WHAT A PANDEMIC TEACHES EYE PRACTICE LEADERS AND ADMINISTRATORS

When U.S. macroeconomics are shocked, causing unexpected downturns in revenues, business model operations are inevitably revealed. Small businesses are often the first to feel the effects of related risk exposures. Professional services organizations, such as independent medical practices, can be especially exposed largely because the tax structures do not favor retention of cash reserves to support operations when revenue productivity suffers.

For many independent medical practices, including eye care practices, the COVID-19 pandemic revealed business model vulnerabilities in record time. Summaries of the more pertinent are provided here. The purpose of this monograph is to create a guide to eye practice business model redesign as a safeguard to the next shock to practice economics.

Remedies to the inherent risks exist. The synthesis of priorities follows:

Practice legal structures and tax management for the owners:

Legal structures that are designed and operated to minimize tax exposures for owners which leave organizations under-capitalized and in a constant state of cash insufficiency when faced with both opportunities for growth and development, as well as downturns in revenue performance productivity. The incentives for owners to drain cash to avoid double taxation often cause the practice to assume debt to maintain practice capitalizations at acceptable levels. Every organization has debt limits. Excessive debt is the principal governor on business growth, development and the ability to have sufficient balance sheet "degrees of freedom." Debt becomes excessively problematic when assumed for paying owners compensation to levels that exceed the real financial productivity of the practice. Stated simply, practice investment potential is sacrificed by owners to pay themselves more than the practice can afford. Over the last 100 years, the business models that have produced the greatest returns for the owners, across industries, have been those that effectively reinvested reasonable proportions of free cash flow back into smart growth and development strategies.

Deceptive balance sheet risk:

Certain unfunded practice financial liabilities go unappreciated for their risk to the practice. Chief among these are unfunded and unbooked asset depreciation and paid time off (PTO) for employees. Each issue presents a unique risk to the practice. Both are encouraged by compelling taxation regulations that cause required funding to be diverted from the practice to owner compensation in the name of "smart tax planning." The other side of the coin is under-investment in the practice, including its future financial and strategic productivity.

Economic/ financial productivity and operating "at scale":

Real financial and economic productivity potential of a practice is rarely understood or effectively pursued and managed. A large number of practices operate to support each practitioner's idiosyncratic plan for "their practice." The operating expense structure of most practices is largely fixed, including the human resource operating expense structure. When the business model of the practice favors unmanaged clinical practice models, the economic and financial models will invariably under-perform. Operating "at economic scale" means the productivity potential on a fixed and variable operating expense structure is optimized. Scaling the economics of a business model is especially important during an economic crisis.

Leadership culture:

Leadership culture is an underestimated and often under-appreciated practice asset. That is until the people of the practice face an imminent threat to their safety, security and stability. The leadership culture of an organization is a decision. It can be intentionally led and it is the most valuable asset of every organization. While the definitions of "culture" may vary, the real meaning doesn't. The evidence is clear; culture is led. It is the intrinsic value of an organization. It binds people together and motivates them to pursue a mission with unity and purpose. It is what holds people together in times of trial. It is a real, tangible asset to draw upon when times are good and at their worst.

Practice buy-ins and buy-outs:

Practice buy-ins and buy-outs, including equity valuation methods, are seemingly built upon accepted business standards and practices. The failure of these models is often an underestimation of related business risk factors; examples include, the ability to sell equity to the next partner at an acceptable price, paid-in capital bypassing the practice going directly to the pockets of other owners, buy-out covenants failing to control the financial risk to the practice, new buyers locked into a model that often puts them at risk for high personal debt, and owners relying upon the uninterrupted and sufficient future financial productivity and cash flows to make the model work. Moreover, physician owners often become too reliant upon the value of practice equity to fund their retirement plans. This is, perhaps, the most significant, under-appreciated business risk, especially in the event of unplanned retirements and career interruptions.

Financial liquidity management:

Financial liquidity is defined here as the ability of a business to access discretionary cash on short notice, including in crisis. Sources are typically limited to cash on hand, bank credit, the encumbrance of practice accounts receivable and the pockets of the owners. As cited here, private practices avoid retention of cash reserves due to the taxation exposures of the corporate structure. Practices frequently exhaust their debt capacity (they become indebted up to balance sheet limits) and owners won't typically preserve personal financial liquidity to draw upon for financial support of the business they own. Consequently, the most available form of liquidity generation is the owners' ability to defer their compensation in favor of funding the operating expense structure. Here the most significant proportion of this structure is people expense. The cash productivity of the practice business model is equal to operating revenue potential minus the value of the owner compensation proportion of

the total operating cost structure. Stated in its simplest form, in the absence of other avenues to cash, owners can elect to work at reduced compensation levels. As simple as that sounds, it is is not uncommon for practice owners to find this option to be untenable. So, when competitors can't afford this option, the practices with the stronger balance sheets will expand market share.

Business model design is critical to economic stability in challenging times. Six design factors matter:

1. Creation of multiple clinical and surgical revenue streams (including facility fees.)

2. Effective clinical allocation of patients between ophthalmologists and the right number of optometrists based upon types of clinical encounters and clinical condition.

3. Work effort productivity scaled up to effectively meet required patient services demand and practice economic productivity potential.

4. A staffing and capital asset structure sized to the full productivity potential of clinical service capacity.

5. Practice brand positioning strategies focused on the predictable acquisition of a sufficient supply of new patients.

6. Business strategies that expand free cash flow productivity with a portion reinvested in disciplined profitable programmatic growth, as opposed to diverting all to owner compensation.

What the pandemic has taught eye practice owners and leaders are business lessons that were always there. Paramount among them is the independent practice business model is subject to all principles of economics, finance and free-market dynamics. While at their core, independent practices are operated from the business leadership and management philosophies of the owners, the difference in performance during economic and market challenges is based upon how the owners of the practice see, understand and manage business risk. For some owners, business risk management is a matter of course and is integral to ongoing business practice. For others, the risk is unseen or, at least, under-appreciated. For the latter, when challenges present, the ability to successfully respond is limited.

Practice owners and leaders are encouraged to set aside conventional thinking in favor of an open mind as a first step to creating a business model that is more resilient and resistant to macroeconomic assaults.

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