



Smart Approach to Practice Transition: Options and Strategies

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ABSTRACT This material discusses contemporary approaches to practice transition for practice owners. Although this discussion is not intended to be comprehensive, it is intended to provide a good overview in the form of a structured outline of selected areas an owner should think about and undertake to implement, as appropriate, to their practice and their goals.

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Being deliberate in taking the steps toward planning the end-stage of your practice career is one of the hallmarks of crafting a successful practice transition. A successful transition should take account of the needs of the practice owner, the practice, and a new doctor(s) coming into the practice. At least three directions are available to the practice owner considering an exit from practice, planning for the growth-oriented practice, maintaining a practice status quo, and preparing for an immediate sale with a possible hire back of the seller. Each of these directions is commented on here and universal inquiries are addressed, such as how to arrive at practice value, securing advisers, and timing issues.

What point are you at now, Doctor?

The following sequence of inquiries has been developed over the author's 26 years of structuring practice futures.

It has proven helpful in beginning the development of a transition foundation.

Inquiry: Are you in a growth-oriented practice?

■ *Considerations:* If you are in a growth-oriented practice, that is one that is growing significantly on a year-to-year basis, in the author's view, at least 10 percent to 12 percent a year, including an annual fee increase, for at least three consecutive years, then specific considerations should be examined. The considerations include the current size of the practice, whether there is more than one doctor presently at the practice, and the surrounding demographics.

Given an analysis of prospective future growth, it can be appropriate if not imperative to plan for a longer-term group practice. Today, longer-term group practice formats built on the foundation of a successful established practice, can 1) provide significant financial return for the practice founder(s); 2) provide for a tailored role for the interests of the founder(s)

to decrease days, pick procedures or patients; and 3) provide the option of the founder continuing clinical care or migrating into a management role.¹

OPPORTUNITIES: For the growth-oriented practice, there is significant latitude to structure a true succession. A true succession means, in part, a planned transfer over time of the managing doctor role from one equity owner to another equity interest doctor(s) who will build further on the group practice foundation. Important contemporary considerations include matching facilities, staff, and the number of doctors with the market patient drawing area. Doing so allows for a carefully calibrated match between the size of the practice and number of the doctors. The founder(s) of such a practice can use the planning process relating to the practice and the drawing area demographics to plan for adding the appropriate number of doctors, types of doctor care providers, and blend their own role(s) into the structuring process.

PITFALLS: Growth-oriented practices must allow sufficient time to plan for the future of the practice. The aspect of planning and execution based on practice development plans is not widely used in dentistry. However, without consistent practice planning and periodic review, the result may be an incomplete execution of the underlying plans and frustration by the founding doctor(s). Further, in an evolving group practice, unless careful consensus building is used to ensure that all doctors, all key staff, and all key advisers to the implementation are aware of the goals and design of the practice, communication difficulties are likely to occur.

Inquiry: Are you in a practice and desire to keep the status quo?

■ *Considerations:* In contrast to planning for the growth-oriented practice

is planning for the practice as a status quo entity. If you are not interested in developing a group with a longer-term future, but you do desire to continue practicing for the next three to seven years, and also desire to cut your time in practice, it is beneficial to plan using the following three steps.



First, analyze your practice current and projected patient flow and patient allocation. Determine if the patient flow will support either two full-time doctors (“full-time” as defined by the practice or doctors) or support one or more of the following combinations: one full-time and one part-time or one part-time doctor growing to full-time as the other doctor (the current practice owner) reduces from full- to part-time and exit. Generally, the doctors’ choice from the above and the practice numbers for patients and procedures, and production and collections tell the story as to which format is likely to meet the needs of the practice.

Second, determine compensation for both doctors. In the author’s view, it must be matched to the practice performance to date and not based on projections. To match the practice performance to date, use the real numbers of the most recent year of the practice to evaluate the transfer combination validity.

Third, if it is less than three years to a planned change in status or an exit, consider setting the practice for an immediate sale or short associate-ship and sale or hire back starting 18 months from the target date.

■ *Further consideration:* If you are interested in not developing an associateship arrangement or in having a partner, a true solo group may be appropriate. This is not a rental arrangement but the purchase of a right to use the facilities of the practice owner for a period of years with appropriate practice and legal safeguards for each party.

OPPORTUNITIES: The status quo-oriented practice has the benefit of providing a very comfortable exit. This will often be the case since the facility is not likely to change, staff for the most part will remain, and the period of years the current owner will remain can be set so long as the patient flow is sufficient.

PITFALLS: To have a viable transfer at the chosen in time, the status quo-oriented practice must at least maintain the historical production/collection ratio and seek to maintain the expense profile of the practice. To do otherwise is to not build on the strength of an existing practice, namely having predictable practice financials for production, collections, expenses, and hence net available for compensation and debt payment for a prospective purchaser.

Inquiry: Are you in a practice and desire to plan for an immediate sale?

