The No-Lo Practice

Avoiding a Practice Worth Less

Shock! Disbelief! Owners are devastated when they learn their practices are worth only a fraction of what they anticipated as they approach retirement and contemplate a sale. But if you can understand why this occurs and identify if your practice is at risk, you can begin the process of recapturing this lost value for your practice.

Sponsored by VetPartners (formerly the Association of Veterinary Practice Management Consultants & Advisors—AVPMCA

Executive summary

Veterinary practice appraisers have always observed a relatively small pool of low-value practices. Often referred to as Mom-and-Pop practices, these generally consist of solo practitioners delivering dated medical services from poorly equipped, marginal facilities and producing low profits each year.

But in recent years, appraisers have seen an increase in the number of practices with no value or an exceptionally low value (*i.e.*, No-Lo Practices℠). Quite unexpectedly, appraisers are also observing a significant change in the mix of practices occupying the low-value end of the spectrum. In addition to the normally predominant Mom-and-Pop practices, this end of the spectrum is currently experiencing an increase in the number of practices traditionally expected to be profitable—practices that offer quality, progressive medicine with the latest equipment; are located in new, state-of-the-art facilities; and offer above average compensation packages to doctors and staff members. Owners in these practices may take home more than $200,000 per year but still have No-Lo Practices.

The common thread linking all these practices is poor profitability in relation to gross revenue generated. To make matters even worse, most owners of these low-profit practices are not even aware of their perilous financial situation and discover the gravity of their situation only as they prepare to put their practices on the market.

If you are a practice owner or potential buyer, this publication is a must-read. It includes a discussion about how the trend developed and the common symptoms of a No-Lo Practice. A worksheet specifically designed to estimate a practice's true profitability is provided so a practice owner can determine if he or she owns (or is at risk of owning) a No-Lo Practice. This publication also identifies the underlying causes of having a low practice value. Finally, and most importantly, this publication provides practical information about how to restore profitability and recapture the lost value for your practice.

VetPartners (formerly the Association of Veterinary Practice Management Consultants & Advisors—AVPMCA) is taking a leading role in educating practice owners about this highly debilitating trend in the veterinary industry. Now it is your turn to help reverse the trend. We need you, the practice owner, to become engaged and proactive about assessing your practice's true profitability. Reading this publication in its entirety is your first step in ensuring your personal financial security.

—VetPartners Veterinary Valuation Resource Council

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Answer this question: Do you view practice ownership as job security or as an investment?

When this question was asked of both general and specialty practice owners who attended recent seminars, the answers were mixed. Those who saw ownership as job security praised the autonomy and control they gained by becoming owners. Those who viewed practice ownership as an investment reported varied expectations. Some said they were content to break even (*i.e.*, just get the bills paid every month), while others said they expected returns on their investment as high as 25% or 30% each year.

Most owners want their practices to provide them with more than mere job security. They want practice ownership to act like an investment and to build wealth for their retirement or for their heirs. But for ownership to act like an investment, owners have to view their practices as investments. See *Figure 1* to learn how.

If you own or you plan to own a veterinary practice, you owe it to yourself to keep reading. The steps you take now can have a significant impact on your practice value and your ability to attract a qualified buyer. Even if your practice generates enough money to meet your personal and practice cash flow needs, would a potential buyer find that sufficient? Your needs are different from what a buyer may expect from your practice. After

Figure 1. How to view practice ownership like an investment

What is your risk of ownership? What reward do you expect to receive for taking that risk?

If you were to invest money in stocks or bonds, you would most certainly analyze the risk vs. the expected return. Is investing in General Electric shares or Treasury bills more or less risky than owning a veterinary practice? Small businesses are almost always more risky. Why does this matter? Because to take a greater risk, investors need to (and expect to) earn a greater return. Otherwise, they won't invest. The bottom line: You should expect a financial reward from owning your practice that is greater than the financial reward if you invested your money in a less risky product such as government bonds, stocks in stable public companies, or savings accounts.

What is your current return on your investment in your practice?

Now that you've discovered that small business ownership is a risky endeavor, you need to determine if you are being adequately rewarded for the risk you are taking with the money invested in your practice. What is your current return on investment?

To determine this, you must step outside your practice and examine it as a potential investor. Pretend you are a silent partner. What amount of money would flow to you while sitting at home if the practice continued to use your money but without your active presence? All the functions you perform in the practice would have to be done by someone else who is fairly compensated for this work. All the expenses would have to be paid before you, as an investor, could get any reward. Your return from the practice is what flows to you sitting on your sofa at home while the practice carries on without you.

This amount can be compared to passively owning shares in General Electric or buying a Treasury bill. Your return on investment comes from:

1. Distribution of your share of the current profits
2. Long-term appreciation in the value of your practice, an amount you receive only when you sell.

This is exactly how a practice valuator views your practice.

all, a buyer will be making payments on debt to acquire your practice and will expect the practice to generate those funds.

