Buying, selling and restructuring practices

By Graham Middleton, BA, MBA

"Francis assumed Tommy would be happy not to buy the practice as had been intended, but to sign a binding contract with a corporate including exclusion arrangements..."

Francis had owned his practice for many years and had a long term employee, Tommy. He had mentioned to Tommy that he would like to sell the practice in a couple of years and then work for Tommy i.e. a reversal of their roles. When it came time to consider the deal, Francis had had the practice valued by an accountant with too little knowledge of dental practice outcomes and the valuation was above market value for dentist to dentist sales of practices of that size and similar location.

After an amount of discussion, the two jointly agreed to get Synstrat to value, which occurred. Tommy started making his plans to get some minor works done around the practice and anticipate a few modest changes and the replacement of an item of equipment or two.

A corporate then entered the picture and approached Francis and offered a higher price, but as usual, the corporate wanted a binding agreement with the lead dentist. Francis was nearing retirement age and the corporate didn't think that he had enough energy left to make the deal viable, but they said to Francis they would buy the practice off him at a price significantly above Synstrat's valuation if Tommy, who had increasing production, agreed to sign a binding employment contract with the corporate. For some strange reason, Francis assumed Tommy would be happy not to buy the practice as had been intended, but to sign a binding contract with the corporate including exclusion arrangements, whereas at present he had no exclusion arrangements.

Predictably, Tommy reacted negatively believing that Francis had violated their understanding. He briskly told Francis what he could do with the corporate contract on which Francis expected to get a higher price than he had been willing to sell to Tommy. Tommy, having bluntly refused, then began to look around and as luck sometimes happens, found a practice elsewhere to buy.

Francis was now an aging dentist who had lost the major fee earner in his practice and the corporate was no longer interested in purchasing it. Francis and Tommy, who had had a good relationship, now loathe each other. Francis's practice has gone into decline and Tommy is determined to do well in his recently purchased practice. The big loser is Francis, who unfortunately let somebody get into his ear with bad advice.

The lessons

1. If you start down the path to selling your practice to an employee and renege on a deal, you wreck the relationship;
2. A dentist who demands that an employee sign a long term contract with a corporate including exclusion arrangements so that they can sell the practice at a corporate price is likely to be told *"if you expect me to bind myself to assist your deal, pay me a part of the consideration";* and
3. The price paid in a simple dentist-to-dentist sale will naturally be less than in a corporate sale where the corporate is binding a dentist to a long term contract in order to justify a higher price.

Rebecca's push off to Mandy

Rebecca is the long term owner of a practice in a rural town, but she is approaching retirement age and now only works two to two and a half days per week, but is involved in various community activities. Mandy is her number one assistant dentist who works full-time. Cyril, a recent graduate, works two to three days per week. Mandy produces 60% of the fees in the practice, Rebecca and Cyril earn about 20% each. Mandy has been in the practice for about six years, is a good clinician and has built up a following in the town and district. Cyril's performance is not up to an acceptable standard and he is more a practice destroyer than a practice builder. His practice standards offend Mandy.

Mandy approached Rebecca a couple of years ago and asked whether she could buy into the practice. Rebecca kissed her off but Mandy is the only logical buyer. Rebecca felt insecure and felt that if she gave up ownership, she would lose her status in the community.

Mandy pressed the issue and Rebecca indicated that she would agree to sell her the practice in three years' time and said she would have a contract drawn up. However, when the agreement from Rebecca's solicitor arrived, it merely stated that she would consider selling it to Mandy in three years' time. In other words it was meaningless. Mandy is now angry and has refused to sign the agreement. There is a non-compete agreement, otherwise Mandy would walk out and start a practice down the street.

However, a bit of common sense needs to apply. If Mandy says to Rebecca *"let's do a silent deal, I'll run the practice for you and you can work here for two to two and a half days per week for as long as you are able. There will be no mention of change of ownership to patients and the receptionist and chairside assistant, (who are mature ladies) will be told not to talk about any ownership arrangements".*

Staff simply refer to Mandy and Rebecca. Cyril will be replaced. The patients who are treated by Mandy and Rebecca will keep coming to the practice and the replacement for Cyril must have better chairside manners.

