

BREAK-EVEN ANALYSIS

A CRITICAL COMPONENT IN FINANCIAL DECISION MAKING

Maureen Waddle, MBA, and Dixon Davis, MBA, MHSA

Every practice owner and administrator must make critical decisions. Here is a small sampling of common questions practices ask regularly:

- *“Should we buy a new piece of equipment to improve patient care?”*
- *“We’d like to add a new physician to the practice. How will that impact practice profitability?”*
- *“My colleagues added this new service line and say it has worked great for their practices. What if we added that service line?”*
- *“I think we should open a satellite near the new hospital that just opened 30 miles away. What are the financial implications of such a project?”*

As managers, it is our job to provide the financial analysis that helps our owners understand the impact on the practice when deciding to move forward with an opportunity. Often times, there are other considerations—such as quality of patient care or long-term strategic planning—that might cause owners to make a decision even though there is a negative financial impact. However, as long as the owners understand the impact *before* making the decision, you’ve done your part to help them prepare.

The break-even analysis is a foundational tool for making sound business/financial decisions. A break-even analysis will identify that point where an

investment moves from financial loss to zero ... and upward into profitability. In simplest terms, a break-even analysis identifies the point when revenue received equals the total expenses and results in a net zero gain/loss (i.e., the practice has not lost money nor has it made money in the endeavor.) This is the break-even point.

PRACTICAL APPLICATION

Following are several examples of where/why a practice might apply a break-even analysis to answer some common—but important—business questions or options.

- **Purchasing new equipment.** A practice wants to purchase new diag-

TABLE 1: BE BY VOLUME

SAMPLE - IC Better, LLC

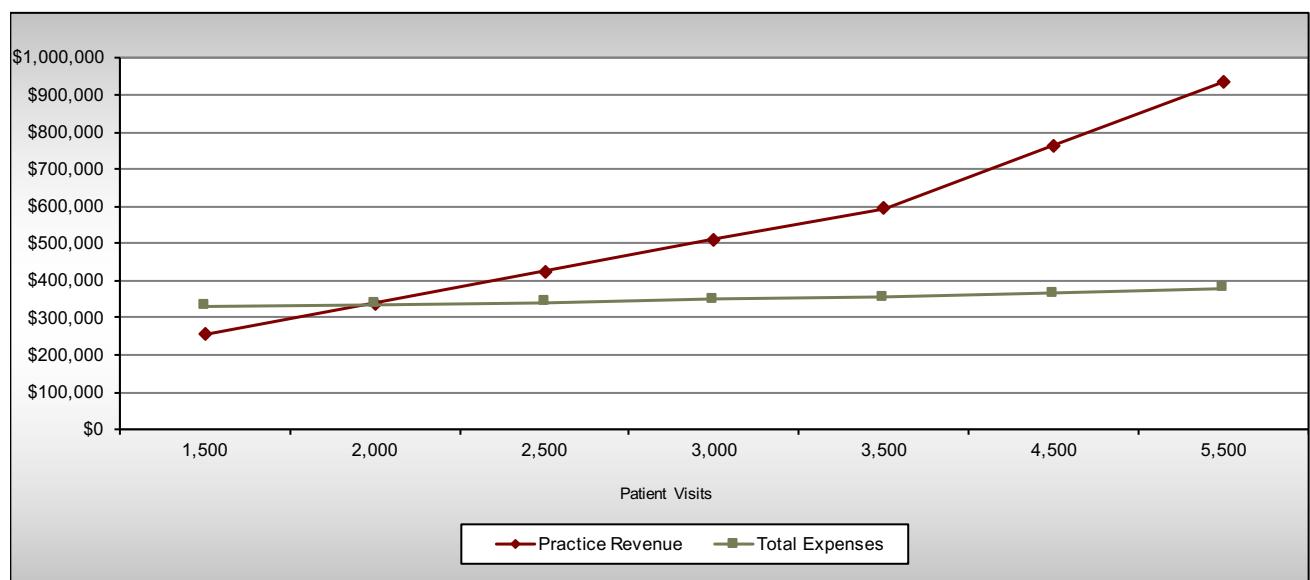
New Physician Break-Even Analysis

Assumptions¹

Revenue Rate per Encounter
 Fixed Expenses (See Exhibit 1)
 Base Salary New MD
 Payroll Tax and Benefits New MD
 Incentive Compensation - Percentage
 Incentive Compensation - Threshold Amount

