Elements of an Office Business Plan, Practice Financing, and Obtaining a Business Loan

CHAPTER 11

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If you want somebody else's money, you're going to have to prove to them that you have a snowball's chance of success.

James Klinler *Professor of Entrepreneurship, Villanova University in Pennsylvania*

There are no short cuts to any place worth going.

Beverly Sills – opera star

THE BUSINESS PLAN

The business plan is a roadmap for your future success. It serves as a guide in decision making and helps the entrepreneur formalize and quantify plans and goals. It details the aspects of your potential practice/business for both you and potential lenders or investors. It must demonstrate your ideas, commitment, and ability to implement the plan. Simply desiring to own a business or to control a business entity is not adequate for success. Detailed planning and diligent attention to the details of the business are required. Review the suggestions contained in the Quick Tips segments. Each provides valuable insights and directions for developing your business.

It is important that you write your own business plan if you are contemplating starting a practice or buying a practice. The process of writing your own business plan will clarify exactly what is involved in making your business (a practice is a business) succeed. Individual entrepreneurs handle financial and personal risks differently. Working through financial projections, considering personnel management, forecasting financial obligations, and quantifying levels of effort to make a business succeed are all val uable tools in determining your suitability to business ownership and executive responsibility. Many doctors tend to underestimate the importance of operating a practice like a business.

QUICK TIPS

HIRE A PROFESSIONAL

Every business benefits by securing the expertise of a lawyer, accountant, or bookkeeper (preferably one focusing on small businesses). They will assist in the following:

- *Setting up your financial records*
- *Explaining financial terms and legal requirements*
- Giving valuable advice on billing, payment, and payroll
- Procedures
- *Giving advice on tax-saving strategies*
- *Assisting with financial components of your business plan*

The business plan, when developed fully, is not only a device to obtain financing but also a guide to establishing and building a practice (whether starting or buying) with your personal stamp on it. Your business plan is usually the first impression that potential lenders/investors have of your venture, thus it should look professional. The finished plan often influences a lender to decide whether to invite you in for an initial meeting. When writing your plan, do not overwhelm the reader with optometric jargon. For example, if you have the need to refer to a presbyopic patient, explain what you mean by a presbyopic patient. At the end of the document, include appendices, if needed, to support the information presented in your plan. Supporting documentation demonstrates to the lender that you are diligent in your efforts to secure financial support.

Dr. Godwin Wong, an Adjunct Professor of Entrepreneurship at the Haas School of Business, University of California at Berkeley, identifies 17 elements that should be addressed in any business plan. Five of these elements he considers critical. The additional elements can help those who review your plan to better appreciate your vision, and they can help you develop your ideas. These elements are not unique to Professor Wong but can be found in any detailed discussion of business planning (see Bibliography at the end of this chapter). Professor Wong's 17 elements are as follows:

1. Executive Summary
2. Introduction/Synopsis
3. The Venture/Business Idea
4. Overall Industry
5. Market Research/Competition
6. Production/Sourcing Plan
7. Service/Delivery Plan
8. Marketing/Sales Plan
9. Management Plan
10. Human Resource Plan
11. Ownership/Organization Plan

12. Financial Plan
13. Financing Plan
14. Growth/Exit Plan
15. Implementation Plan
16. Contingency Plan
17. Assessment/Evaluation Plan

The elements identified as essential in development of the business plan are Market Research/Competition, Service/Delivery Plan, Marketing/Sales Plan, Financial Plan, and Financing Plan. Note that elements 6 through 17 all have "plan" as part of the name.

QUICK TIPS

- *If you follow Professor Wong's 17 elements of a successful business plan and start to identify information that belongs in each section, you will begin to formulate your plan.*
- *Do not worry about hitting your business projections* ***exactly;*** *investors know that things can go "off plan."*
- *Have your plan neatly bound at your local print shop or put in blue, black, or brown covers purchased from the stationery store. If you are rejected by a lender for a loan, retrieve your business plan, if possible. Make sure you have additional copies.*
- *If rejected, ask "why". If you can, correct the problem and resubmit.*

Executive Summary

The Executive Summary is designed to provide a quick overview of the entire project/idea. It should contain limited detail covering the scope of the plan. This is definitely the place to use straight-forward language, and it should be a concise statement.. It allows the reader to understand the intent of the proposal. It should be a maximum of one-page long. This summary is generally prepared and written after the rest of the plan has been completed.

Introduction/Synopsis

The Introduction/Synopsis is a short element that summarizes what is going to be said in the remainder of the plan, with more specifics and detail than the Executive Summary. It should include the following:

- The intended audience
- The reason for the proposal/plan
- The business idea
- The proposed financing method, if needed
- The limits of the scope of the entire document

As with the Executive Summary, this element is appropriately prepared after the remainder of the plan has been worked out. Again, brevity is important. Realize that if this plan is being used to gain financing, there will probably be several levels of readers or reviewers. By providing the two summaries, you have addressed some of those levels.

The Venture/Business Idea

The Venture/Business Idea is the section in your plan in which you demonstrate your understanding of the business or venture you are proposing. It is intended to answer a number of questions the reader or reviewer might have. Questions to answer include the following:

- What is this business?
- Why this business?
- Why this business at this location?
- What type of business structure do you propose?
- What makes this business unique or likely to succeed?
- What, if any, type of specialization?

This is the place to describe your optometric business: professional services, ophthalmic materials, and anything else that is relevant to the enterprise. A description of what makes this particular business unique or allows it to stand out from similar businesses/practices should be included, for example, practice specialties (low vision, pediatrics), high end, discount, convenience (hours, location, speed of service), languages, and insurance coverage.

Overall Industry

Often, readers or reviewers of a business plan may not have a good understanding of the optometric industry. Take advantage of this opportunity to educate the reader. A discussion of the size of the industry (nearly $30 billion), including a graph of growth over the past 10 to 20 years, can be effective. A discussion of the professions and providers who make up the optometric industry is also valuable. It is appropriate to introduce the major players in the industry—manufacturers, chains, and private practitioners. How the market share of the industry is divided is important. A description of the modes of delivery of products and how those products are typically used should be included in this section. A review of the history of the eye care industry and your projection of the future is valuable.

Good sources for this kind of information are as follows:

- American Optometric Association (AOA): "Caring for the Eyes of America" and other AOA surveys
- Jobson and other publishers serving the industry
- CIBA and Essilor's Management & Business Academy publications

A brief discussion of how large corporations and chains might affect your business/practice for the area of the community selected can be valuable to prospective lenders.

Market Research/Competition

Market Research/Competition is an important element in the development of the business plan. Understanding the market and in particular, the competition is a necessary component in any plan. Determining who or what the competition for the venture is will be necessary when trying to develop the target market. How one perceives the market response to the proposed business helps develop the strategy one will use to penetrate that market.

