

A case study in practice transition

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The perpetuation of private practice optometry has become the subject of numerous articles and much discussion in recent years.^{1,2} American Optometric Association (AOA) surveys find the overwhelming majority of optometry school graduates aspire to enter traditional private practice. However, many optometrists with thriving practices are complaining that, as they approach retirement,

A new optometry school graduate and a respected established practitioner overcome problems commonly encountered in the transition of a private optometric practice through a novel “work-to-buy” agreement.

they find themselves unable to sell their practices. At the same time, oddly, a growing chorus of new practitioners fresh from optometry school report they are having trouble finding, joining, and successfully purchasing established practices.

The problem has been documented through formal studies.¹ The reasons have been analyzed,² with the most common being disagreement over practice purchase price, inability to agree on an appropriate starting salary for the new practitioner, misunderstandings regarding expectations for the new practitioner, misunderstanding over how and when the sale of the practice is supposed to take place, and inability to arrange financing. Certainly, for many new practitioners, the road to private practice is proving unexpectedly rocky, and for many established practitioners, the road to retirement is proving surprisingly bumpy as well. However, with a little background knowledge, some cooperation, and a bit of creativity, the way can be smoothed considerably.

Consider the experiences of the coauthor of this article, D. Duane Mohon, O.D., (hereafter generally referred to as the

“new practitioner” or the “junior practitioner”), a 1998 graduate of Nova Southeastern University, who over the last decade has successfully established a practice in his home state of Alabama. Like many young practitioners, Dr. Mohon knew, as he approached graduation, that he wanted to enter private practice. Today, less than 10 years after graduation, the new practitioner is living his dream with a highly successful and rapidly expanding 2-office private practice in Alabama. Unlike many new optometrists, he was able to graduate from optometry school with a practice opportunity (and, therefore, steady income and a means of addressing his student debt) secured. The established practitioner, whom the new practitioner joined after graduation, watched his practice grow modestly after taking on his junior optometrist. After a few years with the practice, the new practitioner purchased the practice’s satellite office for a previously agreed-on price. Today, the senior practitioner can approach retirement knowing that his former junior partner stands ready to purchase his primary office, meaning he will receive a suitable return for the years he has spent developing his practice.

This very favorable outcome was achieved as the result of the new practitioner’s systematic and diligent search for the right practice opportunity, a solid plan for a successful associateship, a firm agreement for the eventual purchase of the practice, and a novel financing arrangement. The new practitioner methodically followed a routine that essentially embodies just about every practice management educator’s dream program for entry into practice. In many respects, the case outlined here exemplifies a by-the-book approach to practice transition. It also illustrates that a little creativity and cooperation can overcome obstacles that might otherwise prevent the transition of a practice. It may well offer a valuable model for many new optometrists who are attempting to enter practice and many established practitioners who are seeking to transition out of practice.

Starting early

In this case, the new practitioner’s formal search for a practice opportunity began as he entered his third year of optometry school. That might seem early by the standards of some. However, it is actually a very good time to begin the search for a practice. Searching for a practice is a more involved and time-consuming process than many students imagine. Often, optometry school students approach graduation having given relatively little thought to where and in

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what manner they will practice. After graduation, they are suddenly faced with the need to quickly find a place to practice and begin earning income to pay off student debt. As a result, they often end up making important decisions with inadequate forethought. In this case, on the other hand, the new practitioner was able to graduate from optometry school having already secured a practice opportunity and a steady income and, therefore, a means of addressing student debt.

Determining the desired mode of practice

An important initial step in any optometrist's entry into practice, of course, is determining the type of practice opportunity desired. The new optometrist must come to some decisions regarding the type of practice to be pursued (in this case, primary care optometry). The new optometrist must also determine the preferred practice location (in this case, a semirural area in Alabama). The more specifics that can be identified, the better (in this case, the new practitioner wanted a potential for a multisite practice, and, ideally, a hospital nearby for future hospital privileges). Initially, he was equally willing to join an existing practice or start a new practice "cold," whichever provided the best opportunity to practice in the manner he envisioned.

