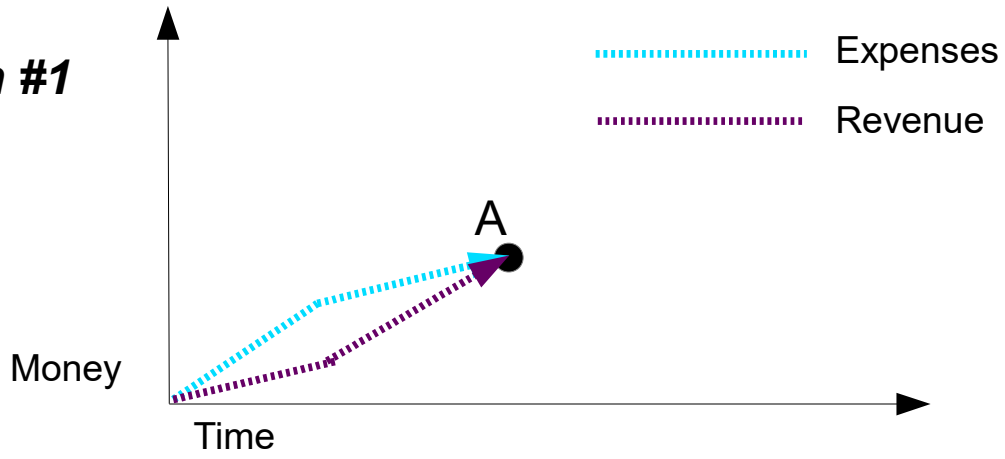
e3Business Four Step Compensation Economics Overview

Four Step Compensation Model
Step 1: "Training Wheels"
The practice provides a base compensation to the new provider to ensure they survive.

Graph #1 shows the expenses and revenue of a new provider starting at a medical practice. Unless the new provider is replacing a mature provider, expenses will normally initially exceed revenue until the provider's revenue reaches the "break even point" where the provider's revenue equals the new provider's expenses.

Point A shows the break even point for a new provider, the point where the blue line for Expenses meets the purple line for Revenue.

Graph #1



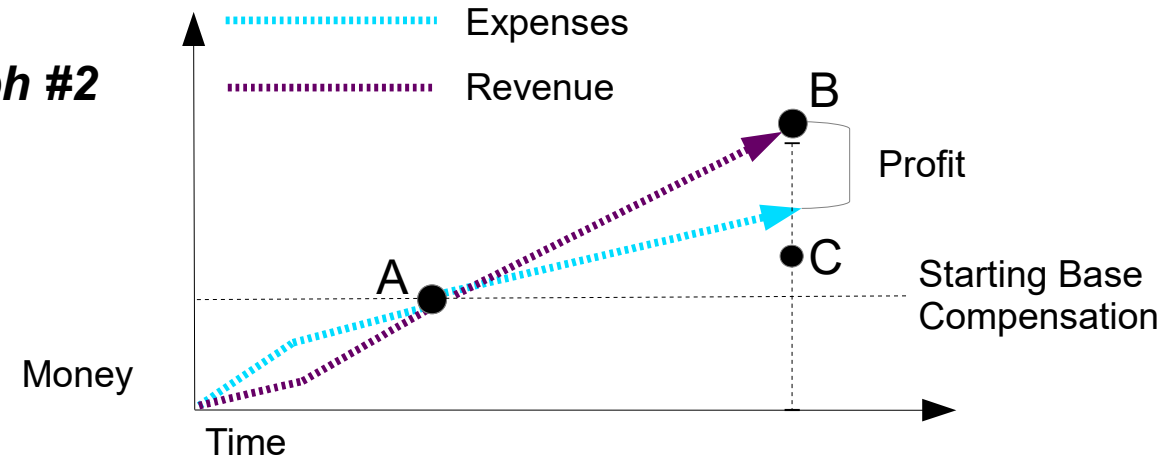
For the period of time prior to Point A on Graph #1, the practice will lose money on the new provider. During this time, the provider will most likely require some starting base compensation, (which would be reflected in the Expenses in Graph #1). Because the new provider will require compensation that they have not earned, Step 1 can be thought of as the "Training Wheels" step. The practice wants the new provider to be financially independent, but knows that assistance is required for the new provider to reach this objective.

