The Real Cost of a Dental Practice Set-up

As we all know dental practices seem to be opening up on every street corner, in every strip mall, in every city, everywhere!

The obvious reason for this phenomenon is that foreign-trained dentists and recent graduates are entering the dental workforce at a rate that is unsurpassed in history. The other reasons may include the fact that there aren't enough practices for sale, and that dentists want to follow growth areas in new communities. As a result, Canada is close to saturation when it comes to dentists. Some reports suggest that in Ontario, alone, there is a 20% oversupply of dentists for the population at large.

We are frequently asked whether it's better to set-up a new practice (start-up) or a purchase an existing practice. While my biased answer is to purchase a practice, the honest answer is that there is no right answer. The right answer depends on a complete strategic evaluation of your specific situation, your goals, the location of the practice, and an understanding that every situation is different.

We know how established practices are performing. But how are new start-ups doing financially? While there are huge differences in the success rates of start-ups, we wondered what the results would be based on an average start-up and its true costs to a dentist. While this is not a scientific study, as we only gathered available data and modelled some numbers, it is an educated commentary based on average inputs and true economic costs.

In this exercise, we are not trying to reject the idea of starting-up a new practice versus buying an existing practice, (as former bankers, we have been involved in 100's of dental practice start-ups), we simply want to point out the true long and short-term costs of your decision making, including opportunity costs, and the need to be very selective in your choices of locations and execution of your business plan. This model could also be used when purchasing a practice to assess the true long-term costs of ownership. The missing portion of this exercise, and likely as important, is what your practice will be worth in 5, 10, or more years. That being said, we believe that dentists should eventually own their own practice or be in a position to influence its direction and the patient care experience.

In our 3 year model, I estimated that the average start-up including working capital would be $500,000 (this is low according to industry experts). We estimated an average start-up to be approximately 1,500 square feet, 3 operatories, rent at $20 per foot plus taxes, maintenance and insurance (TMI) and utilities ($50,000 per year). In addition, we estimated 25 new patients per month (net of departing patients) in year 1, and 20 per month in year 2. We modelled having 1 employee 4 days per week in the first 6 months, 2 thereafter, and added a hygienist in year 2 and 3. In addition, we estimated that the dentist would work in the office 2 days per week in year 1, 3 days in year 2 and 3. In addition, I estimated that the $500,000 loan would be at 4%, and would include the first year at interest only. And lastly, we estimated that an associate in a busy office could earn $1,000 per day (busy office 8 hours).

In this exercise, we forecasted that the practice would achieve revenues of $155,000 in year 1, $270,000 in year 2, and $414,000 in year 3. Even with the above employee costs, the owner performing hygiene in year 1, excluding amortization, the practice would have a cash flow deficiency of $62,000. In year 2, the practice could break even income-wise, but because of capital repayment would have a cash flow deficiency of $55,000. In year 3, the practice would have income of $84,000, but positive cash flow of only $28,000.

Although we didn't model this precisely, the dentist only started to earn the $1,000 per day target near year 5. Although these numbers don't look great, this does not paint the whole picture. When considering true costs, the dentist also needs to look at opportunity costs lost. Therefore, in the above scenario, while the dentist is working in the new office (2 days in year 1, then 3 days in year 2 and 3), he/she is missing out on the opportunity to earn $1,000 as an associate. Therefore, if we consider costs including the opportunity cost, the year 1 total loss is $162,000 ($62,000 loss on practice and missed opportunity to make $1,000 per day ($100,000 on 2 days per week) as an associate. In year 2, the real loss is $205,000 and year 3 is a loss of $122,000 (excluding any goodwill or equity).

The point of this article is not that start-ups are not financially viable, but if you are planning to set-up a practice from scratch, you should be analyzing the real total costs, including opportunity costs. In many new practices, the location was simply not viable as a result of too much competition, no traffic, ethnicity issues, high rent costs, and no visibility. We speak to too many dentists who start a new practice simply because they have found a space to rent. Additionally, if you are planning to set up from scratch, you should be prepared to work harder than you are working today and have a backup plan. In most of these situations, we recommend that the dentist keep a few days of their current associateship to cover the very real losses and cash flow deficiencies that are expected in the first 3 or 4 years.

There is no right answer when it comes to setting up a new practice, buying an existing practice or continuing to associate; however, doing your homework before making a decision is critical. Consult with as many dental professionals as you can who you feel have your best interest at heart, (accountants, sales reps, brokers, bankers, etc.), determine what you truly want in your career, and conduct a thorough analysis of the real costs of your decision.

Please let me know if you would like a copy of the pro-forma template that I used to model this financial scenario. This is for discussion purposes only and you should not infer that details may be missed (taxes, amortization, etc.). Please consult your team of professionals to review your personal scenario.

(Please view the original article on the Professional Advisory Website for access to the aforementioned model)

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