The town's people would not think of such matters at all and will regard it as Mandy and Rebecca's practice. Rebecca's standing in the community won't be affected and if Mandy is wise, she won't say anything about having bought the practice. One day Rebecca will cut back further or simply fade out gracefully.

The lesson

If you make a promise and don't keep it, there can be a lot of unpleasantness and stress.

John and Miranda and the practice broker

John and Miranda share premises, but nearly everything else is separate. They have their own dental assistants and receptionists and co-exist rather than have an associateship. There is a little bit of work sharing by the staff, but negligible and they have covered for each other's patients when one is on holidays. John is in his early 40's and Miranda, who is in her early 60's, wants to retire. Miranda produces about $525,000 of fees per year and her expenses are a bit above average for a practice of this size. She had an inflated idea of value of the practice and engaged a practice broker, whereas everybody knows that other dentists are reluctant to buy into a practice where there is a relationship with another dental owner in the same premises and inevitably there will be documents that the continuing practice owner will need to sign.

Miranda's practice broker visited the practice and managed to back up John in a break between his patients and wanted to know what John was prepared to pay. John's head was on clinical matters and he told the broker he was not interested in talking to him.

Subsequently, John consulted Synstrat while Miranda went to an accountant who is known to other dentists. Miranda's advisor contacted us and indicated that Miranda had the practice valued by some unknown person who says it's worth $675,000, but we (the other advisor) indicated that she should consider offers of around $525,000. Meanwhile the practice broker has disappeared from the possible transaction.

We looked at the figures and tell John that both the $675,000 figure and the $525,000 are well outside the valuation range for a practice associateship with the fees concerned in the particular area which is not popular with dentists. John is busy with his own patient list which is bigger than Miranda's and he can afford to wait. When he buys her practice, he will have to put a dentist into Miranda's surgery and there may be a loss of patients with her departure. The reality is that Miranda's practice is worth much less than both the figures put forward. If indeed someone had valued her practice at $675,000, they had done her no favours because the figure is ludicrous.

A great relationship

A group of dentists has adjoining rooms in a large suite and share some expenses, cover for each other's holidays, and have long been imbued with mutual respect. One of them wishes to sell to a younger dentist working for him and they propose that we work as joint valuer for them. The vendor also indicates that the younger dentist has done some work with one of the others in the group who indirectly has effectively contributed some patients to the goodwill in his practice. He has lunch with colleague, mentions the matter and they quickly settle on a modest amount to pay over to his colleague. *"I can only wish that all our relationships were so mutually respectful"!*

Pulling the chain

Paneek and Kalma (known to colleagues as Panic and Calm) were two orthodontists who operated a partnership which had two principal locations. There were a couple of other places that one or other visited for a day per month using a surgery in a general practice. However, all of the equipment was at their two main locations and when they visited one of their monthly sites, they took some equipment items and necessary stock items with them.

Their relationship had descended to the pits and they were seeking help in their separation. We met with them jointly, to get their joint representation of what they agreed on and what they didn't and then separately to pick up particular points.

At the joint meeting, it became apparent that Calm knew how to yank Panic's chain. Panic made excitable comments while Calm sat there listening with what appeared to us to be an insolent look on his face, then made a single comment which started Panic gesticulating and speaking quickly. Of course, it was pretty obvious what the lines of separation needed to be. Essentially, one had to take the northern practice and one had to take the southern practice with a few minor adjustments, but Panic made it seem difficult while Calm pulled the chain a couple more times. Panic dwelt on one or two problem patients. It wasn't hard to see which one had the wider view of what needed to happen. A day after the joint meeting, I received an email from Panic's solicitor telling me to stop everything. We sent the solicitor a reply which said *"nothing you can do will advance this matter and if you really want to help, you should stay out of it"*.

The individual meetings then proceeded as planned.

The meeting with Panic

Panic was excitable but could not say why the practice should not be split north and south. He had a lot to say about what he believed to be an unrealistic distribution of hand instruments and dwelt on the supply of orthodontic materials. He carried on about a difficult patient.

