Business Transformation in the Care Sector

A Case Study – Regal Care Homes

This case study describes how key strategic and operational issues led to the near collapse of a large care operator and how those issues were addressed in a systematic way to transform the business.

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Economic Background

During the period 2000 to 2007 the healthcare and social care sectors experienced major private sector expansion. This was driven by major expansion of public sector spending in these areas to improve quality and reduce waiting times. Private Equity and individual entrepreneurs invested heavily in the sector fuelled by the wide availability of bank finance. As a consequence business valuations routinely exceeded 10 times earnings and were as high as 13 times earnings at the peak in 2007/08. Many businesses became highly leveraged, which in itself was not a problem provided they were able to generate substantial organic growth, however many grew by acquisition which only compounded the problem.

The reality check happened following the banking collapses of late 2008. Banks drastically cut back on lending, especially asset backed lending and the Government cut spending on social care and severely constrained spending on healthcare. The combination of these to factors severely reduced new investment and led to a normalizing of multiplies in the sector to around 6-7 times earnings. Overnight the asset values of many care businesses reduced by 40% leaving a substantial gap between debt and assets.

The perilous state of many businesses in the sector was brought into sharp focus by a recent report by Company Watch. They looked at the finances of 4,872 Companies which collectively operate 20,000 care homes across the UK. 30% of these Companies had a financial score in the lower quartile which frequently indicates that they may need a financial rescue in the future. 693 Companies were “zombie” companies where net debt exceeded the value of the business. They

Why you should read this!

- Debt levels in the Sector have never been higher.
- Nearly a third of Companies have serious financial issues with many of them likely to require rescuing in the next couple of years.
- 15% of Companies have negative net worth.
- In the wake of Southern Cross the Regulator will now assess the financial health of businesses. The implications of a poor assessment will be severe.
- Owners and Executive teams are often in denial of the extent of problems with their business and as a result do not take action until it is too late.
- Despite cuts in public funding there are significant opportunities in the sector.
- By adopting a top down bottom up approach to Quality, business performance can be transformed.
- A great platform can be created for expansion and service development

estimated that these companies had negative net worth of £217m.

What is clear from this analysis is that there is an urgent need to transform the performance of many businesses in this sector but in many cases management teams or owners are unwilling to recognise the scale of the problem and unable to see how they can change the current performance. We believe that this case study will offer clear insights into how companies can be turned around. Those that ignore the current situation risk compounding their problems. The Regulator – CQC has already been tasked by the Government to assess the financial health of providers in addition to their compliance with regulations. Any adverse comments from the Regulator will have serious consequences on occupancy and may tip many businesses over the cliff.

Regal Background

Regal Care Homes (RCH) were built up from 2005 to 2010 by the acquisition of a number of care homes spread across the country. By 2011 the Group owned 17 care homes comprising 4 nursing homes, 12 residential care homes for elderly service users and one learning disability home. On paper the Group had a registered capacity of 669 beds although only about 600 could be sold.

By 2011 a succession of major quality problems at a number of Homes had left the business with a damaged reputation with the Regulator and many Local Authorities. Bank debts had climbed to £30m and the value of the business had declined to less £20m. This left the business with a major problem of how to reduce its debt given that operating profits were barely sufficient to pay financing costs and cover capital expenditure in the Homes. The usual solution of external business reviews and revised business plans had been followed without success. By May 2012 all options had been exhausted and in the absence of an agreed solution the bank was forced to place the business in administration.

Diagnosing the Problem

Whilst the previous section explained the background to the growth in debt and reductions in asset value it did not fully explain the underlying financial issues at RCH.

Irrespective of the reductions in multiples and the resultant reduction in the value of the business, RCH was generating insufficient cash to start repaying its loans. With a capacity of 669 beds at 90% occupancy and an average weekly fee of £500 per week the business should have been capable of generating revenue of over £15m per annum. At an EBITDA margin of 20% after central costs this would have generated operating profits of £3m per annum - sufficient to finance the debt, maintain capital investment and start to repay the loans. Unfortunately RCH occupancy averaged about 65% in 2011 and the first half of 2012. At this level the business could barely afford to finance its current debt and maintain capital expenditure, any disruption to cash flow resulted in a surge in overdraft levels.

