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Understanding Overhead and What It Means to Your Practice

CE CREDIT HOUR 1

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Conflict of Interest Disclosure Statement
- Dr. Levin reports no conflicts of interest associated with this course. He has no relevant financial relationships to disclose.

Short Description
Dental practices are businesses, and every business has expenses that are essential. However, as a business, it is your responsibility to regularly review overhead costs and work on reductions. This course will explain dental practice overhead and provide ten ways to reduce expenses and improve overhead percentage.

Course Contents

Overview

Dental practices are businesses, and every business has expenses that are essential. However, as a business, it is your responsibility to regularly review overhead costs and work on reductions. This course will explain dental practice overhead and provide ten ways to reduce expenses and improve overhead percentage.

Overhead is one of those factors that ultimately determines the success and profitability of a dental practice. Historically, dental practice overhead grew very slowly. In 2022 however, significant inflation occurred due to several factors, including staffing costs and accelerating technology expenses. In managing overhead, practices must track targets or key performance indicators (KPIs). There are recommended targets that represent a healthy amount of overhead (or expenses) for a practice.

Learning Objectives

Upon completion of this course, the dental professional should be able to:

- Understand the role that overhead plays as a key performance indicator in a dental practice.
- Identify when overhead is higher than recommended.
- Understand why overhead rises faster in an inflationary period or poor economy.
- Learn the 10 key proven methodologies to lower overhead in a dental practice.

Introduction

Overhead is one of those factors that ultimately determines the success and profitability of a dental practice. Most practice management literature focuses on increasing and maintaining practice production and annual growth in revenue. However, overhead is well understood by most dentists and dental teams as the expenses that take away from practice profitability. In other words, every dollar spent on expenses is one less dollar that contributes to profit. Of course, every business has overhead and expenses and cannot function without these. Still, there are essential questions that should be asked by every practice regarding what the overhead level should be, how to achieve that target level, what to do if overhead is higher than expected, and how to plan for and track overhead.

Overhead History

Historically, overhead grew very slowly prior to 2022. In 2022, we saw significant inflation due to several factors, including higher staffing costs and accelerating technology expenses. For the first time, many dental practices saw overhead increase by as much as 8%[1], which had a direct effect on practice profitability. Prior to 2022, overhead always grew slowly and gradually and predictably. Practices would accommodate small increases in overhead using strategies such as raising fees, increasing patient volume, and other methods that will be discussed later in this course.

Many of the strategies used in other industries are not as effective in dentistry due to the large number of practices participating with one or more dental insurance plans. These plans often do not increase reimbursement for years at a time and some plans even decrease them periodically. As an example, if a practice wanted to increase production by raising fees 5%, and half of practice revenue was derived from insurance plans that did not increase reimbursements regardless of the practice's fee increase, then the overall effect of a 5% increase in fees relative to total production is 2.5%.

Building an Overhead Model

In an ideal world, dental practices would build an overhead model before they ever opened and every year thereafter. Big businesses spend a great deal of time planning the annual expenses for the upcoming year. Budgets are submitted, reviewed, and often reduced and submitted again. These companies have individuals or departments that focus on building the overhead model for the coming year and analyzing all possible expenses in a theoretical exercise. Planning for dental practice overhead in this way would be wonderful, but rarely happens.

One way to approach overhead analysis and keep it simple is to evaluate all the expenses of the previous year by category. Categories include areas such as labor, benefits, insurance, taxes, supplies, materials, equipment, subscriptions, dues, continuing education, rent, gas and electric, water, and trash disposal. These categories make it easy to think about annual expense planning.

As you can see in the sample presented in Figure 1 most practices receive profit and loss (P&L) statements regularly from their accountants, and always an end of year final (P&L) statement. The categories in these statements represent broad overhead categories, and the simplest approach is for a practice to simply look at what each category represented in terms of expense in the previous year and then analyze and guesstimate whether it will be more, the same, or less in the coming year. By using this method, it can take as little as an hour to come up with the projected overhead numbers by category for the coming year.

