Estimating your capital needs

Whether you're opening a new practice, expanding a current practice, or acquiring an existing one, you'll need to estimate how much money (also referred to as capital) you'll need and when you'll need it.

Your capital requirements will depend in part on the patient collections forecasts you set for your practice in comparison to its daily operating requirements. For existing practices, unless you've accumulated enough profits, you'll likely have to turn to outside sources to raise capital.

In addition to investment capital, you may find that your practice requires additional money for day-to-day expenses until it generates enough cash each year. This money, called working capital, is equal to your current assets minus current liabilities. Both of these totals appear on your practice's balance sheet—the representation of your practice's assets, liabilities and equity at a given point in time.

Current assets are assets that are in cash or can be converted to cash within a year, such as investments, accounts receivable and inventory. Current liabilities are those liabilities you expect to pay with cash over the next year. Accounts payable (such as what you will be billed for supplies you have already used or equipment you have already installed) and deferred income taxes are examples of current liabilities.

The ratio of current assets (cash on hand) to current liabilities (debts owed) is called the working capital ratio. Prospective lenders will evaluate your working capital ratio when considering your request for funds.

A working capital ratio of 1.0 means current assets equal current liabilities. A ratio of 2.0 means current assets are twice as large as current liabilities. A ratio of less than 1.0 could raise a red flag to a prospective lender since it suggests you owe more than you have available in the near term. A dental practice startup, however, may expect to have a ratio less than 1.0 until collections start rolling in and eventually normalize. This may be acceptable to a prospective lender as long as the business plan acknowledges that this is a short-term situation.

If you underestimate your working capital needs, you could face a situation where you will likely need to raise funds quickly to pay bills or salaries. For this kind of short-term fix, practices often rely on a line of credit from a bank. Absent a line of credit, you may find yourself, as the practice owner, paying expenses with a credit card or other expensive form of debt.

To minimize the risk of underestimating your capital needs, it helps to review your estimate carefully and have a line of credit in place with a lender. It also helps to have an experienced finance and accounting staff to identify potential shortfalls in capital.

Obtaining sufficient capital

After estimating your practice's capital requirements, you'll need to decide how much of your own equity to provide as the practice owner and how much to raise from external sources.

After reviewing your business plan, a lender may decide to provide only enough funding to cover part of your capital requirements. Or they may decide to fund only an amount necessary to cover forecasted cash flow shortages. That's why it helps to forecast as accurately as possible.

Note: We recommend practice owners consult qualified professional advisers for legal, finance, accounting and tax guidance when considering starting or acquiring a practice.

Let's connect

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