SYNSTRAT

Two Hot Topics for Dentists

The current two hottest dental topics are:

1. Dental immigration

   and

2. Dental corporates

Australian immigration policy makes provision for categories of employment which are said to be in short supply in the Australian labour market. Currently dentists are officially in short supply, but is that true?

Australian Bureau of Statistics

The major source of information to the Federal Government on the labour market is ABS data. When we examined ABS data on dental incomes, something which Synstrat knows a great deal about, we found it to be wildly inaccurate. If that aspect of data is so poor, how can we be confident that other ABS data provided to the government is accurate? For example, does the government rely on ABS data on dental numbers? Not to mention differentiating dental fees between dental specialists, dentists, dental auxiliaries and hygienists.

We do know that Melbourne dentists who advertise for even a part-time dentist are inundated with applications from overseas trained dentists, and that this year's Australian Dental Council examiners are expected to test about 330 overseas trained dentists. Dentists who advertise for chairside assistants are receiving applications from immigrant dentists hoping to gain experience! Under these circumstances, a prior estimate by the Association for the Promotion of Oral Health that in order to maintain existing levels of dental services in Australia there was a prospective shortage of 1500 dental and oral health workers Australia wide by 2010 may have been a substantial overestimation.

University Dental Schools

Not only have new dental schools come into existence in recent years, but existing schools have expanded intakes. Much of this increased capacity is yet to work its way through the system to dental graduation. The question posed by the current immigration wave; particularly in Melbourne, is will the dental undergraduates have jobs to graduate to?

Whilst on this subject, where do the press get the dental salaries to quote in their annual list of new graduate incomes? Since the ABS patently don't know what dentists really earn, these figures must be regarded as having been plucked from the sky.

Where Will the New Immigrants Go?

The better informed are heading for rural practices, where there is still a visible demand and they may be expected to earn more than their contemporaries who are left to compete for increasingly scarce jobs in the city. Many will find it very tough getting a proper start, or will do a day or two in one practice then a day or two in another.

How Successful Will the Immigrants Be?

Many earlier immigrant dentists have done well. We observe that many dentists of Chinese, Vietnamese and South African origin are running successful practices; although we suspect that there is a high correlation between how long they have been in Australia, particularly whether they received a substantial amount of their education here, or in an English speaking system.

In Australia, as with all new world countries, such as the earlier experiences of Canada and the United States, each successive wave of immigrants has had to fight their way up from near the bottom of the economy.

A real fear is that with the current seemingly unchecked immigration program we will quickly reach a situation where recent immigrant dentists are competing with new graduates from Australian dental schools for scarce positions. Some persons who got into Australia under a dental quota may never work as a dentist. Will students entering dental school in 2009 have a job to graduate to in four years' time?

Dental Schools' Conflict of Interest

Dental schools have a substantial incentive to justify the existence of their courses in their budgets, and are likely to err on the side of over-estimating the future need for dentists. In this respect they are perceived as having a conflict of interest in that the interest of dental schools and of the dental profession as a whole are not parallel.

Postponing Retirement

Have you noticed how retirement age has been written out of a variety of career structures and "age discrimination" is now an issue? Perhaps it's better medical technology helping us to live longer but there's also a discernible growth in the "grey army" who choose to work for a couple of years longer than they would have in the past.

There has been a deliberate government policy to encourage participation in the workforce and for older workers to stay at work for a couple of years longer. On a national basis it is necessary to expand the workforce in order to cope with the increasing need to provide services to the growing number of retirees. There's a double benefit if we can persuade some of the people who would have been retirees to stay in work for a couple of years longer.

The combined impact of dentists working a year or two longer, of new dental schools and increased graduations from existing schools, plus the 330 dentists coming into Australia from overseas has not been adequately modelled. It should also be noted that the Australian Dental Council is only required to examine dentists who don't come from another accredited system such as the UK or New Zealand.

Under these circumstances a perceived shortage of dentists will quickly turn into a surplus, creating a miserable outlook for new graduates.

We're in favour of meeting the demand in dental practice, but we also note that a schooling process which takes four to five years to produce a dentist has years of inertia in the system from when somebody in government decides that there's no longer a need for dentists in Australia's immigration quota. Since government never reacts in a timely manner, but invariably closes the gate after the herd has passed through, it is near certain that when official notice is taken of the

surplus of dentists that another four years of dental undergraduates will be moving towards graduation to make the surplus far greater before a steady state is reached.

It is apparent that there is not an adequate national model which includes immigrant dental quotas, dental school projected graduate numbers and dentists postponing retirement, as well as including dental auxiliaries and hygienists.

