

Money, Management and Mergers: The Business Aspects of Post-acute ABI Neurorehabilitation

Dexter W. Braff, MBA, MS, BA • Ted Jordan, MBA, BS • Nancy Weisling, BS

One of management's primary responsibilities is to continually seek out ways to improve the business and financial operations of the company. This, in turn, often has the added effect of increasing the value of the firm – even if the company has no immediate intention to sell. In this article, we “reverse-engineer” the relationship, using the fundamentals of valuation as a framework to identify some of the key strategies a post-acute acquired brain injury (ABI) neurorehabilitation company may wish to focus on to make it better, stronger, and yes, more valuable.

The Building Blocks of Value

At its very core, the building blocks of value are profit, growth, and risk management. In fact, if one breaks down all the textbook valuation methodologies heard of in the past – notably capitalization (multiple) of earnings or discounted cash flow – all are firmly rooted in these fundamental elements. Before we delve into how management can impact these elements in a business, however, let us talk about what, to many, may seem conspicuously missing. That is, where does quality fit in? To be sure, it is not that quality does not matter – it does. But not to the extent that may be believed.

That is because in most health care businesses, whether it is deserved or not, a basic level of quality is assumed. On a scale of one to ten, most patients take it on faith that quality is at least a nine (after all, the staff has all those medical credentials, the facility looks state-of-the-art, and despite the realities on the ground, they are under the impression that all medicine is already evidence based).

Now we are not suggesting management should not strive for clinical excellence – the team probably would not have gotten into such a complex field as neurorehabilitation unless they possessed a passion for improving the lives of patients. It is just that it is extremely hard to accurately measure, contrast, and compare clinical outcomes, so from a patient's, or their loved one's perspective, quality is often more about patient experience (was the staff friendly; the food good; the room clean?). What's more, to move from a nine out of ten on the perceived quality scale to a 9.5, it may not only be awfully expensive, it is often lost on referral sources and payers, who, often, want little more in terms of quality than to not get any complaints.



Now, please do not see this as cynical. Providing the highest levels of care, particularly to such a vulnerable population as those suffering from acquired neurological disorders, is laudable. It is just that in health care, from a business perspective, “very good” can compete quite well with “excellent”. And excellent, can be disproportionately, expensive.

Now, back to those building blocks.

Profit

Typically measured in earnings before interest, taxes, depreciation, and amortization (EBITDA), profit is the “return” that buyers get on their investment in an acquisition. Notably though, it is not profit that the team manages per se. Rather, it is the revenues and expenses that produce it.

Revenues and Growth

Perhaps counterintuitively, when it comes to growing the top line, there can be good revenues and less good revenues – particularly in health care. For example, consider the implications of a reimbursement system that is marching inexorably from fee-for-service to fee-for-outcome (CMS has set an ambitious goal of having 50% of reimbursement coming from these alternative payment models by 2019). Such a system demands innovative population health and coordinated care strategies that (a) deliver a comprehensive mix of services to (b) distinct populations over (c) geographic footprints that (d) mirror the coverage area of health systems, insurance companies, or employers.

In the past, just being bigger was often good enough. But as health care evolves, amassing flags on a map that extend beyond the reach of the health systems, insurers, and employers that define it, just does not add what they used to. In a coordinated care environment, hospital systems, large physician groups, and increasingly, so-called “conveners” are now acquiring, contracting, or in some manner affiliating with proximal providers across the healthcare spectrum to then go at-risk with insurance companies, Medicaid, or Medicare managed care plans to manage the health care needs of their beneficiaries.

The question, then, is where does ABI fit in such a system.

Our sense is that with a combination of low underwriting predictability and high, life-time costs, neuro-rehab is likely to be a “carve-out” under these population health umbrellas. But that does not mean that innovative providers cannot develop global payment models at the individual patient level to fill this gap in coverage. So, rather than open new states to grow, might it be better to build an end-to-end solution from transitional care to long-term rehab? Not only does this approach fit neatly in an environment that increasingly values coordinated care, it can create real competitive advantage that can translate to real increases in patient volume. What’s more, such a strategy works well on the expense side of the ledger, as deep penetration in tight geographic footprints tends to be less expensive to operate and manage than a coast-to-coast empire.

Revenue Cycle Management

One final thought on revenues. Absent a comprehensive, integrated, revenue cycle management (RCM) system, what looks like revenue often is not.

Whether it is improperly booking, or accounting for, ever-changing price schedules or negotiated payments, or overlooking all the boxes that must be checked to remain in compliance before a bill is submitted for payment, if a company does not have a strong RCM in place, revenues may be no more than an educated guess. Not only does good RCM enable management to better manage – and optimize – the company’s cash flow, it creates far more reliable financial statements that support greater access to debt and equity capital – and at better terms.

Here is a quick trick to see how well a provider is doing here. Add up cash collections for a defined period – say, 12 months. Then divide this figure by the net revenues booked, adjusted for average days sale outstanding rounded to the nearest number of months (so if it typically takes 65 days to collect, the corresponding 12-month revenue period should begin two months earlier – 65 days rounded – than the cash figures). If the result is not close to 100%, the company may have an RCM problem.

Expenses

Management already knows that the company should constantly be on the lookout for opportunities to change processes or implement technology to reduce costs without compromising the company’s value proposition. What health care providers typically get wrong, however, is assumptions regarding economies of scale. The classic thinking is that once fixed costs are covered, any additional “contribution margin” falls to the bottom line. The problem in health care, however, is that what often appears to be a fixed cost is really a “step-variable”. Like pure variable costs, step-variables vary with volume, but over larger “steps”.

