SYNSTRAT

How Two Dentists Cope with the Recession

Freddy and Mark * were so different that it was a wonder that they ended up as associates. It had been Freddy's practice and originally he employed Mark to do what Freddy considered to be the boring, traditional dentistry with the patients who were unlikely to seek the expensive cosmetic dentistry that Freddy provided.

Freddy aspired to live in the dental fast lane, while Mark was traditional in his approach. Freddy soaked up the expensive dental retreats and the presentations of American gurus along the lines of "How leveraging the potential of my dental practice set me on a path to being a billionaire".

Freddy needed a Mark type of dentist in his practice, and to keep him sold him an associateship on the undertaking that Freddy would manage the practice. Freddy had chosen a glitzy name for the practice, and advertising, website and premises were presented in a manner which would assist him in the quest to be a leader in the cosmetic dental field and to make a lot of money.

Freddy regarded Mark as being pedestrian, but Mark was a good clinician, had sound interpersonal skills and got on well with staff. He was also efficient. Inevitably those likely to be amenable to expensive treatment plans involving lots of cosmetic work found their way to Freddy's patient list. Mark's patients warmed to him over time so were prepared to accept his treatment recommendations and refer family and friends. Although associates, they built two different types of patient list. A third dentist was employed by the joint service trust, and the occupant of that position turned over periodically. At Freddy's insistence a hygienist was employed but had a natural tendency to support Freddy's patients more than Mark's.

Different Objectives

Over time, tensions developed. Freddy and Mark saw the practice needs quite differently. Each insisted on the purchase of equipment that the other didn't want. Freddy wanted to continue expensive practice advertising but Mark vetoed some of the expenditure because he didn't need it to perpetuate his own fully booked surgery. Freddy wanted to spend a vast amount of money on a new fit-out, whereas Mark wanted a more modest practice look because he saw that his patients were attracted to a less dominant environment.

As time went on Freddy had less and less time for Mark, who he viewed as holding him back. Mark viewed Freddy's requirements as being an expensive imposition. The staff had mixed reactions. Freddy's personal chairside assistant viewed him as a masterful dentist, with wonderful powers of persuasion. Some of the other staff saw him as pushing the boundaries when selling patients treatment plans, which in some cases they could ill afford and probably didn't need. Those staff regarded Mark as being stable and reliable.

Freddy's Desire to End the Associateship

One day Freddy announced that he'd been given the opportunity to purchase or lease premises closer to the city centre, and that he wished to end the associateship. Mark sought advice and concluded that whilst practising on his own would add to some costs, particularly the rent of the whole premises after Freddy's departure, in other respects life would be simpler and there would be offsetting cost benefits.

There were a few hassles in the sharing of their equipment equitably, and winding up of the joint trust that administered the practice for the two associates. After some push and pull debate and a couple of hints of legal threats, the equipment was divided fairly. Where there was a dispute about the relative value of two larger articles, on which various opinions differed, a coin was tossed and the winner took first pick. The accountant of the service trust arranged for the transfer of the items in such a way that each received the benefit of 50% of the depreciated value of the major items. The smaller items were pooled and a coin tossed for first pick, then they were divided on a pick for pick basis.
After initial aggravation the practice disassociation occurred smoothly. The hygienist went with Freddy, but the employed dentist stayed with Mark.

Freddy's New Premises

Meanwhile Freddy had acquired expensive new premises and he undertook an expensive fit-out. The premises were rented at $112,000 per annum plus GST, with Freddy having the option to purchase them within four years for $1.6 million. The fit-out, together with some new equipment and furnishings, cost $950,000 financed over six years. When Freddy looked closely at these costs, plus staffing costs, and factored in a heavy advertising budget to sustain the workflow to pay for it all, it was evident that he was going to have to generate extraordinarily high fees.

