How to Obtain Premium Value for Your Podiatric Practice

To maximize worth, consider all these variables.

BY JOHN V. GUILIANA, DPM, MS

As the practice acquisition frenzy continues to heat up, many podiatric physicians suddenly realize their practice's importance as a retirement asset. The sale of a practice can either substantially supplement a retirement nest egg or be the source of retirement-delaying frustration. Understanding the process of a practice transaction or sale, along with a deliberate and proactive strategy to enhance the value of the practice, is likely to reduce the stress and frustration in addition to providing some supplementary retirement funds.

There are many issues to consider when selling a medical practice. The valuation of assets, continuity of patient care, and in the case of retirement, the emotional aspects of leaving the practice are just a few. More often than not, physicians do not allow enough time for this process, as finding the right fit for their replacement as well as completing the steps to assure maximum practice value may take up to two years.

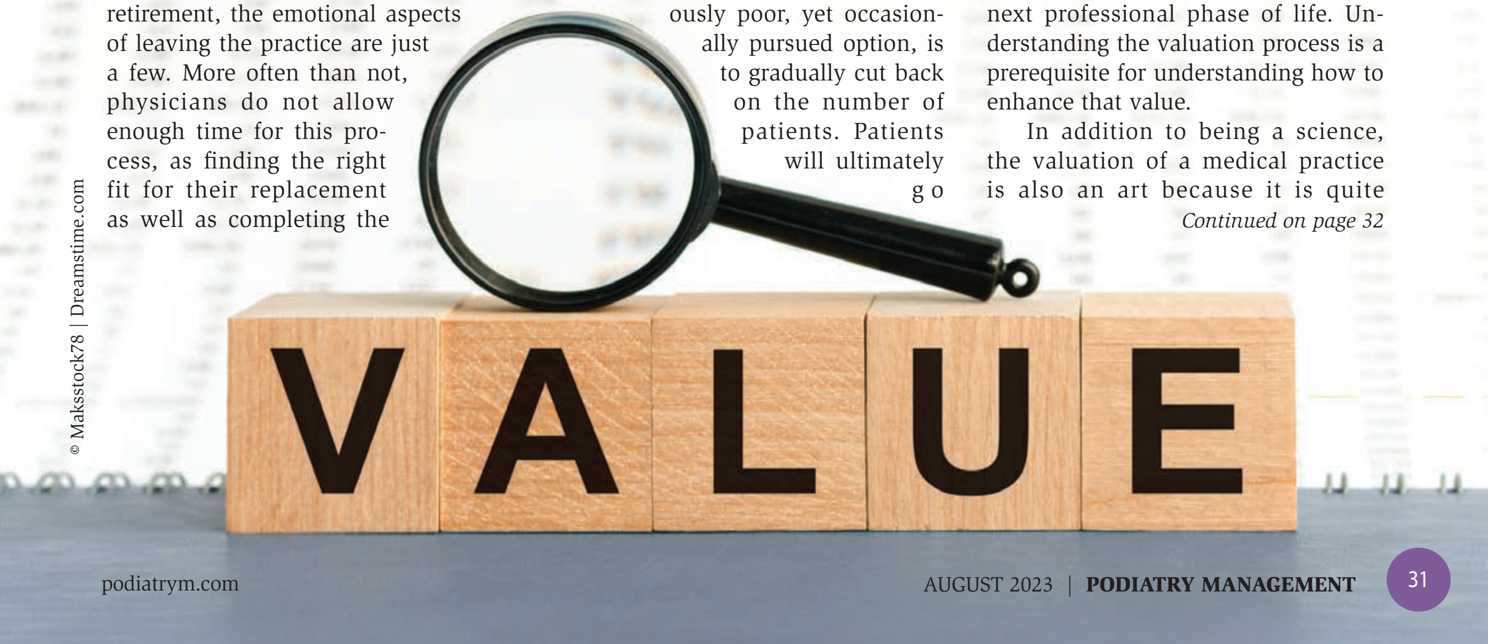
Doctors have various options, and which one you choose will be based on personal preference. In consideration of retirement, a physician might hire an associate and integrate that person gradually into the practice before selling it. A physician might choose to merge with another practice or be purchased by a private equity entity. An obviously poor, yet occasionally pursued option, is to gradually cut back on the number of patients. Patients will ultimately go to other practitioners and, as a result, the staff begins to leave. By the time of the sale, the practice will have its value compromised.