Just as you recommend regular exams for your clients' animals, you need to conduct a self-exam on your practice's health. In particular, you need to examine your true profit, which is an important component of practice value. Unfortunately, that hasn't been easy to do. The accounting principles that drive the reports you see are largely tax-driven (*i.e.*, your financial statements are designed to minimize your profits to reduce your income taxes, not to give you a snapshot view of your practice's financial health).

In the absence of a reliable method for knowing if your practice is financially healthy and thus building value, you may own a practice that has little or no value. In the last few years, the number of practices with no value or low value has increased—to the point where the VetPartners coined the term No-Lo Practice to describe these businesses.

This insidious disease is particularly dangerous because owners are often caught totally unaware until they try to sell the practice and a qualified practice appraiser gives them the bad news. That's much too late—by then the practice may be too infected and too diseased for short-term treatments to cure the illness quickly. As valuators, we don't like giving owners bad news, so we want to help you self-diagnose if you have a problem and show you how to fix it before it's time to sell.

History

To a certain degree, historic methods employed to estimate practice value played an inadvertent yet causative role in the development of today's No-Lo Practice. Ever since the appearance of the first small animal practices, owners were in a quandary about what their practices were worth when it came time to sell. Gradually, over time, rules of thumb developed. These were deceptively simple, easy to understand formulas that allegedly provided a quick and dirty determination of a practice's value. The most common and most enduring of those rules was one that simply stated, "A practice is worth one year's revenue." This single rule governed the sale of thousands of practices during the last half of the twentieth century, and it lingers today.

> **"The biggest mistake made by practice owners is to assume all the money they take home from the practice (*e.g.*, salary, management fee, rent) is their return on investment or profit."**

Despite common use, these rules were seriously flawed. Most of the rules' simplistic formulas were based solely on a practice's ability to generate revenues and totally ignored a practice's ability or inability to generate profits. This was a serious deficiency. For example, a practice could sell at one times gross revenue (a high value), yet in reality, the practice could be barely profitable, leaving the new owner struggling to find sufficient profits to maintain operations, invest in staff and equipment, and pay down debt related to the practice purchase. In essence, the use of a revenue-based rule of thumb, in many circumstances, could inadvertently establish the foundation for a No-Lo Practice.

Historically, for most rules to work at all, a 10-year or longer repayment period was essential because inadequate cash flows from practice operations didn't allow for shorter payback periods on practice acquisition debt. Inadequate cash flows to pay down debt are a symptom of the rules' most serious shortcoming: there was no link between revenue and profits. But common sense suggests that if two practices both gross $1 million, wouldn't you rather own the one that produced higher profits?

In the last 20 years, the veterinary practice marketplace has changed considerably. Appraisal methods have become more sophisticated and are based on a practice's profit-generating capabilities. These profit-oriented methods have almost totally replaced the old rules of thumb, and the one-times-gross rule is only a myth—even

though it continues to pervade the minds of some owners.

Financing has changed, too. Years ago, the primary means for financing the sale of a practice was through the owner: the seller also became the lender. Today, commercial cash flow lenders are an integral component of the market, assuming the financial risks previously taken by the seller. These lenders understand the importance of profits as the source of their repayments.

Occasionally, a practice owner still offers to finance the buyer. That seems to happen when a practice appraiser or cash flow lender insists that a practice is worth less than the seller wants, so the seller goes for the quick fix: become the lender and seller-finance the buyer. The hope is that by doing so, the seller will actually receive the inflated price. While that may ease the buyer's short-term cash flow issues, it doesn't address the underlying issue: it takes profits to generate the money to repay debt. If the buyer increases future profits, it's the seller—not the buyer—who is being rewarded for the buyer's efforts to operate and grow the practice because of the inflated selling price.

Yet the rules of thumb live on despite the advancements in the veterinary marketplace and despite the often-repeated warnings of the hazards of using revenue-based formulas that ignore profits. Some practice owners today still believe their practice is worth one year's gross revenue. Other owners clamor for a mythical percentage of revenue that establishes the desired value of their practice. Such a formula does not exist. Knowingly or unknowingly, when reverting to these antiquated rules of thumb, owners effectively try to take profits out of the mix when determining practice value. In so doing, they set their practices up to be potential No-Lo Practices.

Finally, a correlation may exist between the expectations of younger doctors and the increase in No-Lo Practices. Many owners have observed in the last few years that younger doctors are less willing to work long hours but have high expectations for compensation and benefits. They place an increasing emphasis on work-life balance, value flexibility in scheduling, and seek attractive, well-equipped facilities as desirable places to be employed. That puts increasing pressure on practice owners to build and maintain those facilities, buy or lease the latest equipment, offer attractive compensation packages, and accommodate their associates' needs wherever possible.

