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Goodwill hunting: What's your practice worth?

The sales value of a practice is set mainly by intangible assets such as patient mix, physician reputation and number of interested buyers. For many practices, those assets aren't worth what they used to be.

By [Karen Caffarini](#), AMNews staff. Sept. 15, 2008.

Steven Arnold, MD, believes he has built up goodwill valued by the patients he's cared for during his nearly two decades as a family physician in Milo, a rural town of 2,000 near Maine's geographical center.

What Dr. Arnold hasn't been able to do is build up the kind of goodwill that makes his practice valuable enough for anyone else to buy.

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A practice's goodwill consists of intangible assets, including patient base, accounts receivable, reputation, location, size, specialty and payer mix. While a building and equipment are tangible assets

that fetch a market rate as set by federal and state law, goodwill is the variable that makes or breaks a practice's salable value.

"People are still paying a premium to join the right practice. If you're in the middle of nowhere with no real barrier to entry, no one is inclined to pay a premium for your practice. They can just set up their own practice and compete with you," says Sandra McGraw, JD, CEO of The Health Care Group Inc., a physician advisory firm in Plymouth Meeting, Pa. "But if you want to join an ophthalmologist practice in Manhattan, generally you will be willing to pay goodwill. It would be difficult financially to start on your own."

Unfortunately for Dr. Arnold, a small practice in rural Maine with 60% of its patient base on Medicare or Medicaid doesn't have the payer mix buyers are seeking. On Nov. 1, Dr. Arnold is shutting down the practice he acquired for \$125,000 in 1989 -- \$25,000 of it for goodwill -- and taking an employed position with a federally qualified health center 15 miles away in Dover-Foxcroft.

"People aren't buying practices here -- they're just absorbing them. Apparently they don't have to pay for them," Dr. Arnold says.

He discovered three years ago, while trying to form a partnership, that his practice could command no goodwill, making it virtually worthless. Dr. Arnold says that with reimbursement rates only getting worse, he has to leave or go bankrupt.

He didn't even try to sell his practice. "It has no value. Anyone who would buy my practice would be bankrupt in six months. I don't want to stick anyone." Dr.

Arnold donated his 3,500-square-foot building, appraised at \$282,000 several years ago, to the town of Milo.

Today, potential purchasers are more tight-fisted and particular concerning goodwill payouts, pointing to reduced reimbursements from managed care plans, lack of patient loyalty and the fact that some earlier buyers overpaid and got stung, advisers say.

David Marcinko, CEO of Medical Business Advisors in Atlanta, says that in the late 1990s he was seeing internal medicine and primary care practices sell for up to five times their gross annual revenue, boosted mainly by goodwill. Today these practices are more likely to receive one to two times their gross annual revenue.

Maximizing your goodwill

Goodwill matters not only when a practice is for sale, but also when a group is setting a formula for a new physician to buy a partnership or for a retired physician to cash out of one. Goodwill also matters when a value is being set on the practice during a legal proceeding, such as divorce or a liability case. Experts say goodwill value needs to be determined only when a practice anticipates an alteration in its ownership structure. With appraisals costing up to \$30,000, simple curiosity likely isn't enough reason to seek out a number.

Chances of getting a more favorable goodwill value will be improved if physicians have good records of accounts receivable and capital purchases and maintain a profitable practice, advisers say.

"At the end of the day, what matters is that you have a well-functioning, good business," McGraw says.

Setting goodwill isn't just about the cash value of your practice. It also could affect your taxes, says Keith Kamperschroer of Kolb and Co. health care consultants in Milwaukee.

"If the buyer adds a ... sign-on bonus, that puts the doctor in the highest tax bracket, 35%. But if you argue that the bonus is for the personal goodwill of a doctor, which is an intangible asset, it is considered a capital asset and taxed at 15%," Kamperschroer says. However, he says the IRS can, and has, stepped in if it deems the amount of goodwill was set unreasonably high in comparison with similar practices.

As in real estate, amenities and location affect a practice's goodwill value. The more varied the payer mix, the better, experts say. That way, a practice can prove it is not reliant on a dominant payer that could negatively affect the practice by lowering reimbursements or splitting from the practice. The definition of one dominant payer includes self-paying patients, which is why, experts say, a cash-based practice might not have a high goodwill level.

In large metro areas, fast-growing locations, or areas where health systems are actively acquiring practices, physician groups have a better shot at fetching some level of goodwill, experts say.

Right place at the right time

The Milauskas Eye Institute in Palm Springs, Calif., is one practice that hit the trifecta: right practice, right specialty and right place. So it was able to maximize its goodwill value assessment.