Aside from these fundamental choices, as retirement approaches, physicians need to understand how their medical practice will be valued. During this process, it is critical to engage the expertise of consultants, accountants, attorneys, and financial planners to properly prepare for this next professional phase of life. Understanding the valuation process is a prerequisite for understanding how to enhance that value.

Understanding the valuation process is a prerequisite for understanding how to enhance that value.

In addition to being a science, the valuation of a medical practice is also an art because it is quite

Continued on page 32



Premium Value *(from page 31)*

different from an ordinary valuation since it involves intangible assets. Intangible assets, or goodwill, lend value to a practice but often lead to questions as to whom or what that value is attributed. Quantifying goodwill often becomes the most challenging task during the valuation process. There are four main components in the valuation of a medical practice:

Tangible Assets—Tangible Assets are items of equipment, cash, accounts receivable, and other property that are owned by the practice.

Liabilities—Liabilities are debts that the practice has incurred and for which there is a future obligation to pay. Principally, these are accounts payable or loans.

Equity—Equity is the difference between what a practice owns (its assets) and what it owes (its liabilities). It is the residual value of stock and retained earnings.

Intangible Assets—Intangible assets include all the characteristics that contribute to the success of the practice, collectively termed "goodwill". This may include the reputation of the physician, the location of the practice, the loyalty and volume of high-paying insurance companies, and the management systems that contribute to low overhead costs.

There are many methods of calculating a practice's value. The rule of thumb governing the valuation is based on the percentage of revenue concept. Briefly, it is equivalent to saying that one dollar in revenue should translate into a specified amount in cents on the bottom line.

Perhaps the most popular approach taken by appraisers to value businesses is the income-based valuation, in which the appraiser looks at the historical revenue stream and projects future revenue streams to come to an understanding of value based on future benefits.

A Summary of Three Traditional Approaches to Determining Value

Asset-Based Valuation—Asset-based valuation begins with the construction of an adjusted balance sheet to determine the book value of the tangible assets. The asset-based valuation should also examine and determine the value of intangible assets. The intangible value may be determined by measuring factors such as reputation, name recognition, and location, and is often difficult to quantify.

Income-Based Valuation—Perhaps the most popular approach taken by appraisers to value businesses is the income-based valuation, in which the appraiser looks at the historical revenue stream and projects future revenue streams to come to an understanding of value based on future benefits. This method of valuation is often most applicable when it is clear that the new entity has an opportunity to gain improved revenues because of increasing productivity, decreasing costs, or other value-adding strategies.

Market Valuation—The third classification builds on the previous two approaches but asks the question: "What is the practice worth in the market?" The more often such transactions occur in the market, the easier it is to ascertain a ballpark figure for the value of the medical practice.

Throughout their years of practice, a practitioner's financial focus is often too narrow, usually concentrating merely on revenue production.

An appraiser must ascertain how much of a practice's goodwill is attributable to personal goodwill and how much is attributable to corporate goodwill to assess how reasonably a buyer will be capable of replicating the present revenue. Personal goodwill is a result of a physician's relatively unique charisma and personality, or unique medical skill, and might not be transferable to some buyers. Corporate goodwill, on the other hand, is easily transferred in the transaction.

Aside from the tangible assets of the practice, corporate goodwill constitutes much of what a buyer is purchasing. Corporate goodwill is mostly created by "factors of revenue production", which include location, payer mix, referral base, the practice's historical growth pattern, visit volume, collection ratio, effective management systems, etc. Strategies designed to maximize the value of a podiatry practice should therefore place a great deal of emphasis on these factors.

Throughout their years of practice, a practitioner's financial focus is often too narrow, usually concentrating merely on revenue production. As a result, practitioners often become disappointed in the valuation at the time of their retirement. This disappointment is usually because of the deficiencies in management systems and tools that enable a future buyer to easily replicate the revenue stream. Throughout the span of their career, practitioners often fail to invest in the management infrastructure of their practice causing the value of their practice to be compromised.

