An Integrated Approach to Strategic Planning & Financial Modelling … Securing The Future of Aged Care Organisation's

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About the Article

The original version of this article was published in the magazine Australian Ageing Agenda (March – April 2019) under the title 'Financial Crisis or Financial Success ... Your Decision'. It has been updated to account for the release of the Aged Care Royal Commission (ACRC) Recommendations, the Australian Government's response and Department of Health Reforms.

This article can be read in conjunction with the article Implementing Consumer Directed Care in Residential Aged Care, which is focused on the practical implementation of Consumer Directed Care in residential aged care.

Introduction

In March 2019 the 2016–17 Commonwealth Government cost saving measures began to impact organisations. At that time, it was noted that for aged care organisations to be successful and sustainable in the new customer–driven, competitive marketplace, aged care leaders must adopt an integrated approach to the strategic transformation of their organisations. Such an approach entails bringing together strategy, service and business modelling and financial modelling; all of which should align to the organisation's Financial Management System. This statement continues to hold true and its practical implementation is now more critical than ever before.

The Crisis & The Evidence

Stewart Brown has tracked the financial results of providers over many years. The number of residential aged care facilities operating at a loss (negative earnings before tax) has been steadily increasing. In June 2017 it was 33.9%, June 2018 45.1%, December 2019 56%, March 2020 60% and June 2021 58%.

That is 58% of residential aged care facilities were operating at a loss (negative earnings before tax). As of March 2020 for Rural and Remote facilities it peaked at a catastrophic 74%. Taking into account the impacts of COVID19, declining occupancy nationally that has been worsened by COVID-19 and the reputational damage from the ACRC the financial strain many aged care organisations are under cannot be underestimated.

Despite the Australian Government announcing some additional funding in the May 2021 Budget there is no doubt that a large percentage of aged care organisations continue to have significant financial challenges. Utilising the data from their December 2020 survey Stewart Brown forecast that measures announced in the May 2021 budget[1] would:

- improve the average operating result from a deficit of $9.95 per bed per day to a deficit of $0.38 per bed per day for FY2022; and
- this would equate to 45% of residential aged care facilities operating at a loss declining from 60% in FY2021 to 45% of services in FY2022

Residential aged care and home care organisations support some of Australia's frailest aged 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.

The declining financial position of many of residential aged care organisations has played a large part in the reduction of organisations. In the 1990s there were approximately 2,900 residential aged care organisations.

1 The $10 Basic Daily Fee Supplement, increase in the viability Supplement and the Government's decision not to change the method of indexation for residential aged care subsidies.

As of the 30 June 2021 there were 830. The Department of Health Reforms will continue to drive this consolidation.

Similarly in home care Stewart Brown has tracked a financial 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 costs. Again, this is before the impacts and implications of COVID19 are considered.

Typically, these financially troubled organisations (a large number of which are community businesses (NFPs)) are caught in a vortex of negative cash flow, increasing losses and diminishing balance sheets resulting in the cannibalisation of reserves, or worse RADS, to cover operating costs.

Whilst some directors on these boards and a majority of chief executive officers recognise the reality of their organisation's financial situation, they struggle to address the decline, typically stating that the decrease in 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.

ACRC as the Saviour

From a funding perspective the ACRC has not been the saviour many organisations thought it would be. Despite the political pressure on the government of the day to undertake significant funding reform the Australian Government's response to the ACRC funding Recommendations has been to:

- tie additional funding to specific outcomes, for example the basic daily fee supplement of $10 per resident per day comes with the requirement for quarterly reporting on food and nutrition spending and quality of daily living services.
- progress with its planned transition to the Australian National Aged Care Classification (AN-ACC), which will have its funding levels recommended by a renamed Independent Hospital Pricing Authority (IHPA) from 2023. This will likely be via the establishment of a nationally efficient price.

In its current role of determining the price paid for public hospital services IPHA undertakes a range of benchmarking activities to develop cost and prices models to establish a nationally efficient price for services. Such a mechanism will reward organisations who have or can find efficiencies and maintain them. It will likely fund the viability of the top financial performers (25 – 50%), not the bottom 50%.

Given the huge discrepancies between the top financial performers in aged (top 25%) and poorest financial performers (bottom 25%) many organisations will likely struggle to deliver residential aged care services at the price IHPA advises. Let alone at the price the Australian Government decides to fund services.

Despite the ACRC Recommendations, it remains the case today that a significant portion of aged care organisations continue to be in financial decline, remain on the brink of insolvency or are trading whilst insolvent, and knowingly or unknowingly breaching prudential requirements. We should also not forget the psychological distress and risks for directors, the chief executive officer and executives of these organisations.

Based on the current Department of Health Reforms it remains incumbent on directors, chief executive officers and executives to proactively address not only their financial challenges and risks but also other legacy issues created by their traditional home care and/or residential aged care business, service and financial models.

