Exit Strategies

The key is to develop practice profitability.

BY JON A. HULTMAN, DPM, MBA

An exit strategy is an owner's planned exit from his/her business. Just as a person needs a plan to start a business, s/he needs a plan to exit from it. Selling or otherwise "disposing" of a business can in some ways be as complicated as starting it. One exit strategy for a private podiatric practitioner is selling his/her practice and fully retiring. Others who are in partnership may retire and sell their partnership shares to the remaining practice partners and/or to current associates. The selling partner may then either exit or become a part-time employee of the practice. Another option for exiting is to merge with, or be acquired by, a practice that sees value in adding your practice to their group. One could also choose to sell to a private equity backed management company. The practice's value will be different in each of these scenarios, depending on the specific "buyer."

One may spend a lifetime building what s/he sees as a valuable practice, and yet, there have been scenarios in which doctors have been forced to simply close their doors and walk away. It is likely that these doctors had not planned for their eventual exit from practice. Even though practice values and markets for practices have fluctuated significantly over the years, there has always been—and continues to be—value in ownership or partnership. For most, the practice represents a significant part of one's net worth, and fortunately, this is a point in history at which demand for practices is higher than in previous years, and there are more options available when planning an exit strategy. With careful planning, upon exiting a practice, a doctor should be able to receive a reasonable value for this asset that s/he has built over a lifetime.

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When should you begin planning your exit strategy? Because there are so many variables and unknowns in life making it hard to predict exactly when you might want, or need, to stop practicing, you should begin planning when you first start out in practice. Whether you are an owner, partner, or an employee of a practice, a major goal of your exit strategy is the accumulation of sufficient wealth over your career to have enough financial resources to last through retirement.

Regardless of what you plan or predict, the most significant restric-

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tions on your exit strategy may be your financial, physical, and/or mental health. Your physical and mental health are major determinants of how long you will actually be able to work and accumulate wealth. Fortunately, you will have significant control over your financial health, and although you do not have the same degree of control over your physical or mental health, you do have some control—particularly over those determinants related to diet and exercise. The challenge is that physical, mental, and financial health are interrelated. Your greatest financial risk in retirement is actually good health; there is greater risk of running out of money should you be fortunate enough to live a long, healthy life. While the focus of this article is on exit strategy, suffice it to say that—as it relates to your financial health—personal financial habits such as living within your means and paying yourself first (i.e., allocating at least 20% of your salary to investment, while living on the remaining 80%) virtually guarantee that you will have sufficient wealth to retire, even if you are not a practice owner. Those who are practice owners or partners have even more control over their careers and, if they begin planning their exit strategies early, receiving additional value from an eventual sale will be a nice exit bonus.

You want your practice to have maximum value when you are ready to exit. This means that if you are a practice owner, a major focus of your exit strategy should be to increase the value of your practice over the years. Ways to accomplish this are: (1) be a great doctor, (2) complete a three-year residency, and (3) focus your clinical and operational strategies on quality, patient satisfaction, and efficiency. A wide range in profitability exists among practices in which the doctors produce similar revenues. When analyzing compensation as a percentage of a doctor's productivity, we see some inefficient practices with high overheads in which the doctors are compensated at the level of 24% of their productivity and efficient practices with lower overheads in which physician compensation is more than 60% of productivity.

When we examine these practices, we find that the primary difference between these two groups—which are equally productive—is the efficiency of the clinical and operational processes they employ. Earning more than double on the amount of revenue a practice collects makes a huge difference in a doctor's financial condition over the long-term. To achieve compensation at a higher percentage of production requires that as part of your long-term exit strategy, you integrate management skills into your daily operations—including the ability to implement quality and efficiency work-flow principles similar to the ones used by industrial engineers. This not only increases quality and profitability, allowing you to build a larger nest egg during your working years, but produces a higher profit margin which ultimately increases the sale value of your practice when you are ready to exit.

The total amount you will earn over your career from your practice is based on its profit. Most practitioners do not understand what, in a medical practice, is specifically meant by "profit." In many cases, a doctor sees his/her salary as whatever is left over after paying all the overhead. In this interpretation, there is no accounting for profit. To understand what is meant by profit, let us envision a business other than a medical practice. For example, say that you want to invest in a Seven Eleven. You may need to hire a manager, clerk, etc., to work in the store. As the buyer, you want to know how much money will be left over after paying these salaries and all related expenses. This amount will be the profit. From this, you can value the business. If the business' average profit is $100,000, you need to determine how much you would be willing to pay for this investment yielding an annual return of $100,000. If you were to select a multiple of 10, that business would be worth $1,000,000 to you; however, the multiple depends on the amount of risk associated with a continuation of this yearly $100,000 return. A risky investment, for example, will have a much lower multiple than one with less risk.

As a general rule, given the amount of uncertainty in healthcare, private medical practices are considered risky. It will be significant for a potential buyer assessing the amount of risk associated with a practice purchase to determine what the profit actually is and whether it is growing, stagnant, or declining. It is important to note that if you were to choose to work at the Seven Eleven in the above example, instead of hiring a manager, the amount of profit, and hence the value, will be the same. The same is true in a medical practice if you were to choose to work in the practice instead of hiring an associate. The salary paid to the doctor producing the revenue is not included as profit.

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Knowing that for someone selling or buying into a practice, profit will be the most essential determinant of that practice's value, one's exit strategy needs to be focused early on finding ways of converting a higher percentage of practice revenue into profit. Profit will be a percentage of the practice's revenue, and growth is the biggest driver of revenue—growth in both patient volume and in the number of services provided. We do know, however, that growth in revenue does not always translate to growth in profit. Growth in patient and service volumes can potentially have a negative impact on patient satisfaction, quality of service, and profit. Fortunately, high quality and patient satisfaction—two important and interrelated factors for increasing growth (and, ultimately

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profit)—can be achieved through increased efficiency.

Greater efficiency, combined with growth, will be your foundation for increasing profitability because it is this combination that enables a practice to spread an ever-growing volume of patients and services over stable fixed costs. Once fixed costs are covered and remain relatively stable due to efficiency, the only costs that will increase with additional volume are the variable ones—mostly supplies. This is why instituting efficiency principles into your practice results in much higher profit from the same amount of revenue. A practice with high quality and greater patient satisfaction is desirable for patients, provides a better working environment for its doctors and staff, and also increases a practice's profitability—an eventual "bonus" when the time comes to exit.

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There are important takeaways when considering your exit strategy. First, focusing on profitability while in practice must be a major feature of a well-prepared exit strategy since profit is a significant determinant of value, and although we have no idea what the environment will be for practice sales in the future, what we do know is that (1) you have chosen a great profession, (2) practice ownership/partnership will always have value, (3) diet and exercise are important for the good physical and mental health necessary for running a successful practice, and (4) quality care, effective management, patient satisfaction, and growth will matter over your entire practice career regardless of ownership. An additional "bonus" from a practice sale at the end of your career will be nice, but it should be the "icing on the cake" and not the main goal of your exit strategy. **PM**

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