Heir Apparent Associate: Plan for Your Practice Transition Now!

By John F. McDonnell

If you have a quality associate in your practice now or want to add an associate in the future, it is important to create an equity plan that will assure your having a healthy practice transition.

As the number of dentists who are retiring, becoming disabled or deceased are outnumbering the dental graduates each year, more practice owners are choosing to create an equity plan for an associate.

This strategy allows the practice owner to achieve the following:

1) *Peace of mind that the practice sale is planned.* As baby boomers plan to retire during the next 10 years, planning your transition with an associate-leading-to-equity plan allows the owner to not worry about the sale of their practice.
2) *Solidifies the relationship with the associate.* As consultants, we constantly get the calls from owners asking us to find them a new associate or from an employee dentist seeking a new associate position. This strategy will end and prevent this revolving-door pattern of associate changes.
3) *Increases income for the owner during this associate- to-equity timeline.* When planned properly, both the owner and equity associate will earn more income, as the practice grows with the associate committed to the equity plan and more new patients joining the practice.
4) *Maximizes the value for the practice sale.* When a solo practice owner does not have a plan, the practice revenue normally stabilizes or decreases as the owner ages. The owner takes more time off, has fewer young families and new patients, and refers most specialty procedures out of the office.
The practice will have increased availability, attract young families and new patients, and keep some specialty procedures in-house with the planned equity associate program. In our experience, the practice shows considerable growth in revenue and profit. For this reason, the value of the practice continues to increase during this time period and allows the owner to maximize their practice sale. The new owner is of course given consideration for their contribution to the increase in the value and revenue of the practice. They, in turn, have a practice worth substantially more than they paid when they complete the practice transition.
5) *Allows for vacation and time off without closing the office.* Having this plan in place allows both the owner and the associate to take more time off for vacations and continuing education. They are able to do this and keep the office open and productive when one doctor is away from the office.
6) *Prepares patients in a healthy manner for the transition to the heir apparent.* Because the owner and the associate are working together over an extended period, the patients and staff experience a seamless transition. With the outright sale of a practice when the owner leaves as the buyer enters, the patients and staff are sometimes not happy with this abrupt transition.

HOW TO PLAN

Whether you have the right associate now or are planning to add one, we suggest that the practice owner has the practice valued by a certified valuation analyst (CVA) that deals exclusively with dentists and a written plan including cash flows for the associate-to-equity program.

Because new owners have so many choices to get into business, having a plan will put you in the upper 5% of dentists who are prepared for their future transition.

The important thing is to do the valuation, cash flows and plan in the beginning. Do not wait as it will cause problems the longer that the associate is in the practice.

New dentists can purchase or start up a practice, and many do exactly this because they are unaware of the advantages of the associate-to-equity program. Offering this program to the new owner-dentist can be more attractive to them for the following reasons:

- *Opportunity to be mentored* — We hear many prospective new owner-dentists express that they realize that they are not yet ready to own their practice by themselves because they are unprepared both clinically and from a business standpoint. Being in this type of program allows them to improve their clinical skills and be mentored in the business aspects of practice development, while being on a clear path for practice equity.
- *Less risk in the beginning* — For the prospective new owner, this program is far less risky than either the outright purchase or practice start-up. One of the concerns the buyer of an existing practice has when the seller is leaving is whether the patients will stay. With the associate-to-equity program, the owner is staying with the practice for an extended period, and patients are comfortable with them when the seller eventually exits. In a start-up, the new owner is now spending over $300,000 to start up a practice with no income or patients in the beginning.
- *Chance to work with another colleague* — I frequently hear from both the owner and the new associate that having a colleague to share information, experiences and ideas with is very helpful. Both the owner and associate are teaching and mentoring one another in a positive manner.

TYPES OF ASSOCIATE-TO-EQUITY PLANS

1) *Fractional Sale* — This type of plan has a period of time that the new owner will associate with the practice before beginning the buy-in process. The value of the practice is established in the beginning along with the timeline for the buy-in. There will be a partnership for a period of time and a required buy-out at the end of the process. This buy-out requirement is very important, as we have seen many transactions in the past that, without this provision, have had serious problems at this stage. In this method, the owner normally receives the payment of the buy-in with after-tax dollars and the buy-out in lump sum. This method is normally the choice of the 40- to 59-year-old.

2) *Deferred Sale* — This method normally is chosen when the owner wants to stop owning the practice in one to four years. Again, the value is established in the beginning along with the cash flows and methodology for the purchase at the end of the associate period. This method is utilized when the owner is closer to retirement and does not want to be in a partnership. Having been a solo practice owner for over 30 years, this owner is used to being in control and normally does not want to have a partner. On the other hand, since there is clear timetable and purchase price established, the associate has an incentive to commit to the practice, preparing for their future ownership. In this method, the seller receives 100% of the practice sale at settlement from a loan that the associate buyer has taken out. This method normally is chosen when the owner is 55 or over.

WE RECOMMEND

1) That you plan your future transition as early as possible.