

Health Care Finance

Customer's Name

Academic Institution

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### **Introduction**

An enterprise whether for profit or non-profit should always find ways of how to improve their operational status quo. These certain improvements can be realized by improving on business processes, increasing revenue, improvement of the overall productivity and quality, although most of the examples discussed are internal, external factors can be considered base on strategic decisions for companies to improve. All organizations enters a decision, especially if it gained a net income on their financial statements, this money depending on the company's board agreement can be redistributed for shareholders dividends, can be used for debt repayments or to allocate a budget for a certain capital project with the purpose of amplifying revenue and profits, increase shareholder's wealth and expand its business operations each industry has some set of methods on which how they could utilize the said allocated capital. Healthcare industry is no exception either for profit and non-profit purposes, the challenge on "how best to allocate limited capital across a large number of requests for capital investment" (Kleinmutz and Kleinmutz, 1999 p.52) is ever present. Some healthcare organizations may tend to focus on allocating capital budget for procurement of new beds (Hardy, 2004 p. 199) to better meet the increasing number of patient demands, while others may have focused on necessary replacement and renovation of depreciated medical equipments (Kleinmutz and Kleinmutz, 1999 p.52). While those are certainly necessary and should be part of budget allocation, certain firms may opt to use a certain amount to fund an expansion project which if successful can received a fast return on investment (ROI) and be profitable as well.

As an example, non-profit health care organization the Adventist Health System has a combined total of “43 hospitals and employs 55,000 individuals, Adventist Health System hospitals are comprised of 7,700 plus licensed beds, providing care for 4 million patients each year in inpatient, outpatient and emergency room visits” (adventisthealthsystem, 2010). This statistics shows how significant as a health care system this institution is. In This study, we will look on viable options for a capital project that will improve overall Adventist Health System (AHS) demographic market range and analyze if the allocated capital can be recouped and what would be the break even sales level. But first it is important that we need to look at AHS’ current financial position.

### **Relevant Financial Figures (AHS Annual Report 2009).**

#### **Revenue**

The total posted revenue for AHS is at **\$5.496** billion USD.

#### **Net Income**

Net income declared at \$233 million USD. Which in this case as a non-profit institution, this amount could be carried over for future expenses such as employee compensation, supplies. Professional fees etc. But most importantly a significant part of this income can be a source of capital available for a particular project.

#### **Potential Project**

For AHS to be able to serve more patients and fulfill their mission on reaching and healing every individual, the best project would be for them to expand to other areas of the country. In this study, we will create the “New Hospital Project” as our sample viable option. All

statistics would be considered estimated and would be projected based and on consideration for  
Break even analysis.

**New Office Capital Project Projected Financial Figures**

ADVENTIST HEALTH SYSTEM  
**Break-even analysis for Adventist Health System's new hospital**

| <b>Cost Description</b>               | <b>Fixed Costs (\$)</b> | <b>Variable Expenses (%)</b> |
|---------------------------------------|-------------------------|------------------------------|
| Price of a New Hospital               | \$ 15,000,000           | 0.0                          |
| Direct labor (includes payroll taxes) |                         | 0.0                          |
| Other expenses                        | 500,000                 | 0.0                          |
| Other expenses                        | -                       | 0.0                          |
| Salaries (includes payroll taxes)     | 600,000                 | 0.0                          |
| Supplies                              | -                       | 12.0                         |
| Repairs & maintenance                 | -                       | 0.0                          |
| Advertising                           | -                       | 0.0                          |
| Car, delivery and travel              | -                       | 0.0                          |
| Accounting and legal                  | -                       | 0.0                          |
| Rent                                  | 100,000                 | 0.0                          |
| Telephone                             | -                       | 0.0                          |
| Utilities                             | 45,000                  | 0.0                          |
| Insurance                             | -                       | 0.0                          |
| Taxes (Real estate, etc.)             | -                       | 0.0                          |
| Interest                              | -                       | 0.0                          |
| Depreciation                          | -                       | 2.0                          |
| Other (specify)                       | -                       | 0.0                          |
| Other (specify)                       | -                       | 0.0                          |
| Miscellaneous expenses                | -                       | 1.0                          |
| Principal portion of debt payment     | -                       | 0.0                          |
| Owner's draw                          | -                       | 0.0                          |

|                         |               |      |
|-------------------------|---------------|------|
| Total Fixed Expenses    | \$ 16,245,000 |      |
| Total Variable Expenses |               | 15.0 |
| Breakeven Sales level = | \$ 19,111,765 |      |

On this chart, for simplicity purposes the projected costs of a New Hospital is disclosed at \$15 Million USD, the total cost includes construction of the new building and its basic amenities, other expenses such as permits, direct labor and taxes. And equipment, facilities and initial supplies to be used for the new hospital which has an entry for other expenses is projected at \$500 thousand USD. Salaries for the whole staff will be estimated at \$600,000 and rent and utilities will be projected at \$100,000 and \$45,000 respectively. All of these are considered fixed costs for the entire project. Total fixed expenses amounted to \$16.245 Million.

The variable costs which are expressed by raw percentage are the medical supplies (at 12%), depreciation at 2% and lastly other potential miscellaneous expense at 1%. Total Variable expenses are at 15%. To calculate for the breakeven sales level the formula is:

$$\text{Total Fixed Expenses} / ((100 - \text{Total Variable Exp}\%) / 100)$$

Thus, following that formula the Breakeven sales level should reach the exact amount total of \$19,111, 765 million dollars.

### **Conclusion**

This study has discussed several options any organization for both profit and nonprofit purposes on how to allocate capital for certain projects. From the basic repayment of debt, allocation for dividends and most importantly to further improve financial position to expand business operations. The case of Adventist Health System, as a non profit organization, shows the possibility and viability of expansion due to its Net income gained, which provide ample cash reserves to fund a specific capital project such as an expansion. The Break even analysis, would guide the company in both projecting initial costs of both fixed and variable and would provide a

certain and accurate figure for breakeven sales level, this would help the board of trustees for AHS to decide whether the allocated capital of this project would be beneficial for them.

#### References

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