Buying and selling practices and dental associateships

By Graham Middleton, BA, MBA

"The days are long gone when virtually all new start-ups had a rapid build-up of patients. These days, there are just too many dentists and patients tend to patronise practices to which they have been personally referred..."

Jack was one of two dentists employed in a practice which was conducted by three associated owners. Ed, the original owner of the premises, had never relinquished the belief that the practice revolved around him. Tony and Lou, the other two owners, both competent dentists, finally had had enough and decided to move into their own premises elsewhere, taking their patients with them. There were some hassles about equipment and various payments but aided by a practice valuation, a settlement figure was agreed and Tony and Lou moved on.

Ed had long employed his wife part-time and she shared his surgery. Ed had done 4 clinical days per week and Marie, his wife, 1½. Jack, the senior of the 2 remaining employed dentists, was invited to buy into the practice. Acting on advice, Jack insisted on a right to purchase a half interest in the premises within 3 years. A new associateship agreement defined how costs were to be shared. The agreement favoured Ed but Jack was advised to be patient as due to Ed's age and the desire of Ed and his wife Marie to take more time off for travel, Jack would be in a good position to control the practice in due course. Jack was able to have first and last rights to purchase the remaining equity share in the practice should Ed decide to retire.

Jack, like Tony and Lou before him, found that working with Ed was frustrating. Ed tended to take decisions which affected the entire practice unilaterally and then react when Jack insisted on being consulted. Intermittently, there were reoccurrences. Ed and Marie also decided to take a 15-week overseas trip at relatively short notice, throwing the burden of managing the entire practice on Jack's shoulders. Jack handled the absence with an additional temporary locum dentist and partly by stretching his own hours. Some of Ed and Marie's patients simply went elsewhere. However, when Ed and Marie returned, Ed immediately acted as though he was in control of the practice and reverted to unilateral decision-making. The experience infuriated Jack.

Meanwhile, Jack was advised to exercise his right to purchase half the premises at independent valuation. Jack was advised that this would place him in a stronger negotiating position when Ed and Marie decided to retire. To Jack's surprise, Ed offered to sell him the whole building and the offer was taken up by purchasing into Jack's Family Trust. Jack and his wife owned Jack's goodwill jointly.

During Ed and Marie's long absence, the practice had been overstaffed and Jack had to bear some extra costs. The experience had not impressed him nor did Ed and Marie's later absences, albeit that they were not as long. Bit by bit over a period of 2 years, Ed and Marie's fees were being taken up by the 2 employed dentists and a few of Ed and Marie's patients were squeezed into Jack's busy schedule. They were also losing some long-term patients.

Eventually, Ed and Marie decided to sell out and they got their accountant to value the associateship on the financial outcome from the year prior to their long absences. This was quickly corrected by Jack's advisers who valued on the recent results with Ed and Marie's own fees, plus 50% of the employed dentists fees being attributed to them. They were told bluntly that Jack's much greater fees were as a result of his hard work. It was not Jack's fault that they had let their associateship in the practice dwindle through taking long holidays, some at short notice, causing changes to patient appointments. Ed was belligerent and threatened to move elsewhere but at this stage of his dental career and diminished patient following, it was clearly a hollow threat. Ed's accountant tried to up the offered price but was told bluntly that Jack's offer was final. By this stage, Ed's surgery had lots of gaps in the patient bookings. Inevitably, the sale of Ed's associateship to Jack was completed and Jack now owns the entire practice. Ed and Marie are now retired. Jack has 2 busy dentists working with him and he himself is busy. There are 2 spare surgeries in the practice which Jack is in no rush to fill, preferring to run 3 tightly booked efficient surgeries.

