Government and Public Sector

DfES Children's Services

The Childcare Market

PricewaterhouseCoopers

Contents

1 Introduction

1 This report addresses the market for “formal childcare”. This encompasses the market for formal, non-parental supervision of children as purchased by parents or other responsible adults and as provided by schools, local authority nurseries and the private, voluntary and independent sectors (PVI).

2 It does not include a review of the informal sector (grandparents, friends, family, and neighbours) except where it impacts on the quantity of formal provision demanded by parents.

3 The report does not review the market in terms of meeting the specialised demands for children with disabilities for this exercise.

4 The report uses make all relevant, existing data and information made available to us from the DfES’s strong knowledge base in this area.

5 The work has sought additional information on:

- Whether there is scope in the market for consolidation within the private, voluntary and independent sectors;
- Whether consolidation will produce good quality outcomes for children;
- How local authorities are gearing up to meet the incoming duty to secure, as far as reasonably practicable, sufficient childcare to meet the needs of working parents;
- How local authorities are assessing demand in their local areas.

6 Our work is focused on the perception and expected impact of current Government and local authority activity within the PVI segment of supply, particularly private providers. It does not concentrate on assessing parental demand. Within the PVI segment the work focuses on the private sector as it is the most significant provider of childcare, although there is some comment on the voluntary and independent sectors.

2 Executive Summary

Introduction

7 This report reviews the market for formal childcare provision (contained in Market Definition, section 4a) and the impact on PVI (Private, Voluntary and Independent) providers of recent Central Government and local authority activity, i.e. extended schools, education provision for 3 and 4 year olds under the free entitlement for 3 and 4 year olds, children's centres and local authority approaches to commissioning. The report is particularly focused on the perceptions of and impact on private providers who provide the majority of places in the market (for instance, private providers supply c. 57% of full daycare places (Laing & Buisson Childcare Database 2006)).

The Market

8 Since the early 1990s, the childcare market has seen strong growth (both in terms of fees and volume of places used) due to high demand and limited supply.

9 Growth in supply has been mainly driven by expansion of the full daycare and out of school care sectors, which reflects both the changing nature of demand and the way in which supply has developed in response. The majority of providers target 0-5 year olds and in particular 3 and 4 year olds as their key market.

10 Supply remains highly fragmented, with the largest private provider having a market share (in terms of places) of only 1.8%, but some consolidation has taken place, e.g. Nord Anglia acquiring Leapfrog Nursery Group and 28 nurseries from the Jigsaw Group in 2004.

11 Before 1998, and the launch of the National Childcare Strategy, Central Government and Local authorities had a limited role in commissioning and providing childcare capacity; more recently, however, they have had a more active role. The Childcare Bill, currently before Parliament, will take this further by placing a new duty on the 150 top tier local authorities to secure, as far as is reasonably practicable, sufficient childcare to meet the needs of working parents and to make an assessment of local demand.

12 PVI providers believe that recent activities could impact market development and in some areas already are. In particular they have concerns about three key factors:

- If the local authority provide childcare in children's centres it could compete with incumbent providers if local supply and demand is not fully assessed, and if this is not commissioned out, as the Government advocates;
- Changes in funding for free nursery education places for 3 and 4 year olds could result in PVI capacity growth. However, in this area PVIs face, and may face greater potential competition from schools, who currently provide the majority of this provision;
- Extended schools could impact on demand for wrap around daycare in older age groups, e.g. primary school children, if schools choose to deliver this themselves, instead of commissioning it out as many currently do.

The case study local authorities we met also expressed some concerns about these changes, primarily around the sustainability of funding and the likelihood of new capacity being able to fund itself in the future.

13 Despite these concerns, the key changes being put in place by government should, in principle, have only a limited impact on incumbent providers in the market place if handled appropriately at a Local authority level. However, this requires a robust, local, granular understanding of current demand, supply and trends in each as well as positive interaction, communication and relationships between PVI providers, local authorities and schools.

14 Whilst there is concern and uncertainty amongst PVI providers, these changes could in fact represent opportunities for some – e.g. those registered to offer the free entitlement for 3 and 4 year olds could benefit from the additional funding in the market place and some PVI providers may work with children's centres or schools to provide capacity.

15 Feedback from PVI providers, particularly the private sector, suggests that in some areas growth has slowed in the past one or two years, and some providers are experiencing falling occupancy, fee pressure and increased staff costs, despite continued high levels of demand nationally. The feedback we gathered from the PVI providers who have settings in areas exposed to a less favourable market environment suggests that increased local competition is a key factor, but some believe that additional local capacity in children's centres and schools is having a significant impact.

16 These supply and demand trends are localised and can vary from area to area. Our primary research questionnaire, covering c. 100 providers (outside the top 20 providers) indicated the different experiences, in terms of occupancy trends, across providers even within one local authority area. For example, in one case study authority 15% of questionnaire respondents had seen an increase in places used, 30% a decrease and 55% no change.

Conclusions

17 Our conclusions are discussed in more detail in General Themes and Findings (section 3) and in Suggested Improvements (section 5), but we have summarised the key points below

18 In relation to the aims set out in section one, the key themes are:

"Whether there is scope in the market for consolidation within the private, voluntary and independent sectors"

- The market remains highly fragmented and there is considerable scope for further consolidation,
- The Top 40 private providers only account for 10% percent of total places,
- The extent to which the market is likely to consolidate in the short- to medium-term is in doubt. More challenging market conditions and uncertainty about the future may prevent some players or financial investors from driving consolidation, although some businesses may reduce capacity or close, and,
- Consolidation offers only limited benefits for either providers or commissioners. There may be some benefits to scale for providers who may grow via acquisition. Consolidation may also benefit local authorities who could reduce the number of contact points and improve supply visibility but there is a risk of reduced parental choice and market flexibility.

"Whether consolidation will produce good quality outcomes for children"

- Given that consolidation is unlikely to change staffing levels or setting standards significantly, then consolidation per se is unlikely to impact on outcomes for children. However, if higher quality operators are growing during consolidation at the expense of lower quality operators, then this may improve outcomes.

"How well local authorities are gearing up to meet the incoming duty to secure sufficient childcare to meet the reasonable needs of working parents" and "How well Local authorities are assessing demand in their local areas"

- Of the local authorities surveyed in the case studies, many were more focused on achieving short-term goals around children's centres, extended schools agenda and free entitlement for 3 and 4 year olds than structural long-term market making,

- The robustness of needs assessment also appears varied – one authority had carried out a particularly strong analysis, but this was not replicated elsewhere. Developing a robust view of local demand and trends in demand is highly complex and represents a significant challenge to authorities, and,

- The case study authorities were at different stages in assessing local demand and supply and the assessment was often concurrent with commissioning new capacity. This suggests there may be a risk that authorities are setting up capacity, such as children's centres, which may not be appropriately placed in terms of demand or may negatively impact on incumbent supply.

"The perception and expected impact of current Government and local authority activity within the PVI segment of supply, particularly private providers."

- Some PVI providers express concern about the clarity and communication of government initiatives and are uncertain about their future impact on the market place. Some private providers believe that their businesses have been directly impacted by increased early education in schools. Providers also queried the economic sustainability of some of the new capacity being developed,

- Additional funding may flow into the sector if PVI providers offer educational places, capacity for children's centres or extended schools places.

- The key barriers to taking these opportunities appear to relate to the relationship with the local authority, the ability to deliver educational input and the highly competitive staffing costs offered in some local authority provided children's centre capacity,

19 Our suggested improvements are based around ways of ensuring that the risks associated with current initiatives do not materialise and that the developments support market development.

20 The key risks of poorly implemented initiatives, locally, are:

- Local authorities could be faced with the cost of under-occupied in-house capacity,

- Not all expanded capacity will be sustainable without substantial long-term central funding,

- Some capacity in the PVI sector could be lost due to competition from schools and children's centres and losses may not discriminate between high and low quality capacity. This would hamper market development and could leave the local authority footing the bill for a larger proportion of child care than is necessary,

- The capacity developed may not suit the nature of local demand, e.g. in areas where cultural factors impact demand for childcare,
- A proportion of the market may remain under-served, e.g. working families unable to afford the full cost child care places but not located near to or qualifying for children's centre capacity.

21 The key areas to focus on for improvements are:

- Ensuring that local authority needs assessments are fine-grained and robust,
- Ensuring that the needs assessments take place before capacity is laid down or contracted,
- Ensuring local authorities are able to monitor the impact that new capacity has on local supply and demand patterns,
- Improving relationships and dialogue between the local authority and the local supply base, be it private or voluntary,
- Improving visibility of government plans, the reasons for them and what opportunities they present,
- Ensuring complete co-ordination between school activity, local authority activity and the current supply base within the overall strategy for delivering childcare,
- Developing plans or models for sustainable provision, e.g. children's centres, for local authorities to use
  - Understanding which areas may not be sustainable without significant on-going funding and quantifying it,
- Childcare capacity has the opportunity to deliver different outcomes in different areas. Clear understanding of the key aims of additional capacity may help local authorities to take a view on sustainability and resource allocation.

3 General Themes and Findings

22 The key themes arising from our work are set out in this section, in relation to the aims set out in the introduction:

"Whether there is scope in the market for consolidation within the private, voluntary and independent sectors"

- Analysis suggests that there is scope in the market for consolidation. The level of fragmentation in the private and voluntary sectors is significant, even after high levels of merger and acquisition (M&A) activity in recent years,
- The childcare market (excluding childminding, which is fundamentally a sector focused on the individual) is dominated by single independent childcare settings or small chains, often with roots in local communities,
- The Top 40 private providers only account for 10% percent of total places. Though this varies somewhat by region, even the regions which have seen most consolidation still have very fragmented markets,
- The extent to which the market is likely to consolidate in the short- to medium-term is in doubt. Observers suggest that difficult market conditions and uncertainty about the future of childcare in the UK are limiting investment in the sector and thus restraining consolidation,
- In any case it appears doubtful that consolidation offers significant benefits for either PVI providers or local authorities. There are few economies of scale to be gained in the childcare sector, while for local authorities benefits in terms of a minimum of contact points and more apparent supply visibility may be outweighed by reductions in parental choice and reliance on a small number of providers,

"Whether consolidation will produce good quality outcomes for children"

- It is difficult to assess quality of childcare provision as observers, governmental agencies and childcare providers cannot agree on common standards or definitions of "quality",
- What little academic and research evidence exists suggests that the type of care setting has less impact upon outcomes and childhood development than technical indicators such as staff qualification levels, staff-to-child ratios and equipment levels,
- Given that consolidation is unlikely to change staffing levels or setting standards significantly, there is likely to be little correlation between consolidation trends and shifts in outcomes for children,
- What could impact upon quality and outcomes indicators is the increasing amount of childcare provided in children's centre settings. Children's centres typically have higher staffing levels and have a requirement to have a teacher on staff , albeit at a much higher cost per child per week than most private settings,

“How well local authorities are gearing up to meet the incoming duty to secure sufficient childcare to meet the reasonable needs of working parents”

- Of the case study authorities surveyed many had not begun to consider their prospective incoming duty to secure sufficient childcare as a stand-alone objective. Many were more focused on achieving short-term goals such as developing children’s centres, implementing the extended schools agenda and extending the free entitlement for 3 and 4 year olds,

- Within the case study areas all had begun to consider how best to determine what “sufficient” care might be, what constitutes demand and how demand and supply should be measured and mapped (see below). There was significant variation in how they were attempting to do this,

- Local authority priorities in terms of care development and care sub-type selection are to a great extent determined by historical development patterns (such as an increased reliance on childminding care in more rural areas) and authority perceptions of care types and providers,

- Overall it may be too early to determine accurately how well-prepared local authorities are, as many authorities are in a period of considerable service change and development,

“How well local authorities are assessing demand in their local areas”

- All authorities surveyed as part of the case study program were found to have well-developed Children’s Information Service (CIS) which gathered and collated limited demand data based on parental enquiries and monitoring of local providers and their occupancy levels,

- Beyond CIS information there was significant variation in authorities’ attempts to assess and map local demand. One case study authority had developed a sophisticated street-level demand modelling system which had allowed them to challenge traditional assumptions about resource allocation and care provision. However, other authorities had only just begun to devise needs assessment systems or had been forced to allocate resources and develop settings such as children’s centres before they had an accurate and detailed understanding of local demand characteristics,

- The extent to which authorities assessed demand, and used gathered data seemed to be dependent upon the initiative being “sponsored” or driven on a day-to-day basis by an empowered individual or group. In the absence of such commitment authorities’ needs assessments tended to be less advanced,

“The perception and expected impact of current Government and local authority activity within the PVI segment of supply, particularly private providers.”