Separating the Patients

In the split-up patients would be directed according to their primary loyalty. Freddy and Mark took new practice names but kept the old business name registered, together with the telephone number. Those patients who still used the old telephone number were directed to push buttons for either Freddy or Mark's practice. Outstanding accounts were jointly settled, and both refinanced their share of the existing business debt under their own names.

Naturally there were a lot of little issues, and I won't dwell on them here.

There were periodic outbursts during the separation process, but Freddy had an urgent need to start practising from his new premises, whilst once Mark had been advised through the various pitfalls of the negotiation he wanted the process concluded in order that he could settle into running his own practice. The speed of events took control of the situation.

Contrasting Strategies

Freddy launched an even more glitzy website under his new practice name and undertook a mail-out of a lavish brochure to existing patients whilst signing up for cinema and other advertising.

Mark mailed his patients a carefully worded letter emphasising his commitment to their long-term care as a family dentist.

Over an extended period of years Freddy had treated far fewer patients, with much longer appointments and much higher average invoices when compared to Mark.

As Mark had been more available he had treated more patients. Those patients and many of their families and friends had become his patients. Freddy thus had fewer patients than Mark, but they had paid him higher average fees. They had also tended to refer friends of similar personality and financial status. That suited Freddy.

Immediately following the separation Freddy was exhilarated that he had thrown off the anchor chains, believing that Mark had held him back for far too long. He pursued his strategy of high end dentistry at breakneck speed but was frustrated because he didn't have somebody like Mark to treat those who weren't receptive to buying high cost treatment. There was spillage from his practice.

Little Change for Mark

Mark found that it was pretty much life as usual. He and his employed dentist were well booked. He charged a good level of fees and was efficient with his patient throughput, thus maintaining a high hourly fee. He used two surgeries for personal efficiency and the employed dentist one. Having the employed dentist ensured that all patients were booked for treatment within a reasonable time. Like most employers he found that after he had paid the employee dentist the normal percentages he tended to make only a modest return on that individual, but he made a good level of profit in his own surgery. There were three spare surgeries vacated by Freddy, but Mark did not hurry to re-equip them, preferring to work his existing three surgeries with two dentists. He reasoned that if patient numbers grew beyond existing dental capacity, his first step would be to hire a dentist into the third surgery for a few sessions, giving up some of his own flexibility, until there was sufficient regular work to justify reopening and equipping a fourth surgery. Mark had low debt and therefore low interest cost, although the rent had increased substantially because he was now paying it all. The employed dentist, who had previously had much greater fees than the hygienist, was making a contribution via the fees generated in his surgery. A lot of the over the top advertising costs previously shared with Freddy were cut following his departure.

The Recession Bites

The Australian recession of 2009 seemed to come without apparent warning. While the stock market had fallen disastrously in 2008, the general attitude was that the underlying economy was sound. The government had taken some measures before Christmas 2008 to stimulate the economy, but unemployment was low at that time except for previous employees of investment banking organisations. In early 2009 there was wave upon wave of bad economic news as thousands lost their jobs across a wide variety of industries or felt threatened with job losses. It quickly became apparent that the theory that Chinese economic growth would be stronger for longer and therefore propel Australia forward was built upon consumer demand in the United States, which had plummeted. The bad economic news was global and it seemed that it kept getting worse. Interest rates on home loans were reduced sharply, but Freddy's expensive fit-out was loaded into a chattel mortgage built on a still significant interest rate, which was fixed for the duration of the contract. He faced huge monthly payments on the chattel mortgage, and he had signed an expensive long-term lease on the premises. As Australia slid deeper into recession, other premises were becoming available at much cheaper rents but Freddy was locked into his lease and the expenditure on his fit-out. The rent review periods were subject to a ratchet clause, which meant that rent would increase but not decrease. His landlord realised that Freddy had invested heavily in the fit-out and was tied to the building. He refused point blank to reduce the rent when Freddy approached him. Still, Freddy had a history of producing extraordinary dental fees based on his ability to sell comprehensive treatment plans.

