Taking Care of Business

Life has its ups and downs and, in the case of the our hypothetical medicos can change in an instant. The practice of medicine can be demanding enough without nasty surprises such as a partnership split, a fatal heart attack or a marriage breakup and all have financial repercussions. Expert advice in all these scenarios would seem to be good idea, as is the age-old Boy Scout motto, *Be Prepared.* We put a case to three finance specialists to discover how they would advise these doctors.

Love Hurts

Adam Smith

All sorts of potential disasters emerge from the woodwork when a marriage-made-in-heaven turns hellish. Insurance and estate planner, Adam Smith, gives his take on a situation in which a business partnership is also part of the equation.

Dr Kathy T. is 44 years-old, her husband is also a doctor. The marriage has broken down irretrievably, there are two young children to consider and it's complicated by the fact that the parents are partners in a medical practice.

AS: It's probably best for all concerned to get a formal and watertight grasp of the issues and that, in the above case, means lawyers. Kathy T. should also be paying a visit to an accountant with expertise in legal separation and asset settlement. The latter aspect is vitally important for two reasons: ensuring the children are not adversely affected and to provide a window of opportunity for the viability and enduring value of the business.

If business partners, who also happen to be married, are no longer on the same 'team' one party will probably want to exit the practice in a timely manner. The question is how?

First, let's assume there's a pre-existing partnership in place. This will make the following considerations comparatively simple to resolve.

Notice Period: If a party wishes to leave the partnership within the terms of an agreed notice period it remains crucial to estimate the potential impact on the value of the business. When a relationship has turned toxic a desire to exit immediately is common, understandably. It's worth noting that a hurried and early exit may end up by devaluing the business.

Practice Valuation: How is the practice valued, and when? Most medical practices use a 'multiple of profit' model (including 'Goodwill') assessed at June 30 on a yearly basis.

Practice Consideration: Once a business valuation is agreed upon there will need to be some consideration of the applicable terms for an individual exiting the business. For example, 25% paid upfront and the balance paid over a two-year period out of practice cash flow.

Restraint of Trade: If a partner is 'paid out' the medical practice may well wish to protect itself from patient/staff poaching and from a practice 'start up' in close proximity. The relevant clause should be inserted into any exit agreement.

Equipment: Normally, a practice owns relevant equipment within the confines of a Service Trust and/or Company Arrangement.

Staff: Usually employed in a Service Trust. A timely, well-planned and civil exit will lessen any negative impact on staff morale.

The second case, in which a partnership agreement does not exist, will have to address the above issues. Those, and any 'exit procedures', will be complex and expensive. They may also be toxic, leading to staff retention problems and the dissolution of the business.

Some other points to consider:

- **Estate Planning:** Dr Kathy T. would be looking to ensure that the financial benefits she's worked so hard for end up with her own children and not with her ex-husband's future partner and/or children.
- **Wills:** Divorce automatically revokes an existing Will.
- **Testamentary Trust:** Protect children from potential 'Predators and Creditors' such as future partners and ex-spouses.
- **Debt:** It may be prudent to resolve any encumbered debt to simplify the children's financial position.

Dr Kathy T's situation underscores the importance of pre-planning the settlement of assets in both a personal and professional sense. More specifically, any medical practice requires formal documentation of partnership expectations and doubly so if marriage complicates an already potentially convoluted scenario.

Heart Sink

Life can be cruel, even a leisurely swim in the Indian Ocean can go horribly wrong. Medical finance expert Warren Dworcan deconstructs the tragic consequences of attempting to avoid the admittedly exorbitant Rottnest ferry-fare.

Dr John T. was a radiologist in private practice with three colleagues. John, in his early 50s and planning to retire in five years, suffered a heart attack and died during the Rottnest Swim. He has two investment properties, significant debt and is survived by his wife and two children at university.

Warren Dworcan

WD: The bleakest outlook for John T's widow (let's call her Sally) is one that flows from being totally unprepared for such a scenario. Some important decisions will need to be made and the consequences for the business could be unsettling for all concerned.

John T's proportional ownership of the medical practice falls within his deceased estate and in normal circumstances the spouse will be the beneficiary. Let's pursue the hypothetical nature of this example and assume that, despite having no prior commercial experience, Sally decides to pursue an active role in the business. In fact, she's actually looking forward to putting some new ideas to the three remaining partners.

The radiology practice has no debt, generates around $300k per annum/partner and an estimated value of around $4m. After hearing the proposals put forward by the widow of their former colleague the thoughts of the three radiologists immediately turn to buying Sally's share of the business as quickly as possible.

