A tale of two dentists

By Graham Middleton, BA, MBA

"Warren Buffett famously observed that if you introduced a good manager to a poor company, it was usually the company that emerged with its reputation intact..."

Lena and Rupert (not their real names) are both in their mid forties. They graduated from dental school in the same year, but were employed for a period before buying their own practices. Here the similarity ends, as Lena has been vastly more successful than Rupert.

On graduation, Lena worked for two dentists in an associated practice which operated from two locations; one being an established suburb, the other a slightly less established suburb about six kilometres further from the CBD but on the same axis. The practice was well-booked, albeit that one of the associate owners worked at a relaxed, comfortable pace while the other worked faster and was a more accomplished practitioner.

Lena was keen to do well and was a quick learner. The faster of the two associates ensured that fee protocols were applied and encouraged Lena to enhance her skills. He also ensured that she was aware of the need to be productive and keep an eye on her book. He was keen to ensure that her use of practice resources, including both her equipped operatory and chairside assistant, was efficient. There was no practice manager, but the practice was well-run, particularly in respect of the faster of the two associates, who also shouldered most of the management responsibility.

He hated the idea of a chairside assistant standing idle during normal work hours. As a result of his mentoring, Lena rapidly became efficient. She had good dental hands and, importantly, an engaging personality, but retained the determination to focus on timely outputs. She was quick to grasp the essentials of running a successful operatory inside a successful practice.

Meanwhile, Rupert had also joined a practice as a full-time employee. The practice Rupert joined had more dental assistants than actually required, although the DAs routinely complained that they were overworked. The two associates routinely discounted their fees and if patients asked the receptionist nicely, they would be discounted further. The appointment book was messy and the dentists were unaware of how to set the book up for optimum output. The practice had a practice manager, whose efficiency and motivation was not up to good practice standards.

In truth, many practices of this size operated efficiently without a practice manager, albeit that some gave the courtesy title of practice manager to a receptionist. Rupert too was rather casual. He was glad to be working and earning reasonable money, but had no idea as to how he could optimise his output. The associates didn't seem to mind if he discounted his fees and he let a significant proportion of his potential gross walk out the door, even though the practice was located in a well-established, above average socioeconomic area. This hurt the bottom line of the practice as well as his own percentage of receipts. Nobody seemed to care about practice efficiency.

Three years out

As a consequence of their divergent past and attitude towards practice, by the third anniversary of graduation, Lena was producing 50% more fees per week than Rupert.

About this time, both married and purchased their first homes. Lena and her husband took sound advice and set their mortgage payments to an accelerated schedule. Lena was also salary sacrificing super payments to her tax deductible limit. Rupert and his wife struggled to make the minimum payments on their mortgage and only paid the minimum amount of super.

Lena's husband worked in the IT industry and was able to do a lot of his work from home. He was also able to help out significantly with their first child and Lena was able to return to work after a short break.

Rupert's wife also gave birth to their first child and gave up her job.

Meanwhile, the less productive of the associates at Lena's practice decided to retire. After proper valuation advice, Lena was able to purchase his associateship. Soon after, the other associate sold out as well, to the other assistant dentist, Donald. Lena quickly moved to get Donald's agreement on key issues such as fee protocols and management of the receptionist's book.

Six years out

At the sixth anniversary of Lena's dental graduation, her hands had become much faster. Her associate, Donald, was of similar vintage but quite a bit steadier. Lena's communication skills were of a higher order and she attracted more direct referrals. Her work was quicker and more accurate. She quickly outpaced Donald, whose interpersonal skills were off a lesser order and realised after a time that he was holding the practice back.

Rupert too had been offered entry into his practice, buying out one of the principals. However, the practice's low productivity and high overheads had become embedded in the structure. Neither the continuing associate nor the staff were mindful of the need for change; indeed, being resentful at any hint of it and Rupert was insufficiently forceful.

Eight years out

By this stage, Lena was earning over twice as much profit from her associateship as Rupert was from his. Lena and her spouse had built up substantial equity in their first home and after getting advice as to the optimum repayment schedules, traded their home up to one worth $1.5 million, $750,000 more than their first home. In due course, they renovated their new home and were confident that it would meet their long-term family needs.

Meanwhile, Rupert had found that he and his wife had scant money left over after making minimum mortgage payments and meeting normal family lifestyle expenses. It didn't seem to matter to Rupert how hard he worked, he couldn't kick the discounting habit either personally or within the practice. He and the other associate, Christian, had a practice manager who resisted change and protected her position vigorously. She also carried an additional dental assistant, with the undisclosed reason being that there was then little reason for her to become involved in any of the irksome tasks within the practice. As a result, the practice was paying two full-time wages, including that of a practice manager, more than Lena's practice.

On purchasing her associateship, Lena had adopted an ownership structure which enabled her to share practice income with her husband as necessary and both were contributing the maximum tax deductible amount to their superannuation fund. For his part, Rupert had received poor structuring advice, was not paying his wife adequately and was only able to afford a minor amount of superannuation.

