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Should you buy a no-lo practice?

By Leslie A. Mamalis, MBA, MSIT, CVA

Don't automatically rule out a profit-challenged hospital. The problems, from a less-involved owner to poor inventory controls, might be easily correctable.

With so many practices being sold to corporate consolidators, private practice veterinarians might have a harder time finding a hospital to buy. If the asking prices for the "best" hospitals are out of your comfort zone, should you consider purchasing a no-lo practice? The VetPartners Valuation Council coined the term "no-lo practice" to describe practices that have no value or exceptionally low value.

Many factors could be responsible for a veterinary hospital's producing no or very low profit. Some of these are fixable and others can be tough to change without significant investments of time and money. What's critical to consider when deciding whether to buy a no-lo practice is directly related to what led to the reduced level of earnings. Let's go through some examples.

Shrinking Revenue

I have seen some hospital owners, particularly those in single-doctor practices, begin to treat the clinic more like a hobby than a business. As the owner starts to pursue interests and lifestyle changes he plans to enjoy in retirement, he spends fewer days in the hospital. He might start working one less day a week and gradually schedule more and longer vacations, shorter hours and less-aggressive treatments.

Given this pattern, the revenue drop is probably a function of the seller's reduced availability to see patients. He might exude confidence that a buyer can recapture revenue by being open more hours. Is that a realistic argument? Unless the practice is booking weeks out, regaining revenue isn't as simple as returning to "normal" business hours. Clients and potential clients who couldn't get in quickly might have been lost to competitors.

Industry studies show that veterinary clients are very loyal to the practices they patronize. For lost clients, whatever loyalty they had to the no-lo practice has been transferred to another hospital. In the absence of a bad experience, unless the no-lo practice is much more convenient than the new practice, lost clients will not be motivated to return.

If the revenue reduction is tied to a condition that has been resolved, the situation is more promising. The practice might have lost a doctor and had difficulty finding a replacement. Or, if major property damage occurred, part of the practice might have been off-limits for months while restoration occurred. If the decrease in revenue is easily explained and is just as easily remedied, the cause for concern is less.

Higher Cost of Goods Sold

Often, expenses creep up when no one is paying attention and can be exacerbated when business is slow. This is especially true for inventory and other cost of goods sold (COGS), or items and services the hospital purchases to provide veterinary medicine. Quantities of inventory on hand increase because order levels haven't changed even though the practice isn't seeing as many patients as it used to nor selling as much dog food.

Complacency might be partly to blame for increases in costs. Supplies might not have been shopped for months, even years. Perhaps no one negotiated lower prices from reference labs, or poorly trained staff members are using excessive supplies. Product sales have much higher levels of COGS than services do. If a doctor isn't present every day to provide professional services, the practice might be highly reliant on product sales.

Correcting these situations is straightforward: Modify reorder points, reduce the level of inventory on hand and actively price-shop. These tactics are time-consuming, and the buyer might get pushback from the inventory manager, but the problem fixable. Also, a renewed emphasis on professional services will naturally reduce COGS.