- There is concern amongst some PVI providers about the visibility, clarity and communication of government initiatives at a national level but particularly at local level, leading to uncertainty about the future of the market place – this relates in particular to occupancy levels for the 3 and 4 year old age group,

- The PVI sector does have some opportunity to benefit from additional funding coming into the sector either by offering early entitlement for 3 and 4 year olds, working together with local authorities in children’s centre development or schools in delivering extended schools places,

- The key barriers to taking these opportunities appear to relate to the relationship with the local authority, the ability to deliver educational input, the authorities' view on the market based on limited data, varied approaches to planning for new capacity, and a perceived preference amongst local authorities for the voluntary sector

- Interviewees and cases studies also raised issues around the sustainability of new capacity. The costs and quality of children's centre provision appear high compared to the PVI sector provision. Children's centres also pay relatively high salaries to workers. The risk is that these centres may compete for demand currently using incumbent players, and whilst this may raise the benchmark for quality it may negatively impact on the viability of existing provision, reducing parental choice.

4 Analysis and Conclusions

4a. Market Definition

23 For this research the market we are considering is "formal childcare". This encompasses the market in formal, non-parental supervision of children as purchased by parents or other responsible adults and as provided by schools, local authority nurseries and the private, voluntary and independent sectors (PVI). These sectors can be summarised as follows:

- The private sector comprises all profit-making companies and sole-trader operations;
- The voluntary sector comprises all charities, community groups, local associations and not-for-profit organisations; and
- The independent sector (combined with the voluntary sector in all statistical analysis) comprises all remaining organisations including ex-local authority non profit-making trusts.

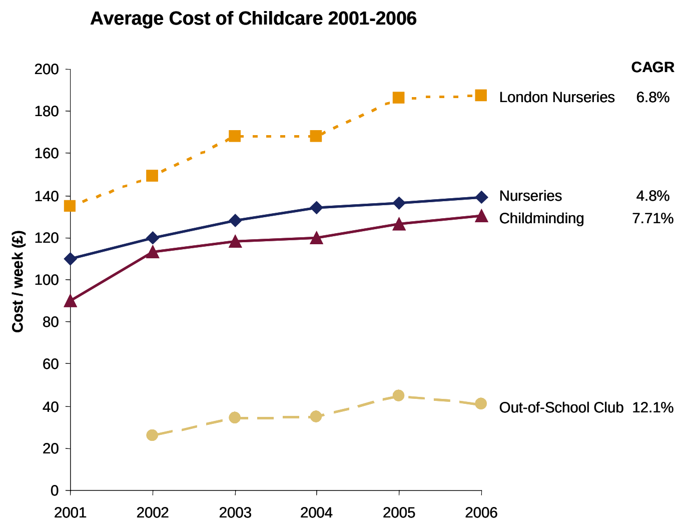
24 We have not reviewed or taken account of the informal sector (grandparents, friends, family, and neighbours) except where it impacts on the quantity of formal provision demanded by parents.

4b. Introduction

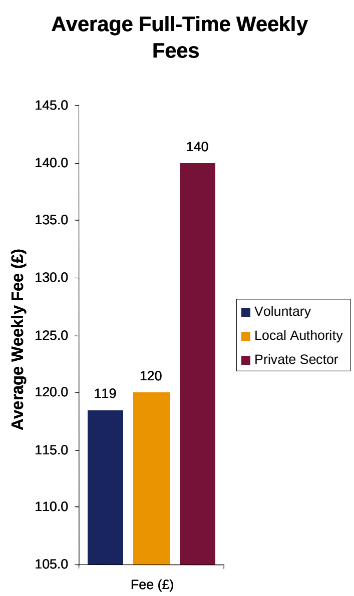
25 Historically the market for provision of "formal childcare" has been dominated by the private and voluntary sectors, which operated nurseries, workplace crèche facilities or out-of-school schemes. The childcare sector saw little government intervention outside the regulatory arena, and local authority involvement in provision was limited. The onus was on the market to satisfy parental demand, and there was significant sector growth in terms of volume and value as a result of increasing demand in the early 1990s. Several major new businesses and a large number of individual nurseries or smaller chains entered the market, and investment levels were high.

> *"Between 1990 and 1994 inclusive, annual growth in value averaged around 20% in nominal terms… [and] growth in nursery services remained very strong in the second half of the 1990s, averaging around 10-15% value growth per annum"*
>
> Laing and Buisson – Children's Nurseries UK Market Report 2006

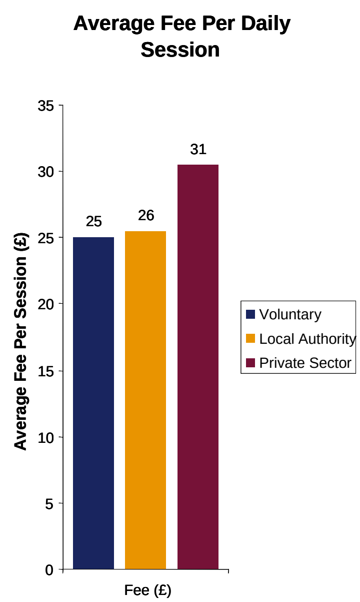
26 During the 1990s and early 2000s the market was also characterised by high occupancy rates and increasing fees levels in the private and, to a lesser extent, the voluntary sectors as in almost all geographical areas demand for childcare exceeded supply.



Source: Daycare Trust Annual Childcare Cost Survey



Source: Laing and Buisson Children's Nurseries Market Report, 2006



Source: Laing and Buisson Children's Nurseries Market Report, 2006

4c. Central Government Activity / Policy Context

27 Since 1998 and the launch of the National Childcare Strategy, a number of central government policies and initiatives have impacted the development of the childcare market. Some of these initiatives and targets are aimed directly at increasing place capacity whereas others are designed to improve market management or improve the ways in which providers responded to demand (e.g. by giving them more information on which to base decisions).

28 Many of these objectives have been further developed as part of the Government's Ten Year Strategy for Childcare – *Choice for parents, the best start for children* - published in December 2004 and the subsequent Childcare Bill. Goals set in those documents include:

- A statutory duty on local authorities to improve the Every Child Matters outcomes for all under fives and reduce inequalities in achievements, through helping them to access to integrated, pro-active early childhood services,

- A duty placed on local authorities to secure, as far as is reasonably practicable, sufficient childcare to meet the needs of working parents and those making the transition to work.

29 Subsidiary to those high-level duties were targets driving local authorities to:

- "Prepare assessments of the sufficiency of the provision of childcare in their area" to determine how much, what types and in what patterns childcare is needed in line with the Joint Commissioning Framework.

30 The Ten Year Strategy also laid out other changes aimed at enabling parents to better balance work and family life which may have affected demand for childcare:

- The extension of maternity leave from six to nine months by end 2007,

- Legislation raising the level of paid paternity leave to two weeks,

> *"Extended paternity rights have also decreased demand for… services, as one or both parents can stay at home for longer"*
>
> Top 20 Private Provider

- Increased flexibility in working conditions for fathers of children between 0 and 5 years old.

31 The specific activities resulting from these strategic policies are set out below:

Information collection

- The Childcare Bill will also place a duty on local authorities to ensure that childcare information is readily available to parents. This has led to a renewed emphasis on the development of comprehensive Children's Information Services.

Capacity Targets

- The Neighbourhood Nursery scheme was introduced in 2001 to stimulate the development of 45,000 new full daycare places in the 20% most deprived wards and selected other pockets of deprivation. The programme officially ended at the end of 2004, with many of the facilities established now being absorbed into the children's centre programme.

- The government has committed to establishing a children's centre for every community by 2010, some of which will have childcare. Children's centres in the 30% most disadvantaged areas, are required to have childcare either on-site or within "pram-pushing distance" (i.e. about half a mile). In many cases these children's centres built upon Sure Start Local Programmes, Early Excellence Centres, Neighbourhood Nurseries, and existing PVI providers. Children's centres in phase 2, in the 70% more advantaged areas, do not need to provide childcare places, but again should base extended services around existing provision. Children's centres are encouraged to partner, where appropriate, with existing childcare providers,

- Extended schools are expected to "build on existing childcare provision in schools, such as breakfast and after-school clubs, to provide a guarantee of childcare provision between 8am and 6pm all year round". As such they will impact market development and demand for childcare,

  - There is emphasis on encouraging schools and education officers to use existing local services,

- The extension of free entitlement for 3 and 4 year olds may also impact on demand. It is likely to stimulate overall demand for childcare by increasing the number of parents who can afford to return to employment.

Funding Initiatives

32 Ring-fenced funds have been set up and funding support is offered to eligible parents (based on a range of assessment criteria around parental / household income, employment status and number of children):

- The Dedicated Schools Grant (as of 2006 replacing funding through Formula Spending Share) supports free entitlement for 3 and 4 year olds,

  - The ring-fenced DSG funding is used to fund the free early education offer to 3&4 year olds,

  - Providers are funded to offer a free place consisting of 12.5 hours a week, for 38 weeks a year from 1st April 2006, and 15 hours a week by 2010,

  - Eligibility requirements, funding information and guidance for providers can be found in the DfES guidance document; *Code of Practice on the Provision of Free Nursery Education Places for Three- and Four-Year-Olds,*

  - While this presents an opportunity for some, other PVI providers have expressed concern that the response of some schools to the grant has been to open nursery wings or extend existing provision to ensure eligibility for grant funding, duplicating provision.

- General Sure Start Grant funding of over £3bn in 2006-2008,

  - This grant is targeted at supporting market development, developing children's centres and extended schools, supporting inclusion and providing training for the childcare market.

4d. Demand

33 It is difficult to quantify the overall level of demand for childcare. Research and survey findings indicate that there is still unmet parental demand for childcare, in spite of significant recent growth in the overall number of places available. Woodland, Miller and Tipping (2001/2002) concluded that in their survey year "*one quarter of all families experienced some form of unmet demand*" while the National Audit Office (2003-2004) concluded that "*about 26 percent of families with pre-school children had unmet demand for childcare in the previous year, and 77% thought there should be more pre-school places*."

