Are Your Accounts Receivable Healthy and Balanced?

Having "healthy" accounts receivable means that a significant amount of your monthly income comes in the form of monthly payments from patients, few of whom are delinquent. Even though low accounts receivable are a goal for many orthodontic practices, receivables that are low because of excessive paid-in-full accounts, high down payments, short-term contracts, or excessive use of orthodontic financing companies provide no financial cushion for the practice. That can lead to drastic crashes in cash flow during vacation periods and other times when case starts are down.

Too many paid-in-full accounts, while temporarily bringing in substantial cash flow, can create a significant clinical liability with no future revenue—a major issue in many practice sales. Big down payments and short-term contracts also generate cash flow, but at what cost to your case acceptance rate? Heavy use of third-party orthodontic financing such as Orthodontists Fee Plan creates cash flow in months when you have lots of case starts, but at what cost to your patient relationships and your future supply of new patients? Many people are not interested in having their accounts handled by finance companies.

On the other hand, accounts receivable may be too high due to excessive delinquency, weak financial arrangements, low down payments, and overly long contracts. This can cause significant damage to the practice's well being, most notably in the administrative workload associated with keeping those receivables under some control. Practices in this situation generally have strong collections—even with high delinquency—simply because there are so many patients on the books owing the practice so much money that the cash flow is still more or less equal to the average monthly production.

Balance is what is needed to keep receivables healthy! Balanced accounts receivable are roughly equal to 5.5 months of production, with no more than 5% of all accounts (not dollars) 30 days or more past due. Balance also requires that the average down payment be about 20-25% of the average full case fee. Some patients may choose to pay 50% down, and some may choose to pay nothing down. Both extremes are acceptable, assuming you grant credit appropriate to risk; it is only the average down payment that counts. The average contract length should be roughly 85-90% of the average diagnosed treatment time. Some full 24-month cases may pay in 12 months, and others may be given 24 months to pay, or sometimes even longer. Again, it is the average contract length that determines balance. To have balanced receivables, your paid-in-full accounts, whether by patients or by orthodontic financing companies, must be balanced as well. No fewer than 10%, but no more than 20%, of your case starts should be paying in full.

Having balance in your accounts receivable will ensure a consistently strong cash flow, even during brief periods of low productivity such as vacations, or when you simply have a bad month. More important, the policies and procedures you must implement to have your receivables in balance are also the policies and procedures that will promote the best possible case acceptance and practice growth.

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A Response

There are many third-party prepayment programs available, although OFP is the one used most in orthodontics. There is no question that the use of such a financing company will move cash flow forward in time by prepaying the doctor for the entire fee. I outline below the reasons why I feel that this is a benefit for the practice and certainly not a detriment.

1. No monthly statements need be sent out to patient families who have enrolled in prepaid programs.
2. The practice does not need to perform a credit check when referring the account. Poor credit risks will learn of their refusal from the financial institution, not from you. Should the prospective patient's credit not be acceptable, you may be able to develop some other way for payment to be made—perhaps by the child's grandparents, perhaps by using a "high-risk program" with a higher rate of interest. But in the event of poor credit, you will not be the bearer of bad news.
3. You will have the use of the money in advance of treatment. To some degree, of course, this will create a period of "limited financial heaven". There will come a time when the doctor-held contracts will be paid off and the practice must realize that it is on a different cash-flow program than it was before.
4. The percentage of patients who elect to pay in advance—with a discount of (usually) 7%—will increase dramatically. A substantial number of patients will elect to pay in advance with a discount rather than pay interest on the obligation.
5. If tooth movement is completed earlier than expected, there will be no reluctance on your part to remove the appliances. You will sever the relationship of "the money to the medicine" in the minds of your patient families. For many years, people believed that the monthly payments were compensation for the monthly visits. This, in turn, created a reluctance by the orthodontist to debond if payments were incomplete. Now, since the payments are unrelated to the visits, you can be a hero by finishing early.
6. If a patient family's payments become delinquent, you will not have to chase them down, with all the displeasure and agony that always accompany those efforts. Orthodontists in general are not emotionally prepared to press for payments or exert pressure upon families who become delinquent.
7. When you sell your practice, you will not have to reduce the price because you are using a third-party financing company. No practice management consultant today recommends any change in the formula for determining a sale price because the practice has collected in advance for treatment. As the use of third-party financers increases, however, some adjustment factor may be developed to reflect early collection of fees in advance of the delivery of orthodontic services.

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