

# Financial crisis or success is in providers' hands

To be successful and sustainable in the new customer-driven, competitive marketplace, aged care organisations must take an integrated approach to their strategic transformation, and align business and financial modelling to their financial management system, writes MICHAEL GOLDSWORTHY.

A large and increasing percentage of aged care organisations are in a financial crisis and struggling to deliver care within their annual budgets. This financial crisis is characterised by financial decline, impending insolvency or trading whilst insolvent and knowingly or unknowingly breaching prudential requirements, not to forget the psychological distress and risks for directors, the chief executive officer and executives.

Residential aged care and home care organisations support some of Australia's frailest older people, individuals with emerging or actual chronic or complex health conditions. However, the delivery of safe, quality care cannot be divorced from the financial realities of viability, sustainability and profitability.

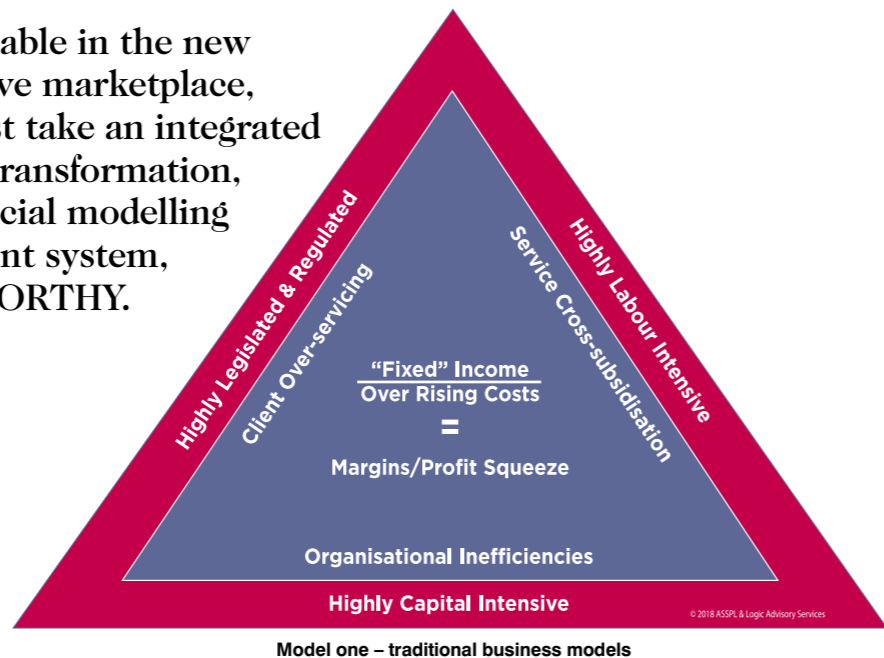
Benchmarking by StewartBrown shows from June 2017 to June 2018 the number of residential aged care facilities operating at a loss (negative earnings before tax) increased from 33.9 per cent to 45.1 per cent.

StewartBrown forecasts this to increase to 49.2 per cent by June 2019. As of June 2018 it was even more acute for inner-regional facilities (47.2 per cent) and outer-regional, rural and remote facilities (63.5 per cent).

The lack of financial sustainability of residential aged care organisations has also played a large part in the reduction of the number of residential aged care organisations from approximately 2,900 in the 1990s to under 900 today.

Similarly in home care StewartBrown has tracked a profitability decline caused by increases in unspent funds, deregulation increasing the number of competitors substantially faster than the release of home care packages and increases in the consumer price index.

Typically, these financially-troubled organisations, a large number of which are community businesses (commonly called non-for-profits), are caught in a vortex of negative cash flow, increasing losses and declining balance sheets



Model one – traditional business models

resulting in the cannibalisation of reserves to cover operating costs.

Whilst some directors on these boards and a majority of CEOs recognise the reality of their organisation's financial situation, they struggle to address the decline, often stating that the decrease from the Aged Care Funding Instrument (ACFI), limited indexation or the constraints of package funding, in an environment of increasing costs, are the heart of their financial challenges. In fact, these funding decreases are just one of several contributors to their organisation's current financial situation.

