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Associate to Owner – When to set the Purchase Price?

Do you want to watch that perfect working relationship go from good to bad? Hire an associate to eventually replace you and buy out your ownership stake without setting up a clear vision on how that ownership buyout will occur. This is a very real situation that occurs on a regular basis.

The path for a solo owner dentist to sell their practice is pretty common:

1. Find a good dentist that wants to be your associate and eventually buy the practice.
2. Hire this dentist as an associate.
3. Sell the practice to this associate.
4. Either retire or stay on as an associate yourself.

Seems fairly simple, right? Four basic steps... but it's never that simple and let's go through why:

Associate/Buyer

Wants the price set at the onset of the associate agreement.

The argument for the associate -turned- buyer will be, "I have put a lot of sweat equity into the practice, why should I pay for it?"

Many times this new associate works nights, weekends, extended hours, covers emergencies, vacations for the current owning dentist, helps manage the staff, develops new marketing plans, etc. all with the understanding that the practice will be theirs someday. This buyer knows that the effort and time that is put into the practice on the front end will benefit the practice, while also increasing the value of the dental practice.

So does the associate/buyer lay an egg on purpose and not grow the practice to decrease the purchase price? That is not the type of associate that most owners want or expect… but by not setting a price on the front end this possibility looms over the seller ("Is the associate working as hard as they could be?") and associate ("The harder I work, the more I will have to pay to purchase the practice").

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Current Owner/Seller

Wants the price set at the time of the practice sale.

The argument for the associate -turned- buyer will be, "I have put a lot of sweat equity into the practice, why should I pay for it?"

If the associate damages my reputation/practice in any way, I am the only one that gets hurt. They can go find a job someplace else, but how can I recover as the owner of a practice with nowhere to run to?" Point being- the risk that any owner dentist carries while bringing on an associate is great, and with roughly 80% of 1st time associateships failing, there is a need to be concerned. This is a huge risk taken and should be properly rewarded.

1. Additional Expenses: Equipment, supplies, marketing, web site updates, salary, benefits, taxes, etc. for the addition of an associate add up pretty quickly, with most of these costs being absorbed by the owner.

2. Patient shift: To get a new associate up and running requires the owning dentist to transfer over some of their existing patients to the associate. This reduces the owners personal revenues while increasing what this owner dentist now has to pay the associate.

Is there a realistic answer to make sure everyone involved in this transition is covered?
YES, and it's not that complicated:

1. At the time of the associateship, get the practice valued by a mutually agreed upon source.
2. At the time of the buyout, get the practice valued by the same source.
3. Average the two valuations together and that will be the purchase price.

Example:

PRACTICE VALUED IN 2010 (TIME OF ASSOCIATESHIP) FOR $700,000
PRACTICE VALUED IN 2013 (TIME OF SALE) FOR $980,000
$700,000 + $980,000 = $1,680,000 / 2 = $840,000 SALE PRICE

This model rewards the risk that the current owner took by bringing on an associate and the headaches and heartbreaks that that involves. It also gives credit to the associate who came into the practice and worked from the bottom up to help increase the value of the practice. This results in the associate being responsible for roughly half the increased value, rewarding the associate and owner alike.

There will never be a perfect model out there regarding this type of transition, but this is the model that has worked for the team at Edge Advisors!

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