In any labour system which is slightly short of numbers, what in fact occurs is that one employer poaches employees from another. Under these circumstances, a nationwide shortage of one or two percent is magnified since the number of dental practices which will be short a dentist for a period of time in any one year will be several times greater. Then too there is always likely to be a shortage in some unpopular pockets of the dental economy. Isolated rural towns and some positions in government-run clinics come to mind. There will always be shortages of doctors, dentists, veterinarians and pharmacists in isolated rural communities even if there are unemployed and under employed dentists in capital cities. Professionals are desirous of the need to provide educational and employment opportunities for their children. They are resistant to the concept of moving to Bullamakanka or the Black Stump.

Issue Two: Dental Corporatisation

The Greencross Example

In further discussing the issue of dental corporatisation, it is worthwhile looking at other professional examples. A recent example of professional corporatisation was that of Greencross Ltd, a consolidation of veterinary practices with significant clusters of practices in Townsville, Brisbane and the Gold Coast, plus some Melbourne practices and one in Adelaide.

The initial public offer and listing in the stock market occurred late in the 2007 financial year. It made its listing into a still buoyant share market, and those who had subscribed at $1 per share were delighted as it climbed towards $2.15 on negligible information. As the stock market began to tremble, reality set in. It fluctuated along the way, but has recently traded at around 96 cents to $1, i.e. back to about where it started.

Greencross has yet to produce a full year's result as a listed company, and its climb to $2.15 is more likely to have been attributable to day traders' chat room rumours than to any rational analysis since there was no worthwhile information in the market beyond that in the IPO disclosure documents. However we've kept an ear to the veterinary grapevine and note that already some practising veterinarians who sold their practices but were contracted to work for Greencross for several years are talking about leaving as soon as their contracts allow. They have found working for a corporate not to their liking, and are no longer as enthused as when they were running their own practices. Older vendor vets simply want to retire, while younger vendors are reported to be looking forward to their contractual release point to re-enter business on their own.

The Stockford Disease

It's early days for Greencross but the reported dissatisfaction mirrors the widely observed experience in the failed Stockford Accounting Ltd model. Stockford enthusiastically bought up accounting practices and approached a multitude of others (including Synstrat Accounting, which rejected the approach). Accountants who had worked long hours in building their practices and servicing their clients, and who were used to being their own bosses, quickly became disenchanted with the company song emanating from Stockford's head office. Practice vendors got sick of debating with head office, and rediscovered the joys of normal work hours. Other accountants who had aspired to becoming partners in these practices concluded that the new arrangements were unattractive, and departed to another practice where they could hope to become a partner.

Staff who were used to doing a little extra because their bosses regularly worked late now became clock watchers. The workplace rule book reigned supreme. The staff also found that now that

their old bosses were employees, they no longer seemed to care nearly as much. Naturally, clients detected the lack of urgency and began to change accountants. Practices which had previously been nicely profitable turned into lemons.

Stockford's leadership didn't diagnose the real cause, which was related to organisational behaviour and staff morale, and kept looking at the figures. Their response to most issues was to put another executive onto the head office team to manage that problem company-wide. The more the head office grew, the more autonomy was taken from the practices. The vendor accountants had little choice but to acquiesce. In conjunction with these attempts to manage its problems, Stockford's board approved the acquisition of new practices. Each new practice's immediately preceding profit demonstrated that it would be earnings accretive for Stockford. Unfortunately as each new practice was purchased and joined the Stockford system, they caught the Stockford disease and slid into unprofitability. Stockford declined inexorably toward eventual liquidation.

The liquidating trustee quickly realised that the only people who would buy the practices (which were Stockford's only significant assets) were accountants working in them who had a relationship with the clients. The only problem was that the accountants realised that they were the only buyers, and they paid low prices accordingly. The practices they bought back were a pale shadow of those which had previously existed, but were quickly resuscitated, albeit not to their former size.

In some cases, vendor accountants had unwisely accepted large quantities of Stockford share scrip and little cash. The entire episode represented personal tragedy for those accountants. Other accountants, more market attuned, insisted on cash. In some cases persons who had been paid large cash sums were able to buy back their old practices for a fraction of what they had received, and then set about reconstituting a viable practice.

Will Greencross Fare Better Than Stockford?

