

# A strategy for financially sustainable care homes

Many people in the care home sector, whether they are commercial or non-profit providers, are aware of the continued significant financial challenges in the market place. Revenue growth is stagnant and increasing costs are squeezing profitability for commercial operators of all sizes, and equally, threatening the financial viability of many non-profit making providers.

The focus of this article is to assist providers to explore their current costs and to make practical suggestions for sustainable efficiency savings that eliminate financial waste.

## Care sector challenges

Overcapacity, a lack of available finance to improve properties and an increasing focus on alternative forms of care have pushed care home occupancy rates to 10-year lows. Together with below inflation fee increases, or even decreases caused largely by local authority spending cuts, there are revenue growth challenges for operators now and within the next couple of years.

At the same time that revenue growth is stalling, exceptional cost pressures are exacerbating the situation. Increases to the minimum wage in October 2010 and changes to employers' pension obligations in April 2011 have helped to keep payroll-related costs as a proportion of revenue at historic highs. The global surge in commodity prices like oil, food and even paper, over the last 12 months will filter through to non-payroll costs as well in the short term.

These challenges have squeezed profitability and put pressure on margins, which makes it vital for providers to control and manage their costs more closely than ever.



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**At a time when the health and social care sector is facing enormous economic challenges, Kien Lac looks at how sustainable profit improvement can be achieved for care providers.**

## Cost management

While many organizations resort to crude cost-cutting in difficult times, such as staff cutbacks or slashing training, these short-term savings may be detrimental to service quality. An uncontrolled decline in care service quality poses significant risk to the long-term health and sustainability of an operator.

Instead, the approach recommended here is proactive 'cost management' rather than simple cost-cutting or reduction. The cost management approach not only reduces costs in a sustainable manner, but maintains the required levels of service and improves efficiency. The two basic principles of cost management are that:

- Every cost incurred by a business supports the business objectives
- Every cost is incurred efficiently.

Any costs not conforming to these principles are considered as financial waste. Cost management is the process of identifying and eliminating this waste through improving procurement pricing of goods and services purchased; it also involves optimizing the consumption of those goods and services.

## Cost saving opportunities

The opportunities for realizing cost savings exist at a number of different levels. Significant price or consumption savings can be achieved purely by implementing some simple quick wins and by effectively managing the different costs on a routine basis.

However, the real essence of cost man-

## Box 1: Steps to cost saving

- 1 Know where you are at all times through:
  - Routine in-depth analysis of your current expenditure
  - Consumption profiles—what is consumed, when and by whom
  - Recording costs or unit costs—by product/service/supplier
- 2 Know where you should be by:
  - Adopting standards/compare industry benchmarks for usage
  - Competitive tendering to determine the best market place prices
- 3 Take actions to close the gap
- 4 Ongoing monitoring and continuous improvement.

agement and the thing that really opens up most of the opportunities are proactive cost management activities around:

- Capturing accurate cost data
- Analysing data to further understand your business
- Benchmarking costs
- Finding and implementing solutions
- Constantly monitoring and adjusting to make continuous improvements.

If you do not understand your cost base, you have little chance of controlling it, let alone reducing it in a planned manner. See *Box 1* for steps to proactive cost management.

## Proactive cost management

More complex cost areas may require specialist expertise or industry intelligence to identify and access beneficial solutions. For example, technology advancements are bringing energy efficiency, IT and product solutions to the market and some may offer efficiency opportunities to operators.

Finally, leveraging available purchasing power can also yield some good improvements on procurement efficiency. Most independent care providers or small care groups may not have the internal expertise or purchasing power to experience these savings, but outsourcing can make them accessible.

**Payroll-related costs**

Payroll-related costs comprising of direct pay, national insurance, pensions, and other benefits are the most significant area of cost for all care providers; often representing up to 75% of their cost base. Therefore, this must be a priority when reviewing for efficiency savings.

As with all costs, total payroll-related cost is a function of the amount of labour or staffing (hours) used and the labour rates paid for those hours. Efficiency reviews need to consider both parts of the equation to ensure that:

- Staffing resources required to deliver the desired service matches the business activity at any given time
- Average labour rates are competitive for the service provided and for the local labour market.

Whether formal or informal, optimizing staffing efficiency requires care homes to know how many hours of each type of care serv-

ice every service user requires per day. Care homes also need a system of daily planning and scheduling in place that is flexible and matches staffing requirements to known levels of business activity. Areas to consider include:

- Re-profiling rotas to increase flexible working patterns, agreeing changes to staff working hours and employment contracts where appropriate, and reviewing rest breaks within the rules set by the working time regulations.
- Adopting a clear sickness absence policy
- Managing underperformance through effective performance reviews
- Resolve disciplinary situations promptly to avoid drawn out and costly disputes.

