Buying or Selling a Practice:
The Top Three Things you Need to Know

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Results of Benchmarks 2010: A Study of Well-Managed Practice® by Wutchiett Tumblin and Associates and *Veterinary Economics* reveal that a current partner, or a current or future associate is the most likely buyer in 69 percent of practices. And, one of the most important steps to take to prepare an associate for ownership is teaching them about and involving them in the business side of practice.

Do you have your exit strategy mapped out? Do you plan to sell a part interest to an associate, continue to practice for a few years, and then sell your remaining share of the practice? Do you have your practice valued every 2 to 3 years as part of your planning process until you're ready to sell, and then plan to present the most recent valuation report to your associate and ask for an answer in two to three weeks?

Unfortunately, the above strategy doesn't do much to prepare your associate for a buy-in. You haven't considered where the associate is in his or her thinking. And sometimes because of a lack of knowledge, training, and preparation for ownership, the associate is overwhelmed and backs off. If this sounds familiar, read on.

The sale of an interest in a veterinary practice is not an event; it is a process that starts 4, 5, even 10 years before the sale. The timeframe depends on the readiness of the practice and the people involved. The top three areas you must plan for:

- Moving into a tax structure that minimizes your tax on the sale proceeds may require 10-year advance planning. The benefits of planning can mean hundreds of thousands of dollars of tax savings.
- Timing the sale to catch the peaks in value as the practice goes through its growth phases. Even 12 months can make a sizeable difference in the selling price.
- Preparing an associate for the financial responsibilities of ownership takes 5 or 6 years and is a critical part of the process, particularly if you are financing the purchase.

How do you prepare an associate for ownership? Let's look at the steps Dr. Steve Bailey and Dr. Meg Jones took to assure Meg would be ready for ownership.

Meg joined Steve's companion animal practice in Maryland two years ago. She brought five years of medical experience, a special interest in feline and senior wellness, and a desire to become a practice owner. Meg and the practice proved to be an excellent match. Now, she and Steve are ready to begin her transition into a management role with the intention of a 30 percent buy-in in the year 2015.

Steve knew developing a plan for the buy-in would give Meg time to get used to the idea of ownership, provide an opportunity for her to learn about management, and assure the buy-in would be a positive, successful experience for both. With Meg's input, Steve created the following four-year action plan.

2012

Transition Meg into management

Steve divides his ownership responsibilities in management into five areas – Employee Development, Financial Management, Client Development, Medical Development, and Facilities, Equipment and Technology Management – and receives management compensation of 3 percent of total practice revenue.

Steve and the practice's management consultant identified the specific responsibilities and related implementation for each management area, and then allocated the management compensation among the five areas based on time and effort required for each (see Figure 1).

Meg reviewed the management responsibilities for each area and agreed to assume responsibility for Medical Development. Meg's schedule will be modified to reflect 4 hours of management time – 2 hours for management planning on Tuesdays, and 2 hours for management meetings on Wednesdays.

Involve Meg in weekly management meetings

Steve and Meg will conduct management meetings on Wednesdays. From 12:30 to 1:30 they will discuss short- and long-term medical and business planning for the practice, with each leading the discussion for their own management area.

Then, from 1:30 to 2:30, they will meet with the Client and Patient Care Coordinators - the team leaders in the front office, or Client Care Department, and the back office, or Patient Care Department - to discuss items for consideration from the 12:30 meeting, and challenges (and recommended resolutions) the Coordinators identify from their respective departments. Together they will make final decisions, determine how the decisions will be implemented, who will implement the decisions, and a target date for completion.

Increase Meg's management knowledge and awareness

Steve and Meg mapped out the medical and management continuing education programs each would attend during 2012. Their plan included 8 to 10 hours of management programs for Meg, and she will begin reading management journals.

Compensate Meg for management

Steve and Meg agreed the current compensation allocation for each management area was reasonable. Once Meg satisfactorily completes a six-month management orientation period, she will begin receiving 10 percent of the management compensation for her management role in Medical Development.

They also plan to adopt Split-Rate Compensation℠ for veterinary pay in 2012 and will seek guidance from their practice management consultant to create the appropriate formula for their practice.

2013

Expand Meg's management involvement

Steve will begin involving Meg in financial decisions such as setting fees, establishing the annual spending budget, setting salaries for staff members, etc. She will also assume responsibility for an additional area of management, Client Development. After satisfactorily completing a six-month orientation period, Meg will receive 40 percent of the management compensation (10 percent for Medical Development and 30 percent for Client Development).

Enhance Meg's involvement in developing current and long-range practice goals

Steve recognizes Meg has goals and visions for the practice too and wants to involve her in shaping the future. Developing practice goals will be part of their weekly management meetings.

