HEALTH & LIFE'S BEST PRACTICE NEWS ALERT

CURRENT CIRCULATION: 7007
DATE: 6th February 2007
ISSUE NO: 138

Welcome to Health & Life's free email newsletter service. Tell a friend that we would be happy to add their email address to the distribution list. This service is to provide Health and Life's clients and those who attended our presentations with up to date information on key financial and practice management issues that may affect your practice. Please do not use this as a substitute to seeking professional advice.

Writer in charge: **Mr David Dahm** CPA, BA Acc, FTIA, FFin, FAAPM,GLF.

Succession Planning Part I - How Not to Screw it Up!

This is the first part of a two part series on successful succession planning in your practice. The first part covers the general issues and the second part is a practical how to guide on key steps your practice can take. The bottom line is if you are having recruitment and retention problems these are some positive key steps that can immediately improve your situation.

Part I

1. Problem: *The majority of practice owners will retire or semi-retire in 10-15 years*

> *"Are you leaving yourself a legacy or a liability?" - David Dahm*

2. Change your Attitude – understand how your practice makes money

> *Practice Tip – Realistically understand what your practice is worth?*
> *Practice Tip – Get rid of the common ownership myths?*

3. First Impressions are critical

1. **Mentoring New Owners**
2. **Keep the Vision Real**
3. **Show me the money and put it in writing!**

Part II (To be published on 11th February 2007)

4. So where do you go to from here?

1. **Assess whether succession planning is important to you**
2. **Establish a Compelling Vision for your practice – one that everyone can understand and that will inspire others!**
3. **Establish a Strong Strategy**
4. **Establish Good Systems and Procedures**
5. **Get Good Staff and Make them More Productive**
6. **Use an Elevator Pitch and be Open to Negotiations**

7. **What if I am a Solo Practitioner or a Solo Rural Practitioner?**
8. **Get Good Quality Advice**

Succession Planning Part 1 - How Not to Screw it Up!

1. Problem: ***The majority of practice owners will retire or semi-retire in 10-15 years***

The business of medicine is an oxymoron. The reality is it is a business and if you are a self employed practice owner this is your 9% employer superfund and this can only be realised if you can sell it.

The main reason why people are in business (or private practice) is so they can sell it one day. After all you cannot take it to your grave!

Very few practitioners have started a practice thinking about the end game – how are they going to exit?

Many have either long term property and practice leases or own their purpose built buildings only to realise they do not know who is going to takeover should something to happen to them.

Another point is what happens if a key medical staff member leaves. Is a bird in the hand is worth more than two in the bush? Should an owner practitioner try to (in a nice way) lock in employee or contractor practitioners for life by offering them an ownership interest with personal guarantees?

Alternatively, should owners rely on employee/contractor practitioners who can give two weeks notice and leave? Can a practice afford to lose its key providers and continue to work under this kind of financial pressure with the lack of certainty? Corporates are currently head hunting for GP's so this emerging trend is a major issue for both rural and urban practices together with the ageing workforce.

Does this sound like your practice? If so, put off investing any more money into your practice and think seriously are you leaving a legacy or a liability for yourself and the community. You have a responsibility to yourself and staff to offer your practice workplace security and a future.

This issue is called succession planning and it is a 3 year process and not an event. The problem arises due to a failure to plan not because they practice plans to fail. It is preventable.

A lack of succession planning presents further problems such as an owner's investment in the building and practice may be significantly reduced if the practice no longer continues.

This compounds a dilemma that many practices face today and that is whether to continue to throw good money after bad. If the practice cannot be sold or practice liabilities assumed by a new owner, then owners have no choice but to stop investing in practice infrastructure which makes succession planning even more difficult. Furthermore, it may also impact on patient care as owners may be reluctant to initiate regular practice upgrades such as computer systems.

The most common responses we receive about ownership of a medical practice are:

> ***"There is no goodwill in a medical practice - it is worth nothing"***
>
> ***"The young ones are not interested in ownership; the red tape is putting them off"***
>
> ***"The next generation are more interested in work life balance"***

Whether you are planning to stick around for another 20 years or a sudden illness takes you, the liability of owning and running your own practice can come to haunt you if you do not have a good succession plan in place today. It is a process, not an event, and can take up to 3 years to get it right. Time is the only enemy facing owners. Those that are able to proactively manage this issue will immediately have more successful in their recruitment and retention activities.

Many of those who are looking for help have tried to sell and can't; or have come to the realisation that they want to capitalise on their investment but don't know where to start.