Searching for opportunities

With a good idea of his desired practice in mind, the new practitioner, while still in his third year of school, was able to begin a serious effort to search for that type of practice. He began by registering with Optometry's Career Center® (OCC)—the AOA online placement program established to match those who are seeking practice opportunities with those who have opportunities to offer. Participation in the OCC allowed him to begin networking with established practitioners and assessing the types of practice opportunities available. He then took out a map of Alabama and compiled a "long list" of 30 locations in the state that might prove suitable for his practice and began studying them carefully. In developing the list, he considered population, the current eye care workforce in the various locations, access to hospitals (for future privileges), and other factors including the semirural atmosphere he desired. He contacted the Alabama Optometric Association for a list of member doctors to determine where optometric services were already available in the state. He also made personal visits to the state to check out potential locations. At that point, he was still willing to consider both joining an existing practice and starting a new practice.

He then initiated contact with a few of the doctors that he found in the OCC (then known as the "AOA Practice Resource Network"). After conducting initial telephone interviews with practitioners, he was able to reduce his list to 12 practices. Several of the practices he contacted appeared to be compatible with his desired style of practice and were in a position to take on an associate. A few promising locations for cold start-up practices also re-

mained on the list. After a second round of more detailed follow-up interviews and practice visits, he was able to reduce his search to a "short list" of 4 practice opportunities by the beginning of his fourth year in optometry school. By the second half of his fourth year, it was down to 2 finalist practices and the still-existing opportunity to start a practice.

The finalists

While still in his fourth year of optometry school, the new practitioner was holding formal meetings with the senior doctors in those 2 finalist practices on his short list. The meetings centered on 2 points: salary and the eventual purchase of the practice. The 2 are actually very much interrelated. In many cases, the new optometrist who accepts a starting salary of \$60,000 but also gets the option for eventual equity ownership in the practice may be getting a lot more than the new optometrist who accepts a starting salary of \$100,000 somewhere else. Many new optometrists enter practice simply wishing to do nothing more than quickly secure an income and begin paying off their student debt. All too often, new optometrists view their initial practice arrangement as a temporary practice setting. Eventually, they reason, they will move on to the practice they really wish to pursue, having obtained a bit of financial security. However, such an approach can waste valuable career years that could be used to immediately begin developing the equity of a practice that will continue to develop over the course of a career. In this case, the new practitioner specifically stated, entering his interviews with the finalist practices, that he was interested in potential buy-in opportunities in as little as 1 year. If the senior optometrist was not willing to discuss buy-in arrangements in the beginning, the new practitioner was prepared to end the negotiations.

In fact, in this case, the final selection of a practice was made on the basis of whether the new practitioner would eventually have the opportunity to become a partner and purchase the practice.

While still in optometry school, the new practitioner made the decision to join a prominent practitioner in a 15-year-old practice with 2 semirural offices, both of which had grown to the point that they could support a full-time optometrist. The critical factor in the decision: the senior doctor offered the new optometrist the option of either eventual partnership in the entire practice or eventual purchase or partnership in the practice's satellite office. Furthermore, they agreed the new optometrist would be able to act on those options at the end of a specified 2-year period.

Negotiating the terms of employment

Moreover, while still in optometry school, the new practitioner then began "hard negotiations" with the senior optometrist on the terms of employment starting with the usual provisions: salary, benefits, bonuses, and the responsibilities to be assigned to the new associate.

Negotiations were conducted in a manner that reflected the concerns of both the junior and senior practitioner.