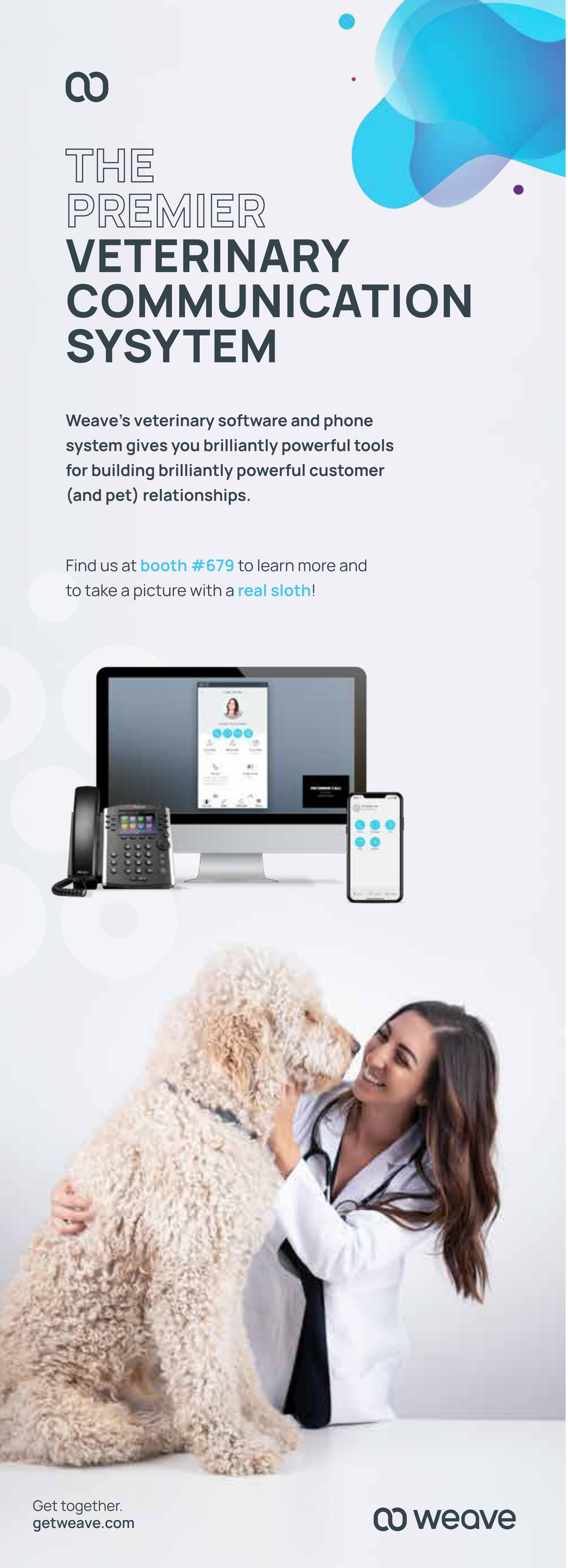
Outdated Fee Schedules

Even when revenue is growing, costs might be increasing even faster. This occurs when costs are too high or revenue too low, meaning the fee schedule hasn't kept pace with inflation. How recently were fees for professional services adjusted? If a buyer must raise fees to stay afloat, how will clients react? How will the staff react? While raising prices might seem like an easy fix, loyal clients could leave if they believe the buyer is overcharging them.

Fat Paychecks

If the payroll is high because family members receive generous salaries, the easy fix is for them to leave when the practice is sold. Otherwise, when payroll costs contribute to a lack of profit, the best solution is to increase revenue, not cut pay. The best way to demoralize employees is to reduce pay. A better option is to freeze pay until you have time to evaluate individual performance.

Some buyers are tempted to ditch legacy employees earning



well above market wages. Think again. With the seller on the way out, possibly taking family members, clients need to see familiar faces when they walk in. The long-time receptionist or veterinary nurse might provide the reassurance necessary to keep some clients.

The Hospital Itself

A clinic won't affect profitability unless it is so small that the practice is unable to grow or if the rent is too high when compared to gross fees. If the building is too small and no good option exists to expand or remodel, there is no easy fix. When the practice is already a no-lo and the building limits growth, this is a deal-breaker.

The second situation, where rent is too high compared to revenue, ties into the discussion on shrinking revenue. How quickly can you increase the number of appointments on the books? Unless the landlord is willing to negotiate the rent, the only remedy is increasing gross fees.

Poor Practice Culture

If you think that changing your practice's culture is hard, you're right. What's even harder? Try changing the culture in a practice where no one knows you. You might be the boss, but you are the outsider and haven't earned your employees' trust. Expect active and passive resistance, or even sabotage, to your efforts. Short of firing everyone and starting with new employees, culture is one of the hardest things to change.

Please Don't Leave!

Staff retention isn't directly related to low profits, other than when constant turnover wreaks havoc on the practice. But when you buy a no-lo practice, you will have enough challenges on your hands. You don't want to deal with staff turnover at the same time.

Can you retain most of the staff, or will a mass exodus occur when the seller leaves? If the seller's spouse or child is the practice manager, how long will she stay? Will you lose both a doctor and a manager when you buy the practice? Is someone else learning the practice manager position? Can they step in immediately?

A buyer I spoke with mentioned that the entire staff planned to retire or quit when the sale was finalized. Yikes! Think of the difficulty the buyer would have just keeping the business open. While loyalty to an employer is admirable, losing every staff member would devastate the business. The buyer would not only have to hire and train for every position, but the goodwill associated with having a team in place would be lost.

The No-Lo Opportunity

Veterinarians who wish to own a practice sometimes have a hard time finding a profitable hospital to buy. Don't reject outright the possibility of purchasing a no-lo without first understanding why the profits are depressed. Is it because of mismanagement? Lack of attention? Benign neglect? Each of these issues can be easily addressed.

If the causes relate to the facility itself, revenue or a faulty culture, buyers should understand that these represent long-standing problems that will take time and money to address.

Low-profit practices have low values. As long as the no-lo practice is priced appropriately, you should be able to support the purchase without having to increase profitability to make ends meet. Any improvements in the bottom line will result in increased cash flow you can use to buy equipment, give staff raises or do anything else you wish. ■

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