The complicated world of dentistry in 2016

By Graham Middleton, BA, MBA

"Most of the practice aggregators won't get to the critical mass required for... listing on the stock market, but will on-sell... to a larger aggregator..."

The belief that there's a lot of money to be made by aggregating dental practices reached a crescendo in 2015. It was unclear who some of these "doorknockers" and "practice finders" were representing; some approached dentists spouting wonderful dollar figures but couldn't disclose who they were representing. They then hawked practice financials to a number of corporates, seeking one who will pay them a 5% commission to introduce the practice vendor. I wonder how many dentists' financials have been hawked around in this manner?

Lack of critical mass

Most of the practice aggregators won't get to the critical mass required for an initial public offering and listing on the stock market, but will on-sell a parcel of practices to a larger aggregator. The result is that vendor dentists who sign on to work as a lead dentist in their old practice can find themselves working for a different owner. In fact, that has already happened with Dental Corporation, who were originally owned by Australian shareholders headed by Mark Evans, then found that the company had been sold to a subsidiary company controlled by two wealthy Indian businessmen, who in turn on-sold it to the UK-owned Bupa health insurance provider. The result was that a group of vendor dentists who loathed the thought of being a preferred provider ended up with their old practices controlled by a major health fund.

Negligible paid up capital!

Dentists all over Australia received a flyer from a company called Strategic Equity Alliance, with paid up capital of $100 and its shares owned in turn by a company registered in Vanuatu, whose details cannot be searched. Dentists will be wary about handing their practice financials to a company whose controlling shareholder is a company with unknown ownership. Who really has access to financials handed over to them?

Predictions: The best of the corporate practices

1. The corporate which runs practices best is 1300SMILES Ltd, and it will continue in its successful niche in the market.
2. Some of the recent smaller dental corporates will struggle and be bought out by bigger ones.
3. Corporates which get into a relationship with health funds will find that ultimately they'll be in a position of having only one customer, i.e. the health fund, which will then dictate their terms.
4. Bupa will increasingly break its ties with independently owned practices who are its preferred providers and direct "its" clients to Bupa-owned practices.

Practice closures and ethical compromises

Dentists who open practices will continue to fail. Having no referral base compared with long-established practices, they must rely on the occasional walk-in patient or the odd patient who, for some reason, is dissatisfied with their current dentist. However, they won't get many new patients because in the main, patients come to practices because they have been referred by existing patients (aka word of mouth). Therefore, existing practices with good patient lists will continue to obtain new patient referrals while simultaneously new start-up practices in their neighbourhood will struggle to gain patients because they have no referral base.

Eight fillings but no holes

Practice start-ups with no patients can and do lead to significant breaches of ethics. A long-established and widely respected dentist recently told me of an old patient who turned up. The patient had responded to a free check-up notice from a newly-established practice. The dentist at the newly-established practice then advised him that he needed eight fillings. The patient smelled a rat and went back to his old dentist, who did a thorough inspection and advised him that no fillings were required!

Comment

Starting a practice with no patients is a sure way to get into serious financial difficulties. People in serious financial difficulties tend to become desperate and compromise their ethical standards.

One of the serious defects of the Medicare Chronic Disease Dental Scheme was that it was open to serious rorting and that rorting was particularly concentrated among recent practice start-ups who cultivated relationships with referring doctors, who also got paid a fee for filling in the referral form. Their start-ups were based on the assumption that the scheme would continue for many years. Not only did they rort the scheme, but when the Labor government ceased the scheme at short notice in September 2012, with work and billings to be completed by 30 November 2012, practices which had built their business around the scheme subsequently saw their fees plummet and closures occurred.

Success has many parents; practice closures are orphans which disappear in the night.

Banks wary of start-ups

Wildly optimistic start-ups may continue to occur but will be less frequent as banks increasingly become wary of them. The banks are learning to differentiate and the old assumption that "I know a dentist who is profitable therefore this new practice should be profitable", won't hold.

