

MANAGEMENT & MARKETING

(Editor's Note: Every few months, this JCO column presents a successful approach or strategy for a particular aspect of practice management. Your suggestions for future topics or authors are welcome.)

Have you ever wondered if you will have enough money to retire? At what age you will be able to retire? How much life insurance you need? What your family will live on if you die young? Whether you're saving enough for your kids' college expenses?

To answer questions like this, you need to go through a two-step process. The first step is to create three spending models, based on: 1. Current levels, 2. If the primary breadwinner dies, and 3. Projected retirement spending. The second step is to determine your financial position by calculating your current savings rate, projected investment returns, proceeds from the sale of your practice, projected college costs, and life insurance levels.

In this month's column, Dr. Jerry Clark starts us on the way by demonstrating how to produce well-organized office and personal budgets. I recommend you read this article a couple times, then create the three spending models I have listed above and set up a meeting with your financial adviser to discuss your financial future. Understanding your current savings rate and comparing it to your budgets will allow you to be proactive long before you retire. You can then thank Dr. Clark for a better night's sleep.

ROBERT S. HAEGER, DDS, MS



Dr. Haeger



Dr. Clark

Six Steps to Wealth and Financial Independence

My stepdaughter Sarah is about to buy her first automobile and is as excited as any 16-year-old would be. In our family, we have an agreement that the parents will match whatever our children save toward the purchase of their first cars. As Sarah and I ride around town, she is always pointing out vehicles like Jeeps and Xterras that are popular with her generation. I have to remind Sarah that these are expensive, and I ask her how much she has in her savings account. The bottom line is that Sarah will probably not be able to afford the car of her dreams because she is constantly spending her money on less important things that she wants now, but doesn't really need. Sarah has never established a firm goal as to how much she will have to save for the car she truly desires, nor a plan to achieve that goal. When she finally does make her purchase, she will almost inevitably be disappointed.

The story of Sarah, of course, is also my story and the story of many of you. We want what we want, we want it now, and we end up spending our hard-earned money on things we may desire, but we don't really need. We're orthodontists, and we make a good living. If we see something we want, we buy it. Only now the things we desire are much more expensive than our first automobiles. We want that brand-new \$70,000 car with all the extras. Or we might desire a new boat, or a second home in the mountains or at the beach or at some resort destination. That is all well and good if you can afford these luxuries. But the sad truth is that many of us cannot afford them.

My consulting group deals with many orthodontists who have million-dollar-grossing

practices and yet have no idea how much money they will need to accumulate for their retirement. In fact, four out of five have not built up the savings and investments necessary for them to retire comfortably. We are just like my stepdaughter Sarah, but on a much grander scale.

Until 2000, I was in the same boat. Now, after working with a financial management group, I have a strategic plan in place to help me achieve my retirement goals. I'd like to share some of the things I have learned over the past few years, so that you won't be part of the 80% who will be unable to experience a comfortable retirement or, even worse, be unable to retire when they choose.

Here is a way you can fulfill your own

dreams and provide real security for your family. It won't be easy. It will take discipline and sacrifice. It will most likely force you to make some difficult decisions concerning the way you spend your money and live your life. But in the end, whether you are 30 years old or 65, I truly believe it will be worth the effort. The following are the "Six Steps to Wealth and Financial Independence".

Step 1: Establish Your Retirement Funding Goal

In the December 1993 issue of JCO, Gottlieb wrote a classic Editor's Corner entitled "You

TABLE 1 ESTABLISHING A PRACTICE BUDGET

1. *Begin with a good profit-and-loss form (Fig. 1).* Most accountants and CPAs use the same format to monitor an orthodontic practice as they would for a manufacturing business. This kind of P & L does not break down expenses specifically enough to allow appropriate tracking or meaningful budgeting for an orthodontist.

2. *Track all revenues and expenses for the past three years.* Use your existing P & L to develop a trend analysis. Note seasonal variations in both revenues received and expenditures. Attempt to pinpoint the causes of increases and decreases.

3. *Project monthly revenues for the upcoming year.* Once you are armed with enough information on past trends, you can project future annual revenue and then break it down into estimated monthly income. Take into account seasonal trends and marketing plans for the upcoming year. Be realistic!

4. *Project monthly expenses for the upcoming year.* First, use a sharp pencil to determine all the ways you can save money and cut expenses, without cutting the quality of treatment and service. Begin with *fixed expenses* (those that remain constant regardless of the level of treatment activity). Track staff efficiency. Are you overstaffed? Evaluate rent, utilities, janitorial services, subscriptions, etc., and cut wherever you can.

