overall, revenue-independent expenses are hard to alter. These expenses are ones that have been committed to in order to provide the capacity felt appropriate to accommodate an anticipated level of business activity (demand).

Comparing these expenses over different periods of time or between different practices will identify varying levels of efficiency. The comparison may be done in absolute dollar amounts or expressed as a percentage of gross revenue. If the expenses are expressed as a percentage of gross revenue, comparisons can be made over periods when revenues were significantly different and can be made amongst practices of different sizes.

The earlier example of discrepancies in occupancy costs can be further developed:

Gross Revenues	\$425,000		\$430,000.00		1999 - 1998	1999 - 1998
	1998	% of Revenue	1999	% of Revenue		
Occupancy Costs	\$36,800	8.66%	\$45,300	10.53%	\$8,500.00	1.88%
Rent	\$24,000	5.65%	\$25,000	5.81%	\$1,000.00	0.17%
Business Taxes	\$3,200	0.75%	\$3,300	0.77%	\$100.00	0.01%
Property Taxes	\$2,400	0.56%	\$2,500	0.58%	\$100.00	0.02%
Gas/Water	\$1,200	0.28%	\$1,250	0.29%	\$50.00	0.01%
Hydro	\$800	0.19%	\$850	0.20%	\$50.00	0.01%
Property Insurance	\$1,000	0.24%	\$1,100	0.26%	\$100.00	0.02%
Repairs	\$3,000	0.71%	\$8,000	1.86%	\$5,000.00	1.15%
Janitorial Services	\$1,200	0.28%	\$3,300	0.77%	\$2,100.00	0.49%



It is readily apparent that the occupancy costs increased by \$8,500, while revenues increased only by \$5,000. It is further apparent that a significant component of the increased occupancy cost was due to increases in repairs and janitorial subcategories. Hopefully, this expense pattern constitutes good news as these expenses are probably more easily controlled in the future.

Revenue-Dependent

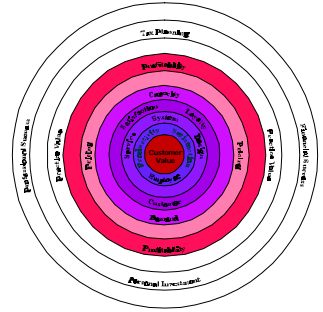
This sector of the chart of accounts includes data on both revenues and expenses. The revenues are normally included as a single-line item in the practice income statement. Revenue-dependent expenses are normally grouped into a single-line item on the income statement, labeled “cost of goods sold”. These costs will change with the level of business activity. They can also be influenced by an increase or decrease in the level of inventory.

As is similar to revenue-independent expenses, subdividing revenue and related expenses into categories and subcategories is very beneficial when making comparisons and identifying changes and discrepancies. Unlike revenue-independent expenses, each revenue-dependent expense has an associated revenue source. Tracking both revenue and expense items to a given category or subcategory permits a calculation and comparison of contribution to profit.

Following is an example for the pharmacy category:

Pharmacy	1998 Revenue	1998 Expense	Profit Contribution	1999 Revenue	1999 Expense	Profit Contribution	Change in Contribution
General Medications	\$48,000	\$24,000	\$24,000	\$54,000	\$34,000	\$20,000	-\$4,000
Preventative Medications	\$22,000	\$14,000	\$8,000	\$24,000	\$14,750	\$9,250	\$1,250

In this example, initial exuberance at the 1999 increase in revenue from pharmacy disappears when it is realized that the contribution to profit is \$4,000 less than that experienced at a lower revenue level in 1998. The effect of the managerial decision to reduce the markup on those “expensive medications” has become apparent .



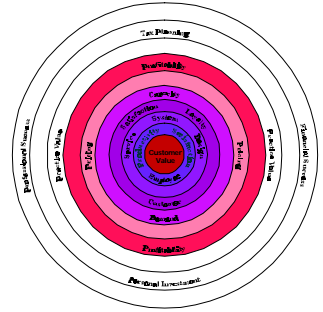
A chart of accounts is a detailed historical record of a practice's activities. It allows significant insight into "how and why" forces internal and external to the practice have influenced the financial operation of the practice. A chart of accounts further allows managers to make decisions based on this historical data.

Historical Measures

Although the chart of accounts should be scrutinized to the level of its finest detail, much information can be gleaned by exploring capacity utilization. The two areas of capacity that are of interest are staff capacity and facility capacity.

The actual dollar costs of occupancy and staff can be compared to the historical costs. This comparison will alert managers to significant changes in the cost structure of the practice. However, profit is a factor of both cost and revenue, and much more is learned about capacity utilization when costs are expressed as a percentage of total revenues. High dollar costs are more acceptable if accompanied by high revenues. Cost-to-revenue ratios allow comparisons of capacity utilization over periods of differing revenues. The ratios also compare capacity utilization across practices of any size and to that of industry averages. A further measure of facility capacity is the revenue generated per square foot of practice facility.

Detailed historical information on revenue sources reveals changes in revenue sources that have occurred over time. These changes can be assessed relative to known industry changes or to managerial decisions and efforts that have had an influence, whether intended or not.



Cash Budget

Maintaining a chart of accounts constitutes approximately 80% of the effort needed to develop and maintain a cash budget. A cash budget is forward looking and enables those proactive managerial decisions that will increase profitability.