In trying to address occupancy levels in this sector many businesses look for the magic solutions:

- Improve our marketing.

- Recruit specialist sales staff.
- Engage specialist brokers to fill the beds.
- Offer incentives or discount prices.
- Replace the Home Manager with someone who can fill the beds.

In talking to providers many have tried some or all of these potential solutions with very limited success. What really surprised us at ODCG was that most had not really looked at the quality of the product. This is something you would automatically do in fast moving retail or consumer products but these fundamentals frequently get ignored in social care. Excellent care homes delivering great care don't have occupancy issues. In many cases they have waiting lists. By contrast unattractive care or nursing homes delivering institutional care services with poor inspection reports from the Regulator will always have empty beds or eventually close.

In examining the issues at RCH several things were immediately obvious:

- The estate was tired and urgently in need of investment.
- There was a high turnover of managers in the business.
- Several homes had significant areas of non-compliance with the regulations.
- In general these homes also had a very patchy track record with the regulator over a period of 1-2 years.
- The business routinely had bans on referrals from Local Authorities affecting 1-2 homes each year.

Having said that, about 25% of the homes enjoyed an excellent reputation and high occupancy levels. So problems were not universal across the Group, however, they were sufficiently serious and long lasting in other homes to damage the reputation of the Group and its financial performance overall.

At this stage many people may ask "What were the management of the business doing to prevent this happening?" The root cause of the problem was not that the management team didn't care, they did, but the management style and culture within the business created a toxic environment which negated the efforts of individual managers. The financial performance of Homes was micro managed by the owners. This was manifested by staffing levels being set from the centre, relatively minor purchases being challenged and inferior products and services being selected and imposed on Homes based on price rather than cost effectiveness.

This micro management was extended to HR and maintenance where decisions were frequently imposed on Home Managers. Whilst this approach secured very tight cost control it effectively created a culture where managers' decision making powers were effectively removed and trust was virtually non-existent. The four excellent performing Homes were able to largely ignore this as they were generally left alone, but for the rest this approach created an environment where managers were afraid to take decisions. The best managers left leaving the weakest behind; in many instances some Homes had a succession of new managers. By May 2012 only 5 out of 17 Home Managers had more than one year's service with the business and of them only 3 had two or more years' service.

Talking to many Home managers across the industry this situation is unfortunately very typical of owner managed businesses in the care sector. Whilst there are many excellent examples of owner run businesses the

majority of owners, in our experience, are afraid to trust their managers to really run their Homes. This is perhaps understandable given the sums they have invested in the operations and the personal risk they potentially face from increasing regulation, but the quality of services delivered by staff in the Homes cannot be micro-managed from the centre.

Returning to RCH, whilst there is no doubt that the financial issues facing the business, in the 18 months prior to RCH being placed in administration, took up a lot of management time the primary cause of the problems facing the business was a systematic failure of management.

The question was could this be fixed in time to save the business from closure?

Implementing the Solution

The immediate priority was to talk to all of the key stakeholders in the business and very quickly. The most important amongst these were RCH's customers. These comprised the service users in the Homes, their relatives, Local Authorities and other agencies that funded the care provided. Whilst BDO (the Administrator) reassured the Local Authorities, CQC and other agencies, we set up meetings at all the Homes with service users, relatives and staff.

These were held every evening for the two weeks immediately following the appointment of the administrator and provided the ideal way of talking face to face with everyone who used the services and worked in them. As well as reassuring everyone that the business was viable and at no immediate risk of closure, the main feedback received from relatives was that in general the quality of care provided in many of the Homes was good. In addition they and many of service users said that they liked the homely feel of the homes, they did not want to move to larger, more modern Homes where they were frightened of becoming "lost in the system".