Next, look at *variable expenses* (those that vary according to practice activity). These include orthodontic supplies, laboratory expenses, office supplies, etc. Carefully scrutinize these expenses for necessity. Quantity discounts can often save tremendous amounts of money.

Be sure to factor in loan payments, which are not reflected in the expense section of your P & L, but can have a major impact on cash flow. If any monthly numbers are negative, look for ways to shift spending to positive months, or prepare to sharpen your pencil even further. Build in savings for major equipment purchases or new office construction. And don't forget to pay yourself—in other words, to fully fund your retirement plan.

5. *Track revenues and expenses monthly.* Once the budget is established, it must be carefully monitored to ensure that projected revenues are realistic and that revenues are indeed exceeding expenses. Make adjustments when necessary. If no further adjustments can be made, marketing efforts should be stepped up. Otherwise, more drastic measures will need to be taken to reduce expenses and promote positive cash flow.

Will Retire”.¹ Given that all of us orthodontists will eventually retire, he goes through an extensive computation to arrive at the minimum goal doctors should be striving for to afford comfortable retirement. His amount was about \$3 million, but that editorial was published in 1993. Most of the experts I’ve talked with recently agree that the number is now much closer to \$4 million. Your needs might not be as great, but virtually all investment advisers today believe you will need somewhere between 80% and 110% of your preretirement income to retire comfortably. So the first thing you need to determine is what your total retirement needs will be.

Step 2: Determine Your Practice’s Profit Realization

Every sport we play has not only a goal, but some way to keep score. Your most valuable asset is your practice and the income it generates. To help you determine how your practice scores against others, I have devised a simple formula called Profit Realization that will tell you exactly how much profit you are taking in for each hour you work. This formula was thoroughly described in a JCO article in June 1999,² but it can be summarized as the actual profit you generate in a year divided by the total number of hours you worked that year.

If your Profit Realization is less than \$200 per hour, you are working hard for little profit, and I would encourage you to get some management help. Between \$200 and \$300 per hour is very good, \$300-400 is excellent, and \$400-500 is outstanding. Your goal, however, should be to get your practice’s Profit Realization over \$500 per hour. In most offices that is achievable; one Midwestern practice we worked with had a Profit Realization of more than \$1,000 per hour.

So the second step is to determine your practice’s Profit Realization and then take steps to improve that number. Doesn’t it make sense to be as productive and profitable as you possibly can during the time you are working at the office? If you make changes that result in a profit increase of only \$50 per hour, over a one-year

period that will add up to an increase of about \$72,000 in net income.

Step 3: Establish a Practice Budget

Amazingly, many orthodontic practices that gross more than \$1 million do not have budgets. To develop one, you will need your last three years’ profit-and-loss statements, in a format that will allow you to accurately determine exactly where you are spending your money (Table 1, Fig. 1). You will also need to estimate how much you expect to make in orthodontic fees in the upcoming year. Systematically go through each expense item to see where money can be saved, and project expenses in each category. Then track these numbers throughout the year to make sure you are on target. The process works—in the first year I developed a budget for my practice, I was able to save \$52,000.

Step 4: Establish a Personal Budget

Even fewer orthodontists have personal budgets than have practice budgets. The purpose of a budget is not to remove all the fun from your life or to eliminate meaningful purchases that you choose to make. The purpose is to stop wasting money. In the past, I spent an average of about \$4,000 a month on stuff that I couldn’t even account for. Now, I spend about \$400 and have money left over at the end of the month. The only difference is that I am more aware of how my money is budgeted (Table 2, Fig. 2).

Step 5: Establish an Advisory Team

Of the six steps, this is unquestionably the most important. An advisory team can help you identify the weak areas of your plan and can provide wise counsel based on their experience. Your team should include your attorney, accountant, banker, investment adviser, insurance agent, practice advisers and consultants, transition specialist, and, of course, your own family. Our