It probably will, but its management needs to produce impressive end of year financials for the 2008 financial year, and they need to demonstrate that they can go on doing it in 2009 and 2010. They urgently need to solve the practice staffing challenge which is coming closer. This is a real problem in a profession staffed by a multitude of part-time female vets who insist on working hours which suit their family needs. The challenge lies with replacing the senior positions filled by the vendor vet/managing vet in each of the practices with somebody who is both a capable vet and an enthusiastic believer in a career working for a corporate managing a corporate practice as opposed to aspiring to running and developing their own profitable practice. It is daunting.

Organisational behavioural experience points to the failure of professional consolidations except in very limited circumstances. The next two or three years will be critical for Greencross Ltd but it may struggle to turn out to be more than a mediocre performer. There is a significant danger that Greencross will not solve the critical practice management issue requiring employment of experienced full-time vets as replacement practice superintendents for those vendor vets who will have departed or indeed that the vendor vets will catch and transmit the Stockford Disease.

The Pearl Healthcare Ltd Experience

From its IPO as a dental laboratory company, Pearl Healthcare Ltd has yet to declare a profit or a dividend. Along the way it has consolidated its shares on a 50 to 1 basis. Therefore, correcting for a consolidation, recent share market price represents three percent of the IPO subscription price. It has undergone changes of directors and senior management and, in more recent times, its board has struggled heroically to stem the tide of red ink and has kept the company afloat through lending substantial sums as directors' loans, some of which have been converted to shares in the company; there being no possible way that those loans could be extracted from the company without causing it to collapse. Perhaps Pearl Healthcare will survive but it will require a massive turnaround in its fortunes. It is evident that its original consolidation model, put together by personalities who had had significant experience with Mayne Healthcare, was hastily thought out.

It is also evident that some of the vendor laboratory principals quickly caught the Stockford Disease.

What of Dental Corporates?

In buoyant share market conditions a host of "merchant bankers" and "corporate advisers" trawl through businesses and professions looking for groups to consolidate; basically anything that they can spin a story to the share market about. In many cases, corporatisation has been an outright failure. In isolated cases it is a way of capturing massive referral value. For example, a recent consolidation of orthopaedic surgeons into an as yet unlisted company was almost certainly driven by the certainty that in providing surgery, the orthopods have their staff make hospital bookings and theatre bookings. The combined hospital, theatre and radiology fees dwarf the surgeon's operating fee. A company which is able to drive high bed occupancy and operating theatre usage in a private hospital adds value to these facilities. In such cases the consolidation has more to do with these additional facilities than with what the orthopaedic surgeons charge their patients.

By contrast, if there is a not a substantial upward referral or secondary business advantage (way beyond that of most dentists) then consolidation models are heavily dependent upon the vendors maintaining high ongoing personal productivity. In the case of dentists it is also dependent upon the ability of the corporate organisation to replace vendor dentists as they reach contractual release points. Maintaining high personal productivity is dependent upon vendor dentists wanting to sustain the edge after they have sold the practice.

The vendor dentists have, in nearly all cases, signed up because the corporate was offering them a price for their practices which was difficult for them to achieve on the open market, but the sale came with conditions and deferred payments not present in a normal practice sale and therefore the prices should not be directly compared.

In some cases high end dentists who were highly productive and had a superlative ability to sell expensive treatment plans had little ability to sell their practice to a more typically average dentist. The typically average dentist looked at somebody doing three or more times their normal fees in their own surgery and realised that they either lacked the dental skill or the commercial hard nose to sell and provide that type of work. Realistically, if an average dentist buys a practice off a high end dentist, the probability is that the practice fees will rapidly tend towards the norm. As a result, many high end dentists found that they had little to sell, despite being highly profitable by dental standards.

The dental profession at large is awash with stories of dentists selling their practices for large amounts of money, of which 70% or more is paid to them up front, with the remainder being paid in the form of share scrip and cash at the end of a contractual period subject to maintaining a contracted level of fees or profitability. Since many of these dentists were receiving more cash than they could get in the open market, they have openly said to colleagues that they'll sell out for the cash but they're not banking on getting anything for the share scrip or the rear end payment.

If this attitude, which can be likened to Stockford Disease, is widespread, then within a year or two we expect the corporates concerned to be struggling to maintain profits projected in an IPO document.

All dentists who own their own practices can reflect on their own motivation to buy a practice and run it to the best of their ability. The motivation is multi-faceted. It includes not only the ability to make profit but the ability to exercise effective control and to have substantial freedom of choice concerning the type of dentistry they practice, the fees charged and who they employ.

Presently, the mantra of corporates is that they are relieving dentists of some administrative worry in order that they will be free to run their practices, or words to that effect. That's an old message but it was also the message provided to the Stockford accountants and the Pearl Healthcare laboratory technicians. As soon as things got tougher, the corporate message changed.