34 However, parental expressions of unmet demand are complex and must be differentiated. While local authorities will have a duty, in 2008, to secure childcare, there is some demand that is not practicable for them to attempt to meet. Parents are often looking for childcare of an unusual or problematic nature, such as care at antisocial hours or care within a certain distance of their residence. Equally, parents can sometimes be forced to look for childcare at short notice, such as when the regular childminder is unwell. Given the complexities of providing such care it is

unlikely that the local authority or the wider market will be able to cater for every need in an affordable manner. The way the duty in the Childcare Bill around securing sufficient provision has been drafted attempts to reflect this.

> *"The public sector has perhaps failed to provide the short-term odd hours niche care that some parents may desire but it is very expensive to provide and can actually be very damaging to the rhythms and routines of care life"*
>
> Top 20 Private Provider

> *"The voluntary sector may well be better at providing some niche care types than the private sector but it is still very low-level, there isn't a great deal of difference"*
>
> Voluntary Provider

35 The authority, and more broadly the market, is more likely to meet demand of a more standard type. This is parental demand for care at "usual" hours (e.g. Full Daycare from 8 o'clock in the morning to 6 o'clock at night) for a standard duration. This measure is most reflective of overall surpluses or shortages of childcare for the majority of demands. There will, however, also be an issue of whether the supply developed to meet that demand is affordable; while parents may recognise that there is a "reasonable" supply of childcare in their area, they may not be able to afford to enrol their child in those settings. As such there may be an "affordability gap" between supply and demand

36 Surveys assessing parental demand often elicit responses concerning impracticable demand, and while this is valuable as an expression of absolute parental preference the results should not be taken to mean that there is a fundamental shortage of provision on a nationwide basis. This view is supported by regional information – in one local authority survey of parents who reported unmet demand, 42.4% stated that flexibility requirements were not met, 33.5% that choice requirements were not met, 33.1% said that the available care was too expensive, but only 27.1% reported an absolute lack of provision in their area.

37 The government activity identified above has focused not on addressing parental expressions of absolute demand but on satisfying the remaining two demand types, filling "gaps" in provision. The increased availability of grant and support funding has raised the amount of affordable supply in the market. In concert with that the Sure Start Children's Centre and Neighbourhood Nursery initiatives have attempted to inject affordable supply into deprived areas where childcare was lacking, thus reducing unmet demand for standard care. However, some question whether this new provision is sustainable given uncertainties about the future of the government funding streams that subsidise its operation. A key theme arising from our work was uncertainty surrounding the sustainability of such capacity without substantial continued funding.

> *"There are always sustainability questions where government funding is involved, because there are never firm plans more than two or three years ahead. However, I would think the concern about new childcare provision is more substantial, because a lot of funding is needed and many doubt that the childcare will generate enough money to support itself"*
>
> Leading Academic, Children's Services

Demand Drivers

38 There are several factors driving underlying demand for childcare capacity, many of them concerning demographics and social trends:

- The population of children aged 0-7; population trends are unlikely to stimulate demand growth in the future as the number of children aged 0-7 is likely to remain broadly flat (after decreasing in recent years),
- The "aging population" effect is also likely to reduce demand for formal childcare by increasing the number of grandparents, retired family members and other informal carers available to parents. This will be at least partially balanced by the increasing number of adults working later into life, thus reducing the number of years during which they can provide informal childcare,
- The number of single-parent families; academic research and demand mapping surveys suggest that lone parents require higher levels of formal childcare than family units with both parents. It is difficult to determine the manner in which this trend is likely to develop going forwards,
- The number of mothers returning to the workplace after the birth of their child, and the length of time that it takes for them to do so, will impact on the demand for childcare. At present the number of mothers returning to the workplace is increasing, fuelling demand for services.

39 Economic trends also affect demand for childcare:

- High-level economic trends such as GDP growth and unemployment will impact on the demand for formal childcare by increasing or reducing levels of parental disposable income. Feedback from market observers and providers suggests that the market is to a degree pro-cyclical, moving in step with general economic growth, though data is not available to prove this,

> *"For most families childcare is not a frivolity, it's an item of household spending that they prioritise and place a high value on, but that doesn't mean that the childcare market is immune to economic cycles. Though the market has changed significantly since the last recession, making it hard to judge, I believe that a recurrence of such an event would significantly reduce practical demand, though not latent demand, for childcare services"*
>
> Leading Academic, Children's Services

- Overall employment levels will partially determine demand for formal childcare. If levels of unemployment continue to be relatively low then demand for formal childcare services will be increased as a result. A downturn in employment would be likely to have the opposite effect,

- Increased allowances of maternity and paternity leave, as a result of recent legislative developments, are likely to reduce the uptake of formal childcare as they increase the amount of time that parents can spend with their children during the first year of life.

40 Thus, although underlying demographics suggests that long-term demand may decline, there are other factors that will drive variations in demand trends year on year. It is unlikely, after the implementation of changes in the Tax Credit and parental leave entitlements, that another step change in demand will take place in the next 5-10 years, unless there is a significant movement in the macroeconomic climate.

Local Drivers of Demand for Childcare

41 Academic and case study information shows that there is a significant amount of variation in demand at the local level. In order to appropriately support the development of local capacity authorities will have to take into account a range of local demand drivers, including:

- Local employment trends and patterns of work; areas with multi-generational long-term unemployment may have limited demand for childcare if aspirations to enter or return to the workplace are low,

- Geographical picture and population distribution; the market for formal childcare is likely to develop differently in areas of dispersed populations as a sustainable model for nursery-style settings may be difficult to deliver. Our case studies also suggested that historical market development has been different in more rural areas, often with an increased reliance on childminding. Areas where children or parents naturally gather, such as schools or the workplace, may offer better opportunities for nursery-style care,

- Cultural background / ethnicity; national research has suggested that "white and black Caribbean families were more likely than other families to have used childcare" while there are "relatively low levels of childcare use among Pakistani and Black African families", suggesting segmentation along ethnic lines,

- Local supply patterns will affect demand; case study local authorities noted, for example, that demand was lower in areas where supply was distant from residential sites and housing developments. Similarly local authorities have suggested that schemes offering "free" or heavily subsidised childcare places have both stimulated and satisfied demand, but that fee-charging places do not impact in the same way,

- Local consumer perceptions are also significant; some case study local authorities suggest that certain socio-economic groups are reluctant to use local authority provision because they have unfavourable perceptions of "free" or government-provided services.

42 The range and complexity of these drivers means that local authorities must conduct thorough and accurate needs assessments if they are accurately to develop, support and monitor local supply. Service planning based on national-level demand trends without local mapping may lead to an inaccurate assessment of local needs. Case study evidence suggests that there is significant variation in authorities' needs assessment capabilities. One case study area conducted a detailed, neighbourhood-level assessment based on detailed demographic information and data collected by specially-devised parent surveys to monitor the interaction of local demand and supply, although even in that area it was suggested that *"you can't do truly accurate demand mapping [without] huge resources"*. The analysis in this area included an examination of the impact of local geographical features such as roads and residential communities, on area demand for childcare.

43 However, in other case study areas needs assessment was considerably less advanced, or was out of step with service development. In one area the initial assessment had only just begun, and as a result children's services were being developed "*with only a limited understanding of local needs and the likely outcome of service development choices*". In another area a thorough needs assessment is nearing completion but local children's centres were placed and capacity thus increased prior to the start of the process. As a result the authority found that the full daycare provision in its children's centres was inappropriate for the predominantly Asian areas in which they had been placed, limiting the uptake of the service and reducing the extent to which local gaps between supply and demand were being efficiently closed.

4e. Supply

Segmentation of supply

44 There are a number of ways in which childcare can be segmented to allow detailed analysis. The primary segmentation is based on the type of care session provided:

- The main segments, as outlined earlier, are Full Daycare (care of more than four hours per day), Sessional Daycare (care of less than four hours per discrete block per day), Childminding (care conducted by an individual childminder, usually at his/her residence), Out of School Care (care that "wraps around" usual school hours), Holiday Care (care provided outside of school terms) and Crèche Care (care provided at sites like conference, shopping and leisure centres and which are used occasionally by individuals),
- Both supply and demand vary by segment – for example, both demand and supply are greatest for full children's centres daycare places, while Sessional Daycare has seen declines in recent years,
- Within the daycare sector it is possible to further segment the market according to whether a provider has registered its settings to be eligible for the Dedicated Schools Grant support for 3 and 4 year olds.

45 Childcare also segments by the age of the child in care:

- In terms of age of child, Woodland, Miller and Tipping show that in their sample, use of childcare was significantly higher among 3 and 4 year-old children than any other age range (with 96% of the relevant sample group using some childcare in the survey year, as opposed to 78% for 0 to 2 year-olds and 87% 5 to 7 year-olds).

46 There is significant overlap between the segments identified – for example, some daycare providers may also be delivering the free hours entitlement as a standalone session etc.

47 There are also some specialized segments, such as disabled and special needs care.

Identification of Key Market Sectors Addressed by PVI Providers

48 Within the childcare market certain sub-sectors are more central to private and voluntary sector operations than others. Children between the ages of 5 and 7 require fewer care hours per day than younger children due to time spent at school, and are not a key target for private and voluntary providers. The two key addressable sub-sectors are 0-3 year olds and 3-4 year olds. Both age bands see a high level of care usage, although there is significant sub-sector variation (e.g. parents of 3-4 year olds use significantly more nursery school and Out of School places than parents of younger children, in part because of the free entitlement mainly delivered through schools). However, anecdotal evidence from interviews suggests that PVI providers view the 3-4

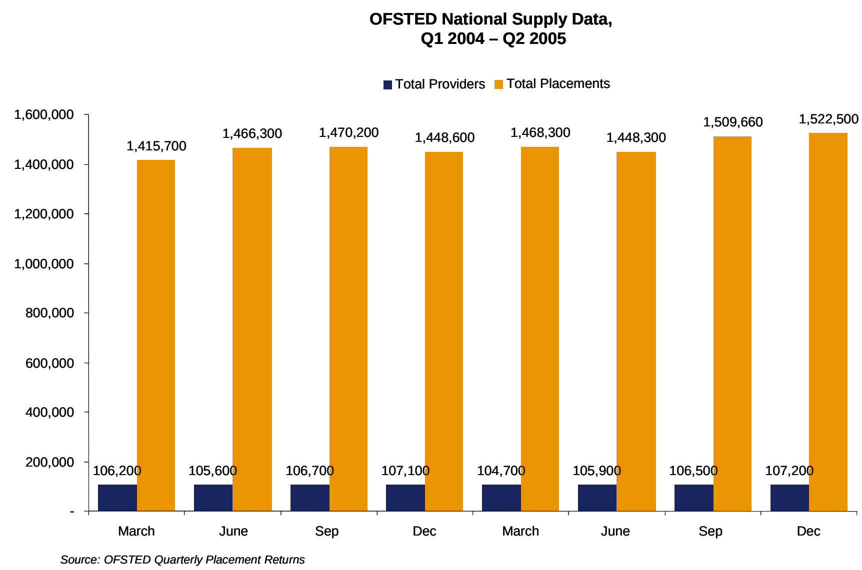
year old age group as their key addressable market and their most significant source of profit. 3-4 year olds require fewer carers per child than the younger group and as such the per-child margins recoverable by private providers are higher, and prices lower.