This may well be the preferred outcome for Sally because she will now have a lump sum to pay out her mortgage debt. The downside is that any ongoing business income will now cease.

A far more positive picture emerges if John T. had sat down with a team of experts and put in place some relevant strategies. The following four issues would have formed the crux of discussions involving a financial planner, an accountant and a lawyer.

- **Buy/Sell Agreement:** this would ensure, in tandem with 'Key Person' insurance, that John's widow would receive a substantial payout. The remaining business partners would assume ownership of John's share of the business.
- **Insurance Policy/Self-Managed Super Fund:** the proceeds of the policy would be paid (tax free) to Sally. This would give her the option of retaining the investment properties until market conditions were more favourable.
- **Wealth Creation Plan**: allowing the remaining proceeds of the insurance policy to generate investment income for his wife and children. Any rental income would supplement this figure.
- **A Will, Power of Attorney and Guardianship:** these documents set out clearly and simply the procedures to be followed to ensure that life will go on in a relatively comfortable fashion for Sally and her children.

It's readily apparent that the latter scenario is far more preferable than the former. Personal and professional circumstances can change in the blink of an eye and a decision to seek some form of advice in advance is prudent.

Putting in place a holistic, workable and legally-binding strategy before your luck runs out is money well-spent.

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Managing your finances

May e-Poll

Q Do you manage, partly of fully, the finances and future planning of your practice?

Yes	38%
No	57%
Uncertain	5%

Q You answered 'yes' to the preceding question so we ask, what best describes the time you spend on planning future financial considerations for your medical practice:

Significant time spent and it feels productive.	12%
Adequate time but should do more.	44%
Negligible time, which worries me.	32%
Non-existent time and not something I think about.	4%
Prefer not to say.	4%
None of the above.	4%

ED: For those GPs handling their own business affairs a third feel vulnerable financially which just goes to show how complex running a modern general practice has become.

Practice Meltdown

Finance broker Sarah Wells bounces off a scenario in which a medical partnership turns decidedly pear-shaped.

Dr Meredith S. is a co-founder of a GP Practice incorporating six doctors, two allied health professionals and support staff. Meredith announces that she intends to leave and work part-time. Her principal partner becomes visibly angry, with comments ranging from 'legal ramifications' to 'competitive exclusion'.


Sarah Wells

SW: Going into business with another person should be viewed as something like a marriage. If you make an unwise choice it could cost you a lot, both personally and financially.

While most people are aware of the importance of discussing what might happen in such a situation, it's a topic that's often pushed to the background or avoided entirely. It can be a difficult conversation and who wants to be the party-pooper clouding the beginning of an exciting new venture?

Mundane issues such as maternity and sick leave need to be aired at the outset, and even more so when it comes to talking about a potential partnership split. The latter requires the expertise of a lawyer and it all needs to be in writing. From my experience, if you can't get through these early stages of a business relationship then the possibility of working together in a mutually beneficial fashion may not be on the cards.

Plan for the unexpected

The situation involving Dr Meredith S. is an interesting one. Unless there has been some provision for just such an eventuality there will be consequences, some unpleasant.

Meredith's decision to work part-time will result in an interruption to the normal flow of the practice as a business. This will inevitably impact on her partners and support staff. If there's a prior agreement in place that clearly states that a partner who decides to leave at short notice must 'work out' their time on a full-time basis then that's one problem solved.

On the other hand, the person concerned may be required to find a suitable replacement and take a leave of absence that extends right up until their official departure date. If this occurs Meredith may be subject to a restrictive covenant in which she finds herself unable to practise in specific geographical locations for a defined period of time. There's always the option of legally challenging such an outcome but that is often costly and time-consuming.

Meredith S. will be well aware that, whatever the outcome, the patient-list she's worked to develop will be diminished at best and non-existent at worst.

Making 'ideal' reality

Ideally, all these details will have been discussed and formalised when the practice partnership was first established. But, as we all know, life is seldom 'ideal'.

Before anyone in Meredith's position makes any decision they should seek legal advice. Some business breakdowns resolve themselves amicably while others are fractious, time-consuming and expensive.

The phrase 'always begin with the end in mind' is worth remembering. It's a truism that applies to many aspects of our professional, financial and personal lives. Take the time to work through potentially complex partnership agreements and make sure you're comfortable with the outcome. If you don't talk this through at the outset it's a fair bet you'll be having a longer and more acrimonious discussion sometime in the future.

It's a bit like your own health, really. If you look after yourself now there's a good chance you'll end up in pretty good shape in the future.