



The Anatomy Of A Turnaround

The resuscitation of a failing company often requires the help of outside experts and a willingness to accept radical change.

IT'S COMMON KNOWLEDGE THAT nursing facilities face challenging business conditions: extensive state and federal regulation, stiff competition, ever-changing laws, and a relative scarcity of capital. And it's unlikely that these conditions will change in the near future.

Inevitably, there will be winners and losers in the battle to remain fiscally and operationally successful, but that doesn't mean that providers who lose their way cannot turn things around and regain a positive footing. However, it may be necessary to bring in outside help and make some radical changes along the way, including installing a new management team, renegotiating vendor contracts, rethinking the culture of the business, or seeking Chapter 11 bankruptcy protection.

Turnaround Defined

In his book "The Turnaround Experience," Frederick Zimmerman mentions three basic criteria for a successful turnaround to occur:

- Profitability is improved from the levels of the period of crisis for a period of at least several years;
- Profitability is positive; and
- Market position is significantly strengthened, either by increasing market share or by successfully concentrating on an important subset of the market.

Often turnarounds are categorized; they may be thought of as operational, financial, and statutory or nonstatutory. Success often requires addressing all of these concurrently; however, it is of value to examine each of these in turn.

An operational turnaround seeks to enhance revenue and reduce the per-resident costs of delivering services. The exigencies of running a nursing facility make this a daunting task at best, and it can only be done with the disciplined application of performance management, which—beyond being merely an efficiency study—seeks to address the sources of operational defi-

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ciencies. In an underperforming nursing facility company, these might include:

- Lack of rigor surrounding the cash management process;
- Poor to nonexistent controls in areas of staffing, procurement, or quality of care;
- No linkage between financial measurements and key performance drivers;
- Lack of accountability within the ranks of management; and
- Ownership generally lacks focus on results.

For any company, decay and decline is never precipitous. Rather, it is an aggregation of habits and thinking that

are inimical to survival. Performance Management addresses the entire culture of an organization, providing a platform for long-term recovery.

The Project

Recently, a team led by a certified turnaround professional was brought in to help reverse the fortunes of a group of four nursing facilities with more than 400 beds. Applying the principals of performance management, the team went to work by launching an operational turnaround effort that began with the renegotiation of some highly unfavorable vendor contracts.

For example, when the provider of pharmaceutical services gave the company a 30-day termination notice, the turnaround team negotiated a deal with an out-of-area pharmaceutical provider that was eager to extend its service into a new locale. Often, a nursing facility in crisis has fallen into paying much higher than necessary costs for services—essentially a risk premium by the service providers.

A per-prescription analysis had also indicated that the pharmaceutical provider had been exploiting the financial condition of the company in question. The team obtained a reduction of approximately 20 percent in drug costs, and, by plainly setting out an

CHARLES FERRARO, LNHA, is administrator of the Grace Manor Health Care Facility, Buffalo, N.Y. TOMMY M. ONICH, CTP, is president of TCMI, Buffalo, N.Y., and a director of the Corporate Renewal Network.

accurate financial representation of the company along with a plan of recovery, they were able to negotiate a temporary 90- to 120-day payment cycle from the pharmaceutical provider, rather than the customary 30-day cycle. In addition to immediately saving almost \$20,000 per month, this effectively freed up some \$300,000 to \$400,000 in working capital, which could then be used to meet other pressing obligations. The pharmacy provider, in effect, became a partner in the company's recovery, as the turnaround team worked to meet the payment obligations and then to reduce the payment cycle to a more normal one.

Continuity Of Services

A similar arrangement was made with an existing external major therapy provider, who continued to provide services to the company. This enabled the turnaround team to free up working capital and effectively deal with the problem created when professional staff "bailed out" for more secure employment. It also helped ensure the consistency in professional services necessary to maintain the company's high-margin, core rehabilitation business.

Next, the team went to work on the cash flow process by imposing monetary discipline. It was decided that all expenditures would be based on the company's quality and fiscal needs, replacing the unwritten policy-in-effect of panic-paying vendors who screamed the loudest or threatened to cut off service at the time. A single, trained individual was put in charge of cash-disbursement decision making, and he, in turn, communicated with the administrators of each facility in the company to ensure the provision of necessary services, based on company priorities.

This individual, a certified public accountant, also directed the company's accounting department to produce a cash-flow analysis and cash-flow

budget to give the organization a cash-available road map with which to operate during the crisis stage. This enabled the turnaround team to estimate maximum cash available in order to meet the needs of the company and negotiate minimal amounts acceptable to maintain service from critical vendors.

Critical Quality Issues

Next the team turned its attention to quality issues. External threats to a

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nursing facility in fiscal crisis often include zealous intervention by state or federal inspectors in their effort to protect residents from harm. Although completely understandable—perhaps even laudable—this intervention, nonetheless, can be the final straw that breaks a company's back.

Quality issues at one of the four facilities had already led to the imposition of a denial of payment for new admissions (DOPNA), which elicited a two-pronged response from the turnaround team. First, efforts were focused on removing the root causes of the problem in the shortest possible time consistent with maintaining a sustainable ongoing effort. A corrective-effort team was formed, which included knowledgeable and dedicated members of other facilities in the company under the direct guidance of the administrator of the affected facility.