> *"Our money comes from the 3 and 4year olds, that's where our bread and butter is. We tend to get more of them through, but just on a child-per-child level we can make higher margins on those children because our costs are lower, we need fewer staff"*
>
> Top 20 Private Provider

> *"Just operating for 1 and 2 year olds is not a financially viable model. Staff cost more to deal with those groups, we have to have more staff per child"*
>
> Top 20 Private Provider

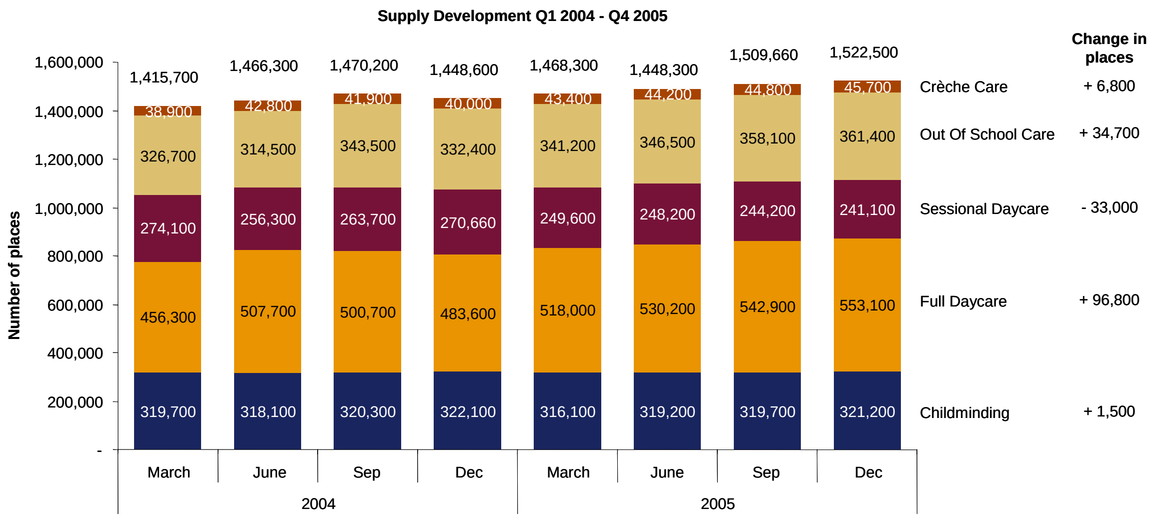
Current national picture of supply

49 At the end of December 2005, the national Ofsted registered supply of childcare showed 1,522,500 places in 107,200 registered settings. Since March 2004 there had has been an increase of more than 100,000 places and 1,000 settings; however the rate of growth appears to be slowing. Anecdotal evidence suggests this is the result of increased market saturation in some areas (particularly affluent urban communities), with market analysts suggesting that some regions had even reached the point of oversupply.



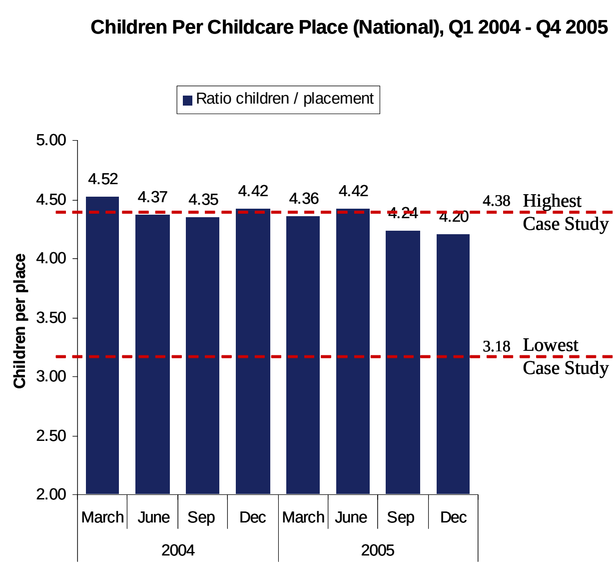
> *"It's not surprising that we are seeing falling growth rates. There is over-provision in most of the areas that are attractive to non-governmental providers, and outside those areas there really isn't much of an incentive to start at all"*
>
> Journalist, BBC Social Affairs Department

50 Segmenting the market by provision type, Full Daycare is both the largest and most rapidly growing care sub-type. At the end of December 2005 there were 553,100 Full Daycare places, one third of total places. This segment had grown by 96,800 places since March 2004. Equally the second largest segment, Out of School Care, accounted for 361,400 places at period end had grown by 34,700 places. Also significant is Childminding with 321,000 places, although this segment had seen little growth during the period. Sessional Daycare accounts for 241,100 places but has been declining, shedding 33,000 places during the two year period. The smallest segment is Crèche care, which grew by 6,800 places to a total of 45,700.



Source: OFSTED Quarterly Placement Returns

51 Supply varies at local levels. In general in affluent areas, where parents are likely to be able to afford childcare, the total number of places available appears adequate, judging by the feedback from PVI providers and local authorities. However, this is by no means true of all areas. Going forward we would expect the market to correct in areas of over-supply and expand in areas of under-supply. Over time it might be expected to balance out, but there are some issues that may impact its ability to do this.



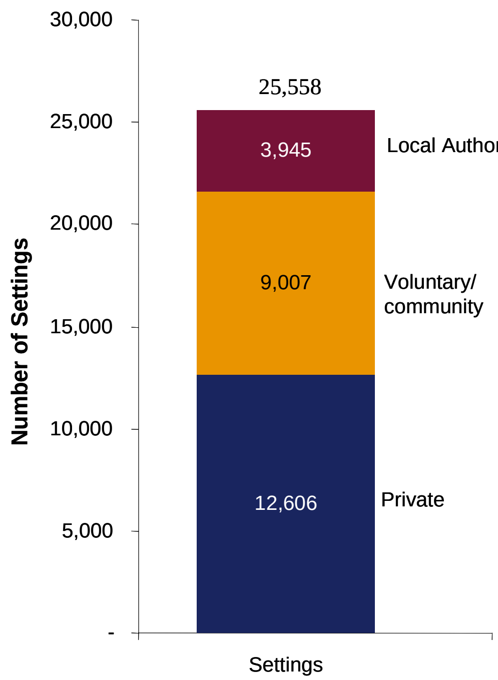
Source: OFSTED Quarterly Statistical Returns

52 While it is difficult to get an accurate picture of setting size across the full range of provision,

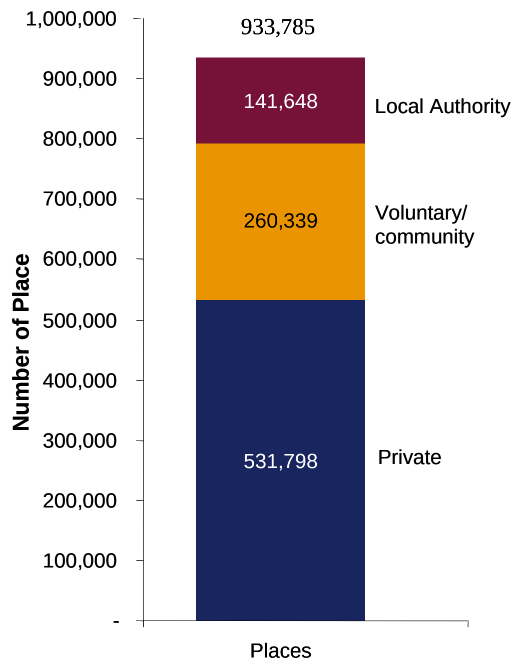
given the relative lack of transparency of the voluntary, local authority and childminding segments, an examination of childcare provided in nurseries suggests that small-to-medium sized facilities are most prevalent. However, there are a significant number of facilities with between 61 and 120 places and anecdotal evidence suggests that it is this model of delivery that the larger private sector groups are increasingly focusing on.

53 Using Laing and Buisson data (which excludes childminding, Out of School care and crèche care) it is possible to analyse childcare supply by provider type. While there are limitations in the data, it shows that the private sector (including single owner-operator nurseries) is the largest provider of childcare, offering over half of all places, although the voluntary sector is also significant. The statistics also show that private sector settings have a higher average number of places than voluntary facilities. Local authority settings also contribute 141,648 places, and while it is not possible to show this qualitatively, anecdotal evidence suggests that this segment has been growing most rapidly in the last one to two years.

National Setting Levels by Provider Type, 2006

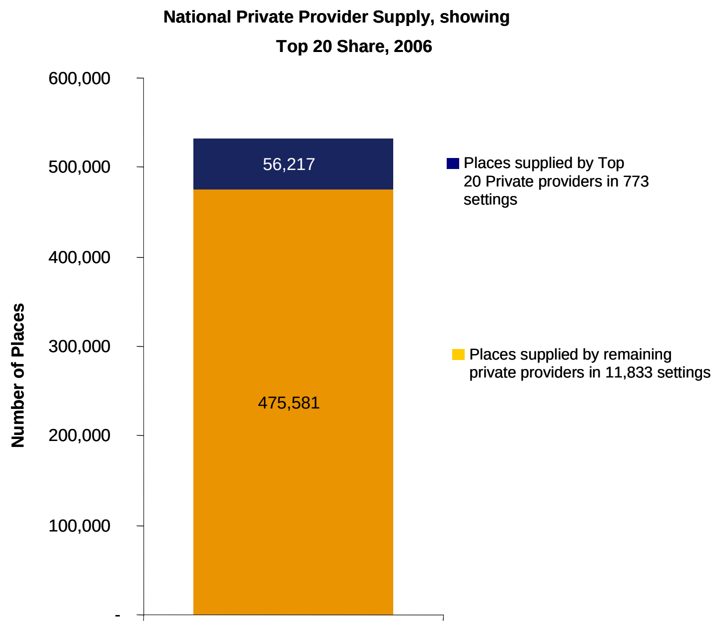


National Place Levels by Provider Type, 2006

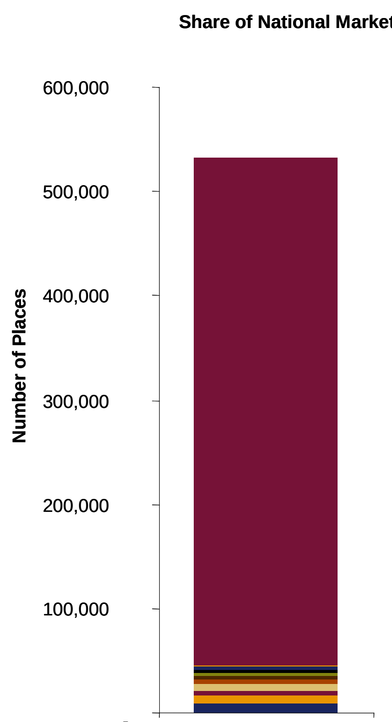


Source: Laing and Buisson Childcare Database 2006 - Dataset 53

54 While the voluntary sector is difficult to analyse due to a lack of national-level data related to place and setting levels of individual providers, it is possible to examine the private sector provision in more detail. Within this segment the market is significantly fragmented – according to Laing and Buisson, the Top 40 national providers have a cumulative market share of only 10%, with the largest group, Nord Anglia, supplying only 9,762 places in 101 settings for a 1.4% market share. There is significant variation even with the Top 40 – the 40th largest group, Magic Roundabout Nurseries, offers only 547 places in 5 settings for a market share of 1.1% (on average Nord Anglia operates at 97 places per setting and Magic Roundabout Nurseries at well over a 100). Case study data suggests that this pattern of fragmentation is fundamentally mirrored at a local level, although some variation can be observed. In essence there are no significant national chains, no single provider is approaching a controlling market share and there are no oligopolies or monopolies at local levels.