Key investments which could enhance your practice's value involve:

- Facility
- Staff
- Reputation
- Technology
- Billing/collections systems

Continued on page 34

Premium Value *(from page 32)*

• Policies/procedures
• Compliance (medical, OSHA, HIPAA, ADA)
• Vertically integrated services
• Financial Records

Facility—The design and maintenance of the facility itself are important for a practice's inherent reputation. Periodic investments into the office structure, as well as aesthetics, are long-term value-added decisions.

Staff—In the typical medical practice, the supporting staff should be considered its most valuable asset. Patients often spend more time with them than with the physician. If staff turnover can be kept to a minimum during the transaction, patient retention will usually be higher, resulting in more value. In addition, a well-trained staff leads to significant revenue production and is costly to replace.

Reputation—The building block of a practice's value is its reputation. In today's environment, physicians must maintain their reputation from a clinical perspective as well as a brand recognition standpoint. Many companies now specialize in reputation management.

Technology—In today's economy, a medical practice cannot survive, let alone thrive, without technology. Not too long ago, computers were the top technological investments made by medical practitioners. We have evolved into a time where the need for technology is far greater in order to remain competitive. Digital x-rays are rapidly replacing their ancestors, and diagnostic ultrasound now allows for greater treatment plan accuracy.

At the forefront of prudent technological investments which enhance a practice's value are electronic health records (EHR). EHR implementation allows for cost containment and quality improvement concerning the documentation process. It allows for more accurate and legible documentation which might elevate coding to a more profitable level, and surely provides a return on the investment during a practice valuation. In addition, electronic records are more secure than paper charts, and are easily recovered should a disaster such as fire or flood occur.

Billing and collection systems—A key factor of production capable of having a significant impact on profitability and value involves the practice's efficiency in collecting money. The management of a practice's accounts receivable (A/R) is easily measured and benchmarked. Whether outsourced or performed on-site, less than 10-15% of a practice's total A/R should be aged accounts (over 90 days). Missing this benchmark may indicate the need for structure and consistency in the billing and collection process. Creating fiscally sound and consistent financial policies, along with an effective system of dealing with accounts as they progress through the aging cycle, is crucial for A/R management and cash flow.

Policies and procedures—A fairly constant finding during the analysis of a medical practice is a deficiency in operational policies and procedures. An Employee Manual, supplemented by a responsible Policy and Procedure Manual, may add significantly to a practice's valuation.

Compliance—A highly profitable practice made up of a revenue stream built upon non-compliance is virtually worthless to an ethical buyer. Periodic internal audits of medical records should be performed and documented. During this audit, randomly selected medical record documentation should be compared to the charge entry as well as assessed for medical appropriateness. Physician feedback and education should follow any findings of deficiency. OSHA and HIPAA compliance should be well documented and available for review.

Integrated Services—Successful podiatrists have one important trait in common—they recognize the need to periodically "re-invent" podiatry as a means of offsetting declining reimbursements. Profitability, and hence value, can be enhanced by integrating patient-focused services that might also be value-based, such as lower extremity amputation prevention strategies, therapeutic diabetic shoes, vascular testing, wound care, physical therapy, and in-office dispensing of value-added products. The provision of these services is often facilitated by the construction of practice protocols or clinical pathways for the most common conditions treated by the practice.

Financial Record Keeping—Diligent record-keeping and maintenance of important financial documents such as tax returns, bank statements, profit and loss statements, balance sheets, and practice data reports will facilitate and add value to the appraisal process.

Today's podiatric practice, whether large or small, has value. Physicians who plan on selling their practice should have the practice's value evaluated by experts at least two years in advance of the decision to retire to determine if the maximum value is being yielded based on the resources committed. **PM**

A key factor of production capable of having a significant impact on profitability and value involves the practice's efficiency in collecting money.

Dr. Guiliana is a nationally recognized speaker and author on topics pertaining to medical practice management. He is a Fellow of the American Academy of Podiatric Practice Management and holds a Master's Degree in Healthcare Management. He has authored numerous columns in various journals and is the co-author of *31½ Essentials to Running Your Medical Practice,* as well as *The Million Dollar Practice…Keys to Success.* Dr. Guiliana is currently a Medical Director of Podiatry for Modernizing Medicine's award-winning technology. He can be reached at John.guiliana@modmed.com.