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Dr. Ortho Dentics				JANUARY	
ACTUAL vs. BUDGET ANALYSIS				2004	
<i>Month Ended January 31, 2004</i>	ACTUAL	%	BUDGET	%	DIFFERENCE
COLLECTIONS					
Collections	\$ 128,272	101.2%	\$ 95,300	100.0%	\$ 32,972
NSF	(1,582)	-1.2%	-	0.0%	(1,582)
Refunds	-	0.0%	-	0.0%	-
Net Collections	\$ 126,690	100.0%	\$ 95,300	100.0%	\$ 31,390
STAFF EXPENSE					
Payroll - Gross	\$ 29,606	23.4%	\$ 21,700	22.8%	\$ 7,906
Payroll - Bonus	-	0.0%	-	0.0%	-
Payroll Tax - Social Security	1,452	1.1%	1,345	1.4%	106
Payroll Tax - Medicare	429	0.3%	315	0.3%	115
Payroll Tax - Unemployment	-	0.0%	250	0.3%	(250)
Retirement	-	0.0%	1,200	1.3%	(1,200)
Retirement - 401(k)	-	0.0%	-	0.0%	-
Insurance - Medical/Reimburse.	2,422	1.9%	1,000	1.0%	1,422
Insurance - W.C.	-	0.0%	-	0.0%	-
Uniforms	-	0.0%	200	0.2%	(200)
Continuing Education	163	0.1%	150	0.2%	13
Travel	-	0.0%	-	0.0%	-
Dues	-	0.0%	-	0.0%	-
Misc. Gifts	-	0.0%	-	0.0%	-
Misc. Lunch	78	0.1%	50	0.1%	28
Other Staff Expense	2,092	1.7%	50	0.1%	2,042
TOTAL Staff Expense	\$ 36,242	28.6%	\$ 26,260	27.6%	\$ 9,982
ORTHODONTIC EXPENSE					
Disposable Supplies	\$ 965	0.8%	\$ 550	0.6%	\$ 415
Products - Bands/Brackets	3,207	2.5%	2,500	2.6%	707
Products - Elastics	1,904	1.5%	450	0.5%	1,454
Products - Wires	262	0.2%	2,200	2.3%	(1,938)
Invisalign	-	0.0%	1,800	1.9%	(1,800)
Commercial Lab	2,616	2.1%	3,000	3.1%	(384)
Lab Supplies	416	0.3%	250	0.3%	166
X-Ray Expense	-	0.0%	200	0.2%	(200)
Photo Expense	-	0.0%	150	0.2%	(150)
Other Orthodontic Expense	395	0.3%	75	0.1%	320
TOTAL Orthodontic Expense	\$ 9,765	7.7%	\$ 11,175	11.7%	\$ (1,410)

Fig. 1 Sample budget analysis using Excel spreadsheet (continued on next page).

BUSINESS MANAGEMENT					
Bank Charges	\$ 192	0.2%	\$ 150	0.2%	\$ 42
Collection Expense	-	0.0%	-	0.0%	-
Credit Check	-	0.0%	-	0.0%	-
Marketing - Video	-	0.0%	-	0.0%	-
Marketing - Advertising	25	0.0%	400	0.4%	(375)
Marketing - Brochures	-	0.0%	-	0.0%	-
Marketing - Doctors	104	0.1%	500	0.5%	(396)
Marketing - Patients	474	0.4%	400	0.4%	74
Marketing - Magazines	-	0.0%	-	0.0%	-
Marketing - Promotion	600	0.5%	300	0.3%	300
Office Supplies	1,200	0.9%	2,000	2.1%	(800)
Computer Expense	-	0.0%	650	0.7%	(650)
Repairs & Maintenance	-	0.0%	200	0.2%	(200)
Rental/Leased Equipment	286	0.2%	2,628	2.8%	(2,342)
Insurance - Bus. OH	-	0.0%	-	0.0%	-
Insurance - Liability	-	0.0%	-	0.0%	-
Insurance - Other	-	0.0%	-	0.0%	-
Taxes & Licenses	-	0.0%	100	0.1%	(100)
Outside Services - Accounting	135	0.1%	250	0.3%	(115)
Outside Services - Consulting	-	0.0%	-	0.0%	-
Postage & Shipping	17	0.0%	450	0.5%	(433)
Travel & Entertainment	-	0.0%	300	0.3%	(300)
Dues & Subscriptions	-	0.0%	250	0.3%	(250)
Printed Items/Stationery	-	0.0%	150	0.2%	(150)
Other Business Management Exp.	3	0.0%	100	0.1%	(97)
TOTAL Business Mgmt. Expense	\$ 3,036	2.4%	\$ 8,828	9.3%	\$ (5,792)
OCCUPANCY EXPENSE					
Rent	\$ 5,600	4.4%	\$ 2,692	2.8%	\$ 2,908
Utilities	-	0.0%	200	0.2%	(200)
Telephone	223	0.2%	1,200	1.3%	(977)
Janitorial	270	0.2%	500	0.5%	(230)
Maintenance - Exterior	-	0.0%	-	0.0%	-
Maintenance - Interior	-	0.0%	200	0.2%	(200)
Other Occupancy Expense	310	0.2%	100	0.1%	210
TOTAL Occupancy Expense	\$ 6,403	5.1%	\$ 4,892	5.1%	\$ 1,511
TOTAL EXPENSES BEFORE DOCTOR COMPENSATION	\$ 55,446	43.8%	\$ 51,155	53.7%	\$ 4,291
OPERATING INCOME	\$ 71,244	56.2%	\$ 44,145	46.3%	\$ 27,099
OVERHEAD RATE	43.8%		53.7%		-10%

Fig. 1 (cont.) Sample budget analysis using Excel spreadsheet (continued on next page).