It will remain almost unknown for long-established practices to fail after changes of ownership unless there is something very unsavoury about the new dental owners.

Hygienists and laboratory technicians owning practices

We've seen a few of these and they perform poorly, often ending in tears. Successful practices will continue to be owned and run by dentists.

Health funds losing members and churning of members towards cheaper options

This will continue and accelerate in 2016. A Federal government which inherited a large budget deficit is not likely to increase subsidies to health insurers; nor should it. Bit by bit, misleading information in health fund advertising is being questioned. In an economy of very low wage growth of 1-2% per annum, health funds cannot continue to put up premiums by 6% per year and hold membership. People will continue to drop either their hospital cover or their extras cover as they are squeezed financially.

The larger funds which dominate preferred provider arrangements will become increasingly desperate to hold their profit margins by forcing dental fees down and rationing treatments to members.

The ADA and health funds

Under the current Federal President, the ADA has shown a tendency to speak out against health funds. This long overdue trend will continue with the growing realisation among dentists as to how past ADA policies based on incorrect assessment of dental numbers caused it to advocate for more dental schools and more dental immigrants. This in turn opened a gateway for health funds to influence dentists to sign up as preferred providers.

The reality is that the dental profession will take years to fully awaken, but eventually it will be better off with less health fund involvement.

Move towards a managed care model?

From the health funds' perspective, their recent utterances indicate desperation to move towards a managed care model and to get government endorsement of their strategies.

Now that the Commonwealth government has divested itself of Medibank Private, it is no longer compromised by having a stake in private health insurance and is less inclined to give in to their demands.

Why should it assist British-owned Bupa to remit profits from Australian health insurance to its UK parent?

Churning

It's likely 2016 will bring the continuation and probable increase in the rate of churning of health fund policies towards cheaper options, with more members dropping either their hospital cover or their extras cover.

Regulation of dental practices

Perhaps 2016 will be the year the regulators learn that books full of regulations are nowhere near as effective as on-site inspection of practices and practice procedures.

Dental numbers

With about 680 students in first year dentistry and another 140 per year coming through the Australian Dental Council exam system, the surplus of dentists will grow worse rather than better. Ceasing the dental classification among the skilled immigrant program will only be partially successful, as dentists will enter Australia under the guise of family reunions and through other loopholes.

For example, I know of a South African-born pharmacist who migrated to Australia with his family, even though the skilled immigration list excluded pharmacists; the Pharmacy Guild having been very successful in lobbying government. The individual got in by doing an approximately one-month carpentry course in the equivalent of an Australian TAFE and presenting a certificate whereupon Australian immigration classified him as a carpenter and belonging to an occupation listed in the skilled immigration program.

I wonder how many dentists are going to migrate under other job classifications or under the heading of family reunions?

Dental students

During the last couple of years of study, be extra nice to your tutors in the hope they may put in a word for you with a mate who owns a practice. If you're entering the first year of your course with several years of large graduations banked up in front of you nationwide and a growing surplus of dentists, consider changing courses. The earlier you make this decision, the better.

The Australian economy

Australia will struggle in 2016, with minerals export income having crashed, little wages growth and government deficits. Established practices will be challenged to maintain fees and profitability.

The United States economy

With the US trade deficit dramatically narrowed by reaching energy self sufficiency, albeit this may be temporary and an oil glut worldwide coupled with greater employment as its manufacturing industry has recovered, the US will continue to outperform Australia economically in 2016. Its stock market is likely to outperform the Australian stock market and the US dollar is likely to strengthen against the Australian dollar.

The European economy

It's difficult to see the European economy being nearly as strong as the US. The economic difficulties in parts of Europe dwarf those of the United States.

China's economic slowdown?

Nobody believes Chinese growth figures. Figures aggregated by regional party officials are widely believed to be sanitised so that officials don't have to admit not achieving targets issued by Beijing. Hence the official figures are almost certainly overstated.