However, a balance must exist between what the practice can afford and what the practice pays. Focus on maintaining that balance seems to get lost in many No-Lo Practices, where owners expect the practice to grow into a higher expense structure much sooner than actually happens.

Clinical signs of the No-Lo Practice

Imagine you are a practice owner a year before you plan to retire. You've spent the last 30 years building a small animal practice that is now debt-free and operates from a modern and attractive hospital facility you own. You feel your practice is very valuable because of the cash you are able to pay yourself each year—as the sole owner of this unincorporated business, you take home more than $275,000 per year. Your two very capable associates are interested in forming a partnership and buying your practice when you retire.

In anticipation of the sale, you hire a veterinary practice appraiser who asks you for data about your practice, analyzes the data, and gives you a report saying that your practice—which grosses $1.5 million annually—is worth only $210,000. You are stunned! How can that be? You say to yourself that the appraiser must have done something wrong, so you call her.

The appraiser then tells you that a primary determinant of practice value is the earnings the practice operation delivers to the owner. You remind her that your practice generated a respectable $275,000 for you last year. The appraiser acknowledges this, but she further tells you that the $275,000 you draw from the practice actually represents several different payments (see *Figure 2*, page 6).

First, because you are a sole proprietor and don't pay yourself a salary as an employee, part of that sum represents payment for your services as a veterinarian. Since you personally produce $375,000 annually, the appraiser tells you that 22% of $375,000 is a reasonable approximation of what it would cost to replace your production with that of an experienced veterinarian, so this $82,500 represents payment for your services, before payroll taxes. In addition, you were entitled to be paid for your management services. Owner management compensation in a practice this size would normally be 2% to 3% of gross fees. At 2%, your management compensation would then have been 2% of $1.5 million, or $30,000.

Second, a commercial real estate appraiser valued the hospital facility at $1.2 million, and fair rent on that facility was determined to be $120,000 per year.

Figure 2. Net profit: A striking example

Whether you continue to own the facility and charge a fair rent to the buyers or whether you choose to sell the real estate now, the practice will have to pay a fair rent to someone to continue to use the facility.

Finally, the appraiser reminds you that the difference between the $275,000 you are drawing and these expenses (*i.e.*, $82,500 for your veterinary compensation, $30,000 for management compensation, and $120,000 in fair rent) leaves only $42,500 as net profit from this practice. But that suggests that this practice is not very profitable based on today's standards (*i.e.*, a $42,500 profit on $1.5 million of gross fees represents only a 2.8% net profit, which is very low for the industry).

The $42,500 doesn't provide the buyers with enough cash flow to service all the debt. Furthermore, the appraiser reminds you that your practice's growth in gross fees, the number of new clients, and average transaction charges are nominal, which you acknowledge is probably because you've been coasting a bit in anticipation of retirement. You have not adjusted fees regularly as costs have risen, and you haven't been as active in the community as you used to be.

Is this the kind of news you want to get just as you're ready to retire? You thought your practice was worth somewhere between $1.2 million and $1.5 million, based on gross fees. How could you have been so far off?

Diagnosis

Unknown to you, your practice was showing No-Lo symptoms for several years. Lack of profitability is the single most critical underlying factor resulting in a No-Lo Practice. But the second most common factor was on display as well: a lack of owner awareness that the practice was poorly profitable.

A No-Lo Practice is frequently either a mature practice owned by a solo practitioner approaching retirement age with no debt, or a larger multi-doctor practice with high fixed costs from a facility that's too large or too expensive in relation to its revenue. Surprisingly, a No-Lo Practice often is a high-quality, attractive, and well-equipped business. Some are specialty practices or even specialty referral centers.

Other symptoms can include:

- Large, new facilities that generate little growth in either revenue or profits
- No or artificially low rent paid to the facility owner, who is also the practice owner
- High payroll costs as a result of being over-staffed or from paying high labor costs necessary to compete in a tight local labor market
- A practice location where client demographics are marginal—with limited discretionary income and/or a shrinking population
- Infrequent or inadequate fee increases as costs rise
- Periodic cash flow crunches characterized by a lack of cash reserves to cover the normal seasonality of veterinary practices
- Increasing client accounts receivable (*i.e.*, clients don't pay at the time services are rendered)
- Excessive giveaways and service discounts
- Excessively high inventory levels and poor inventory management
- Lack of internal financial management systems (*i.e.*, owners watching the bank balance but not the metrics)
- Major equipment acquisitions but minimal training and limited use of that equipment, resulting in inadequate revenue production associated with the equipment
- Continual reliance on debt as the means to finance or lease ongoing equipment and technology needs, rather than relying on cash from prior practice profits
- Associates who drive newer cars, have more time off, and get better benefits than the owner
- Inability to fund full retirement options for the owner(s).

To make the diagnosis of a No-Lo Practice easier, VetPartners has developed a worksheet called the No-Lo Practice Threat Advisory Worksheet. Any practitioner or practice manager

can use this worksheet to arrive at an estimated level of true profitability for his or her practice. Further, based on the profitability, it also forecasts the relative threat of being a No-Lo Practice.

