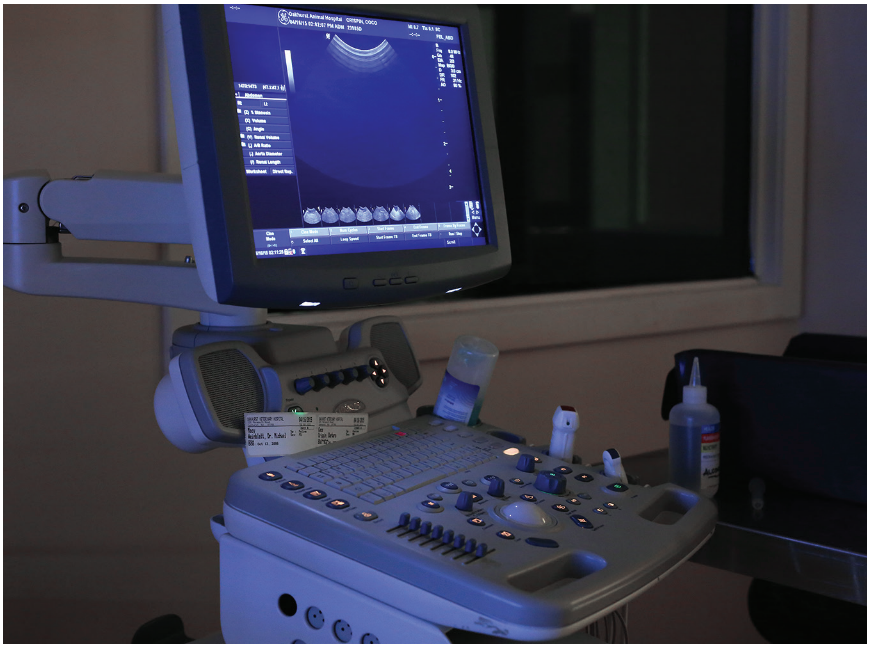
Stith Keiser, BA (Business Management)
My Veterinary Career
Cheyenne, Wyoming

Calculate Your ROI Before You Buy



During my recent presentation on veterinary medicine compensation models, a Michigan State University student asked why 25% of production is used as a rule of thumb for compensation and benefits. “Why not a higher percentage?” he asked.

I explained that practice owners need to evaluate where gross profit is distributed among various expense categories (eg, Cost of Product Sold [COPS], Cost of Goods Sold [COGS], payroll, utilities, equipment). Most aim for a net income between 16%–18% of gross revenue, although the average practice nets closer to 10%.

Although the student’s question revolved around compensation, practice owners often use “rules of thumb” to make decisions, including not only payroll but also equipment purchases. With any practice investment, we must measure return on investment (ROI).

Another such rule I personally agree with is that we should not buy a piece of equipment we cannot pay off within a year. Anecdotally speaking, if we cannot pay off most pieces of equipment in that timetable, there is a lack of demand, under-usage by the team, or our price point is off.

Practices often invest excess earnings (ie, a percentage of net income) into the practice as new equipment, building renovations, marketing efforts, or team benefits, but it is important to know the ROI.

Many practice owners may be familiar with ROI but not know exactly what to do with it. ROI usually implies a financial return (ie, getting more financial benefit from an investment than that investment costs).

The ROI does not have to be short-term; for example, when repainting a practice, the cost of paint and labor is unlikely to result in direct financial ROI, but the expenditure is a good use of capital because the facilities will match the service and experience levels desired for clients.

Cost of Investment

The goal of practice owners is to end the quarter or year with net income to enable them to evaluate the practice and determine where and how the extra cash would be most beneficial.

I have been involved as an owner in several practices where my partner, a recent graduate from the "ivory tower" of veterinary school, was enamored with having cutting-edge equipment and facilities. Thus, I have had frequent opportunities to calculate expected ROI on expenditures; for example, I recently evaluated the cost of purchasing an electronic bull ejaculator at a Kansas mixed animal practice.

This $1,850 piece of equipment costs little compared with a new computer system or digital radiograph machine. Too many practices take too lightly such “small” investments, and before too long, the practice is littered with seldom-used equipment gathering dust.

Important Questions

To help combat poor investments, whether equipment, facility renovations, marketing, or human resources, first ask the following questions:

1. Where are you with period (daily, weekly, monthly, quarterly, annual) production goals?
2. If you are not reaching your financial or service-based goals, why not? Lack of clientele? Lack of veterinarian or team member training? Lack of equipment?
3. If you are hitting your goals, how is your bank account? (I suggest you keep at least one month’s expenses in the account; however, this is not a magic number and some suggest a larger cushion, so discuss the amount you should keep in your account with your CPA.)

If your practice is not performing at the expected level, you must diagnose why. I do not believe in throwing money at a problem, but I am a firm believer that well-thought-out investments can help solve some problems—think of the “You have to spend money to make money” adage. If you are reaching your goals and maintaining a healthy bank account balance, you have money to invest.

Do the Math

Next, follow this process:

1. Review your list of potential needs/expenditures.
2. Consult your mission statement because before investing in equipment, renovations, or your team, you need to determine if that investment will help achieve your mission.
3. Settle on a potential expenditure.
4. Test the feasibility of that expenditure with the following process. Using the electronic bull ejaculator as an example:
   a) **Total Cost of Expenditure** = Cost of equipment ($1,850) + marketing to promote the new equipment and service + team training time + cost of veterinarian’s time (in this case, 15 minutes per bull = “opportunity cost”) + cost to use equipment (eg, reagents for laboratory equipment)
   b) **Determine Price Point** = $57.50 per bull
   c) **Determine Usage Volume**: How often will this piece of equipment be used?
   d) **Calculate Break-Even Point** = (price point x usage volume) – total cost of expenditure
5. Research equipment models, contractors, and benefit plans to determine the best deal, which not only refers to price, but also to quality, post-sale support, and team training.

If you are reaching your goals and maintaining a healthy bank account balance, you have money to invest.

You should aim to pay off a new piece of equipment within 12 months. If an expenditure will not pay for itself within this timeframe, re-evaluate. With the electronic bull ejaculator where a new service was being introduced, the practice elected to lease an ejaculator for $100 for one week to determine client demand. Any purchase should be based on initial client interest.

Another of my practices used the above equation to determine the feasibility of purchasing a digital x-ray machine, even though the cost of investment was much higher.

If the expenditure is facility-related (eg, adding more space, remodeling existing space), calculate gross revenue per square foot (the average is $336[1]) to determine the benefit. For example, we recently remodeled our food storage room into another examination room because when we calculated gross revenue per square foot, we realized it should be higher.

Knowing how to calculate the return on any investment will help you take care of your team, practice thorough medicine, and address patient and client needs.

Conclusion

Reflecting back to the student's question, practice owners need to be the best possible fiduciary stewards of their practice's revenue. Knowing how to calculate the return on any investment will help you take care of your team, practice thorough medicine, and address patient and client needs.

Editor's note: *Stith Keiser is the founder and manager of My Veterinary Career (powered by AAHA), which matches veterinarians and practice managers, at no charge, with practices across North America. He is also a partner in several mixed and small animal practices where his responsibilities include financial sustainability, strategic planning, and team management.*

Reference

1. ***Financial & Productivity PulsePoints***, 6th ed. Lakewood, CO: AAHA Press, 2010.