\$170
\$125,000
\$150,000
\$37,500
30%
\$375,000

Patient Encounters ²	Revenue Rate per Encounter	Practice Revenues	Variable Expenses	Fixed Expenses	Total Expenses	Net Income
1,500	\$170	\$255,000	\$18,000	\$312,500	\$330,500	-\$75,500
2,000	\$170	\$340,000	\$24,000	\$312,500	\$336,500	\$3,500
2,500	\$170	\$425,000	\$30,000	\$312,500	\$342,500	\$82,500
3,000	\$170	\$510,000	\$36,000	\$312,500	\$348,500	\$161,500
3,500	\$170	\$595,000	\$42,000	\$312,500	\$354,500	\$240,500
4,500	\$170	\$765,000	\$54,000	\$312,500	\$366,500	\$398,500
5,500	\$170	\$935,000	\$66,000	\$312,500	\$378,500	\$556,500



Courtesy BSM Connection® new provider feasibility analyzer.

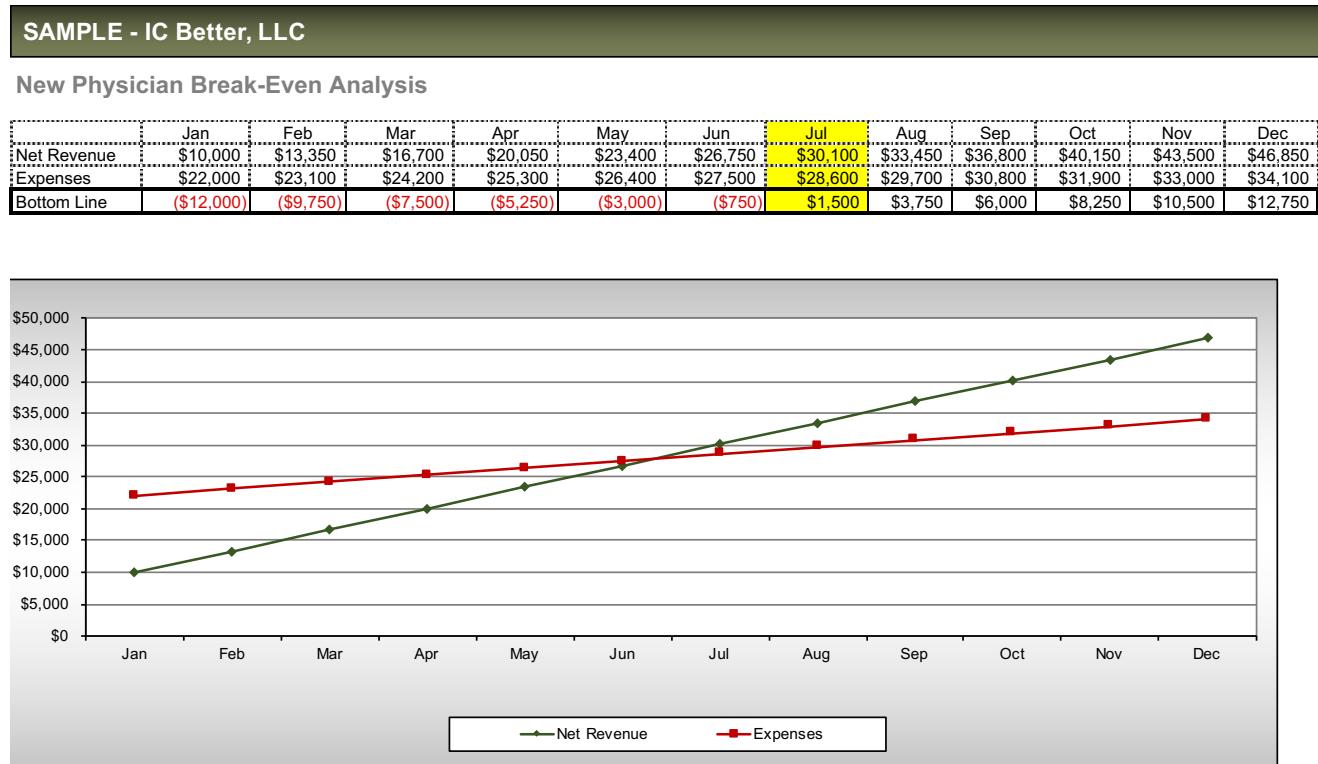
nostic equipment because the doctors believe they will receive better information in order to determine treatment for patients. A break-even analysis can identify the number of