The Threat Advisory Worksheet

See *Figure 3* (page 8) for a copy of the No-Lo Practice Threat Advisory Worksheet. The worksheet and detailed instructions for completing it, including where to find the correct information in your financial data, are also available at www.vetpartners.org. The worksheet can be completed manually by printing a copy and filling in the blanks, or it can be done in Microsoft Excel by using the worksheet format available on the webpage.[1] The first thing a user should do is print the instructions, which provide step-by-step directions for completing the worksheet.

The worksheet requires that you enter only a few numbers to get a snapshot view of your estimated true profitability. Our goal was to make the worksheet as user-friendly as possible, which means that we have built in certain estimates and assumptions that may well be different from those in a complete valuation report. However, the worksheet will help you learn more about your practice's financial results.

Here's what one user told us: *"We found this to be an extremely useful and simple tool. It evaluates the critical issues without getting bogged down in detail, explains why adjustments are needed and where to find the numbers, and can be used effectively no matter how your practice is legally organized. Best of all, it comes down to a bottom line that explains where you stand. I appreciated its straightforward and easy-to-use format and instructions."*

—Diane S. Reeves
Northeast Veterinary Hospital
Seattle, Wash.

If your practice scores in the yellow, orange, or red areas of the worksheet, you need to do further analysis. Because the worksheet cannot cover all possible practice scenarios, yours might be a rare case where the worksheet presents an overly pessimistic conclusion. However, the worksheet has been found to be quite accurate in identifying practices that have—or are moving toward—low practice values. If the worksheet shows that your practice is threatened, what should you do?

Q: How do you know if you have a No-Lo Practice?
A: You score severe or moderate on the No-Lo Practice Threat Advisory Worksheet.

Treatment

Keep this in mind as you read this section: With adequate investigation into the underlying causes, almost all No-Lo Practices can recover and become increasingly profitable once again. This disease is treatable! Remember, though, that lost profits cannot be recaptured, so don't delay treatment. Every dollar of lost profit represents $3 to $5 of lost value.

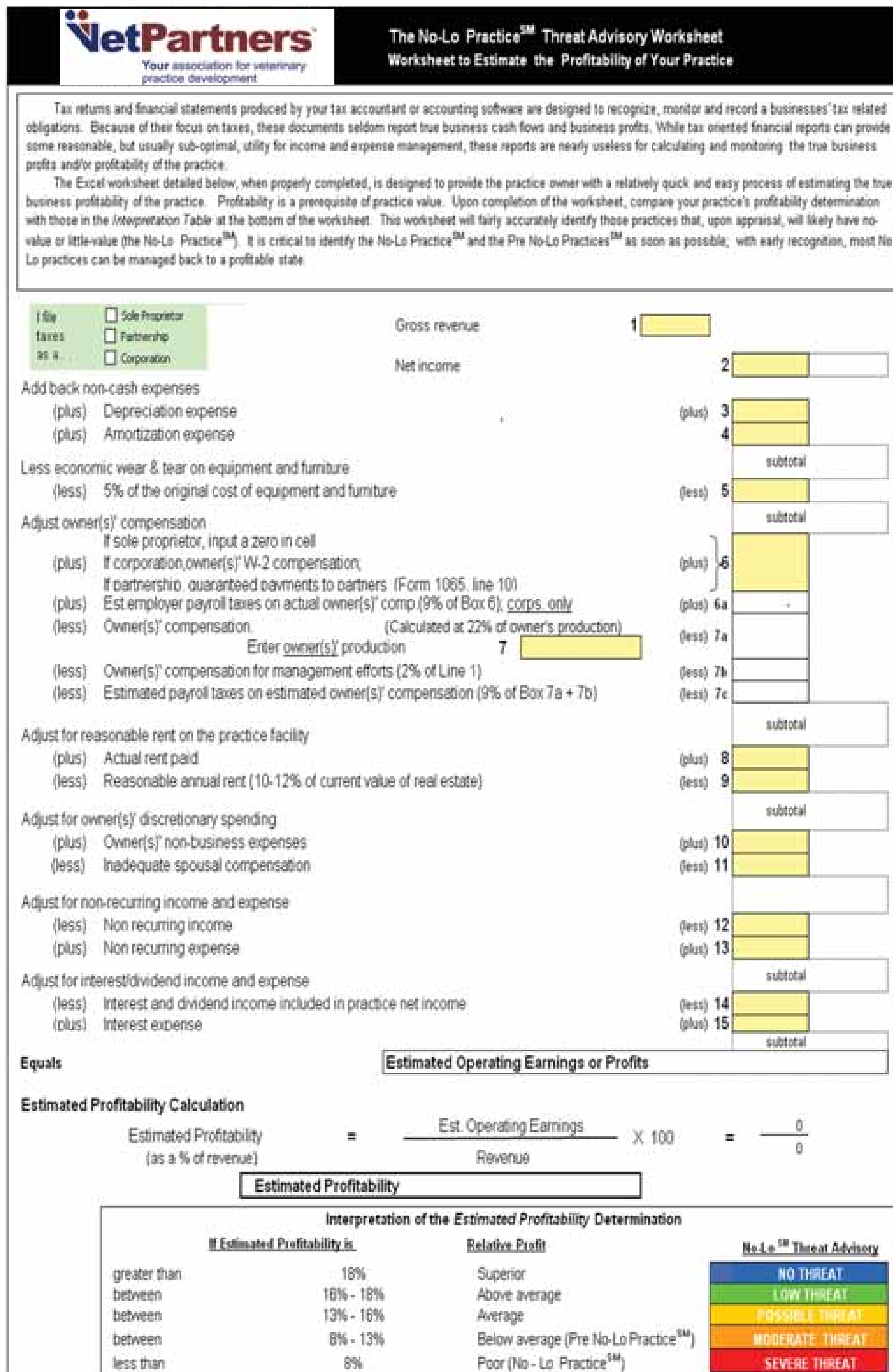
The first step in treating a No-Lo Practice condition is acknowledging that profit is not a four-letter word. Practice profits enable owners to pay reasonable salaries and benefits, cover all operating expenses, reinvest in the practice by maintaining and upgrading equipment, and still earn a reasonable return on the owner's investment. If your practice scored poorly on the threat advisory, then the second step is determining why profit is low. To improve practice profit, you must either reduce operating expenses or grow revenue (or a combination of the two).