Does the competition have similar or different themes? The market size of the target market is a determining factor in potential success. Once the target market segment is defined, analysis of that segment is needed (e.g., potential utilization of the optometric services to be offered; the return per unit of service or product; price elasticity of that market; and the potential price stability given a variety of possible competitors, present or potential). When the potential market is identified, one needs to determine the share of that market needed to succeed.

Additionally, understanding the reasons patients/customers come to the business is important (e.g., annual examinations, desiring new spectacles or contact lenses, medical reasons, surgical consults, location, and so on). How will the proposed business satisfy those needs (see Service/Delivery Plan)?

An important component of any evaluation of a potential practice location is a detailed evaluation of the demographics of a proposed location and area, as well as a detailed analysis of potential competition. The following elements should be considered:

Average age of population

Income level of population

Population growth of area

Number and size of families

Quality of schools

Availability of public transportation

Trends in number and distribution of optometrists, ophthalmologists, opticians, etc.

Gaps in eye and vision care in community (What will your niche be?) Penetration of managed care

A number of resources are available to aid in determining this information. Much of it is readily available through city and town offices, local Chambers of Commerce, state boards, and local optometric societies. Another way to gather this information is by using a variety of web sites on the Internet such as the following:

http://www.census.gov

http://quickfacts.census.gov

http://mcdc2.missouri.edu/websas/dp3_2kmenus/us/ZIP_Codes/

http://www.FreeDemographics.com

http://www2.fdic.gov/recon (family income)

http://www.yellowpages.com

Production/Sourcing Plan

The Production/Sourcing Plan describes how the products of the "business" are produced. How will this business obtain the product? Will the business make it or will parts of it be obtained from a wholesaler or other supplier? Materials supplied to patients in an optometric practice are seldom produced from "scratch" by the practitioner. Identifying desirable frame vendors and finishing laboratories will indicate knowledge of the business of optometry and can enhance the lender/ investor's confidence in the potential success of the business. Contact lens vendors and delivery strategies should be addressed. Buying groups should also be identified. (Buying groups allow the small, independent practice to compete on material costs with the chains and corporate practices.)

A large portion of the production of the business/practice revenue is derived from professional services, but, in most optometric practices, materials/ophthalmic devices constitute a large revenue source for the overall business.

It is important to identify and attempt to quantify the cost of a product. It is a necessity when trying to allocate sources of funds and in determining profit for a given "product." Since a reasonably large portion of the revenue for an optometric practice derives from professional services, it is valuable to determine the cost of delivering a unit of service.

Service/Delivery Plan

The Service/Delivery Plan defines how the business/practice will function and determines the business climate proposed. It is possible to start here to determine how one wants to practice. In addition to being of great value in the overall business plan, the Service/Delivery Plan can help one find a practice to buy or determine the location for a new business. Selecting a location for a new practice requires investigation. Different choices may include the following: a professional building (best space is on the first floor); shopping center ('end cap' unit is more desirable offering more visibility); a storefront space (easy parking); mall (usually has good foot traffic, but expensive to rent); a freestanding building (expensive to purchase, but good investment); and office condominium (association fees, but good real estate equity).

Examples of topics to be covered under this heading are as follows:

- Hours and days of service
- How will the "product" be delivered
  - Professional services
  - Product turnaround
- Convenience of delivery
- What makes this proposed practice special?
- Floor plan or office design

Marketing/Sales Plan

The Marketing/Sales Plan for the business/practice is another of the key elements that needs to be covered thoroughly. It serves as the foundation for development and subsequent growth of the business.

How will the numbers and concepts presented elsewhere in this overall plan be delivered? How will new patients be attracted to this practice? How can one expect to get additional income per patient while continuing to put patient benefits first? It will be important to explain how the advantages in patient perceptions will improve market penetration. How will patient perceptions be managed and enhanced? How will insurance panel membership be obtained in both "well vision care" and medical coverage insurance plans? How will these benefit the success of the practice itself? What are the plans for increasing awareness of the practice in the general community and attracting new patients? Answers to these questions will aid in demonstrating to the lender/investor the reasonable outlook for achieving success.

It will be important to project costs for all marketing and practice development plans. What identity, logo, or name, if any, are proposed? Are special promotions planned? The 4 "Ps" of marketing need to be addressed in detail:

1. Product
2. Placement
3. Promotion
4. Place

Management Plan

In the Management Plan the various operational functions of the business are identified, and job areas or individuals responsible for those functions are defined. In a small business like an optometric practice, having an employee for each job or assignment is generally not practical. Therefore most individuals in a practice have multiple responsibilities. The important element to be included in this section is the identification of those business functions that need to be monitored and managed on an on-going basis.

Many of the responsibilities will remain with the business owner(s). Those duties and responsibilities that can be delegated or given to outside professionals should be identified here. Tasks that can be done by outside professionals include bookkeeping, payroll, tax preparation, accounting, legal documents, and so on. Those tasks delegated to staff might include (but would not be limited to) the following: daily settlements (subject to review and verification by the owner), vendor interaction, cost control, or bookkeeping.

Human Resource Plan

Human resources constitute a major portion of office expenses, generally accounting for 18% to 22% of gross receipts. As such, this area should be addressed in a business plan, as well as how monitoring will occur as the business evolves. The costs generally increase as the business grows, although the percentage of gross revenues devoted to this expense may decrease due to efficiencies of scale. Hidden costs must be considered if one is able to project the sources. They may include matching costs of Social Security and Medicare; employer-paid taxes, such as unemployment insurance and workers compensation; and health insurance, retirement, and other employer provided benefits. These costs can add from 10% to 25% to the payroll categories.

The specific elements that should be addressed under the human resource plan are as follows:

- Positions
- Recruitment
- Retention
- Motivation
- Pay
- Benefits

Ownership/Organization Plan

The Ownership/Organization Plan describes the form of business entity being proposed (e.g., sole proprietorship, partnership, S corporation, or C corporation) should be described. This section delineates the planned ownership of the entity. Will it be owned by a single individual (who)? Will there be partners (who)? If so, how will the partnership be structured? If a corporation, what type and how will shares be distributed or owned?

Consult a good accountant and seek legal advice and always ask, "Why do I need to do this?" and "What will happen if I do not do this?"

Financial Plan

The Financial Plan is the most important element of the business plan. The Financial Plan separates the dreams from reality. It is most easily developed and communicated with a spreadsheet. A minimum of 3 years should be projected. Figure 11-1 is a 1-year sample spreadsheet.

For an optometric practice the Financial Plan should include the following:

- Patients per day
- Gross revenue per patient
- Occupancy costs (rent, upkeep, utilities, office insurance)
- Payroll costs
- Cost of goods (frames, lenses, contact lenses, other materials)
- Debt service
- Insurance—professional liability
- Advertising
- Draw or salary to owners

This plan also serves as the initial budget for the business. If appropriate, the plan should include the transition plan if the practice is being purchased. The plan essentially serves as the projected profit and loss projection for the first 3 years. It identifies potential revenue sources and expense expectations. An example of a 1-year projection can be found in the sample spreadsheet provided in Figure 11-1.