Because the practice is losing money during this phase, two qualifiers are suggested for the base compensation. First, the base compensation needs to be less than the target compensation desired by the provider. Second, the base compensation needs to provided only for a set time period, like six months, or until a certain revenue is reached. These qualifiers motivate the new provider to work at increasing revenue. If the new provider does not increase revenue to at least Point A by the end of the starting base compensation period, the practice and new provider should revisit the relationship to determine why the new provider is not meeting expectations.

Four Step Compensation Model
Step 2: "Percentage of Revenue"
The practice and new provider split the new provider's revenue with no base compensation amount.

Once the new provider moves past Point A, the practice generates a profit as revenue exceeds expenses, (such as Point B below in Graph #2). Between Point A and Point B, the new provider is generating revenue above the revenue necessary to support the starting base compensation amount. Because the starting base compensation amount is minimal, at some point the new provider will need to have their compensation increased beyond this amount.

Graph #2

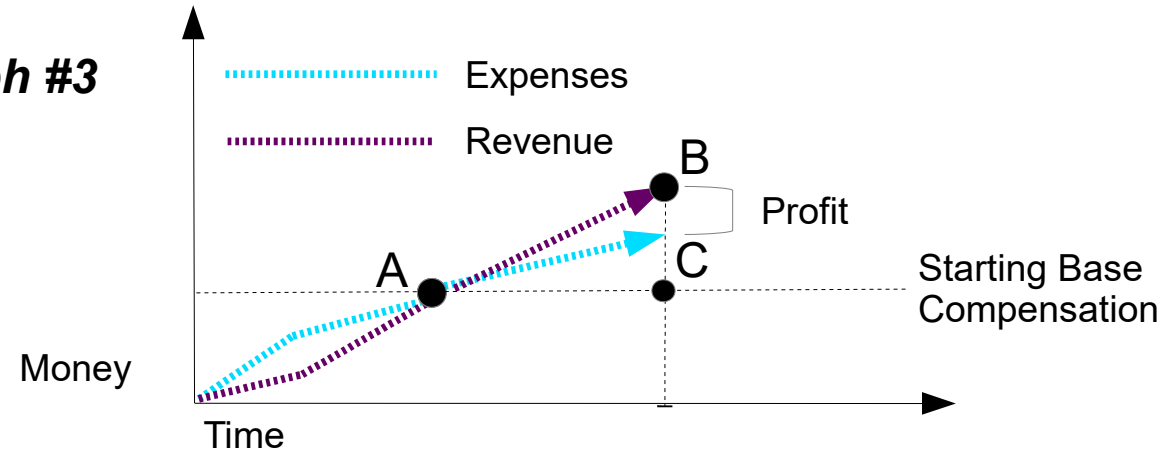


The challenge for the practice is to insulate against a decline in the new provider's revenue, especially if added expenses have been incurred to support the expected revenue, (such as increasing a staff member from part time to full time in anticipation of the new provider's increased patient volume).

To protect the practice against a decline in revenue and to further compensate the new provider, Step 2 bases provider compensation on a split of revenue between the practice and the new provider, (such as 50%). In Graph 2 above, when revenue is at Point B, Point C represents 50% of revenue. Since Point C is above the base compensation amount of Step 1, the new provider's compensation will have increased. Assuming that the new provider's increased compensation is still included in the Expenses shown in the blue line, the difference between the blue Expense line and purple Revenue line would be the practice's profit.

The "trigger" to move from Step 1 to Step 2 can either be a period of time, the new provider's revenue or a combination of both. The new provider may receive Step 1 starting base compensation for six months OR until revenue is greater than or equal to Point B in Graph 3, whichever occurs first, for example. If the new provider achieved Revenue Point B in Chart 3 in month four under this agreement, the provider's revenue would trigger Step 2 compensation based on a percentage of revenue. Because it is expected that the new provider's revenue will continue to increase, it is favorable to the provider to move to Step 2, (and Steps 3 and 4), as quickly as possible.