The lessons

- When selling parts of a practice creating dental associateships, it is essential to realise that the new associates have equal rights in the management of the practice and that effective communication is essential if harmony is to be maintained;
- Dentists who desert some of their patients reduce the value of their goodwill; and
- Big practices aren't necessarily more profitable. An owner dentist plus two full-time employees is an optimum size. Adding more dentists and employing a practice manager tend to be recipes for a reduction in profitability. We've seen it many times. It also seems that when a third employed dentist is added, the owner dentist spends so much time fixing other dentist's problems that the efficiency of their own output deteriorates. Very few dental practices can increase profitability and fees by employing more than 2 full time equivalent employed dentists plus the owner dentist. Other successful ratios are one owner plus one dentist, two owners plus one dentist or two owners plus two dentists. Having valued many dental practices of a variety of sizes, we are struck by the difficulty that most dentists have in managing more than two other busy dental chairs successfully. There are rare exceptions.

Erica's practice

Erica had a long-term practice in dated premises but situated in an attractive location. Her fees had deteriorated a little over several years while the market level rent she paid to her superannuation fund was around 14% of the fees she generated and was far above the average percentage of rent paid by dentists.

This, together with the fact that she only worked a leisurely 7-day fortnight but had a full time receptionist, meant that based on comparative benchmark data, she was actually working for less than her personal opportunity cost, being that which an experienced dentist would expect to be paid for generating the same amount of fees in another dentist's practice.

Erica's practice was advertised for sale and she asked for about 66% of the fees. Potential buyers and their accountants figured out that if she paid herself a true dental salary package, as well as the rent, her practice was actually running at a loss.

Some buyers considered whether they could build the practice but were aware that it was located in an area well-serviced by competing dentists.

Erica eventually sold her practice for about half of the fees to a dentist who had work in the area and was able to attract additional patients. That dentist knew that on day one, they were giving up more in personal opportunity costs than the practice would bring them but had confidence in her ability to build the fees to a point at which the rental overhead fell to about 7.5% of fees. That was still way above average but manageable and Erica was lucky to find a buyer who was prepared to pay more than her practice was worth because they had an ability to bring in more fees locally.

The lesson

If you leave the practice sale too long, the practice fees begin to decrease while rental value of the premises increase. The value of your practice will deteriorate.

Rudolph was conned

A dentist running a 2-chair practice died. A couple of "main chancers" known in the dental profession for sharp dealing quickly bought the practice from his widow, gave the premises a low cost repaint and ran it with an employed dentist and temporary locums. They then quickly advertised it for sale at around twice its true value and stitched up a deal with Rudolph. Rudolph was innocent in these matters and had gone to an accountant who bragged that he had a strong relationship with the dental association but who failed to pick up the essential details being that the dentist with the long term relationships with most of the patients had died and the employed dentists who had been offered the practice at an unrealistic high price was likely to leave, resulting in there being no dentists in the practice with relationships with patients. Hence, there was no dentist able to conduct a reasonable practice handover. The financials proffered to Rudolph were about 9 months old. The practice had been in decline.

On the recommendation from the accountant, Rudolph bought the practice and quickly learnt that the fees were running at only about half the rate of the prior year but expenses were eating the fees and in reality, he would be working in the practice for much less than his personal opportunity cost. He had been poorly advised.

Rudolph then took informed advice but unfortunately, a bad deal could not be undone. Rudolph was advised that his only recourse was to make all the remaining patients feel special, redecorate the waiting room, provide suitable reading material for patients and improve his communication with patients, particularly concerning discussion about sporting events. Fortunately, Rudolph's wife had high-level interpersonal skills and was able to fill the receptionist vacancy. The practice is still a long way below what they thought they were buying but significant progress has been made in turning the situation around. Fees are up substantially from their low point.

The lesson

Be extremely careful from whom you seek advice. The vast majority of accountants know insufficient about dental practices to give sound advice on acquisition.