Financing Plan

The Financing Plan identifies sources of funding for the venture, including bank financing, Small Business Administration loans, savings, family, or partners. The expected contribution of each source should be itemized. To assist an optometrist interested in starting a new practice or in buying an existing practice, there are a few companies who understand and specialize in optometric practice financing. VisionOne Credit Union and Matsco, A Wells Fargo Company, are two of those. These companies are usually more willing to lend money to optometrists not qualifying for traditional loans since their expertise is concentrated on this profession. VisionOne (800-327-2628) specializes in optometric practices. Matsco specializes in medical and dental practices.

Funds should include working capital. The Business Plan should account for the cash needed to operate while the

Assumptions

Gross income per patient exam	$ 250	Annual professional draw	$48,000
Annual rental/occupancy costs	$15,000	Annual staff salary	$27,000
Annual telephone expenses	$ 2,400	Annual office expense	$ 3,000
Annual insurance costs	$ 1,800	Annual supplies	$ 1,200
Annual utilities costs	$ 3,600	Annual miscellaneous expenses	$ 1,800

Month	1	2	3	4	5	6	7	8	9	10	11	12	Total
Number of Patient Exams	20	30	35	40	50	60	60	60	60	70	70	75	630
(A) Practice Income	$ 5,000	$ 7,500	$ 8,750	$ 10,000	$ 12,500	$ 15,000	$ 15,000	$ 15,000	$ 15,000	$ 17,500	$ 17,500	$ 18,500	$ 1,57,500
(B) Material Costs and Laboratory Expenses	$ 1,750	$ 2,625	$ 3,063	$ 3,500	$ 4,375	$ 5,250	$ 5,250	$ 5,250	$ 5,250	$ 6,125	$ 6,125	$ 6,563	$ 55,126
(C) Expenses, Rent,Utilities	$ 1,550	$ 1,550	$ 1,550	$ 1,550	$ 1,550	$ 1,550	$ 1,550	$ 1,550	$ 1,550	$ 1,550	$ 1,550	$ 1,550	$ 18,600
(D) Telephone	$ 200	$ 200	$ 200	$ 200	$ 200	$ 200	$ 200	$ 200	$ 200	$ 200	$ 200	$ 200	$ 2,400
(E) Insurances	$ 150	$ 150	$ 150	$ 150	$ 150	$ 150	$ 150	$ 150	$ 150	$ 150	$ 150	$ 150	$ 1,800
(F) Taxes/Licenses	$ 300	$ 0	$ 0	$ 450	$ 0	$ 0	$ 450	$ 0	$ 0	$ 450	$ 0	$ 0	$ 1,650
(G) Professional Monthly	$ 4,000	$ 4,000	$ 4,000	$ 4,000	$ 4,000	$ 4,000	$ 4,000	$ 4,000	$ 4,000	$ 4,000	$ 4,000	$ 4,000	$ 48,000
(H) Office Salary	$ 2,250	$ 2,250	$ 2,250	$ 2,250	$ 2,250	$ 2,250	$ 2,250	$ 2,250	$ 2,250	$ 2,250	$ 2,250	$ 2,250	$ 27,000
(I) Office Expenses	$ 250	$ 250	$ 250$	$ 250	$ 250	$ 250	$ 250	$ 250	$ 250	$ 250	$ 250	$ 250	$ 3,000
(J) Promotion/Marketing	$ 200	$ 200	$ 200	$ 200	$ 200	$ 200	$ 200	$ 200	$ 200	$ 200	$ 200	$ 200	$ 2,400
(K) Supplies	$ 100	$ 100	$ 100	$ 100	$ 100	$ 100	$ 100	$ 100	$ 100	$ 100	$ 100	$ 100	$ 1,200
(L) Loan Payment													
(M) Misc	$ 150	$ 150	$ 150	$ 150	$ 150	$ 150	$ 150	$ 150	$ 150	$ 150	$ 150	$ 150	$ 1,800
Total Expenses *	**$10,900**	**$11,475**	**$11,913**	**$12,800**	**$13,225**	**$14,100**	**$14,550**	**$14,100**	**$14,100**	**$15,425**	**$14,975**	**$15,413**	**$162,976**
Net Income or Loss	–$5,900	–$3,975	–$ 3,163	–$ 2,800	–$ 725	$ 900	$ 450	$ 900	$ 900	$ 2,075	$ 2,525	$ 3,337	
Cumulative Income or Loss	–$5,900	–$9,875	–$13,038	–$15,838	–$16,563	–$15,663	–$15,213	–$14,313	–$13,413	–$11,338	–$ 8,813	–$ 5,476	

***Does Not Include loan payments**

FIGURE 11-1 Cash flow projection.

Explanation of Figures Used in Cash Flow Projection Chart

All of the figures listed are very basic (minimum) costs. You will have to adjust according to your particular business plan projections.

A. Practice income is determined by multiplying the number of patients seen during the month (in parenthesis) times $250 (hypothetical average patient charge for examination and materials.)
B. The cost of laboratory expenses is estimated to be 35% of patient fees.
C. Rent is figured on a 750 square foot office at $20 per sq. foot, or $15,000 per year. Utilities are estimated to be $300 per month.
D. Telephone expenses are estimated to be $200 per month.
E. Insurance costs are estimated to be $1,800 per year or $150 per month.
F. Initial license expenses and local, state, and federal taxes paid quarterly.
G. The monthly professional draw is the amount of money you take out of the practice as your salary. You may need to raise or lower this figure depending on your projected personal living expenses.
H. Salary for office staff assumes one full-time assistant.
I. Office expenses include cleaning, bank service charges, accounting services, etc.
J. Projected expenditures for ongoing promotion/marketing of practice, e.g., newspaper ads, patient newsletters, web site, etc.
K. Expenditures for supplies used on a daily basis such as stationery, forms, tissues, etc.
L. Loan payments, (once known) will need to be factored into the overall expenses.
M. Miscellaneous is just a catchall for any additional expenses not recorded elsewhere.

According to Jerry Hayes, OD, Management & Business Academy, practices can simplify their budget into seven categories:

Gross Revenue is 100%

- Cost of goods 23-33%
- Staff salaries and benefits 15-20%
- Occupancy costs 4-8%
- Patient care equipment 3-5%
- Marketing and promotion 2-4%
- General office overhead 6-9%
- Practice net income 30-40%

The above figures are averages and may be different, depending on individual practices. In conclusion, lenders want to know that you and your venture are a good risk. Where the money will come from and where it goes are key components of a business plan.

FIGURE 11-1—cont'd

business is beginning to grow and until it reaches the break-even point, which is the financial benchmark that demonstrates the business can support itself and the principal owner(s). The Financial Plan, discussed in the previous section, needs to demonstrate that the cash flow is sufficient to support the loan debt service and the take home pay for the principal(s).

