# Smart Business Analysis, Part I: Beginning Basics

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***Abstract:*** *Having a finger on the pulse of your practice's financial health is smart business, which is why it's imperative to have a knowledge of financial terms, planning issues and budget breakdowns. Even if you aren't involved in the day-to-day number-crunching, having a general overview helps you stay in the know about the viability and profitability of your medical aesthetic business.*

***Editor's note:*** *This is Part I of a three-part series on financial analysis in the medical aesthetic setting. Be sure to check out Part II and Part III of the series, as well.*

Business is a numbers game. Everyone has heard that saying before, and it is very true. Having a positive bottom line in this industry means really keeping an eye on operating expenses and understanding what the numbers mean and what to do to keep them in alignment.

It starts with you and your vision, and continues with educating your team members as to their roles in the financial process. Keeping an eye on your numbers allows control over knowing where you are, as well as planning for where you want to go. Your numbers represent a series of actions—or lack thereof—that culminate to your bottom line. To make sure your end result is positive, look at your income statement as a living document that is a reflection of actions that continually can be altered and improved.

## Financial projections

Every business plan must include pro forma financial statements. These financial statements are used to predict the future profitability of your business. Your projections will be based on realistic research and reasonable assumptions. If you are going to seek a lender or investor, these statements will be reviewed to scrutinize your practice. The pro forma statements required include an income statement, cash flow statement, balance sheet and yearly projections.

The income statement is a tool to review gross sales versus the expenses incurred while operating your business. The statement should be done at the end of each month to identify what is working and where there are opportunities for improvement. The most important result is the timely completion of the statement; however, you only need to understand the process and don't physically have to do it. If you are not a numbers person, a bookkeeper, accountant or tools such as accounting software or a computer spreadsheet program can help get the job done.

The income statement—often called the profit-and-loss statement or P&L—reports on profitability for a period of time. The main purpose of income statements is to track revenue and expenses. Gross revenue is listed first followed by expenses. Projections should be completed monthly for the first year and annually for the next two years.

Information for a three-year projection can be developed from your pro forma cash flow statement and business and marketing analysis. You can also pull together a first-year forecast by combining information on sales from business owners and trade associations. The first year's figures can be transferred from the totals of income and expense items. The second- and third-year figures are derived by combining these totals with projected trends in the industry.

The P&L statement also must follow an accepted accounting format and contain certain categories. The following is the correct format and a brief explanation of the computations to be made in each category in order to arrive at the bottom line.

**Income:**

- Net sales and revenues—your service and retail sales for the period *
- Gross profit—service revenue plus retail revenue

**Expenses:**

- Variable expenses—amount on items directly related to the practice. These include marketing costs, employees' sales commissions and salaries, and any other service overhead.
- Fixed expenses—amount spent during the period on overhead. These are costs not directly related to rendering of services, and these expenses include normal office overhead such as accounting and legal, bank charges, administrative salaries, payroll expenses, rent, licenses, office supplies, utilities, insurance and so on. Administrative expenses are those that remain constant if the practice suddenly ceases business for a period of time.

**Net profit, or loss, before income taxes:**

- The net income from operations plus interest received minus interest paid out.

**Income taxes:**

- List income taxes paid out during the period.

**Net profit, or loss, after income taxes:**

- Subtract all income taxes paid out from the net profit or loss before income taxes. This is what is known as the bottom line.

### Cash flow statement

The cash flow statement projects what your business needs in terms of dollars for a specific period of time. A cash flow projection tells first whether or not you can pay the practice's bills, and second, when you'll need cash infusions to keep going. Use the P&L statement for a starting point. For each item, determine when you actually expect to receive cash for sales, or when you will actually have to write a check for expense items.

## Smart Business Analysis, Part II: Focusing on a Balanced Plan

### Balance sheet

A balance sheet shows what items of value are held by the business—assets, and what its debts are—liabilities. Professional lenders look at your balance sheet to analyze the state of your finances at a given point in time, focusing on things such as liquidity and capital structure.