No CEO of a listed public company will be able to wash their hands of falling profits and say to shareholders that they can't interfere because the vendor dentists have complete autonomy to run their practices. That message will be unacceptable coming from the CEO of a listed public company.

To What Degree is Stockford Disease Likely?

The answer is that it's going to vary from company to company, but we would expect a significant element of it to be present in all dental consolidations. Younger dentists with ambition do not foresee a 30 or more year career running a dental practice on behalf of a dental corporate. Dentists nearing retiring age who have had many years experience of running their own practice are selling to corporates, banking the cheque and then gritting their teeth as corporates do some things which they regard as being silly.

Predicting the future is never easy, but I expect that each of the corporates involved in dentistry are going to find the future very challenging. Maintaining high and growing profitability to satisfy the share market will be dependent upon the ability of senior management to replace vendor dentists with dentists equally as competent to sell the dental plans and provide the treatment as efficiently as the vendor dentists previously did.

If we think about it, the vendor dentists come from a very narrow cross section of the dental population. In the case of at least two companies hoping to list, the vendor dentists are going to be older than the average dentist in practice and have well above average fees in their own surgeries. The chance of replacing an above average group of vendor dental fee producers with an above average group of employee dental fee producers may well prove nigh impossible. The reality is that whereas the vendor dentists have been targeted from a narrow segment of the dental practice owning population, it is unlikely that the corporates can as easily identify, isolate and contract the next generation of dentists with the same abilities. The next generation of dentists of this level of ability will aspire to build up their own practices and hence will seek employment in conventional practices, then seek to buy or start their own practice. They may be interested in selling to a corporate in thirty years' time as they approach retirement; if the corporates still exist.

It is likely that as the vendor dentists approach their contractual release points, they will leave the employment of the corporates and will be replaced by a cross section of recent graduates and immigrant dentists. It is near certain that in real terms the average of fees produced by the dentists who replace the vendor dentists will be much lower. Since profit is never earned evenly on each dollar of fees, but rather is greatest at the margin after fixed costs have been dealt with, there may prove to be a substantial impact on profitability.

A dentist running a freestanding practice is more easily able to motivate their staff, with whom there is often close bonding, than are either the senior executives of a major corporate or a dentist managing a branch practice. The corporates will inevitably have far greater turnover of dentists at each practice level precisely because they no longer have a proprietor dentist at that location. Patient referral to a practice where the dentists are continuously changing is likely to prove lower than to good dentists who build up a practice over a period of, say, thirty years.

In an ageing population with fewer children, we identify with those with whom we deal on a regular basis. That includes relationships with doctors, dentists, veterinarians, hairdressers and a host of other service providers. Where there is a long-term service provider such as a hairdresser or dentist, then loyalties and habits develop. Where there is constant change at the point of service delivery, client loyalty is destroyed.

It has long been known that there is a substantial difference between the providers of professional services who bond with their clients on a long-term basis and the providers of packaged goods such as McDonald's or KFC. Others have tried to Big Mac medical practices (remember Geoffrey

Edelsten?) as well as a host of other services. That was what Stockford Accounting was trying to do to accountants. It didn't work.

The challenge facing the dental corporates who are yet to list is first of all to get to IPO with a credible story, and then to convince the investing public that they can be providers of dental treatment on a mass scale efficiently and with growing profitability once the vendor dentists have departed. The biggest challenge comes after IPO.

I do not believe that dental corporates will succeed in being successful listed public companies in the long term. It will be interesting to see when and if Dental Partners Ltd, Dental Corporation Ltd and Pacific Smiles succeed in listing on the stock market; what their profit projections are at time of listing, and whether they can sustain their profitability long-term without catching Stockford Disease.

By GRAHAM MIDDLETON, BA, MBA, AFAIM

Graham Middleton is a director of Synstrat Management Pty Ltd and Synstrat Accounting Pty Ltd. He has spent many years advising dentists in respect of their business and financial strategy and measuring their practice and financial performance. The Synstrat Group is an independent data-based organisation providing management, benchmarking, valuation, financial and accounting services to the dental profession. Synstrat Management Pty Ltd is a Licensed Dealer owned by its directors who work within the Synstrat Group. Graham Middleton personally has been an investment adviser to dentists located throughout Australia, and has been providing this service for 20 years, the last 13 as a partner and director of Synstrat Management Pty Ltd.

Tel: (03)9843 7777 ***Fax: (03)9843 7799*** ***Internet: www.synstrat.com.au***
Email: dental@synstrat.com.au