Chapter 2

The Economics of Dental Practice
A dental practice is a business, and so responds to the laws of economics like other commercial ventures. If you are going to make your practice a profitable venture, you should be aware of these economic foundations and use them in your decisions making. This sequential process is the same paradigm that the computer program uses to generate the results of your decisions.

Step #1: Determine the Area or Industry Demand
"What is the size of the pie?"

Area wide demand determines the number of people who want dental services, and the total amount of dental services that these consumers want. Each geographic area will have a different potential demand for dental services. Many factors affect this potential demand, but the more important factors include:

1. The general affluence of the population
   More-affluent people have more disposable income to spend and, therefore, "buy" more dentistry.

2. The average educational level of the population
   More-educated people consistently use dental service to a greater degree than their less-educated cousins. Education and income are linked; as more-educated people have higher incomes.

3. The urban/rural location
   Urban families use dental services at a higher rate than their rural counterparts do.

4. Level of third party reimbursement
   People who have third party payers spend less themselves, out of pocket. Insurance programs lessen the apparent cost to the consumer and therefore increase demand for services.

5. Local economic factors
   A single factory closing may have a severe impact in a small community but would be less noticeable in a larger diversified community. General business prosperity, on the other hand, suggests that unemployment is low, wage rates may be increasing, and the consumer base is expanding.

In this simulation, three factors primarily determine area wide demand. The "Business Index" is an indicator of general business prosperity and is by far the most important factor influencing dental demand. The index begins at "100." A reading of "102" would mean that business prosperity is growing at the rate of 2% per quarter (8%/yr). Aggregate marketing expenditures and pricing decisions of the participants also affect area wide demand. Lower average prices or a large marketing effort by the dentists in the community will both stimulate demand.

Step 2: Estimate Your Individual Demand
"What is the size of my potential piece of the pie?"

The area demand will determine how much dental service the population demands as an entire group. You, as the individual practitioner, then compete with other practitioners in the area for a portion of that total demand, or share of the market. In effect, you are carving up the economic "pie." If your piece gets larger, it is only at the expense of other practitioners, whose pieces must get smaller. However, if the size of the entire pie gets larger or smaller (due to changing area economic conditions), your piece (or share of the market) will increase or decrease correspondingly. Economic competition plays an important part in the supply equation. The number, age, and type of practitioners affect the
amount of dental service that dentists can provide and therefore, how they divide the pie.

Factors that affect your individual practice's demand generally are decisions that appeal to individual patients. You should not make these decisions without considering what the other practitioners in the area (competitors) are doing. For example, if you raise your prices, you will lose some patients who are price sensitive to other practitioners because you are now relatively more expensive. However, if all practitioners raise their fees a similar amount, your share of the market will remain constant since your price compared with other practitioners' remains the same. (Overall area demand may decrease with a general price increase.) Antitrust laws prevent businesses (including dentists) from overtly "fixing prices" to increase profits.

Each dentist actually faces two types of patient competition. The first is competition with other dentists to have patients patronize their particular dental practice. However, this is competition only for the patient's initial interest or intention to have dental services completed. Once the patient enters the office, the individual dentist competes for the patient's spendable dollar. This competition is not with other dentists, but rather with alternative forms of discretionary spending. The patient's decision is, to have the crown and bridge work done, or to take a vacation to Hawaii. Therefore, in this larger context, each dentist competes with travel agents, electronic equipment sales clerks and auto salespersons for the individual consumer's discretionary purchases. This second form of competition involves personality and individual persuasive technique. We do not factor it into this simulated practice.

An individual dentist can use many business techniques to stimulate demand for each individual practice. Since there are both positive and negative implications to most of these decisions, you need to make them in an overall practice context. These individual demand factors include the following:

1. **Pricing Decisions**
   If your price is lower when compared to other practitioners, you will stimulate some demand, but your revenues per patient will be lower.

2. **Practice Style**
   Patients select practices based upon the types of procedures that you perform and your personality. The number of practitioners in the area who have a similar practice style will influence demand for your services. If too many competitors vie in a small niche style of practice (such as reconstructive or esthetic services), you will feel increased competition for patients.

3. **Credit / Collection Policy**
   An easy credit policy will stimulate demand, but will result in higher accounts receivables and uncollectable amounts.