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<i>Month Ended January 31, 2004</i>	ACTUAL	%	BUDGET	%	DIFFERENCE
DOCTOR'S COMPENSATION					
Payroll - Doctor	\$ 15,000	11.8%	\$ 15,000	15.7%	\$ -
Payroll - Doctor Bonus	-	0.0%	-	0.0%	-
Payroll - Family	1,000	0.8%	1,085	1.1%	(85)
Payroll - Family Bonus	-	0.0%	-	0.0%	-
Payroll Taxes - Social Security	373	0.3%	997	1.0%	(624)
Payroll Taxes - Medicare	87	0.1%	233	0.2%	(146)
Retirement - Doctor	-	0.0%	3,000	3.1%	(3,000)
Retirement - Doctor 401(k)	-	0.0%	-	0.0%	-
Auto - Lease	718	0.6%	1,262	1.3%	(544)
Auto - Gas	-	0.0%	200	0.2%	(200)
Auto - Insurance	-	0.0%	-	0.0%	-
Auto - Phone	-	0.0%	-	0.0%	-
Auto - Other	-	0.0%	-	0.0%	-
Cellular Telephone	-	0.0%	-	0.0%	-
Continuing Education	-	0.0%	150	0.2%	(150)
Insurance - Disability/Medical	-	0.0%	500	0.5%	(500)
Insurance - Life	1,032	0.8%	-	0.0%	1,032
Dental Reimbursement	-	0.0%	-	0.0%	-
Travel	-	0.0%	-	0.0%	-
Meals & Entertainment	-	0.0%	1,200	1.3%	(1,200)
Uniforms	-	0.0%	-	0.0%	-
Professional Dues	300	0.2%	-	0.0%	300
Professional Journals	-	0.0%	-	0.0%	-
Other Doctor Compensation	72	0.1%	200	0.2%	(128)
TOTAL Doctor Compensation	\$ 18,582	14.7%	\$ 23,828	25.0%	\$ (5,245)
TOTAL PRACTICE EXPENSES					
	\$ 74,028	58.4%	\$ 74,983	78.7%	\$ (954)
NET OPERATING PROFIT (LOSS)					
	\$ 52,662	41.6%	\$ 20,317	21.3%	\$ 32,344
NON-PRACTICE (INCOME)/EXPENSE					
Depreciation/Amortization	\$ -	0.0%	\$ -	0.0%	\$ -
Donations/Contributions	150	0.1%	-	0.0%	150
Non-Practice (Income)	-	0.0%	-	0.0%	-
Non-Practice Expense	181	0.1%	250	0.3%	(69)
TOTAL Non-Prac. (Income)/Expense	\$ 331	0.3%	\$ 250	0.3%	\$ 81
REPORTED BOOK INCOME/(LOSS)					
	\$ 52,331	41.3%	\$ 20,067	21.1%	\$ 32,263

Fig. 1 (cont.) Sample budget analysis using Excel spreadsheet.

TABLE 2
DEVELOPING A “ZERO-BASED” PERSONAL BUDGET

1. Develop a budget for each month of the year, using a suitable budget worksheet (Fig. 2).
2. Agree that you *must* spend every dollar every month.
3. Distribute large expenses throughout the year to even out the monthly expenses. (Example: Taxes, insurance premiums, and other large expenses should not come due in December when you have all your Christmas expenses.)
4. Allocate the first 10% of your income to charitable gifts and contributions.
5. Allocate the second 10% of your income to investments and savings.
6. Allocate the remaining income to pay your monthly expenses.
7. If any money is left over, divide it between investments and savings and debt reduction. The goal is to get out of debt as soon as possible. The key to building real wealth is to become *debt-free*.
 - a. First, set aside an emergency fund of \$5,000.
 - b. List *all* your debts in order from smallest to largest, regardless of the interest rates. Pay off the smallest first, then the next smallest debt, and so on until all debts have been eliminated. Do not include your house and your office, if you own it, at this point.
 - c. After these debts have been eliminated, use the extra income to establish a savings fund of three to six months' expenses in case of emergency. The objective is not ever to have to borrow any money from the bank.
 - d. Don't forget to save for college expenses for your children.
 - e. Pay off your house and office as early as possible—preferably in no more than 10 years.
8. Invest regularly in high-quality equities, using mutual funds in a balanced portfolio, and in high-quality real estate.
9. Maximize your pretax retirement investments at the office: IRA, 401(k), pension and profit-sharing plans. NOTE: This example is only one possible plan; each of us is in a different situation. I highly recommend that you consult with a trusted financial adviser, who will tailor a plan for you and then hold you accountable to the plan you develop.