The uninformed accountant

Nigel was employed in a four-chair practice for about 6 years. The practice was staffed by the owner dentist, Cyril, who worked full time; Nigel who similarly worked full time; and a third dentist, Racheal; together with two hygienists who shared the fourth chair. The practice was profitable and functioned at close to benchmark. Cyril had had the practice valued at arm's length because he contemplated selling a 50% associateship to Nigel. Nigel consulted an accountant who told him that the practice was "overvalued". Nigel instructed the accountant to speak to Synstrat about the value. The practice owner gave permission to him to discuss the valuation. It quickly became apparent that Nigel's accountant had no clients who owned dental practices and zero knowledge of the market. He had locked himself in to a silly position by telling Nigel that he would get the price reduced.

It was pointed out to him that if Cyril had advertised the practice for sale on the open market, it would almost certainly sell at valuation and the new owners might not wish to employ Nigel. It was also pointed out that a dental corporate would pay more but require the vendor to work for the corporate for at least three years with 20% of the purchase price being deferred and being conditional on performance.

Nigel's accountant had shot off his mouth with too little knowledge and Nigel expected him to knock down the price by around $250,000. Cyril, the owner, was never going to allow that to happen. Cyril then bypassed Nigel and offered the associateship to the third dentist, Racheal, who accepted the offer with the condition that she be offered first and last rights to purchase the remaining half of the practice when Cyril retired so that she could bring in her husband, Geoffrey, who was also a dentist. Nigel now found himself being the joint employee of the two associates with no chance of buying into the practice in the future.

Nigel went looking for practices to buy but found out that the ones advertised by brokers were invariably highly priced but had much inferior performance to Cyril's practice. He slowly realised that none of the practices advertised by brokers were as good as Cyril's. Good practices invariably had employed dentists eager to buy in and hence were not available to outsiders. They did not appear in brokers listings.

Nigel spent many years regretting that he had taken advice from an accountant who had little knowledge of dental practice. It is likely that over his career path, Nigel would have ended up several million dollars better off had he purchased the associateship in Cyril's practice and in due course, purchased the remainder of the practice. For many dentists, opportunity only knocks once.

The lessons

Be extremely careful from who you seek advice. Lots of accountants understand taxation rules but very few understand the relative value of practices or understand their subtle differences. Too many compare a dental practice's fees or profits with that of an unrelated business such as a garage, plumber or bread shop. Some accounting advice costs their clients millions of dollars over a career span.

Displacing a practice builder

Marian was a sound performing dentist with great interpersonal skills. Early in her career, the practice she was working in had had its premises acquired by a developer who notified the practice owner that he was not going to renew the lease. Marian was therefore forced to move to another practice and many of the patients she had treated previously followed her. She was diligent and the practice respected that her patients and the personal referrals they generated were booked to her. She was paid salary, superannuation and a holiday package, based on the common dental formula relative to fees. One day, the practice owner accepted a large offer from one of the smaller dental corporates. Marian was handed a contract by the corporate and told that if she wanted to continue to work in the practice, she had to sign it. The contract had a rigorous non-compete clause. She sought advice and was strongly advised not to sign it and the new owners were told that they had no right to violate her current employment status. She continued to work diligently but was advised a short while later that she was being replaced. She could legitimately have fought the decision but didn't want to sully her reputation.

Instead, she set out to establish her own practice and in the meantime, a dental friend made a spare chair in their practice available to her on a sessional basis while she obtained and fitted out premises of her own. Lots of her patients, on being told that she had left the old practice, went to her website and made appointments with her. Also, Marian has a good memory for names of her old patients and tracked down their telephone numbers and addresses. She is rapidly creating her own practice. The purchasers of the practice in which she worked failed to determine the source of her patients or discuss employment terms with her before buying in and then tried to bully her into accepting their onerous conditions. As a result, they lost a substantial percentage of the practice's patients.

The lessons

There are two types of dentists - practice builders and practice destroyers. If you drive a practice builder away, the consequences will be costly.