Entering the talks, both parties understood that the junior practitioner's salary would have to be sufficient to allow the servicing of student loan payments as well as an adequate standard of living. However, both also understood that the new practitioner would have to be able to generate enough revenue and take on enough responsibilities to cover that salary. A starting salary of \$60,000 was ultimately negotiated. That represented a compromise for both the established and new optometrist. To an established practitioner, that may sound like a reasonable salary for a new associate; however, it is important to understand that for today's optometry school graduates, faced with student loan payments of \$12,000 or more a year, accepting a \$60,000 salary can actually represent a sacrifice. It can mean the new practitioner will have about the same standard of living the practitioner might have had if the practitioner had elected to pursue a research fellowship and lived on a stipend instead of entering practice. However, the contract also included that important nonsalary provision: the option to purchase a specified interest in the practice at the end of a 2-year period for an agreed-on price. Under terms of the agreement, the senior practitioner had the practice formally appraised, before bringing in the new practitioner, to establish a baseline value for the practice. The practice would then be appraised again at the end of the new practitioner's 2-year employment period. The initial appraisal would represent the agreed-on price at which the new practitioner would be able to purchase the practice. By creating a baseline practice value, the junior optometrist knew the purchase price from "day 1" and would be motivated to make the practice worth more than that baseline 2 years later at the time of the agreed-on purchase date. Establishing an initial price essentially provides instant motivation for the new practitioner to grow the practice.

Almost as important as that basic salary and purchase agreement was the assignment of specific responsibilities to the new practitioner. For a variety of reasons, relationships between established practitioners and their new associates often fail. Senior practitioners may fail to explain the workings of the practice, specifically assign responsibility, or, most importantly, firmly establish in their own minds what they want their junior optometrists to accomplish. Junior optometrists, newly introduced to the working world, may not know just how much work is required to maintain a practice. In this case, the contract provided a specific list of responsibilities for the new practitioner. Responsibilities were assigned to the new practitioner in terms of both geographic location and job function. It was decided that the senior doctor would remain primarily at 1 of the practice's 2 offices, and the new practitioner would be given responsibility for the other. However, the new practitioner was also assigned a number of specific areas of responsibility related to the overall practice: performing some office management tasks, weeding out poorer paying insurance carriers, organization of some of the office meetings, weekend and after-hour coverage, and time-consuming outside-the-office

care in nursing homes, patients' residences, and specialized care facilities.

Performance appraisal

This very specific outlining of the new practitioner's responsibilities facilitated a 2-fold performance appraisal program to objectively track the new practitioner's *tangible* (that is to say, monetary) and *intangible* (that is to say, time savings) contributions to the practice. The appraisal program tracked 2 factors:

Production

Average production figures for the practice were calculated for the 5 years before the junior practitioner's arrival. Production figures would then also be compiled for each ensuing year. This would allow for the objective measurement of practice growth attributable to the junior partner. Moreover, it would allow the senior practitioner to set specific practice growth goals for the junior practitioner and allow the junior practitioner to show when the benchmarks were met.

Time savings

Similarly, the hours worked by the senior optometrist before the arrival of the junior optometrist were noted. They were later compared with hours worked after the arrival of the new associate. This allowed an objective determination of just how much time the junior practitioner was saving the senior practitioner around the office by attending to various administrative functions. The term *negative production* was coined to describe work the senior optometrist was no longer required to perform as responsibilities were taken over by the junior optometrist. In this case, the senior optometrist reported his working hours had been reduced by a third, allowing him to spend more time concentrating on the aspects of practice that he enjoys the most.

Even with such objective measures in place, performance appraisals for new optometrists can be a source of disagreement within a practice. Senior practitioners should understand that practice gross revenues and patient counts may not spring up immediately when a new practitioner joins a practice; in fact, they may go down. New optometrists will take some time to learn how to provide care and perform administrative functions efficiently. Even when new practitioners aggressively work to bring new patients into the practice, it will take some time for their efforts to produce results.

The contract also included an "exit clause," applicable if either party became dissatisfied with the arrangement. However, through the periodic evaluations, the junior optometrist was able to objectively demonstrate that he was meeting or exceeding specified performance criteria. The new practitioner selected the option of full ownership in the satellite practice. The new and senior optometrists set out to arrange financing and complete the sale of the office at the agreed-on price. The exit clause was never invoked.

Financing—the problems

Optometrists often consider financing to be a problem when it comes to the purchase of a practice. In attempting to secure a loan for the practice purchase, the established optometrist and new practitioner faced several problems commonly encountered by those who are attempting to sell or purchase a practice. Fortunately, in this case, the senior and junior practitioners responded with creative solutions that allowed the sale of the practice to become reality.