Source: Laing and Buisson Childcare Database 2006 - Dataset 53, and Nursery World Private Provider Top



Provider	No. of places	Market Share (%)
Other providers:	485,988	91.4%
Primary Steps	1,910	0.4%
Child Base	2,650	0.5%
Teddies	2,627	0.5%
Buffer Bear	2,802	0.5%
Busy Bees	4,229	0.8%
Kidsunlimited	4,307	0.8%
Bright Horizons	5,326	1.0%
Just Learning	5,847	1.1%
Asquith Nurseries	6,466	1.2%
Nord Anglia	9,736	1.8%

Source: Laing and Buisson Childcare Database 2006 -

55 The private childcare sector has, over the last fifteen years, attracted investment from individual and institutional financial investors, and this is reflected in the diverse ownership base of the large private providers. Three of the Top 10 providers are owned by Private Equity investment groups, one is a London Stock Exchange listed business and a further two are subsidiaries of larger childcare or healthcare groups. Most of the Top 10 groups are profitable at the EBITDA level (Earnings Before Interest, Taxes, Depreciation and Amortization standard, which reflects corporate profitability) which, when coupled with the dramatic growth, both in the size of the

sector and number of providers in that period, may explain investment levels. However, no single owner or group has been able to develop a consolidated presence that has a significant market share.

"Many of the big groups entered perhaps two or three years before us. At that point it had very much been a "mom and pop" business. Then there were 12 chains, then 20, then the Venture Capitalists came in, and that did convert it into a market and a sector. Then so many piled in that some areas are now subjected to an oversupply"

Top 20 Private Provider

Table 1: Size and ownership status of Top 20 Private Childcare Providers

	Group Size (Settings)	Group Size (Places)	Group Turnover (£000)	EBITDA (£000)	Group Ownership Status
Nord Anglia	101	9,762	04-05: 115,287 (52,473 derived from childcare)	5,034 (no split to show childcare possible)	London Stock Exchange listed
Asquith Court	113	6.668	03-04: 44,086	9,347	West Private Equity
Just Learning Group	68	6,002	04-05: 26,039	6,422	Alchemy Private Equity
Bright Horizons	93	5,176	-	-	US Parent, NASDAQ Listed
Busy Bees	44	4,232	03-04: 17,360	2,447	Owned by Gresham Trust PE
Kidsunlimited	46	4,068	03-04: 16,848	528	Independent Group
Buffer Bear	45	2,767	03-04: est. 8,000	533	Independent, affiliated with Childcare Partners
Child Base	32	2,427	03-04: 15,762	2,081	Independent Group
Teddies Nurseries	38	2,180	2004: 13,470	-1,517	Owned by BUPA
The Childcare Corporation	18	1,763	04-05: 3,923	-1,236	Independent, Enterprise Investment Scheme Organisation

56 One indication that there is an ongoing consolidation trend in the marketplace is that there has been Merger and Acquisition activity in recent years. In particular the Nord Anglia group has been active, purchasing the Petits Enfants Group, 28 nurseries from the Jigsaw Group and taking over the Leapfrog Nursery group since 2003. However, anecdotal evidence suggests that the level of investment and interest in the childcare market may be declining as larger groups endure integration and management issues (in particular the Nord Anglia / Leapfrog integration has been problematic) and some investors and operators become concerned about the future of the sector given uncertainty about the impact of current governmental agendas and falling occupancy levels.

> *"There has been quite a lot of trading; people keep sending each other facilities. Everyone thinks they can run it better than everyone else, and it's turning out that we're all really the same. And we have seen a couple of big deals, particularly the Leapfrog one, but that has left such problems in its wake for Nord Anglia that there hasn't been much since then"*
>
> Top 20 Private Provider

> *"There isn't any capital coming into this sector. Investors are pretty scared off. That's why people are buying each other out and eating each other up. There isn't enough outside money coming in to enable real natural growth, so people are trying to get bigger artificially"*
>
> Top 20 Private Provider

57 National Audit Office data (2004) for the complete childcare market, including childminding and pre-school education, shows that public sector funding is a key part of overall early years provision, with private individuals' contributions forming only 45% of the total, private companies' only 2% and the remainder coming from central or local government. There is some evidence (Laing and Buisson) that the private nursery market, which is more heavily directed at higher income families is more dependent upon self-paying parents, who contribute 77% of *nursery* funding (£2,600 million of £3,360 million). Private companies contribute a further £420 million in paying for childcare for their employees, the government spends c. £260 million on direct provision and a further £80 million comes from "miscellaneous" funding such as development grants and charitable contributions. This area highlights one of the major differences between the present market and the historical market – of the parental contribution, £325 million is derived from government indirect subsidies. The government contributes to the care costs of parents, and primarily underprivileged parents, and this has stimulated both demand and supply. The key forms of financial support available to parents are:

- The Child Tax Credit can be claimed by families with a combined income of under £58,000 per year. It is "paid" to the family, with every family with at least one child able to claim a "basic" portion of up to £545 and then an additional "per child" allowance of up to £1,690 per year,

- The Working Tax Credit is for lower income families (with a combined income of less than £37,500 for one child, or £62,200 for two or more children, or higher if either the child or parent is disabled). It is means tested, and can currently pay up to 80% of childcare costs, from April 2006. Linked to hours worked, it is "paid" via the wage packets of the parents,

- Student support for studying parents is available through a number of sources including universities and colleges, the Student Loan Company and a number of government bursaries,

- The Dedicated Schools Grant, as detailed earlier, supports the free childcare entitlement for 3 and 4 year olds.

58 In addition the market has been shaped by increased Government provision or coordination of childcare services via initiatives such as the Neighbourhood Nurseries program, the children's centre programme, the free early entitlement for 3 and 4 year olds and the extended schools agenda. These initiatives have both stimulated demand for childcare and acted to fill geographical and affordability gaps in supply.

4f. Perceived Barriers to Entry and Exit

59 Evidence suggests that in the private and voluntary sectors of the childcare market barriers to entry are few, and that barriers resulting from central and local government activity are appropriate and fair. The main barriers appear to be:

- Regulation. Childcare providers have to register their settings with Ofsted and ensure that on an ongoing basis it meets their standards. In addition there are statutory minima concerning staff-to-child ratios that typically increase entry and ongoing costs. However, PVI sector providers seem to agree that not only is the level of regulation in the industry appropriate but that it is beneficial to their businesses as it drives out sub-standard providers and improves the image of the market as a whole,

- Capital Requirements. The initial costs of setting up a childcare facility (excluding childminding) are limited, but investment is nevertheless required to purchase and convert a building and for other start-up costs such as equipment purchasing and promotion spend,

> *"The childcare sector needed more regulation and higher quality-assurance standards, and those have been brought in… In terms of the regulatory regime… I think it is fair… Ofsted is pretty rigorous in what it does, and though that drives our costs up I think it is beneficial to have a well-regulated industry"*
>
> Top 20 Private Provider

> *"The industry as a whole was in real need of regulation, something had to be done to keep standards up – or in some places to raise them – and we weren't at all opposed to it"*
>
> National Voluntary Provider

- High staff costs. While childcare staff in general are poorly paid relative to other care service areas, wage costs have been growing above the rate of inflation, which has increased entry costs for providers. In addition anecdotal evidence suggests that there is a shortage of trained childcare staff (most notably of nursery managers, and staff with NVQ Level 3 and 4 qualifications). Interview comments suggest that recruitment problems are particularly acute for the PVI sector given the higher wages paid by competing local authority bodies. Coupled with the high cost of training staff this can constitute a barrier to entry,

> *"Barriers to entry… there are some technical ones. You need a registered facility that is going to pass inspections. You need the appropriate staff, and that is in many ways the most difficult thing, and the most costly thing. After that you have to attract an initial stock of clients, and that can be difficult given that many densely populated areas have too many places anyway"*
>
> Leading Childcare Academic

- Lack of clarity about government plans. There is a perceived lack of clarity about the extent to which the government is likely to become and remain involved in the childcare sector. There is a plan of action laid out in the Ten Year Strategy, but some uncertainty about the future is perhaps unavoidable due to the limited funding horizons of most government initiatives. There is some evidence that this is discouraging investment in the sector.

Similarly there are very few barriers to exit in this market, and those that exist are very limited:

- Leases / long-term costs. Businesses may incur long-term costs such as property leases, which have to be discharged or resolved prior to market exit
- Bankruptcy conditions. Usual bankruptcy conditions must be met if the business is insolvent. If not then the business can be sold or closed
- For voluntary providers, local authorities (and, to a lesser extent, for private providers) there are issues of reputation and prestige. Closing a setting is likely to damage the perception of the parent organisation

60 Overall it does not seem that the barriers to entry or exit in this industry are abnormal or inappropriate. Indeed many providers argue that high barriers to entry, particularly in terms of registration and inspection, are both necessary and important in maintaining quality levels and perceptions of childcare providers. There is the obvious risk that part of this is a traditional problem of incumbents attempting to build higher barriers to entry to prevent new competitors entering the market.

61 In terms of government activity outside the regulatory sphere, the impact upon barriers to entry and exit is likely to be limited. The introduction of children's centres may exacerbate the difficulty and expense of finding staff, and the perceived lack of clarity regarding government agenda-setting is a concern for many private and voluntary providers, but the impact of these issues is likely to be limited.

4g. Trends in Supply

62 Private sector providers expressed concern about developments in the childcare market, suggesting that if trends continue the sustainability of their supply may be threatened. Several of the trends concern dynamics within private and voluntary provision, including:

- Increased competition in some regions. While childcare supply has increased in recent years, much of that supply has been focused on certain areas, chosen due to perceived high demand and relative affluence. However, in some areas, increased provision by existing providers and the arrival of new entrants has led to high levels of competition between private sector providers,

> *"While there is the potential for nurseries to open in some areas, in others we have reached or gone beyond the saturation point"*
>
> Top 20 Private Provider

> *"In some places the amount of voluntary sector support seems to be decreasing as private provision becomes established"*
>
> Top 20 Private Provider

- Falling occupancy rates have at least in part resulted from that increased competition, though anecdotal evidence also suggests that increasingly high prices for all childcare sub-types have deterred parents. These trends began before the implementation of the deployment of children's centres. The impact of new Governmental initiatives (in particular children's centres) and the ongoing development of free entitlement for 3 and 4 year olds provision on occupancy rates is unclear as they have only recently been implemented,

> *"Our occupancy rates have fallen, though I think less for us than other providers. Part of this is just a function of competition. That's inevitably going to cause you problems"*
>
> Top 20 Private Provider

- Increased staff costs. Staff costs have been escalating because of supply constraints. It is estimated that staff costs account for 75% of nursery operating costs (Investec / Nord Anglia figures). Staff cost levels have been exacerbated by market growth, included within which is the development of children's centres,

> *"While a few of our staff are pure volunteers, we have to pay our trained nursery and care staff, and that is getting prohibitively expensive. And we have trouble finding them, we may have to hire agencies to help us search which will be another layer of expense"*
>
> Voluntary Care Provider

> *"Our margins have also fallen, per child that is, because we are having to spend a bit more on staff. We don't actually mind doing that, we value our staff and want them to be well-paid, and we aren't trying to stockpile money, but on the other hand it does mean that when things go badly you might be forced to lay some people off. We're finding that we have to put more staff through training as well, you can't just cherry-pick NVQ-level people anymore"*
>
> Top 20 Private Provider

- Price Pressure. Historically private providers have been able to pass on cost increases to parents while still remaining broadly "affordable", but there is now evidence of price pressure in the market. This has limited fee growth and, according to anecdotal evidence, eroded provider margins.

