Spotlight on the
Aged Care Sector

The aged care sector in Australia – comprising home care services, and residential aged care – delivers services to over 1.3 million Australians. It is a material sector; Commonwealth funding alone in FY17 was $16bn, and is budgeted to grow at 7.2% pa to FY21, with $93bn in cumulative funding FY17-FY21. Additional consumer payments are estimated to contribute a further 39% in revenue to the residential aged care sector alone in FY15.

It is also a sector facing significant financial challenge. The Aged Care Financing Authority noted that, in FY15, 28% of home care providers, and 32% of residential aged care providers, did not report a net profit. The introduction of consumer directed care is challenging established models in home care, with providers grappling with an increasingly competitive retail marketplace. In residential aged care, the Commonwealth is taking steps to limit funding growth through freezing indexation of ACFI – representing ~60% of residential aged care sectoral income.

The net result is a sector under transformation. Providers are seeking to delivers economies of scale and service differentiation in home care, and are responding to lower revenue outlooks in aged care through reducing costs and implementing more efficient ways of delivering essential services.

Azure Consulting has worked with several aged care providers to identify and implement winning strategies, and develop lower cost service delivery models. Our analysis has clearly demonstrated that, in residential aged care, the path to financial outperformance is not necessarily through better top-line performance:

FIGURE 1: REVENUE IS NOT A PERFORMANCE DRIVER IN RESIDENTIAL AGED CARE

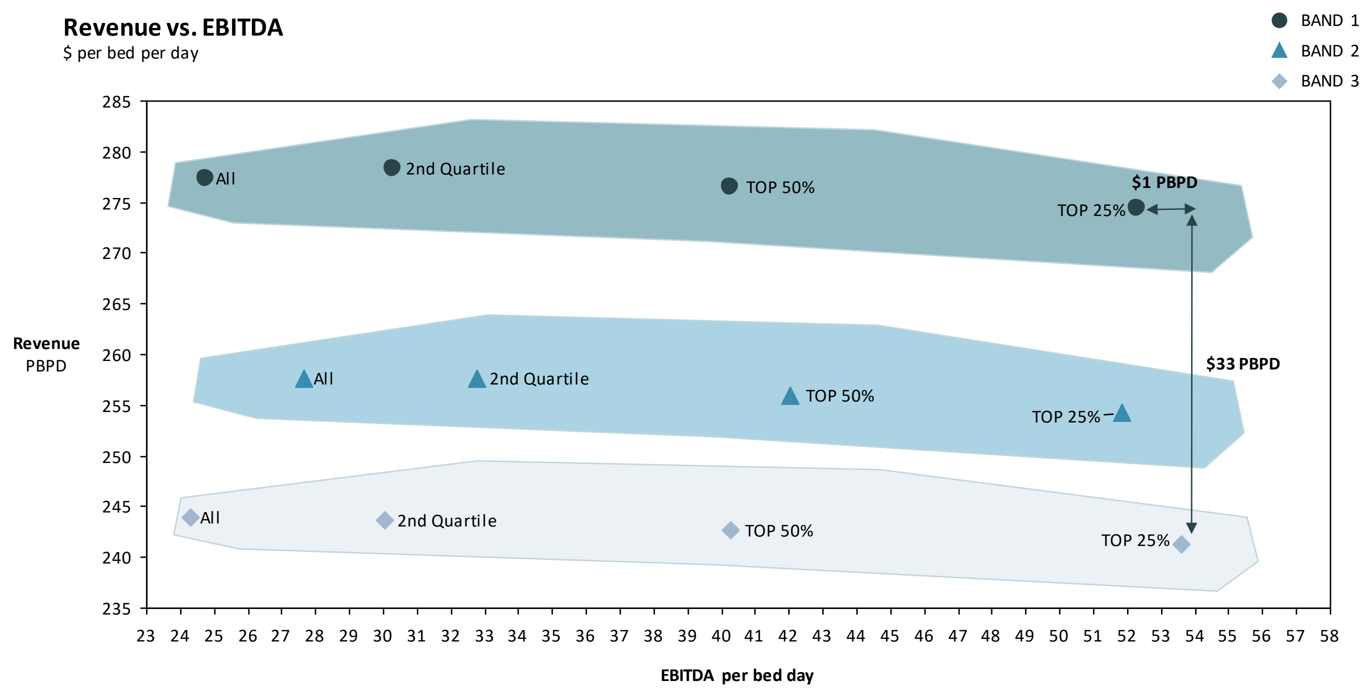

Figure 1 demonstrates EBITDA per bed per day ("pbpd") and revenue pbpd for top quartile, second quartile, top 50%, and average provider performance across three defined revenue bands, as defined by StewartBrown in their ACFP benchmarking survey. The data demonstrates that top quartile Band 3 providers generate higher EBITDA pbpd than top quartile Band 1 providers, despite Band 1 sites generating an additional $33 pbpd in revenue. That is not to say that providers shouldn't take steps to maximise the revenue levers at their disposal – such as ACFI and occupancy – and our work shows that material gains can be achieved in both of these.