These meetings also allowed us to meet key commissioners from the Local Authorities and many of the key staff in the Homes including the managers. In addition we were able to see at first hand the environment issues at all of the Homes. In the majority of cases the environment was just tired, requiring replacement flooring and furniture and redecoration. In some cases, however, overgrown gardens and poor exteriors did not make a very good first impression.

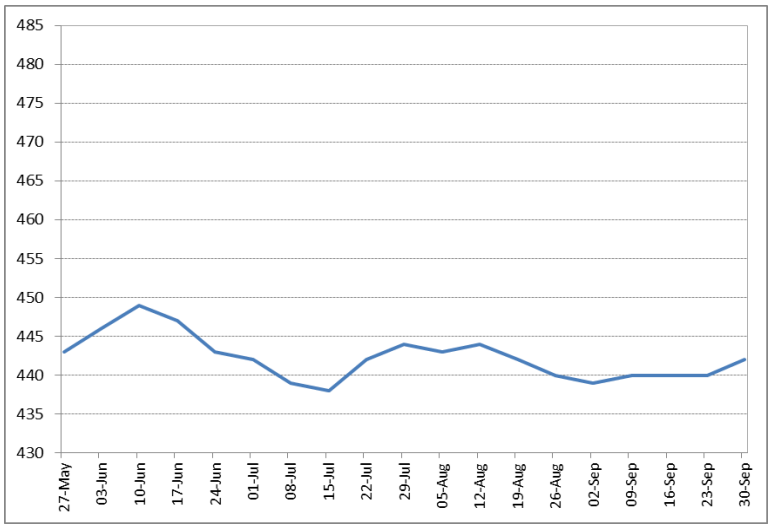
By mid-June the plan to transform RCH was taking shape. It comprised the following key areas:

1. Maintain the current occupancy and performance.
2. Strengthen the management team.
3. Change the culture in the business.
4. Significantly improve the quality of the product.

Maintaining Current Performance

This was easier said than done. Many local competitors, sensing blood, spread rumours of imminent closure to encourage good staff to leave and private funded clients to switch. In our experience the only way of overcoming this is great teamwork and excellent communications. In partnership with the team at BDO the commitment of key suppliers to the business and the Local Authorities was secured very quickly. This was backed up by clear and frequent communication with the Home managers and the service users and their relatives. Every Home received a weekly update on what was happening with the business and every relative received a monthly letter telling them what we were doing and things that had already happened. Every relative also had senior management e-mail and mobile numbers in case they had any concerns.

The table below shows the occupancy data for the four months following the appointment of the Administrator.



Many people predicted that occupancy would collapse given the uncertainty and fear that is associated with the word administration. It should also be remembered that this occurred at a time when high street retailers were being placed in administration on a weekly basis with many of them closing.

Occupancy on 27th May was 443 and at the end of September was 442. Given that 4-5 residents each week were passing away, this shows that the business continued to attract and secure new referrals despite being in administration. This achievement was significant in view of critical next phase of the business.

We recognised that to improve the business further, we needed to normalise the running of the business. In order to achieve this BDO led the creation of a new company and hived down the operations from RCH leaving the property assets and debts in RCH. With support from the bank a new bank account was created to enable the new company Regal Care Trading Ltd (RCT) to operate normally. All staff were transferred under TUPE to RCT and new supplier contracts were created to replace the undertakings previously given. This arrangement not only created a near normal operating company but it removed the stigma of administration in the eyes of the key stakeholders. Finally it created a new “clean” company which could be sold at a future date without the baggage of the old business.

Strengthening the Management Team and Changing the Culture

The strategy in this area was broken down into several stages many of them overlapping.

- Replace managers who were just not capable of doing the job.
- Create a culture of team working spiced up with a dash of healthy competition.
- Empower managers to take decisions.

- Train and support them to make the right decisions.
- Get Home Managers to really own the quality of the services in their homes.

