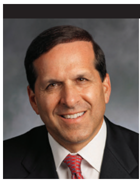
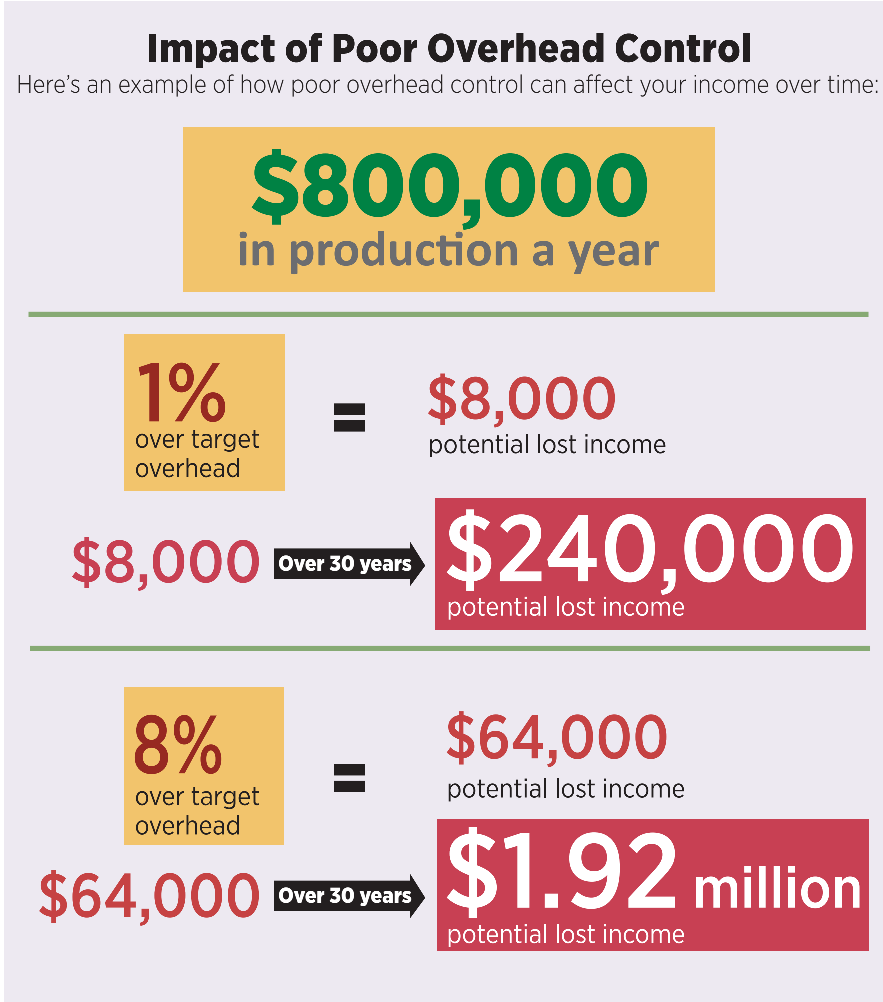


FINANCE

Controlling Overhead to Increase Net Income

By Roger P. Levin, DDS



Even before the Great Recession, many dentists were working to maximize production. They simply wanted to care for more patients and grow their practices. Since 2009 — when the new, more challenging post-recession dental economy took hold — there has been a greater sense of urgency. Doctors found that if they continued doing business as usual, production, revenue and income actually declined.

Responding to this intense financial pressure, dentists in all types of markets across the country are attempting to increase income by attracting more patients and raising average per-patient production — not only with new patients, but also with long-term patients. These are, of course, the right strategies for bringing more revenue into the practice. But what happens on the other side of the ledger? What you do with the money that comes into the practice deserves much more attention than most dentists give it. The better you control overhead, the more revenue will reach your bottom line as net income.

To Appreciate the Impact of Overhead, Do the Math

In our society, we tend to think that the cost of living and the cost of doing business inevitably go up every year. We tend to ascribe it to "inflation," shake our heads, and do little or nothing to counter it. But the consequences over time are significant.

If operating expenses rise at, say, a rate of 0.2 percent annually, it may seem negligible. However, if this occurs year after year, it adds up. And the rate of increase often creeps up, unnoticed, so that the total accumulated overhead in many practices stands at 6–8 percent above the recommended 59 percent target for general dentistry practices.

Look at the impact of poor overhead control over time. In a practice producing $800,000 a year, 1 percent translates to $8,000 of potential doctor income lost. Over a span of 30 years, that represents a $240,000 reduction of income. Unless you're quite successful financially, you probably agree that it would be worthwhile to make the effort to retain that money. And that's if you're just 1 percent over the target. Now, do the calculations for that same practice ($800,000 in production) with overhead 8 percent higher than it should be. That adds up to a $64,000 annual hit and a staggering $1.92 million loss during a 30-year period. All these figures represent lost efforts on the doctor's part, with nothing to show for a significant amount of the dentistry performed.