### Traditional business models

As the reforms of the Commonwealth Government transition the industry to a customer-driven, competitive market place, boards, chief executive officers and their organisations are confronted with three dilemmas:

- increasing resident and client acuity and care levels
- the demands and dynamics of the new customer-driven, competitive market
- the need to strategically transform their organisation, re-engineer their business model and re-invent their culture.

Fundamentally, a significant number of both residential and home care organisations are still operating traditional business models. They have either not completed, or worse still not commenced, the strategic transformation of their organisation, re-engineering of the business model and re-invention of the culture, which will

allow them to adapt to the new world of aged care and health care.

Whilst the vast majority of directors, CEOs and executives have or are undertaking various organisational or service improvements, they really need to grapple with the cataclysmic paradigm shift. At best they are just creating a more efficient and effective version of their current business model. Ultimately this is a recipe for disaster. An old business model cannot exist mid to long term in a new paradigm.

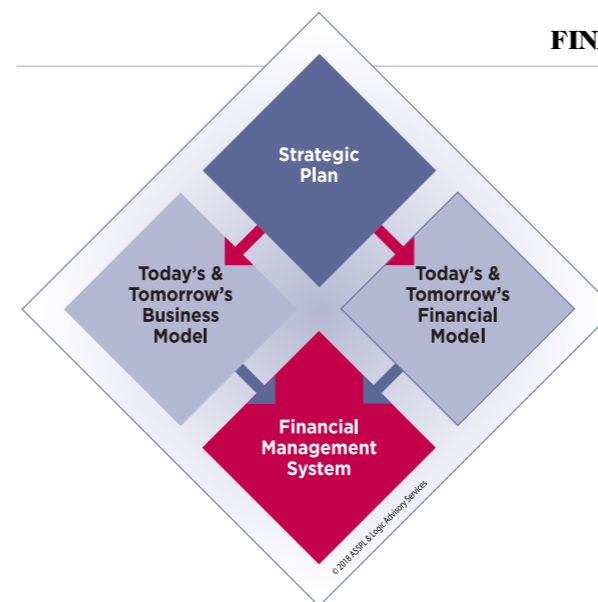
Under traditional business models, which is represented in model one (above), organisations:

- live on fixed income over rising costs, resulting in margin squeeze and profit decline
- fail to completely negate inefficiencies, over-servicing and cross subsidisation
- remain highly labour intensive, legislated and regulated and capital intensive.

Most annual budgets are no more than shopping lists based on last year's profit and loss results and will typically have no long-term, rigorous projections or robust underlying assumptions.

Having assisted nearly 7,000 organisations over the last thirty years it is evident that 95 per cent to 98 per cent of human service organisations, including aged care, have no integration between their strategy, or strategic plan, today's and tomorrow's business models and the supporting financial model, let alone to the organisation's financial management system.

Typically, there are a number of



Model two – critical components model

metrics that are not robust. Furthermore, there is limited or no direct correlation between organisational and service targets or metrics and internal and external industry benchmarks.

Such an approach may have been sufficient in the government-funded welfare paradigm. Today this approach has no place in the new customer-driven, competitive marketplace of aged care and health care, wherein public, private and community businesses increasingly compete to attract and retain customers and increase market share.

### The integrated approach

Two years ago we partnered with financial modelling specialists Daniel Cadart and Charles Lord from LOGIC Advisory Services (LOGIC) to design and enact an integrated approach to the strategic transformational requirements and financial crisis confronting an increasing number of aged care organisations.

This integrated approach brings together the processes and activities of strategy, business modelling and financial modelling, enabled by a strategic transformation process, which is represented in model two (above left).

