ADDING A PARTNER – HOW MUCH SHOULD YOU SELL?
July 2019

There are many reasons to consider selling a partial interest in the practice to one or more of your employees. The most common reason is for succession planning. Ideally, practice owners begin planning how to sell their businesses many years before they intend to do so. There is no question that it is an ideal situation for the owner to have a valued internal buyer who has an existing relationship with the practice, the clients and the staff.

But it can be hard to get the timing just right. Adding a partner may not even be on your radar when the perfect associate comes along. If you aren't ready to retire, but you already have the ideal buyer on your staff, offering a small ownership stake now may be the perfect way to reward a valued employee and begin the process of slowly mentoring this person to become an ideal practice owner.

Or you may be ready when that perfect associate has family responsibilities, or other priorities that make becoming a practice owner seem impossible. Begin the conversation with them and talk about why you became an owner and what it has meant to you. If appropriate, send links to articles about the benefits of hospital ownership. Just don't sugarcoat things! While the benefits are many, it takes hard work and some sleepless nights to be a business owner.

How much of the business should be offered to an associate?
It can be a difficult decision, particularly because the best interests of the buyer and the seller seem to differ. From a purely financial/business perspective, it is prudent for the seller to keep as much of the practice to herself as possible to maintain control and keep the lion's share of the profits. However, buyers usually want to acquire as much as possible in order to have more control and receive a greater financial advantage.

Let's look at this from both perspectives.

Seller perspective
From the perspectives of money and control, you may wish to sell the smallest piece possible to secure the buyer as a partner. Why? When you sell a minority share of your practice, the price is lower than it would be if you sold the whole thing. Someone buying the entire practice has control over the money. They can change compensation and benefits, change the mix of services, hours of operation, anything and everything. In contrast, a minority owner can't do anything of significance without the approval of the majority owner. If the buyer can't control the money, they can't pay as much for the practice.

Certainly, the other significant factor is control. When you are the sole owner, you can pay yourself in whatever manner you choose, take additional vacation time, attend the conferences that you wish, take the family with you when you want, all without the need to explain your decisions to anyone but your tax accountant. When you have a partner, they are part of those decisions. Can you both take extra vacation time? Who covers the cost if families travel? Even when you have the final authority, you have to consider that you aren't the only one affected by your business decisions.

Buyer perspective
One of the biggest reasons to become a hospital owner is having the ability to make the practice an expression of yourself and your values. One of the other big reasons: money. As an owner, you have the rights to a portion of the profits from the business. At first, this money will go toward your payments for acquisition loan. Payments will not come from your compensation *for clinical duties*. Therefore, you can continue to make student loan payments, car payments, house payments, etc., while financing the purchase of the hospital.

There is an inherent risk to this plan, however. What happens if profits decline? The payments for the practice will still be due, even if profit distributions are minimal. What if new equipment needs to be purchased or there are substantial unexpected repairs? While some protections can be built-in to the partnership agreement in regard to decision-making for capital investments, there is no guaranteed level of profit distributions. In fact, there is no guarantee that you will receive any profit in a given year.

In the best case scenario, your share of the profits covers your loan payments. As the business grows, your profit distributions will increase while your loan payments stay the same. That means you can use the money for other things, like a vacation or paying down your educational debt.

In the worst case scenario, profits will decline, and you will need to find another way to make your loan payments. This is why it is essential that you carefully consider the percentage to buy. You may want to buy the biggest piece possible, but understand the additional risk you assume with a large piece.

If you buy 30% of a practice valued at $1.5 million and finance 100% of the price, your monthly payment would be ~$4,900[1], for a total of $58,600 per year. How much of that $58,600 could you come up with on your own if you had to? While we hope you would never need to come up with that entire amount, consider what you would need to do if it happened. How long could you come up with an extra $4,900 per month before it created a burden for your family?

If you buy 10% of the same practice, your payments would be $1,630/month, for a total of $19,560 per year. These payments represent significantly less risk to you as a buyer. And honestly, there isn't much difference between owning 10% and owning 30% when it comes to the control you have over practice operations and spending. Unless your owners' agreement says otherwise, your partner can veto your ideas.

Preparing for a partial sale
Both buyer and seller must prepare for a partial-interest sale. Since you get along well with each other (at least we hope you do!), you may think a "handshake agreement" is all you need. Think again. An informal agreement does not serve either party (or the practice) well. While no one ever expects a partnership to turn sour, it is much better to prepare for various contingencies than to assume that nothing will go wrong simply because you get along so well right now.

We strongly recommend that both buyer and seller have their own financial and legal advisors looking out for their specific interests. Never allow the other party to pressure you to sign an agreement before your advisors have adequate time to review it.

Have the practice professionally valued by a credentialed valuator with experience in the veterinary arena. This way, both the buyer and the seller can be assured that the price being paid is fair. A valuation helps to reduce the risk assumed by the buyer while assuring an appropriate return on investment for the seller.

Plan ahead because private sales take time. If you want the transaction to occur at the end of the calendar year, allow enough time for the valuation and for legal counsel to draft the relevant documents, such as owners' or partners' agreements, employee agreements and loan documents. Once the valuation is complete, it will take a month or more for both sides to approve all of the paperwork.

If the current practice owner also owns the real estate, a formal lease must be in place between the hospital and the property company. Often, minority buyers do not acquire a portion of the real estate when they buy part of the practice. A lease protects the buyer from unexpected increases in facility rent that could consume the profit needed to pay for the practice buy-in. The lease should include renewal options and annual adjustments for inflation.

Depending on the size of the practice, the owner or the owner's spouse may handle the finances from home. Before a change in ownership occurs, be sure all parties have access to financial information. In addition, the practice's books should be maintained in business software like QuickBooks, not in a personal package such as Quicken or Mint.

Summary
Whether you are a practice owner wishing to offer partial ownership to an associate or an associate ready to buy a piece of a practice, taking the next step requires significant decision-making. As the owner, you must decide how much of your practice to sell, when, to whom and at what price. These are huge decisions with significant impact on the remainder of your career. As the buyer, you must weigh the risks and rewards of practice ownership in general plus those of owning a specific hospital. At first glance, the goals of the buyer and seller may appear to conflict, but in the right circumstances, a win-win result can be achieved.

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[1] Assuming a loan at 5.5% interest over a 10-year term.