Associates and the Sale of Your Practice — An Appraiser's Perspective

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Buying and selling a dental practice on the open market in Canada was a rare occurrence prior to the 1970s. That was a time when, upon graduation, a dentist could simply move to the community of his or her choice, open a practice and be immediately busy providing dental care. Many practice transitions at that time involved the retiring dentist 'giving' the practice to a colleague in the hope that the new owner would pay a token amount for the equipment, perhaps assume a premise lease and look after the patients.

But times have changed. As more areas of the country have become better served by the profession, there has been a recognition of the many benefits to a practitioner of buying an existing practice and paying the departing dentist a significant sum for the goodwill in their operation (in addition to monies for the equipment, leasehold improvements, instruments and supplies). As a result, the marketplace has become very active. Hence the importance of focusing on the best way to sell a dental practice. Some dentists wonder if an associate buy-in is the answer. Based on my experience as a practice appraiser, I will answer the often asked question: "How does having an associate in my practice affect its sale?"

Attracting an Associate

With the average age of practising dentists from the baby boomer cohort continuing to increase, and the seemingly younger age when they choose to sell, one can safely predict that there are several hundred practices on the market at any given time. While there are about 450 new graduates in Canada each year, only a fraction of them are looking to buy a practice right out of school. An owner might rightly be worried about competing for this limited pool of potential buyers. This is especially true in rural and remote regions of Canada, where fewer young dentists are willing to locate and where it can take years to sell a practice.

One long-standing perception is that the best way to sell a dental practice is to attract an associate as a potential buyer. In the ideal scenario, this person works collaboratively for a few years under the mentorship of the senior practitioner, gradually becoming more confident and accepting of more responsibility. The owner continues under the illusion that the associate is eventually going to buy him or her out. It has been my experience that this belief often proves false and most owners are disappointed that the hoped for buy-in doesn't occur. The (usually) younger dentists in these situations thrive by virtue of being able to gain valuable experience while enjoying a level of security and limited risk. If you do attract an associate and get assurances that he or she will buy the practice, remember that anything can happen. If the associate leaves, you will have to start the process all over again, but you'll now be further along your retirement timeline. You'll also have to assume any additional financial investments you may have made to expand the practice when you found an associate.

If attracting an associate for a buy-in isn't such a good idea, what about an associate who is already in place? It has been my experience that long-term associates are often not good buyers of the practice they work in. If a dentist has been an associate for more than 5 years, it's usually because he or she does not want to own a practice — ever. Consider this true story: 3 associates were asked to make an offer on the practice they worked in. The owner had made it

Dr. Williams' half-day session at the CDA Annual Convention, titled "Dental practice appraisal and brokerage. The current status of the marketplace with projections for the future," will be presented on Saturday, August 26. For more information on the 2006 CDA Annual Convention, to be held August 24–26 in St. John's, Newfoundland, visit the CDA website at www.cda-adc.ca.

clear for years that he wanted to retire 'soon'. These associates were great practitioners and were successful by all measures. They also had an excellent rapport with their senior colleague. When the request for an offer to purchase was made, the owner naturally thought all of them would be very interested. One associate declined outright. The second, who was a newer graduate, thought the practice was overvalued, while the third simply left (there had been no written associate contract) and moved a kilometre down the road, even attempting to take patient records as he left. So much for perceptions and collegiality!

The Impact of Having An Associate in the Practice

From an appraiser's perspective, having an associate in a practice usually impacts negatively on the goodwill value, for several reasons:

1

In the absence of a written associate agreement, goodwill values will be adversely affected. Although the enforceability of such an agreement is not certain, the existence of non-competition and non-solicitation clauses will go a long way toward protecting an owner from sudden departures from the practice. Without a robust agreement which stipulates that the associate(s) cannot simply move 'next door' after leaving or after a new owner takes possession of the practice, there is a great risk to the purchaser of paying for something (cash flow based on a certain number of clinical hours and patients) he or she may not receive.

2

A long-tenured associate may feel as though he or she 'owns' some of the practice, simply by virtue of having treated patients that the owner has never seen. Furthermore, the associate's efforts may be the reason behind the growth of the practice (revenues, patient base, staff numbers, etc.). Potential buyers may see this perceived 'ownership' issue as a risk to them, so they are generally less willing to pay as much for goodwill in a situation where there are long-term associates in a practice.

3

Assuming that there are adequate agreements in place and that the associate desires to stay with the practice after the owner sells, there remains the issue of compatibility. Every one of us is an individual, and we just might not get along with someone new for professional or personal reasons. If these differences are material, the new owner may have to seek out another associate to work in the practice. This can prove difficult in geographically challenged remote and rural areas. If no one can be found, the new owner may be forced to work longer and harder than planned, or to refer some patients to another office — patients who have contributed to the cash flow of the practice and who would have been part of the patient base included in the purchase of the practice.

There will always be debate about the benefits of grooming your buyer. If you need an associate in your practice, either to handle increased patient flow, to allow you more opportunity for time off, or to fulfill your desire to mentor a promising young practitioner, then hire one. However, don't automatically think of your associate as your successor.

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