

Practice valuation

Quentin Skinner, chairman of **DPAS** Ltd, discusses the importance of valuing your practice in the current financial climate

At some point, most dental practice owners will need to determine the value of their practice. Formal valuations are essential for practice sales or purchase – as well as for partnership changes, incorporations, re-financing, tax negotiations, probate or divorce settlements.

Inevitably, the nGDS will significantly change the way that UK dental practices are valued. Such changes will have important consequences for both those dentists considering selling their practice as well as for those buying practices. Dentists should also be wary of these changes, as they are currently in danger of overpaying.

An understanding of the real issues of valuation, while being hugely significant to predominantly NHS principal dentists, is also extremely relevant to largely private dentists if they view the capital value of the business asset that they have built up over the years as important.

NHS dentists

First of all, let's examine the position of a wholly NHS practice. Naturally, since dentists themselves are responsible for financing the provision of the practice assets, recent contract changes do not have any particular bearing on the valuation of surgery premises, stocks and depreciated value of surgery equipment and fittings. However, where the changes have happened – even if the extent of them and the appreciation understood of them in the marketplace has not yet caught up – is in the value of patient goodwill.

Often one of the most valuable parts of a practice's worth, NHS patient goodwill value has been expressed traditionally as a percentage of practice turnover. This made perfectly good sense when almost 100% of dentistry was delivered under the NHS. Where the provision of all dentistry was remunerated on the same fee scale, it made sense for practices generally to be valued on the basis of turnover, with the valuers taking an expert view of any reasonable (often geographical) variations according to the likely resultant variance in overheads – central London naturally being significantly different from less affluent, far-flung areas.

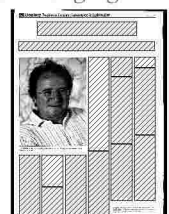
However, things have changed significantly over the last decade or so. No longer is dentistry delivered wholly under the NHS. Indeed, in turnover terms, it has halved, and the introduction of non-uniform private fee structures – based upon market forces' take-up of varying private dentistry pricing, service levels and efficiency – presents a completely different playing field in practice valuation. Now, there are hugely different patient outcomes which are arrived at with hugely different resultant turnover and, importantly, profitability.

Ask any corporate financier how a business should be valued, and they will say that it obviously must be based on profitability and return on investment, rather than turnover. Boots' foray into

corporate dentistry resulted in ever-growing losses as its turnover increased – not exactly a successful business model to build capital value! So as the move to independence increases, hugely significant in revenue terms if not so much in patient numbers, the time has come for patient goodwill value to reflect the following:

- Relationship control between practice and NHS patient – something enormously diminished as a result of the new contract.
- Goodwill value in any normal business reflects the likelihood that existing customers will return in the same frequency for a similar pattern of profitable business as before. This is now no longer the case with NHS dental practices, although it is with private dental practices. Some of the new high-needs patients sent to practices by their PCT may use up considerably more in resources than the corresponding UDAs are worth – how does that provide any goodwill value?
- Practices that move from the NHS to largely private fee-per-item (PFPI) funding often feel that this is a sensible cost-effective option. However, this route has many disadvantages. Very often, when a move to PFPI is instigated, fee rates are under-priced, leading to a revenue shortfall at a time when patient expectations of 'private' practice rather than NHS practice produce expectations that are likely to incur significantly higher practice overheads.

- When practices change to PFPI, they may experience significant reductions in patient attendance frequency (often rather more than expected) – impacting negatively on the anticipated cash-flow from regular patients. A monthly-paid dental plan funding structure maximises the likelihood of regular patient attendance, optimising practice revenue.
- The concept of goodwill rests on the basis of the loyalty of a customer base towards a business. Where private dental plans are used as a funding method, national branding of such plans and interference in the dentist/patient relationship can prise away patient loyalty from the practice to the national brand. Funding dentistry via someone else's brand must have a depressant effect on goodwill value.
- Practice-branded plans are less risky than nationally branded plans, as they stand or fall on their own merits, and are not affected by the welfare of other practices. They avoid the patient perception under a nationally-branded plan that somehow membership of the plan – or as most patients think, their dental insurance – somehow guarantees their oral health. Whereas a nationally-branded scheme brings the risk that a retiring dentist may be pressured by the scheme administrator to refund a purchaser alleging



supervised neglect with possibly the entire patient goodwill value, this does not happen under practice-branded plans. This rather stark fact dictates that the goodwill value of the latter is considerably higher.

- The last consideration, and from an accountant's view the most important when it comes to valuation, is profitability. When regular patient attendance is maximised by dental plans (capitation, maintenance, membership, etc), goodwill value must be placed higher than mere PFPI. Such a regularity of attendance, where patients know that they have already paid to be seen regularly, presents a more frequent opportunity to carry out necessary restorative treatment and to offer higher margin cosmetic work.

- Having said that, in the light of comments above about the importance of profitability rather than turnover, those practices with substantial private dental plan patient numbers producing the highest profitability must surely produce the highest worth for any practice.

- Dental plans that offer best

value for money inevitably increase profitability and thus goodwill value. There is no sense in paying for additional 'consultancy services' that will be of no value after the first year of conversion.

The current situation

Currently, the value of NHS goodwill remains defiantly high, despite the obvious underlying common sense that this should not be so. The position is exactly the same as the latter part of the South Sea Bubble, the Dutch Tulip disaster, and the dot.com boom and bust in 2000. The thought that somehow the corporate chains will inevitably be bidding up the value of NHS contracts has no intellectual truth to it, as any related benefit of volume is naturally eliminated by corresponding UDA price reductions. Evidence abounds of PCTs forcing down UDA values by competitive tendering on any opportunity to agree a contract variation.

