Why are private equity and venture capital groups interested in dental practices?

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DENTISTRY IS A FIELD that typically has experienced evolutionary, not revolutionary, growth. During a 2014 cerecdoctors.com symposium, one speaker stated that 20% of the changes in dentistry occurred prior to 2005, and 80% of the changes have occurred since then. A great explanation for this is the increase in research and development and technology in dentistry. On one hand, we have seen revolutionary changes in dentistry delivery and clinical resources, and on the other, we are starting to see rapid changes in its organizational structure and business operations.

The US Census Bureau's 2012 and 2007 economics censuses indicated the number of offices controlled by multilocation dental groups jumped 25% to 10,557 in this five-year span, whereas single location practices increased only 3.4%.[1] Revenue and number of employees in these multilocation practices also increased 33.7% and 24% respectively, while single location practices only realized an 8.8% and 4.9% increase.[1]

Dentistry is viewed as one of the top three most profitable small businesses. This profitability along with scalability makes ownership of dental practices appealing to private equity and venture capital groups. These organizations look at the fixed and variable costs associated with dental practices and think that by applying their fiscal and operational processes that they can rapidly increase the profitability and value of the practices that they control. Their desire to get involved has led to increased values for practices. Historically, practices have been valued at 65%–70% of annual revenue. We are now seeing this value moving to as high as 110% of annual revenue and even multiples for larger groups.

As independent practitioners, we have to evaluate our environment and decide whether we are going to merge our practices into larger groups or take our own steps to increase our profitability. If outside groups recognize that dentistry can be highly profitable, then we should take control of our own destiny and work to increase our profitability and value.

EXPENSES WE CAN CHANGE

The next question that a practice owner should ask is, "How do we do this?" My response is that it is simpler than one would think. To start, we should examine our practice numbers. When examining a practice's metrics, we talk in terms of percentage of revenue. Since profitability is collections minus expenses, we look at the expenses that we can change. Staff costs, dental supplies, and lab costs typically account for our largest variable expenses. Most practices target staff costs to be less than 28% of revenue, clinical supplies to be 6%–7%, and lab expenses to be 8%–10%. The sum of these with other fixed and variable expenses culminates in a target overhead of 62%–65%. If we streamline our practices to reduce overhead in the same manner that a corporate practice group would, we should be able to reduce our overhead to 52%–55%. This would increase profit 10%–12% for the practice owner.

STAFFING

Several years ago, I began implementing cost-saving strategies to increase profitability. We staff in a manner that keeps us from overstaffing while developing a top-notch staff. Many doctors like to have multiple front office members and dental assistants. We cross-trained our staff and have only one dental assistant and one front desk person. We hired very qualified individuals and paid them above-market rates in hopes that they could more efficiently operate and lead to increased profitability. This resulted in us bringing staff costs down from 28%–29% to 23%–24%.

SUPPLY AND LAB COSTS

The simplest thing that we did to further reduce our costs was to reduce our dental supply expenses. This is a clear target of corporate practice groups. They accomplish this by using their leverage to negotiate more favorable pricing from the distributors. As independent practitioners, we can achieve the same supply savings by joining a buying group or a group purchasing organization (GPO). When I founded the Synergy Dental Partners, our mission was to level the playing field for independent dental practices by leveraging our collective buying power to achieve the same cost structure that large groups receive. By utilizing Synergy, my practice's supply costs dropped from almost 7% to 4%. A 3% reduction in a $1,000,000 practice will result in adding $30,000 to the bottom line. In a practice with 60% overhead, it would take an additional $75,000 in production to net the $30,000.

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An additional cost containment method is controlling lab costs. There are a variety of ways to approach this. The three that I would mention are the following:

1. Negotiate with your existing lab. Typically, they do not want to lose your business and may work with you regarding fees.
2. Use a GPO's lab partners. The GPO has already negotiated preferential pricing. By using one of these labs, you get the savings while not having to negotiate it yourself. We are seeing a growing number of labs participate. Synergy recently added Dental Arts Lab. With this type of partner, a practice can realize savings on everything from higher-end master level technicians to cost-conscious varieties of milled restorations.
3. Use CAD/CAM systems similar to CEREC. People normally question how they can realize cost savings while having to make a significant investment in the system. By using CEREC, my practice saw a reduction in lab expenses from a very high 14% to 3.8% today. This may be the single greatest change that I made which improved profitability. In addition to lab cost savings, CEREC also allows doctors to expand the breadth of services that they provide. Dr. Mike Skramstad of cerecdoctors.com has discussed Sirona redefining ROI for CEREC. By taking it solely from a fiscal definition, ROI is defined as restorations, orthodontics, and implantology. We all understand the restorations aspect, but it is the orthodontics and implantology that can digitally change the scope of services that general dentists provide.

INSURANCE RATES

A final piece that can be utilized is insurance rate negotiation. While this is something normally reserved for large groups, we are seeing the formation of companies who will do this for individual practices. Apex Reimbursement Specialists is one such group. A typical practice can average a 10%–12% increase in PPO reimbursement rates through services like this. This can result in a $32,000–$35,000.00 increase in annual reimbursement. Like using a GPO for supplies, this is found money. The office doesn't have to change anything or produce any additional dentistry to realize this revenue.

CONCLUSION

Contrarians will tell us that savings on things that account for only 6%–8% of practice overhead will not have a meaningful impact on a practice. I would counter that practitioners need to look at their practices in a more "global" manner and think in terms of utilizing a full "suite" of services to significantly reduce practice overhead. Private equity, venture capital, and corporate practice groups are number-centric regarding dental practices. If all of their CPAs and MBAs are advising them to approach dental practice profitability in this manner, then why are we doing ourselves a disservice by not being better focused on improving our key controllable metrics to better enhance our profitability and continued sustainability for the practice of dentistry as we know it? **DE**

REFERENCE

1. Economic Census. United States Census Bureau website. https://www.census.gov/econ/census/. Accessed October 28, 2016.

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