investment adviser, Brian May of Jonathan Smith and Co.,* coordinates all these individuals and helps my wife and me with the development of our practice and personal budget, and with the execution of our investment and spending plan.

Step 6: Prepare for the Eventual Sale of Your Practice

Practice transition is not a one-time event; it takes planning and forethought. You need to start planning for the last day you practice on the first day you practice. Orthodontic practices are extremely valuable, but the sad reality is that in the future, at least one out of three will not be sold. To avoid becoming one of these, you must

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start the planning process as early as possible and make your practice as good as it can possibly be.

Conclusion

What will your legacy be? Will it be the biggest house in your neighborhood? Will it be the most expensive car? Or will your legacy be securing the future of your family and donating millions to help support your favorite charities? It has been said that “the most fun you can ever have with money is giving it away”. Maybe it is time for my orthodontic colleagues and me to stop wasting our money on conspicuous consumption and become more responsible with the financial resources with which we have been so abundantly blessed.

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MONTHLY BUDGET PREPARATION WORKSHEET FOR MONTH OF _____				
BUDGETED ITEM		AMOUNT BUDGETED	ACTUALLY SPENT	% OF TOTAL INCOME
SAVINGS	CHARITABLE GIFTS			10%
	INVESTMENTS			10%
	EMERGENCY FUND			
	RETIREMENT FUND			
	COLLEGE FUND			
	INVESTMENT FUND			
HOUSING	FIRST MORTGAGE			
	SECOND MORTGAGE			
	REAL ESTATE TAXES			
	HOMEOWNERS INSURANCE			
	REPAIRS			
	FURNITURE			
	OTHER MORTGAGES			
	OTHER			
UTILITIES	ELECTRICITY			
	WATER			
	NATURAL GAS			
	PHONE			
	CELLULAR PHONE			
	CABLE			
	INTERNET			
	TRASH PICKUP			
FOOD	GROCERIES			
	RESTAURANTS			
TRANSPORTATION	AUTOMOBILE PAYMENT			
	AUTOMOBILE PAYMENT #2			
	AUTOMOBILE PAYMENT #3			
	GAS AND OIL			
	REPAIRS AND TIRES			
	AUTOMOBILE INSURANCE			
	LICENSE AND TAXES			
	AUTOMOBILE REPLACEMENT			
CLOTHING	CHILDREN			
	ADULTS			
	LAUNDRY AND DRY CLEANING			
MEDICAL, DENTAL, HEALTH	HEALTH INSURANCE			
	DENTAL INSURANCE			
	DISABILITY INSURANCE			
	DOCTOR BILLS			
	DENTAL BILLS			
	OPTOMETRIST			
	DRUGS AND PRESCRIPTIONS			

Fig. 2 Monthly budget preparation worksheet (continued on next page).

MONTHLY BUDGET PREPARATION WORKSHEET FOR MONTH OF _____				
BUDGETED ITEM		AMOUNT BUDGETED	ACTUALLY SPENT	% OF TOTAL INCOME
PERSONAL	LIFE INSURANCE			
	CHILD CARE			
	BABY SITTER			
	TOILETRIES			
	COSMETICS			
	HAIR CARE			
	EDUCATION			
	SCHOOL TUITION			
	SCHOOL SUPPLIES			
	CHILD SUPPORT			
	ALIMONY			
	SUBSCRIPTIONS			
	ORGANIZATIONAL DUES			
	GIFTS			
	CHRISTMAS			
	MISCELLANEOUS			
BLOW \$\$\$\$\$\$\$				
RECREATION	ENTERTAINMENT			
	VACATION			
DEBTS	VISA			
	MASTERCARD			
	AMERICAN EXPRESS			
	DISCOVER CARD			
	GAS CARD			
	DEPARTMENT STORE CARD			
	FINANCE COMPANIES			
	CREDIT LINE			
	STUDENT LOAN			
	OTHER			
OTHER				
TOTALS	GRAND TOTAL			
	MINUS TOTAL INCOME			
	EQUALS ZERO			

Fig. 2 (cont.) Monthly budget preparation worksheet.

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