Part 3: Strategic Planning Financial Considerations

A break-even analysis and the integration of a budget are equally important to the success of your strategic plan. Part 3 of this series on strategic planning offers insight on both.

By Bruce S. Maller

To this point, I've been delineating the steps involved in successfully developing and implementing a strategic plan for your practice. As I mentioned in the last section, developing a plan tends to be easier for many practices than actually implementing the plan, consequently separating the "men from the boys."

A well-documented action plan, supported by strong physician leadership and staff involvement, is crucial to successful implementation of your practice's strategic plan. However, this alone will not necessarily bring success; rather, success calls for financial tools that will aid you in limiting risk and ensuring your strategic plan is having a positive financial impact on your practice.

Financial Tool 1: Break-Even Analysis

A break-even analysis will clarify whether planned objectives are viable. This tool is particularly useful for evaluating expansion opportunities, new capital purchases, new services, or new providers. A break-even analysis suggests what level of business activity is necessary to cover expected costs. Cost categories generally include fixed and variable expenses.

Fixed expenses usually do not vary with the volume of patients treated. However, there is a limit to how much volume can be handled with a certain level or amount of fixed overhead. If the volume goes up or down significantly, it may be necessary to either increase or reduce overhead. Examples of fixed overhead include facility rental, most staffing costs, and insurance. On the other hand, variable overhead expenses are proportional to the level of business activity. An example is the cost of goods associated with the sale of retail products. Variable expenses will fluctuate with the number of patients treated or with the amount of revenue generated by the practice.

The break-even analysis is an attempt to determine if the proposed activity is financially viable. In financial terms, the analysis will assist in determining the level of business activity necessary to cover the associated fixed and variable costs of the venture. For example, the sample break-even analysis for addition of a new physician on the next page indicates the practice will need to see 2,500 new encounters at a revenue rate of $100 per encounter to cover expected fixed and variable costs.

Financial Tool 2: Integrating a Budget into the Planning Process

As I have previously mentioned, a budget is a critical component of the strategic plan. It is the tool that can assist in evaluating the financial impact of the initiatives discussed during the planning meeting. A budget provides an important contextual setting for each objective. Once

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Exhibit 1

Break-Even Analysis for Addition of New Physician

Patient Encounters	Revenue Rate	Practice Revenues	Variable* Costs	Contribution Margin	Fixed* Costs	Total Costs	Net Income
2,000	$100	$200,000	$20,000	$180,000	$225,000	$245,000	($45,000)
2,500	$100	$250,000	$25,000	$225,000	$225,000	$250,000	$0
3,000	$100	$300,000	$30,000	$270,000	$225,000	$255,000	$45,000
3,500	$100	$350,000	$35,000	$315,000	$225,000	$260,000	$90,000

*** Assumptions**

Variable Costs: Ten percent of revenue for consumable expenses, such as medical supplies.

Fixed Costs: Include physician guaranteed salary, payroll taxes, and benefits, plus salary, payroll taxes, and benefits for a medical assistant.

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an initiative has been defined and the financial analysis completed, practice stakeholders can act in a decisive and timely manner. Practices that recognize, develop, and apply rigorous financial analysis consistently achieve greater success. It is not uncommon for practices to consider a potential opportunity, only to have analysis indicate that the risk contemplated is too great in relation to the potential benefit. Development of a budget generally includes the following four components.

Examination of Historical Data and Production Information. It is normally recommended the budgeting process begin in the practice's fourth fiscal quarter. This allows for the availability of ninth-month data and feedback from the strategic planning meeting. Historical review should include an examination of revenue by provider and by key service line or location. In addition, a line-item assessment of the profit and loss statement is recommended. Rather than look at categories of revenue or expense and apply a percentage adjustment factor for the next fiscal year, it is recommended a more "bottoms up" approach be applied. Avoid the assumption that the way things were done in the past is the way things should be in the future.

Assessment of Future Changes. A strategic plan provides a blueprint of the goals and objectives the practice may want to pursue in the future. Each of these opportunities must be evaluated within the context of the potential impact on revenue, physician schedules, capital expenditures, staffing, marketing, space and equipment leases, etc. Utilizing conventional spreadsheet software such as Microsoft Excel, a practice can look at the "before and after" financial impact of the proposed action items. Specifically, the analysis should allow owners to see the bottom-line impact of each proposed initiative, as well as the overall plan.

Forecast of Revenue and Expense. Exhibit 2 provides an example of a forecasting tool that illustrates the economic impact of dispensing cosmeceutical products within the practice. As illustrated, the analysis begins with a projection of the number of internal female patient visits, utilizing a 15 percent conversion rate and an average patient purchase amount of $71. These assumptions yield a projected revenue rate and cost of goods sold per patient. Forecasting of operating expense is done for each line item. An estimate of capital expenses, i.e., build-out costs, equipment, and display cases, must also be provided. As illustrated, the projection indicates that, based on the assumptions, dispensing cosmeceutical products would generate an approximate 38 percent operating profit margin.

Exhibit 2: Dispensing Cosmeceutical Products Forecast

Production Assumptions	
Annual Female Patient Visits	10,000
Capture Rate	15%
Average Purchase Per Patient	$71
Cost of Goods Sold Percentage	41%
Income Forecast	
Cosmeceutical Sales Revenue	$106,500
Cost of Goods Sold	($43,665)
Gross Profit	$62,835
Expenses	
Internal Marketing	$2,500
Incentive Compensation: Existing Staff	$10,650
Allocated Salaries: Existing Staff	$6,000
Allocated Benefits: Existing Staff	$1,200
Other	$2,000
Total Expenses	$22,350
Net Income Before Taxes	$40,485

Integrating the Budget with Financial Reporting. As mentioned, there needs to be a financial scorecard for practice initiatives otherwise agreed to by the shareholders. With the forecast in hand, it is important to integrate the budget into the practice's financial reporting. In this manner, actual results can be compared to forecast and the group can better measure success. Furthermore, those responsible for implementation of the initiative and management of the operating functions can be managed in a more objective fashion. The sample comparative income statement on the next page illustrates an actual budget reporting format.

Make It Happen

Strategic planning will bring order, discipline, and focus to practice shareholders and will ultimately help your practice meet and perhaps exceed its goals. In these three articles, we've looked at what it takes to develop and successfully implement a practical, achievable strategic plan for your practice. Now it's your turn to make it happen.

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Exhibit 3: 2002 Comparative Income Statement

	Actual	% of Revenue	Budget	% of Revenue	Variance
Operating Revenue	$2,143,510	100.00%	$2,125,000	100.00%	$18,510
Cost of Goods Sold	($53,545)	2.50%	($47,500)	2.25%	($6,045)
Gross Margin	$2,089,965	97.50%	$2,077,500	97.75%	$12,465
Operating Expenses	($1,103,942)	51.50%	$1,105,000	52.00%	$1,058
Net Operating Income	$986,023	46.00%	$972,500	45.76%	$13,523

Depending on the reader, these numbers may be applicable to a 1, 2, or 3 physician practice.

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Having a clear practice strategy is a key factor in achieving success. Along with having a well-documented action plan, a strong physician leadership team, and a committed staff, financial tools can provide an important control mechanism to limit risk. At the same time, integrating a practice budget into the financial reporting process can provide a guidepost to ensure there is direct linkage between the strategic plan and the operating results of the practice.

For more information, contact BSM Consulting at 1-800-832-0609.