Traditional Business Models

As the Department of Health Reforms continue to transition the industry to a customer–driven, competitive market place, leaders are confronted with four strategic dilemmas:

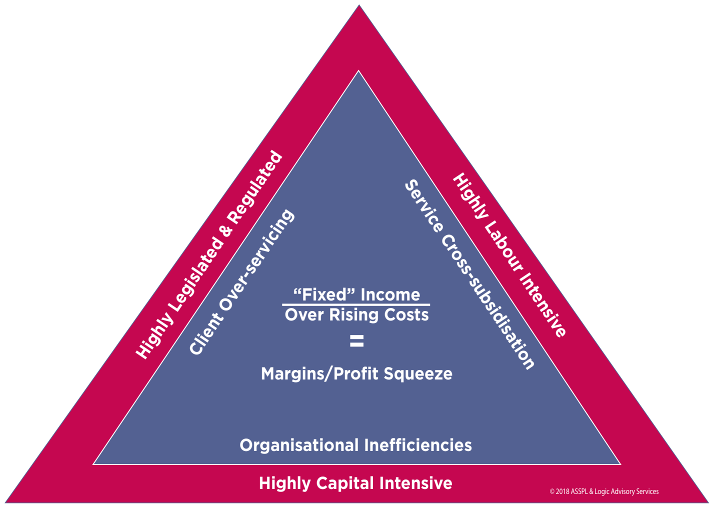
- increasing resident and/or client acuity and care levels;
- the ever-increasing expectations and requirements of residents and/or clients;
- the demands and dynamics of the new customer-driven, competitive market; and
- the need to strategically transform their organisation, re-engineer their business model and re-invent their culture.

Today there is overwhelming evidence that a significant number of both residential and home care organisations are still operating "red telephone boxes"; that is traditional service, business and financial models. Leaders have either not completed, or worse still not commenced or even considered, the strategic transformation of their organisation, re-engineering of the business and financial models and re-invention of the culture, which will allow them to adapt to the new world of aged care and health care.

Whilst an increasing number of directors, chief executive officers and executives have or are undertaking various organisational or service improvements, what they really need to grapple with, is in fact, the cataclysmic paradigm shift. This has been accelerated by the ACRC, and the subsequent Department of Health Reforms. At best they are just creating a more efficient and effective version of their current service, business and financial models. Ultimately this is a recipe for disaster. Old service, business and financial models cannot exist mid to long term in a new paradigm.

These traditional approaches are represented in the model below, where in essence aged care 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, highly legislated and regulated and highly capital intensive (acknowledging capital requirements are lower for home care).



Model One – Traditional Business Models

Annual Budgets are Just Shopping Lists

Most annual budgets are no more than "shopping lists" based on last year's profit and loss results. Typically, they have no long-term, rigorous financial projections or robust underlying assumptions, and are not derived from an integrated financial modelling tool.

Having assisted nearly 7,000 organisations over the last thirty years it is evident that 95%–98% of human service organisations, including aged care, have no integration between their strategy (Strategic Plan), today's and tomorrow's service and business models and a supporting financial model; let alone to the organisation's Financial Management System. Furthermore, there is limited or no direct correlation between organisational and service targets or metrics and internal and external industry benchmarks.

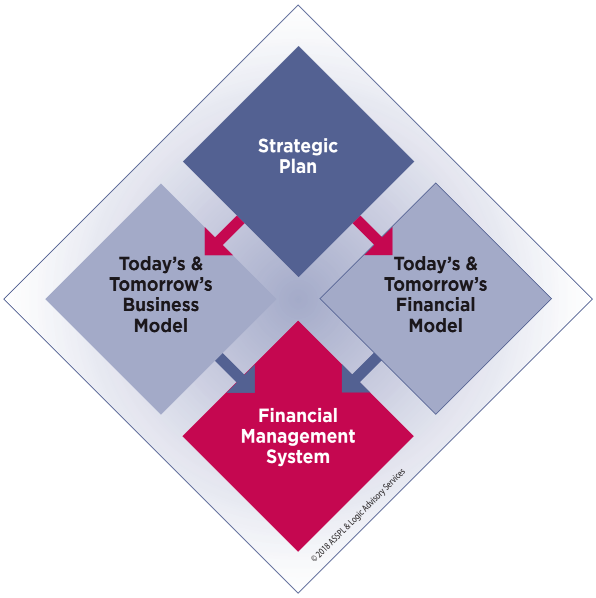
Such an approach may have been sufficient in the government funded welfare paradigm. Today this approach has no place in the new customer-driven, competitive marketplace of aged care and health care, wherein public, private and community businesses (NFPs) increasingly compete to attract and retain customers and increase market share. The process of strategically transforming their organisation is a process that must be lead by directors.

It falls squarely in their strategic leadership role and associated responsibilities. It is not a process government will expressly direct providers to undertake. A number of organisations have however been able to partly fund such work through the Business Improvement Fund (BIF), now closed, and its successor the Structural Adjustment Program (SAP). However it is funded the strategic transformation must be undertaken.