Only four of the 17 managers were replaced over the first three months. These were individuals who either couldn't provide the type of leadership required in their Home or those who were seriously out of their depth. Our view is that removing managers should be viewed as a last resort; too many companies keep changing home managers without changing the performance of the Home. However when it is clear that somebody is out of their depth they should be removed quickly, professionally and with some humanity.

Right from the start fragmented management meetings that occurred every 6 months were replaced by structured monthly management meetings held in the south and the north. This was to ensure that numbers were kept to a level where discussion could be encouraged, to cut down on travelling and to reflect the different market conditions in each region. At these meetings the key performance indicators (KPI's) of all the Homes were shown and discussed with all managers present. This created peer pressure to improve and perform but also enabled other managers who had tackled difficult issues to share their experiences with colleagues both within and outside of the meeting.

One of the critical areas was developing managers' skills. Many managers in the care sector have had little formal management training; most have risen through the ranks and picked things up as they go along. The critical areas that needed to be addressed were managing people skills and financial management. Six managers in Kent and Essex were enrolled in the My Home Life programme which gave them a well-rounded programme together with a support network to enable them to develop their skills. Elsewhere other managers have been enrolled on specialist people management courses and dementia training to enable them to lead the development of their care teams.

Financial training was addressed by developing a full top down / bottom up budget for RCT in conjunction with the Home managers. For many of them this was the first time they had been involved in setting financial budgets and they now own them. Purchasing decisions, especially on food, has been delegated to the Home level so that managers are able to source produce locally often at lower cost and/or improved quality. Financial targets have been reset to reflect the cost per resident week. This makes it easier for managers to understand how costs should flex as occupancy changes.

Incentives were deliberately designed to reward individual and team performance across a small range of KPI's. For any manager to achieve their full bonus they would have to contribute to the Company performance but they could be recognised for excellence in their homes. Employee of the month and quarter awards were introduced to recognise the unsung heroes that every organisation has and to publicise their achievements across the company.

Finally the central support functions were deliberately kept very small and focused on ensuring all the work they did was to help the Home managers improve their service and its performance. In a group that employs 550 people across the business, the central functions – finance, operations, HR and estates consist of only 10 people including a regional manager. Everyone else is employed in the Homes. In addition to this the central team were

encouraged to change their approach from "policeman to expert" this was not easy but has significantly improved the quality of the dialogue between the Homes and the Central Team.

The result of this is that we don't have support functions creating loads of work for the Home manager. This is something that much larger organisations would do well to emulate. The key service delivery entity in the residential sector is the care or nursing home. All support functions should be asked the following simple question. *What do you do which tangibly improves the quality of care that an individual carer or nurse gives to a service user in the Home?* We know that many staff in support functions and in some cases entire support functions would fail this simple test.

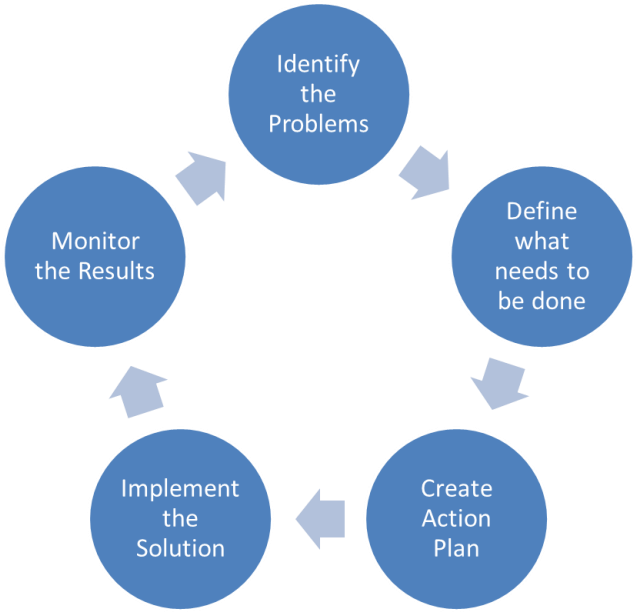
Significantly Improve the Quality of the Service

The primary focus of efforts in this area was to improve the reputation of the business with the regulator - CQC - and Local Authorities and to improve the environment in all Homes. A number of Homes had enjoyed a good reputation with fully compliant inspections but in nearly half of the homes there was a history of problems with the regulator and local authorities.

