Payment Arrangements

Lump Sum or Installments. Which Should You Choose?

When it comes to selling a medical practice, there are basically two different kinds of payment arrangements: Lump Sum Payments and Installments.

In most cases, the two are mixed in some fashion. There are also earn-out and stock swap deals, which we'll touch on at the end of this article, but let's stick to what's most common for now.

A Lump Sum Payment, in the purest form, means that the buyer is paying for the whole cost, the whole price of the business, all at once at closing. The buyer may have deep pockets, the sale may be small, the buyer may be a big company buying a much smaller entity, or perhaps the buyer got a loan for the total upfront.

For most sellers, this is the dream scenario, not having to be concerned about getting the full payout for the business over time. Getting paid the entire total up-front is so desirable that, if your buyer is even considering it, the allure may be incentive enough to reduce the total price of the practice in exchange for getting the money all at once.

What is more common and a more realistic expectation for most of us is that the buyer will pay a **down-payment due at closing** in the form of an account transfer or cashier's check, and pay **the rest in installments, with interest, over time**. Regardless of the situation, the truth is that installment payments are inherently risky, as, until you have all of the money in-hand, there always exists the risk that the buyer could walk away before the payment period is over.

In order to balance the risks of installment payments, there are many things you can consider doing before the sale and as part of your sales contract (make this its own article):

Before the Sales Contract

- Get a personal guarantee. If the buyer of your medical practice is a corporate entity (LLC, S-Corp, C-Corp, etc.), it may be that their corporation was just formed to buy your practice or otherwise doesn't have a lot of resources or history behind it. In this situation, in addition to having the corporate officer signing the installment agreement in your sales contract, you should also have it personally guaranteed (signed) by the individual seller. In many instances, this is the same person, but it would show up on the contract as two separate signature lines.

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- Get a credit report on the buyer and their mate. This is what any lender would normally do, and you should as well. A credit report will allow you to get a sense of someone's history of paying their debts, and will give you a snapshot of what your future may look like when you're holding the bag. Say no to anyone with a funky credit history!

  For more on how to obtain someone's credit report, check out this simple article.

- Get personal financial statements and/or the last few months of bank statements to prove that the buyer not only has the funds to pay the down payment, but also has reserves to keep them and their family in the black after the sale.

- Get a third-party guarantee. If the buyer doesn't have a lot of assets to back them up, you may wish to have them find a third-party. This is also something banks frequently do, get a co-borrower. In this case it may be someone with a lot more assets, such as a parent or relative, a spouse, or even a friend. Someone who is willing to sign on the dotted line such that, if your buyer defaults, the third-party's ass(ets) are on the line.

  One note here: Just as you are checking out the credit and financial history of the buyer, you should also obtain a credit report and financial statement from the guarantor.

- Keep A Legal Interest In The Business. This means the buyer doesn't really own the business until all payments are made. In the mean time, if they default in their payments, you can have it written into your sales agreement that you can repossess the practice if they fail to pay. You see this all the time when financing a car or a house: If you fail to pay, the bank can repossess the asset, even if you've paid off 90% of it.

  To make the repo option legally binding, most states will have you file a Uniform Commercial Code (UCC) financing statement with the Secretary of State. Check your Secretary of State's website page for details on how to get and file a UCC in your state.

- Use An Acceleration Clause. Putting this clause in your Promissory Note (the part of your sales contract that relates to the installment payments) means that, if the buyer does not make a payment (or a certain number of payments) on time, the whole unpaid balance of the Note is immediately due. This should help motivate a buyer to keep abreast of their payment responsibilities, especially if you have also taken the precautions listed above.

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- Put The Fees on Them. You can also add a clause to your Promissory Note that, if they fail to pay, the cost of your needing to collect from them (including collection agents, attorneys' fees, etc.) falls on them. Though of course, if they have no more assets and that's why they stopped paying, you may still be stuck with a bill!

In the Sales Contract

- Go for as large a down payment as possible. The larger the down payment, the less the remaining monthly payments will be, and the more commitment the buyer is showing to purchase the practice.

- Be sure to charge interest. You're not getting the full use of the financial value of your medical practice as long as it is being paid off, so it makes sense that you would charge interest. You should charge interest regardless of whom you are selling to, even family. This also makes the buyer more motivated to pay you earlier to avoid interest (see below). The amount of each payment, with interest, is simply the amount remaining after the down payment + interest. Amortization calculators are available online to help you out with this. Check this one out (http://www.amortization-calc.com/)

- Make the payoff time at or under five years. Two to three years is preferable. The longer the payment period, the higher the risk. That said, it needs to be realistic for the buyer such that their profits will easily be able to accommodate that monthly payment.

- No pre-payment penalty. If the buyer wants to pay you out early, more power to them (and you)! Again, less risk, more up-front reward.

- Give your buyer a runway. Make the first payment due one or two months after they've taken over the business so they have some time to gather financial momentum. This strategy can also be a card you hold in the pre-sale contract negotiations. They want something from you, and you may refuse or reduce their demand in exchange for the opportunity to have their first payments due a few months after they start running the business.

A note on earn-out and stock-swap deals

Earn-outs

This is when a buyer with little money offers to pay the seller back for the price of the medical practice over time as they earn money, based on their volume in most cases. We see this a lot with small acupuncture practices and sellers who are

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desperate to sell. They'll take a small down payment and then, say, $30 per patient seen per month.

There are a couple of problems inherent in these types of arrangements. They include:

1. Trust. As a buyer you have to trust that the amount of patient visits you are being paid for are accurate.

2. The buyer may fly the practice into the ground. No patients means no earn-out.

The only conditions under which we'd be ok with an earn-out arrangement would be if you were still running the business until it's paid off; you get additional money if the business grows; and you're getting a great price for the practice.

Otherwise…well, we don't recommend these arrangements unless you're a desperate seller and you have no other time or options.

Stock Swaps

Occasionally a business will buy another business and will be paid in stock of the buyer's business. We'd say, unless the stock the seller is offering is already public (on the stock exchange) and from an established company, say no. You may be left with nothing.

In Summary

There are many ways of looking into how to buy or sell a medical practice, and hashing out the details of the payment arrangements are a key part of the sale. We hope this information is helpful. At the same time, we'd love to talk about your individual situation. Contact when you're ready and we'll get on a free call to talk about it.