Freddy's Bankers Turn Nasty

Faced with multiple difficulties, Freddy approached bankers and financiers for an additional line of credit. He found that the happy jolly people, who had been prepared to promise what seemed like unlimited loans prior to the recession, had disappeared and been replaced by tough minded individuals who demanded up to date financials, cash flows and insisted on measuring his financial exposure. They were unwilling to lend any more. They pointed out that they rated him as a risk, and suggested that he make drastic economies in his practice; yet Freddy was faced with the reality that most of his costs were locked in or, in the case of advertising and marketing, were regarded by him as being essential to maintaining his work flow.

Mark's bankers voiced no concern, and leasing consultants made it plain that they were happy to finance more equipment if he needed it. He and his financials projected a picture of reliability and low risk.

The Recession's Impact on Treatment Plans

As the recession deepened, a trend became apparent. Freddy's success rate at persuading patients to agree to elaborate treatment plans was falling. Many patients either didn't have the money or were too afraid of losing their job to sign up to a treatment financing plan. Freddy began to feel real financial stress, and this made it more difficult for him to clinch each sale. Selling became much harder now whereas it had seemed easy when he had no pressure on himself.

Meanwhile Mark was noticing little change. His treatment recommendations were aligned to patient needs, and the vast majority took his advice. His employed dentist was similarly busy.

Where patients had had a previous relationship with both Freddy and Mark, they had come to understand that Mark was more likely to provide them with affordable dental options, whilst Freddy was on a mission to sell his expensive cosmetic treatment plans. Freddy found that he had to wind back the plans he was offering to his patients. This cut into his budget, but he couldn't afford to lose many patients either.

The Recession Worsens

The Prime Minister morphed from a fiscal conservative to a Keynesian economic stimulator in the blink of an eye, while State Premiers rushed to dig into the Commonwealth Government's pork barrel. The Reserve Bank cut interest rates repeatedly over a number of months, and the slowing international economy cut demand for ore, which meant that prices fell at the pump. Despite all of this, Australian unemployment continued to rise and the population went on a spending strike. Suddenly it wasn't fashionable to buy a new car, as lots of the population decided that their existing car could last another year. In this environment reducing mortgages and cutting credit card debt became the new in things to do. There were now a lot fewer patients prepared to buy expensive treatment plans. They were more inclined to ask for the treatment which was presently necessary rather than go for the full plan, and many would seek a second opinion. Freddy found that he had to tone down his website, mute his practice brochure and subtly change the décor of his waiting room to reflect a more traditional approach to dentistry. Times were indeed different.

Mark kept the appearance of his practice clean and simple. His mantra that he provided quality family dental treatment didn't need to change. His approach had always been to win patients' trust over time and provide high quality dentistry. He was a dentist who was capable of doing good work at good speed. His hands were good. He charged well and he resisted the temptation to discount. He refused to sign up as a preferred provider to a health fund. When patients complained to his receptionist about health fund rebates, she carefully explained to them that health insurers made money from their general cover tables which they placed into their investment reserves, and that most insurers had poor payout ratios in respect of dental treatment. She also explained that while health funds sometimes tried to refer patients to "approved dentists" those dentists had not been chosen on the basis of their quality, but rather on their willingness to sign a contract with the health fund. Overwhelmingly, Mark's patients preferred to be treated by him and he found that he could keep the health funds at arm's length. Mark's practice continued to prosper.

Quality of Patient Relationships

Mark was aware of the economic storm clouds, but was confident that the quality of his relationship with the patients would keep them loyal to his practice. This was proving to be the case, and because his patients understood that he was attentive to their needs he still found that when he did recommend crowns or implants that there was a high rate of acceptance. Where patients didn't accept, it was generally because they couldn't afford it but they nevertheless recognised that they had a genuine need.

