Dividing Owner Income in a Group Practice

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Given that there is no single standard for “fairness,” how do clinic administrators and managing physicians ever help their practice’s owners reach an agreement regarding the allocation of income?

“Your owner compensation plan isn’t fair. Just because I’m a high producer, I end up paying more of the overhead expenses. I don’t use any more resources than the other doctors; in fact, I may actually use less.”

Sound familiar? Most group practices have faced owner disagreements about “fair” income distribution. These disputes can become bitter and last years, zapping the energy of practice owners and management and disrupting nearly every doctor meeting.

Fairness Is a Perception

Here is a typical refrain that all parties tell us when these arguments erupt: “I just want to have a system that is fair to everyone.” That is an appropriate objective, but in the real world it is easy to find two individuals whose ideas of “fair” are diametrically opposed. For example, consider a two-opthalmologist practice with an agreement that the partners split net income in proportion to their respective percentage of total collections. Combined revenue totals $2,000,000 with overhead expenses running 60%, or $1,200,000. After expenses, they have $800,000 to split as their personal income. The calculation is shown in Example 1.

All goes well until Dr. Smith realizes his overhead burden in dollars exceeds his partner’s. From the example you see that he generates $1,400,000 in collections, but keeps $560,000. Therefore, he pays $840,000 in overhead expenses compared to his partner’s $360,000 ($600,000 in collections minus the $240,000 the partner keeps).

Dr. Smith suggests a system that would be “fairer” to him: Since they are equal partners, why don’t they each pay the same amount in overhead? He suggests they equally split
all overhead expenses, so that each partner pays the same each year. **Example 2** demonstrates partner compensation under the new proposal.

When it comes to splitting income between partners, agreement on what is “fair” is often elusive. In the first example, the lower producer considered the income allocation method to be fair, while the higher producer disagreed. In the second example, perceptions of fairness were reversed.

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**Six Methods of Income Allocation**

The first step is for stakeholders to learn about the six basic methods of ownership compensation so they can craft a plan that produces a consensus. There are nearly as many formulas for splitting income as there are group practices because every organization takes a unique approach. However, most compensation systems use one or more of these six foundational methods:

1. **Equal Pay:** In this system, the net income (dollars available after expenses) is divided equally, regardless of production levels by individual doctors. An advantage of this method is that it creates a real “partnership” culture because all owners benefit equally from any successes of the practice. It further reduces internal competition between the doctors for patients since a procedure performed on a patient by any doctor has the same financial effect on all of the owners.

2. **Production Percentage:** This is probably the most commonly used compensation system in ophthalmology practices. The method distributes funds available to the doctors by the percentage each owner produces of the combined collections. This is the method used in Example 1—Dr. Smith generates 70% of the collections in the practice and receives 70% of the available net income. Advocates for this method point to the strong incentive for individual productivity.

3. **Equal Overhead Percentage:** Overhead percentage is the amount of overhead expenses divided by net collections. Some practices distribute income by charging each owner the same overhead rate. In Example 1, overhead percentage is 60%. If we subtract 60% overhead from the physicians’ collections, the pay for each doctor is the same as in the Production Percentage system. For example, Dr. Smith paid $840,000 in overhead ($1.4 million minus his income of $560,000), which is 60% overhead ($840,000/$1.4 million); likewise, Dr. Jones paid 60% of his collections to overhead expenses. Using this method encourages owners to manage expenses.

4. **Equal Overhead Dollars:** In this method, the total overhead expenses of the practice are divided equally among the owners. This is the method used in Example 2 and generally results in an advantage to high producers, as every dollar earned above the overhead amount becomes personal income. This system has less of a “partnership feel” than some of the others because each doctor is essentially independent of the other owners in terms of his or her personal productivity and income.

5. **Resources Used:** Some practices believe that each owner should pay for the expenses that the owner generates and the resources the owner uses in the practice. For example, if Dr. Brown uses one technician to see patients, but Dr. Green uses four techs and one scribe, Dr. Brown will likely object to contributing to the pay and benefits for all of the staff Dr. Green likes to employ. In this case, they may decide to assign the wages and benefits of technical personnel to the respective doctors. In some practices, nearly all expenses are divided among the owners based on usage.

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**Example 1**

<table>
<thead>
<tr>
<th>Doctor</th>
<th>Collections Generated</th>
<th>Percent of Total Collections</th>
<th>Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Smith</td>
<td>$1,400,000</td>
<td>70%</td>
<td>$560,000 (70% of $800K)</td>
</tr>
<tr>
<td>Jones</td>
<td>$600,000</td>
<td>30%</td>
<td>$240,000 (30% of $800K)</td>
</tr>
</tbody>
</table>

**Example 2**

<table>
<thead>
<tr>
<th>Doctor</th>
<th>Collections Generated</th>
<th>Overhead Paid</th>
<th>Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Smith</td>
<td>$1,400,000</td>
<td>$600,000</td>
<td>$800,000 ($1.4 million minus $600,000)</td>
</tr>
<tr>
<td>Jones</td>
<td>$600,000</td>
<td>$600,000</td>
<td>$0 (all collections would go to pay overhead)</td>
</tr>
</tbody>
</table>
6. Ownership Percentage: In this method, net income is divided among partners based on percentage of ownership. This method is rarely used to allocate all of a practice’s owner income. More common is a combination method in which just a portion of net income is divided among partners as an owner dividend. For example, a practice might divide 70% of net income by the Production Percentage method, while the other 30% is split based on ownership percentage.

**Combination: What Most Practices Do**

Most ophthalmology practices use a combination of two or more of these income distribution methods. We have mentioned one combination method in the previous paragraph, but there are many others. Many practices split net income by the Production Percentage method, while also employing the Resources Used method for certain doctor-driven expenses such as CME and travel expenses, dues and subscriptions, and sometimes even health and malpractice insurance. In addition, there are other, less commonly applied methods of income distribution such as allocating income based on days or hours worked or assigning sources of revenue to different distribution methods such as when a practice allows doctors to keep a higher percentage of speaking or consulting fees as personal income.

**Dependence vs. Independence**

In working with owners to create an agreeable income distribution system, it is important to ensure that everyone understands these basic methods and how they affect partner relationships. One question that often arises during income allocation discussions is whether the practice wants to emphasize the partnership nature of the relationship between the doctors (“we’re all in this together”) or whether it wants to focus on rewarding each doctor according to individual production (“eat what you kill”). A simple way to envision the effects of income distribution models is to place them on a continuum between dependence and independence (see Figure 1).

This graphic illustrates how the six basic systems emphasize either teamwork and dependence or independence and economic autonomy. Under the Equal Pay method, each doctor is directly dependent upon all partners for income; every dollar of collections one doctor produces results in a portion of that dollar going to all owners as personal income. In the same way, if one partner reduces his or her work schedule and thereby produces lower collections, all partners feel the effect of that decision in their take-home pay. Compare this to the Equal Overhead Dollars method in which each dollar of revenue affects only the doctor who generated those collections. The other doctors’ income is not affected by increases or decreases in their partners’ work habits. The Ownership Percentage method results in a high degree of dependence, and the Resources Used system is on the independence side of the continuum, while the Production Percentage and Equal Overhead Percentage models lie somewhere in the middle. A practice that uses more than one method to distribute income can emphasize both dependence and independence elements.

**Reaching an Agreement**

Disputes regarding the method for distributing owner income in group practices will likely continue to occur in the future because there is no single system that appears “fair” from every physician’s point of view. The best chance for reaching an agreement on income allocation is for each stakeholder to understand the basic methods for sharing income and how those methods affect the relationships among partners in the practice.