4. **Hours of Operation**
   If you have extended hours (weekends and evenings), you will gain many patients that would otherwise find it difficult to keep dental appointments. However, finding and keeping staff that are willing to work these hours is more difficult.

5. **Marketing and Advertising Efforts**
   More money spent on marketing and advertising results in more patients for the practice. Whether the economic return is justified is a management decision you need to make.

6. **Managed Care Plan Participation**
   You will gain additional patients if you participate in the various managed care plans that operate in your area, but participation may adversely affect the practice's profitability.
7. Continuing Education
If you and your staff attend more continuing education hours, you can offer more and newer procedures and techniques to your clientele, thereby stimulating demand.

Your management decisions determine your individual demand. In the real world, personality and a host of other factors will also influence your individual demand. In this simulation, only those factors that you can control, from a management perspective, influence the number of patients that might come to your office for services.

Step 3: Estimate Your Productive Capacity
"Can I eat my piece of the pie?"

If you stimulate demand, you must have the capacity to "do the dentistry" or to satisfy the demand. A "work ethic" is inherent in each of us to a greater or lesser degree and accounts, largely, for your ability to see certain numbers of patients. However, the dentist can control many operational factors to make it easier for him or her to produce dentistry. Those factors include the following:

1. Number of Operatories
You can see more patients if you have more operatories. However, there is a point of diminishing returns in which the operatory simply becomes a waiting room for the patient. Limitations in staffing or your individual ability become the factors that determine how much dentistry you do.

2. Clinical Staff Numbers and Types
If you have too few staff members for the number of operatories, the office will be underutilized. Conversely, if you employ too many staff members, costs will increase and efficiency will suffer. When you staff the office appropriately, every staff member will add to the production and profit of the office.

3. Number of Hygienists
Hygienists will increase the productive capacity of the office dramatically. Hygienists free your time to perform more complex (and financially rewarding) procedures, if you provide adequate patient demand and operatory space.

4. Hours Worked
The number of hours that you work in a typical week has obvious impact on the potential number of patient visits. You need to balance availability for appointments with the additional costs of staying open longer hours.

5. Number of Receptionists
Receptionists affect your capacity to see patients in several ways. The receptionist schedules patients, manages the recall system, sends billings, clarifies insurance coverage and answers incoming calls. An overworked busy receptionist will not be nearly as effective at these duties as one in a properly staffed business office.

Your management decisions will affect your ability to do dentistry. It does no good for you to stimulate demand for your services if you have not equipped and staffed the office at a level that is appropriate for your anticipated number of patients.

Step 4: Determine Financial Return
"What did it cost me to eat my piece of the pie?"

The "bottom line" of the business of a dental practice is the financial return that the previous decisions generate. While these financial considerations are only one factor in the preceding decisions, they
are obviously an important issue. As the owner-dentist, you will need to decide if those actions are worth the costs. Your banker has a personal stake in seeing you succeed (since she lent you the money to buy the practice), but you need to set policy and make decisions in your particular practice to ensure that you do succeed. During the initial several years, you may find it difficult to balance financial needs as you pay off initial start-up loans and build or convert the practice to reflect your needs and desires. However, a successful practice should eventually be able to meet all of the following five indicators of financial success for the practice.

1. Meet Regular Obligations
   Any practice must be able to “pay the bills” to survive. These include daily supplies, monthly bills, staff salaries, and professional insurances and education needs.

2. Service the Debt
   You borrowed money to buy and begin the practice. Your banker has arranged a payment schedule that will allow you seven years to pay off your initial debt. You should be sure to meet or exceed that payment schedule.

3. Pay Taxes
   Taxes are a reality. You can’t avoid them entirely. While using legal techniques that reduce the tax burden is acceptable and appropriate, you should plan to pay taxes regularly to avoid troublesome or potentially devastating action by various taxing agencies.

4. Provide for Family Income
   The practice should provide for an adequate financial return for the individual practitioner. Otherwise, you would find another form of employment! You must decide what “adequate financial return” means to you in your particular circumstance.

5. Provide for Financial Security
   As an individual practitioner, you do not participate in a company-sponsored retirement plan. Most people do not plan to work their entire life. You must therefore set aside money to reach a state of financial independence. A viable practice will allow a practitioner to provide for his or her future financial security.

The purpose of the business side of a dental practice is to satisfy all five of the financial indicators given above. To accomplish that, you must assess the costs associated with various management actions that you make. Your financial return is one critical factor that decides your success in this game.