

# Starting Your Own Medical Practice

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## ***What risks are involved?***

*Before taking the plunge, first ask these important questions.*

Making the decision to design and develop your own medical practice can be exciting, but it requires careful thought and planning. It's not for everyone. Physicians certainly may have plenty of intellectual capacity and personal confidence, but the benefits of being your own boss are offset by subtle but dangerous business risks for which physicians may be ill-prepared.

### ***Are You Ready?***

Going solo in a group-practice world means going against the flow, and yet it is just the right thing for some physicians to do. The group practice model developed across the country rapidly in the 80's and 90's as a risk-sharing business model especially as managed care emerged, and along with it the need for costly investments in information technology. By the mid-90's, more than half of all physicians practiced in groups, and it became the preferred model for about three-fourths of all new physicians. The group practice model also offers call-sharing, the potential for efficient contracting with insurers, and the potential for collegiality and/or peer review.

But the group practice model also requires physicians to make concessions for the good of the group, and sometimes that causes friction. Highly productive physicians can feel weighed down by less-productive colleagues, and sometimes the extra energy required to keep the relationships vital and to develop group consensus just don't seem worth the effort; causing some physicians to wonder about the benefits of being on their own. Before you take the plunge to owning your own practice, ask a handful of hard questions:

1. How much income am I willing to risk while the business builds?
2. How much debt am I willing to incur to reach a sustainable cash flow?
3. Do business decisions and tasks really interest me as much as medicine such that I'll attend to them rather than simply tolerate them?
4. Is my family ready to fully support this decision and to join me in making the sacrifices that might be necessary?

What benefits can I realistically expect to achieve by owning my own practice that I can't get any other way?

If your most honest answers still point in the direction of being on your own, then it's time to develop an agenda of decisions. Starting up a new practice literally requires hundreds of decisions about legal, financial, office and staffing issues, and each decision holds risks that can undermine your success.

### ***Managing Risk Through Budgets***

Two of the cornerstones for planning a new practice are to develop an operational budget and a capital budget. The operational budget will be a forecast of your revenues and expenses based on a variety of assumptions about your activities. The capital budget will be an estimate of the amount you may need to borrow for furniture and equipment, office improvements, and initial operating costs. Together,

**The benefit of operational and capital budgets**

these two budgets summarize the financial risks you'll be taking and help you discern whether the venture is feasible. Excel worksheets are vital tools for developing budgets like these since you can easily test multiple variables at various values until you get a balanced budget. Here is a simple example of how an operational budget for family practice might look under three scenarios:

|   | Conservative | Mid-range | Thriving  |
|---|--------------|-----------|-----------|
| <b>Assumptions</b>                      |              |           |           |
| FTE Physicians                          | 1.00         | 1.00      | 1.00      |
| Average Visits per FTE Physician        | 3,500        | 4,000     | 5,365     |
| Average Insurance Premium per Physician | \$9,500      | \$10,500  | \$11,500  |
| Average Benefits per Physician          | \$9,000      | \$9,500   | \$10,000  |
| Mid-level practitioners                 | 0.0          | 0.5       | 1.0       |
| Average Visits per FTE Mid-levels       | 2,674        | 3,272     | 4,385     |
| Average Wage per Mid-level              | \$55,000     | \$65,000  | \$70,000  |
| Average charge per visit                | \$80         | \$90      | \$100     |
| Gross collection ratio                  | 75%          | 80%       | 82%       |
| Managed Care Income (all types)         | \$0          | \$10,000  | \$25,000  |
| Inflation rate                          |              |           |           |
| Square feet                             | 1,300        | 1,500     | 2,000     |
| Utilities per square foot               | \$1.75       | \$2.00    | \$2.25    |
| Rent cost per square foot               | \$12.00      | \$15.00   | \$18.00   |
| Repairs and maintenance per square foot | \$8.50       | \$9.00    | \$10.00   |
| Property taxes per square foot          | \$0.00       | \$4.00    | \$4.50    |
| Equipment to depreciate                 | \$60,000     | \$75,000  | \$90,000  |
| Depreciation rates @ 5 years            | 20%          | 20%       | 20%       |
| Support staff per FTE Provider          | 2.0          | 3.0       | 3.2       |
| Support staff FTEs                      | 2.0          | 4.5       | 6.4       |
| Average wage                            | \$20,000     | \$25,000  | \$30,000  |
| Benefits and taxes as % of wages        | 20%          | 25%       | 30%       |
| Information Technology                  | \$7,234      | \$9,306   | \$14,520  |
| Medical and Surgical Supplies           | \$15,821     | \$20,329  | \$26,145  |
| Furniture and Equipment                 | \$2,356      | \$3,987   | \$8,594   |
| Admin Supplies and Services             | \$8,319      | \$12,576  | \$16,525  |
| Outside Professional Services           | \$1,567      | \$2,971   | \$5,382   |
| Promotion and Marketing                 | \$631        | \$1,401   | \$2,663   |
| Radiology and Imaging                   | \$0          | \$0       | \$0       |
| Miscellaneous Operating Costs           | \$3,293      | \$6,033   | \$30,000  |
| Physician encounters                    | 3,500        | 4,000     | 5,365     |
| Mid-level encounters                    | 0            | 1,636     | 4,385     |
| Ambulatory encounters                   | 3,500        | 5,636     | 9,750     |
| <b>Income/Expense</b>                   |              |           |           |
| Total Income                            | \$210,000    | \$415,792 | \$824,500 |
| <b>Expense</b>                          |              |           |           |
| <b>Support Staff Costs</b>              | \$48,000     | \$140,625 | \$249,600 |
| <b>Information Technology</b>           | \$7,234      | \$9,306   | \$14,520  |
| <b>Medical and Surgical Supplies</b>    | \$15,821     | \$20,329  | \$26,145  |
| <b>Building and Occupancy</b>           | \$28,925     | \$45,000  | \$69,500  |
| <b>Furniture and Equipment</b>          | \$2,356      | \$3,987   | \$8,594   |
| <b>Admin Supplies and Services</b>      | \$8,319      | \$12,576  | \$16,525  |
| <b>Insurance Premiums</b>               | \$9,500      | \$10,500  | \$11,500  |
| <b>Outside Professional Services</b>    | \$1,567      | \$2,971   | \$5,382   |
| <b>Promotion and Marketing</b>          | \$631        | \$1,401   | \$2,663   |
| <b>Radiology and Imaging</b>            | \$0          | \$0       | \$0       |
| <b>Miscellaneous Operating Costs</b>    | \$3,293      | \$6,033   | \$30,000  |
| Total Overhead Expense                  | \$112,321    | \$230,228 | \$400,929 |

An excel worksheet is a vital tool for developing budgets.

**Budgets help you manage the risks before launching!**

|  |           |           |           |
|--|-----------|-----------|-----------|
| Net Income                               | \$97,679  | \$185,564 | \$423,571 |
| Add back depreciation                    | \$12,000  | \$15,000  | \$18,000  |
| Net Cash Flow                            | \$109,679 | \$200,564 | \$441,571 |
| <b>Midlevel wages</b>                    | \$0       | \$32,500  | \$70,000  |
| <b>Physician Benefits</b>                | \$9,000   | \$9,500   | \$10,000  |
| Net Available for Physician Compensation | \$100,679 | \$158,564 | \$361,571 |

Excel spreadsheets allow the planner to play with the assumptions that feed into formulae in the budget and see the impact on the bottom line instantly. Each set of assumptions represents a set of business risks, and by testing the assumptions with an Excel spreadsheet, you can begin to manage the risks associated with them before launching the business. Information about standard business costs for each specialty can be purchased in survey reports from the Medical Group Management Association as a starting point, but it is vital to refine the revenues and expenses based on your own realities.