Consider billing and collections. Typically lumped into fixed costs, staffing requirements will change as volume increases. Maybe not for the first additional 30-40 patients. But, add a hundred patients and these costs will rise (while the “real” fixed costs – heat, light, and rent – stay the same). Why is this so important? Pity the operator who prices a contract assuming that a big chunk of these “incremental” revenues – even at a substantially discounted rate – will fall to the bottom line. They may for a while. But, add a biller, scheduler, or a middle-management supervisor, and those profits can turn to losses real fast.

Deploying Technology

One of the primary ways to capture real economies of scale is to invest in technology to reduce variable or step variable costs – and increase contribution margin. For example, one of the selling points of robust, “end-to-end” revenue cycle management solutions is to create efficiencies and reduced staffing requirements. The problem is that, rather than grab those efficiencies right away, providers adopt the “we’ll-just-grow-without-adding-additional staff” approach. Although conceptually valid, rarely does it work – at least completely.

Human nature as it is, employees tend to expand their workload, regardless of its “real” volume, to match the work day (that is why it is a rare employee that does not believe they are working at full capacity). So, when volume increases, employees who have not been “forced” to realize gains in productivity find the additional workload unmanageable. Difficult as it may be, the best way to capture these gains is to reduce staffing levels once the technology is fully implemented.

268-0053
1-250-144-4574

412-8079
1-362-570-6

Real Estate

If management is looking for a lower-risk, long-term investment that can appreciate and generate long-term income, real estate fits the bill. But, if the rationale is that it adds value beyond its appraisal amount, note that most buyers believe that they can generate a higher return by adding more capacity. Accordingly, they rarely want to tie up their limited dollars in bricks and mortar.

Growth

Growth is almost always good, but to create incremental value, it must be (a) identifiable, (b) greater than market, (c) sustainable, and (d) institutionalized. All too often, sellers cannot articulate what they are doing specifically to grow, owing it to “quality and our reputation in the community”. Perhaps this is the case. However, if buyers cannot identify specific initiatives that can increase market share, like adding sales reps, opening new programs and services, securing contracts, or partnering with referring entities, they will owe it to market growth rather than a business-enhancing proactive strategy. Growth must be sustainable. One new contract is good. But if the company hasn’t experienced executive sales professional with a history of bringing in new agreements and a pipeline of new opportunities in the works, that is the kind of growth that can pay dividends long into the future.

Lastly, when we visit companies, it is usually quite apparent when they have a culture of growth – an overarching management emphasis on market innovation and expansion. Such growth is almost “institutional” in nature. Buyers can just feel it – and then, comfortably build it into their value equations.

Risk

In health care, perhaps the greatest contributor to risk is reimbursement – especially when one or two payor sources, contracts, or other payment relationships account for the bulk of a firm’s cash flow.

With such “concentration” risk, even modest cuts in reimbursement can have an immediate and profound impact on a firm’s profitability.

The Fault with Michigan No-Fault

Herein lies a fundamental challenge in brain injury treatment. Even though it has been a dependable source of reimbursement for many years, the fact that many providers rely heavily on Michigan no-fault insurance is a point of great exposure. Accordingly, firms that develop other payer sources – private insurance, employer groups, unions, and increasingly, Medicaid – insulate themselves from “stroke-of-the pen” risk that makes buyers nervous. Similarly, while limited or exclusive contract relationships can be extremely valuable and profitable, the downside is that large chunks of revenues can come – and go – with these agreements. Accordingly, we like to see contracts as part of a balanced “portfolio” of payer sources.

Broadening our perspective, risk comes from the potential for sudden, hard to control, unfavorable developments. So, anything a provider can do to mitigate such occurrences improves both the sustainability – and value – of the business. That is why companies with a management infrastructure that does not rely on the primary shareholder are attractive; why lots of referral sources vs. just a few are preferred, why systematic oversight of billing and regulatory compliance reduces exposure to potentially catastrophic lapses in record-keeping and documentation, why reviewed, or better yet, audited financials increases the likelihood that the story your numbers are telling is not fiction.

The above are just a few items ABI providers may consider to strengthen their firm. The larger point, however, is that if a strategy in some way touches on the fundamental elements of value – if it increases profits, creates identifiable, sustainable, and institutional growth, or reduces the risk profile of the business – it is probably a strategy worth evaluating, and perhaps implementing. So, think like a seller, even if you are not.

Author Bios

Dexter W. Braff, MBA, MS, BA, received his Masters in Business Administration from the Katz School of Business, University of Pittsburgh, where he was the recipient of the Vincent W. Lanfear award for academic excellence. He received his Bachelors of Arts from Cornell University, and a Masters of Science from the University of Oregon. He has more than 30 years of experience in health care mergers and acquisitions, and founded The Braff Group, ranked by Thomson Reuters as one of the nation’s leading health care M&A advisory groups, in 1998.

Ted Jordan, MBA, BS, received an MBA from Emory University and a BS Economics / BS Finance from the University of Florida. Prior to joining The Braff Group in 2010, Ted served as Vice President of Mergers and Acquisitions for The Mentor Network, and was a financial analyst at Legacy Securities Corp., a boutique investment banking firm in Atlanta. He has worked in the behavioral health sector for more than 20 years.

Nancy Weisling, BS, earned here degree at Bradley University. She has more than 20 years of experience in the behavioral health sector having begun her career teaching special education and later moving on to manage group homes for individuals with intellectual or developmental disabilities. Immediately prior to joining The Braff Group, she was Vice President for Mergers & Acquisitions and Business Development for The Mentor Network.