It is helpful to observe the cash flow that occurs in a successful and profitable start-up practice. *Figure 4* (page 9) presents a graphic representation of cash flow and how it relates to the practice's financial statement. In the very beginning, an investment in capital is made.

The funds for this investment originate from a combination of equity capital (savings and similar funds from the owner) and from liability or debt capital (loans from banks or other lenders). Using this invested capital, the start-up owner purchases various tangible assets such as inventory, equipment, and leasehold improvements. Using these assets, the owner opens the doors and begins to deliver medical services to clients, generating the first revenues. In the process of providing these services, the owner incurs expenses that are paid from the generated revenues.

1. Be sure to enable macros when you open the worksheet, which might require that you adjust your security settings in Microsoft Excel.

Figure 3. Threat Advisory Worksheet



VetPartners
Your association for veterinary practice development

The No-Lo Practice℠ Threat Advisory Worksheet
Worksheet to Estimate the Profitability of Your Practice

Tax returns and financial statements produced by your tax accountant or accounting software are designed to recognize, monitor and record a businesses' tax related obligations. Because of their focus on taxes, these documents seldom report true business cash flows and business profits. While tax oriented financial reports can provide some reasonable, but usually sub-optimal, utility for income and expense management, these reports are nearly useless for calculating and monitoring the true business profits and/or profitability of the practice.

The Excel worksheet detailed below, when properly completed, is designed to provide the practice owner with a relatively quick and easy process of estimating the true business profitability of the practice. Profitability is a prerequisite of practice value. Upon completion of the worksheet, compare your practice's profitability determination with those in the *Interpretation Table* at the bottom of the worksheet. This worksheet will fairly accurately identify those practices that, upon appraisal, will likely have no-value or little-value (the No-Lo Practice℠). It is critical to identify the No-Lo Practice℠ and the Pre No-Lo Practices℠ as soon as possible; with early recognition, most No Lo practices can be managed back to a profitable state.

I file taxes as a... ☐ Sole Proprietor ☐ Partnership ☐ Corporation

Gross revenue — 1

Net income — 2

Add back non-cash expenses
- (plus) Depreciation expense — (plus) 3
- (plus) Amortization expense — 4

subtotal

Less economic wear & tear on equipment and furniture
- (less) 5% of the original cost of equipment and furniture — (less) 5

subtotal

Adjust owner(s)' compensation
- (plus) If sole proprietor, input a zero in cell; If corporation, owner(s)' W-2 compensation; If partnership, guaranteed payments to partners (Form 1065, line 10) — (plus) 6
- (plus) Est employer payroll taxes on actual owner(s)' comp (9% of Box 6); corps only — (plus) 6a
- (less) Owner(s)' compensation. (Calculated at 22% of owner's production) — (less) 7a
  - Enter owner(s)' production — 7
- (less) Owner(s)' compensation for management efforts (2% of Line 1) — (less) 7b
- (less) Estimated payroll taxes on estimated owner(s)' compensation (9% of Box 7a + 7b) — (less) 7c

subtotal

Adjust for reasonable rent on the practice facility
- (plus) Actual rent paid — (plus) 8
- (less) Reasonable annual rent (10-12% of current value of real estate) — (less) 9

subtotal

Adjust for owner(s)' discretionary spending
- (plus) Owner(s)' non-business expenses — (plus) 10
- (less) Inadequate spousal compensation — (less) 11