Using a more detailed variation of this exercise, a practice could analyze every expense of the previous year. This exercise not only allows practices to project expenses for the coming year, but it also reveals wasteful, unnecessary, or undesirable expenses and allows a practice to make changes to reduce and control overhead. Rarely is this exercise performed where immediate savings do not take place and certain expenses recognized as no longer necessary. In one case, a practice found hundreds of dollars in annual subscriptions for services that they no longer used. In another case, a significant insurance payment was being made for two automobiles that the practice no longer had. These may seem obvious; however, this type of oversight happens all the time.

Overhead Targets

In managing overhead, practices must track targets or key performance indicators (KPIs). The recommended KPIs for overhead from The Levin Group are as follows:[2]

- General practice – 59%
- Periodontics – 51%
- Orthodontics – 49%
- Oral and maxillofacial surgery – 50%
- Pediatric dentistry – 49%
- Endodontics – 42%
- Prosthodontics – 64%

These are recommended targets that would represent a healthy amount of overhead or expenses for a practice. The national averages tend to be approximately 5–6% above these recommended targets; however, overhead is increasing and it's possible that average overhead may end up being 8% or more higher than the recommended targets.

Most practices, as explained above, do not perform annual budgeting or overhead planning. But one approach that is easy to implement is to start tracking overhead against the recommended targets above. For example, if a general practice has a recommended overhead target of 59% and is operating at 65%, then that would represent an overhead that is 6% higher than the recommended target. While most of this is obvious, practices don't take the time to plan for overhead. But here is why it is so important…

For every one percent that overhead is higher than the expenses necessary to operate a practice, the practice is losing $1,000 of bottom-line income on every $100,000 of production.[3] This means that if a practice is 1% higher than the recommended target and has an annual revenue of $800,000, the practice will lose $8,000 of bottom-line income per year. If that same practice is 6% higher than the recommended target and the revenue of the practice is $800,000, then the practice is now losing $48,000 of bottom-line income per year.

Understanding the effect of overhead and realizing that most practices are approximately 5–6% over their recommended targets explains why it is so important to analyze overhead, participate in annual overhead modeling and budgeting, and keep track of overhead as compared to the annual goal monthly.

Revenue & Overhead

EXAMPLE

January through December

Financial Statement in U.S. Dollars

Revenue

Gross Receipts	3,512,472		
Less: Patient refunds	98,932		
Total Gross Receipts		**$ 3,413,540**	

Expenses

Salaries - staff	518,702		*15.2%*
Payroll taxes	45,996		*1.3%*
Health insurance	52,676		*1.5%*
Pension contribution	21,430		*0.6%*
Uniforms	1,752		*0.1%*
Total Staff Costs	**640,556**		**18.8%**
Dental Supplies	468,014		*13.7%*
Office Supplies	62,252		*1.8%*
Computer	28,468		*0.8%*
Rent	208,740		*6.1%*
Telephone	14,624		*0.4%*
Utilities	27,324		*0.8%*
Postage and Deliveries	9,596		*0.3%*
Legal and Professional Fees	51,230		*1.5%*
Bank and Credit Card Fees	55,348		*1.6%*
Payroll Service Fees	3,978		*0.1%*
Insurance	61,888		*1.8%*
Repairs and Maintenance	9,990		*0.3%*
Miscellaneous	24,300		*0.7%*
Dues and Subscriptions	8,752		*0.3%*
Licenses and Permits	3,000		*0.1%*
Continuing Education	2,790		*0.1%*
Staff Training and Meetings	9,254		*0.3%*
Advertising and Promotion	14,324		*0.4%*
Meals and Entertainment	10,092		*0.3%*
Social Media and Website	17,340		*0.5%*
Total Expenses/Overhead		**$ 1,731,860**	**50.7%**
Net Income		**$ 1,681,680**	**49.3%**

Before owner/doctor compensation, depreciation and taxes

Figure 1. Sample Profit & Loss Statement

10 Strategies for Reducing Overhead

The following recommendations may be of help to any practice that is serious about reducing overhead. With full implementation of these strategies the practice can be expected to reduce overhead by 5–7%.

