11Ys5318 E

Partnerships

A Popular Means to Practice Ownership

HENRY SCHEIN®
PROFESSIONAL PRACTICE TRANSITIONS

More than 20 percent of today's new dentists will enter practice ownership as partners, electing to become part of a "group practice" instead of a "solo practice." Unfortunately, 50 percent of the planned partnerships never occur, and approximately 50 percent of those fail to last. Properly laying the foundation for a partnership greatly enhances the chance for success.

Important Definitions

The first term is "partnership," an equal or proportional ownership (depending on the number of partners) of a business. This typically means an equal ownership of the hard assets of the dental practice, (not necessarily including the building), and may include an equal ownership of the intangible assets such as goodwill or the profits.

Partnership refers to two or more individuals as owners. A true legal partnership specifically includes one very undesirable characteristic for a dental practice, which states that all partners, to the full extent of their personal assets, are responsible for the acts of any other partner.

The next definition we need to address is "office-sharing." Under the terms of an office-sharing arrangement, two or more dentists share a physical space, but actually operate two or more individual practices. They may own some equipment in common. Typical office-sharing arrangements may include: a common reception area, business office, staff lunchroom and/or laboratory—and may also include one or more staff members.

Office-sharing arrangements are designed to share facility expenses. They occur when one of the sharing doctors desires to sell their practice. The doctors practiced separately, but to the world it appeared they were in a partnership. This view includes potential buyers and existing patients of the lenders who will generally be hesitant to provide financing for a sale involving an office-sharing arrangement. These practices are very difficult, if not impossible, to sell.

Assets Acquired

When a new dentist purchases an entire practice, it is fairly simple to understand what has been purchased—everything. Ownership in the assets of the jointly owned dental practice is typically demonstrated through "stock ownership." The key is to clearly define what are considered to be assets of the partnership.

Becoming a partner should initially mean an equal ownership in all of the assets necessary to operate the dental practice. Ownership of some of these assets will remain equal, including the equipment, furnishings, and dental and office supplies. However, the valuation relative to the goodwill aspect of the practice is typically tied to the individual production of the owner dentists.

Initially, the new dentist is buying equal access to the existing patient base. This means they are to receive equal opportunity to see recall patients, present treatment needed, and provide the required services. In addition, they are buying the right to see an equal number of the new patients. The need for these two aspects of "sharing" must be thoroughly discussed with the seller.

Partnership interest goodwill is typically valued in accordance with the joint and individual net income of the practice. If one doctor, during the prior 12-month period, has generated 60% of the net after operating expense income, that doctor would be entitled to 60% of the goodwill value.

Splitting the Income

Agreement on how the practice net income (income after expenses) remains for the owners involves two steps. The first is a determination as to how expenses will be split. Some will be split according to individual production, and are calculated as a percentage of the doctor's gross production. Dental and office supplies are also normally handled this way.

Rent should be split equally–that is, each should pay 50% of the rent. Other facility-related expenses such as utilities, building taxes, and building maintenance also fall within this category. Remaining expenses are allocated to individuals who incurred them.

After the operating expenses, what remains is profit. Most partnerships split the remaining profit in proportion to the ratios of their individual owner dentist's production. If one dentist has produced 60% of the dentistry, that dentist gets 60% of the profit. Some partnerships will set aside 10–20% of the profit, which is split in accordance with the percentage of practice ownership, and split the remaining profit according to the production ratio.

For the general dental and periodontal practice, the hygiene revenue may also be split, and may be based on the owners' production ratios; some will split the revenue in accordance with which doctor conducted the hygiene exam. Each partner competes to conduct the hygiene exams, seeking the additional revenue.

Associateships Leading to Partnerships

Most partnerships begin as associateships. New dentists join the practice as associates seeking employment that provides needed income and time to enhance their clinical skills.

If ownership is also intended, this associateship allows the parties to evaluate each other's personalities, treatment priorities, and communication skills. Equally important is the willingness to share patients, production, knowledge, financial information related to the practice, and management responsibilities. The associateship provides time to assess the compatability of the individuals before they "marry" as partners.

Prior to accepting partnership employment, careful assessment must be made of the new dentist's personal financial needs and the practice's ability to provide that income. This is a common reason why many associateships fail—the inability of the practice to support two or more doctors.

The average new dentist will require, at a 35% compensation rate, from $250,000 to $350,000 in available doctor-only production. Many senior doctors have the opinion that they will make some production available, but the associate is primarily responsible for developing their own patient base. The associate will not be able to develop this patient base quickly enough before becoming financially strapped and unable to continue employment.

Required Preliminary Agreements

An associateship intended to lead to a partnership should follow specific steps that occur at the start of employment. The "Buy-In Price" is an agreement based on the proposed purchase price prior to the start of employment. Three out of four partnerships occur as planned. If they do not, only one in ten associateships lead to the intended partnership.

Another item that must be agreed to is a written "Letter of Intent," spelling out the preliminary terms of the Buy-In/Buy-Out. It is suggested that the letter be non-binding: that the parties discussed important matters, agreed to them, and wrote them down. This significantly increases the chances that a successful transfer of ownership and subsequent partnership will occur.