China's demographic time bomb

China is building a demographic time bomb. Its long-term one child policy, dating from Chairman Mao's reign, with births heavily skewed towards male babies, means that the birth rate is falling below that needed to replace the population. With Chinese women following the modern Asian and Western trend of having their first child at a significantly older age and hence naturally seeking to have fewer children, regardless of the changes to the one child policy, China's rate of population growth was always going to slow and then begin to fall. An ageing diminishing population will inevitably slow economic growth regardless of official policies.

The popular belief that China will overtake the USA economically may not occur.

Dental practice sales

The majority of practice sales will continue to be of a dentist to dentist nature without the involvement of brokers. Synstrat estimates that over 90% of its dental clients bought their practices from another dentist, without broker involvement.

Sales to corporates

In 2016, these will mainly be by dentists within three to four years of retirement from dentistry who do not have a well-performing employee dentist wishing to buy their practice.

Come back in 25 years

Young practice owners with good clinical skills should say to corporates and finders "Come back in 25 years" The ability to structure practice ownership to share income with your spouse, to superannuate you and your spouse, to build up goodwill steadily over a long period, thereby increasing practice value, to own and renovate your own premises and capitalise on their investment on the infrastructure within the premises without reliance on a landlord and to realise substantial capital gains when practice and premises are sold prior to retirement will far outweigh the benefits of selling to a corporate and working as a vendor dentist.

Long-term prediction

In 20 years' time, the greatest proportion of dentistry will be performed by competent dentists in their own practices. The remaining corporates and government clinics will be seen as the less desirable dental career options.

Housing in 2016

The market for freestanding homes will drop in 2016 but hopefully not by huge amounts. The key to holding most value will be position, position and position.

High-rise apartments in 2016

There will be a lot of shocked investors when apartments which were over-hyped in off-the-plan sales are completed and the buyers find that the valuations required by their banks indicate that they're worth around $150,000 less than the contracted price. The high price spruiker salesmen will have vanished.

Not surprisingly, high-rise developers who have to get around 70-80% presales on firm contracts before banks will allow them to commence building are desperate for sales. To achieve sales they budget about 20% of their project cost to marketing, which is effectively added on to the price. That 20% goes into fancy literature, architects' models, artists' impressions, sales displays and sales commissions. The spruikers know the selling price is loaded up to accommodate the selling costs, including the hefty commissions earned by the spruikers. It's a case of nudge nudge, wink wink. The spruikers then go to work on unsophisticated investors who have been rung up and invited to property investment seminars. In effect, the over-pricing is due to the cost of sales. This is reminiscent of the dud eucalypt lot investment companies which paid 10% commission to unethical accountants to flog their product to their clients.

The time lags in high-rise development mean that in every succeeding market cycle, too many apartments are produced and then overhang the market. Investors find that rents are less than they anticipated and ownership costs are higher. Many put them back on the market and they are far more difficult to shift in the secondary market than they were via the spruikers. After considerable difficulty by normal agents who can only access tall towers at certain times by appointment, they eventually attract offers which lock in the aforesaid loss of around $150,000.

About the author

Graham Middleton personally has been advising dentists on strategic, practice management, valuation and conflict resolution processes for 27 years, the last 20 as a founding partner and director of Synstrat Management Pty Ltd and Synstrat Accounting Pty Ltd. He was once a regular army officer, and later Director Human Resources Manager, Attorney General's Department of Victoria. He is considered an expert on dental practice valuation and practice performance benchmarking. He has spent many years advising dentists in respect of their business and financial strategy and measuring their practice and financial performance. He is the author of Synstrat Dental Stories, the Synstrat Guide to Practice Management, 50 Rules for Success as a Dentist and Buying & Selling General & Specialist Dental Practices. He is a long-term contributor to the Australasian Dental Practice magazine. 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 financial services company. Both Synstrat companies are owned by the same directors who work within the Synstrat Group. For more info, call (03) 9843-7777, Fax: (03) 9843-7799, email dental@synstrat.com.au or see www.synstrat.com.au.

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