Setting out to arrange financing for the purchase of the practice, the new practitioner was confident he would find lending institutions anxious to arrange a loan. The practice was well-established and successful, and the senior practitioner was highly regarded in the area. However, the prospective practice purchaser was surprised to find virtually no interest among area banks in financing the entire purchase arrangement. Ironically, practice good will, which new practitioners generally consider to be the greatest asset of an existing practice, is considered to be of virtually no value to commercial lenders, the new practitioner found. (For the purposes of this article, “good will” is defined to include all of the intangible assets of a practice such as an established patient base, widespread knowledge in the community of the practice’s existence, and the practice’s active patient records.) Area banks were interested only in providing loans for the purchase of the tangible assets of the practice (although tangible assets represent only a modest portion of the true value of a well-established optometric practice). In fact, the new practitioner found that it would have actually been easier to obtain a commercial loan for the start-up of a new practice than the purchase of a successful existing practice with a 15-year track record. Bank officials also expressed concern that the new practitioner had not independently managed a practice, despite the success of the satellite office under his management.

In this case, the tangible assets of the practice consisted of the ophthalmic equipment in the office to be purchased. (Real estate was not included in the purchase. *See* Box.) At the request of lenders, the equipment was appraised independently by a well-known appraisal company using the standard 3-tier format (purchase price, current market value [CMV], and replacement costs). Lenders extracted from the appraisal the CMV of the equipment, offering to loan 80% of that value. Clearly, 80% of the CMV of the practice equipment did not represent a fair purchase price for the practice. Had real estate been included in the transaction, the banks would have had additional tangible assets to consider and would have ultimately been willing to lend more money; however, the loan amount still would not have covered the agreed-on purchase price for practice.

The new practitioner could have probably obtained financing from one of several national firms that specialize in loans for health care practices. However, local banks were generally offering lower interest rates and more favorable terms. Besides, the new practitioner wished to establish a relationship with a local bank to facilitate the eventual

securing of additional loans that might be necessary for anticipated real estate purchases and the establishing of a planned second office.

Financing—the solutions

With commercial lenders apparently not willing to lend the agreed-on price for the practice, the junior and senior practitioners were left with 1 alternative: self-financing the bulk of the practice purchase. Bankers suggested the senior practitioner self-finance the purchase of the goodwill portion of the practice assets. Bank financing could then be used to cover the purchase of the practice’s tangible assets.

To facilitate such an arrangement, the junior and senior optometrists worked out a 2-year extension of their contract, this time incorporating a unique “work-to-buy” agreement. Under the new agreement, the junior practitioner would continue to manage and operate the satellite office and begin to receive his salary solely from the funds generated in that office. In turn, the practice good will would be financed by the senior doctor, and a monthly payment would be required from the junior doctor. At this point the ownership of the satellite was with the junior practitioner, and the ability to service the practice debt would be based on the money generated under his management.

This “work-to-buy” arrangement would allow the junior practitioner to complete the purchase of the practice good will by the end of the 2-year purchase extension. Bank financing could then be used for the purchase of the practice’s equipment, and the sale of practice would be complete. The junior and senior optometrists drew up papers for a work-to-buy arrangement.

The extension would mean some extra time before the junior practitioner could take total possession of his own practice. However, it would also offer some benefits. Over the 2-year purchase extension, the junior practitioner developed a solid track record as a practice manager. His practice grew, and he had the financial statements to prove it. He was a much more attractive loan applicant when he returned to one of the banks to arrange financing for the practice equipment. The junior practitioner essentially demonstrated the positive growth of the practice under his control. More specifically, he went over each of the concerns cited by the loan officer during his initial visit to the banks, utilizing the financial statements. Essentially, he was able to take all the commercial lender’s previous “no’s” and turn them into “can’t say no’s” by addressing all of the lender’s concerns one by one. His presentation to the loan officer was favorably received. The financing for the equipment was arranged, and the sale of the practice was completed.

