  

**Australia’s Disability Services Sector 2017**

**Report 2 – Financial Performance**

**Summary of Key Findings**

**(National Benchmarking Project)**

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Executive Summary

This is the second report of the Market Design and Evolution for Better Outcomes Research Program (also known as the Disability Services National Benchmarking Project). It provides a snapshot of the changes in the financial performance of a Panel of 154 disability service providers (providers) between 2014/15 and 2015/16 as they transition into the National Disability Insurance Scheme (NDIS)

A significant proportion of existing providers are not exclusively delivering disability services. That is, they also provide services such as aged care, child protection and other human services. As their activities in other service sectors effects their financial sustainability this report includes data on the overall financial performance of organisations as well as their financial performance from to the provision of disability services.

## Key findings

The results show growth in the aggregate financial performance of the cohort examined which is the result of some organisations getting financially stronger and some getting weaker. As this is only the second year of the study, it is too early to determine if the findings are indicative of trends.

**Aggregate financial performance**

* Between 2014/15 and 2015/16, the total income for the Panel increased by $220.5m (9.2%) to reach $2,623m. As such, these 154 organisations alone represent a significant economic group.
* Aggregate income from NDIS increased by $40.4m to $77.9m. Although this represented an increase of 108%, NDIS sourced income represented only 3% of total income in 2015/16. The growth of income from States and Territories by $111.2m was more than double the growth in NDIS-sourced income.
* Aggregate total expenses increased by $193.1m or 8.3% to reach $2,507m. Employee expenses continued to represent approximately 71% of total expenditure.
* Aggregate profit grew by $27.4m or from $88.0m (3.6%) to $115.4m (4.4%).
* Donations and bequests are a significant contributor to sector income and profit. Aggregate donations and bequests represented 3.1% or $82m of total income in 2015/16. When donations and bequests, are removed, aggregate Net Profit was $12.5m (0.5%) growing to $33m (1.3%) in 2015/16. A reliance by some organisations on this resource adds risk to service provision.
* Median profit declined from 3.9% to 3.8%
* While overall profits showed good growth, disaggregation of the data shows that the profits achieved is not uniform across all size cohorts. In 2014/15, for example, the median profit ratio of Very Small organisations (under $1m in income) was 6.3% whereas the median profit of Large organisations was 2.8%. This data challenges commonly held beliefs about larger organisations being more efficient.
* In 2015/16, there was less variation in median profit across the size cohorts. The median profit of Very Small organisations declined to 4.0% and that of Large organisations increased to 3.6% (still lower than the profit margins achieved by the smaller organisations). As large organisations account for 68% of total income, it is their growth in profitability that accounted for the majority increase in overall profits.
* The variation between higher and lower performing organisations is evident in the number of organisations making a profit or loss. In 2014/15, 18 organisations made a loss, but this increased to 26 in 2015/16.
* The total assets of the Panel increased by $159m to $1,896m and total liabilities increased by $41.6m to $685m. As a result, net assets grew by $125m (10.2%) in the 2015/16 year to reach $1.35bn. This a is a positive result for the Panel and indicates efficient use of resources. However, some of this growth may be due to specific-purpose donations being differently disclosed, operating assets being purchased and/or asset revaluation.
* Panel members’ rating of their organisation’s financial performance declined. In 2014/15 two thirds of Panel members rated their organisation as strong or very strong, but this dropped to 44% in 2015/16. Optimism about their future financial performance was also weaker.

**Disability services financial performance**

* Total income from the provision of disability service increased from $1,818m to $2,030m, a growth of $212.5m or 11.7%. The majority of this increase ($104m) was the result of an increase in income from State and Territory governments. (As mentioned above, NDIS income increased by $40.4m).
* Total disability expenditure increased from $1,738.7m to $1,958.9m an increase of $220.2m or 12.7%. Growth in Employee Expenses accounted for most of this increase, but employee costs increased proportionately and remained at approximately 70% of total expenses.
* **As the rate of growth in disability income was lower than the grown in disability services expenses, profit declined in absolute terms from $79.5m to $71.8m, a drop of $7.7m. This represents a fall in profit margin from 4.4% to 3.5%**
* **The median profit ratio from the provision of disability services remained at 2.1% for Large organisations, but declined across all other size cohorts.**
* **Removing disability related donations and bequests, the total profit from the provision of disability services dropped from 2.7% to 0.04%.**
* Nearly three-quarters (73%) of the Panel reported that demand for their disability services increased during 2016, but a third (33%) reported they were unable to satisfy all requests for service. The same proportion (77%) expected demand for their services to increase during 2017 and, again, 32% expected they would not be able to meet demand.

## Implications

To fulfil the policy objectives of the NDIS, the disability services sector will require:

1. Existing providers to further transform their business models so they align with the National Disability Insurance Scheme (NDIS) policy, and
2. Significant growth in capacity - which can be achieve through an increase in the capacity of existing providers and/or from entry of new providers.

Both transition and growth require the investment of resources and these dual pressures are amplifying the change, the risks and the related costs. This is reflected in the results from this study.

Panel members reported that their investment in transitions includes the costs of restructuring of their workforce, purchasing new information systems and training staff for new working environments. They are also investing resources in supporting their clients transition to the NDIS.

At the same time, Panel members are investing resources in building capacity to meet demand. These costs are also incurred in staff recruitment and training, new infrastructure (e.g. vehicles and Information technology) and spending on marketing. However, in managing growth, they must plan for, and fund, the differences between the prospective linear growth in revenue and the stepped growth in some costs, as well as match the pace of growth in staff numbers with the pace of growth in demand. The cost of any unused staff hours or other resources must be absorbed, directly impacting financial results.