The corporate chains do not have limitless purses, are generally heavily indebted, and while they might buy short-term relief in revenue growth, they will inevitably

see their margins continually squeezed by cash-strapped PCTs. There is a limit to their re-financing capacity, especially as financial markets realise how much of their loan finance is tied up in potentially overvalued so-called NHS goodwill value. In the current circumstances of a global credit squeeze, any bank lending money to individual dentists to cover NHS goodwill, quite frankly, should urgently reconsider.

Retirement and relocation planning

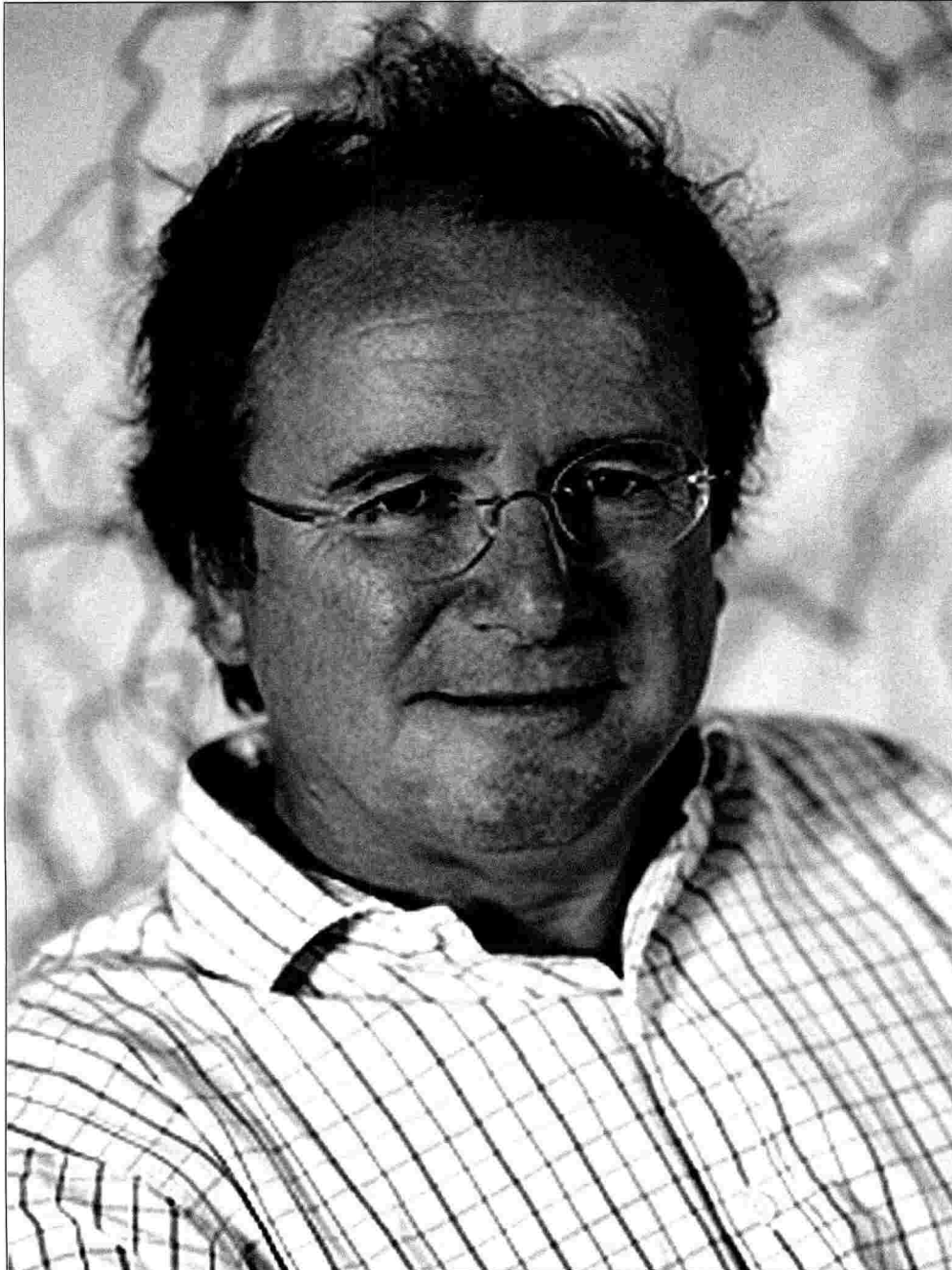
Of course, while regular revenue continues to flow in, the capital value of patient goodwill may not be an immediate concern if NHS clawback is not yet raising its ugly head, and if private dentists are happy funding their dental practice by means which are not the most cost effective. However, for those dentists who are planning to retire in the next few years, or indeed who are thinking about relocating and selling up, the amount received in respect of patient goodwill could be hugely important.

Without a doubt, they should be planning their exit

from the NHS now, rather than relying on any NHS goodwill value to come in as a lump sum. They should be looking to move to private dentistry, in a fashion that maximises patient attendance and loyalty to their own practice brand, on the most cost-effective basis that yields the best ongoing profitability for the practice. They should be reassured that all of the research and actual experience of those who have made the move before them shows that the large majority of their regular patients are, and remain, loyal to the dentist and the practice team, rather than to the funding method.

Don't leave it too late

Above all, the most important point is to avoid leaving the planning of any move – whether from NHS to independence, or from more expensive and less profitable private funding to the optimum solution to maximise patient goodwill value – until the last moment. Rather than jeopardising the potential value built up over the years, there is nothing to lose by starting to act now. ■



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DPAS is a leading administrator of practice-branded private dental plans. For more information, please contact DPAS on 01747 870 910 or visit www.dpas.co.uk