Growth/Exit Plan

Any good business plan should include a consideration of the future. Planning for growth and expansion are incumbent on the business owner. Although this is discussed in more detail in the section on the Contingency Plan, a brief discussion of an exit strategy is important. When does one leave the business? How does one leave the business?

Implementation Plan

An Implementation Plan delineates how one plans to actually accomplish the opening or takeover of a business. An implementation process is defined in time, and the plan can be created in chart form. The chart may take several different forms, such as time bars, critical path, or other accepted illustration tools, that incorporate time dependencies. Frequently, for a business plan that does not have a defined start date, the chart may be created in relative terms (e.g., 1 month from start, 7 days before opening, and so on).

Items to be included in the Implementation Plan are as follows:

- Renting/obtaining space
- Remodeling as needed
- Buying or leasing equipment
- Supplier agreements
- Insurance panel membership
- Obtaining needed licenses:
  - Professional
  - Business
  - Other
- Seller’s permits

Contingency Plan

The Contingency Plan describes strategies for unexpected events and the strategies to be implemented in the event forecasts are not met. Where will additional funds be sought for unachieved events? How will expenses be reduced to offset potential losses? Is there a situation in which the business would/could be abandoned with minimal financial loss?

Assessment/Evaluation Plan

The Assessment/Evaluation Plan describes the techniques that will be used to measure the performance of the business. This plan will include the assessment tools to be used and how frequently the assessments would be done. This plan can also describe the methods to be used to fine tune the business performance. These measures will help evaluate the relative success of the business or alert the owner to the warning signs that the business is potentially in trouble. The benchmarks that will be used to trigger corrective changes should be identified.

Additional Resources

The advent and growth of the Internet has made those reference materials once difficult readily available to anyone with access to a computer and rudimentary computer skills. A review of these references will show that there are a number of ways to build a business plan. A single version has been described here. The review will also demonstrate the diverse approaches that are available.

The following is a compendium (but not a complete one) of available sources:

- http://www.sba.gov/starting
- http://www.onlinewbc.gov
- http://www.nawbo.org (National Association of Women Business Owners, specifically for female entrepreneurs)
- http://www.nfibonline.com (National Federation of Independent Businesses)
- http://www.business-plan.com
- http://www.entrepreneur.com
- http://www.entrepreneur.com/startingabusiness/businessplans/article38290.html
- http://www.entrepreneur.com/startingabusiness/businessplans/article38292.html
- http://www.entrepreneur.com/startingabusiness/businessplans/article38308.html

PRACTICE FINANCING AND OBTAINING A BUSINESS LOAN

The usual initial encounter with financing a business venture is the creation of a business plan to either start or buy into a practice. Once identified, the steps of the business plan described here will guide the strategy used to create practice goals, make financial projections, organize the office, identify target markets, and obtain required resources and financing. A business plan should anticipate and answer basic questions that will be asked by potential creditors from whom the optometrist seeks funding (Box 11-1).

Proper financing is an integral part of the success of every optometric business. Understanding the basic financial concepts and methods used by lending institutions is fundamental to obtaining favorable financing. Money is necessary to start a new practice, to purchase part or all of an existing practice, or to obtain working capital to expand an operating practice. It is an unfortunate situation when a new practice with great potential fails because it was undercapitalized. The following sections identify fundamental components in the financing process and describes basic financial situations an optometrist encounters, types of loans available, sources of funds, seller financing, and standards used to evaluate applicant credit worthiness.

BOX 11-1

Business Plan Questions to Answer When Requesting Financing

- Have all expenses associated with location, patient demographics, rent, laboratory costs, and fixed and variable office overhead been explained and justified?
- Have projected revenue and expenses been realistically estimated?
- Is the business plan achievable and practical to implement? Has the business plan been reviewed by advisors?
- Has a marketing plan that satisfies practice objectives been given an adequate budget allocation?
- Does the borrower have a favorable credit history?
- Are emergency funds available for slow periods?
- What is the amount of the loan, and what collateral will secure the loan? How much equity or personal funding is the borrower investing?
- Is there an outside guarantor who is willing to secure the loan?

E

DETERMINING FINANCING NEED

Projections of income, expenses, potential profit, and financing requirements are, as a rule, required by nearly all lending institutions. A good understanding of financial or accounting statements can benefit an optometrist by facilitating this undertaking. The three primary financial statements are as follows:

- Income statement (profit and loss statement)
- Balance sheet
- Cash-flow statement

Each of these tools has a different purpose and can be used to help assess the financial implications of the business plan for the practice.

Income Statement

The income statement, also referred to as the profit and loss statement, shows the profit that a practice produces in a given period, usually a year. Income statements are based on the accrual method of accounting. In this method, income is recorded when earned rather than received, and expenses are recorded when incurred rather than paid. The income statement shows just how profitable a practice is and is represented by the following formula:

Net profit = Revenue − Expenses

The five areas reported in the income statement are as follows:

- Revenue generated from professional services and the sale of products (income)
- Costs of acquiring products and inventory that have been sold (cost of goods sold)
- Operating expenses (fixed and variable expenses)
- Financing costs (credit interest and principal)
- Tax payments (taxes paid)

An example of an income statement can be found in Chapter 36.

Balance Sheet

The balance sheet offers a glimpse of a practice's financial health at any given point by reporting the cumulative result of all previous decisions that influenced the finances and operations of the practice to that time. It shows the assets owned by the practice, the debt obligations owed, and the equity (net worth) the owner has invested in the practice. The balance sheet is represented by the following formula:

Assets = Liabilities (debt) + Owner's equity (net worth)

An example balance sheet can be found in Chapter 36.

Cash-Flow Statement

A cash-flow statement reveals the sources and uses of practice income for any given period. It is the definitive account of cash-flow status because it is generated using the cash basis method of accounting. In this method, income is reported when received and expenses are reported when paid. Noncash expenses such as depreciation, credits, or uncollectable debts are not included. An example cash-flow statement may be found in Chapter 36.

The amount of capital required will vary with the type of practice situation. New offices require equipment, inventory rental deposit, and sufficient working capital funds to operate until the practice becomes self-supporting. The purchase of an existing practice usually requires a substantial down payment, ranging from 10% to 25% of the purchase price, and adequate working capital for operations and payments to the seller for financing. These payments should be included in the monthly projected operating budget.

It is necessary to accurately determine the amount of money that will be needed from a creditor. If funds are inadequate, the creditor may not be willing to extend the amount borrowed or modify the terms of the loan. To support insufficient start-up capital, most optometrists incur long-term debt rather than sell equity in the practice. Long-term debt is paid with interest, usually over a period of more than 5 years (average 5 to 10 years); it gives the creditor neither ownership interest nor control of the practice.

Increased expenses, a slowdown in patient visits or payments, or rapid office expansion may create a shortage of working capital. The classic resolution is the use of mediumto long-term credit. New or additional debt should only be obtained, however, if cash-flow projections show that the loan will generate sufficient profits to pay the debt.