In this series we are going to debunk many of these myths and explain what are the common mistakes and assumptions that practice owners make, which is the main reasons for a lack of practice ownership interest.

More importantly what you can do to avoid this problem as there is a lot of evidence that practitioners are interested in owning a practice if the deal is presented properly to them. Many owners are unnecessarily missing out on realising their practice goodwill.

2. Change your Attitude – understand how your practice makes money

The number one reason why owners cannot sell their practice is they do not believe it is worth anything nor would anybody be interested. Many do not like talking about it and are uncomfortable discussing the subject. Behind many closed consulting room doors there are quite a number of practice owners considering semi or full retirement and this is becoming quite a pressing issue.

In the last 3 months we have sold 4 practices with an average 10% interest in general practice to younger doctors selling for $200,000 and they are guaranteed a 30% pre-tax return on their investment. The fact they can borrow at 7% makes the whole proposal self financing and secures the medical workforce. The problem with selling a practice gets back to the owners attitude.

If you believe your car is a lemon don't be surprised that it will fetch a similar price.

When practices try to sell themselves a common mistake is they say that 30% of the practice turnover is goodwill. The incumbent finds themselves inheriting $100,000 of overheads per annum for life plus an $80,000 upfront payment. Any financial adviser would laugh at such a proposal and advise against it.

Owners need to understand the real value of their practice and be prepared to share profits. This is important in convincing people who are influential in the final decision making process, such as spouses, bankers and accountants.

Valuations need to be believable to the layperson as well as to a discerning accountant and financier. Using a traditional investment methodology based on a return on investment approach and not the current medical/industry practice based on gross fees makes a significant difference.

The practice must sell its profitability and not the overheads. At the end of the day the purchaser wants to know how he/she is going to pay for it.

As an owner, remember you do not have to sell your whole practice. You can say sell 5% for $50,000 and remain in control and still offer the same tax benefits as a full time owner. It is a win win. It takes pressure off in offering higher percentages. Furthermore is it not better to own 95% of something rather than 100% of nothing and sleep better?

Practices are worth a lot of money. The major mistake is many owners do not understand the business model or how it makes a profit and therefore they are not in a position to properly communicate this to a potential incumbent and/or their advisers. Many of their own accountants find themselves in a similar position and it is easier for them to advise against such a decision if you make it easy for them to say no.

If you were the purchaser and had $100,000 you would take the investment approach. Would you pay for something that appears to be liability for life! Surely you are better off investing your money in a fixed term investment albeit for a lower return but for a lot less stress? To make it work you need to make the deal worthwhile and comparable to other investments.

Practice Tip – Realistically understand what your practice is worth.

Generally solo practices have little or no value other than the book value of its assets less liabilities. Why? There is generally no other sources of revenue which is not based on the new owners personal exertion. Where the practice income is not based on an individual owners efforts that is less than on “eat what you kill” then the practice is more valuable. Examples include passive income from services such as specialist rents, associate doctors, sale of consumables, PIP’s etc.

To the contrary, group practices with greater than 2 principal owners do have additional value. This is because the income of the practice is not dependent on one individual and not only are overheads shared but so are the administrative and patient workloads.

The larger the practice the more valuable this is in the market place depending on the business model and profit sharing arrangements.

Practice Tip –Get rid of the common ownership myths

To beat the common myths about owning a practice owner should ensure the practice offers the following:

1. It is a high yielding investment with a guaranteed pay back – contact us for more information or see our past broadcasts for further information;

2. Ownership is not a headache – just because you own shares in BHP does not mean you are expected to run the company – ownership is not hassle with the right systems, procedures and personnel in place such as a good practice manager.

3. First Impressions are critical

Many practice owners have realized that finding a doctor let alone one that wants to buy into your practice is rare as hen’s teeth. Even more difficult is to have doctors prepared to answer advertisements in the media where there are many offers to work or join the practice. Practices must offer a career progression from employee doctor to non-owner associate to owner associate.

Placing advertisements and pitching to potential candidates requires three simple rules. Keep it:

1. Short;
2. Simple to understand; and
3. Different.

The practice owner only has about 1 minute to pitch the value of the practice to a potential incumbent. If you sound disorganised or unsure of yourself this does not resonate much confidence.

To a certain extent it is given practices are accredited, the staff are friendly and it is a high quality practice – everyone is pitching the same line. If you can offer opportunities for ownership, good investment return and tax and family friendly, this starts to set you apart from the rest.

