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THE EDITOR'S CORNER

Taking Stock of Management Service

A number of management service organizations are forming, and at least two are already active. If enough of these companies achieve the affiliations necessary to start operations and the capitalization necessary to make public stock offerings, then management service will have a place at the table, in competition with managed care, dental insurance, and unaffiliated private practices on the other three sides.

Here is more or less what management service organizations are saying about their intentions:

- The MSO will take over or guide the management of affiliated practices.
- Initially, at least, it will seek the affiliation of active orthodontists with above-average incomes, including some who seek to retire.
- It will also assist recent graduates in setting up practices.
- The combination of assisting doctors wishing to retire and young graduates wishing to start practice provides for ready-made transitions.
- A combination of cash and company stock will be paid for affiliation.
- Affiliated practices will be charged an annual management fee.
- The combination of affiliation arrangements and management fees will create a capitalization base that will support an initial public offering (IPO) of stock in the company.
- The company expects that the initial price of the stock will be a large multiple of expected earnings—a high P/E ratio—and that the stock will increase in value.
- The affiliated practitioners' expenditures for management fees will be recouped through increased income and increases in the price of the stock as the company's financial base grows.
- The company supports high-quality treatment, affordable fees, and fee-for-service orthodontic practice.
- Group purchasing discounts will reduce expenses.
- Marketing (advertising) will increase the patient base.

- A no-down-payment fee policy will enable people to afford treatment who previously could not.
- The affiliated practices will pool their management ideas.
- Overall, affiliated practices will increase their annual incomes and their net worth.

These are the promises. The reality remains to be seen. In general, however, the appeal seems to be to three kinds of orthodontists:

1. Recent graduates who may be unwilling or unable to obtain financing for establishing their own practices and who may already be burdened with substantial debt. These new doctors are loaned the money to establish their offices, in return for long-term contracts and initial income guarantees of around \$100,000 a year.
2. Established active practitioners who are not seeking retirement. These orthodontists are offered ways to improve their management and increase the size of their practices, with the added incentive of an up-front payment of 100-120% of gross income, in a combination of cash and stock. For this, they pay management fees of about 15% of gross per year, with bonuses for reducing expenses.
3. Practitioners who wish to retire. These are offered higher prices for their practices than would be available on the open market, along with the potential of increased value in the portion of the selling price that is paid in stock. In some cases, they are also assisted in their transitions.

When all the other inducements to join a management service organization are peeled away, what is left is the stock. If there were no stock, the idea would be far less attractive and have far less potential. The initial success of the first IPO in orthodontics appears to have caught the attention of others who would like to do the same, and it is indeed possible that several of the recently formed MSOs will have profitable IPOs. Many companies with a lot less going for them than MSOs have raised large amounts of money through public stock offerings. And it is likely that an MSO will grow—initially, at least—through increased practice affiliations, increased

case starts (from mass marketing), increased fees (Orthodontic Centers of America has raised its fees substantially in less than three years), and reduced expenses (from group purchase discounts).

While some orthodontists may benefit from affiliation with MSOs, some may not. It may be an incautious leap to voluntarily exchange an independent private practice for a long-term contract under a relatively untried concept. Therefore, it would be prudent to look at the possible downside scenarios before jumping in:

- Management consultation is available from independent consultants without signing a long-term contract one might later regret.
- It has yet to be determined that a viable practice can be sustained over time with an additional overhead rate of 15% or more.
- MSOs will not operate in a vacuum. They will be in competition with low-fee dental insurance, lower-fee managed care, and value-added traditional private practice. Will the promise of high case loads at substantial fees be sustained in management-service offices?
- IPOs are not without risk, as the present stock-market gyrations confirm. Perhaps for orthodontists who want to retire and can take a significant amount of the selling price in cash, the stock may be attractive—especially if they would not have to depend on it for a happy retirement. However, for a beginning orthodontist or an established one who will remain active, there are risks involved in exchanging a substantial piece of the practice for a stock that may or may not perform. Just as it does not make good economic sense to mortgage one's home to invest in the stock market, it may also turn out to be inappropriate to mortgage one's practice in the hope of passive gain.
- Success for participants in MSOs depends on growth. Since any growth ultimately has a limit, it would seem that someone will be holding this stock when the music stops. If it is the orthodontist, he or she may not be able to enjoy the added value that was anticipated.
- Management service plans are predicated on building large case loads, with continued growth

at perhaps 10% a year. Size alone cannot be said to preclude high-quality treatment; there are many large practices that produce highly satisfactory results. Still, time will tell whether management service is generally consistent with high-quality treatment.

- One would have to assume that, sooner or later, a majority of the stock in publicly held MSOs will lie in the hands of non-orthodontists. Will the companies then be managed under the concept that it makes good sense to deliver the highest quality of orthodontic care? Or will they be guided by a concept of maximizing the bottom line?

The private, fee-for-service practice of orthodontics is one of the remaining entrepreneurial opportunities in this country in which one has the freedom to guide one's own destiny, practice when and where and how one wishes, and reap the uncommon rewards that orthodontic practice has to offer in personal and financial terms. While it would be wrong to equate the joys of orthodontic practice with financial success alone, orthodontic practices have been uniformly successful, with average incomes in the upper first or second percentile.

Furthermore, we are entering a period of 10-15 years in which there will be large numbers of children of orthodontic age, resulting from the sustained birth rate of around 4 million per year that began in the early part of this decade. At the same time, there will be a net decrease in the number of orthodontists as more orthodontists retire than graduate from university programs each year. This combination of events will benefit all orthodontic practices.

Management service organizations may be an idea whose time has come, but as long as a part of the public appreciates and will pay for the unique added value of a dedicated and well-managed private practice, the traditional orthodontic practice will survive.

If you want to invest in the stock market, buy stocks. If you want to practice orthodontics and are not a manager, hire a management consultant. If you are convinced that the possible rewards outweigh the risks, join a management service organization. If you are satisfied with your ability to sustain a professionally and financially rewarding orthodontic practice, hang in there. You still have a place at the table.

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