Tim Milauskas, administrator of Milauskas Eye Institute, says its goodwill value came in higher than expected. In fact, he says, the practice's value is

higher today than it was in the 1990s, when it was sold to a practice management group. Milauskas did not reveal numbers.

When the practice management company folded, the founder bought back the practice at a lower cost. It has since grown to 12 ophthalmologists and optometrists, compared with the two or three ophthalmologists in most other practices in the area. Milauskas says the practice accepts most major insurance plans but no longer contracts with HMOs.

The practice had other aspects that made it ripe for receiving goodwill, experts say. It is in Southern California, a prime location; it represents a specialty in demand; it is the dominant practice in its specialty; it's consistently grown through the years; and it's made wise decisions regarding payers.

"Goodwill in this day and age is a very amorphous thing," Milauskas says.

By contrast, rural Maine, where Dr. Arnold is, is not an ideal place to sell a practice, according to Andrew MacLean, general counsel for Maine Medical Assn.

"I would be fairly skeptical that you would find much in the way of goodwill here. Hospitals continue to buy primary care and specialty care practices, but they aren't paying goodwill." MacLean says.

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ADDITIONAL INFORMATION:

When to have your practice valued

Experts say it costs \$5,000 to \$30,000 to have the value of your practice, including its goodwill, appraised. Here are the circumstances where that is necessary.

Retirement: When approaching retirement, a physician may want to seal a deal in which the physician can work for two to five years for the buyer, then retire with a cash payout. Have your practice appraised three to five years before you plan to retire.

Sale of practice: A physician wanting to sell and work elsewhere should get the practice appraised a couple of years before putting it up for sale.

Sale of partnership: Both the practice and the physician buying the partners' share can arrange valuations of the practice, or stipulate in the contract that an independent valuation be performed.

Divorce: Some courts have taken a practice's goodwill into consideration when awarding a settlement to ex-spouses. You will want someone knowledgeable in practice valuation available to testify at the court proceedings about your practice's real worth.

Other litigation: An expert should be on hand to attest to your practice's actual worth.

Sources: Keith Kamperschroer, Kolb & Co. financial advisers, Milwaukee; Steven Goodman, The Goodman CPA Group, New York and New Jersey; Sandra McGraw, The Health Care Group Inc., Plymouth Meeting, Pa.

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How goodwill is determined

A number of factors contribute to a practice's goodwill. Among them:

Location: Being in a fast-growing or economically desirable area can help. Even more helpful is being in a market where hospital systems or other entities are competing to acquire practices.

Payer mix, accounts receivable and collection rates: A good variety of insurers, including Medicare, is desirable. Although accounts receivable and collection rates are tangible, they are added to the intangible mix because they show the practice's financial future based on patient load and the ability to get paid.

Competition: Being the dominant practice of your kind in the market is valuable. But being the only one might lead a buyer to set up a new practice rather than buy yours.

Reputation: Part of the downward pressure on goodwill stems from the conventional wisdom that more patients are loyal to their insurers than their physicians. But a practice's reputation in the community still matters.

Statutes and court rulings: Many states have rules that dictate how to set a goodwill number so it does not arouse anti-kickback or antitrust concerns.

Sources: David Edward Marcinko, Medical Business Advisors, Norcross, Ga.; Keith Kamperschroer, Kolb and Co. financial advisers, Milwaukee; Sandra McGraw, The Health Care Group Inc., Plymouth Meeting, Pa.

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Boosting your goodwill value

There are several measures a physician can take to increase the value of goodwill, which in turn will make the practice more desirable, and profitable, when selling or taking on a partner.

- Keep good financial records. Know your capital purchases, and have your balance sheet, statement of cash flow and net income statement up to date.
- Continually monitor key financial ratios, such as profitability, creditors, long-term debt management and medical equity value-added.
- Have adequate practice insurance, including property liability coverage, plus have workers' compensation for staff and life and disability insurance on the key doctors.
- Build a brand identity for the practice rather than an individual brand identity for you as a physician. This helps in developing a business that others could assume and operate.
- Have a practice continuation plan that stipulates how the practice will be sold or continued in the event of a physician's death or disability. Specify who will buy the practice and for how much. And specify whether the purchase will include land, buildings, inventory, licenses and goodwill.
- Have a covenant that specifies the procedures to follow when a physician leaves the practice.
- Have strong relationships with everyone who does business with your practice, including supply vendors as well as referring doctors and fellow physicians.
- Be organized when it comes time to present the supporting information.
- Don't accept the first valuation given. Numbers can be changed, if you can present substantive reasons.

Sources: Tim Milauskas, Milauskas Eye Institute, Palm Springs, Calif.; David Edward Marcinko, Medical Business Advisors, Norcross, Ga.

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