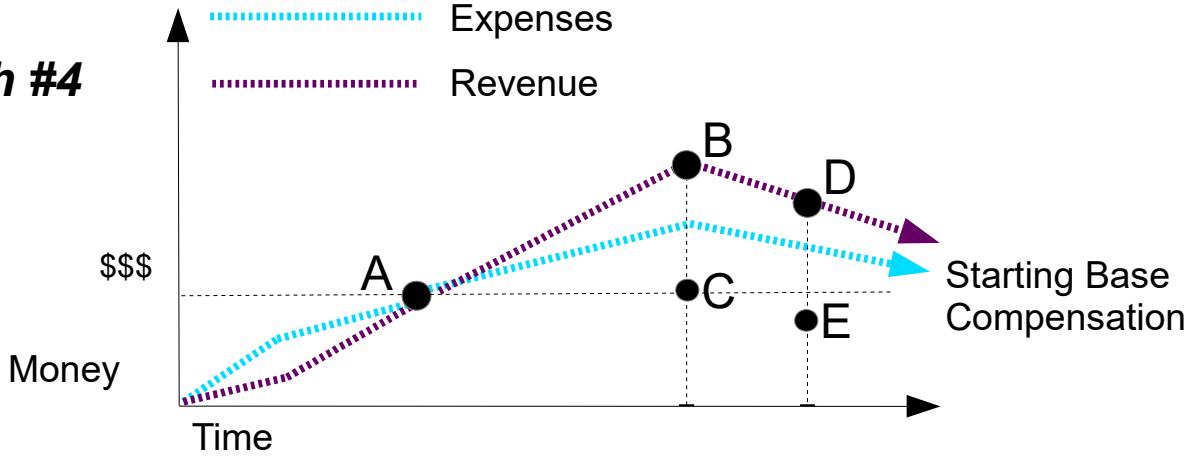
Graph #3



Step 2 protects the practice against a decline in the new provider's revenue as shown in Graph #4. Where Point B is the break even point to support the provider's compensation at Step 1 or Step 2, a decline in new provider revenue, such as to Point D, will result in a decline of the new provider's compensation, shown as Point E.

The effect of Step 2 on the new provider's compensation is that so long as the provider increases revenue past Point B, the new provider's compensation will be above Step 1 compensation. If, however, the new provider generates revenue less than Point B, the new provider will see a decline in their compensation below Step 1 compensation.

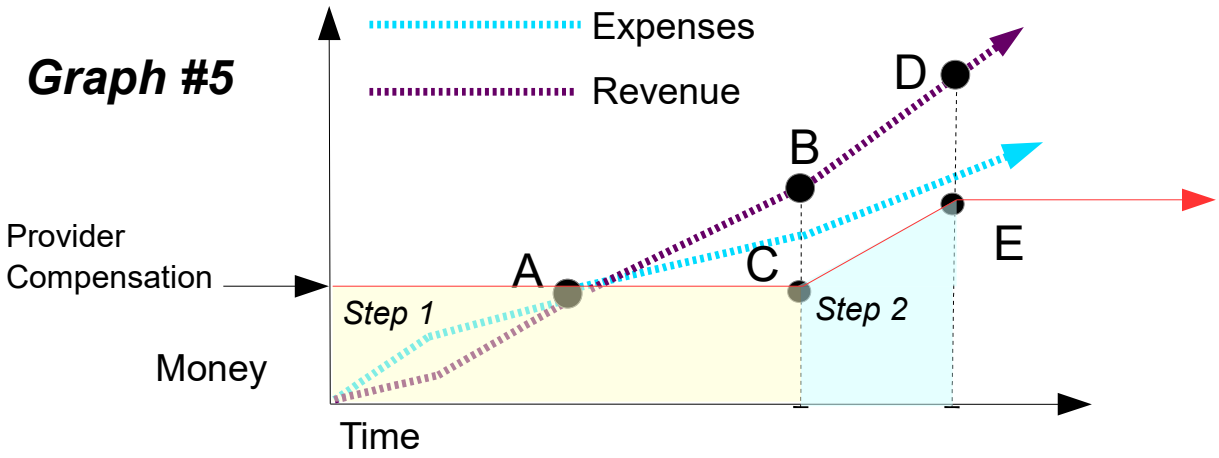
Graph #4



Four Step Compensation Model
Step 3: "Target Compensation"
The new provider receives fixed compensation so long as the new provider's revenue exceeds target revenue.

Assuming that the new provider continues to increase their revenue as expected, there will become a point where the practice will want the new provider's compensation to plateau so that the practice can recoup their investment in the supporting the new provider.