> *"We have had 4% price rises over the last couple of years, and 8% and up increases in costs. That's mainly related to staffing. Then our occupancy rates are falling"*
>
> Top 20 Private Provider

63 While these trends are of concern to PVI providers, it has also been suggested that government initiatives may be damaging the PVI sector by increasing the amount of directly provided public sector supply through schools and children's centres (where new capacity run by the public sector is created in children's centres). Any local authority activity in this vein appears to be a contradiction of Government's intent to local authorities. According to Central Government, local authorities should be moving away from providing, and should instead be commissioning services specifically targeted at meeting the childcare needs of families in their local area, as far as reasonably practicable, taking into account PVI provision. In that framework it is counter-productive for local authorities to create provision which either directly competes with or duplicates capacity already supplied by PVI groups.

> *"The whole setup around childcare seems to be shifting. The government seems to have come to the view that childcare should be about development, which is something we have tried to say for a while, and education – and they also think that they are under an obligation to guarantee care…, which is also probably fair"*
>
> Top 20 Private Provider

1. Children's Centres

64 Our interview feedback suggests that the creation of c.800 children's centres so far, rising to a total of 3,500 by 2010, is a cause of concern among some PVI providers. Providers and some Local authorities have suggested that the initiative will result in the duplication of supply. However, the vast majority of children's centres currently in place are conversions of existing Neighbourhood Nurseries and Sure Start Local Programmes, and as such, are building on existing provision. Equally concerns have also been raised about the sustainability of children's centre based provision as the current level of funding is only guaranteed until 2008, in line with the Spending Review cycle. There also appears to be a strong misconception that children's centres provide subsidised places, which are not included in the core offer. Childcare in children's centres should be self-sustaining, according to Central Government.

> *"The UK nursery market remains very difficult. Nursery operators remain concerned about the government's plans to offer subsidised childcare in thousands of new children's centres and in some state schools"*
>
> Investec Securities Broker Note, Nord Anglia

> *"The private sector must be particularly worried about children's centres. In the 30% most deprived areas they have to offer 50 childcare places"*
>
> Ivana LaValle, National Centre for Social Research

65 In our view, the immediate impact of children's centres on the private sector is likely to be limited. In terms of location, children's centres have so far been rolled out in the 30% most disadvantaged super output areas (sub-ward areas defined by the Office of National Statistics to standardise analysis of geographical areas), which have not historically been served well by the private sector. However, case study analysis suggests that some authorities may not yet have an accurate view of local supply and demand. Providers also appear concerned that children's centres, as a result of their proximity to residential communities and range of additional services, might erode private sector supply in surrounding communities.

66 Surveys by DfES suggest that 50% of children's centres, to date, have some private or voluntary involvement including family support, suggesting that authorities are willing to work with the PVI sector in developing provision in these areas. In a more limited number of children's centres the overall management of the centre, not just the childcare element, is being delegated to PVI providers, although to date this is relatively rare. In most cases the authority in question is retaining the management responsibility. Overall, however, some providers view children's centres as an opportunity and that their "one-stop-shop" setup helps parents locate nursery care, including private and voluntary provision.

"We are very interested in getting involved with the children's centre scheme, although perhaps not in Phase I. Why? Well, Phase I is focused on poorer, more troubled areas and we wouldn't want to be left with provision in those areas if funding for children's centres was ever cut. But when it comes to linking children's centres with local providers in other areas, we would want to be involved. I think children's centres will probably become important sources of information and guidance for parents, and we don't want to be left out of that"

Top 20 Private Provider

67 Whilst private providers may be excited by the opportunity to work more closely with children's centres outside disadvantaged areas, this is less likely to happen given that these children's centres will not be required to provide childcare. Indeed, if existent supply is found to be sufficient after a mapping and assessment exercise local authorities will be under no requirement to support expansion at all.

"[Some local authorities] don't see the private sector as being a comfortable or appropriate bedfellow. There is a million miles between the Government's advisory notes and suggestions, and local authority behaviour"

Top 20 Private Provider

"If local authorities follow government guidelines, new facilities will not be sited near existing private sector nursery schools. If new facilities are located in deprived areas, as the government intends, they could expand the nursery school market by making childcare more affordable… the creation of children's centres could yet represent an opportunity"

Investec Securities Broker Note, Nord Anglia

"I would probably lean towards providing services myself too. It's easier to set up a new service in a children's centre location… than to persuade a [PVI] group to move their facility. [and] if you are looking at guidelines compelling you to "ensure" provision in the long term, it has to be more attractive to do it yourself than to enter a relationship with a third part who you might not have the same control over "

Top 20 Private Provider

68 To date there is no evidence of increased closure rates or other direct impact on the private sector, although impact should be monitored as part of the local authority needs assessment process.

"It's too early to see if children's centres are going to have an impact on wide areas. My feeling is that unless you have a facility which is in very close proximity to a children's centre you won't be disadvantaged by it"

Top 20 Private Provider

69 Beyond the immediate threat of competitive capacity, PVI providers are also concerned that the quality of the childcare provided in children's centres is high in terms of staffing, facilities and equipment and, though it is run at a high cost (case study evidence suggests around £250 per place per week), there is a fear it is offered at a low price or free to parents. This may impact parental expectations around pricing and quality in a market where margins are under pressure.

> *"Children's centres are driving out some private provision in some areas, it is unavoidable. They are not theoretically intended to do so, but they are – if you were offered a standard, expensive private service versus an authority one with all sorts of bells and whistles, what would you do?"*
>
> Local authority

> *"The large factor is the shortage of quality, trained staff, and I don't think that local authorities have truly thought through the consequences of what new provision will have on the pool of staff"*
>
> Ivana LaValle, National Centre for Social Research

70 Both PVI providers and local authorities also expressed concern that as a result of this high cost per place supply in children's centres may not be sustainable. The ability of local authorities to pass on costs to parents, especially in the most disadvantaged areas, is likely to be limited.

> *"My fear is that the government is going to follow this course of action which is going to drive private providers out then won't be able to sustain the funding for the places they are bringing in"*
>
> Professor Edward Melhuish, Birkbeck University

> *"I think it's a good idea in the abstract to have one site where parents can find out a lot about children's services. But the system was set up in such an unstructured way… it had to allow that local authorities could provide childcare where none was already present, but it was so loosely devised that the authorities seem to think that it's in their best interests to do that everywhere"*
>
> Top 20 Private Provider

2. Free Entitlement for 3 and 4 year olds

71 The Dedicated Schools Grant system has been structured so as not to favour one provision type or setting. All childcare providers including nurseries, crèche settings and schools have the opportunity to register with the DfES and Ofsted as a setting that is eligible to receive grant support (allocated on a per-child basis rather than a per-place basis) provided that they meet conditions set out in the Code of Practice

72 Some private and voluntary providers view the free entitlement for 3 and 4 year olds initiative as an opportunity as it brings increased funding to the market and enables parents who would otherwise not use Full Daycare to do so, increasing per-child hours spent in care. This is likely to be further enhanced by the forthcoming increase in the number of care hours supported by the grant funding (see earlier outline of fund allocation).

"The big development is about the funding of places for 3 and 4 year olds, the nursery grant scheme. To be frank, I'm not sure what this will do to our business. You would think that it might help, by helping more parents to afford quality care, and we are certainly going to try and take advantage of that. But then there are two problems – it lets schools in, and they have not yet demonstrated that they are good at childcare provision, and then there is the sustainability issue. If we add educational support it will cost us, and if grant levels don't rise in time to meet rising costs, or if they are cut altogether, we will carry the can"

Top 20 Private Provider

"Yes, there are some problems with the system. But overall it has to be beneficial. A steady, reasonably substantial stream of funding tied to higher standards. It's what the voluntary sector has been asking for"

Voluntary Care Provider

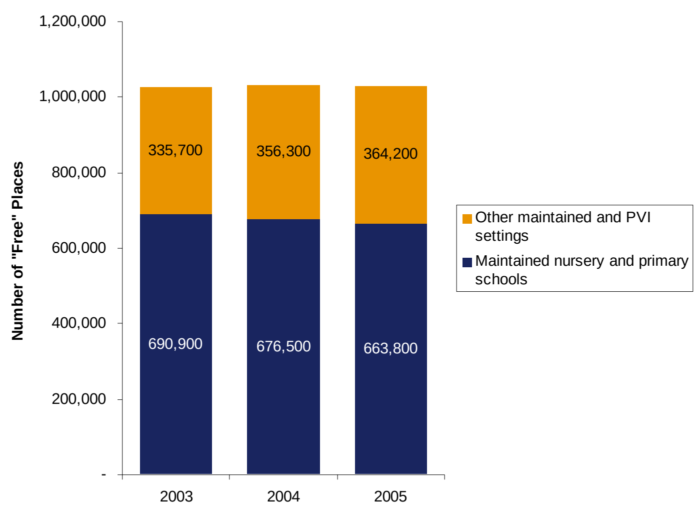
73 Others, particularly those with limited or no education provision see this as a significant threat since they may lose part of their key addressable market, the 3 and 4 year olds. It must, however be remembered that at present over 65% of 3 and 4 year olds receive their free offer in a maintained school. The conditions of the Grant require an increased educational element in the care package. Although anecdotal evidence suggests that this is unlikely to be an insurmountable barrier for most providers, it may be an issue for smaller operators.

"Some of the private sector seem to be quite nimble in moving over and adjusting to the increased educational component of what they have to do"

Professor Edward Melhuish, Birkbeck University

74 There is also concern amongst PVI providers about the potential for expansion of capacity in schools themselves, which may be developed without accounting for incumbent local capacity.

Provision of "Free" Places for 3 and 4 Year Olds, 2003-2005



Source: National Statistics First Release SFR43/2005 - Provision for Children Under Five Years of Age in England

75 Schools have some advantages in developing these places and attracting demand. Parents place trust in the ability of the school to deliver high quality “educational care” or try to position their children for entry to the school at age 5. The training of school staff makes them suitable for providing care that meets the new standards. In addition, school-based care can be very convenient for parents, if they have other children over five already in the school. However, the Government seeks to emphasise that early years care should be integrated with education, resulting in provision that provides play-based learning and development opportunities for children.