Our response to the apparent maldistribution of hand instruments was: *You can put all the hand instruments in the southern practice on a table or benches. You can toss a coin for the first pick and then take pick for pick until all the central pile is exhausted. Calm can pack his half in boxes and on the following day, you can do exactly the same in the northern practice. Having done that, if you're short one or two items in your future practice, you will have to go to a dental supplier.*

It negated the necessity of trying to value a hoard of small second hand items which is impractical in any case. Our solution to the stock of orthodontic appliances and consumable items was identical.

The meeting with Calm

Calm had long worked out what needed to happen, he was agreeable to the method of dividing the instruments and consumable stock. He simply wanted to hasten the dissolution of their partnership. There were a few simple balance sheet items to be recorded and adjusted. There needed to be an adjustment for the disparity of leave owing to staff in respective locations. There were one or two other balance sheet items.

The sticking point with Panic was one difficult patient case in retention. We pointed out that it would be unrealistic to hold off the separation of the entire practice because of one patient, but rather as ongoing professional responsibility for that patient, they could refer her for a third expert opinion, and if necessary, longer term retention management and could indemnify each other to jointly share the cost.

They parted.

A lesson coming out of it was that lawyers can effectively do nothing to resolve such matters. What in fact sometimes happens is that lawyers write inflammatory letters to the other party who engages a lawyer then both lawyers consult barristers who ask for a lot more information and ask for practice valuations, etc. Lots of money gets wasted on pointless legal activity.

Untying a Gordian Knot

A practice in a major city was started long ago by a dentist now long retired. The original owner had finished the purchased premises and in the early days, traffic flow was good and there was ample parking nearby. The practice became a busy four-chair practice.

Over time, the original owner added satellite practices in the suburbs which we will call A-SAT, B-SAT and C-SAT and ran them with the original practice referred to as Central.

The original owner has long since moved on and the division of chairs is as follows:

- Four chairs at Central.
- Two chairs at satellite A (A-SAT).
- Four chairs at satellite B (B-SAT).
- Two chairs at satellite C (C-SAT).

A-SAT and B-SAT are about 25 minutes' drive from Central and within about 10 minutes' drive of each other, while SAT C is much further away in a different direction.

The practice now has four partners, each of whom work in two or three of the four locations but it is evident that the least preferred location is Central and there a couple of days when no partner is present there. It is mainly staffed by assistant dentists whose productivity per chair is lower. In recent year's, traffic and parking restrictions have made it unpopular with patients and partners alike.

The practice manager occupies spare space at Central and has taken on assistants. Profitability of the group has fallen and the expense ratio per dollar of fees has risen. The practice accountant was out of his depth and had not identified the real issues.

The practice manager was way out of her depth as well and has been focussed on protecting her nest.

Each of the partners earn a percentage of their fees and take a profit share of the bottom line profit which is left over. The problem is that the bottom line profit is in decline and the practice has a difficult name. They went looking for another person to buy into it after a fifth partner left but couldn't find anybody that was interested in joining. Instead of each partners' associated part of the practice being worth a substantial capital sum, they worry about whether it is saleable. Yet at the same time, we see evidence of many practices of similar size to a partnership slice of this practice as having substantial profitability and selling for substantial prices. Something was clearly wrong.

The reality

In reality, the group will be much better off closing Central, referring those patients who can drive to A-SAT or B-SAT where parking and access are satisfactory. They can use as their marketing tool the fact that they are asking patients to come to a more convenient location from the point of view of access for patients.

C-SAT, because of its isolation, is naturally a practice which could be owned by one of the partners/associates who could leave the group.

The practice manager needs to be relocated to B-SAT which is the real epi centre of the practice and to shed her assistants.

If C-SAT is transferred to one of the partners/associates, then the remaining three can jointly operate A-SAT and B-SAT which are a natural pairing because of their proximity. Those two practices have six chairs between them, and hence, a ratio of one principle to one assistant dentist is more efficient that what has been occurring.

The considerable savings in closing Central, selling off the premises and streamlining practice administration would outweigh any modest spillage of patients caused by the closure and will enhance future value and saleability of each associate's equity in the practice.

The real issue

The real issue is whether the four partners, who each earn a base percentage and profit percentage and are worried about declining profit, are prepared to make the necessary strategic decisions. Inevitably, there are concerns about closing down the original part of the practice; concerns which are magnified by the fact that it underwent an inappropriate re-fit without the proper analysis as to whether it should have been retained. People in this type of situation have a tendency to spend a lot time at frustrating meetings, wading through micro-detail and administrative "flim-flam", but having an inability to undertake the necessary strategic changes. It is likely to be the case that practices with multiple owners will have a tendency to waste more time and with every month which passes progressively lose more potential profit.

