**WEEKLY ORDERING BUDGET**

To increase profitability, practice owners and managers often focus on reducing inventory expenses. There are many different industry benchmarks for how much inventory to have on hand and how much a veterinary hospital should spend on the expense categories that make up inventory. When you look at these benchmarks, make sure you understand how they are calculated and what they include because there are definitely some differences. For example, The Well-Managed Practice Benchmark Study[[1]](#footnote-1) published in 2019 reports that average spending on therapeutic and retail diets represents 2.3% of total gross fees. In 2020, the American Animal Hospital Association (AAHA) published the tenth edition of Financial and Productivity Pulsepoints. In it, the average spending on prescription diet[[2]](#footnote-2) is 2.5%of gross fees, and the median percentage is 2.3%. Which one of these benchmarks is right for your practice? Perhaps none of them is a good fit!

Before you decide, let’s look at the percentage of revenue diet represents in each of these studies. The Well-Managed Practice Benchmark Study shows that diet sales represent 3.2%[[3]](#footnote-3) of total revenue while AAHA[[4]](#footnote-4) reports 3.5% for both the average and median percent. There isn’t a lot of difference, right? So, should your practice spend somewhere between 2.3% and 2.5% of total income on diet? Not necessarily! These expense percentages only fit when diet sales represent ~ 3.5% of total revenue. Even then, your spending will be directly related to the products you carry. Instead of using national publications as the source of spending targets, start by calculating the percentage of revenue diet represents in your hospital and how much (again as a percent of total income) you currently spend. This is the first step in creating a purchasing budget.

Much of the solution is related to reorder points and order quantities. Can you give the inventory manager an ordering budget, and if so, what should that budget be?

Understand that benchmarks are not goals; they are merely averages. When you create parameters for an inventory budget, be careful not to tie the hands of the person doing the ordering. The last thing either one of you wants is to run out of a product or supply that the doctors or clients need. If you want to keep spending on diet products to 3.5% of gross revenue, understand that this percentage applies to a year’s worth of spending and can’t be applied to a weekly ordering schedule.

Let’s say that your hospital generates $50,000 in sales every week. Let’s further assume that 3.5% of total annual sales represent purchases of diet. Therefore, what is the weekly amount the inventory manager can spend on food? Is it $1,750? Maybe yes, maybe no! It all depends on how much food was sold, not how much money came in. You don’t sell the same amount of food every week. Instead, sales fluctuate by the size and type of patient seen as well as the cases seen. Instead of assigning a fixed amount of money that can be spent on food each week, put a little more finesse into your budgeting.

If your hospital typically spends 18% of gross fees on inventory items, the weekly ordering budget should be 18% times last week’s fees. In our example, $50,000 in sales would mean the inventory manager has a budget of $9,000 to spend in the next week. If usage were precisely the same from week to week, the food order would equal $1,750 per week, or $50,000 x 3.5%. Of course, no two weeks are ever the same in a veterinary hospital! That $9,000 ordering budget is allocated based on what was sold the previous week, which items are at a reorder point, and what specials are offered. And this is the tricky part! To determine the amount of food to purchase each week, you also need to know the ratio of diet income to diet expense. In other words, how much income does the practice receive from every $1 of diet purchases?

Referring back to AAHA’s Financial and Productivity Pulsepoints, prescription diet sales generate $1.20 - $1.50 for every dollar spent.[[5]](#footnote-5) If the ratio in your hospital is 1.5-to-1, meaning for every $1,50 in food sold, the cost to replace it is $1, if you sold $1,500 of food, the budget for food purchases would be $1,000 ($1500 / 1.5). If $2,600 of food were sold, the budget for the following week would be $1,733.

Income-to-expense ratios give that extra bit of insight that really helps you determine the amount of product to order. Calculate these ratios for as many inventory categories as possible. This is easy to do if you pair each category in your PIMS to a matching account in Cost of Good Sold. You will always know the total dollar amount that should be ordered each week and how many dollars to allocate to each category. Let us know if you would like some help with this.

1. Tumblin, D, Tassava, B. The Well-Managed Practice Benchmarks Study. Columbus, OH:WMPB, LLC; 2019: 74. [↑](#footnote-ref-1)
2. Financial and Productivity Pulsepoints. Tenth edition. Denver, CO: AAHA Press, 2020: 181. [↑](#footnote-ref-2)
3. Tumblin, D, Tassava, B. The Well-Managed Practice Benchmarks Study. Columbus, OH:WMPB, LLC; 2019: 52. [↑](#footnote-ref-3)
4. Financial and Productivity Pulsepoints. Tenth edition. Denver, CO: AAHA Press, 2020: 89. [↑](#footnote-ref-4)
5. Financial and Productivity Pulsepoints. Tenth edition. Denver, CO: AAHA Press, 2020: 193. [↑](#footnote-ref-5)