FINANCIAL FORECASTING

Capital financing of a practice is accomplished through 1 of 2 means. The first is equity capital, which may be external (financing from the initial investment an optometrist makes in a practice) or internal (financing generated from practice operations that is reinvested into the practice, not paid out as salary or profit). The second means is through the loan process (assumption of debt capital).

The projected performance of a practice is used by loan officers to substantiate the worthiness of giving a loan. Projected data come from pro forma financial statements (see Figure 11-1) that are used to answer the following questions:

- How profitable can this practice be given the likely level of revenue and associated operating expense?
- What determines the optimal amount and type of financing, either debt or equity?
- Will the practice have sufficient cash flow, and how is it to be used? Potential practice profit can be forecast by making the following calculation:
- Make realistic sales projections based on recent past performance.
- Subtract the anticipated cost of goods sold and operating expenses to obtain the operating profit of the practice or earnings before interest and tax.
- Deduct the amount of interest to be paid on anticipated outstanding loans to acquire and operate the practice.
- Deduct the estimated amount of taxes that will be owed.

The result will be the net profit (or loss). An example of this calculation may be found in Chapters 8 and 36.

Liquidity measures the ability of a practice to pay off current debt obligations through adequate working capital. A way of measuring liquidity is to calculate financial ratios. The *current ratio* is a measure of cash, accounts receivable, and inventory (collectively referred to as *current assets*) that is divided by the amount of short-term debt, or *current liabilities*, as shown in the following equation:

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

This ratio should be at least 2 to 1 to be considered adequate. Another related ratio that indicates a practice's liquidity is the debt-to-asset ratio, which measures the total amount of debt as a percentage of tangible assets.

LOAN CATEGORIES

Financing available to optometrists generally falls into the following categories:

Long-term capital: An arrangement in which repayment extends for more than 5 years. Long-term loans are repaid from earnings. This type of loan is usually required when purchasing a practice or when a practice is unable to meet the obligations of an intermediate-term loan.

Intermediate-term capital: An arrangement in which repayment must be made over 2 to 5 years. These loans also are repaid from earnings and are often used for the purchase of ophthalmic equipment.

Short-term capital: An arrangement in which repayment usually takes no longer than 1 year.

Short-term loans are used to finance the purchase of a large quantity of inventory, with repayment expected from the sale of goods.

Banks may make a loan based on the borrower's reputation, usually for a small amount and for a short term, as an unsecured loan. Collateral is not required, and the bank relies on the borrower's good credit rating. Credit cards and lines of credit are examples of unsecured loans. A secured loan requires the borrower to possess an asset ("collateral") that can be taken or sold by the bank if the borrower cannot repay the loan. The bank requires the collateral as protection for its depositors against the risk that the loan will fail.

There are many factors in the loan process for which the borrower has no control. Recession, fluctuating interest rates, and changes in bank regulations can interfere with an optometrist's ability to obtain financing.

DETERMINING CREDIT WORTHINESS

When an optometrist applies for a loan, the creditor will ask two major questions. The first is: What is the likelihood that the borrower will default on the loan? To answer this question, the creditor will want to determine how risky the loan is and assess the borrower's ability to repay. Creditors will find answers by analyzing the practice's profit and loss statement, balance sheet, and cash-flow summary. Loan institutions often request all data about both business and personal income, including expenses and equity. For start-up offices, comparisons to industry data can be obtained from *Annual Statement Studies* (Philadelphia, Robert Morris Associates). If the borrower is purchasing an existing practice, financial information about the practice will be requested as part of the loan proposal. A practice appraisal is recommended to assist in obtaining this information.

The creditor's second question is: What is the borrower's credit history, as obtained from a credit report? To answer this question, the creditor will investigate the borrower's prior borrowing history. Any late payments, even from years earlier, will require proper explanation to the lending company. A poor credit repayment history will severely affect the ability to obtain funds. An excellent credit rating will not guarantee a loan but will help significantly in the total process of obtaining funds.

Before a lending agency will advance money, the institution must be satisfied with the borrower's answers to the questions listed in Box 11-2.

To determine whether a borrower's business is credit worthy, satisfactory financial data will be necessary. Loan institutions want to make loans to businesses that are solvent, earning profits, and expanding. The two fundamental financial documents used to ascertain those positions are the income statement and the balance sheet. The income statement is a primary measure of profits and losses, and the balance sheet is a fundamental gauge for assets and liabilities. The bank usually will request the profit and loss statements and balance sheets of an office for at least 5 years preceding the loan. If these documents are not available, tax returns are substituted. A consecutive sequence of these two statements over a period is the primary means for measuring financial balance and development capacity.

BOX 11-2

Questions Lending Institutions Ask Borrowers

- What type of individual is the borrower? Most often, personal qualities come first.
- What is the borrower's ability to manage an office?
- What is the purpose of the loan? The answer will determine whether a short- or long-term loan will be granted. Money to be used for inventory may require faster repayment terms than money used to buy equipment.
- Do income and expense projections allow the borrower to pay the loan back and afford ample income for all projected living expenses?
- Is there a cushion in the loan to make allowances for unforeseen developments?
- What is the outlook for optometry in general and for the proposed office in particular?

EVALUATING A LOAN APPLICANT

After a borrower has furnished the required data, the next phase in the borrowing process is the evaluation of the application by the bank's loan officer. Most lending agencies consider similar factors when determining whether to award or decline a loan, based on what has come to be known as the *5 Cs of credit:*

- Borrower's Character
- Borrower's Capacity to repay the loan
- Amount of Capital invested by the borrower
- Current economic and industry Conditions
- Amount of Collateral used to secure the loan

Additional factors that will influence the decision to grant or withhold a loan are based on the borrower's previous history of debt payment, previous business experience and employment history, the ratio of the borrower's debt-to-net worth, and the practice's past financial performance.

In reviewing loan documents, the banker will be particularly interested in the following:

Fixed assets. What is the fair market value of the major equipment and furnishings? What are the depreciated values? Fair market value appraisals by qualified appraisers for banks often will need to be obtained. Qualified appraisers for ophthalmic equipment often can be hired from companies involved in selling ophthalmic equipment. The loan institution will inform the borrower of its requirements for an appraisal. A second type of appraisal involves the calculation of *book value*. The book value of equipment is determined by subtracting the amount of depreciation claimed from the original cost of the equipment. Depreciation tables can be used to determine an item's book value.

Accounts receivable. Are accounts receivable part of the sale and value of the practice? Are the accounts receivable low in value because many patients are behind in payments? What is the percentage of accounts receivable that is being collected? The lending institution must be asked to state its policy for loans that include accounts receivable. If funds are not available for the payment of accounts receivable, the purchase agreement must be negotiated with the seller so that the accounts receivable are not part of the sale.

Inventory. Are frames and supplies current? Is a large part of the inventory on consignment (held for sale rather than purchased)? Is the inventory turnover similar to that of other offices? Many lending institutions prefer not to support a portion of a loan that is backed with inventory as collateral. The reason is that inventory used as collateral is difficult to liquidate by a creditor in case of foreclosure.