First, they plan to address the potential growth areas identified by the practice's valuator during the valuation process – restructure fees, increase client visitation, reduce their annual drug expense, and improve staff retention – to accomplish their mutual goals of enhanced patient care and improved profitability.

Begin educating Meg about financial statements and production reports

The practice's management consultant will facilitate a discussion about the purpose of and use of financial statements and production reports. Steve's goal is to guide Meg's understanding about the financial reports, the key revenue and expense components they track, and explain where to find and how to interpret the information they need to manage the practice. Then, once a month, they'll discuss selected revenue and expense components during their management meeting.

Steve is aware the buy-in will be Meg's largest monetary transaction to date. He wants their advisor's help in guiding Meg to an understanding of how her cash flow will change once she becomes an owner, so she sees the benefit of ownership.

Continue conducting weekly management meetings

When conflicts come up down the road, Steve and Meg know they will be in a much better position to reconcile them favorably if they've established a pattern of meeting regularly and have learned how to communicate and co-work with each other through some of the easier challenges.

Continue to expand Meg's management knowledge and awareness

Steve and Meg's continuing education plan for 2013 plan includes 12 to 16 hours of management programs. Meg will continue to read management journals, and she and Steve will update their list of management books outside of veterinary medicine they each plan to read.

Begin Meg's education about the valuation process

The practice valuator will facilitate a discussion with Steve and Meg about the valuation method that will be used to value the practice and explain the buy-in process in detail. The valuator will discuss the compensation formula for practice owners (see Figure 2) and how it will affect Meg as a future owner, as well as the affordability of the buy-in.

2014

Share all practice financial and production reports with Meg

Steve and Meg will discuss the results of the monthly financial statements and production reports during their management meetings. Their goals – continue their progress with enhancing patient care, improving profitability, and enhancing Meg's knowledge about the business side of practice.

Discuss financing arrangements for Meg's buy-in and the portion of the practice that will be available for purchase

Currently, Meg is planning to purchase 30 percent of the practice, and Steve will finance the deal. Meg plans to pay 10 percent down, with the balance financed over 7 years at prime plus 2 ½ percent to 3 percent interest, and loan payments will be paid quarterly. Meg will also explore outside financing options. Meg and Steve will re-evaluate the portion of the practice she will purchase and the financing terms and make a final decision during this stage in the process.

Ask the practice's valuator to value the practice

Steve's valuator will value the practice at the tax year-end of December 31, 2014, which will take approximately 8 to 10 weeks. Once the valuation is complete, Meg will sign a Confidentiality Agreement, drafted by Steve's attorney, and receive a copy of the Valuation Report. She will have 4 to 6 weeks from the date of receipt to respond with her intent to proceed (or not proceed) with the purchase. Meg will ask her own advisor to review the Valuation Report on her behalf.

Determine the owner's compensation formula

Currently, Steve and Meg plan to utilize Split-Rate Compensation℠ for veterinary pay, divide the 3 percent management fee 60 percent Steve and 40 percent Meg, and divide owner return based on share of ownership. They will re-evaluate this and make a final decision during this stage in the process. Their valuator will prepare a written summary of Meg's after-tax/after-loan payment income.

Ask the practice's attorney to draft the Buy/Sell Agreement

The attorney will guide Steve and Meg through the legal steps and documents that are necessary to complete the transaction. Steve and Meg will also inform their tax accountants of the pending buy-in for advice about tax issues that should be addressed before the sale is completed.

Ask the valuator to update the Valuation Report as of the closing date

Steve and Meg know it will take some time for the attorney to finalize all of the necessary legal documents. They will ask their valuator to update the Valuation Report as of the closing date, which will primarily consist of an update to the Net Asset Value.

Steve and Meg are confident their four-year plan will smooth Meg's transition into ownership. They may make some revisions to the plan along the way, but the co-working relationship they develop will assure a positive, successful experience for both.

But what happens if midway through the process Steve or Meg decides the future partnership isn't a good fit? They've agreed to discuss it and determine the necessary adjustments to keep the buy-in moving forward if possible. If the differences are too great to overcome, Meg will likely leave the practice and Steve will begin the search for a new associate who has the potential for becoming an owner.

Use the above guidelines as a starting point for developing your own transition plan. Seek counsel from your advisors (practice management consultant, practice valuator, tax accountant, tax attorney, etc.) to create the best exit strategy for you and your practice.

Figure 1 – Sample management compensation allocation

Employee Development	30%
Financial Management	15%
Client Development	30%
Medical Development	10%
Facilities, Equipment and Technology Management	15%

Figure 2 – Sample owner compensation formula

Veterinary compensation – Based on individual production:

- 23 percent of medical services
- 4 percent of medical products

Management compensation – Based on total practice revenue:

- 3 percent of revenue
- Divided among five management areas (see Figure 1)

Owner return – Based on ownership share:

- Amount available to owners after all operating expenses have been paid (including veterinary and management compensation)