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The Business Side of Veterinary Medicine

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Practice Evaluation

In the real world the only way to truly establish the value of anything, including a veterinary practice, is by what someone will actually pay for it. We will assume that someone is interested in the practice and wants to buy it because it makes good business sense and they are not looking at "buying themselves a job".

There are 3 generally accepted ways to evaluate a practice:

1. **Comparative** – compares the practice to other, similar practices, which have been sold in the area.
2. **Value of assets** including equipment, inventory, accounts receivable, furnishings, leasehold improvements, real estate, and good will.
3. **Excess Earnings** – uses the income from the practice, past performance, and future predictions.

For the purpose of this exercise, a combination of 2 & 3 will be used.

The value of a business is based on mainly 2 things:

1. What the business owns – shown on the Balance Sheet
2. What the business earns – shown on the Income Statement

Remember – these two documents are prepared to maximize tax opportunities
Simply using these two documents can cause a problem. They are usually prepared in such a way as to minimize taxes. This is not so much of a problem when it comes to the Balance Sheet as it usually uses "generally accepted" rules and tables to arrive at values. Therefore determining Fair Market Value (FMV) for the assets is relatively easy to do. Determining the true nature of the Income Statement is another matter. Income splitting, personal use of vehicles, travel, accommodations, advertising and promotion, etc. may also be manipulated in such a way as to minimize tax. However, these manipulations negatively impact the "net income" of the business and thus negatively impact the salability of the business. The income statement has to be "normalized" before it can be a true picture of the practice.

Assets

Assets are usually broadly defined as:

i) Cash – assigned a value of 100%
ii) Accounts Receivable – assigned a value of 60% or can use a sliding scale according to age

iii) Inventory – generally use a figure of 80% of invoice price. Note: must be actually counted and assessed to finally determine value

iv) Fixed assets – furniture, fixtures, equipment – assigned a value of 50% of replacement costs

v) Real estate – should be treated as a separate entity

Income

The veterinarian/owner's income needs to take into consideration:

1. FMV as a veterinarian
2. FMV for management time
3. Return on Investment (ROI) – this is the amount of income that would be received if an equivalent amount of capital was invested in tangible assets of a similar risk. Veterinary practices are considered a moderate to high risk investment requiring 8-15% return.
4. Reasonable net income from operations (usually considered to be 3-5% of gross revenue.

What is left over, after taking these things into consideration is what determines the value of the practice. This is the amount of money left over that the buyer has to payoff the debt of the purchase.

The first 2 are relatively easy to determine.

1. FMV as a veterinarian – what would you earn, with your level of experience, in your practice area if you went to work for someone else.
2. FMV for management time – if you are doing any management of your practice, you should take that into account as you would have to pay someone to do it if you were not. Account for FMV of a manager.

The last 2 are a bit harder to determine.

3. ROI
4. Net income

You need to be totally honest both with yourself and the buyer. All the things that are used to reduce tax, one time expenses, one time income, excessive perks, etc. now have to be accounted for as much of it, in reality, goes to make up these two items. In other words, the income statement has to be "normalized".

Leave real estate out of the equation. It should be considered as a separate investment. It should be separated out from the "practice" anyway. If it is not, it is something that you should consider doing.

What you want to determine is how much is the operations side worth. Once you have determined what the true "net income" or "excess earnings" is of the practice, this figure can be used to determine its value. This amount X number of years it takes to pay off the practice will give you a good "ballpark" figure as to its value. It is generally accepted that 5 years should be used as the time period

Example

Practice gross		- $1,000,000
Value of hard assets		- $ 200,000
Net profit not counting what the owner takes out		- $280,000
Owner remuneration as a Veterinarian	- $90,000	
Management @$20/hr	- $20,000 (100 hrs/yr)	
ROI (200K X 15%)	- $30,000	
Net Income (1 mil X 5%)	- $50,000	
Owner remuneration	$190.000	-$190,000

True Net profit $90,000

This "true net" has to pay for the operations plus the hard assets. If you consider that the hard assets should be paid off in 5 years then that will consume $40,000 per year (200K/5).
Therefore: The value of the operations side of the practice is:

$90,000 - $40,000 X 5 years = $250,000

And the value of the total practice is: $250,000 + $200,000 (tangible assets) =
$450,000

Caveats:
This is just a "ballpark figure" and does not take into account things like:

- Expansion / growth possibilities
- Competition
- Location
- Trends in the practice
- Stability of staff
- Stability of client base
- Etc.