Average labour rates are affected by factors including the proportion of premium rate overtime used, the number of agency staff hours, unplanned absences and holidays, and the local labour market. Average rates are also affected by the staff grade and ex-

perience mix of staff employed. Providers face the challenge of maintaining a staff pool combining the appropriate mix of qualifications and experience for the required care, without staffing being too 'top heavy'. Areas to consider include:

- Reducing reliance on premium overtime hours and agency staff
- Establishing a 'care bank', sharing staff with other local providers if necessary
- Amend terms and conditions of employment for new staff, for example holidays and pay bands
- Review staff team profiling and organizational structure.

Many of the solutions to addressing staffing efficiency and labour rates will involve taking actions that are governed by employment law. Obviously, cost management of staffing must respect the rights of employees enshrined in the relevant laws. It is prudent to take advice from an employment lawyer in the appropriate situations.

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### Overhead costs

Some of the essential care business overhead costs, including utilities, telecoms, food, and cleaning supplies, are all too easy to overlook. Although these costs may seem smaller and less important within your organization, effectively managing overhead costs can really make a difference.

### Utilities costs

Like all areas of costs that a business wants to control and reduce, a necessary starting point is to carry out a full review of your energy costs on a regular basis to:

- Identify and validate your complete list of electricity and gas supplies, especially in multi-site environments

- Identify the suppliers for each supply
- Understand the contractual status of each supply
- Understand your annual kWh consumption based on the latest 12 month usage
- Understand the rates for each supply
- Understand and validate the accuracy of billed costs from the above data.

Savings opportunities for electricity and gas are around reducing energy consumption and securing the best possible rates when each supply is ready to be tendered. See *Box 2* for more energy saving tips.

Although it is not currently possible to leverage competition to secure better rates for water charges, you can monitor and analyse your bills and consumption. This en-

ures the business is only charged for what it consumes, takes advantage of any available allowances, and pays the lowest level of standing charge. Even providers not using metered water supplies would benefit from regularly analysing their water usage to determine whether they would benefit from metered supplies. All local water companies will provide advice about water efficiency for customers.

### Food costs

Food is a significant area of expense for care providers. It is a commodity market that can be fairly volatile, with poor weather, bad harvests and oil prices all having adversely effected food prices in the past year.

As with other cost areas, food cost management initially requires a detailed understanding of the consumption in the business and the unit prices you pay for these items.

The analysis aims to get a clear 'core list' of food items that account for the top 80% of the business' annual spend on food. The remaining 20% is usually accounted for by low volume/value or irregular purchases, which have a lower impact on total costs. This information is useful, not only for controlling usage, but also for engaging suppliers in a competitive tender. Suppliers will often give you a more favourable quantity-related quote for items that account for 80% of your spending. These types of savings opportunities are achieved by switching suppliers or negotiating with current suppliers to bring them down to the best market rates.

Many providers, especially the smaller ones, believe it is cheaper to use their local supermarkets rather than purchase through a specialist food supplier. This can appear to be the case because providers have not gone through the above 80:20 analysis before engaging suppliers. If suppliers do not have sufficient information about a provider's consumption they may not be offering them the best possible discounts.

### Other overhead costs

While it is difficult to cover how to manage and reduce every conceivable cost in this article, the underlying principles explained above can be applied to any of the business' costs.

Irrespective of the overhead cost area, it is the proactive cost management culture of always measuring, analysing, comparing, tendering, innovating and monitoring that optimizes the opportunities for savings and efficiencies.

### Outsourcing

Of course, effectively managing your overhead costs requires significant time, a degree of expertise in some areas, and the ability to leverage some purchasing power.

While the larger providers may have sizeable teams to devote to rigorous cost management, it is unlikely that smaller independent providers will have such resources. Giving important responsibility to unqualified staff also poses significant risk to the business if incorrect decisions are made.

The critical thing for any provider to consider is what the business can do internally, and what it cannot do. Activities, tasks and functions that a business cannot undertake internally can be outsourced. By outsourcing some or even all of your cost and purchase management needs, you can access specialist skills, industry expertise and the necessary purchasing power that can unlock all the potential opportunities. Effective outsourcing will also free up your own management and staff time to focus on your core business objectives, while still allow you to remain in full control.

### Key points

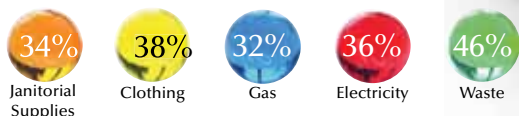
- **Proactive cost management is better than short-term cost cutting**
- **Cost management is about identifying and eliminating waste**
- **Financial waste can be in the form of inefficient consumption or price**
- **Analyse costs thoroughly to understand where you are and where you should be**
- **The gap is the waste element, take actions to close the gap**
- **Continuously monitor and improve.**

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