For the balance sheet, information is needed from the income statement, cash flow statement and start-up costs.

1. List current assets that can be converted into cash within one year of the date on the balance sheet. These include monies on hand, accounts receivables, merchandise inventory, prepaid expenses and notes receivable.
2. List fixed assets, or resources you own and do not intend for resale. These include vehicles, furniture and fixtures. Input the actual value for each of these, as well as for equipment, with a depreciation and net amount calculated based on a seven-year time frame. Fixed assets also include the actual value of your land and building, with the depreciation and net amount of the building to be calculated based on a 39-year commercial property term.
3. List current liabilities, which are what your business owes. These are obligations payable within one operating cycle, and they include accounts payable and sales tax payable, which both can be found on the yearly cash flow statement; and payroll taxes payable and accrued wages payable, which can be found on the yearly income statement. You can note the following short-term liabilities: unearned revenues, short-term notes payable and short-term bank loan payable. You do not need to address these if you do not have these liabilities. Additionally, long-term liabilities can include long-term bank loans payable and mortgage payable.
4. Capital, which includes owner's equity and net profit, and is assessed by taking assets minus liabilities minus owner's equity.

## Strategic assumptions data

The following is an explanation and instructions of how the strategic assumptions data will apply to a business plan.

**Revenue assumptions**

- Number of treatment or exam rooms
- How many hours a day and days per week the practice will be open
- Estimate of the price points for services offered
- How long each of the services will take

*These assumptions will be used to answer the following questions.*

- Hours open per day *divided by* length of treatments = number of treatments per day per room
- Number of treatments per day *multiplied by* the price of service = revenue per room per day
- Revenue per room per day *multiplied by* number of treatment rooms = total service revenue per day
- Total service revenue per day *multiplied by* days per month = total service revenue per month
- Total service revenue *multiplied by* retail percentage = approximation of retail sales
- Retail sales *plus* total service revenue = total practice revenue operating at 100% capacity

- Total practice revenue operating at 100% capacity *multiplied by* a selected percentage that identifies which of the below works for your model = actual capacity assumption

*Actual capacity of your practice will depend on many factors. For example, if you are an existing practice expanding into an ancillary business, your actual capacity ratio would be higher than that of a new practice with no existing clientele.*

- If you are building a practice with no existing medical practice attached to it, begin with an assumed actual capacity rate of 10% for the first month. If you are expanding your practice to include an aesthetic medicine component and you have an existing clientele base that will support these efforts, begin with an assumed actual capacity rate of 20–35%.
- Calculate an average of approximately 4% growth per month.
- A good goal to be met by the end of your first year may be 45% capacity, and your ultimate goal should be to operate at 75% capacity.

**Expenses**

Expenses include all the up-front costs of opening a practice. This information is gathered from the vendors and professionals you choose to work with. Enter in all data that is applicable.

Keep careful notes on your research and assumptions, so you can explain them later if necessary, and also so you can go back to your sources when it's time to revise your plan.

# Smart Business Analysis, Part III: A Detailed Analysis

## Service expense analysis

When it comes to your expenses, shopping around will do you well. Remember it is not what you make but what you keep that constitutes your profit. If you notice some of your expenses are out of line, use these strategies to help get them back in line.

***Fixed versus variable expenses.*** Fixed expenses are those costs that remain the same month in and month out. It is easy to incorporate them into your budget because you know the numbers you are dealing with already. Items such as lease and loan payments, retainer accounting fees, insurance, cleaning services and depreciation are all examples of fixed expenses.

Variable expenses change with the volume of business your practice does, meaning the more business you do, the more these numbers can fluctuate. Examples of variable expenses include credit card fees, education and travel, repairs and maintenance, salaries and commissions, telephone and utilities. Keep in mind that with either type of expense your percentage invested in a certain area may be inappropriate. You then have a choice of researching cost reduction measures or looking at increasing productivity to lower the expense percentage.