The results

Today, the new practitioner has achieved his goal of becoming a private practitioner. After the 2-year extension of the work-to-buy agreement, he took full ownership of his office at the originally agreed-on price (despite the additional growth that occurred in the previous 4 years). He then

Box

Should real estate be included?

Should real estate be included in the sale of an established optometric practice to a new practitioner? One of the coauthors of this article believes very strongly that it should not be. The other is just as adamant that it should.

Dr. Mohon feels strongly that the purchase of a practice and the purchase of any real estate should be handled in separate transactions. In purchasing a practice, a new practitioner is primarily purchasing the good will (including the patient records) of the practice. In addition, the new practitioner is purchasing the office's ophthalmic equipment. It would be difficult to cover the entire cost of practice real estate through a "work-to-buy" agreement. Therefore, including real estate simply increases the amount for which the new practitioner will have to arrange conventional financing. That means bigger loan payments. Putting off the purchase of practice real estate allows the new practitioner some time to further develop the practice. The new practitioner may also have partially paid off the loans on the practice good will and some education expenses. That means the new practitioner may then be in a better position to afford loan payments on practice real estate. Besides, Dr. Mohon reasons, the purchase of the real estate effectively ties the practitioner to that location. If, for some reason, a new practitioner finds a location is not working out as well as he thought it would, the practitioner will want to have the option to take the practice equipment and move.

Dr. Silverman, however, believes including real estate in the practice purchase offers some valuable protections for the new practitioner. "From my own experience in selling my practice, I can tell you that often the location is a major factor in the success of a practice. Waiting until the successful practice agreement has been signed and then negotiating the real estate portion could be a problem. If the real estate agreement is not to the liking of the purchaser, it could be possible for the seller to either continue charging rent for the office, or even sell or rent the building to another party. In the sale of my practice, the purchaser had an option to purchase the building at an agreed-upon price, subject to the inflation rate as published by the First Bank of Boston, within 2 years of purchasing the practice. I can tell you that the purchaser makes out much better that way," Dr. Silverman said. Moreover, the investment in real estate can offer potential benefits for the new practitioner. "In my case, the building sold for \$125,000 in January 1982, but 7 years later, the purchaser was able to sell the building (by itself) for \$350,000."

obtained a second commercial loan and purchased the real estate on which the office is located. He has even opened a second office with funds secured easily by the commercial lender he had been using. Although he and his former senior doctor now run 2 separate and independent practices, the new practitioner holds the first right of refusal on the senior optometrist's current practice.

In this case study, the new practitioner encountered many trials and tribulations in his quest to become a private practitioner. However, by starting early, conducting a methodical search for the desired practice, establishing the option for practice partnership and purchase as a criteria for employment, clearly defining his duties (including targets for practice growth) in his employment agreement, proving his performance through periodic reviews, and utilizing a work-to-purchase arrangement to finance the bulk of the practice purchase, he was able to prevail.

The new practitioner was able to begin developing his lifelong private practice immediately after graduating—without years in an interim career. The senior practitioner was able to ensure that he can sell his practice, realizing a reasonable return, while also realizing increased practice revenues over the short run, because the practice had a motivated junior optometrist with a vested interest in building the practice. There is significant difference in motivation between an OD who is just looking for a job and an OD who is looking for a partnership opportunity or an opportunity to purchase.

The new practitioner's experience shows that there are workable solutions to the increasingly serious parallel problems of new optometrists unable to find a private practice to purchase and established practitioners who are unable to sell their practices at retirement time. The factors that have created these problems are not likely to go away. Established optometrists are in most cases going to continue to desire to sell their practices at retirement. The way to address these issues is for established and new practitioners to work together to develop solid working arrangements and creative agreements for practice transfer. Practitioners who wish to sell their practices, or take in an associate who will eventually become a partner, must be fair as well as be able to develop creative methods of enticing these graduates to consider private practice, rather than employment. In this case, without the senior optometrist's willingness to explore such creative avenues, the purchase would have probably fallen through.

References

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