At around the eighth anniversary of her dental graduation, Lena negotiated a separation of her practice from Donald. Donald retained the more established of the two locations and purchased her interest in the premises at that location. Although Lena was 6km further out, her patients were quite willing to drive the extra distance to have her treat them. Lena had negotiated to take with her the busier of the two assistant dentists.

At this stage, Rupert was mired in an inefficient, overstaffed and undercharging associateship.

Nine years out

In Lena's ninth year out of dental school, she purchased a suitable site and began organising plans for a functional but not ostentatious future dental premises. After careful consideration she confined it to a three-practitioner size after advice indicated that few practice principals made a significant return from having more than two assistant dentists. She resisted the overtures of expensive design consultants and after looking at a number of premises of dental colleagues, settled on a straightforward, functional design with the assistance of an architectural draftsman. Her husband spent reasonable time on site with builders and Lena visited regularly. The finished premises fitted in well with the area and the overall project cost was contained. Importantly, the premises did not look overly expensive to her patients.

By this stage, Lena's financial performance was impressive and bankers competed to finance the purchase of the site and building of premises, into which she was able to move her practice at about the tenth anniversary of graduation.

Rupert struggling

Rupert was struggling to perform in a practice loaded with extra costs, in conflict with his associate, Christian, who didn't want to change and practice manager Clementine, who also wanted to preserve the status quo. The practice had adequate space and reasonable rent, but it was badly in need of refurbishment. Rupert toyed with the idea of separating his associateship from Christian, but he needed to see out the current term of the lease to which he was legally bound. He shuddered at the thought of having to pay for a fit-out in a new location.

Both now had two children. Rupert's wife managed to earn a little income in a part-time job. Lena's husband worked partly in and partly out of home and had built up a successful niche in his IT role.

Twelve years out

Lena has now been in her purpose-built premises for two years. She produced $850,000 of fees in her own surgery. Her most experienced assistant dentist produced $575,000 and her part-time (three days per week) assistant dentist $325,000. A hygienist working two days per week produced $175,000. The practice gross was $1,925,000. Lena had kept the core practice acquisition debt and premises acquisition debt on an interest only basis and accelerated home loan repayments. Her fit-out and some new equipment had been financed on a lease basis. She and her husband were able to maximise their tax deductible superannuation contributions and now had $600,000 in their fund.

Their home, to which they had made some renovation improvements, was now worth $2.3 million. The dental practice premises had been revalued for bank purposes and were now considered to be worth $1.4 million. Debt on the premises, including purchase of a site, was $800,000 and her occupancy (interest) cost relative to gross fees was below the average shown up in dental benchmarking.

Rupert was still in his first home and grappling with the mortgage. He'd taken some benchmarking advice and been told that the practice in which he had an associateship did not measure up; in fact, it was very poor by comparison with other dentists. His associate was reluctant to change and the practice manager sided with his associate because it reinforced the continuation of her comfortable existence. The practice remained overstaffed and there was huge reluctance to make improvements. It finally dawned on Rupert that he could not introduce profitable change and he gave notice to his associate that he intended to leave the associateship before the lease on the premises renewal option had to be taken.

Rupert knew he had to move, but he could not afford to buy premises so he went looking for rental options. The only option he could find relatively close to his current location was in a modern commercial/retail complex and the rent was $10,000 per month. He took the plunge and fitted out three surgeries and after salvaging a reasonable amount of equipment from his earlier practice arrangement, had a fit-out and re-equipment cost of $550,000 financed over a six-year term. His non-professional staffing costs fell because he no longer needed to share the cost of an unnecessary practice manager or a surplus dental assistant. At this point, Rupert and his wife had combined superannuation assets of $200,000. Their home was worth $750,000 and their home mortgage stood at $380,000. Rupert too had carried his practice acquisition debt of $400,000 on an interest only basis. He moved into his new premises with an assistant dentist and a combined fee base of $900,000. Compared to benchmark, Rupert's rent factor as a percentage of gross fees is way over the top.

Sixteen years out

Lena forged ahead. Her success has bolstered her confidence and the confidence of those around her. Her pleasant professional manner means that she generates a lot of personal referrals. Her senior assistant dentist has followed her lead and while not yet a practice owner, generates an impressive share of take-home fees. The part-time dentist and the part-time hygienist are fully booked. Fee adjustments have occurred annually. The practice remains tightly staffed and as a result, everybody knows their job. Lena works three almost full days and two half days and her schedule allows her to have reasonable time with her children. She utilises a part-time bookkeeper.

Such is the practice's and Lena's confidence that she has ignored overtures to become preferred providers for health funds and the practice has educated its patients concerning the shortcomings of ancillary/general health cover encouraging patients to ditch this insurance and simply retain hospital cover. The practice's patients are used to paying fees for quality dentistry. There are no third party agreements with other organisations except for Veterans' Affairs.