Adjust for non-recurring income and expense
- (less) Non recurring income — (less) 12
- (plus) Non recurring expense — (plus) 13

subtotal

Adjust for interest/dividend income and expense
- (less) Interest and dividend income included in practice net income — (less) 14
- (plus) Interest expense — (plus) 15

subtotal

Equals — **Estimated Operating Earnings or Profits**

Estimated Profitability Calculation

Estimated Profitability (as a % of revenue) = Est. Operating Earnings / Revenue X 100 = 0 / 0

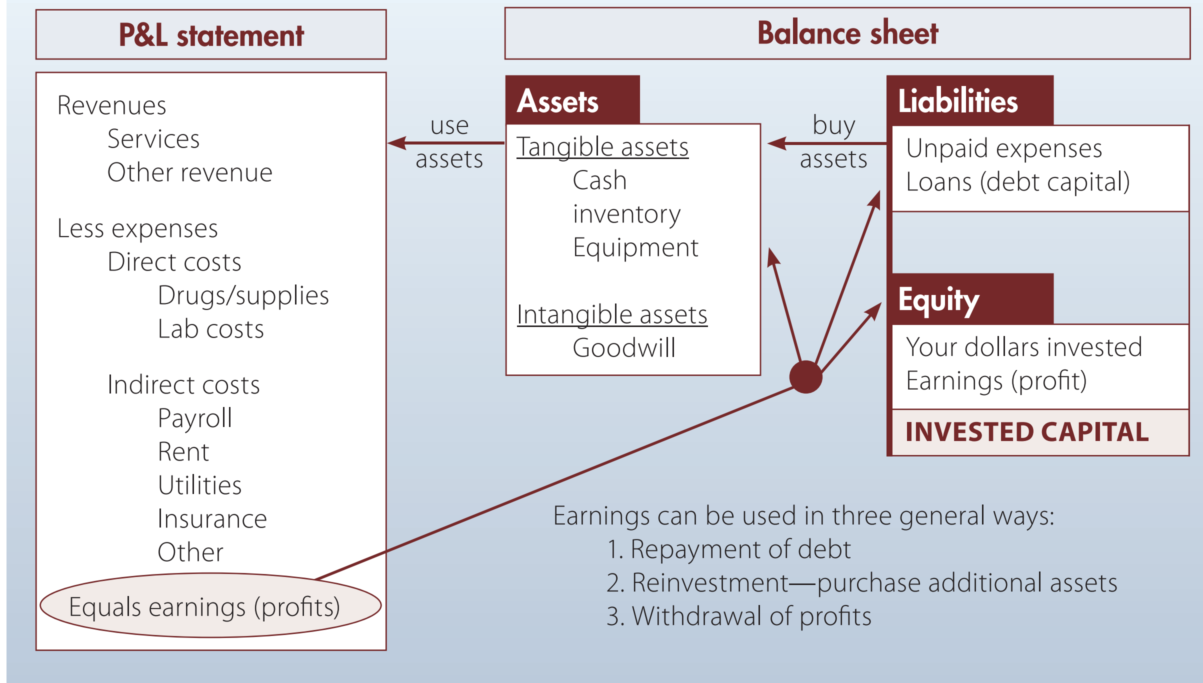
Estimated Profitability

Interpretation of the *Estimated Profitability* Determination

If Estimated Profitability is		Relative Profit	No-Lo℠ Threat Advisory
greater than	18%	Superior	NO THREAT
between	16% - 18%	Above average	LOW THREAT
between	13% - 16%	Average	POSSIBLE THREAT
between	8% - 13%	Below average (Pre No-Lo Practice℠)	MODERATE THREAT
less than	8%	Poor (No - Lo Practice℠)	SEVERE THREAT

www.vetpartners.org — This Analysis Tool Developed by the Veterinary Valuation Resource Council of VetPartners

Figure 4. How profits build practice value



In successful practices, revenues exceed expenses, creating earnings or profits. Profits are utilized in one of three ways:

1. To pay down the liabilities incurred in starting the practice
2. To reinvest in tangible assets consumed in providing services
3. To withdraw the earnings for various discretionary purposes.

Over time, successful practices develop a pattern of profits, creating a new asset called goodwill. Goodwill represents the practice profits generated in excess of what would be expected from owning the tangible assets alone. In successful practices, goodwill is by far the largest asset, accounting for 70% to 90% of the practice's value. It is especially important to note that goodwill is a result of the practice's ability to generate profits. Further, the greater the profits, the greater the goodwill value and, thus, practice value. In practices with low profits, goodwill shrinks or even disappears.

As *Figure 4* shows, earnings or profits are a function of revenues generated and expenses incurred during the operation of the business. Any attempt to correct a low-profit practice must focus on these factors.

