Dental business experiences

By Graham Middleton, BA, MBA

"Australian financial markets are now deeply suspicious of corporate consolidations of professional practices. Subscribing to the IPO of a new dental corporate can be a risky investment indeed...."

The comments below about various dentists and dental strategies are taken from actual situations but necessarily names and some detail has been changed to preserve confidentiality.

The stayer

I first met "Johnny" in June 1987. His then accountant had told him to go and buy some "pine trees" prior to the 30th of June! Luckily, he reached my door and I explained what a dumb investment pine trees were. Instead, he took out some superannuation and did some sensible tax planning. Over the years, he built up a healthy superannuation fund for himself and his wife. He purpose-built dental premises and eventually sold the practice and premises and was able to access the small business active asset sales capital gains tax concession. These days he's engaging in post-retirement travel.

The lesson

Traditional assets of home, practice and premises were much better than heavily promoted forestry schemes.

Doing everything correctly

I met Derrick, a country dentist, about 20 years ago. He had been running a small investment portfolio and needed some additional help. We advised he and his wife Caroline with respect to his superannuation fund and investment portfolio, assisted with tax and business planning and eventually advised him on sale of practice and premises. The buyer, a dentist who worked for him, firstly didn't want to buy Derrick's premises but when we pointed out the cost of fitting out new premises, he realised what a sensible option purchase of premises was. Derrick had factored into his planning the upgrading of his home and following the sale of the practice, he worked for a time as a locum and part-time for a University dental school. He and his wife are now fully retired enjoying golf, travel and grandchildren and have superannuation and investment assets of around $6 million.

A dentist who thought he bought a dud

I first met Henry about 24 years ago. He came to me thinking that he had bought a dud practice which had a fee base equivalent to about two days of full-time work per week. We advised him in respect of improving the premises, which at that stage were rented, but suggested that the improvements needed should be treated as a marketing expense. He made the improvements including having a professional sign writer do the signage outside his practice and including a toilet, whereas previously patients had had to go out the back door and visit a toilet in the courtyard behind. Henry had a quirky personality which was attractive to many patients and his practice grew rapidly, outshining a couple of practices located nearby. Along the way, Henry had purchased his premises. Henry has recently sold his practice and premises but is working part-time for the buyer. Along the way, he had significantly upgraded his home and is now in the process of building a new house near a beach. He will enjoy a comfortable retirement with investment assets well in excess of $5 million and more once he finishes his beach house and sells his home.

Confidence destroyed when financial advisory organisation placed in liquidation!

Many years ago, Ernest was blown out of the water by a letter saying that his previous advisors had gone into liquidation and the letter writer was preparing to take over his affairs. As he said, that rather destroyed his confidence and he sought alternative advice.

It transpired that he had strange investments in timber plantations and a chocolate factory. Apparently, adverse publicity about various schemes had cut off the normal May/June sales hit which kept his previous advisors' firm afloat and it had collapsed.

He was advised back to a proven path having an already successful practice and owning a nice home and attractive practice premises.

Since the collapse of his former advisors and getting proper advice, he has concentrated on the basics of effective tax planning including funding his and his wife Harriet's superannuation fund which spilt over into an investment portfolio. He is now preparing to sell his attractive practice and has felt much more comfortable since escaping the clutches of advisors of dubious repute and incompetent methodology.

Lessons

The pine tree and eucalypt plantation schemes had flaws which were obvious to this writer over 30 years ago yet unscrupulous advisors, many of them regarded as reputable heads of well-known accounting practices, misled their clients into "investing in them". I can remember scheme promotors trying to tempt advisors with 9% commissions partly paid upfront and partly in the form of volume bonuses to sell their schemes. Yet these schemes lacked an adequate secondary market in which partly grown trees could be on sold and hence, they lacked a basic feature of investment grade assets. Consequently, professional investors shunned them.

Years ago, an individual associated with promoting eucalypt plantations advised me that they had found it impossible to continue selling to dentists because my adverse comments had turned dentists against them! I'll happily plead guilty to that accusation.

