Why it is important to factor profit into the cost of care

How profitable is your care home?

New research recently revealed that thousands of British care homes are facing collapse because of a funding crisis.

The National Living Wage increase is one of the main causes as it has put an increased burden on the running costs of care homes. It will rise again in three years, putting further pressure on a stretched system.

To survive, it means that it is increasingly important for care homes operators to factor profit into the true cost of care. But where do you start? Here is our advice:

A standard cost of care calculation will generally cover items such as staffing costs, other direct costs and overheads. This is true whether the cost calculation comes from you as a provider, or as a template for completion from, for example, a Local Authority as part of an annual review of fees.

The issue of profit (or cost of capital) is often less straightforward.

It is important providers understand the level of reasonable profits they should be looking to make, and to be in a position to have appropriate discussions with commissioners about why this is also important for them to consider properly.

Providers are often hesitant or nervous around having a discussion with commissioners around the need to make profits, what level of profits should be made by a business, and why this is the case. There may be a feeling that commissioners would see profit as being directly related to what an owner takes out of the business, when this is not the case.

Commissioners do not always give the issue the prominence it deserves when looking at fees and can be dismissive of it.

We have seen templates from Local Authorities which completely ignore a detailed discussion of profit – stating they will 'apply a fixed percentage to all returns from providers to account for return on capital employed'. This is unsatisfactory.

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What does 'Profit' include?

Profits made on care home businesses would be used to cover the following items:

- Interest on bank debt;
- Repayment over bank debt (which traditionally will be over a 15 to 20-year period);
- Capital Expenditure (including, for example, new beds, new boilers, kitchen equipment, significant refurbishments – none of this is properly accounted for as an 'overhead');
- An adequate return for the owner's time spent in the business;
- An ability to build reserves of cash within the business to cover any unforeseen events;
- A return on the amount of capital (asset value) invested in the business.

Why is this important?

What is your annual budget for capital expenditure? Have you any large projects on the horizon (over the next 1 to 3 years for example)? Perhaps you have significant levels of equipment in the home nearing the end of its useful life.

Consider how all this will be funded. Standard models for calculating 'overheads' would include repairs and maintenance but not these items. These are funded from profits, either directly or by way of funding further debt to buy assets on a HP agreement for example.

Any care provider funded by bank or other debt will almost certainly have profit targets (Bank Covenants). Failure to meet those targets will over the longer term have consequences for continued availability of funding and the viability of the business. Failure to meet those targets by a significant margin will impact ultimately on the ability to repay debt.

This factor is likely to be relevant to all debt funded homes.

As a provider, how much time do you spend within your business on a weekly basis? What do you feel this time is worth, and is the business in a position to reward you adequately for your time and efforts?

Does your current fee structure leave sufficient free cash to enable the business to cope with unforeseen events? Consider what you would do if there was an unexpected drop in occupancy combined with a need to utilise a lot of agency staff over a short period of time, and a key piece of equipment failed.

Why is this important for commissioners?

A stable care sector requires investment. It requires this investment in order to maintain and improve on quality standards over time, and ultimately to have a sustainable provision of social care.

Profit is a vital part of this alongside other cost elements.

Can any commissioners attract or even expect investment in the future if they do not properly account for a reasonable level of profit within their fees?

Whilst we understand there are many non-financial reasons providers work in the sector, would good providers ultimately leave the sector if they feel they could make more money with their time (and assets) elsewhere?

To conclude

Profit is an important element within the calculation of the true cost of providing care. There are many reasons behind the need to make a reasonable level of profit and these can form the basis of a detailed calculation and subsequent discussion with commissioners. At Caresolve, we do not feel that providers should be unwilling to have this discussion.

A reasonable level of profit should be able to be confidently explained and justified.

Richard Shore, Finance Director of Caresolve, the specialists in care home transformation.

About Caresolve

Caresolve provides its clients with insight into the operational, financial, recruitment and compliance position of a home or group of homes.

Caresolve also helps its clients negotiate the ever-changing landscape determined by the CQC and equivalent governing bodies in Scotland and Wales.

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