Systematically Track and Eliminate Wasteful Spending

The best way to find and eliminate unnecessary spending is to subdivide all expenses into categories that you can then review separately. Although you may want to start listing categories based on standard breakdowns accountants use for businesses, bear in mind that you'll need to modify them to more accurately represent the costs of operating a dental practice. Don't expect your accountant, no matter how professional, to know how to categorize your expenses or how your totals compare with regional or national norms for dental practices. Unless you start your spending analysis with the right categories and all expenses properly sorted, you may end up looking at costs that seem to be reasonable when, in fact, they are not.

As you approach this process, also keep in mind the fact that you may be spending a significant amount of practice revenues purely out of habit rather than necessity. Former needs and poor decisions made in the past may still be impacting your spending patterns, so you need to question everything. Otherwise, you may overlook waste that should be eliminated.

Every practice is different when it comes to the specifics of overhead and potential reductions. Following are four examples of the types of costs and reductions that will give you a general idea of what to look for.

What you do with the money that comes into the practice deserves much more attention than most dentists give it.

1. Labor

As a rule of thumb, the practice payroll, excluding doctor income, should represent approximately 25 percent of total overhead. If your labor costs exceed that amount, there are probably ways to reduce them.

For example, if a team member has been with your practice for many years and has received raises regularly, he or she may be overpaid at this point. Although you wouldn't want to reduce this person's compensation, you might be able to adjust her responsibilities or schedule so to better align the pay with the job.

Under some circumstances, an across-the-board salary freeze may be in order. Done in conjunction with the implementation of new growth strategies, such a move could serve as a powerful motivator. If staff members know that hitting higher performance targets will result in higher pay, they will have a personal stake in achieving greater practice success.

You also may want to consider establishing a performance-based bonus system. This would enable you to regulate labor costs, spending more when and if revenues increase.

2. Technology

Many dentists tend to overspend in this category, especially in recent years, when there is a steady stream of exciting new technologies, and this appeal can overrule what makes sense financially. This is not to say that such expenditures should be avoided — just that you should weigh these purchase decisions in a realistic, businesslike way. Otherwise, you may be paying the price for such impulsive investments for years to come.

3. Marketing

This is one area where dentists are as likely to underspend as overspend, which can make it difficult to determine how much money to allocate. In a competitive dental market, you can't afford to just sit back and wait for new patients to discover you. You must somehow call attention to your practice if you want prospective patients to contact your office, and you must acquaint existing patients with the entire range of services you offer if you want to increase per-patient production. Both of these are marketing functions.

The question is: What type of marketing makes the most sense for your practice, and how much money should you spend on it? You should rely on experts with knowledge of the dental industry, but there are some general guidelines you should follow as well.

First, focus resources on generating referrals from patients. Because this is an internal audience with whom you already have a relationship and existing channels of communication, you can get excellent results in return for a modest investment.

Next, invest in a good website. Most prospective patients, even those referred to your practice, will check your website before making contact. If it's unattractive, outdated, poorly written or difficult to navigate, you may never hear from these prospects. If you can't do this on your own, use professionals to create and optimize your site, and do the same for other components of your online presence, such as social media, local directories and reputation management.

Carefully scrutinize any expenditures in traditional marketing activities, including print advertising, direct mail, discount coupons and other ways of generating leads. These frequently fail to break even, let alone yield a return on your investment.

4. Supplies and Lab Fees

You'll probably discover many opportunities for reducing overhead in these expense categories. The most obvious is eliminating waste. Look in all the storage areas around your office. You'll probably discover types of supplies you haven't used for a long time, excessive inventories of items that have reduced cash flow and outdated materials. All are signposts for ways to reduce overhead.

You also should review how you deal with suppliers. They're probably up against intense competition, so they will often be willing to negotiate with you, offering better prices, delivery and service in order to get your business.

In addition, you may be paying dental labs more than necessary. You need to meet certain standards of quality work and responsive service, but you may be spending more than necessary. For example, you may insist on using the best labs in the country for critical work on cosmetic cases, yet also send other, less demanding work to those same high-end labs. A shift to a good national lab for routine work could reduce your lab costs dramatically. As with other suppliers, you also may be able to negotiate better arrangements with labs.

Practice overhead tends to rise steadily if allowed to do so. Although the increases are incremental, which can lull you into thinking there's no problem, they can quickly add up to substantial amounts. Overinflated costs and sheer waste erode practice income, directly undermining any production increases you may be able to achieve. Controlling overhead requires diligence, but it can increase net income just as surely as the other strategies you use to grow your practice. ✦

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