In many instances major problems had occurred in the past and significant efforts had been made to address the issues. The usual solution was to change the registered manager. Sometimes this effort paid off and the home enjoyed a sustained improvement. However, in the majority of Homes this improvement was not sustained resulting in further issues with the regulator. Many factors were blamed for this but ultimately the short term improvement had not resulted in a long term focus on quality. In many instances financial performance took priority over quality.

The decision was taken to introduce a Quality Management System (QMS) which would create a single focus for improvement. The chart below shows the basic structure of any QMS, however, in many Care Homes the focus is fragmented and the effort is frequently blown of track by the latest crisis. RCTL had Microsoft Excel based audit questionnaires that home managers were supposed to complete. In addition a large number of word based action plans existed. Finally senior operations managers carried out spot checks to identify issues they wanted the home manager to address. The major problems with this approach were as follows:

1. Managers frequently forgot to carry out their audits and were not followed through.
2. It was impossible for senior management to compare audits and see trends.
3. Training/skills issues were difficult to identify.
4. Action plans were not updated or linked to audits and were not visible across the Company.
5. Spot checks were entirely separate and ill-recorded.



Working with a specialist software service provider, IPROS CUBE ltd, a small group of home managers and senior operations managers developed a cloud based audit system which addressed all of these issues (separate case study available on this system). For the first time managers completed regular monthly compliance audits on the following areas. The first 5 audits went live in Nov 12 with the second 4 audits added in March 13.

Phase 1 - Nov 12

- Care Documentation
- Infection Control
- Medication
- First Impressions
- Meals & Nutrition

Phase 2 - March 13

- Dignity
- Domestic Services
- Financial
- Personnel
- Health & Safety

Each manager completes each audit every two months with the exception of infection control which is completed each month. A full health and safety audit is completed every three months. Each item of non-compliance has a specific action plan with dates and owners and spot checks are shown against each manager's own assessment. The system reminds managers to complete their audits and their actions and there are cut-off deadlines to ensure that managers don't let things slip.

Overall the system enables managers to identify and track issues together with the resulting solutions. Common problems are easily identified as all results are shown by home and region. Trends in each compliance area and each home are easy to spot and finally the results for all Homes are reviewed each month in regional management meetings. This has ensured that the QMS has a high focus, introduces an element of completion between homes but also allows the managers to share experience between them. Finally the system has been well received by CQC inspectors who can see that issues are being identified and addressed in a systematic manner.

The real test however, is the effect this system has had on the perceived quality of the service delivered. The table below shows the position of CQC inspections as at Jan 12 compared with the position in June 13.

	CQC Inspections - Jan 2012			CQC Inspections - Jun 2013		
	Major	Moderate	Minor	Major	Moderate	Minor
Home 1	Compliant			Compliant		
Home 2	Compliant			Compliant		
Home 3	Compliant			Compliant		
Home 4	Compliant			Compliant		
Home 5	Compliant			Compliant		
Home 6	Compliant			Compliant		
Home 7		3	1		1	2
Home 8			1	Compliant		
Home 9			4	Compliant		
Home 10		1	2			1
Home 11		2	1	Compliant		
Home 12		2	3	Compliant		
Home 13		4	1	Compliant		
Home 14	6			Compliant		
Home 15	1	3	3	Compliant		
Home 16	2	3		Compliant		
Home 17	5	3		Compliant		

The figures indicate the number of items of non-compliance split between major, moderate and minor. As can be seen there has been a transformation in the results of CQC inspections. In addition because the improvements have been driven by the home managers supported by the central team, the home managers now really own quality in their homes and have become increasingly confident with all external agencies. This in turn has had a positive impact on safeguarding issues especially where these are the result of anonymous complaints from disgruntled ex-employees.