The main points of difference come down to three key factors:

3.1 Mentoring New Owners:

Nobody likes to join the Titanic. Practice owners should be prepared to stick around a couple of years to support the new owner(s). The biggest turn off will be that you will not be there Monday morning. Make sure you are prepared to show the new owner the ropes and be available on call. Offer to train the owners spouse on how to watch the numbers if they are interested. Ownership of anything is a lonely existence without friends. Get them comfortable at the wheel.

3.2 Keep the Vision Real:

Is your practice smarter than the rest or will it be just another get on the treadmill story? Will it make a difference to the community and will it embrace the skills, work ethic and lifestyle of the incumbent(s)? Will the potential incumbent have an opportunity to influence this future regardless of whether they are full or part-time? You may not be prepared to embrace change like investing in new technologies but are you prepared to let others have ago, and go along with it? See below for more information.

3.3 Show me the money and put it in writing!

At the end of the day an owner of a practice expects to be rewarded more than a non-owner practitioner otherwise why would they take on the additional responsibility?

A strong and transparent business model that shows an increase to the hip pocket through additional access to passive income and/or legitimate tax breaks will make a difference.

Traditional financial statements do not show the true value of a practice. This is because it is usually coloured and complicated by tax structures such as service trusts which are hard to understand by individuals and advisers. Furthermore they do not clearly show an owners profit share without the funny adjustments for items such as a spouse wage, inflated property rents and the like. It starts to get into the “all too hard basket”.

It becomes critical to prepare a separate document that stipulates the financial and non financial benefits of ownership. It helps an external accountant sign off such representations to add credibility.

Furthermore practice documents such as a well written practice agreement (which we can provide - see below for more information) that is legally binding is important. It provides confidence in the running and the sharing of responsibility and profits of the practice. This acts as a pre-nuptial agreement, living and final will and testament. It tests the relationship before all parties “get into bed” with each other.

Many owners complain of bad partnership experiences and the main reason for this is they never wanted to put their expectations in writing upfront. A broken engagement is much cheaper than a divorce. Gone are the days of a “gentleman’s agreement”. If they do not want to enter into agreement they probably would have made difficult partners.

In terms of money, put yourself in their shoes for a second – a practitioner with a high HEC’s debt, a new young family or new home owner or an overseas doctor with a family with little or no money in Australia – what does your practice do to accommodate these needs? New owners are still primarily concerned about getting food on the table. It is not an unreasonable request to help them out initially if they have long term plans with your practice.

Practice owners need to bat for the incumbent’s interests as well as their own – it needs to be seen and treated as a win vs win opportunity and not just a chance to take advantage over another. Why ….because these sorts of deals are guaranteed to lead to an expensive divorce if there is little or no goodwill between the parties. The spirit of the deal is more important than the money or legalities, however always make sure you put everything into writing. This will guarantee you call any one’s bluff in the early stages before it is too late.

4. So where do you go to from here?

Next week will cover some real practical steps to what you can do to improve your recruitment and retention problem and some practical key succession planning strategies.

<u>**Which topics would you like to be covered?**</u>

If there is a particular topic that you would like covered in one of our future News Alerts, please email pa@healthandlife.com.au and let us know what it is. We will then endeavor to cover your requested topic.

<u>**Do we have your email address?**</u>

It is apparent feedback we are receiving that there are persons receiving this regular email who are not on our email list. If you are receiving this email ‘second-hand’ from another source, we would be delighted to receive your email address and we will add you to our list so that you can receive it first-hand on the day that it is sent. This invitation is open to all medical practices. Please send your email address to pa@healthandlife.com.au

<u>**Do you wish to unsubscribe from our list?**</u>

Please email pa@healthandlife.com.au if you wish to be removed from out distribution list

Disclaimer Notice

Health & Life Pty Ltd's Best Practice News Alert is designed as a comprehensive and up-to-date Accounting and Practice Management news service to alert readers to the latest in practice and related developments affecting the medical, dental and allied profession as they happen. It is published when there is news to report. No responsibility can be accepted for those who act on its content without first consulting us or obtaining specific advice.

Health and Life Pty Ltd (formerly acpm.com.au)

Accounting & Practice Management Services.
"Looking after your future"

PO Box 8145 Station Arcade, ADELAIDE SA 5000

Telephone (08) 8415 5400

Fax (08) 8231 6767

Email: pa@healthandlife.com.au

Web Site www.healthandlife.com.au