Displacing another winner

Ricky was an experienced dentist working in two practices, one for 7 days per fortnight and the other 2 days per week. She had been working in the two practices, which were distant from each other, for about 7 or 8 years, producing solid fees and was remunerated on the common formula. The practice in which she did the greater amount of her time and had a significant patient following set about squeezing her to divert patients to a family member joining the practice. A significant proportion of her patients were upset by being shunted to a less-experienced dentist.

Ricky bought a run-down practice within a reasonable distance and used a website and social media to connect with patients. A significant number of patients followed her to the new location, thus reinforcing how critical dental relationships are.

The practice that she left has now realised how important it is to keep a dentist with a loyal patient following happy. They needed to be much more careful in building the fee base of a family member. Ricky renovated parts of her premises and is on the way to creating a busy 2-chair dental practice.

The lessons

- Dentists are in the relationship business. Their interpersonal skills are often as important as or more important than their clinical skills; and
- Displacing a practice builder with an inexperienced family member is a recipe for a substantial reduction in practice fees.

Manna from heaven!

Bryan had a 4-chair practice but in recent times, despite a good level of personal referral to him and to a couple of his dentists, it's been harder to build the business than it was, say, 10 years ago. There is more competition and the misleading activities of health funds shift a few patients away. The practice had been running at the full time equivalent of 3 dentists.

Adrian, a dentist in a nearby shopping centre, had a reasonable fee base but astronomical shopping centre rent, eventually forced him to close.

Bryan had been his personal dentist and the dentist respected the quality of Bryan's practice and decided that it would be a good place to refer his patients.

Bryan paid him a modest sum for his recommendation, patient records and redirection of his telephone line.

The retiring dentist was moe than happy to unburden himself of his obligations in respect of retaining his patient records and have his patients directed towards a safe harbour.

There was a continuing stream of Adrian's former patients making appointments for Bryan's practice and some had referred family and friends.

Bryan found that the payment made to Adrian was the best investment he had ever made.

The lessons

- Rundown practices of older dentists have value when transferred into a practice with spare capacity; and
- Opportunities are more likely to be offered to a dentist who has earned respect than one who has not.

Start-up misjudged

Simon put a map of a major portion of the city and suburbs on a backing board and started putting pins in it to represent dental practices. He observed that there were many clusters of pins and some areas where the pins were less dense. He found an outer suburb with only one practice and based on his map exercise, acquired premises, with debt finance and fitted them out with more financing.

Simon then circulated brochures expecting to get prospective patients ringing. Alas, little did he know, but the other practice in that suburb was headed by a charismatic dentist who was also well-known in the suburb and surrounding areas for his involvement in local theatre.

The other dentist's established 3-chair practice had a loyal patient following and received lots of word-of-mouth referrals. Simon's new practice had no referral base and Simon was unknown to the populous.

Apart from the charismatic dentist's following in the community, a portion of the populous worked closer to the CBD and attended other established practices closer to their workplace, reflecting that people from outer suburbs tended to look and work inwards towards the CBD. Year by year, the established practice continued to grow, receiving many more new patients than the recent start-up, which remained relatively unknown. Simon realised that it was going to take several years to make a modest profit and probably many years before he had a viable well-staffed full time practice.

The lessons

- Practices which maintain quality relationships with a large patient base retain and grow their fees;
- The days are long gone when virtually all new dental start-ups had a rapid build-up of patients. These days, there are too many dentists and patients are wary of new start- ups. They tend to patronise practices to which they have been personally referred by friends, neighbours, relatives or workmates;
- Starting a practice in an area where a dentist is unknown is a risky enterprise; and
- Distributing brochures to letterboxes is a marketing strategy which no longer works for dentists; if indeed it ever did.

About the author

Graham Middleton personally has been advising dentists on strategic, practice management, valuation and conflict resolution processes for 30 years, the last 23 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 a Human Resources Manager, at the 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 information, call (03) 9843-7777 Fax: (03) 9843-7799 Email: dental@synstrat.com.au or visit www.synstrat.com.au.

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