Free tickets to the Gold Coast and Keyman Insurance Policy

When I first met George, he was a young dentist contemplating buying a satellite practice operated by his boss. He told me that he had been given free return airline tickets for him and his father to fly to the Gold Coast and look at high rise apartments. On being told the pitfalls in high rise rental accommodation, particularly on the Gold Coast, his response was "well what do I do with the tickets"? My response was "leave your dad at home, leave your cheque book at home, take your girlfriend for the weekend and don't buy any property"! George took that advice. He had been sold a Keyman Insurance Policy by his previous accountants which, as an employee of an organization, he had no basis for owning. On advice, he demanded a refund as it had been incorrectly advised to him.

Subsequently, he completed the purchase of what had been a satellite dental practice and he and his wife Lindsey have upgraded to a beautiful new home, purchased the practice premises and built up a $4 million plus superannuation fund. George is still working at a comfortable pace and will probably do so for several more years.

The lesson

There has never been a time in my memory when dentists didn't have better financial options available than buying Gold Coast rental apartments, many of which are difficult to tenant apart from holiday season.

The toxic associate

Louis, Freda and John were in an associateship and had a fourth associate "Boadicea". Boadicea had a number of disagreeable mannerisms which upset the other associates and the staff and was never happy. She had purchased her associateship off her father and eventually she decided to purchase premises nearby and move her part of the practice. The other associates welcomed the change. Boadicea made unreasonable demands concerning practice name, telephone, etc and was promptly told that nobody else was going to disadvantage themselves to satisfy her whim. It was only fair that she took the major equipment in her own operatory to the other location. When she demanded that all the small hand instruments be valued, we advised that the better method was to bring them all to a central location, draw lots for the order of pick and for the four associates to take turns in picking up items until there were none left. That method was fair and simple. Boadicea removed her share of the pick and the other three purchased the odd new item to replace that which they were short of. A similar process was taken in respect of the practice consumables. Subsequently, Louis, Freda and John - the continuing associates - had a smooth relationship.

Reliable dentistry vis a vis upmarket ambitions

Manny and Goldfinger practised together. Goldfinger wanted to move to ritzy state-of-the-art premises on the better side of the regional centre in which their practice was based. Manny provided reliable dentistry and ran a profitable associateship but didn't want to be a super salesman. Goldfinger demanded that Manny buy out his fit out. However, Manny pointed out that he really didn't have any need for the extra surgeries that Goldfinger was intending to vacate and in fact, the impact of Goldfinger moving was that Manny would have to shoulder the full rent for the premises, rather than half, together with associated costs. Manny sought advice and was told to be patient. In due course, Goldfinger acquired expensive premises and set about an expensive fit out. Goldfinger was told that he could take his share of the equipment and Manny certainly wasn't prepared to pay for fit out that he himself wasn't likely to use any time soon. As Goldfinger was not prepared to continue the lease, Manny negotiated with the landlord and had the lease renewal done in his own name. Goldfinger moved out and Manny changed the locks.

The lesson

There are many profitable dentists with good client lists like Manny who practice successfully for many years without turning their practice into one which is too upmarket for their locality. When another associate in the same practice has ambitions which are incompatible, separation is inevitable.

Don't drop to three days

Dave had moved gradually moved down from a five-day working clinical week to a four-and-a-half day week and then a four-day week. He announced that he was going to move to a three-day week and was strongly advised against it. The truth is that when dental practice owners move below four days presence in a practice, their profit invariably plummets. It seems that moving to that level of involvement sends the wrong message to staff and patients and we strongly advise against it. The reality is that in all successful privately owned dental practices, the lion's share of the true profit is generated in the proprietor's own surgery or surgeries and that if this is reduced markedly, not only are fees shifted to employee dentists at significant cost, but the overall fees of the practice invariably drop.

Dave continued to work four days per week for several years until being of retirement age, he sold his practice for a significant price.

The lesson

The fact that he had kept up the fee generation in his own surgery enabled him to get a much better price for his practice than would likely have been the case had he stepped back to three days.