1. **Bid out to top expenses annually.** Managers working in large businesses are often forced to get three bids on their major expenses in each department. There are two purposes to bidding. First, is to get a sense of current market conditions rather than having an expense that has inflated over time without any attention. The second is to be able to either select a lower bid for the expense or to renegotiate with the current provider to bring them back to a more normalized market rate. You do not have to leave the company you work with. You simply want to get a sense of what the expense would be from other companies and be able to have a conversation with the company you currently work with about reducing costs.

2. **Join a buying group.** Buying groups for dental products and services are springing up all over. By having numerous dentists in the buying group, the group can then negotiate lower prices for certain products or services. This is known as volume-based pricing. The prices will typically be lower as it is an opportunity for the product company to sell more of the product (or service) to a larger number of dentists.

3. **Reduce or eliminate subscriptions.** Many companies today offer subscription services, which are beneficial in many ways. However, sometimes you either are no longer using the subscription, or have even changed products or services and did not remember to turn off the current subscription. It is very common for practices to continue paying for subscriptions monthly, quarterly or annually without even realizing it. Subscriptions will become more commonplace in the business world and dental practices, but you want to be diligent about not paying for services or products that you no longer need.

4. **Select less expensive products or services.** Dentists are committed to quality, but sometimes they also commit to the most expensive products when others are equally as good. Periodically talk to colleagues and get a sense of what they are using for different clinical treatment or administrative services and determine if perhaps there are less expensive options that provide the same level of quality or efficiency for the practice. All too often dentists become committed to one specific product or service without evaluating other options or price points.

5. **Ask for the “meeting special.”** At dental meetings, there are usually discounts on many products and services. These are commonly known as the “meeting special.” However, many companies will be happy to give you the same discount year-round, whether you attend a tradeshow with exhibits or not. Just ask for the meeting special and determine if it will be provided or if you should wait for another meeting. In addition, if you do not actually attend a meeting, but contact the company during the meeting time they will almost always offer you a discounted meeting special.

6. **Wait a little longer before purchasing the newest technology**. Most technologies become less expensive over time. The first generation or breakthrough technology will usually be the most expensive for two reasons. First, because it was the first company to bring the product or technology to market. Second, because as competitors arise, they often can create the technology at a lower expense, or the presence of competition alone brings down the price point. So, don’t feel like you must have the newest technology immediately. Waiting a little longer can often result in 20%, 30%, or even 50% reductions in cost.

7. **Bid out your practice insurance.** In this case, we are not talking about dental insurance reimbursements. Every year your business insurance costs will tend to rise; however, some of them you

may not even need any more. Others, like cyber insurance can rise by quite a bit each year. Start the process with your insurance broker and bid out your insurance early. Ask your broker to get at least three bids so that you can get a sense of what multiple companies are charging. In many cases you can reduce your overall cost of insurance by 6% to 10%.

8. **Properly manage patient dental insurance.** Insurance is often mismanaged by dental practices. Unfortunately, the number of codes that are incorrect and result in lower reimbursement each year is significant. Additionally, many practices do not submit their fee increases to the dental insurance companies on the chance that they may raise your profile. While this is not a direct expense reduction, it does result in a direct production increase, the net result of which is an improved overhead percentage.

9. **Raise your fees annually**. Again, this is not a direct reduction in cost or expense, but it will lower the overhead percentage. Every year, costs will increase. In some years, the increase will be minor and other years it will be significant. As an example, in a poor economy or even a recession, dental inflation can be as high as 6 to 8 percent. This needs to be offset by increasing fees. Most fees are not known to patients, so the practice does not have to worry about patients comparing fees to the last time they had a specific service.