***Advertising and promotion.*** This covers all of the tools you use in marketing and promoting your business. It is a category you have to pay particular attention to as advertising costs can quickly add up. Items covered under this include advertisements on the Internet and in magazines, newspapers, the

Yellow Pages, television and radio; marketing materials such as business cards, menus, brochures and referral cards; all direct mail pieces; and patient entertainment, such as refreshments at an open house.

With any investment into advertising and promotion, think about the tangible return. Can you track the return on investment? If you are investing heavily in any particular area, you must have a tracking system in place to monitor results.

If you take on a long-term advertising contract, you can look at it as a fixed cost in your budget. Another scenario would be a month where you produce and pay for marketing materials that take more than your allotted budget. In this case you can amortize the expense over a period of time and look at the dollar amount as a fixed part of your advertising budget until it is paid off.

***Bank and credit card charges.*** This expense covers your monthly business checking fees in addition to your credit card processing fees. There is no fee negotiation for American Express and Discover since they process their own cards, but be sure to shop around for your Visa and MasterCard services because merchant service providers can vary widely in their charges. Watch out for front- and back-end fees. Do they have different qualifying rates for certain types of cards? What are their statement fees? Is there a fee per transaction? Do you have a limit to how much you can process? Are there different rates for swiped cards versus keyed-in entries? How long does it take for funds to reach your account? Find out answers to all of these variables and add up their costs while looking at the amounts you are currently processing. Make sure these fees stay within your allotted budget.

***Benefits.*** Benefits include items such as health insurance, vacation, 401k and SEP savings accounts. They are an additional value-added component of the compensation structure, and items such as health insurance can vary dramatically from state to state. Create your list of ideal benefits and assign specific costs to each. Total the costs and see if it fits within your budget. If the percentage is too high you may need to trim benefits and add them as your business increases productivity.

***Business equipment.*** This includes office equipment or machinery needed to provide technical services.

***Education.*** This category covers the costs of continuing education. Examples include tools needed to provide in-house education, outside advanced education training classes, trade show tickets and coaching fees.

***Insurance.*** Insurance coverage includes fire and theft, liability and disability insurances, as well as any medical malpractice insurance and other physician insurance necessities. Rates vary, and it is worth your time to investigate your options. You may be able to cover all your needed insurances with a single company and get a better overall rate.

The two insurances that are allocated to other areas on the income statement are health insurance, which goes under benefits, and workman’s compensation, which is placed under the salaries and commission category.

***Loans.*** Repayment of bank loans or credit card payments goes under this category. In a pure income statement, only the loan interest paid would be listed on the statement and the loan balance would appear on your balance sheets. Because you are looking at actual monthly expenses in this model, it will list the total payments each month, as they are an expense that comes off gross sales.

***Miscellaneous.*** This category covers expenses not listed in other areas or those that come up infrequently. These are one-time payments or infrequent purchases. Dues and subscription fees and parking fees can be listed here.

***Payroll expenses.*** Your costs for salaries, commissions on employees' revenues, EDD, FICA and worker's compensation insurance are totaled and listed here. This is one of the most challenging areas for a business, and it has to be monitored closely to maintain profitability.

***Professional services.*** This is a straightforward category, including expenses incurred by using a CPA, payroll service or bookkeeper to keep track of your finances, in addition to filing your taxes. This category also includes any legal fees your business incurs.

If you dread itemizing your budget expenses, having a bookkeeper do this in a timely fashion can be less stressful. And because industry numbers can be very specific, it is good to choose a financial person who understands and takes an interest in your business. You can provide that person with the proper template from your income statement as a guideline, and that professional can then categorize your numbers in the same way for easy reference.

***Rent or mortgage.*** This is the amount you pay each month toward the occupancy of your business space. This number needs to include triple net and CAM charges, if applicable. If you own your building, the mortgage plus applicable charges would be listed here.