Growing the revenue

If revenue is low, the problem is either the fee side of the practice or inadequate client demand (or a combination of both). The importance of maintaining adequate levels of revenue generation cannot be over-emphasized. This is the cause of little to no value in the vast majority of No-Lo Practices.

Fees and production

On average, small animal practices produce $450,000 to $500,000 of medical revenue per doctor and target an average doctor transaction of at least three times the exam fee. If your practice isn't at these levels, you have an opportunity to expand profitability by improving production. How might you do that?

• **Raise your overall fee structure.** Ideally, you will evaluate fees every three to six months and implement appropriate changes in a timely fashion. The time lag between when expenses rise and when practice owners actually increase fees can deal a deathblow to the practice over time. If your costs increase but you fail to raise fees to cover those costs, you have lowered your profits for the entire period until your fees rise enough to catch up. For many practices, that never happens—once costs rise faster than fees, owners are either unwilling or unable to increase fees enough to catch up. To learn how a sample of your fees compares with other practices in your state and across the country, visit the National Commission on Veterinary Economic Issues website (www.ncvei.org).

Table 1. Controlling higher-than-normal expenses

Expense	Remedy
Variable expenses (target = 22% to 24% of revenue)	
High purchase cost	Shop prices with three to four suppliers who consistently provide the most favorable pricing
Inadequate markup	Standard markups: Cost plus 140% to 175%
Low turnover or overstocking	Target eight to 12 inventory turns per year
Unbilled services or products	Institute internal controls and bill appropriately for all services and products provided
Fixed expenses (target = 8% to 9% of revenue)	
High purchase cost	Shop for the best price
Low overall fee structure*	Bill appropriately for services provided
Inadequate client demand*	Boost your marketing efforts to attract new clients, look for untapped potential to provide additional necessary care to existing patients
Lack of budgeting	Plan ahead to avoid overspending or emotional purchases
Staff compensation (target = 22% to 25% of revenue; includes employer's cost of employment)	
Minimum-wage employees	Choose and offer competitive pay for a caliber of employees that will boost practice efficiency
Too many part-time employees	Hire more full-time staff members to enhance efficiency, effectiveness, and productivity
Lack of supervision and training	Hire good staff members, then provide adequate training and supervision
Turnover	Pay a competitive wage, provide valuable benefits, and value team members' input and contributions
Facility costs (target = 5% to 8% of revenue)	
Underutilized facility	Expand your hours or the number of doctors or staff members
Inadequate client demand*	Boost your marketing efforts to attract new clients, look for untapped potential to provide additional necessary care to existing patients
Community economics	Investigate the cost of living and other factors that may drive up your rent, utilities, and taxes, but keep in mind that there's no real remedy (other than growing revenue)—you can't control this factor
DVM compensation (target = 22% to 25% of doctor's production revenue; includes employment cost)	
No relationship between compensation pay and production	Tie doctors' compensation to their production
Turnover	Improve selection process and provide consistent, quality care
Lack of supervision and training	Provide doctors with adequate training and mentoring
Too many part-time and not enough full-time doctors	Hire adequate number of doctors to meet client demand

Source: Modified from "Why are my expenses so high?" 2007 Benchmarks by Wutchiett Tumblin & Associates and *Veterinary Economics*.

* Although these problems are revenue issues, many times expenses are high as a percent of revenue not because of overspending but because revenue is too low.

• **Reclaim missed charges (intentional and unintentional) and giveaways.** Charging for the care doctors provide is critical to giving the practice the resources necessary to continue to elevate patient care, invest in new medical technology, give raises to the doctors and staff, and maintain profitability. Commonly missed services, such as fecal exams and medical progress exams, often amount to $15 to $25 of missed charges on 10% to 20% of outpatient cases. On hospital cases, $40 to $60 of missed charges on 25% to 30% of cases is common for items like in-patient exams, injection fees, and the use of fluid pumps. This can easily add up to tens of thousands of dollars a year in lost profit and hundreds of thousands of dollars of lost practice value.

• **Analyze your revenue mix.** Ideally, medical services (*e.g.*, examinations, laboratory, diagnostic imaging, dentistry) represent 85% of medical revenue while medical products (including preventive medications) represent 15%. Practices with a service to product mix weighted more heavily towards products tend to have lower profits.

• **Identify your medical philosophy.** Do all doctors share a similar philosophy regarding the standard of care used to manage patients? If not, opportunities for optimal healthcare could be slipping through the cracks. Periodically conduct case reviews to determine whether the doctors have similar medical philosophies regarding patient care and charging for that care. Discuss the results in meetings to enhance awareness and create consistency among the doctors.

• **Gauge the doctors' availability.** Does the practice have an adequate number of doctors and support staff to effectively and efficiently meet client demand? Is necessary healthcare slipping through the cracks because doctors rush through appointments to prevent long client waits? Alternatively, does your practice have enough technicians so doctors can focus on doctor responsibilities and not have to do everything themselves? Proper leveraging of doctors' time is often overlooked and can have a significant impact on profitability.

