# Cash Flow

Keep it under control by examining financial operating ratios.

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RUNNING A SUCCESSFUL physical therapy practice means keeping a close watch on a long list of issues, from productivity and employee management, to contracting and referrals.

While these areas are important, financial management requires even greater scrutiny. A crucial aspect of financial management is analyzing financial operating ratios. By determining these figures and using a formula to analyze them, you can appraise your clinic's fiscal performance, forecast future success and keep cash flow under control.

One way is to look at your numbers every three months to confirm productivity or allow you to take corrective measures before the practice suffers. Another goal is to try to gain economies of scale, which appear as an increase in your bottom line. For starters, set up a format to measure your clinic's performance. The best way is to compare the current fiscal quarter to the corresponding quarter last year.

You also can set a target goal for each of the major categories listed below, depending on your own standards. At our clinic, we strive for a pre-tax margin of 15 percent to 20 percent. To achieve that target range, we've set up operating ratios based on a percentage of net sales for each of the following categories:

• *Net sales.* Look at gross sales minus contractual allowances. Contractual allowances are dollar amounts that aren't paid by insurance companies. For example, if your gross sales totaled $566,000 with 40 percent contractual allowances, you would deduct $266,000. That would give you net sales of $300,000.

• *Professional payroll.* Compile salaries for physical therapists and physical therapy assistants, and list payroll taxes.

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Professional payroll, which is one of the more important categories, runs around 15 percent of net sales. But this number will depend on the established "productivity" standards your practice follows. If you have a small staff, you may need to lower the net sales goal.

For example, to generate $300,000 in net sales for a quarter, you need approximately 2.5 physical therapists and two physical therapy assistants to handle 3,188 patients. By contrast, a team with a physical therapist and physical therapy assistant could treat about 1,275 patients per quarter and produce around $135,000 in net sales.

• *Office payroll.* List collections, billing, accounting, clerical salaries and payroll taxes.

Office payroll should run around 14 percent of net sales, depending on your internal data processing, billing and accounting systems. This percentage also includes your collections, clerical salaries and payroll taxes.

• *Overhead expenses.* Determine rent, computer costs, professional association dues, travel costs for attending conferences, medical supplies, utilities, continuing education and postage fees.

Overhead expenses usually run around 20 percent of net sales. Rent for office space is a big-line item that can range from 5 percent to 10 percent of net sales.

The remaining overhead expenses (including rent) should total 20 percent of net sales. But if you spend more on medical supplies than most facilities, you'll need to decrease another line item so the total doesn't exceed 20 percent of net sales. For instance, if you spend more on repairs and maintenance, then decrease your travel and entertainment expenses.

• *Indirect expenses.* Assemble costs for legal fees, accounting, advertising, marketing and consultants.

Indirect expenses should be in the range of 7 percent. This percentage consists primarily of expenditures for legal counsel (1 percent), outside accounting (2 percent), advertising (2 percent), consultants and marketing (1 percent each). (Expenses also can be direct, fixed and variable. However, those factors don't apply to financial operating ratios.)

Once you've put these figures on paper, take the net sales number and subtract it from professional, office, overhead and indirect expenses. This number should equal your operating income.

Then, deduct incentives, followed by owner costs, such as salary, payroll taxes, expenses and depreciation. After those calculations, you'll have your pre-tax income.

You can base incentives on several performance plans. For managers, incentives can be ▷

structured around exceeding forecasted operating income or earning 10 percent of net sales that exceed forecasted net sales. Employees can earn incentive pay by exceeding the forecasted numbers for referrals, visits or total collections.

Because you're the owner, salaries and expenses are up to your discretion. But think conservatively. You don't want to drain excess compensation or spend frivolously when you could use that extra money for new equipment and continuing education courses, or offer higher raises and bonuses to increase employee retention.

The key to financial operating ratios is comparing current results with the same quarter last year. To determine the leading indicator, look at the change in net sales. For example, if net sales increased 7 percent over last year's quarter, strive for an operating income greater than 7 percent. Be careful with expenses. Make sure this category doesn't grow as fast as your net sales growth.

You should try to gain economies of scale with net sales. You can do so by increasing expenses at a lower percentage rate than the rate of revenue growth percentage increase. For instance, if net sales decrease, you should decrease expenses at a greater rate so your operating income can still show growth over last year's quarter.

One of the first places to look is staff salaries. For example, if you're spending $45,000 in salary expenses to produce $300,000 in net sales, that's equivalent to a 15 percent operating ratio. If your net sales drop to $250,000, you should also drop salaries by reducing the number of employees to get down to the 15 percent level, or $37,500.

Use the same philosophy for other expense categories, too. If net sales increase, expense categories might grow, but expenses shouldn't exceed net sales growth. If net sales go down, you must decrease expense categories by a percent that exceeds the net sales decline. You may need to reduce staff, trim the budget for office supplies or cut back on business expenses. Taking these steps enables you to maximize profits.

Clearly, you must keep your eyes on operating ratios and net sales by maintaining detailed financial records. In an instant, these numbers provide a report card of your good and bad areas. And by adhering to a quarterly analysis, you can manage the practice effectively and maximize profits. ■

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