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Q&A: A Guide to Understanding Goodwill Value in Today's Economy

By **Richard C. Koval, M.B.A., CMPE**
BSM Consulting

Q: I hear many people saying that goodwill doesn't really exist anymore. Is this true?


A: Currently, the majority of purchase/sale and co-ownership transactions in ophthalmology include goodwill value. However, certain differences exist among specialties. Some professional societies have discouraged recognition of goodwill while others find limited value due to the characteristics of the specialty. Goodwill is still present in most ophthalmology practice transactions.



Q: Is there really an accurate way to determine goodwill value? It seems that there are so many approaches to measuring it, and most of the formulas seem to be selected on the basis of whatever best suits the needs of the party trying to value things.

A: For the most part, goodwill should provide a reasonable reflection of the value derived from long-term profits of the practice in excess of the physician's labor. If we assume that most practice owners will have net income proximal to 40 percent of collections (i.e., the inverse of the typical overhead of 60 percent), and if we assume that most employed physicians will be paid at a 30-percent contract rate, the 10-point difference represents profits attributable to ownership. In most cases, goodwill value will be based on two to three years of these profits.

Alternately, goodwill can be estimated by examining comparable transactions involving other practices. Currently, a practice will average levels of overhead and stable, ongoing revenue will usually have a goodwill value proximal to 25 percent of its revenue.



Learn More About Goodwill and Practice Valuation

Editor's note: Additional tools, resources, and insight into goodwill value and practice valuation are available in the **BSM Café**, located at www.bsmcafe.com.

Q: But even if I were paid three years of "profits" or 25 percent of my recent years' revenue upon selling, wouldn't it be better for me to just keep working for another three or four years rather than sell at a price based on two or three years of profits?

A: If your goal is to maximize your financial return, continuing work would probably prove more lucrative than selling. That's true of most businesses. Working is usually more remunerative than selling, but working also requires time and effort by the current owner that's not needed if the practice is sold. Additionally, selling does nothing to maintain the legacy of the practice or the ongoing employment of loyal staff members.

Q: How do I know that a goodwill price is reasonable? Does the fact that a particular formula produces a goodwill value really mean anything?

A: As with all valuation, the price set for goodwill must not only conform to a reasonable valuation methodology, but it must also ensure reasonable cash flow and a positive return on investment for the buyer. A goodwill value will have little or no legitimacy if it places the buyer at unreasonable risk or creates an unviable financial position.

Q: How precisely can goodwill value be determined?

A: A number of commonly used methods will typically be employed by the valuator to determine this. In most cases, variability among methods will produce a range within which a reasonable price can be established. Ultimately, the correct goodwill price will be a product of negotiation rather than empirical analysis. The valuation simply determines appropriate parameters for that negotiation.

Q: What things will affect pricing within the possible ranges of goodwill value?

A: A practice with consistent financial performance over prior years will normally have a relatively narrow range of potential values. Variability of historical performance will create certain challenges for valuation, inasmuch as a number of potential performance levels may be possible. And a practice with above-average or below-average overhead will be priced differently from those resting closer to the norm. In the face of this variability, pricing will often depend on the buyer's perceptions of risk. A cautious buyer will err on the lower side of goodwill value, while a confident buyer will approach matters with greater equanimity.



Q: What can I do to maximize goodwill value?

A: Maintain consistent revenue levels each year, control expenses, and create a practice infrastructure that demonstrates value. That latter aspect comes in the form of a loyal and dedicated staff, well-kept facilities and equipment, and an atmosphere that potential buyers will see as valuable and difficult to replicate.



About the author: Richard C. Koval is a principal and senior consultant with BSM Consulting, an internationally recognized health care consulting firm headquartered in Incline Village, Nevada and Scottsdale, Arizona. For more information about the author, BSM Consulting, or content/resources discussed in this article, please visit the BSM Café at **BSM Café** at www.BSMCafe.com.

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Success Tip: Reduce Anxiety with a Proper Orientation

Any employee, when put into a new, strange situation, will experience anxiety that can impede his or her ability to learn to do the job. Proper orientation helps to reduce anxiety that results from entering into an unknown situation and helps provide guidelines for behavior and conduct so the employee doesn't have to experience the stress of guessing.

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