Partnerships: *A Match Made in Heaven or the Pathway to Financial Hell*

There is no greater, all-consuming argument on the business side of the veterinary industry than that of whether or not partnerships are good or bad for the individuals involved in them. There are national companies that have their entire business model based upon the idea that partnerships are the only way veterinary practices should be run. So, who is right? We are firmly and unequivocally of the mindset that… it depends!

We believe that most partnerships are rushed into without a lot of thought given to the complexities of what is needed to formulate a good partnership, or they are created by companies that really do not have the experience necessary to create complicated legal documents. Too often, people believe that because they are friends or family that they can work together without having to deal with the specifics of a partnership. "We've known each other for years and are best friends" is probably one of the worst sentences that can ever go through your head when contemplating a partnership. If you don't plan this properly, and protect and value that relationship, your best friend (or family member) will become your greatest enemy. It is that serious and thus needs to be approached from a position of protecting that relationship, because aside from your spouse (and maybe your kids) this will be the most important relationship in your life. Therefore, when formulating a partnership, you need to analyze the individual veterinary practice, the individual personalities of the partners, the individual philosophies of animal care and (dare I say it?) the individual personal lives of the partners. If you are not prepared to discuss these topics with your possible partner, don't even think of getting "into bed" with them, because it will be a long, cold, sleepless night.

Another issue that may arise is doctors attempting to enter into partnerships when there simply isn't enough money to go around. Routinely, individual doctors call our office who plan to bring on a partner to "lighten" the work load. This is almost always a poor reason to enter into a partnership. First, the workload the doctor is complaining about is oftentimes well below the threshold needed to provide for a healthy two doctor practice. Secondly, a partnership should not be based upon a lessening of the workload, rather it should be based upon a sharing of the workload in order to get to an overall higher plateau than an individual doctor might be able to accomplish, while at the same time providing more family and vacation time to the individual practitioners. While there is no set rule, we like to see a practice with revenue of roughly $1,500,000 and an active client count of 3,000 (for general practitioners). When broken down utilizing normal statistics, this equates to $1,200,000 in doctor production, which leaves each doctor producing $50,000 per month. Doesn't seem like such an unascertainable number when broken down that way, does it? Far too often, a doctor wants to bring on a partner when they are producing between $800,000-$1,000,000. When you analyze the practice using the metrics above, there isn't enough doctor production to go around. This will lead to both doctors becoming frustrated, which leads to a substantial likelihood of the partnership dissolving.

So, when the practice does provide enough cash flow to allow for the creation of a partnership, how do we divide up revenue between the partners? Below is a list of possible compensation formulas along with the pros and cons of each:

<u>Individual Doctor Collections and Profit Pools</u>
In order to incentivize the partners to work hard, work as a team, and to grow and maintain the veterinary practice, one idea is to pay each doctor a standard associate wage based on a percentage of collections from each doctor's production (e.g., 25-35% in a general veterinary practice, depending upon the overhead of the practice). With all profits going into a pool to be distributed based on your ownership interests. So, Dr. 'A' collects $700,000 on production, Dr. 'B' $500,000, and if you are using a 30% compensation model, Dr. 'A' receives $210,000 and Dr. 'B' $150,000 as compensation on production. If the veterinary practice is collecting $1,500,000 and it's generating 40% profit (before doctor distributions) the practice will have a total profit of $600,000. Once overhead has been paid (which will include the initial doctor compensation of 30% of production), the profit pool should have $240,000 available to distribute as profits based upon the partners' percentage of ownership. Assuming a 50/50 partnership, Dr. 'A's' total compensation would be $330,000 and Dr. 'B's' would be $270,000.

<u>Collections on Individual Production</u>
Let's say one doctor wants to take more time off and pursue other passions, while the other partner's passion is veterinary medicine, and as a result puts in more hours at the office. Using this model, the collections are totaled on each doctor's production, and compensation is based upon the individual doctor production relative to the overall doctor production of the practice. Using the example above for this scenario, Dr. 'A' who collected 58.33% of doctor production would get $350,000 and Dr. 'B' who collected the remaining 41.67% would get $250,000.

<u>Individual Production Against Fixed and Variable Expenses</u>
This model involves identifying common expenses (e.g., rent, insurance, utilities, etc.) and paying them on a 50/50 basis. Other expenses such as staff, laboratory, supplies, maintenance, etc., would be paid by each partner based on the respective percentage of the individual doctor production compared to the total doctor production. To put it in simple terms, each doctor would keep 100% of their individual collections generated from production, while all expenses associated with that production would be paid 100% by the individual doctor and all fixed costs not related to production would be shared equally between the partners. This can be a complex model to work with due to the difficulty of identifying individual expenses and must be weighed against the additional accounting fees a partnership would have to pay to receive accurate accounting.

<u>Profits Split 50/50</u>
Unless you are a partnership that primarily manages associate doctors, we strongly advise against this type of compensation model as it doesn't incentivize the partners financially. Last time I

checked, we still lived in a capitalistic society (debatable I guess) and socialism doesn't seem to work too well in business. This model tends to have a negative pull against increasing production and actually incentivizes one not to work as hard.

Finally (even though there are numerous other issues which need to be dealt with in a partnership), what is the proper structure for a partnership? Depending upon which state your practice is located, this could have huge tax and liability consequences for you if you get it wrong. We generally recommend staying away from a single entity partnership as it is the most restrictive from a tax strategy standpoint, and provides the least amount of protection from a liability standpoint. Yes, it will save you some money by only having to deal with one tax return for the partnership, but the negatives far outweigh the meager monetary benefit. In our opinion the best structure for a partnership is a multi-entity approach where each individual doctor has an entity which owns the interest in the partnership. That way, (i) each partner has full control over their own taxes; (ii) can sell the partnership interest to a potential buyer as an asset sale without impacting the other partner tax wise; and (iii) provides as much liability protection as possible with the management and operation of the veterinary practice. Depending upon which state your practice is in, the multi-entity approach may take the form of professional corporations forming the partnership, or it may be LLC's/PLLC's which form the partnership. You need to discuss with your CPA and your attorney the right corporate entity for your particular situation, but always make sure that you are creating an entity for your partnership interest.

Regardless of the eternal debate about partnerships, both sides will agree that a partnership is doomed without proper planning and thought being placed into the formation of the partnership. In discussing the possibility of entering into a partnership, everything should be on the table for discussion. The two main reasons why partnerships fail are (1) divorce and (2) not having a partnership document/or a poorly written partnership document. While you cannot control the first issue, you can definitely eliminate the second. When you enter into a partnership, you truly are marrying this individual which means that you need to know as much about them as their spouse does in order to make your partnership successful. If you make sure the hard, tough questions are asked, and the planning and strategies are put forth into your partnership agreement, you can guarantee that you have placed yourself into a very stable relationship that should last your entire career.

"A friendship founded on business is a good deal better than a business founded on friendship"
John D. Rockefeller

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