General business information. Are the books and records upto-date?What are employee salaries? Have employment taxes been paid? What is the number of employees? Does the office provide health insurance and other benefits to employees? These and similar questions will customarily be posed by the creditor.

OBTAINING A BUSINESS LOAN

The traditional means of delivering optometric services—sole proprietorship—requires offices to be equipped with an array of up-to-date instruments, inventories of frames and contact lenses, specialty service instrumentation; and tasteful fixtures and furnishings, which places a heavy financial burden on practitioners seeking to practice in the time-honored way. In addition, there are operating costs that must be met (e.g., rent, taxes, utilities, and salaries), which means that the graduate seeking entry into private practice must obtain financing to be able to afford the start-up costs of such a practice. Whether the venture being proposed or the business seeking funding is a sole proprietorship, a partnership, or a professional corporation, certain requirements remain the same.

In the usual case, financing must be acquired both for capital assets and operating expenses. Thus the creditor may be required to loan more money than there is collateral to serve as security, which necessitates careful planning and meticulous preparation on the part of the borrower because the creditor will have to be convinced that the risk is minimal to make such a partially unsecured loan. To ensure that the risk is low, the creditor will dictate the terms of the agreement and will protect the interest in the collateral. The following discussion is on the conventional devices used by creditors to secure loans and to protect collateral in the event of default on the part of the borrower. It also describes the preparation of a loan proposal intended to secure the necessary financing.

FUNDAMENTALS OF FINANCING

The usual source of loans for the initiation of a practice is a full-service bank, although there are numerous other alternatives (see Sources of Funding section). The most basic aspects of bank financing involve the method of repayment and the type of interest. Borrowing money involves not only the act of obtaining the loan but also the repayment of principal and interest. Although there are number of methods used for the repayment of loans and for the computation of interest, this discussion is limited to the usual techniques used by banks.

Banks rely on the following two principal methods for the repayment of loans:

Renewable short-term notes are instruments that acknowledge the loaning of money for relatively brief periods (usually 90 days), with provisions for renewal at the option of the lender. At the close of any 90-day period, the lender can demand payment of the balance due—in full.

Installment notes are instruments that provide for the periodic repayment of a stated sum at regular intervals, such as monthly payments, usually over 3 to 5 years.

Either of two types of interest rates, simple or add-on, may be applied to short-term loans:

Simple interest. This rate applies a fixed percentage to the amount borrowed for a stated period. An example that illustrates how the interest is computed is found in Box 11-3 . Simple interest is one of the most advantageous ways to borrow money. Should the borrower decide to pay off the loan early, there is no prepayment penalty because the interest is *prorated* for the actual number of days that the money has been borrowed. However, renewable 90-day notes are subject to fluctuating interest rates based on the prime lending rate during any 90-day period. Rates may be set at the start of the 90-day period or change each time the prime rate goes up or down. In the latter case, the rate may change many times during the course of the life of the note. Simple interest shortterm bank loans are a preferred means of borrowing money to purchase equipment and start a practice.

Add-on interest. This method of determining interest is the more costly of the two rates. It is called add-on because the interest is computed on the amount borrowed, without proration, and added to the principal. This total is then repaid in installments during the course of the loan, which is usually 3, 4, or 5 years. An example that illustrates the method of determining repayment is found in Box 11-4 . Add-on interest is commonly encountered in installment loans such as those used for the financing of automobiles and boats. If a borrower decides to prepay (i.e., pay before maturity) an installment loan, the interest is *shortrated* rather than prorated. Shortrating means that if the borrower pays off the loan early, the lender will charge a fee for administrative expenses and profit. Normally this fee is governed by the Rule of 78, which has been a standard formula for figuring the interest due (Box 11-5). A good clause to have with any loan is "no prepayment penalty." A borrower should always inquire into the shortrate charge with add-on interest before borrowing money, if the borrower believes there is a possibility that the loan could be repaid early. Early repayment of an add-on loan usually is not advantageous if the interest is shortrated. The reason is that the interest charge is heavily weighed toward the start of the loan (Box 11-6).

BOX 11-3

Simple Interest Loan

If $10,000 is borrowed at 10% simple interest on a renewable 90-day note, what would be the interest payable at the end of 90 days?

Amount borrowed: $10,000
Interest rate: 10%
Total interest if the note was held for a year: $1,000
Interest for ¼ of a year: $250

If the note is due in 90 days without renewal, the total amount that has to be repaid is $10,250.

BOX 11-4

Add-On Interest Loan

If $10,000 was borrowed at 10% add-on interest for a period of 3 years, what would be the total cost to the borrower?

Multiply $10,000 × 10% (× 0.10) = Yearly interest: $1,000
Multiply $1,000 × 3 years = Total finance charge: $3,000
Add principal: $10,000 + $3,000 = Total amount financed: $13,000
Divide by 36 months $13,000 ÷ 36
Monthly payments: $361.11

BOX 11-5

Calculation of Interest Under the "Rule of 78"

How is $1,000 in interest computed over a 12-month period under the "Rule of 78?" The 12-month period is summed as follows:

12 + 11 + 10 + 9 + 8 + 7 + 6 + 5 + 4 + 3 + 2 + 1 = 78
The interest is computed as follows:
First month 12/78 = $153.84
Second month 11/78 = $141.02
Third month 10/78 = $128.20
Fourth month 9/78 = $115.38
Fifth month 8/78 = $102.56
Sixth month 7/78 = $ 89.74
TOTAL $730.74

Therefore, 73% of the interest due is paid in the first 6 months, leaving $270 of interest to be paid in the last 6 months.

BOX 11-6

Shortrated Interest Under the "Rule of 78"

3-Year Note	4-Year Note	5-Year Note
50% of interest in first year	43% of interest in in first year	36% of interest in in first year
33% of interest in second year	29% of interest in second year	28% of interest in second year
17% of interest in third year	18% of interest in third year	18% of interest in third year
	10% of interest in fourth year	12% of interest in fourth year
		6% of interest in fifth year

Usual banking custom is to use simple interest notes for relatively small amounts and for short periods, if based on the borrower's signature. Although an unsecured simple interest note often can be obtained for various personal needs, the financing of equipment and the start-up of a practice will necessitate the use of the equipment (and other collateral) to provide security for the loan.

Add-on interest is used for long-term financing involving periodic payments and is normally secured by an automobile, equipment, or other collateral that is financed. Of course, the personal endorsement of the borrower also is obtained. The burden is on the borrower to determine the type of financing being offered and whether the rate and terms of the loan are favorable and competitive for the market.

BASIC PROVISIONS OF A BANK LOAN AGREEMENT

Although individual bank agreements may differ somewhat in their terms, there is a commonality to these contracts that permits some generalizations to be made. The basic provisions of loan agreements invariably include the amount to be borrowed and the terms of the loan, the interest type and rate, collateral requirements, limitations on additional indebtedness, the repayment provisions, and an acceleration clause.

