The Problem with Payroll

There are rarely 'homeruns' on the financial side of our practices. Instead, look for 'base hits' - small incremental changes that when added together over time make a big impact.

Remember that when selling your practice, the top line makes your first impression, but it is the bottom line that determines the price. Improvements to the top line (more revenue) add $.15 to $.20 per revenue dollar to the bottom line (the amount is determined by <u>your margin</u>). Improvements to your expenses, however, add $1.00 to the bottom line for every dollar saved in expenses. To say it another way, you have to earn $5 to $6 in revenue to have the same impact on your bottom line and eventual price, as one dollar saved in expenses.

The number one expense that upsets a practice's bottom line is payroll. It is usually the largest expense in your budget and the personal nature of this expense makes it very difficult to change. It also appears to be highly susceptible to 'creep' (the upward growth of this expense without explanation – it just seems to get bigger).

To understand how the payroll problem is detected, we use the measure 'payroll as a percentage of revenue'. There are actually two payrolls in the analysis – staff payroll and doctor payroll. To be clear, this is <u>staff payroll</u>, and most optometrists who have meaningful profit and loss statements (P&L's) will separate "doctor payroll" from "staff payroll" (these have two very different measures and when they are separated on the P&L, this is easy to assess and make improvements).

> The Management Business Academy (MBA) study, sponsored by Ciba and Essilor, including over 1,600 established optometric practices, states the average cost of staff to be 20% of the adjusted gross income. Aug 1, 2011

As with any improvement measure, staff payroll as a percent of revenue is best understood as a range. If you fall outside of that range, it is an improvement opportunity flag. We like to see staff payroll between 23% and 27%. You will hear other statistics quoted but they are often old (a decade or more) and staff costs have risen dramatically over the past 5 years. Also, we are discussing the measure in the context of selling your practice.

$$\frac{\text{Staff payroll(not taxes and benefits)}}{\text{Collected revenue}} = \text{Staff payroll as a percentage of revenue}$$

When I am explaining to a seller why we didn't get the price offer we expected, our eyes often turn to payroll as the culprit that submarined our price negotiations. I often hear seller comments like, "I am proud of the way I pay my people." "I really take care of my staff." "My team has been with me for a long, long time." All are valid comments, but they really don't address why your payroll is so high as a percent of revenue.

Long-time staff should be earning a higher wage, but with time, they should also take on greater responsibility and become more efficient. They earn their higher wages because of these two traits not length of time. If you have a performance problem with a long-time staff member, address it and make sure they are shouldering enough responsibility and performing at a level that warrants their higher salary.

Balance long-time staff with new recruits. New recruits do require an investment of time, but they bring new life into the office and are often compensated at a lower rate.

Create compensation models more closely aligned with growth of the practice instead of time-based increases. Many doctors I work with tie salary increases at the end of the year to the revenue growth of the practice. You can also keep salaries flat and increase compensation through SPIFs (Sales Performance Incentive Fund). Add to this fund based on the achievement of goals set (second pair sales, increase in optical sales, number of new patient appointments). Like any goal, make sure the staff has control over the goal they are trying to achieve. Talk about it often and share data results as often as available.

Take-Aways

1. Separate staff payroll from doctor payroll in your chart of accounts. This will provide better insight
2. Expense reductions have a 5X to 6X impact on your bottom line as compared to adding revenue
3. Tie increases in compensation to increases in practice performance whenever possible.
4. Bring your staff payroll to 23% to 27% of revenue

Photo by [Amy Hirschi](#) on [Unsplash](#)