Rather, the data demonstrates that the driver of profitability in residential aged care is prudent cost management:

Figure 2: Financial performance in residential aged care is driven by prudent cost management

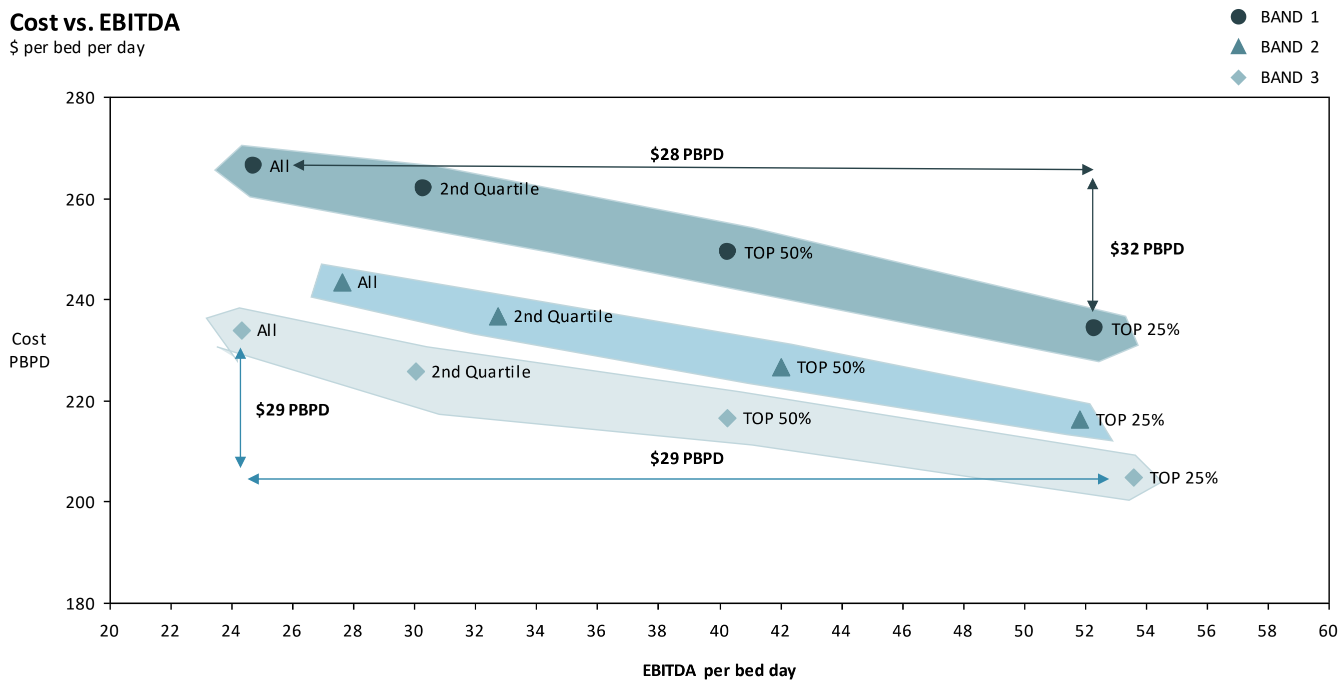

Figure 2 clearly demonstrates that within given revenue bands, **the top quartile EBITDA providers are the lowest cost providers**, and that the cost difference between top quartile providers, and average providers, is **entirely explained by differences in cost performance**.

This finding is stark, and compelling. It creates an imperative that **providers are as efficient as they can be**.

A number of providers realise this, and are taking active steps to reduce their cost structures. Over the past 18 months, we have worked with several providers to **transform their profitability**. In our experience, there are a few cost levers of focus:

- **Wages costs** may represent ~65% of residential aged care cash costs. We have undertaken **detailed redesigns of residential aged care rosters**, focused on carefully optimising staffing mix, minimising penalty triggers, limiting shift overlaps, and aligning staffing levels with periods of highest need.
- **Corporate administration recharges** are a material cost item, and it is incumbent on the sector to ensure that overheads to be borne by the operations are appropriate. We use industry and functional benchmarks to highlight areas of cost focus in corporate functions, and then work with management to redesign work, and right-size teams.
- Providers should not overlook the opportunity to **reduce non-labour cost items** through operational efficiency, category management and sourcing, and pragmatic controls on discretionary spend.

In summary, the aged care sector is **in transformation**, adapting to new competitive dynamics and addressing funding pressures. As providers face real cuts to Commonwealth funding, optimising the cost base is a critical step to financial sustainability, and enables reinvestment into new service delivery.