Amount and Terms

Any creditor will have loan limits that will not be exceeded without good cause and will have established loan repayment terms that vary with the purpose of the loan and the amount borrowed. For example, most automobile loans are for 3 to 4 years; most practice loans are for 5 to 7 years. There will be an upper limit on the amount loaned that can be used for nontangible items; the more conservative the bank, the lower the amount allowed for these expenses (e.g., working capital).

Interest Rate

If the loan is for simple interest, it is likely that the agreement will specify a short-term renewable note. In this event the interest charge will probably fluctuate in accordance with changes in the prime interest rate; the only variable will be the frequency with which the rate changes. Some banks specify a floating rate that changes whenever the prime rate rises or falls, whereas others set the rate at the renewal of the note (e.g., quarterly).

If the loan is for add-on interest, the rate usually is set at the start of the loan and does not change thereafter; add-on rates are customarily found on installment notes. If add-on interest is used in conjunction with a renewable short-term note, the rate can be changed at each renewal.

Collateral Requirements

There are two customary collateral requirements in practice loans: a purchase money security interest in the equipment (and other tangibles) and a life insurance policy that is assigned to the bank.

A security interest is created when the borrower and creditor adhere to the following procedures:

- The creditor and borrower must agree, in writing, to the formation of the security interest, which is done through the execution (signing) of a security agreement.
- The creditor must make the loan, and the borrower must acquire the property.
- The creditor must file a financing statement, which is a document putting the public on notice that the creditor has a financial interest in the property.

The filing requirement is necessary to protect the creditor from subsequent creditors; if the borrower fails to repay the loan, the creditors will have to fight among themselves for whatever assets remain, and the creditor who has filed the earliest security interest will prevail over the others. For this reason, there is considerable emphasis placed on security interests by creditors. The bank usually will require the borrower to assign a life insurance policy to the bank that is sufficient to cover the loan balance in the event of the death of the borrower. An assignment is a transfer of a contractual right or benefit, which operates to extinguish the right for the one making the transfer and establish the right exclusively for the benefit of the one to whom it is transferred. Many banks require the borrower to assign the rights to a life insurance policy to the bank, placing the bank before any other beneficiary in terms of payment in the event the borrower dies unexpectedly, before the loan is repaid.

The borrower will be asked to execute an assignment agreement and will have to surrender the policy to the bank, which will hold it as long as the loan is outstanding. When the loan is repaid, the assignment will be extinguished and the policy will be returned to the borrower. In addition to the life insurance policy, the bank may require the borrower to maintain other types of insurance coverage. These requirements obligate the practitioner to purchase property and professional liability insurance sufficient to indemnify the bank in the event of the loss of the collateral. Of course, the bank may require additional collateral, a cosigner, or other such items as it deems necessary to adequately protect its security.

Limitation on Additional Indebtedness

To prevent borrowers from overextending themselves, some banks limit the ability of borrowers to obtain additional loans from other creditors. The limitation is usually expressed as a cash limit not to be exceeded without the prior approval of the bank. These limits do not apply to consumer purchases or debts incurred during the course of everyday practice activities.

Repayment Provisions

Repayment provisions vary widely from bank to bank and with the type of note and interest charged. Installment notes specify a stated payment per month for the period of the note.

The monthly payment does not change during the repayment period, which is usually for 3 to 5 years, but may be longer. Short-term renewable notes offer the bank more options. These loans are described as being for a period of years (usually 5 to 7) but are actually renewable at the option of the bank at stated intervals that are specified in the loan agreement. Renewable periods may be as brief as 90 days or may be for as long as a term of several years. Notes retain a degree of flexibility that enables the bank to adjust the repayment schedule as necessary to accommodate the borrower's ability to pay. Some notes specify interest repayment only during the first year of the loan, then amortize the principal and interest over a period of several years thereafter. Other notes allow the borrower to pay less during the first years of the repayment period.

Regardless of the type of note or repayment schedule, the bank will require the borrower to submit periodic financial statements so that the status of the borrower's practice can be assessed.

Acceleration Clause

Any note will contain a so-called acceleration clause, which permits the bank to demand the full amount of the loan due and payable in the event the borrower fails to comply with the provisions of the agreement. This provision affords the bank some protection in the event the borrower cannot make the required payments because it allows the bank to claim its collateral and proceed as necessary to collect the full amount outstanding. These clauses are a standard aspect of any financial agreement and can only be enforced by the creditor if there is some default on the part of the borrower.

Loan agreements are complex and comprehensive documents that typically involve the transfer of large sums of money. A potential borrower who is not knowledgeable in financial affairs would be well advised to secure professional counsel before entering into any long-term financial arrangements with a creditor.

The Loan Proposal

The loan proposal, which is used to secure funding for the operation of the practice, is a key element of the practice plan. Starting a practice, buying a practice, or acquiring a partnership interest in a practice requires financial investment. The amount of money needed can be many thousands of dollars. A creditor is required to provide financial support. Part of the amount borrowed will be unsecured—unprotected by assets that a creditor can sell if the borrower fails—which motivates the creditor to review the borrower's status meticulously. The loan proposal is used to create confidence in the borrower's financial acumen, justify the amount being borrowed, and provide monetary projections against which the borrower's progress can be measured. It requires a considerable amount of time to prepare. Generally, there are three phases of the proposal process: research, drafting the proposal, and presentation.

Research

Research is the key component of preparing a loan proposal. The value of the proposal is directly related to the accuracy of the information in it. Reliable figures should be used for calculations. For example, repayment of educational loans is a financial burden that most new graduates must consider. The amount of each monthly payment and when payments will begin can be accurately determined and so can the cost of leasing an office; purchasing insurance; or paying for water, gas, and electricity. The effort taken to secure accurate information will repay itself many times, for the value of the loan proposal as a true measuring rod for financial success will be far greater if reliable information is used. The creditor may doubt the validity of the proposal if many projections are obviously inaccurate, creating a less supportive attitude. However, the biggest failing of insufficient research is that the predictive value of the proposal is lost and it serves only as a justification for funding. Ideally, the loan proposal should continue to be used after funding has been secured and the practice plan initiated, as part of the effort to measure success toward financial goals. It should be constantly updated and revised to reflect the evolving situation in the practice. In such a role, it fulfills the short-term goal orientation that is so necessary to a successful outcome.

Drafting the Proposal

The loan proposal requires a stepwise approach: first, all items that are to be purchased, such as equipment, furniture, real estate, computer, and inventory of frames, need to be valued. Second, other key expenditures, such as loans, taxes, leases, utilities, and so on, need to be determined. Third, projections need to be calculated—on a month-by-month basis for the first year and annually thereafter for the remaining years of the loan repayment period (which generally is 4 to 6 years). Fourth, practice income projections need to be calculated, and fifth, the "bottom line"—the profit or loss to be realized— needs to be determined, month by month for the first year and annually for all subsequent years.

