

WHAT IS YOUR PRACTICE WORTH?

By Andrew M. Malec, Ph.D.

Value of what? To whom? For what purpose?

A practice valuation may be performed for various purposes, including determining value prior to a new partner's buy-in, sale of a practice by a retiring physician, shareholder disputes, divorce, merger, sale to a strategic buyer or hospital, or for wealth management/preservation purposes. A valuation analyst must answer the aforementioned questions in the above since the resulting value is dependent on the purpose for the valuation.

One key value driver to understand in the valuation of physician and physician group practices is the recognition that it is the physician who can perform surgery, admit a patient to a hospital, or order a diagnostic imaging test. Therefore, the starting point in understanding and ultimately valuing a practice is understanding how physician practice patterns impact risk, and ultimately the cash flows of the practice.

In order to properly evaluate the risk and cash flows of the business, the following questions must be answered and understood by the valuation analyst.¹

1. Which physicians are responsible for the current patient volume?
2. Does any physician represent a significant percentage of the volume?
3. What is the expected remaining professional practice term of each physician?
4. Who is the competition?
5. Which key physicians might have compelling reasons to leave the practice? For what reasons?
6. Are there barriers to exit or entry that would deter a departing physician from competing with the practice?
7. What capital costs are associated with the development of a new business?

In addition, there are a number of factors that influence the value of a professional practice:²

- Level and stability of practice cash flow
- Qualifications and work habits of the professionals working at the practice
- Age and health of the practicing physicians
- Practice specialty

¹ Hitchner, James R. *Financial Valuation: Applications and Models*, 2nd Edition, (John Wiley & Sons, Inc.: 2006), pp. 1143

² Ibid, pp. 860

- Fees earned relative to the industry
- Trained and assembled workforce
- Referrals and patient loyalty
- Types of patients served
- Contractual relationships with third-party payers
- Geographical location
- Competition and supply of professionals

First, as one can infer from above, the valuation of a professional practice is not merely computing a number. In fact, the quantification of the value of any practice is the end result of the valuation analyst asking many “help me understand” operational, industry, and financial questions, as well as understanding how the practice is positioned in the economic and regulatory climate for which it operates.

Second, a significant portion of the value of any physician or physician group practice lies in its intangible value, or goodwill, which is defined in the valuation industry as, “that intangible asset that arises as a result of name, reputation, customer loyalty, location, products, and similar factors not separately identified”.³ Goodwill can be further separated into “practice goodwill”, which is the component that is attributable to the practice entity and “professional goodwill”, which is the goodwill attributable to the professional. The split between practice and professional goodwill can become important in divorce, as well as in transaction matters. For example, bringing in an associate and introducing the associate to patients may facilitate the transfer of some professional goodwill to practice goodwill and may increase the price received by the exiting physician. Value drivers such as the qualifications, skills, and work habits of the professional impact professional goodwill. While a trained and assembled workforce, geographic location, patient type, and contractual relationships with third-party payers impact practice goodwill.

It is important to understand the organizational economics and value drivers of the practice, as well as the split between professional and practice goodwill.

What is your practice worth?

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³ *International Glossary of Business Valuation Terms*

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