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How to Capture More of What You Produce

The key is to become more efficient by stabilizing fixed costs.

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Growth is a natural outcome for businesses that provide valuable products or services, and private medical practices are no exception. A doctor who renders quality care will develop a good reputation with an ever-increasing number of patients coming to his/her office. Practice revenue increases along with growth, but unfortunately, so do the expenses and the complexities of "doing business." Your goal is to meet these challenges and increase the percentage of profit you receive from any newly generated revenue. Your percentage of profit will grow significantly as you increase the level of efficiency in your practice. An efficient practice will capture a greater percentage of profit from revenue growth than an inefficient one. This is because volume growth in an efficient practice will have less impact on fixed costs than it will in an inefficient one.

Doctors often incorrectly put the blame on lower fees when their growing practices produce little to no increase in profit, but failure to convert an increase in revenue into a commensurate level of profit mainly results from using inefficient processes to manage increasing volume and complexity. It is easy to calculate and track a practice's percentage of increase in profit relative to its percentage of increase in revenue, and monitoring this statistic will help doctors improve their performance.

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A growing practice whose rev-

Continued on page 122

Capture More *(from page 121)*

enue is increasing at a higher rate than its profit is showing sure signs of inefficiency. In contrast, an efficient practice will have a percentage increase in profit that is at least as high as its percentage increase in revenue; and a superior, efficient practice might even achieve a percentage increase in profit that is greater than its percentage of revenue increase. To demonstrate how significant this phenomenon could be was a practice that had generated a 24% revenue increase over the period of only one year. This is a spectacular achievement by any standard; however, the doctor was unaware that his practice could have performed even better. Unfortunately, the concurrent 36% overhead increase that the practice experienced kept his profit increase to only 6%. While he was pleased that profit had increased 6%, he was unaware that his 24% increase in revenue should have resulted in an increase in profit closer to this 24%.

The tables on this page demonstrate this relationship between revenue and profit. They show three separate practices, each experiencing a growth of 25% in volume along with concurrent increases in revenue. What the numbers reveal is that, depending on each practice's level of efficiency, the impact of growth on expenses can vary significantly which, in turn, impacts profit. The goal to be achieved using efficient processes is to maintain stable fixed costs while seeing a greater volume of patients and providing a greater number of services. Variable costs should be the only ones that increase along with volume—costs mainly generated by the need for additional supplies. Comparing the rates of increase in revenue to the rates of increase in profit for the three example practices reveals a clear pattern. The practice using superior processes shows three times the growth in its profit compared with that captured by the inefficient one. While any growth in profit is desirable, it is easy to recognize the 45% increase in profit of the superior efficient practice is preferable to 15% of the inefficient one—and, while doing the same amount of work.

Suffice it to say, practices with superior levels of efficiency will be well positioned to convert a greater percentage of their growth into profit. Doctors in these practices will capture more of what they produce. Similar to the "magic" of compound interest as it relates to the cumulative effects of financial returns over the years, even a small percentage improvement in one's profit margin will compound substantially over a 30-year career. Warren Buffett, one of the world's most astute investors, has stated this concept well: "Great businesses make lousy investments if management cannot convert sales into profit. Managers of high-cost operations tend to find ways to continually add to overhead, whereas managers of low-cost operations are always finding ways to cut expenses." **PM**

TABLE 1

Inefficient Practice

	Before	After	% Increase
Revenue	$600,000	$750,000	25.00%
Expenses	$300,000	$405,000	35.00%
Profit	$300,000	$345,000	15.00%

TABLE 2

Efficient Practice

	Before	After	% Increase
Revenue	$600,000	$750,000	25.00%
Expenses	$300,000	$375,000	25.00%
Profit	$300,000	$375,000	25.00%

TABLE 3

Superior Efficient Practice

	Before	After	% Increase
Revenue	$600,000	$750,000	25.00%
Expenses	$300,000	$315,000	5.00%
Profit	$300,000	$435,000	45.00%

Practices with superior levels of efficiency will be well positioned to convert a greater percentage of their growth into profit.

Dr. Hultman is Executive Director, California Podiatric Medical Association and President, Medical Business Advisors, specializing in practice evaluations, valuations, and mergers. He is the author of *Reengineering the Medical Practice* and *Medical Practitioner's Survival Handbook.*