Buying into a large animal ambulatory practice: The good, the bad, and the finances

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Abstract

Most large animal ambulatory veterinary practices are owned by 1 or more of their practicing veterinarians. For associate veterinarians who aspire to be practice owners, there are several areas which should be investigated before purchasing a share of a business. The advantages and disadvantages associated with ownership should be recognized and considered heavily. Having a working knowledge of the business finances, partner pay structure, decision-making process, and ownership contract details makes for an informed buyer. Before purchasing into a veterinary business, it is important to understand what is included in the purchase price and how the purchase will be paid If financing outside of the current business owner(s) will be used, there are several requirements that must be met to be considered eligible for a business loan from a lending institution.

Key words: practice ownership, debt, veterinary business

Introduction

Practice ownership is a large decision, both financially and emotionally. To make a wise decision, the aspiring owner should have a clear understanding of the advantages and disadvantages of ownership in general. They should research the business to be comfortable with whether it will align with their professional and personal goals. An understanding of what is being purchased at the buy-in and how to finance the endeavor is also pertinent information to be discovered before purchasing. It is this practice owner's opinion that obtaining information in these areas will allow an individual to make a well-informed decision on their future as a practice owner in a large animal ambulatory veterinary practice.

Advantages of Practice Ownership

Practice ownership offers an individual the ability to have a direct impact on the direction of the future of their practice. An ownership share gives an individual the voting right to influence upcoming changes in their business and allows more control over their own outcome. In addition, veterinarians typically see a significant increase in net income after practice ownership is achieved. Veterinarians early in their career (21 to 34 years) see an average of 1.35X and 2.11X increases in average salaries for women and men, respectively. Mid-career (35 to 44 years) and late-career (45+ years) veterinarians also see increases in average salaries ranging from 1.1X to 1.7X higher than their associate counterparts.[1]

A sense of pride and self-satisfaction in one's business is another benefit of practice ownership. A 2020 AVMA economic study found that practice owners have statistically significant lower values for burnout scores and secondary traumatic stress cores than their associate colleagues. They also have statistically significant higher compassion satisfaction scores than associates.[2]

Disadvantages of Practice Ownership

Alternatively, there are several disadvantages associated with practice ownership. The most easily realized disadvantage is the purchase cost for the ownership share, which usually includes monthly debt service payments.

Due to business cash flow fluctuations month over month and year over year, the owners can expect to see variations in owner pay. This may be drastically different if they were accustomed to a guaranteed and consistent monthly salary as an associate. A veterinary business's shareholder pay structure can include production, salary, or a hybrid pay system. Any of these structures along with the frequency of owner distributions has the potential to change the level of volatility in partner pay. A veterinarian's tax liability can be also different and potentially higher as a practice owner. This is strongly dependent on the business tax structure and should be discussed with a professional tax advisor before entering ownership. All of these financial changes can drastically affect a veterinarian's household cashflow situation and should be planned for in advance.

In addition to the fiscal repercussions, emotional investment in the practice after ownership can be significant. Dependent on an individual's personality, they may find ownership to increase stress levels due to their new ownership responsibilities and liabilities.

Considerations in Choosing a Veterinary Business

There are several considerations that need to be investigated and understood before deciding to purchase a share in any specific veterinary business.

Personal Considerations

The first is to evaluate whether the practice culture is a good long-term fit for the individual's professional and personal goals. Attention should be paid to how the partner(s), clientele, business values, and mission statement will interact with the veterinarian's professional goals. In many cases, these are all aspects of a clinic that are difficult for the new owner to significantly change. Thought should also be put into whether the local community and schools, geographical area, and personal connections align with the individual's long-term personal interests and goals.

Business Considerations

An analysis of the veterinary business should include details on how the business is managed and how profitable it is. This entails an understanding of how and when the shareholders are paid, what the business's financial status is, how decisions are made, and how an owner can leave the business.

Regarding partner pay, there are many variations of pay structure which may include salary, production, or a hybrid pay structure which includes both <u>pro</u>duction and <u>sal</u>ary (also called "ProSal"). The way in which these values are calculated should be completely understood by an individual who will be paid from such equations.

General knowledge of the business's current financial situation is imperative before buy-in. This should include transparency from the current owners and a review of the tax and financial statements by a third-party financial advisor.

It is recommended that the individual buying into the practice has been privy to conversations involving practice decisions, including owner business meetings. Understanding how decisions are made and having an insight into upcoming changes in business expenses, incomes, or policies are important for the soon-to-be shareholder as these will have a direct impact on them. The final business consideration that should be evaluated is what the contract and buy-sell agreement will entail when a partner leaves the business. Scenarios within the contract that should be evaluated are divorce, disability, death, removal of a partner, and a non-compete clause. A lawyer representing the purchasing veterinarian is strongly recommenced to protect their interests.

What is Purchased at a Buy-in?

Veterinary private practice buy-in includes the purchasing of 3 items: assets, accounts receivable (AR), and blue sky (also called goodwill). Assets are the tangible items of value, including trucks, products, equipment, and possibly the associated real estate. Accounts receivable is the money owed to the business which is typically outstanding client bills from work done in the previous month(s). The buying veterinarian should know how much of the AR is current and how much is from delinquent clients. Receipt of payment from a bill that is 2 years overdue is highly unlikely and should be considered and valued accordingly when calculating an AR buy-in value.

A business's blue sky is its potential to generate revenue in the future. This can include the current client list, pre-scheduled appointments, and the practice's reputation. Differences in business structure and philosophy allow for significant differences in the value of blue sky across veterinary practices. Knowing the value of blue sky upon entrance and the eventual exit from the practice is important for the individual to be knowledgeable on. The blue sky can also be viewed as a future liability, as the new owner will be expected to help fund payment of this value to any outgoing partners. If a young associate becomes owner with 3 other owners who are all near retirement, that individual should expect significant blue sky buy-out expenses in the near future. Therefore, it is beneficial for the buying individual to find a practice with historically low turnover rate in owners and for there to be diversity in the ownership age demographics.

How is Practice Ownership Financed?

Most veterinary practice shareholder buy-ins include a loan for the purchasing individual. This can be achieved by an "in-house" loan, which is financed by personal loans from the current owner(s) of the business, or an external loan, which typically comes from a lending institution such as a bank or a credit union. An in-house loan offers significant flexibility in many areas including rate, down payment, and amortization length.

When working with a bank, there are several parameters lenders may look for in choosing to loan money to a veterinarian buying into an ambulatory practice. Because these practices have relatively low amounts of tangible collateral, it is considered a "cashflow dependent loan." This means the individual must be able to demonstrate their ability to support their total debt service within the means of their proposed wages. This type of loan is commonly a Small Business Administration (SBA) 7(a) loan[2] which is partially guaranteed by the federal government for up to 85% of the loan value. Due to the nature of this loan, it is important for the individual to not be delinquent on any existing debt obligations to the U.S. government (including student debt)[3] and have a debt-to-income ratio of ≤ 45% using their expected ownership financial numbers.[2] For associates who aspire to become practice owners, achieving these requirements as well as proving to the bank that they can save money and pay down debt are action steps to take as they work towards ownership.

Conclusion

There are many facets in the decision to buy into a large animal ambulatory veterinary practice. It is recommended that the buyer have a clear understanding of advantages and disadvantages of practice ownership. Such an individual should pay close attention to the business they choose to buy into, know what they are purchasing, and realize the types of financing options available. Having knowledge of these areas paired with the help of professional tax and legal advisors are this veterinarian's suggestions to being a fully informed buyer.

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