“Schools have some advantages that we don’t. They are often really well placed, and especially if you are a parent and you already have one child in a school, you will want your other child to be in the same place if possible. Plus they have appropriate buildings”

Top 20 Private Provider

76 The majority of places are delivered by schools, but despite the advantages schools have, the proportion of places delivered by schools appears to have declined from 2003 to 2006. This may be because of the advantages the PVI sector has, in terms of flexibility and diversity of provision.

“In theory parents… can either enrol their children in a school, or apply for… equal funding to use at a private nursery. In practice the initiative is portrayed and publicised in such a way that no-one knows about the grant and people are pulling their children out [of nurseries] to go into schools”

Private Provider

77 Providers may struggle with costs related to staff reward and training, as the increased educational component of care increases the need for the recruitment of highly trained staff and the “continuous development” of staff already in place. As has been noted in other areas providers may also struggle to pass the increased costs incurred on to parents given the increasing fee pressure in the market.

78 Although few of the providers interviewed criticised the push to improve the educational element of childcare, many felt disadvantaged relative to schools as the latter already employ highly-paid trained staff, paid for by other funding streams. Some providers also felt that the lack of geographical variation in grant funding levels is a problem where salaries for educationally trained staff are high. While there are “top-ups” to Grant funding to compensate for local factors such as disadvantage, ethnicity and property costs some providers suggest that these top ups are not sufficient.

“*My worry about the free places is that it is set up to encourage schools to get in. And while that is not necessarily a bad thing, there are… well, it’s meant to be a system of balance and best value, and increasing parental access, but it’s not like that. Schools have teachers on support staff on payroll, so it’s easier and cheaper for them to move into educational care than it is for us. So what might happen is that schools drive other people out, and that won’t have increased overall supply and widened access for parents*”

Top 20 Private Provider

79 Overall it appears that the free early entitlement for 3 and 4 year olds presents both opportunities and threats for PVI providers, but the data available about the impact is limited. Most at risk appear to be providers who fail to register as an appropriate setting, or providers who cannot afford to develop education provision. Therefore there may be some loss of supply in the PVI sector where school based provision is developed without reference to the current supply base. This may result in problems if capacity outside the “free” element of provision and capacity for other age groups is lost along with it. In principal, however, subsidised places can be beneficial to the market by bringing more funding into the market and expanding demand as parents who could not otherwise afford childcare can now do so, but this depends on appropriate delivery and avoidance of capacity duplication.

3. Extended Schools

80 Of the government initiatives discussed, the extended schools agenda is the least clearly defined at present, and is least developed in terms of local implementation. The aim of the initiative is that children will have access to places from 8am to 6pm within a system monitored and developed by schools. Not all the provision used has to be provided by the school directly; schools are discouraged from providing services themselves if the local community is capable of meeting requirements.

> *“Extended schools will have an impact but only on certain types of care. Those who are currently providing sessions of care so that parents can work longer hours are going to be threatened – childminders, sites close to schools offering drop-off services”*
>
> Market Analyst

81 Case study evidence suggests that when attempting to piece together an extended schools offering, local authorities are more likely to consider partnerships with voluntary and community providers than private providers. There are several reasons for this: historically, although often reluctant to use external providers at all, schools have been more likely to work with voluntary groups than private providers; there is often suspicion on the part of school staff about the motives of private providers; and the schools’ knowledge of local voluntary provision is in many cases better than for private provision. This may limit the opportunities for private providers to form partnerships with schools to provide extended schools care.

> *“Extended schools… as it stands I don’t think it will make very much difference. I don’t think the packages being put together are very convincing, I don’t think parents will use it over good quality childcare”*
>
> Top 20 Private Provider

82 Extended schools can offer benefits for parents and increase childcare capacity, but there is a risk that the initiative may reduce demand for other forms of childcare. However, the key focus for nursery providers is the 3-4 year old age group and extended schools usually serve older children. The impact is likely to be greatest on childminders and those providing out of school care for 5-7 year olds, but will be more limited for Full Daycare providers. There may be opportunities for private providers, including childminders, to become more involved as long as schools have visibility of supply and demand locally, and the relationships between the sectors are good.

4. Other government funding initiatives

83 It is thought to be unlikely that governmental initiatives focused on supporting economically disadvantaged parents will increase or decrease significantly in the short to medium term. As has been discussed, the Child Tax Credit and the Working Tax Credit are likely to increase childcare uptake by bringing funding into the sector and enabling parents who would otherwise not be able to afford formal care to do so. These credits may benefit private providers, although many of them are not located in areas where these credits will have the greatest impact, i.e. more disadvantaged areas.

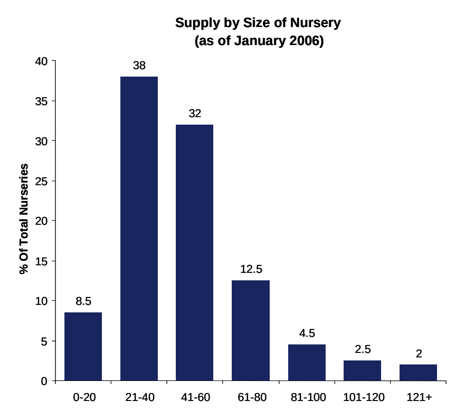
> *"I think the funding initiatives have helped parents and have helped us. There are slight issues about levels of funding relative to what it costs us to provide the place, and parents are often unhappy at being asked to pay anything to make that up, but on the whole it's a bonus"*
>
> Top 20 Private Provider

Consolidation Trends

84 As a result of rapid growth, large government investment, and an influx of large venture-capital backed chains, along with increased private sector competition, the private childcare sector has seen consolidation in the last 4 to 5 years. In particular large venture-capital backed chains have attempted to grow in size by taking over smaller groups or independent operators. There have been several significant purchases or mergers.

> *"Consolidation has happened and will continue to happen. It's not necessarily that smaller operators are doing badly or will become notably more efficient if they are taken into a bigger concern, it's more top-down. It's that large providers are looking to build networks and grow in size and as of now the only real way to do that is to take over"*
>
> Top 20 Private Provider

85 Providers have also been selling or exchanging less profitable units in an attempt to realise greater portfolio synergies or to dispose of underperforming settings. Anecdotal evidence suggests that larger private chains are disposing of less profitable smaller settings (e.g. those offering between 10 and 30 places) which are less flexible in capacity terms and may require more funding per place to comply with inspection and equipment standards. This suggests that consolidation may bring with it some efficiency savings.



86 However, even with recent activity consolidation the sector is still highly fragmented. Thus the exposure of the market to the actions of a single large provider, or a group of the largest providers, is minimal. Market analysts and providers also suggested that consolidation trends may slow in the short to medium term, with less deal activity and fewer portfolio alterations.

> *"In recent years there has been a trend towards consolidation at the top end of the nursery market as some of the largest nursery groups have acquired other nursery groups. However, the impact of this consolidation on the overall nursery market remains small. The consolidation trend halted in 2005 as investors and nursery businesses were uncertain about future performance"*
>
> Laing and Buisson Children's Nurseries UK Market Report 2006

87 Consolidation is thought to offer limited advantages for private providers, as is the case in many other care-related markets. Ownership of a large portfolio with a significant geographical reach reduces the exposure of providers to setbacks or falling margin levels in particular areas. Anecdotal evidence suggests that this "balancing" has allowed some providers to weather the poor performance of certain units by offsetting losses with profits made by other settings. Larger, consolidated groups may also find it easier to attract investor funding, as they offer safer investment opportunities than smaller groups with less national coverage. In addition consolidation may offer per-setting savings in that management functions, marketing spend and staff recruitment and training.

> *"Oh, there are some advantages. We have found that being a scale business has helped us generate capital for expansion and development, has reduced costs per-place somewhat, has helped some settings because parents trust our name more than they did the old branding"*
>
> Top 20 Private Provider

88 Some economies of scale may be derived from larger group sizes, e.g. in terms of equipment procurement. Top-down enforcement of quality assurance and best practise processes may contribute to the raising of standards across facilities, and thus attract parents. However this may be balanced by the need for a sustained focus on the integration of each setting with its local community and parental desires for a "tailored, friendly setting" rather than a "soulless national chain presence".

> *"I'm not entirely convinced that there is a huge advantage in consolidation… I mean, there are at some levels – you can share back-office and administrative staff, you can do centralised purchasing, you can use economies of scale on procurement. But… there isn't a big advantage in terms of staffing, you don't save money on buildings because you still need facilities in your areas"*
>
> Editor, Leading UK Childcare Industry Publication

89 Anecdotal evidence has also suggested that those groups who have attempted to increase in size have faced integration and development problems that may outweigh the benefits to be gained. It has been suggested that the manner in which many private providers have developed makes integration difficult. Many providers have historically either been founded or managed by

individuals or small groups of entrepreneurs or have delegated high levels of day-to-day management responsibility to individual nursery managers. Both of these models pose problems in integration terms as incorporating into a group structure highly centralised or unit-focused business units has been found to be difficult. In particular the merger of Nord Anglia with Leapfrog Nurseries has demonstrated the potential for regional or setting-level managers to clash with national organisations about agenda-setting and service delivery goals.

90 Consolidation in the voluntary sector has been much more limited, and is likely to remain so in the future. Many voluntary groups have strong links to local communities or offer specific services which would not benefit from integration with other providers.

91 From a local authority perspective there seem to be limited reasons to either support or attempt to limit the extent of private provider consolidation. It may facilitate local authority private provider mapping and monitoring exercises to have fewer private providers to liaise with. Similarly, having local groups folded into larger chains may go some way to ensuring that provision in an area is secure as a result of the "balancing" potential described above, but it is difficult to determine precisely the extent to which this is likely to benefit authorities.

92 One potential threat that local authorities should be aware of is the possibility that consolidation could in certain areas threaten to reduce parental choice. Certain areas may find that the balance of supply comes from private operators who offer similar services, and that more idiosyncratic local operators are taken over or driven out of the market. In such areas it may also be the case that a single operator or a cadre of operators comes to control a high proportion of local supply, which increases the exposure of an authority and its parents to a situation in which a single provider reducing the size of or closing its facilities damages local supply significantly. However, such a situation is likely to be remote in most areas given the low level of consolidation observed in all the case study areas.

93 The task of relating care types with quality of care and outcomes for children is problematic. In the first instance there is little agreement within the academic and pedagogical communities as to what the most desirable goals and outcomes are for children between the ages of 0 and 5[532]. Many suggest that childcare during these years should be fundamentally unstructured with little or no focus on outcomes, which makes judgements concerning quality difficult. However, this view is increasingly being disregarded as the government seeks to emphasise that early years care should be integrated with education, resulting in provision that provides play based learning and development opportunities for children and early learning goals which can be assessed through observation.

94 Even with the increased focus on measurable goals, relating particular care types with outcomes is difficult. There is limited academic evidence suggesting that multi-infant settings such as nurseries are more beneficial for childhood development than "individual" care types such as childminding, though even in that instance conclusions should not be overstated. According to experts the clearest link between care and outcomes is dependent upon staffing. Settings with highly-trained staff and low child-to-carer ratios have been found to be considerably more beneficial for children than those with untrained staff or higher ratios. Less significantly the quality of equipment and the condition of the setting have some impact, although this has not been thoroughly tested.