■ *Consideration:* Many owners feel that the least complicated approach to leaving a practice is to sell a practice and perhaps have an employment hire back period. This is in fact, not generally a complicated matter. Two approaches among others are readily available. First, a doctor can choose to list the practice in the *Journal of*

the California Dental Association or other journals, and Web sites for sale, have the practice valued, and have their accountant and attorney prepare appropriate reports and the purchase and sale documents. Second, the doctor can choose to have another party, generally a broker, list the practice, place a price on it, and then have the doctor's accountant and attorney prepare appropriate reports and documents.² The opportunity presented by an immediate sale is to terminate your involvement with a practice on the transfer date with no long pre- or post-practice involvement, and no further legal attachment. However, it must be recognized with an immediate sale there is no opportunity to leverage the sale with the sale of incremental equity interests, no after sale employment income, and no chance to mentor a new practitioner.

Inquiry: Do you understand how to arrive at practice value?

The author wrote the following for a specialty journal hitting on this issue, and thought it would be appropriate to share it here since it has been well received.

"Thankfully, in contrast to 25 years ago when I started in the area of practice transfer, there are now good resources to guide both the buyers and sellers to first understand the theory of professional practice valuation and then how to apply it to get to value. In the case of dentists, the ADA has published *Valuing a Practice, A Guide for Dentists*. The publication discusses valuation approaches and details earnings based methods with an example of the capitalized earnings method. The reason, in part, which owners need to be particularly cognizant of is that with net determined and used to arrive at value, a buyer can identify how much out of the net they can pay for practice purchase debt and project how much they will have to live on.

Consequently, today buyers and their advisers are very interested in pinning down net and using an earnings method to arrive at value. For sellers to apply any other method for arriving at value, in the author's view, simply begs the question of how can the buyer pay for debt and live, which will have to be answered sooner



or later, and ultimately some form of net analysis will be used anyway in one form or another to arrive at value. In short, it is the author's counsel to sellers that it is much easier and more direct to simply go for a professional earnings-based valuation at the start and be done with it. At the same time that sellers grapple with how to arrive at value, they need to bear in mind that value is not price. Value can be arrived at using a valuation methodology or a group of comparables, but price is what is negotiated when the value is known and usually takes into account the tax planning of the parties.³

PITFALLS: The author always says that both practice owners and buyers or prospective partners owe it to themselves to gain an understanding of value and its application to dental practices. Not putting forth the effort to read and apply readily available contemporary dental practice valuation information means the doctors are likely to not be fully cogni-

zant of the financial implications of one of the largest financial transactions they will undertake during their career. If the doctors rely only on others, whether valuation firms or brokers, there can be later misgivings if they don't at least have their own working knowledge of the importance of valuation methodology and the detail necessary to examine a practice.⁴

Inquiry: Are you conversant with approaches to treat equitably a prospective associate/partner?

■ **Consideration:** The practice owner's goal should be to establish a trusting relationship between the doctors with equitable treatment of a prospective associate or partner right from the beginning. Owners should be prepared to discuss the practice opportunity without ambiguity. Owners should be able to answer the following questions, for example: How long will the associate period be? What compensation method will be used for the associateship? When will a buy-in opportunity be offered? What valuation methodology will be used? If a partnership or buy-out, when will a confidentiality agreement be available and then, when will the review of financial and tax records occur? When will an employment agreement or equity interest or purchase and sale agreement be prepared and available for review? The questions are not very difficult in and of themselves, but it does take being organized and straightforward as the practice owner with any prospective associate, partner or buyer.⁵

PITFALLS: The younger professionals today have access to far more practice associateship and transition information than in years past. Far too often, sellers or doctors offering a partnership interest are not prepared for the important and understandable questions to be asked by any potential buyer or associate leading to partner. The lack of prepara-

tion including particularly not having a sequence of items, from discussions to disclosure of practice information to valuation to document drafts, for a prospect can sow seeds of confusion and distrust where there need be none.

Inquiry: Have you thought through at this practice stage a “life plan” that lays out the importance of your practice to achieving any financial and retirement goals, personal satisfaction and family goals?

■ *Consideration:* With years of practice behind you and a routine established it can often be difficult to imagine the shape and form of life with less time or no time at the practice. But using your current professional advisers or a practice transition expert can help add an objective view to sizing up the future and actually preparing a detailed plan can add a welcome sense of relief and assurance for the doctor. In part focusing on the ideal practice for the senior doctor in both working days and times can be invigorating, especially when placed within the context of either the growth-oriented practice or the status quo practice. This can be the time to set performance objectives for the practice and finalize, if not already in place, the doctor’s estate planning.