To minimize the financial effect of the DOPNA at the affected facility, the team expanded a sister facility's 20-bed

subacute unit to 30 beds and made a decision to continue to admit Medicare rehab cases to the affected facility, even though no payment would be made for those cases. This precluded notifying hospitals that Medicare admissions would not be accepted. Such notification would result in high-margin admissions being shifted away from the facility as well as potential harm to its reputation. Such damage would have likely resulted in an irreversible downward spiral for the affected nursing facility.

In its response, however, the turnaround team had to be confident that they could prevent harm to residents admitted to the affected facility and that they could rapidly expand a subacute unit by 50 percent and still maintain both quality of care and cost-effectiveness in the sister facility. To act otherwise would have been unconscionable.

Both objectives were met, and when the DOPNA was eventually lifted, the negative financial and hospital-relations implications had been minimized. What should have cost the company approximately \$85,000 in critical cash flow was reduced to less than \$35,000 by admitting without regard to payment, and that in turn was reduced to zero due to the increased contributions of the expanded subacute unit at the sister facility.

Multiple Disasters

It is not uncommon during this crisis stage of a turnaround to have multiple disasters strike, and this is exactly what occurred when yet another facility in the group was hit with a DOPNA following a resident elopement incident. In this instance, while it was possible to reduce the short-term financial and long-term provider relations impact by following the strategy of accepting nonpaying Medicare rehab cases, it was not possible to expand any other subacute units.

Compounding this was another issue. Performance management

requires addressing the root causes of problems that occur. The turnaround team had to make the difficult decision to replace the administrator of one of the affected facilities, although the company was hardly in a good position to attract new talent.

The team's analysis indicated that the administrator in place had been worn down by too many years of dysfunctional top management and the ensuing lack of focus and ownership. He also simply did not take decisions necessary to resolve this and other critical situations. Therefore, the team could not be sure that sufficient quality-of-care controls were in place to reasonably guarantee the safety of residents.

A licensed administrator from the turnaround team had to pull double duty as administrator-of-record at the affected facility until a suitable replacement was secured. This temporary administrator very quickly reduced per-resident, per-day costs by over 10 percent, while improving quality and restoring the facility to marginal profitability and positive cash flow.

The Financial Turnaround

While the operational turnaround seeks to enhance performance, a financial turnaround refers to activities related to accounting and finance. It does not include debt reduction through negotiation or through Chapter 11 proceedings. In a nursing facility environment a financial turnaround must focus on both financial reporting and the revenue/billing cycle. It will ensure that financial reporting does much more than meet requirements of taxation and cost reports.

Particular attention must be paid to systemic and procedural issues providing a solid platform for the timely delivery of information that is both relevant and reliable.

It is not uncommon, when facilities are in a late stage of decline, for management information systems to be

adversely affected. The ability of the organization to deliver useful information is further impaired by the human factor. Denial is often pervasive, and the result is a paucity of critical thinking and reluctance by anyone to be the harbinger of bad news. In this environment, information systems often produce data that is late, erroneous, and insufficient.

Recently, the authors served in a group of facilities where financial record keeping had deteriorated almost

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completely. Even such basic reports as monthly profit-and-loss statements were no longer being produced, and monthly billing was only about 70 percent of what it should have been. Predictably, many critical areas in the billing/revenue cycle were in disarray. In fact, historically, the group had written off millions of dollars of potential revenue due to the dysfunction in this area.

Restructuring Required

As bad as this situation was, a total financial turnaround was completed over a period of several months. The nursing facilities had incurred so much debt, however, that either a statutory or nonstatutory restructuring was required. This refers to the rationalization of debt either formally through Chapter 11 proceedings (statutory) or informally through a negotiated settlement with creditors (nonstatutory). Rationalization refers to a reduction in debt or a change in terms.

The goal from the creditor's point of view is to reduce debt obligations, thus improving both the balance sheet and break-even position of the business. For both formal and informal proceedings, debtors should accept a reduction only if this is a better option than the sale or liquidation of the firm.

While an informal settlement can be implemented quickly at relatively little cost, it does not provide any protection from creditors or other threats during the process. A Chapter 11 proceeding, on the other hand, is carried out under the U.S. Bankruptcy Code and is a legal proceeding. It provides protection from many different forms of threats and a legal venue for either debt reduction or disposition.

Chapter 11 is litigious by nature and therefore expensive. The proceeding also contains the implicit possibility of bankruptcy (liquidation) if a restructuring plan is not ratified. The potential benefits to a creditor are therefore huge.

However, this is a double-edged sword. For a nursing facility facing difficulties, the benefits of either formal or informal restructuring can be significant. Neither course should be chosen without careful forethought and expert advice. Most importantly, protection from creditors or a rationalization of debt is not a magic bullet. It must always be integrated into a viable plan that will include both an operational and financial turnaround. In such a context, a new business can often emerge from the ashes of a failing company. ■

For More Information

- Charles Ferraro can be contacted at cferraro@gmhcf.org.
- Tommy M. Onich can be contacted at tonich@turnaroundinternational.com.
- Information on the Corporate Renewal Network can be found at www.corporaterenewalnetwork.com.