10. **Bulk purchasing.** One way to reduce costs is to make a commitment to a company that you will purchase a specific amount of a product or service. Many companies offer bulk purchasing discounts to lock in a sizable order. This is a great opportunity if, and only if, you feel certain you would use the full benefit of the product or service.

The 10 recommendations above are actions that can be taken to have an immediate impact on lowering practice overhead.

Summary

Dental practices are businesses, and every business has expenses that are essential. However, as a business, it is your responsibility to regularly review overhead costs and work on reductions. Overhead has a direct impact on practice profitability.

This course has explained overhead, the historical role of overhead and ten ways to reduce those expenses. Following these guidelines, any practice will be able to make a positive impact on overhead.

Course Test Preview

To receive Continuing Education credit for this course, you must complete the online test. Please go to: www.dentalcare.com/en-us/ce-courses/ce701/test

1. Prior to 2022 dental practice overhead grew in which manner?
- A. Slowly and predictably
- B. Without any correlation to the broader U.S. economy
- C. Very rapidly.

2. Which of the following is a unique factor in creating strategies to manage overhead in a dental practice?
- A. The cost of technology
- B. The prevalence of insurance plan participation in dentistry
- C. Erratic patient behavior

3. What is the suggested approach to analyze practice overhead?
- A. Evaluate the expenses captured by the Profit & Loss statement, by category
- B. Compare total production at the end of every year
- C. Make copies of every receipt or invoice

4. The recommended total overhead percentage target for general dental practices is…?
- A. 33%
- B. 10%
- C. 59%

5. Which of the following is a stated reason to solicit bids for top expenses on an annual basis?
- A. To confirm the current market price of a needed item or service
- B. To provide the office manager with sufficient work
- C. To calculate the amount of money wasted over the previous years

6. Setting overhead targets is important because…?
- A. Many business loans are approved based on meeting overhead targets
- B. Patients prefer practices with the lowest possible overhead
- C. Practices need to know when they have exceeded recommended overhead goals

7. Which of the following will improve overhead percentage by increasing total revenue?
- A. Implementing a fee increase
- B. Increasing staff compensation
- C. Enrolling in your local utility's solar energy initiative

8. If revenue does not change, what is the impact of a 1% increase in practice overhead percentage?
- A. Profit will increase by $1,000 for every $100,000 of revenue
- B. Profit will decrease by $1,000 for every $100,000 of revenue
- C. There will be no impact on profit

9. Overhead has a direct, dollar-for-dollar impact on practice profitability.
- A. True
- B. False

10. Which of the following strategies should NOT be implemented to reduce overhead?
- A. Join a buying group
- B. Reduce or eliminate subscriptions
- C. Invest in long-term bonds

References

1. Levin, RP. Profit down, overhead up (a lot): Findings from the 2022 Dental Economics/Levin Group Annual Practice Survey. April 10, 2023. Accessed October 31, 2023.
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Additional Resources

- No Additional Resources Available.

About the Author

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Dr. Roger P. Levin is the CEO of Levin Group, a leading dental management consulting firm. Founded in 1985, Levin Group has worked with over 30,000 dental practices. Dr. Levin is one of the most sought-after educators in dentistry and is a leading authority on dental practice success and sustainable growth.

Through extensive research and cutting-edge innovation, Dr. Levin is a recognized expert on propelling practices into the top 10%. He has authored 65 books and over 4,000 articles on dental practice management and marketing.

Dr. Levin sits on the editorial board of 5 prominent dental publications and has been named as one of the "Leaders in Dentistry" by Dentistry Today magazine for the last 15 years. He was recently named one of the "32 Most Influential People in Dentistry" by Incisal Edge magazine and voted Best Dental Consultant by the readers of Drbicuspid.com. He has been featured in the Wall Street Journal, New York Times, and Time magazine and is the creator of the Levin Group Tip of the Day which has over 30,000 subscribers.

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