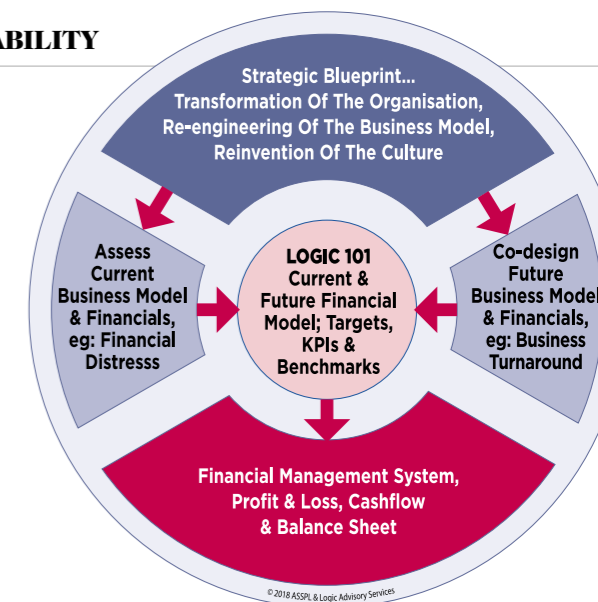
### Case study

Toosey, a small NFP aged care organisation in Longford, Tasmania originally had 40 beds. Like many similar organisations in rural and regional Australia it is a vital service, major employer and the pride of its local community.

The directors of Toosey came to grips with the shifting paradigm of aged care and health care and recognised its financial challenges from its financial statements, as well as the need to transform the organisation.

To ensure Toosey continued to serve the community and vital services were not lost the board resolved to apply the integrated approach of strategy, business modelling and financial modelling, driven by a strategic transformation process.

Whilst the board and management of



Model three – an integrated transition model

Toosey continue to work with us, they have already delivered:

- improved financial performance and a sustainable financial result without compromising care or staffing
- a new business model that transitioned them from being primarily a residential care provider to an integrated aged care and health care provider
- strategic business development projects that have grown services to now include 56 residential beds, 17 independent living units, two rural health beds, home care, community health, allied health and wellbeing services
- service improvements and organisational development projects such organisation wide clinical governance and professional development.

### The full picture

Good financial modelling tools, like Cadart and Lord's LOGIC 101, should create an organisational picture in numbers that stimulates strategic, organisational and service conversations and decisions via numerical scenarios, strategies and projects drawn from the strategic plan.

Turning elements off and on in the financial model enables bold discussions and brave decisions to be made and enacted by leaders of the organisation.

Financial modelling should be based on:

- the current business model including past and current profit and loss, cash flow and balance sheet against organisational metrics and industry benchmarks
- the future business model including researched and documented projected profit and loss, cash flow and balance sheet against targets, metrics, organisational and industry benchmarks
- agreed future scenarios, associated strategies or projects, and a capital plan
- a comprehensive and robust set of numerical assumptions, parameters and rules that drive the integrated

financial model.

In our work with Toosey, the organisation's strategic blueprint guided the application of the tool to achieve the strategic transformation of the organisation, the re-engineering of its business model, re-invention of its culture, and the alignment to the financial management system (see model three above right).

### Your decision

It is encouraging the Commonwealth Government has recently released additional funding, however forgone cuts in ACFI, reduced indexation and the constraints to home care funding will never be reimbursed.

Further, additional funding whilst welcome creates the risk of masking the fundamental challenges of traditional business models. Without adopting a fully-integrated approach to strategy, business modelling and financial modelling many organisations will continue to face financial decline, impending insolvency or be trading whilst insolvent.

The five Ps of passion, purpose, people productivity and performance are the new game in town as the Commonwealth continues its final moves to a truly customer-driven, competitive market place that delivers:

- customer choice and control
- safe, quality care
- measurable value and benefit for customers and families, organisations and communities.

Ultimately the move to a new business model that is underpinned by a robust financial model, helping create a successful and sustainable organisation that delivers services to enhance the health, lifestyle and wellbeing of residents and clients is your decision. ■ **Michael Goldsworthy is the principal consultant at Australian Strategic Services. He has spent 30 years working with boards, CEOs and executive teams of human service organisations with a particular focus on aged care and health care organisations.**