The total expenses incurred for transition and growth must be met by the organisation from their own resources (current-year profits, donations, retained earnings or sale of assets) or from debt (e.g. a loan from a bank). Furthermore, organisations must invest resources many months or even years before they receive income growth.

The findings from Wave 3 and previous Waves of this study show that the Panel is fully supportive of the NDIS policy, but many are reporting financial stress regarding disability services and are concerned about the viably of these services in future. They are also reporting that they do not expect to meet demand for services in 2016/17.

Given the complexity of the changes they face, the resource requirements and risks, Boards and Executives of disability services providers will need a positive perception of the future operating conditions if they are to invest in transition and growth. If leaders feel that the costs of transition are too high or their organisation is not viable in the new operating environment, then they will likely close (or exit the provision of disability services). At least two of the Panel members merged for this reason and others have indicated that they are expecting to discontinue their disability services.

## Key questions for policy makers

**If the low operating profit margins reported by disability services continue or worsen, then providers who are unable to at least breakeven will have to close within two to three years unless they are willing to subsidise their disability services income from other services or donations or sell assets. Based on the findings, some of these may be Large providers. Disability services markets will also be unattractive to new entrants, particularly as aged care and other human services markets offer higher returns.**

**As a third of providers expect that they will not meet demand, there is significant risk of supply-side failure in the current operating conditions.**

A reduction in profits is to be expected across a sector undergoing transition or in the early stages of growth and is being absorbed by providers. The key questions for sector leaders – including policy makers – is whether the sector has sufficient, suitable and available assets to continue to fund the transition and sufficient incentive to do so.

To answer this requires an understanding of the resources available to organisations (presented in this report) as well as considering the outlook for providers from their perspective.

Service providers have increased choice and control over the services they provide and to invest in change and growth, providers need to know the following:

1. The total costs of transition.
2. The price of services and the potential profitability of the ‘new market’, whether it is likely to be sufficient to enable organisations to return to profitably, and if so, how long it will take for them to rebuild their balance sheets.
3. The rate of growth and timing of expenditure in comparison with the growth in revenue.
4. The asset reserves of organisations.
5. The length of time organisations will need to fund investment before they receive returns. That is, will they run out of available assets before they can return to profit?

This information is needed at the service level.

The Commonwealth Government, via the relevant agencies, can influence the outcomes or provide guidance on the answers to some of these questions and doing so would greatly improve the efficiency and speed of transition, and encourage sector growth.

Specifically,

* The price of services must be set with precision so that there is a balance between achieving value for money with creating a market that is sufficiently attractive to new entrants and existing providers. The National Disability Insurance Agency (NDIA) have also stated that this is a key consideration in determining price controls[[1]](#footnote-1). If returns appear low, providers will invest elsewhere or exit service provision, in many cases in order to protect the sustainability of other human services they provide. The data set developed for this study provides essential information for price monitoring.
* The NDIA should be fully transparent about all aspects of the volume and speed of the rollout of services, client numbers and the price of services. While policy level data is available, such as that found in the bilateral agreements between the Commonwealth and states and territories, this transparency should be provided at the lowest possible level of granularity—that is by service types and by location--as the current information that is obtainable in each jurisdiction is not sufficiently specific to facilitate planning.

Organisations will invest in change if they have some confidence in the future operating environment. Therefore, this information should be provided in advance--ideally at least three years ahead. It should also be reliable. That is, NDIS should commit to prices (at least during rollout) several years in advance and in a way that is fully transparent and builds confidence in providers.

* The NDIA should be fully aware of the impact that any delay or changes in service volumes will have on organisations costs and viability. If any alterations to forecast volumes must be made, this information should be provided to providers at least a year ahead, and ideally in the first quarter of the year so they can adjust budgets.
* Prices should be based on the comprehensive cost of service delivery.
* The success of the NDIS is predicated on the existence of a strong and healthy supply of service. To ensure the sector is not depleted during transition and growth, the full costs of transition and growth of organisations should be assessed by the NDIA and compared with the capacity to access resources. If there is a significant difference between the resources needed and those available, the NDIA has various options for directly and indirectly supporting transition and growth, including funding infrastructure purchases, providing access to low interest loans, or other supports.
* These elements can be included in an industry plan that could be developed with a view to creating certainty, developing a longer-term view of the sector composition and structure, and which could then be used to assess progress and outcomes achieved.
* This study is due to finish at the end of 2017. There is no other data available to support efficient pricing and evaluate providers’ financial sustainability. This data is critical to meeting the objectives of the NDIS and the infrastructure for this study is established which will facilitate the ongoing collection of relevant data. The Panel is now established and continuing to monitor its performance will provide essential information to reduce risk and inform policy development, therefore we strongly recommend this study is continued.

#### Acknowledgements

We acknowledge and thank all organisations that are part of our Panel for their anonymous contribution to this study. These organisations range from some of Australia’s smallest to its largest disability service providers and for some, providing the data required was a time consuming and complex process, but they persevered in order to provide the evidence base needed to track performance in this changing environment.

We thank all current and past Panel members for their support and hope you (and others) will continue to participate in this project.

Australians with disability, their families and supporters, and ultimately the whole Australian community will benefit from a strong, efficient and innovative disability service sector.

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1. National Disability Services 2017 Price Controls Review. Consultation on NDIS pricing arrangements Discussion Paper March 2017 [↑](#footnote-ref-1)