
How Much Is Your Practice Really Worth?

By Michael Cash, MHSA, FACMPE

At some point, every practice undergoes physician transitions as physicians join, retire, merge and separate from groups. Advanced planning and communication can help facilitate the process. When physicians wait until the last minute, options are limited and decisions tend to be reactive to the market conditions. During the transition, patients may transfer their care to another physician that can result in the practice struggling to manage overhead expenses. On the other hand, a more proactive approach includes communicating with stakeholders early to manage transitions on a more appropriate schedule. A good transition plan indicates a well-run practice and is more attractive to potential suitors.

Many physicians want to know the value of their practice. The practice value is highest when the physician is working at full capacity, the building and equipment are in good condition, and technology investments are incorporated into the practice. The financial statements are more attractive when the physician is working at full capacity. A certified healthcare appraiser or accountant can help determine the value of the practice, but the appraised value is only as accurate as what the market will bear. The most common appraisals evaluate cash flow, tangible assets including the building and equipment, and comparable sales. Some valuations may include a single valuation approach and some use a combination of all three methods. The valuation method depends on the circumstance and the buyer. For example, a hospital valuation approach may be different than a private practice valuation if the hospital pays a market salary for the physician's integration. The more difficult and subjective approach to a practice valuation is the value of the intangible assets of the practice, also known as goodwill. Some examples of goodwill include reputation in the community, workforce in place, patient panel, and competition. Essentially, a new partner or purchaser of the practice has to determine if the expected earnings of the practice justify the buy-in or purchase amount or if it is more beneficial to set up a practice in another location. The [Goodwill Registry](#) is a national healthcare database that may be a useful comparison tool for determining the value of intangible assets.

Consider a solo physician who has practiced in a rural area for 30 years. The physician is near retirement and is reviewing options to sell the practice. The retiring physician has not invested in the practice nor facility in years, and the building and equipment are outdated. The cash flow might look attractive to a potential buyer, but the buyer would also have to consider the capital investment needed to update the practice. A prospective buyer has to

determine the potential revenue stream of the practice or the goodwill value of the retiring physician's patient panel. A new physician moving to the area may find it more feasible to set up a practice in a nearby location and incur the operating expense of starting a new practice rather than paying goodwill for the retiring physician's practice. Another variable for the retiring physician to consider is the storage and retrieval of patient medical records. The retiring physician might find it more beneficial to assign a lower goodwill value of the practice to transfer the medical records to a new physician to avoid the burden of storage and retrieval of medical record after retirement.

In another scenario, there is a four-physician practice in a metropolitan city. One physician is considering retirement within five years. If the group plans appropriately, they may be able to replace the retiring physician with a new physician so that the new physician has a stable patient panel and revenue stream. The retiring physician would sell his or her share of the partnership to the new physician, and the medical practice would continue. In this case, the new physician partner may invest in the assets of the partnership and be willing to pay some amount of goodwill for the established practice. In this case, the goodwill is the infrastructure of the group. The group has all of the business systems in place for a seamless transition. The goodwill value may be set as a percent of income, accounts receivable or compensation of the group. The incoming physician has to determine if the goodwill value is more or less reasonable than other options.

On the other end of the spectrum is the private practice group that makes the strategic decision to integrate with the hospital. The hospital is required to pay fair market value to comply with the Stark Regulations. Hospitals pay fair market value by providing a salary that is consistent with industry benchmarks, and they buy or lease the physician's building and equipment for the appraised value. It is very rare and highly unlikely that a hospital will pay for intangible assets or goodwill. In private practice, goodwill reflects the business infrastructure in place. When a private practice merges with a hospital, they integrate with the hospital's infrastructure. From the hospital perspective, the value in the integration is the physician's ability to serve the needs of the community. Some physicians considering retirement may find it beneficial to integrate with the hospital or health system for recruiting assistance or medical record transition. The physician near retirement has more leverage if he/she starts the discussions several years before retirement.

A practice transition includes many variables that need to consider. Timing, location, age of the practice, patient panel, recruiting and market conditions impact the valuation. To ease the stress of a future potential transition, physicians should include the topic in their ongoing strategic planning process. The discussions should include theoretical timeframes for physician departure, as well as ways to unwind the relationship. This helps to set expectations among the physicians in the group. It might be helpful to consult with hospitals or other providers within the community for recruiting assistance. State medical societies and residency programs may also be able to assist. If you start the process early, you may find the right physician to continue the care and service you expect for your patients and community. SVMIC is also a good resource to consult throughout the process of making decisions such as these. Our Medical Practice Services department is

well equipped to assist with strategic planning, strategic discussions, and any other business-related issues. SVMIC does not provide practice valuations, but the Medical Practice Services department can assist you with resources.

The contents of The Sentinel are intended for educational/informational purposes only and do not constitute legal advice. Policyholders are urged to consult with their personal attorney for legal advice, as specific legal requirements may vary from state to state and/or change over time.