To establish a true value for your practice, I urge you to seek the services of a practice appraiser.

Worksheet

A. Fixed Asset Value	________	
B. Practice Gross Income		________
C. Expenses (not including owner remuneration)	________	
C. Rent/lease	________	
E. Sub total (B+C)	________	________
F. Gross Profit(A-D)		________
F. Wage for owner/veterinarian	________	
H. Wage for owner/manager	________	
I. ROI (8-15% of A)	________	
J. Net Profit from investment (3-5% of A)	________	
K. Sub total (sum of F to J)	________	________
L.Net Income		________
M. Monies needed to pay down Fixed Assets over __ years Line A / __ yrs =		________
N. Monies left over from operations (L-M)		________
O. Value of operations (N X __ yrs)		________
Fixed Assets (line A)		________
Total Value of Practice (sum of line O & A)		________

So…….
If this figure is below what you had in mind you have to start making plans on how to change it. The only real way to increase the value of your practice is to make more attractive to potential buyers and the best way to accomplish this to generate more "true net" income. There are really only 2 ways to generate more "true net income":

1. Increase income
2. Decrease expenses

There are as many opinions on how to do this as there are people willing to offer them, but the fact of the matter is: there is no other way to increase net income. We will deal with only one here and that is your fee structure.
Note: Make sure you discuss with your tax professionals as to the ramifications that may occur. Unfortunately, the more attractive you make the business look usually the more impact that taxes may have.

Factors Determining Fees

While we are discussing fees, please remember….When a client complains about fees, it is not that the fees are too high it's that the level of service is too low……

1) Value
    - i) What is the value of the service to the client?
    - ii) How does it really help the patient?
        - (1) Improved health
        - (2) Improved economics
        - (3) Reduced pain
        - (4) etc.
    - iii) How does that help the client?
        - (1) Peace of mind
        - (2) Satisfaction
        - (3) Meet the economic needs of the client
        - (4) Meet emotional needs of clients to care for family members
        - (5) Etc.

2) Perception of Value
    - i) Does the client perceive the value of the service to be <u>more or less</u> than the true value?
    - ii) Both scenarios will occur for various services.
    - iii) In some cases the actual fee is set lower than the true value and in some cases it can be more.
    - iv) Whose responsibility is it to shape the client's perception?
    - v) How do we ensure correct perceived value?

3) Quality
   i) Consider the real quality of your service compared to what is available in your area when considering value.
   ii) Do you really provide the best
      (1) Animal/Herd care
      (2) Client care
   iii) Have you developed market niches?
      (1) Nutrition
      (2) Quality Milk
      (3) Ultrasound
      (4) Etc.
4) Need
   i) Is the service or product "needed" for the health and protection of the animal or desired by the owner for some other reason?
   ii) Will the money to pay for the service or product come from the client's "necessary" expenditures or the "discretionary" fund?
   iii) Is the staff (not just the doctors) stating the "NEED" for the animal/herd's healthcare
   iv) This is PATIENT ADVOCACY
   v) This is a <u>foundation</u> for a fee schedule

5) Expenses
   i) What are the actual costs of providing the service or product to the client / patient?
      (1) Do you use a system of profit center management in your practice?
   ii) Consider both direct costs and indirect costs
      (1) Cost of supplies (include mark-up)
      (2) Overhead expenses allocated to the procedure or product
      (3) Labor costs (don't forget a fair wage for yourself)
      (4) Return on your investment in the practice (ROI)
   iii) Operating Budget
      (1) Profit Center Based

6) Regulations
   i) Are there regulations or laws that must be considered that will either directly or indirectly affect the cost (paperwork, postage, consultant fees, etc.)

7) Competition
   i) Are there other practices close to you?
   ii) Will it be inconvenient or costly for clients to go somewhere else?
   iii) Do you know what they are charging?

Current fee schedule
   i) Is your current fee schedule partially acceptable?
   ii) Does your current fee schedule support your practice financially?
   iii) Does your current fee schedule provide you with an appropriate salary, net income and return on investment?
   iv) Do you use all the fees in your fee schedule?

v) Do you repeatedly change the fees in your fee schedule when creating invoices?
vi) Are you charging for everything you do?