A simpler but similar spreadsheet can be developed for capital expenses. It will include costs like these:

- Legal, accounting and consulting expenses to start up the business
- Office furniture and equipment
- Medical furniture and equipment
- Leasehold improvements for office space
- Computer hardware and software for billing, scheduling, and possibly electronic medical records
- Accounts receivable build-up
- Operational losses during the start-up phase

The last two items on the capital budget will be the most difficult to discern. It typically takes 30-90 days to get paid by insurers for “clean claims.” When a new practice starts up, the billing process is usually not without a few bugs, so it may be difficult to get clean claims out right away. Survey data can assist in gauging what the median accounts receivable will be when the practice has stabilized, but in my experience, it can take from six to eighteen months to reach a stable level. In addition, the practice may not be generating sufficient business activity to cover the overhead costs and a modest income for the physician-owner until referrals and schedules become steady at sustainable levels. Meanwhile the practice will have bills to pay that require cash, and that cash will most likely come from bank loans.

Hospitals may offer an income guarantee for new practice start-ups, but pay attention to the details of the agreement. In most cases the cash advances will be limited to certain kinds of expenses for a limited period of time, and they will certainly require some form of payback, either in service or in future cash flows that exceed agreed amounts. Hospital guarantees can be valuable risk-management instruments, but it is absolutely vital that physicians understand the terms of the agreement.

**Resources for the Next Steps**

Discerning the feasibility of starting up a new practice is a complex process, but it is just the beginning. Once the decision has been made to go forward, knowing the financial risks, there are still scores of decisions to be made about where to locate, which insurers to participate with, how many staff to hire – and who they should be – and what they should be paid... It can be satisfying to be fully responsible for your

*Other recommended capital expense budgets.*

***The right consultant makes a world of difference!***

*Lessons learned from working with over 400 medical practices across the U.S.*

own professional destiny, but it will also be a big job to get set up.

Practice management consultants like The Hekman Group offer significant resources to help physicians manage the risks of starting a new practice. The right consultant brings research and experience that can shorten the learning curve and help the physician to manage the risks. An investment in consulting services can be just as important as investments in billing systems, and can produce returns by avoiding costly mistakes.

***Lessons Learned***

The excitement and rewards of being on your own can be real, but not every physician-owned practice is a raging success. I am frequently called in as a consultant to both groups and solo practices where financial strains have reached an intolerable level, and physicians are looking for answers as to what went wrong with their dreams. The lessons learned from troubled practices can often be validated by their healthy counterparts. Here are a few that I've gleaned from working with over 400 medical practices across the U.S. :

1. **Failure to go through the planning process.** Physicians who trust their own problem-solving abilities more than they value the experience of others are setting themselves up for disappointment. The complexities of medical practice ownership are far beyond the days when the new doctor could simply put out his shingle. Test and refine your assumptions on paper (or Excel spreadsheets) before risking real money.
2. **Understand the market.** Physicians need a certain number of patients to provide a revenue stream sufficient to meet their needs. If you go into a community that has more physicians of your specialty than the community can support, you'll have a difficult time making it. Do the research and make sure there is a balanced supply and demand in your specialty, or that if it is unbalanced, it is unbalanced in your favor.
3. **Be prepared to work hard.** When you own your own practice, you – and you alone – are fully responsible for your production. Be accessible to your patients. Make it easy for them to do business with you. Be prepared to defer time off until the cash is flowing soundly. Work hard in the satisfaction that the rewards are yours too.
4. **Watch the spending.** If you're just emerging from the long years of training, you may have deferred gratification for a lot of things you now think you deserve. Hold that thought a little longer. Keep your personal spending low until you earn the money from the business. Keep the business expenses in line with the budget you developed in the planning process. Start-up debts, including hospital guarantees, should further temper your business spending. Keep your overhead structure simple. You can make improvements later when the cash flow is more than enough to meet your needs.

The efforts required to succeed in a solo practice are wide-ranging. It's not for every physician, but it can be a rewarding and gratifying experience for those willing to take risks as they pursue the benefits. Find the resources to help you manage the risks, and you'll increase your potential for a highly satisfying and rewarding professional career.