Rx for Success

Use these financial strategies to boost your medical practice's bottom line.

BY JOHN V. GUILIANA, DPM, MS

Whether you have a general podiatry practice, a focus on wound care, a niche practice that addresses biomechanics and sports medicine or surgery, financial management is critical for the longevity of your business.

Successful medical practices need to balance rising costs, while providing quality care, and this makes financial management even more important. Financial management goes well beyond traditional accounting.

Financial management involves the "4 C's":

Costs—the capital required to run your practice

Cash—the money your practice has available to cover short term expenses, such as salaries and supplies

Capital—funds that can be invested for growth initiatives, such as office renovations and new equipment

Control—making certain that the funds are spent in the best way possible and in compliance with regulations.

Common functions of financial management include financial planning, budgeting and forecasting, revenue management, lease and vendor negotiations, cash flow management, and compliance. Practice managers and administrators must rely heavily on their accounting teams to help them navigate these issues.

Using financial statement reports, such as the practice's balance sheet, income statement, and cash flow statement (covered in detail in previous editions of *PM News*), some important analyses that practice administrators must perform include ratio analyses, a trend analysis, a comparative analysis, and forecasting.

The balance sheet is one the most important financial statements for any business, highlighting the business's financial position at a specific point in time.

First, let's review the important financial statements:

• ***Balance sheet***: The balance sheet is one the most important financial statements for any business, highlighting the business's financial position at a specific point in time. The balance sheet lists the practice's assets, liabilities and shareholder eq-

Continued on page 126

© Alexlmx | Dreamstime.com

Rx for Success (from page 125)

uity. This report illustrates the practice's liquidity, operating efficiency and potential return on investment. It does not, however, provide any information on revenues or cash flow.

• ***Income statement***: Sometimes referred to as a profit and loss (aka P&L) or earnings statement, this statement highlights the practice's revenue, expenses, and resulting profit or loss from a specific accounting period. This report is used to measure the practice's profitability, efficiency, and growth.

• ***Cash Flow statement***: Cash flow is a measure of how much cash a business brought in and spent in total over a period of time. While it's also important to look at business profitability on the income statement, cash flow analysis offers critical information on the financial health of a practice. It provides insight into cash inflows and outflows. Most businesses can sustain a temporary period of negative cash flows, but it can't sustain negative cash flows long-term. Newer practices may experience negative cash flow from operations due to high spending on growth. That's acceptable as long as the owner is willing to keep supporting the business. But eventually, cash flow from operations must turn positive.

Now let's look at some important ratios. A ratio analysis uses the data from the financial statements to provide insight into the practice's profitability, liquidity, leverage, and operational efficiency. There are dozens of ratios that can be used to provide insight, but just a few of them include gross margin ratio, debt to equity ratio, current ratio, and receivables turnover ratio.

Gross Margin Ratio

Gross margin is the percentage of a practice's revenue that it retains after direct expenses, such as labor and cost of goods have been subtracted. The Gross Margin Ratio compares a practice's gross margin to its revenue.

Gross Margin Ratio = Gross Margin / Revenue

A practice that has a gross margin of $250,000 and $1 million in revenue has a gross margin ratio of 25%. Comparatively, practice with a $250,000 gross margin and $2 million in revenue has a gross margin ratio of 12.5% and realizes a smaller profit percentage of its revenue.

Debt-to-equity Ratio

Also known as a leverage ratio, this ratio shows how much debt a business has compared to an owner's investment.

D/E = Total liabilities / Shareholders equity. For example, if a practice has $500,000 in debt and $1 million in shareholder equity, its debt-to-equity ratio would be 0.5. A lower ratio is generally better because it means the practice has less debt.

Current Ratio

The Current Ratio compares all of a company's current assets to its current liabilities. These are usually defined as assets that are cash or will be turned into cash in a year or less and liabilities that will be paid in a year or less. The formula for current ratio is current assets/current liabilities. A higher current ratio is better for the business. A good current ratio is between 1.2 to 2. If the number is 2 it means that the business has 2 times more current assets than liabilities to cover its debts.

Receivables Turnover Ratio

This ratio measures how well the practice manages their accounts receivable. Specifically, it considers how long it takes the practice to collect outstanding receivables. The higher the number is, the better the practice is at getting payments in the door.

Receivables Turnover Ratio = Net Annual Revenue / Average Accounts Receivable

Trend Analysis

Administrators must look for trends to forecast future performance. For example, a medical practice must be able to visualize their trend in new patients, total patients, charges, collections, and account receivables.

Comparative Analysis

A Comparative Analysis involves understanding how trends and data compare to the same time period of the prior year as well as industry benchmarks.

Pro forma Analysis

A Pro forma analysis uses projections and presumptions to forecast or model the impact of hypothetical decisions. For example, if a practice was considering purchasing a laser, a pro forma analysis would examine the number of potential patients that this new equipment will benefit, the expected revenue from its use, its costs, including lease payments and staffing. Additionally, forecasting can be used to predict revenues. For example, if an administrator knows that the historic average gross collection rate—(collections / charges) x 100—is 45%, then the current month's charges can help predict future revenue streams. It can also alert us to breakdowns in revenue cycle management if the forecast is missed.

Effective financial management is the backbone of a thriving medical practice.

Effective financial management is the backbone of a thriving medical practice. By adopting sound budgeting practices, optimizing revenue cycles, and keeping a cautious eye on overhead costs, medical practices can enhance their profitability and ensure long-term sustainability. **PM**

Dr. Guiliana is a nationally recognized speaker and author on topics pertaining to medical practice management. He is a Fellow of the American Academy of Podiatric Practice Management and holds a Master's Degree in Healthcare Management. He has authored numerous columns in various journals and is the co-author of *31½ Essentials to Running Your Medical Practice*, as well as *The Million Dollar Practice…Keys to Success.* Dr. Guiliana is currently a Medical Director of Podiatry for Modernizing Medicine's award-winning technology. He can be reached at John.guiliana@modmed.com.