Considerations When Determining Fees

1) Appropriate fees
   i) Remove emotion from fee setting
   ii) Consider your level of education
   iii) Consider your investment in your practice
2) General Philosophy
   i) "Client Based" Vs. "Dr. Based"
   ii) Practice "Wellness Based" Vs. "Incident Management"
   iii) "Patient/client Advocacy" Vs. "Financial Focus"
3) Value
   i) Objectivity ("Appropriate fees")
   ii) Reality
   iii) Quality
   iv) Perception
4) Perception of Value
   i) Shopped Fees
      (a) Pregnancy testing
      (b) Semen evaluations
      (c) Vaccinations
      (d) Spays / Neuters / Declaws
      (e) etc.
   ii) Non-shopped fees
      (a) Nutrition
      (b) Milk quality
      (c) Radiology
      (d) Surgery
      (e) Anesthesia
      (f) Special procedures
5) Location / Client base
   i) Demographics
      (a) Type of operation (eg Dairy vs Beef)
      (b) Average income
      (c) Population density
      (d) Population age
      (e) Pet population
      (f) Competition
      (g) Accessibility
   ii) Local / regional economy
      (a) City
      (b) Rural
      (c) Suburban
      (d) Agriculture

No magic method!

a) Mathematical cost accounting method
   i) *Management for Results, Volume 1, Chapter 10*, Mike Reigger
   ii) F – Procedure fee calculation
   iii) Detailed fee setting method based on cost analysis
   iv) Tedious and time consuming
b) Office Call Base
   i) Decide on an appropriate Standard office/farm call or examination fee
   ii) All other fees are based on multiples of that
c) Hourly Rate Method
   i) Procedures and services are calculated on a hourly basis.
d) SWAG

My Suggestion

Consider Market Niche, Perceived Value and Service

1) Consider your goals
   i) Maximize income
   ii) Appropriate staff salaries
   iii) Be more competitive
   iv) Attract clients
   v) Limit your practice
   vi) Improve practice value
   vii) Practice as a hobby
2) Consider your market niche
   i) Type of practice
   ii) Clientele
   iii) Level of service
   iv) Reputation
   v) Areas of expertise
   vi) Special services offered
   vii) Image

Start with your current Fee Schedule

i) What's the problem with it?
ii) Are more than 5% of your clients complaining about fees?
iii) Are more than 2% of your clients leaving because of high fees?
iv) Is your current fee schedule partially acceptable?
v) Does your current fee schedule support your practice financially?
vi) Does your current fee schedule provide you with an appropriate salary, net income and return on investment?
vii) Fair salary as a veterinarian
viii) 23% of gross production
ix) 3% of gross production for benefits
x) Return on the money you have invested in the practice
   8 to 15% (high risk investment)

xi) Reasonable net income -3 to 5 % of practice gross
xii) Rent on owned real estate

Do you use all the fees in your fee schedule?
i) Is your fee schedule too extensive or too cumbersome?
Do you repeatedly change the fees in your fee schedule when creating invoices?
i) Are you fee sensitive?
ii) Is your staff fee sensitive?
Are you charging for everything you do?
i) Do your use a "circle sheet"?
ii) Is your staff empowered to correct "omissions"?
iii) Is there a triple check system in place?
iv) Tech
v) Receptionist/data entry
vi) bookkeeper
Locate and utilize general guidelines
i) Specialty group surveys (check legality)
ii) Insurance Tables
iii) Provincial/state Guidelines
iv) Neighboring practice survey
Remember Value Vs. Perceived Value
i) The value must be there
ii) Legendary Service
iii) Highest Quality
iv) Patient Advocacy
v) Client centered
vi) Charge for the Perceived Value
vii) Shopped services – less than actual value
viii) Non-shopped services – more than actual value
ix) Specialty services – premium fee

Training
i) Bringing value to clients requires a trained staff
ii) Train to a level of "competency"
  a. Excellence
  b. Trust
iii) Staff Emotion = PRIDE
iv) Staff automatically takes the message to the client

Odd Fees Concept

i) Most practices round fees to the nearest dollar of half dollar.

ii) Deal in pennies

- Increase fees $.41 to $.98

Example: $17.00 > > > > > $17.83

- Client perception = exact calculation

This strategy results in about $15,000 net income the first year.

Once you have established a satisfactory fee schedule, keep it current

i) Keep up with medical inflation by raising fees 10% per year

a. Monthly increases

b. Quarterly increases

ii) Be sure to account for large increases in supply costs

Some things to remember……

i) Price is about the 7th _ reason that clients choose a veterinarian.
Within reason, it is difficult to set fees too high as long as you back it up with appropriate levels of service.

ii) Extremely high fees are not necessary to generate revenues adequate to meet income goals. Other management techniques are equally or more important.