As the recession grew deeper, Freddy found that his practice overdraft was always at its limit. He struggled to have the right amount in his account to meet the automatic debits for rent and the chattel mortgage. Paying his staff was a struggle. In good times he and his wife, Belinda, had been good spenders on lifestyle but harsh economic reality had set it. They shelved the expensive dental conferences in exotic locations. They had traded in their imported cars regularly, but even though the car industry was awash with unbelievable new car deals, they found that the trade-in values on the second hand vehicles had shrunk alarmingly. Dining out regularly with their social circle had to be severely curtailed, while scraping together the kids' school fees was another horror. Because Freddy had so recently fitted out the new venture, he found that when he approached his financier to reschedule the chattel mortgage payments they could only slightly extend the payment period, and the saving to his cash flow was negligible.

Belinda had a part-time job and tried to move to full-time, but her company's HR manager told her that they were sorry, they were laying off staff and no part-time hours were being extended.

Further Impact on Freddy's Treatment Plans

Meanwhile the hope for growth in practice fees had evaporated, and Freddy was having to offer cheaper treatment plans to a greater proportion of patients just to keep them. He insisted that staff turn out unnecessary lights, and all consumables were closely monitored, with just in time ordering. Freddy was under constant pressure from his dental suppliers and laboratory because he had become a slow payer. Common sense told him that if he could hold on for a year or two the economy would improve. So he practiced on but the enjoyment was much less and he began to wonder whether he had made a huge mistake. His personal family expenditure had been cut to the bone.

Freddy Tries to Sell to Corporates

As Freddy's plans had veered off course, he had tried to sell his practice to dental corporates, but after they took a quick look at the building lease, the undertakings under the chattel mortgage, Freddy's staffing and advertising costs, they quickly came to the conclusion that they would struggle to make a profit out of the practice, and declined his overtures. By this time, dental corporates were also suffering from the effects of the recession. They had wound back their program of buying practices as the recession deepened, and their bankers had become much tougher, effectively modifying financing agreements and refusing to finance the acquisition of practices unless they met a much tighter set of criteria than pre-recession. The corporates were finding the business of dentistry much tougher, and some of their bankers had substantially changed their views of the attractiveness of professional consolidations. Getting to the IPO stage had become much more difficult, and it was now apparent that corporate consolidations of dental practices were a lot riskier than first thought. The deal making and private equity arms of the banks had shed staff and had gone from being glamour business units to being regarded as high risk areas by bank boards.

The Long Term

The probability was that Freddy would survive and that in time he would overcome his problems. When he reached the point at which his chattel mortgage was paid down, the subsequent replacement of some equipment items would be financed at much lower payments. He came to the realisation that he had to accept a long-term reduction in income. He would have to space out the period between renovation upgrades. All other things being equal he could expect that his cash flow and profitability would improve in time and he would reach a point where he could put away a surplus in savings.

Mark had survivor written all over him. He was going to survive the recession without ever being seriously pressed. Whilst in a buoyant economy Freddy would make significantly higher profit than Mark, in a recession it was Mark's practice which shone. He was sensible enough to adjust his fees in small increments and to keep the practice looking nice, but in a more modest, low-key way. He and his employed dentist remained solidly booked. He selectively upgraded equipment and kept his practice in good order, but adapted a lower key presentation than that which Freddy had insisted on. Mark and his wife, Katie, hadn't aspired to an expensive lifestyle before the recession, and they found that their income was adequate to look after family needs and provide for the future.

The Lessons

- Business plans built on "stronger for longer economic assumptions" can prove to be seriously wrong in a recession.
- It is inevitable that high cost discretionary dental treatment will reduce in volume during harsh economic times. Practice business plans need to be modified.
- Observation of dental incomes during Australia's previous recession indicated that the fees of traditional dentists providing essential family dental care held up well.

** The information in this article is based on the author's observation of the financial performance of numerous dental practices over many years. The two dentists in this article are fictional, and any identification with particular dentists is entirely coincidental.*

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