Fred Gold and the corporate that shot itself in the foot

Fred worked with one assistant dentist and he himself had long done first class upmarket dentistry and attracted lots of personal referrals. His personal presentation was first class. Several corporates enquired after his practice and one of them offered him an unbelievable price. Fred generated 80% of the fees in the practice himself and employed one assistant dentist who did 20% of the fees doing the basic treatments which Fred did not have the time to do and which would have crowded out his more lucrative work. The corporate, which paid an unbelievable price with only 20% of that price tied to a three year earn out arrangement, didn't realise the long term implications of what it was doing. When, during the transaction, the employed dentist resigned, the corporate's accounting advisor indicated a concern, but it was pointed out that numerous dentists capable of earning that fee base were available in the marketplace. They didn't ask the obvious question, which was "how on earth would their client replace Fred Gold". As the three year earn out period moved towards completion, the corporate realised that they had no way of replacing Fred and desperately asked him to stay on. Fred agreed to stay on for a limited amount of time but at a higher payment rate and with more holiday breaks. That only postponed the day of reckoning for the corporate. In the meantime, the corporate executive, who had master minded the deal, had been displaced and it is apparent that when Fred retires, the practice will revert to one with a much lower fee base doing average dentistry.

Working beyond age 65 and drawing a super pension

James Barlow is an old school dentist. He has chosen to extend his home late in life and needed some extra cash. Being past age 65, he has exercised the right to draw a superannuation pension having met a condition of release.

A comfortable husband and wife dental partnership

Lucy and Billy still have several years until possible retirement, own a comfortable associateship and own a share of the premises. They have long since upgraded their home which is located in a good suburb and they have a healthy superannuation fund - life is good, and they continue to do profitable dentistry.

You can't soar like an eagle if you work with turkeys

Many years ago, I assisted Royce to untangle himself from a bizarre associateship in a couple of stages. Firstly, from three associates to two and then a final separation from the remaining associate, with one associate continuing with the original practice premises and Royce taking over what had been the satellite practice in rented premises. Royce inevitably lifted the satellite practice with his personality and skills. He purchased a derelict public building on a separate block and built modern dental premises. Along the way, he and his wife Miriam have upgraded their home and have built up a healthy superannuation fund. Royce is very efficient in respect of his own dental production and consistently has produced great dental benchmark figures. He and his wife enjoy high profits, own a beautiful home and healthy superannuation fund.

The lesson

Royce realised that he could not afford to let practice destroying associates hold him back and acted accordingly.

The Toorak poor versus the blue collar cash rich

Long ago, a veterinary surgeon, who was a client of mine and who had previously had a partnership in a Toorak practice which had ended acrimoniously, purchased a run-down veterinary practice in a long-established but working class suburb. He was an excellent surgeon and was noted for his complex work. His practice took off and he produced great fees over a number of years. He told me that in Toorak, nobody had any spare cash. They had expensive houses, big mortgages, invariably had two expensive European cars on hire purchase and had children at expensive private schools. But many of them couldn't afford pets and if they did own pets, were loath to spend money on expensive treatment even when needed.

By contrast, in the established working class suburb where his practice was located, people had modest houses, most of which had been long owned and consequently their mortgages were low. Typically, they were tradesmen married to secretaries or equivalent occupations and their family cash flow was good. If they brought a dog to the surgery that had been hit by a vehicle and needed complex surgery, they were happy to produce their credit card and pay for what was necessary. This client sold his practice many years ago and is now long retired but attributes much of his later success to the fact his practice was located amongst people who were prepared to pay for his services.

The best areas for profitable dental practices

Similar observations apply to dentists and it is apparent that the best practices are neither in Toorak or equivalent Sydney Eastern Suburbs locations but rather in well-established suburbs, but ones not associated with the mega rich and in country towns. Nor are they located in growth areas on the edge of major cities because the population of such growth areas invariably have significant mortgages, young children and very little spare cash.