The Integrated Approach

Four years ago the team at Australian Strategic Services (ASSPL) partnered with Daniel Cadart, an ex KPMG financial modelling specialist, of Cadart Financial, to specifically design and enact an integrated approach to the strategic transformational requirements and financial crisis confronting an increasing number of aged care organisations.

At its highest level this integrated approach brings together the processes and activities of strategy, service and business modelling and financial modelling, enabled by a strategic transformation process, which is represented in the following model.



Model Two – Critical Components Model

Toosey, A Case Study

Toosey is a small, aged care and health care organisation (NFP) in Longford, Tasmania which originally had 40 beds. Like many similar organisations in rural and regional Australia it provides vital services, is a major employer and is the pride and passion of the local community.

When the Directors of Toosey came to grips with the emerging future of aged care and health care, and reviewed their financial challenges and risks they quickly recognised the need to transform the organisation. Thereafter the board resolved to apply the aforementioned integrated approach of strategy, service and business modelling and financial modelling, driven by a strategic transformation process.

Whilst the Board and management of Toosey continues to work with ASSPL and Cadart Financial, to date they have been able to deliver:

- significantly improved financial performance and sustainable financial results 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 ILUs, 2 Rural Health Beds, Home Care, Community Health, Allied Health & Wellbeing; further service development and growth is being planned
- service improvement and organisational development projects, such as organisational wide clinical governance (prior to it being mandated through the Aged Care Quality Standards) and staff professional development.

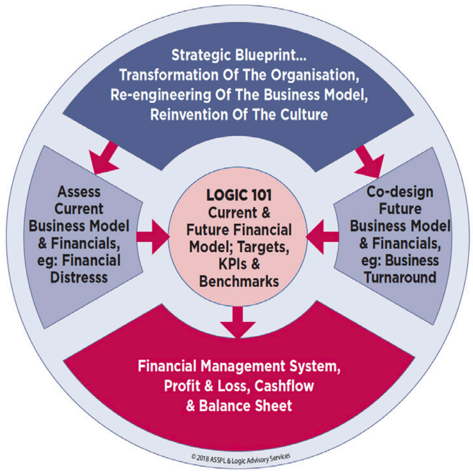
The Aged Care Financial Modelling Tool

The aged care financial modelling tool developed by Daniel creates 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. These can be turned off and on in the financial model, thereby enabling leaders to engage in bold discussions and make brave decisions.

The powerful financial modelling tool is specifically built for aged care and health care organisations, bringing together four critical components:

- firstly, the past and current profit and loss, cash flow and balance sheet against organisational/financial metrics and industry benchmarks, portraying the current business model
- secondly, the future business model, as represented by the carefully researched and documented projected profit and loss, cash flow and balance sheet against targets, metrics, organisational and industry benchmarks
- thirdly, the agreed future scenarios and their associated strategies/projects, which typically includes a capital plan
- fourthly, a comprehensive and robust set of numerical assumptions, parameters and rules that drive the highly granular and integrated financial model.

The application of the financial model is guided by the organisation's Strategic Plan, propelling the strategic transformation of the organisation, the re-engineering of its business model and re-invention of its culture, including alignment to the Financial Management System; which is represented in the model below.



Model Three – An Integrated Transition Model

Your Organisation, Your Decision

It is encouraging that the Australian Government released additional funding, both COVID-19 and non-COVID19 related, and that it is establishing, via the Independent Hospital Pricing Authority, a robust mechanism to establish the true cost of delivering high quality aged care services. However the reality must be acknowledged that forgone cuts in ACFI, reduced indexation, the constraints to home care funding and true cost of COVID-19 will never be reimbursed.

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

An Integrated Approach to Strategic Planning & Financial Modelling … Securing The Future of Aged Care Organisation's *(continued)*

As I often state "the six Ps of Passion, Purpose, People, Productivity, Performance and Profitability are the new game in town". Meanwhile the Australian Government, in responding to the ACRC, has strengthened and accelerated the move to a truly customer-driven, competitive market place[2] that delivers:

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

In summary, in strategically transforming an organisation and creating a new service and business model it is paramount that an integrated approach to strategic planning and financial modelling is undertaken. Ultimately leaders must deliver a successful and sustainable organisation that provides services that enhance the health, lifestyle and wellbeing of residents and/or clients.

2 For further information on the Australian Government's response to the Aged Care Royal Commission contact Michael.

About the Author

A visionary, an entrepreneurial strategist, a big picture thinker, Michael Goldsworthy is widely known by directors, chief executive officers and executives of community businesses (NFPs) throughout Australia for his comprehensive understanding of the big picture and his strategic insights into the current and future trends and dynamics of the various human service industries/sectors.

Michael is an engaging, educative and strategic opinion leader; his primary modus operandi are facilitating, strategically advising and project management. His significant ability to engage and influence boards, chief executive officers and executives/senior managers and provide practical strategies and tools is acknowledged by industry leaders. He has a demonstrated track record of turning theory into practice, ensuring leaders balance their "heads and hearts" (that is business and service objectives) and advance proactive strategies and projects for the future.