PITFALLS: One vivid recollection the author has is of a well-known doctor, active in his community and organized dentistry, who having sold his practice expected to focus on hobbies. However, these were never as satisfying as his practice and he ended up hanging around the practice and buyer for years. How different the result can be to plan for a role if that is desired where the seller or senior partner has continuing duties or responsibilities or, on the personal side, to plan for life’s time and investigate where a life of hobbies or constant travel as a full-time avocation can be too much of

a good thing. In addition to examining a role with the practice, consider the rich rewards of volunteering. This option has been carefully discussed in a book, *Giving From Your Heart: A Guide to Volunteering*, by a well-known and now retired California endodontist, Dr. Bob Rosenberg with his co-author Guy Lampard.⁶



Inquiry: Have you developed your list of professional advisers?

■ *Consideration:* Since the practice owner has the practice and will take the initiative to offer the associate-ship, partnership or sale opportunity, the seller should be prepared. Given the size of many practices today, it is appropriate that the seller develop his or her team early in the process.

Generally the team should include the practice accountant, legal counsel, valuation firm, and as desired a transition consultant or brokerage listing firm. Depending on the complexity of the transaction and variety of assets, practice, lab, real estate, existing or planned trusts, then, as appropriate, estate planning counsel or tax specialists should be consulted. Routinely the author suggests that doctors use either business/tax counsel or health care attorneys to prepare the transaction documents. This is appropriate for both parties but the roles are different.

It is the practice owner, in the author’s view, who should initiate all document drafts, and the younger professional as the employee, partner, or buyer who should review the drafts prepared. The author is aware that some buyer’s advisers like to prepare the purchase and sale documents, and that is certainly discretionary. Further, a critical assessment and instruction must, in the author’s view, be given to all professionals involved. If the parties are committed to having the transaction proceed, then it is important not to allow the advisers to become potential deal breakers.

The orientation, in the author’s view, to all advisers is making the deal and accommodating the other side to the degree possible to arrive at that end.⁷

PITFALLS: Not having advisers in place can waste valuable time of both doctors. Not having advisers with solid credentials can mean the doctor(s) are placing their future in the hands of potentially inexperienced advisers. Further, not having deal maker-oriented advisers means the potential loss of the transaction over the adviser’s obstreperousness and not the actual benefit to the parties.

Considerations Related To Timing

Timing, as an old saying goes, is everything. This is particularly true for professionals. Much time and energy has been spent by any dentist, attorney, or physician in securing their professional education and setting up their practice situation.

Inquiry: When should an owner initiate the associateship leading to a potential partnership and buy-out or sale?

There is much to be said for setting in motion a practice owner’s exit strategy well before health or energy fades or fails. Although it is routine to see doctors these

days practicing longer than when the author started in the transition area, in general, the best time frame still seems to be planning for early to mid-60s with buy-out of a partnership or after a sale hire back to tack on one to three more years as the parties may negotiate. For growth-oriented practices with younger practice owners, contemporary planning and adding of partners is occurring in the 40s. Of course, in general, some doctors plan for an earlier transition and some far later, but the timing noted here is what is reflected in the author's practice. For specialty practices today, the author routinely suggests two to three years prior to an exit as a minimum, and for general practices depending on the geographic area, one to three years. In many cases, it is not the timing that should actually control. Rather, it is when the right candidate presents him or herself and the fit for a practice future or transition is well accepted by both doctors. Most practices today have the elasticity and growth potential to move forward years earlier than is generally thought possible, and the right fit of the doctors can be worth gold in meeting both parties needs and having a comfortable practice relationship.

Inquiry: When to value?

Frankly, short answers are readily available today to the question of when to value a practice. In the case of the associateship likely to proceed to the purchase of all or a part of a practice, it can be helpful to have a practice valuation before or within a reasonable time, usually four to six months, from the start of the associateship. In the case of the purchase of a solo group member under a buy-sell agreement, or in the event a practice owner dies, is permanently disabled, or withdraws, it can be advantageous to have a periodic valuation or at the least specify

the methodology to be used to arrive at value. For life planning and prospective anticipation of retirement needs it can be very useful to have a practice valuation prepared, if not a complete professional work product, at least a value estimate using the suggested steps for the capitalized earnings method in the ADA's *Valuing a Practice: A Guide for Dentists* publication.⁴



Inquiry: How long for the associateship?

More the exception than the rule today is the long-term undefined associateship. Years ago it was common to have multiple year associateships. Today, owners of growing practices should be looking for the commitment to the practice that follows from an equity interest purchase. Practice owners looking to sell their practice should be prepared to move from any associateship to the sale with a potential hire back in relatively short order to meet both parties' expectations for the anticipated close. Note that in today's rapid-fire sale context there may be no associateship period before the sale and depending on the size of the practice, no hire back.

Conclusion

Exiting from practice comes for all dental practice owners. Today, a good suggestion is to ideally start planning for a personalized and well-thought out ap-

proach to practice exit earlier than was the case in years past. For the growth-oriented practice owner, the process for developing sophisticated succession plans can be involved and early attention is beneficial to achieving a coordinated approach.

This discussion has presented a group of inquiries and perspectives relating to practice transition. Thinking through the inquiries will allow any owner to begin to develop a planned practice transition that is both rewarding and comfortable. ■■■■

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