As clinic owners and managers, measurements of business performance and success are critical. Financial indicators, as they relate to the clinical setting, are not always easy to determine or analyze given the nature of a service industry, like physical therapy.

In determining whether you should sign a contract with a third party payer, it is imperative to know your cost of doing business. Often physical therapists sign contracts with third party payers to gain “in-network” status, hoping to increase their patient volume. However, if the contract does not reimburse at a rate higher than the cost of providing the care, the clinic will not be able to stay in business. The additional patients that are gained by having “in-network” status will actually take away from the clinic’s profit, and will hinder the clinic’s ability to provide care long-term. Therefore, before a contract is signed, the first step is to understand the cost of providing care. Incorrect assumptions about your costs or an inability to accurately calculate your cost of providing care will result in poor business decisions.

In this three part series, financial indicators will be explained and applied to the clinical settings to demonstrate their use in measuring business performance. The series will begin with an explanation of variable costs and fixed costs. The impact of these costs on business will be discussed in this article, as well as, in subsequent articles. These costs are primary components to building your business’s income statement and in understanding the cost of providing therapy.

For the purposes of analyzing financial indicators, fixed costs and variable costs need to be identified and understood. Fixed costs are those costs that remain constant in total dollar amount within a relative range of activity. Examples would include your facility’s rent expense or the cost of a piece of exercise equipment. These costs have a total fixed dollar amount. Regardless of the number of treatments performed the cost stays constant. It is important to understand with fixed costs the per treatment cost of business decreases as the number of treatments performed increases. The more treatments that are performed, the greater the fixed cost is spread over those treatments. For example, if your facility’s rent expense is $5000 per month and your clinic performs 500 treatments per month there is a $10 cost per treatment for rent. However, if your clinic increases the number of treatments performed per month to 1000, the rent expense decreases to $5 per treatment. This creates a $5 increase in profit per treatment. This characteristic of fixed costs will also be important when understanding an income statement and when determining your clinic’s profit margin.

Next, the qualities of variable costs are explained. Variable costs are costs where the dollar amount varies in direct proportion to the number of treatments performed. A clinic’s laundry expense is a variable cost. Contrary to fixed costs, with variable costs the per treatment cost of business remains constant, and the total of the variable cost
increases with an increase in the number of treatments performed. Variable costs cannot
be spread out over more treatments to increase profits. If more treatments are performed,
total variable costs will increase as well. For example, if your clinic’s laundry expense is
$2 per treatment and you perform 500 treatments per month, the total laundry expense for
the month is $1000. If your business increases to 1000 treatments per month the total
cost would increase to $2000 per month. It is important to allow for an increase in these
costs when budgeting for growth or expansion. With variable costs profit per treatment
does not increase with an increase in treatments performed.

Fixed costs and variable costs can be part of your business’s calculations when
determining the total cost of doing business. These costs will be applied to the income
statement and will be used to explain profit margin in the second part of the series. The
next part in the series will explain how your clinic’s income statement can be used to
assist you in making critical management decisions.