As dental students approach graduation, there's always one burning question: should I start my own practice, purchase a practice, or work as an associate? Most doctors agree that owning a practice is preferred over working as an associate since the earning potential is much greater.

However, whether to start a practice from scratch or purchase an existing practice is a much more difficult decision. Below we discuss the various factors new doctors should consider when determining if a doctor should start a practice from scratch or purchase an existing practice.

Most doctors that are fresh out of dental school have two things on their mind: find a job and start repaying student loans. The average amount of student debt for a new graduate is between $250,000 and $300,000. If the debt is amortized over thirty years at an interest rate of 6%, a $275,000 note would be $1,648.76 per month, or $19,785 per year. This is more than most doctors' mortgage payments! As a result, doctors think they need to earn money, and earn it fast, in order to repay their debt. The thought of taking on more debt to start or purchase a practice usually does not appeal to new graduates. However, in almost all cases, it pays to borrow money to own a practice rather than work as an associate since the long term economic benefits are so much larger.

Starting a practice from scratch sounds beneficial since the doctor can select the new equipment of his choice, is able to hire the staff they want, select a facility of their choice in the location they desire, and have 100% say in every practice decision. However, the task of starting a practice is very difficult, especially in today’s economic environment, since new patients are so difficult to come by.

Despite the recent economic downturn, some banks are still willing to lend to dentists looking to start practices from scratch. Typically, most banks will loan no more than $400,000 for equipment/office build-out costs and $50,000 in working capital. Additionally, most banks require doctors to have another job before they are allowed to start building a practice. This gives the bank peace of mind knowing the doctor has a stable income stream from another source. Building a prac-
practice, working a second job, potentially playing the role of husband/wife and mom/dad does not leave much time for leisure, and the stress can build up fast.

Banks are even more willing to loan money for the purchase of a practice. The bank has historical data on the seller’s practice, which can help predict how the practice will perform in the future. As a result, doctor applications for a loan to purchase an existing practice are normally approved with ease. Banks do not require the purchasing doctor to have a second job and doctors will not spend as much time working on new patient flow since there will already be a large number of patients in the practice. Most leading institutions do require you to have worked for at least 24 months and require that borrowers have healthy credit scores.

However, the decision on whether to buy or build a practice should not be made based on the ease of obtaining financing. It should be based on which choice will provide the greatest economic benefit to the doctor over the course of his career. For over 30 years, our group has worked with many doctors that have purchased practices, along with many doctors that have started practices. As a result, we have a wealth of information based on our experience and have been able to capture averages and norms from these two different strategies. Below we will discuss and compare the economic impact of each scenario.

For a start up practice, let’s assume that the doctor borrows $400,000 at an interest rate of 7.5% amortized over fifteen years to purchase equipment and build out their space. Additionally, assume they borrow $50,000 at an interest rate of 7.5% amortized over ten years to use for working capital. The payments on the start up loan will be $3,708.05 per month, or $44,497 per year and the payments on the working capital note will be $539.51 per month, or $6,474 per year (combined the notes will cost $50,619 per year).

Assume the practice collects $250,000 in the first year, and collections will grow 50% in the second year, 40% in the third year, 20% in the fourth year, 10% in the fifth year, 5% in the sixth and seventh years, and 3% over the next seven years. Given those figures and reducing the operating cash flow by the amount of debt service payments and the amount the doctor will have to pay in federal income taxes, the doctors cumulative after-tax cash flow over the course of the first ten years is $1,401,763 ($10,881 in year 1, $60,114 in year 2, $108,399 in year 3, $153,277 in year 4, $170,085 in year 5, $179,064 in year 6, $188,475 in year 7, $172,204 in year 8, $177,138 in year 9, and $182,177 in year 10). Even though the practice’s operating income increases each year, the after-tax cash flow is reduced in year eight as large depreciation deductions end, resulting in a much higher income tax liability.

Now let’s assume the doctor has an option to purchase a practice for $450,000 which will be financed over seven years at an interest rate of 7.5% yielding payments of $6,902.22 per month, or $82,827 per year. Assume practice collections are $625,000 in the first year and will grow 3% per year over the next nine years. Furthermore,
As you can see, there are many factors to consider in determining whether to purchase a practice or start one from scratch. Making one mistake in this decision could end up costing a doctor tens of thousands of dollars over the first few years of practice.

The decision normally involves other factors besides cash flow. A buyer of a practice can potentially have the seller work in the practice for a short period of time to mentor the purchaser and teach the new doctor how to run the practice, which could be very helpful. The selling doctor could also work to see patients the purchaser does not have time to see, since the buyer will still be working on becoming a more efficient producer and business manager. On the flip side, the selling doctor may require the purchaser employ them for a certain period of time which could cut into the purchaser’s cash flow. Either way, it is highly recommended the employment of the selling doctor is agreed upon prior to the sale.

As you can see, there are many factors to consider in determining whether to purchase a practice or start one from scratch. Making one mistake in this decision could end up costing a doctor tens of thousands of dollars over the first few years of practice. It is highly recommended new doctors consult with dental specific professionals (transition specialists, attorneys, certified public accountants, etc.) to help them make the right decisions, avoid a disaster, and legally protect themselves.

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