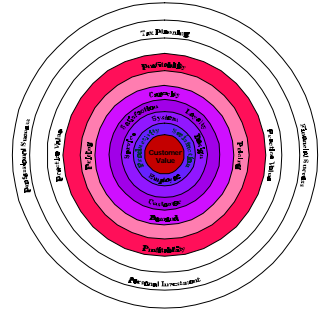
It is important to note that maximizing profit is a matter of optimizing revenue and not maximizing revenue. Similarly, maximizing profit is a matter of optimizing costs and not minimizing costs.

The cash budget should have the same format as the chart of accounts. Historical monthly data is used to forecast the effect of managerial decisions related to cost control or revenue generation. Monthly statements are prepared that include historical as well as projected changes. The influence of managerial changes can be monitored on a monthly basis by comparing monthly performance to forecasted and historical performance. Favorable outcomes to managerial changes should encourage increased human and financial resource utilization to capitalize on the change. Conversely, unfavorable outcomes may induce an alteration of the implemented change.

The point of the cash budget is to plan proactively, measure results, and further continue planning. The greatest gains in profitability will be achieved through efforts to influence the three profit drivers (customer value, pricing, and matching capacity to demand).

Many of the expenses categorized as revenue-independent are related to either the staff or facility capacity. The staff and facility are pivotal to the delivery of high-quality service and client value. Customer value has already been identified as the driver of demand for services and of the resulting practice revenues. The value offered by a practice may be sacrificed by minimizing expenses associated with staff and occupancy may

The effects of minimizing costs associated with occupancy may result in a substandard appearing facility. The substandard facility may be used by clients as an indicator of the quality of care provided by the practice. Low-paid employees may lack skills and job satisfaction that are necessary to provide good customer service which in turn creates highly satisfied and loyal clients.



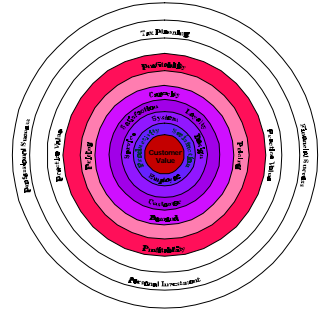
Unfortunately, profitability and practice growth are not generated by minimizing revenue-independent costs. Practices must make judicious decisions regarding cost control. Monitoring levels of client satisfaction helps in making decisions regarding cost control of staff and facility. Utilization of appropriate financial resources is accompanied by high levels of client satisfaction and acceptable cost to revenue ratios.

Establishing a Chart of Accounts and Cash Budget

No “canned” software program will satisfactorily analyze the data obtained from the chart of accounts or forecast appropriately for a cash budget. The best analytical tool is an electronic spreadsheet. The data that originates from accounting and practice software (or manual systems) is input into the spreadsheet, from which appropriate comparisons and forecasts can be made.

Only the most basic functions of the spreadsheet are needed to provide extremely useful comparisons or forecasts. These functions can be self taught or learned through many computer training seminars. Alternatively, a high-school student could help with the spreadsheet functions.

Following is an example of an appropriate chart of accounts.



Revenue-Independent

Occupancy Costs

- Rent
- Business Taxes
- Property Taxes
- Gas/Water
- Hydro
- Property Insurance
- Repairs
- Janitorial Services

Nonprofessional Wages & Benefits

- Technician Salaries
- Reception Salaries
- Administration Salaries
- Kennel Salaries
- Other Salaries
- Group Insurance
- Health Tax
- Benefits (EI / CPP)

Professional Wages & Benefits

- Professional Salaries
- Professional Contracts
- Specialists
- Benefits (EI / CPP)
- Locums
- Professional Dues

Partners' Drawings

- Partner 1
- Partner 2

Office Overhead

- Office Supplies
- Computer Supplies
- Printing
- Phone
- Postage

Promotion

- Advertising
- Gifts
- Charitable Gifts

Education

- Seminar Costs
- Subscriptions & Books
- Staff Meetings

Financing

- Bank Charges
- Interest Operating Loan
- Interest Long-Term Debt

Collection & Accounts

- Bad Debt
- Collection Costs
- Refunds
- Returned Cheques

Professional Service

- Legal
- Accounting

General Expenses

- Automotive
- Travel & Entertainment
- Life Insurance

Miscellaneous

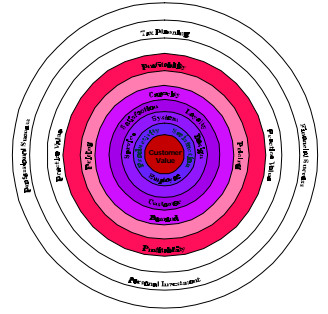
- Waste Disposal
- General Supplies

Equipment

- Repair & Maintenance
- Lease

Sales Taxes

- GST
- PST



Revenue-Dependent

	Revenue	% of Revenue	Expense	% of Revenue	Contribution to Profit
Outpatient Services & Immunizations					
Consultation					
Vaccines					
Euthanasia					
Cremation					
Laboratory Service					
Laboratory In					
Laboratory Out					
Surgical Services					
General Surgery					
Spays					
Neuters					
Anesthesia					
Gases					
Injectables					
Sedatives / Pain					
Inpatient Services					
Hospitalization					
Medications Administered					
Intravenous Fluids					
Dentistry					
X-Ray					
Film					
Developing Supplies					
Ancillary Services					
Boarding					
Grooming					
Retail Sales					
Diet Sales					
Supplier 1					
Supplier 2					
Supplier 3					
Other Suppliers					
Pharmacy					
General Medications					
Preventative Medications					