Lena and her husband have eliminated their home mortgage and their home is now valued at $2.7 million. She has kept business-related debt on an interest only basis and has made modest non tax deductible payments into the superannuation fund, as well as fully utilising the tax deductible contribution limits for her and her husband. The superannuation fund is now worth $1.2 million. Lena's premises are valued at $940,000. Her business debt on an interest only basis is $1 million, but her practice is reckoned to be worth at least $1.5 million (probably more) based on its performance, profitability, location and the dental market. Hence, Lena and her husband's joint assets, excluding cars, furniture and personal effects, total $5.34 million. Lena was receiving overtures from dental corporates but ignored them, correctly assessing that she would be much better retaining practice ownership over the next dozen years or so.

Rupert's situation is that he has grown his fee base to $1.2 million, doing $550,000 of fees himself; his more senior assistant dentist $400,000; and a part-time recent graduate $250,000. His rent has been indexed and is now $135,000 per annum. He realises his practice would be hard to sell because of the rent factor, but a broker has indicated that he might be able to receive $400,000. Dental corporates have looked briefly at his practice and shown no further interest. He is two-thirds of the way through the 72-month repayment schedule on his equipment and fit-out lease, which has a residual due in two years' time of $165,000 and in the meantime is costing $8,000 per month. Rupert's home is now worth $1.1 million but he still owes $250,000 on his home mortgage. He retains a goodwill loan of $325,000. His present payout figure at the four-year mark on his equipment and fit-out lease is $320,000. He and his wife have superannuation assets totalling $325,000.

Unfortunately, Rupert has been unable to break the habit of discounting entirely and his fee adjustments have been delayed through fear that he would lose patients. Rupert's seemingly endless financial struggle has taken its toll on his demeanour. He is not as confident in dealing with his staff and attracts less referrals than does Lena.

Rupert's balance sheet looks like this:

Assets

Home - current market value..$1,100,000
Practice - possible value...........$400,000
Superannuation.........................$325,000
Total **$1,825,000**

Liabilities

Payout figure on fit-out and equipment leases at four-year mark...........$320,000
Home loan outstanding $250,000
Goodwill loan...........................$325,000
Total **$895,000**
Rupert's net assets are..............**$930,000**

Lena and her husband's net assets of $5.34 million are 5.74 times Rupert's at the 16-year mark. The gap is expected to continue to widen. Lena is easily meeting the school fees for her children, practice profit continues to grow at a much faster rate than Rupert's, she is now making significant surplus after-tax income beyond her needs to meet family lifestyle costs and together with her husband's income, is now in the situation of being able to make substantial additional non-concessional contributions to their super fund.

Lena periodically updates the presentation of her practice premises; her dental equipment is in good order; she and her husband have progressively renovated and improved their home and are now in a situation of being able to afford to make substantial non concessional contributions to their fund, which will grow rapidly during this phase of her dental career.

Simple extrapolation would reveal that in a further five years or so, Lena and her husband will have net assets in the order of eight times Rupert's assets. The reality is, Rupert can never catch up.

The lessons

1. Assuming availability, the first choice of employment is vital for dentists. If the practice they are working in is poorly conducted, as soon as they have sufficient experience young recent graduates should seek employment in better practices.
2. As most dental practices are sold from owners to employees, this positioning can be vital. Working in a well-run privately owned practice is preferable to working for a corporate practice. Private sector employment in any reasonably run practice is preferable to the public sector with its inherent inefficiencies.
3. Warren Buffett famously observed that if you introduced a good manager to a poor company, it was usually the company that emerged with its reputation intact. Where dental practices have multiple owners and/or a practice manager intent on protecting her nest, it can be extremely difficult for a new associate to eradicate poor culture and poor outcomes. So it is with dental practices of any size which carry forward their culture. Where the work culture and protocols have been poor, it is extremely difficult to eradicate the bad behaviour of the person involved.
4. No amount of training at dental schools will prepare young dental graduates for the actual task of running a practice. This is best learned by working in a well-run practice and being mentored by a dentist or dentists who understand what is required.
5. In respect of long-term wealth creation, the earlier a dentist can earn a good level of fee income and the earlier they can begin reducing the mortgage on a home, the more likely it is that they will eventually own their own practice.
6. The two most important financial steps in a dentist's career are the purchase of a sound practice and the purchase of their own home.
7. Many years of observing the actual accounting outcomes of dentists have demonstrated to me beyond reasonable doubt that dentists like Lena, who get their initial decisions correct and who then concentrate on their practice, their home, their practice premises and their superannuation fund, are on average vastly better off in the long-term than are those dentists who made a series of random decisions investing in hobby farms, tree plantations, residential rental properties or who paid insufficient attention to their practice, which is the source of their main stream of income.

The final question is, are you a "Lena" or a "Rupert"?

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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