The lessons

In dentistry, overall practice size is often a negative to practice efficiency. The most profitable dental practices we see are typically two or three chair practices with one owner and one or two chairs filled with assistant dentists often with a hygienist working several days per week in one of the chairs. Large practices require additional overheads in the form of practice managers who will have a tendency to multiply staff and lower overall practice profit and efficiency.

Many of the so called practice managers' are not managers' at all but rather low level administrators. In other cases, an effective receptionist is given a courtesy title of practice manager and does a little bit of non-front desk supervision. That is a good solution in a two or three chair practice.

Some accountants find it impossible to re-orientate themselves away from what happened last year, to what needs to happen in the future. While a multitude of accountants have signs on their premises indicating that they give business advice, what most of them in fact do is last year's tax returns. Punching in figures from a range of small businesses including the odd dental practice doesn't equip most of them to give proper business advice or equip them with the vision which an industry specialist needs but which most generalist accountants lack.

Theft in practice and resignation

A story from the veterinary world

Many years ago, two vets, who I'll call Goodfellow and Dodger, entered into partnership in a newly started country practice. Goodfellow had grown up in the area and knew lots of the locals. He had a naturally personable communication style and got on well with the farmers, particularly the dairy farmers, who made up the main veterinary source of income in the area.

He had previously been offered equity in another practice but at a price way outside the normal parameters. He declined and set about starting his own practice. He intended doing the large animal work while his wife, also a vet, did the small animals from the practice premises located in the small town. The majority of the fees were expected to come from the large animal work, which subsequently turned out to be the case. Unfortunately, Goodfellow suffered a serious injury and in his moment of weakness, agreed to take on a partner, Dodger, who came from outside of the area.

It proved to be a disastrous choice and Dodger's rough and ready methods with the farmers lifestyle was not to their liking. Goodfellow's injury mended but he found himself putting out fires that Dodger had ignited and some of the biggest clients were saying to Goodfellow *"you can come to our farm but we don't want Dodger on our property"*.

Dodger's wife Lucrezia (not a vet) did relief work on the reception desk back in town and Goodfellow noticed some unusual patterns in cash takings from the sale of products at the front desk. Rather than trace every veterinary consumable item, he took note of the ordering patterns of a couple of relatively high value items and monitored invoices. There was a steady stream of those high value items disappearing without any record of their sale.

After having posted a sign on the wall to indicate that the practice was under video surveillance, as indeed many businesses have such signs, he had a surveillance camera placed in the ceiling above the front counter in the reception area. Low and behold, the surveillance showed that Lucrezia was putting the money from sales of high value items into her purse. It even showed her doing calculations on the desk pad to work out how much cash had to go back into the till and then showed her making that change out of her handbag after she had sold a relatively expensive item to a customer.

Goodfellow also arranged for several of his friends to visit the practice and purchase flea treatment products and other veterinary pharmaceuticals and low and behold, the cash for the purchases did not show up in the till.

In due course, Goodfellow confronted Dodger in the presence of a witness, inviting him to watch the video and then walked into the next room and came back with a washing basket of products which had been purchased by his friends with the cash having been taken by Lucrezia.

Dodger agreed to resign from their partnership, was paid his entitlements and left. Subsequently Lucrezia, unwisely, went to lawyers but ultimately she and Dodger were unprepared to go to court where their lawyer had been told they would expect a ferocious cross examination from Goodfellow's lawyer who was a prominent QC.

Prologue

Goodfellow and his wife went on to run a successful practice employing several other vets and have done so for many years. Dodger disappeared.

Names and some details have been amended or altered. Any comparison with actual dental practitioners is accidental.

About the author

Graham Middleton personally has been advising dentists on strategic, practice management, valuation and conflict resolution processes for 31 years, the last 24 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 Management, of 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. Call Tel: (03) 9843-7777 Fax: (03) 9843-7799 visit www.synstrat.com.au or email dental@synstrat.com.au.

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