***Repairs and maintenance.*** Equipment and building repairs, laundry services and any cleaning fees go under this category.

***Supplies, back bar.*** This consists of anything used to perform a service. Professional supplies need to be separated from retail products that are purchased for resale. Request that your vendors itemize them separately for you if possible. This can be another challenging area. These expenses, if not checked, can mount up very quickly. The three main culprits are the actual cost of products used to perform a treatment being too high, product waste and inventory control.

- *Product cost.* When choosing professional products to perform treatments, you have to compare the cost of the products needed to perform the procedure along with how much you are charging for the treatment. The product cost should amount to no more than an average of 12% of the treatment price charged. You may find some services are slightly higher and others come under so in they end balance out.
- *Waste.* The second culprit is technicians using or wasting too much product. When staff members are not paying for the product, sometimes there is little care in how much they use. Coach your team in the appropriate amounts of product needed for each particular treatment offered. Another option is to use products that are formatted for individual services so there cannot be waste.
- *Inventory control.* Create a monitoring system for back bar products where technicians have to turn in completed packaging before they can get new supplies. Appoint an individual to be responsible for inventory control and ordering. This person should do a physical count of inventory each week, note missing product and create a master order form to track purchases.

***Office supplies.*** This would consist of any supplies needed for general use in a business. Examples include postal supplies, bathroom tissue, paper towels, coffee, cream and sugar, soda, water, cups and glasses, pencils, paper and sticky notes. Shop around or become a member of a wholesale club, and buy in bulk to reduce some of these costs.

***Taxes, licenses and the like.*** The income statement model is one showing gross sales less expenses before taxes. There are certain states that have a gross business sales operating tax that is taken off the top of earnings. If this applies to your state and business, list the amount under this category. Do not include your bottom line taxes and retail or service sales tax on the form. Licenses would include your operating license to run the business and any others that are applicable.

***Telephone.*** This category includes local and long-distance telephone charges, telephone equipment leasing, on-hold services and cell phones if they are used for business.

***Travel.*** This category includes airline, hotel and travel-related expenses when you go outside your area for education or other business-related trips.

***Utilities.*** Expenses listed here include electricity, water, sewer, heating and garbage service.

***Renovation fund.*** This is a sinking fund where you set aside a percentage of the money you have spent on lease-hold improvements, furniture and equipment for your business. For the purposes of this model, with the help of your financial advisor you would amortize these costs over a period of time. This is saving money for renovation and replacement in the future.

For example: You spend $100,000 on leasehold improvement and are going to amortize the figure over 10 years. You would divide the total dollar amount spent by the number of months in the time period—100,000 divided by 120 months = $833.33 set aside each month for future improvements.

## Retail expense analysis

***Product cost.*** This category covers the expenses of buying the products you retail. You are looking for the highest profit margin possible. Typically a branded line's cost will range between 48–56% of the retail price. Private label or specialty items can have a much lower product cost and higher profit margins that you set based upon market acceptance.

An inventory system is essential for keeping track of ordering. Most software systems allow for inventory control and adjustments. Having a point person handling this is important to monitor cost, orders and shrinkage. It is easy to overspend in this category especially when there are sales and promotions constantly being offered from your vendors.

***Commission.*** This is the compensation you provide to your team members for recommending retail products to your patients. List the retail commissions separately in this section from the rest of your payroll.

***Promotions supplies.*** This category covers all supplies tied into promoting your retail sales, including signage, props and marketing pieces specifically used to promote your product lines.

## National averages

Use this chart to compare your practice's finances to the national average percentages.

Using these tools and tips, you should be able to develop your own, finely tuned financial business analysis. If you find you are having trouble with anything, there are qualified professionals, such as accountants and business managers, who can provide assistance. However, the important lesson is to keep an eye on your finances for your practice—they are what keep your business running day-to-day.