The Letter of Intent should minimally contain the following information:

1. Purchase price
2. Proposed sale date
3. How the purchase price will be paid
4. How income/expenses will be split
5. How "irreconcilable" differences will be addressed
6. How patients will be shared
7. If applicable, real estate purchase details

When handled correctly, the Letter of Intent will form the framework for the future partnership. If the parties follow the agreements that were originally discussed, the chances for success are great. If one or the other party unilaterally decides a major change in the initial agreements is indicated, the chances for failure increase exponentially.

An "Employment Agreement" is also needed, detailing compensation, benefits, responsibilities, hours of employment, and probably a non-compete provision. The new dentist must realize it is not fair for the senior doctor to provide employment, introduce the new dentist to patients and staff, and then allow the new dentist to depart with those same patients and staff to establish a competing business. A new dentist can significantly damage the practice if they breach the non-compete agreement. Even in those states that have established that non-compete agreements are unenforceable, there are other ways for the senior doctor to effectively protect themselves.

The Partnership

Transition to ownership and partnership is fairly straightforward. The Letter of Intent details how the purchase price will be paid. Most partnerships will involve the purchase of stock. It is imperative that the value paid for the stock not be the full amount paid for the practice.

Stock must be paid for with "after-tax" dollars. This means the purchaser must earn $2.00, pay their federal, state, local, Medicare and Social Security taxes, and will then have approximately $1.00 left to purchase the stock. Not only is the purchase price not tax-deductible, but if the money was borrowed, the interest expense is also non-deductible. Paying the entire purchase price for stock actually doubles the cost to the buyer.

The purchase price is generally split between a small amount for the stock and the balance to be paid as deferred compensation to the seller. The buyer is responsible for paying toward the deferred compensation, and the seller receives the compensation from the employer, that is, the dental practice. Using this method of payment actually allows the buyer to pay for the purchase with "pre-tax" dollars. The justification for this type of approach requires precise wording in the "Stockholder Agreement" to pass IRS scrutiny.

The actual partnership agreements are typically called Shareholder or Stockholder Agreements. In addition to the Stockholder Agreement, either included within the Stockholder Agreement or included as a separate document will be a "Stock Restriction Agreement." The Stock Restriction Agreement defines who can own an interest in the partnership. Together, these agreements spell out:

1. How the purchase price will be allocated
2. How the purchase price will be paid
3. How the partnership will be run
4. How the doctors will be compensated
5. How patients, expenses, and profits will be split
6. How future Buy-Ins/Buy-Outs will be handled
7. What happens in the event of death or disability
8. Conflict resolution
9. Management duties
10. Cross-purchase life and disability insurance

Based upon agreement with the terms and conditions of the Stockholder and Stock Restriction Agreements, the senior doctor will agree to sell the proportionate number of shares of stock. The terms of this stock sale are covered in the Stock Purchase Agreement. The Stock Purchase Agreement is a fairly straight-forward, boilerplate-type document, containing an abundance of legal terminology.

The most important inclusions in this document are the warranties and hold-harmless provisions. The warranties are the promises by the senior doctor relative to all the things told and/or presented to the buyer such as the accuracy of financial statements, tax returns, asset values, etc., upon which the buyer relied in his/her decision to purchase the stock. The hold-harmless provisions represent the seller's promise to protect the new dentist from any claims relating to actions occurring prior to the stock purchase, such as alleged malpractice claims, unpaid taxes, or other undisclosed liabilities.

Concurrent with the sale of stock, each doctor will get a new Employment Agreement. As equal owners, these Employment Agreements will be essentially identical. How compensation and profits will be split is generally covered in the Stockholder Agreement and repeated in the Employment Agreements.

The Final Product

The key to a successful relationship is careful preliminary communication, planning, and agreement. The agreements reached must be written down. It is amazing how, in as little as two short years, the parties cannot remember what they previously discussed and agreed to. Everything must be written down.

There is no question that the future success of the partnership will also be dependent upon the personalities, communication styles, and clinical capabilities of the parties. These areas will be assessed during the initial associateship stage. However, the majority of relationships that never reach partnership are directly attributable to the failure to have initial written agreements, including the price.

The final documents establishing the partnership must be comprehensive. Although every possible scenario should be addressed, it is not possible to cover them all. The documents should provide worst-case scenarios such as a split in the partnership and a means to amicably separate the partnership.

Partnerships offer an abundance of advantages: the ability to cover overhead while one party is absent, the means to provide coverage during periods of illness and/or disabilities, the sharing of emergency evening and weekend coverage, the ability to share ideas or get help with unfamiliar or unusual treatment needs, and the ability to share management duties are only a few. For the new dentist, having an experienced mentor is priceless. Those individuals who have forged successful partnerships will tell you they cannot imagine practicing any other way.




When It's Time to Buy, Sell or Merge Your Practice...

You Need A Partner On Your Side