Many organisations have set up compliance or quality functions to carry out this work in their organisations. In our opinion this is a waste of money and fundamentally undermines the accountability of the home managers. Ultimately the registered manager is accountable to CQC for the compliance in their homes. Major issues could result in that manager losing their career in care. By contrast staff in compliance/quality teams are not accountable for the quality in the Homes but create an environment where home managers feel constantly inspected by people who frequently have no experience of being a home manager. Organisations would be better advised to strip out this layer of bureaucracy, focus home managers on quality and put some of the money saved into additional training for home managers.

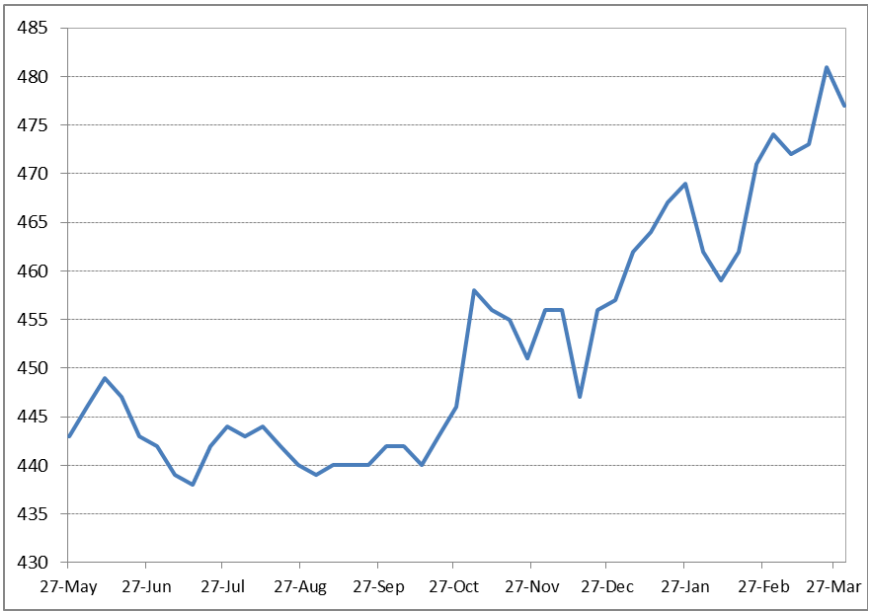
At the beginning of this section one of the priorities identified was to improve the environment in the Homes. With the lack of capital available to the business any improvement would have to be achieved using cash generated by the business. Many organisations take the corporate view of décor and colour schemes using centrally managed maintenance teams to support the Homes.

In RCTL we adopted a different approach; experienced builders were recruited as maintenance men in each Home. A modest budget for materials was provided to each home manager and they decided the priorities for their homes and colour schemes. Larger items like floorings were sourced from the centre. The result was that the vast majority of the managers transformed the internal environment in their homes at limited cost. What is more they took into account the preferences and needs of their residents, something that is impossible to achieve from the centre. More recently some home managers have started to implement dementia friendly environments that help residents and remove the institutional feel of many care homes.

Summary

As can be seen it is possible to transform a care business even in the most difficult circumstances. Whilst Administration should still be seen as a last resort, this case study of RCTL shows that it is a viable solution where lenders have lost faith in the management team running the business. At the same time the case study shows what can be achieved with a different approach and a focused management team.

At the beginning of this paper we made the clear link between the quality of the service and the occupancy. The question that remains is what difference did all this effort make to the occupancy of the business? The chart below shows the change in occupancy that was achieved in the 6 months following the creation of RCTL (Oct 12 – March 13).



As can be seen occupancy jumped from 440 at the end of Sept 12 to 480 (or 80% of the available beds) at the end of March 13. This was achieved against a background of high dependency on Local Authority referrals and cuts in government spending. Whilst other financial information is confidential to the business these results show what can be achieved in a very short period when a business really focuses on transforming its reputation.