A practice manager who was a profit destroyer

About five years ago, the owner of a capital city practice with a country satellite came to us for a practice valuation. He was contemplating selling a half interest in the practice to an assistant dentist working for him and forming an associateship. The valuation exposed the poor profitability of the practice which had a non-clinical staffing cost percentage far above the benchmark norm. He proceeded to sell half of his practice to his assistant dentist, Norma, but the weakness identified had sparked action. He recently requested an updated valuation to restructure his business relationship with Norma but in the intervening years, the practice profit had been much greater. It turned out that the practice manager had been dispensed with and the practice owners identified that she had not added value; indeed, she tended to gum up the works by creating a hidden layer of administration and supervision which was unnecessary in a relatively small practice.

The lesson

While some practices give a courtesy title of "manager" to a receptionist, having a separate practice manager in any dental practice of less than four fully utilised dental operatories producing in excess of $2 million of dental fees is an unnecessary waste of money. Many owners of fully staffed practices with four or more dental operatories find it unnecessary.

The great weakness of dental corporates

No matter how much they brag about efficiency, it is a rare corporate practice which will even closely approach the practice efficiency of the better conducted privately owned practices. Unlike large industrial businesses which can reduce staffing costs by utilizing bigger machines, as in the mining industry, or cut out staff with technology like large supermarkets automating their check out process, dentistry by its very nature is labour intensive. The corporates cannot equip a dentist to drill two patients' teeth simultaneously. Benchmarks show that the labour cost in conducting dental practices has not changed significantly as a percentage of fees in 25 years.

Corporates buy out good practices but after the vendors earn out period has expired and they have moved on, they then have to staff and conduct them with employee dentists. Employees simply don't have the long-term desire to grow the practice to the extent of successful owner dentists. Ultimately, many corporate practices slide into mediocrity.

Australian financial markets are now deeply suspicious of corporate consolidations of professional practices of all kinds after a variety of poor outcomes over many years involving consolidated accounting practices, corporatised dental practices, corporatised medical practices and corporatisation of country veterinarians. The reality, as shown by the Smiles Inclusive disaster, is that subscribing to the IPO of a new dental corporate can be a risky investment indeed.

Over a long career, a capable dentist who:

- Buys and improves a practice;
- Buys and improves practice premises;
- Includes both husband and wife in ownership structure;
- Superannuates both husband and wife;
- Upgrades to a suitable family home which is capital gains tax free; and
- Who is able to access the small business capital gains tax concessions on active business assets for both sale of practice and sale of premises - note: for this purpose, ownership of premises should be kept outside of superannuation fund...

will be vastly better off financially than if they had spent their careers contracting to a dental corporate.

The invisible management barrier in dental practice

Over 32 years of examining dental practice financials has demonstrated to me that the most profitable practices are owned by a single dentist, having one, two or three chairs. Any more than that causes a practice owner to spend too much time dealing with the problems of other clinicians in the practice, rather than concentrating on the efficient patient throughput in their own surgery. They lose more in fees generated personally than they gain on the margin of having a fourth chair after they have paid the clinicians concerned the normal percentage. Adding a practice manager causes their inefficiencies to grow. Big is not more profitable.

The two owner equivalent is having up to four chairs including one each for the two principals and no practice manager.

The dreamtime super fund that wasn't

A dentist and his wife consulted us with concerns about their superannuation fund. It transpired that they had been advised by an organisation selling high rise apartments who gave an enticing presentation at a real estate investment seminar. They then advised them to go to a particular organisation to set up a superannuation fund to buy what turned out to be poor performing high rise residential rental properties. The advisor they were referred to also advised the placement of surplus superannuation funds into inappropriate listed and unlisted managed funds with high internal management expense ratios (MER's). The inappropriate LIC's and managed funds have been sold and the clients have been advised to take advantage of the current low interest rates by putting their poor performing residential rental properties on the market.

The lesson

High rise residential properties invariably have poor net rental outcomes after all of the landlord associated costs have been taken into account. The more recent of the listed investment companies are loaded with high management expense ratios compared to the very old ones like ARGO which have been around for many years and are more reasonably priced. Dentists should seek appropriate advice.

About the author

Graham Middleton personally has been advising dentists on strategic, practice management, financial, valuation and conflict resolution processes for 32 years, the last 25 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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