Inadequate client demand

Perhaps your fees are set at reasonable levels, the other factors seem appropriate, but revenue is still low. In that case, explore whether your practice has correctly assessed and reacted to demand for your services.

• **Recommend appropriate medical visits.** Target client visitations average from two and a half to three times per year for small animal practices. As the patient advocate, always offer appropriate medical recommendations, even if those require a follow-up visit. Don't assume that a client can't afford a certain level of treatment. Be respectful of your clients' choices, but be sure to give them all the information they need to make an informed decision. Don't confuse and overwhelm them. Faced with too much information, too many options, and no clear recommendation from you, often the easiest thing for the client to do is nothing.

• **Increase demand.** Is there untapped potential with existing clients? Can you increase the number of active clients by improving the scheduling rate for potential clients or by spending more money on external marketing?

Managing expenses

Next, let's look at the expense side of your operations. Keep in mind that revenue should cover expenses, including owner's compensation, and still produce a profit, as suggested in the No-Lo Practice Threat Advisory Worksheet. Normal operating expenses include the following:

• **Variable expenses.** This includes items that change in direct proportion to the number of patients you see, such as drugs, medical supplies, laboratory expenses, food purchases, and credit card fees. This category increases in direct proportion to revenue—more patients equal more revenue and more drugs and supplies used. However, variable expenses should remain consistent as a percent of revenue from year to year. Industry benchmarks suggest that variable expenses should represent 22% to 24% of revenue.

• **Fixed expenses.** This includes administrative overhead costs such as advertising, office supplies, continuing education, and health insurance. These expenses stay relatively stable over a wider range of revenue. For example, office supplies will likely remain consistent from year to year, unless you plan to print new brochures, letterhead, or overhaul your client educational materials. Target fixed expenses at 8% to 9% of revenue.

• **Staff compensation.** This includes wages, payroll taxes, and retirement contributions for non-doctor staff members. Normal ranges vary but generally range from 22% to 25% of revenue, depending on staff-to-doctor ratios and your community's economy (*i.e.*, pay ranges and cost of living).

• **Facility expenses.** This includes rent, property taxes and insurance, utilities, cleaning, repairs, and maintenance. In all but brand-new practices, rent should be around 4% to 6% of revenue and

the other costs generally add another 1% to 2%. If you divide your current rent by 6%, does the resulting figure approximate your gross revenue? If not, your facility may be too large or too expensive for the size of your practice. Unfortunately, this causative factor can be very difficult to correct, especially in geographic regions of rapidly escalating real estate values or in situations where an owner has built a Taj Mahal hospital in an area that simply can't support fees to justify this expense.

• **DVM compensation.** This includes wages, payroll taxes, and retirement contributions. Target percentages will vary depending on geography and the local economic climate.

How do your percentages compare? If your expenses are higher as a percent of revenue, can you identify why? Only then can you take steps to improve. *Table 1* (page 10) indicates why your expenses may be higher than normal and outlines the appropriate remedies to address the problem.

The next step

The goal of this publication is to bring awareness to the distressing trend of no- to low-value practices in the veterinary industry. Ultimately, the goal is to reverse this trend. The veterinary industry has always been attractive for investment, and the rewards of ownership can be significant, both financially and personally. Although the percentage of practices valued at low to no value is small, it is growing. We need to keep our industry healthy and attractive to investors. This requires that we address this problem now, before it becomes more widespread.

VetPartners has taken the first step in this direction. Practice owners and managers must make the next step. It's your financial security and retirement that are at risk. You've already started by reading this publication. Don't stop yet! At a minimum, take these steps:

1. Download the No-Lo Practice Threat Advisory Worksheet at www.vetpartners.org.

2. Using Microsoft Excel, open the worksheet and print the instructions. Complete the worksheet to determine the true profitability of your practice.

If your practice's profitability is in the blue or green levels, congratulations! Keep up the good work and repeat the worksheet process at least annually.

If your practice's profitability is in the three lower levels, you have some detective work to do. Start by taking the results of the worksheet as a serious warning: begin investigating the underlying causes and institute corrrective measures as discussed in this publication.

If you need assistance with completing the worksheet, identifying the underlying reasons your practice may be at risk, or improving your practice's profitability and value, there are more than 200 VetPartners consultants who can assist you. For a membership directory, visit www.vetpartners.org or call VetPartners at (352) 243-2014.

Together, we can reverse the trend toward the No-Lo Practice.

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This publication was initiated and developed through the collaborative efforts of the members of the VetPartners Veterinary Valuation Resource Council. VetPartners is a professional organization consisting of members who consult to the veterinary profession and whose mission is to promote excellence and ethics in veterinary consulting and advising through continuing education, communication, collaboration, and collegiality and to establish and improve business practices and standards.

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