Step One: Valuing Purchases. The fair market value should be determined for all items that must be purchased. The cost of a phoropter, sofa, computer, or any other item can be reasonably ascertained. If an inventory of frames is needed, its value will have been negotiated. For all items of purchase, an accurate determination of value should be obtained.

Step Two: Valuing Key Expenditures. The loan proposal needs to be comprehensive. It should include all costs that can reasonably be expected to arise during the projected loan period. Key expenditures that should be considered include both personal and business expenses (Box 11-7, also see Box 14-3, 4, 5 and 6 in Chapter 14).

The more complete the list, the more accurate the determination of the total cost of operating the practice. These expenditures should be calculated for each month of the first year of practice and for each year thereafter until the loan repayment has been satisfied. These expenditures, including the cost of purchases, constitute the "overhead" of the practice. It is important for a new practice that the overhead not be too high. The higher the overhead, the larger the number of

BOX 11-7

List of Key Expenditures

PERSONAL EXPENSES
Rent or mortgage payment
Utilities (heat, electric, sewer, water)
Clothing and grooming
Telephone
Subsistence (groceries, restaurants)
Automobile expenses (insurance, gas, repairs)
Health care (not reimbursed by insurance)
Taxes (personal, property, home)
Interest expenses (credit cards, personal loans, home loans)
Charitable contributions
Nonreimbursed employee business expenses
Contributions to a retirement plan (IRA)
Child care or education costs

PROFESSIONAL EXPENSES
Office lease
Staff salaries
Staff benefits (health insurance, contributions to a retirement plan)
Payroll tax (income, Social Security/Medicare, unemployment insurance)
Business property tax (equipment, furnishings)
Office utilities (heat, electric, sewer, water)
Repairs and maintenance
Telephone and answering service
Janitorial service
Postage
Health insurance premiums
Life insurance premiums
Property and casualty insurance premiums (including workers' compensation)
Professional liability (malpractice) insurance premiums
Office supplies
Computer supplies
Income taxes
Social Security taxes
Debt service for professional loans (bank loan)
Repayment of educational loans
Contributions to a business-related retirement plan (IRA, Keogh
Plan, 401 [k])
Continuing education
Travel, meals and entertainment
Licensure fee
Membership in professional organizations
Legal and accounting fees
(For equipment checklists see Chapter 14)

patients that must be seen to break even or show a profit. If the overhead is so high that the loan proposal projects the practice will operate at a deficit for years before patient flow can generate a profit, it is likely that the loan proposal will be rejected. Therefore overhead always should be kept to a reasonable level, and extravagant expenditures should be discarded. Expensive items, such as an automated perimeter or an edging laboratory, may not be a feasible expenditure when starting a practice "cold." The "bottom line" should be scrutinized carefully. Creditors do not like to fund operations that seem to require a lengthy period before generating a profit.

Step Three: Drafting Projections. Once all information on expenditures has been compiled, it is organized in a spreadsheet format. The first-year projections are arranged month by month; for the subsequent years, a sum of monthly expenditures is used. Projecting overhead costs for these subsequent years is an art; cost of living increases should be added to each year to approximate the rise in costs that can be anticipated.

Step Four: Projecting Income. Perhaps the most difficult aspect of creating a loan proposal is the projection of expected income, especially for a new practice. If there are other practitioners who have recently opened a practice, it may be possible to obtain information based on their experience. If there is no source of recent information, it may be useful to provide projections so that they describe the number of patients needed to pay the overhead or to generate a certain profit level. For the first-year projections, the number of patients seen daily should be determined and a specific gross income attributed to each. Local practitioners can be consulted to determine the reasonable amount of income that can be expected per type of patient. Eye health examinations generate different amounts of income than do contact lens assessments or binocular vision evaluations. The number of expected patients for each service and the projected income for each must be calculated. If a practice has been purchased, it is much easier to make income projections. It should be remembered, however, that some loss of patient base (maybe 10%) can be expected during the first year. The number of new patients needed to eliminate this potential deficit should be determined and used as a goal.

Step Five. Step five is a calculation of the "bottom line." The income and overhead for each month of the first year are used to determine whether there will be a profit or loss. For a new practice, it is not unusual for the first several months to produce a deficit rather than a profit. However, the anticipated income should be such that within the year a monthly profit can reasonably be expected. Creditors will not finance a practice that requires years to be self-supporting. The "bottom line" calculations are the goals against which the practice's actual performance are to be measured. If they are inaccurate, they can be adjusted to reflect the actual financial circumstances of the practice and a new set of goals created.

Once the loan proposal has been calculated, it must be processed and supporting documents must be added. The proposal should begin with a statement of purpose, which summarizes the financial goals of the borrower. Documents that may be attached to the loan proposal include the following:

- A personal financial statement (Figure 11-2)
- A personal income tax return for the past year
- A copy of the office lease (if available)

PERSONAL FINANCIAL STATEMENT
John N. Graduate, OD
June 6, 0000

Assets		Liabilities	
Cash:		Educational Loans	$ 130,000
Checking Account	$ 670	Credit Cards	$ 700
Savings Account	$ 1,500	Total Liabilities	$132,700
Automobile	$ 8,000		
		Total Liabilities	$132,700
Securities:			
50 shares XYZ @	$12 $ 600		
25 shares ABC @	$10 $ 250		
CD:			
Certificates of Deposit $ 1,000			
Total Assets	$ 12,020		
Net Worth			
(Total Assets - Total Liabilities):	$-120,680		

FIGURE 11-2 Personal financial statement.

- An insurance list describing policies and premium costs
- For existing practices prior years tax returns, income statements, balance sheets and cash flow statements

Presentation

The presentation of the proposal to the creditor should be planned, and answers to anticipated questions should be rehearsed. Professional attire should be worn for the occasion. If accepted, the usual means of financing is a line of credit, against which the borrower may draw as the need for money arises. Since creditors do not like to extend lines of credit beyond those originally agreed on, the amount of credit secured should be adequate for the practice's financial obligations. Interest is charged on the amount actually withdrawn for use.

CONCLUSION

The business plan should be viewed as the single most important tool for ensuring the potential success of an entrepreneurial enterprise. It should help in understanding the proposed business and serves as a key vehicle for securing financial resources. The business plan should describe the goals of the business and provide a projection of how they will be achieved over the next 5 years or some other appropriate timeline. It should also demonstrate convincingly that the entrepreneur of the business can sell enough products or services to make a satisfactory profit and also satisfy any loan repayment obligations. Finally, the best reason to create and follow a business plan is to plan for success. Having a plan will not guarantee success but without it, one is certainly *tempting* failure.

The loan proposal is the financial heart of the practice plan. To make the plan viable, the loan proposal must contain accurate information, attainable goals, and reasonable projections and must be capable of modification to meet the changing circumstances that are an inevitable part of practice.

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