Potential Crisis May Await Associate Physicians on Transition to Owners

By Frank H. Sauls, CPA

Physician-owned medical groups may be facing a "crisis" of expectations as associates become owners. Like all of us, they expect their current income to continue and the purchase of the practice to add to this income in the Short term as well as the long term. However, many are surprised when they learn that their income flow may actually drop in the short term upon admission as an owner of the practice. If this is a surprise, it could be a “crisis” both for the physician as well as the practice.

Several trends are occurring to create this result. Unfortunately, this result is affecting not only the new owner but also existing practice owners. Therefore, we need to look at the trends ahead of time and openly communicate them to our associates in order to prevent the crises.

One of these trends is declining profits. The declining profits are generated from both declining revenues and increased overhead. The competition for the patient dollar is increasing as capitated care comes to more areas. The resulting migration to more rural areas means a move away from the managed care environment. Some practices are struggling to maintain patient encounters and market share—gross charges. All practices have experienced declining reimbursement from all major payers, and the trend is continuing. The result is dollars into the practice.

If this is not bad enough, costs are rising. Transcription costs, lab costs, and other variable costs may be creeping up. New compliance regulations, pre admission certifications by payers, etc. are also requiring additional support staff and associated overhead cost well above historical requirements with no additional increase in revenues to pay for these regulatory requirements. Occupancy expenses continue to increase due to increases in building cost, utility bill increases, etc.

Another trend is the increased investment required in the practice. In the past, physicians treated the patient, and the insurance company sent the money in about 30 days. Today the wait for money is often times well over 60 days. From a pure mathematical viewpoint, the investment in the practice just doubled or tripled, whether we wanted it to or not. New medical equipment costs continue to increase, and the day to day support cost of computers, internet hookups, computer support, software support, software upgrades, etc. appears unending. If practices are also trying to recruit new physicians, they have also discovered that a short-term cost and salaries will far exceed the new physicians’ first year revenues, and

possibly the second year. This is a long-term investment in the practice - a good investment but a short term drain on the available cash flow of the practice.

The owner is already aware of these long-term trends and has been bearing the declining profits through the associated phase. Here is where the crisis may come - the associates may be making more than shareholders because the unaware associate may not have shared in the reduced profit pool. Even worse, even if the associate is aware, are they also prepared to participate in a pay cut in order to pay for ownership in accounts receivable, medical equipment, etc? Faced with a potential cut in pay, associates may be inclined to leave the practice.

But what is the solution to the problem or is there one? The answer is initial communication on expectations of the medical group and the associate. If the proposed professional partnership is to grow and prosper, negotiations are involved. The new partner must be flexible with his expectations and the existing partners practice must be flexible with their expectations. After all, is that not what both the associate and the existing owners are expecting from each other? The ability to openly discuss an issue and come to a mutually agreeable conclusion that all partners accept is the basis for a successful practice.

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