In Graph #5, the practice's loses money on the new provider through Point A and makes less than 50% of revenue from Point A to Point B, (assuming that the provider is still on Step 1 during this time). From Point B to Point D, both the practice and the new provider are making 50% of revenue. While this is equitable, it does not address the practice's investment in the new provider prior to Point B and most likely does not address the practice's investment in the infrastructure necessary to create the new provider's position in the practice. While the new provider's commitment to the practice is the term of their professional service agreement, the practice most likely has commitments for a much longer time frame, such as a building lease, equipment purchases, etc. and most likely has investment additional capital for the practice to be a going concern.

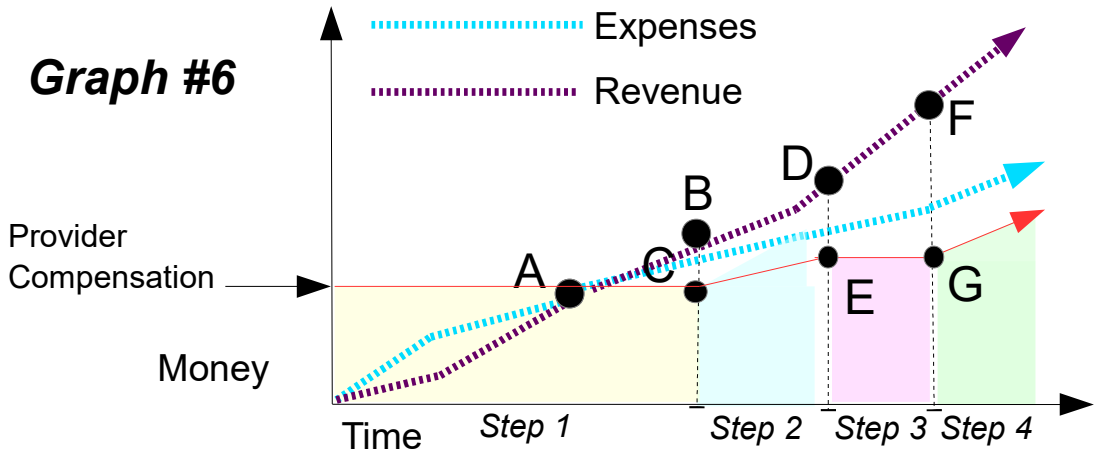


The best point for the practice to begin recouping their investment is at some previously agreed upon "target compensation" for the provider. If Point E in Graph #5 is the agreed upon target compensation, provider revenue of Point D would trigger Step 3. In Step 3, the new provider's compensation would stay constant at the level of Point E, with a qualifier attached that the new provider's revenue has to be at or above the level of Point D. If the new provider's revenue fell below Point D, the practice could revert to Step 2 and compensate the new provider at the previous level of 50% of revenue.

Four Step Compensation Model
Step 4: "Target Compensation Plus Bonus"
The new provider receives target compensation so long as the new provider's revenue exceeds target revenue AND receives a bonus that is a percentage of revenue in excess of revenue goal.

At Step 3, the new provider has reached their target compensation and the practice is making more than 50% of revenue that exceeds Point D. Without Step 4, however, the provider has little incentive to generate revenue in excess of Point D, as the new provider receives none of the revenue that exceeds Point D.

Step 4 adds a bonus to the fixed compensation of Step 3. This bonus is a percentage of the revenue generated at Point D or beyond, such as Point F in Graph #6. At Point F, the new provider generates a bonus equal to 20% of the revenue in excess of Point D, for example. This bonus gives the new provider an incentive to continue to generate revenue beyond the revenue necessary to sustain the new provider's target revenue on Step 3 and further aligns the objectives between the practice and new provider to maximize revenue. As in Step 3, the practice can protect itself against reduced revenue by maintaining the ability to return to Step 2 compensation if Revenue falls below Point D.



The Four Step Compensation Model assumes that there is revenue to support the four steps, which may not always be the case. If the provider cannot accept the starting base compensation or the practice does not expect revenue to support the provider's desired target compensation, the Four Step Compensation Model won't work. In those situations, the Four Step Compensation Model can be adjusted. The provider could start on Step 2 earning a percentage of revenue of 60-70% for a couple of months before being reduced. The new provider's compensation could be only Step 1, Step 2 and Step 4, where the provider makes a 50% of revenue to a certain level and then a bonus of 20% of revenue beyond that. The key is for the practice and new provider to discuss and consider the issues of Revenue, Expenses and Compensation going into the relationship.