Selling To Your Associate, Will It Work?

BY TIMOTHY A. BROWN

In today's market many associate health care practitioners who are working in a great practice suffer from the proverbial greener grass residing elsewhere. They are hedging their bets and want one foot in the door at their current office yet, they are still out on the road looking at practices for sale through brokers or practices that may be for sale privately by the owner. They are certainly talking to health care sales representatives or commercial lenders who are strongly encouraging them to set up a brand new practice in a brand new location. Needless to say, these advisors have a significant interest in a brand new setup because they can help with the financing, buildout and all the brand new equipment, cabinetry and other technical installations required.

Our company often receives a call from a principal who says "I have an associate and they have told me they want to buy my practice. I need an appraisal, but I will not need your services for brokerage because I'm planning to sell to my associate".

In some instances this works out brilliantly, but there are many failures.

Let's look at this from the associate's perspective first. They have absolutely nothing to lose by expressing an interest in buying a practice they may be working in. The owner normally pays for the appraisal so the associate has no out-of-pocket expense. The owner must go through the appraisal process and then eventually reveal all of their private financial information to the associate that was normally unknown until this point. The associate is usually given one or two months by the principal to talk to their advisors and then they are encouraged to make an offer. What does the associate have to lose in this process? The answer is absolutely nothing and quite frankly they have everything to gain.

Let's look at this process from the owner's perspective. If they are negotiating directly with their associate and it is successful, they don't have to pay a commission to a broker. They will pay legal and accounting fees and they are probably a little higher than if they used a broker, but nonetheless, the commission is not payable and the owner receives a significant cost saving by going through this process.

Now let's look at what actually happens in the mindset of the associate as this process commences. The first thing the associate thinks is that because they are not competing with the open market and other buyers they are in distinct strategic advantage position. The truth is they are. And more importantly, the advisors to the purchaser will tell them "If you're not competing with other buyers, you're in a great position". The reason being is that the advisors will recognize that the lack of competition will always yield a lower sale price. Accountants and lawyers have admitted this to me on many occasions.

The associate reviews the appraisal that the owner paid for and thinks, "If I'm not competing I might as well offer 5-10 per cent less than the appraisal because the owner doesn't have to pay the commission". As well, the associate will often begin to promote the concept that because they helped the principal to build the practice to its current value, that they feel entitled to a special purchaser discount, which could be another 5-10 per cent, if not more. I don't blame the associate for taking this approach and it is a natural conclusion to a one-buyer only circumstance. The above scenario details how most respectful and well intentioned associates tend to appoint themselves. There are some instances where we will meet outrageously entitled associates that want to take credit for massive portions of goodwill and see themselves as overly responsible for the success of the clinic.

Any successful associate will rightfully feel that that they have contributed to an owner's success. This is true but they must understand that they got paid for their efforts and they at no point shouldered any of the risk associated with running a successful enterprise. Actual ownership responsibility is the only thing that entitles you to equity and it takes a special individual to shoulder and own the physical and mental burden associated with owing a successful clinic.

What happens from the owner's perspective at this juncture? He or she feels that the practice valuation was a fair, independent professional appraisal and on the principal of pride alone, struggle to fathom why the associate would take such a position. Why should they sell to their associate at 10 or 20 per cent below fair market value? This is where things start to break down.

I call this an accidental insult. The associate, who is trying to maximize his or her position, means no disrespect to the owner, but they have accidentally told the owner "Your practice is worth less to me than it is to somebody else".

I know many practitioners who have spent 20-30 years of extra time and invested a great deal of sweat equity who are very proud of what they have created in their practice/business. They feel at this stage in their career that they are entitled to maximum value of the practice.

The result - the associate has accidentally insulted their principal.

In some cases a breakdown of relations occurs and the associate may quit or be terminated by the principal. If they do continue to work together, it is obvious that tensions may increase because now the owner knows that the associate knows every financial detail and it makes them very uncomfortable in a long-term, continued relationship.

This is why more than half of these associate buy-in negotiations will fail. I don't blame the practitioner. I blame the advisor group seemingly giving good advice to their clients, but the end result is accidental insult. Should we expect the aforementioned advisors to appreciate the delicate line between accidental insult and successful deal? Probably not, after all, their responsibility is to their client and providing advice within a client relationship. These professionals are the ones that with will have decades long relationships with the soon to be owner and given the premiums that offices currently command, I can see how shaving off a couple of thousand dollars, to up future cash flows would certainly look like a no brainer when creating a business plan.

If my associates were to approach me to sell my company, I would take the position that it is worth what it is worth in the open market. If I decided to give any discount because of their contribution, it would probably be very minor. Regardless of whether I choose to use a broker or not, the value is the value and the costs of disposition are mine to bear alone and I do not feel I have to share that with the purchaser.

In conclusion, if you own a practice and your associate has approached you to buy it, prepare yourself. While the associate may not be disrespecting what you have accomplished you are likely to feel this is, in fact, the case. Selling an office is an exposing experience, regardless of whether you decide to sell to an associate or on the open market. This may lead to ill feelings and the dissolution of your relationship with your associate.

Selling an office is an exposing experience, regardless of whether you decide to sell to an associate or on the open market. This may lead to ill feelings and the dissolution of your relationship with your associate.

BOTTOM LINE: The author provides tips regarding selling a practice to associate.

Timothy A. Brown
Timothy A. Brown is the CEO of ROI Corporation, Brokerage. His company provides a wide range of services for health care professionals and business owners, including practice/business sales and appraisals. He can be reached at **timothy@roicorp.com** or at 905.278.4145.