tests (and subsequent revenue) needed to cover the expense of purchasing and operating the new equipment.

- **Hiring a new provider.** Hiring additional physicians can provide

additional resources and specialty skills for patients. A break-even analysis can identify how much revenue the new physician will need to generate to cover the additional expenses incurred. It can

TABLE 2: BE BY MONTH



also determine how long it may take to accomplish this and the financial impact until that time. Based on an accurate assessment of market demand, this is a good “gut-check” as to how quickly a new provider will contribute profits to the practice.

- **Adding a new service line.** In this scenario, practices need to make several assumptions about the types of services provided and the revenues received for those services, and compare the results against the expenses that will be incurred from space and equipment requirements to adding new providers. A break-even analysis can provide a clearer picture of timing and realistic expectations of when (if) the service offering will become profitable.

- **Adding a new location.** A break-even analysis can help identify the costs associated with new construction (both hard costs and potential down time) and then identify the amount of revenue required to cover both the initial and ongoing costs related to the new site.

CASE STUDY

To work through a break-even analysis, let's use this scenario: a plan to hire a new physician. In break-even analysis, the basic mathematical equation is:

$$\text{Revenue} - \text{variable expenses} = \text{fixed expenses}$$

The break-even point is referred to as the point where revenue for services minus all variable expenses, equals the fixed expenses. In other words, at what

point will the net revenue for services provided cover all of the costs associated with the service?

An important component of a break-even analysis is to identify and define the appropriate measurement and time intervals that will be used in the calculation. For example, the calculation might include the number of encounters (appointments) that will need to be performed during the year in order to cover the expenses that will be incurred during that same year. A different application of the principle is to identify the point in time during the year when revenue will finally cover fixed expense.

Hiring a new physician can be exciting and beneficial. At the same time, it can be a major financial

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investment. In this scenario, the fixed cost of hiring the new physician will include his/her salary, salary for additional techs or assistants, benefits for both, insurance premiums, association membership, hospital privileges, credentialing expenses, office space, equipment, marketing, and other costs associated with bringing on the new physician. Variable expenses include medical supplies, office supplies, and any single-item expenses that increases in use with the number of services provided.

Tables 1 and **2** show two types of break-even calculations that provide value in two different ways.

Table 1 shows the volume required in a one-year time period for the new provider to be profitable. This will help in understanding if the practice can realistically achieve the key assumptions (volume and average revenue per visit) in order to cover the anticipated expenses and, more importantly, achieve profitability as quickly as possible.

This analysis demonstrates that with 2,000 encounters, the physician reaches break-even and starts to be profitable for the year.

Table 2 is used to identify the month (in the first year) during which the new physician will break even (cover his/her monthly expenses), based on 2,000 encounters identified in the previous table. While not

all expenses for the investment will be recouped at that time, the new physician will start breaking even on a monthly basis at this point.

In this analysis, the new physician will break even and start to be profitable in July, fully covering his/her monthly costs with monthly revenue.

BETTER BUSINESS DECISIONS

The break-even principle provides valuable information to make better business decisions. Although quality of care is always the paramount driver, if practices fail to take the time to use good information to make better business decisions, then the business cannot succeed and patients are negatively impacted. Owners and managers who apply the break-even principle are able to make investment decisions with a higher level of financial awareness and with an increased ability to plan for the financial impact on the business. **AE**



Maureen Waddle, MBA (916-687-6135; mwaddle@bsmconsulting), and Dixon Davis, MBA, MHSA (801-510-2278; ddavis@bsmconsulting.com), are senior consultants for BSM Consulting.