"I think the quality is the same across provision types –that's to say, there is huge variation in all areas" Local authority

95 Thus it seems that, initially at least, increased consolidation will have little bearing on quality and outcomes. Larger chains may be better-placed to ensure high and consistent levels of quality as a result of well-defined training processes, staff development programs and equipment standards. However, Ofsted regulation should ensure that minimum setting and staffing standards are met no matter whether the setting is independent or is part of a larger group, and as such baseline standards will not be affected by consolidation. There is little evidence to suggest that independent private facilities offer higher care standards than chain-owned settings, or that the increased consolidation of the market is driving out smaller providers who offer high-quality services.

Primary Research

96 Evidence to date from the Primary Research program suggests that private providers have been impacted by these governmental initiatives, albeit not significantly. Many report that children's centres have impacted their occupancy levels although in a limited fashion (see annex).

4i. Local Authority Activity and Commissioning

Assessing Demand and Supply

97 The local authorities examined had very different approaches in assessing demand, although several of the authorities were still developing assessment processes or had yet to complete their initial survey. While all the case study Authorities were making progress in terms of demand assessment, concern was expressed in some areas that extended schools activities are being developed and children's centres rolled out before the completion of a full needs analysis. One local authority suggested that this time gap had led to the inaccurate location of children's centres, causing problems in terms of service delivery and targeting.

> *"Phase 1 children's centres weren't necessarily targeted right, or appropriately, to adjust this imbalance, and they are not necessarily sustainable. I do think children's centres are appropriate but they had to develop too quickly. In reality what things should be about, and what many of the reforms have been about, is existing setups working in different ways, but all children's centres did was plough millions into new infrastructure"*
>
> Local authority

98 All of the authorities contacted had a Children's Information Service (CIS) which conducted a simple form of needs assessment. The CIS departments collected data relating to the enquiries that they received, which gives authorities a high-level impression of which services are in demand, which geographical areas are well- or poorly-served and which types of parent felt that their demands were not being met. In addition the CISs in all case study areas maintained databases containing information about private / voluntary / local authority supply in their area. Most monitored vacancy levels in those settings on at least a semi-regular basis. However, refreshing the data often enough to ensure that it was up to date was a challenge for several CISs since it relies on feedback from providers. However, it is a useful high-level indicator of supply and occupancy levels. However, the extent to which such information is useful in terms of market management may be limited, and the reliance placed on CIS data by authorities was thus constrained.

99 In terms of formal demand and supply analysis the approach at each case study authority varied. One area had an extremely detailed analytical and geographical modelling framework in place which could analyse local supply and demand factors in a complex fashion. The exercise incorporated factors such as local road systems and the layouts of residential communities to determine the extent to which local patterns of usage were moulded by such features. The conclusions formed by the Authority using outputs from this exercise had led to a re-evaluation of local strategic priorities, staffing models and facility development. The authority in question had furthermore begun a dialogue with DfES to discuss its findings and to ask that national-level targets and guidance notes be modified to take into account the sophisticated, tailored service that the authority wished to implement.

100 In contrast another area had yet to complete its initial mapping exercise, and the others were arrayed somewhere between these stages. None of the other authorities had developed a system that was as detailed or capable of integrating geographical data as Case Study 2, though several were comprehensive in their goals in relation to the mapping and monitoring of local private and voluntary sector supply.

101 Case study evidence suggests that as important as the information-gathering mechanisms are those for sharing and discussing the resulting material. The extent to which different individuals, groups or agencies (e.g. extended schools leads, children's centre managers, local authority coordinators etc.) shared information seemed to vary significantly. In one area an ongoing examination by the extended schools team appeared to partially duplicate work being carried out by the Children's Services department, while in another area a children's centre manager reported that he had little visibility of supply and demand information.

102 In all of the case study authorities the formal processes described were overlaid with the informal or "implicit" knowledge and experience possessed by local authority staff. It was often stressed that staff used their own understanding of local demand and supply patterns to guide authority actions, unsupported by published data or formal evidence. While the recruitment and development of trained and knowledgeable staff is clearly beneficial for local authorities the

current system, with its partial reliance on informal knowledge, increases the importance of staff retention.

103 The development of a needs assessment process depends on resource availability and "sponsorship" by an influential individual or group who pave the way for detailed mapping exercises to be carried out. In the most advanced case study area a single individual who occupied a post with joint local authority / Primary Care Trust responsibility and funding allocation powers had driven the assessment process and made its results available to interested services. Even in that instance it was stated that a great deal of effort had been required to persuade local councillors, service managers and ground-level staff that the reallocation of services suggested by the outcomes of the assessment was justified. Local elected officials and stakeholders in affluent areas or areas which had previously received high levels of funding were often unhappy when resources were transferred to other areas. However, in other case study areas the responsibility for needs assessment seemed to be split between several departments and, if no individual or group was driving the process, often seemed to be a low-priority activity.

Relationships with External Providers

104 The manner in which local authorities interact with childcare providers is to an extent determined by their high-level strategic priorities. Some authorities prioritise certain types of childcare setting as a result of local circumstances or a belief that a particular care model offers the highest quality care. For example, two case study authorities expressed a particular commitment to building and sustaining childminding. In one case this was because the area was a rural community with a dispersed population that was best served by the flexibility of childminding rather than nursery provision. In the area there was a good stock of childminders as a result of historical and developmental factors, but the authority also suggested that even if that wasn't the case they would seek to prioritise childminding because they supported the style of care that it provides. As a result those authorities might not focus their attention on developing relationships with private or voluntary nursery providers, or meeting the actual needs of parents.

105 That aside there was a divergence of views regarding the basic modes of interaction between authorities and private providers. Some providers stated that they had good relationships with authorities, and felt that the authorities were interested in involving private providers in local mapping, strategy and service development agendas. Equally two of the case study authorities stressed that they invested significant time and resources in communicating and working with private sector providers – as well as maintaining their traditionally close relationships with voluntary groups – and felt that working relationships were open, cordial and productive.

> *"In some of our areas we have very good relationships with authorities. Fundamentally these are areas in which both sides respect and trust each other, that's built up over time and it's manifested in everyday behaviour. We help the authority by providing information about our services, by participating in their events, by cooperating with local initiatives. And in return we are made aware of what developments are in store, we are brought in for consultation about important decisions"*
>
> Top 20 Private Provider

106 In addition many providers stated that they valued the "additional services" offered by the local authorities. In particular providers stated that they planned to take advantage of staff training, support and guidance offered by local authorities or affiliated bodies. A number of providers

complimented the authorities for providing good clarification sessions for facilities approaching Ofsted inspections, and also supported the efforts made by the local authorities to enable staff to complete NVQ-level training processes.

> *"You have to give credit where it's due. The council does offer some very good training support, they are never less than polite and helpful when we have particular issues we need help with"*
>
> Top 20 Private Provider

107 However several of the providers interview claimed that in some of their areas of operations there were tensions between them and local authorities, leaving providers feeling isolated and marginalized. The providers suggested that this was the result of historical tensions between local authorities and private operators concerning motives, with authorities resenting the profit-seeking motives of the private organisations. Some providers admitted that *"things run both ways"*, that they were often uninterested in developing more cordial or effective relationships with local authorities. They stated that the reasons for this reluctance were both practical (several reported that interacting with local authorities was often drawn out, unproductive and costly) and philosophical (two providers stated that to a certain extent they viewed the local authority as a competitor). In a similar vein several local authorities suggested that they didn't believe that private providers offered a service that was equivalent in quality to local authority in-house childcare.

> *"But in other areas there is no trust and respect, there is some enmity really. It seems apparent to us that authorities are not only not sensitive to private provider issues but in fact are actively uncaring, they don't believe that we offer a good service or have the interests of children at heart. And when that has been ongoing then it leads to antagonism, it doesn't make us keen to respond to them either. It's not worth us investing our time into it"*
>
> Private Provider

108 The same providers who reported attitudinal differences with the local authorities tended also to identify communications problems, complaining that they were often uninformed and unconsulted by authorities. In some cases providers reported an absolute lack of involvement in consultative bodies or other information-sharing arrangements, while elsewhere providers felt that the bodies did not meet frequently enough or were not taken seriously by the relevant local authority representatives.

> *"Communication channels are practically non-existent, even with all the talk about partnership. I would be more than happy to communicate, to talk, but we just have no idea what the authority plans are. We sit on EYDCPs and things like that, some months they might even consist primarily of private provider representatives, but it's a bit of a sham"*
>
> Private Provider

> *"Especially in the last 3 months things have been really unsettled, the relationships between local authorities and private groups have become really unstable"*
>
> Top 20 Private Provider

109 Provider concern was often more significant than irritation that they were not fully involved in consultative processes. Many providers suggested that the breakdown in relations could result in a lack of support for private providers or a lack of awareness on the part of the local authority with regard to the development and location of supply. Some of the larger providers interviewed reported that they had no regularised or detailed communication with the local authorities, and that they didn't feel secure about the future of authority-provider interaction centring on staff training and service development. A selection of providers also expressed concern that this lack of communication was resulting in provision duplication, with children's centres and Early Years provision located in areas already served by private provision. A lack of appropriate data makes it difficult to verify this claim, although market analysts suggest that any overlap between local authority provision and private supply is at present likely to be limited.

110 One significant area of local authority / provider interaction concerns the commissioning of childcare in children's centres, especially in the deprived super output areas in which new provision is to be created. All the authorities questioned claimed to have an ongoing dialogue with private providers in their regions about the children's centre initiative. On one level it can be observed that if such communication is truly ongoing outcomes have been very different - in one area that dialogue had led to the direct involvement of a private provider in childcare provision in a children's centre, while in another it was admitted that a strategic decision had been made not to involve private providers. However, in many areas the channels of communication between the authority and the providers seem opaque at best, with little evidence of formal tendering processes. Many areas suggested that they planned to increase consultation with and possibly the involvement of private providers in Phase 2 children's centres, but none offered concrete plans as to how they intended to do so.

111 Some authorities reported that they had better communications and more open relationships with the voluntary sector, which had lead to a higher level of voluntary sector involvement in the children's centre programme. Anecdotal evidence suggests that there are two reasons for this – first of all local authorities are less cautious in dealing with voluntary groups than with private providers because the former has no profit-seeking motive. This reduces authority concerns about getting value-for-money and cooperation. Secondly, the duties that have historically fallen to local authorities have brought them into closer and more regular contact with the voluntary sector than with private providers. This has led to the development of close relationships and bonds of trust between authorities and voluntary groups.

112 However, even this interaction was not without difficulties. One of the key challenges reported in building relationships with the voluntary sector is the fragmented nature of services and providers. Using umbrella organisations as a way to catch a larger number of voluntary groups is being explored by several authorities, although in the other case studies areas such models were underdeveloped. Authorities also reported that they found it more difficult to hold voluntary sector providers to scrutiny and were often frustrated by the opaque performance monitoring processes of the voluntary sector. There are indications that voluntary providers are going to come under greater scrutiny going forward in terms of performance and delivery monitoring.

Suggested Improvements

113 Our research suggests that the current initiatives driven by central government should not negatively impact market development in principle. They should offer an appropriate means of delivering access to child care to parents where supply has been short or unaffordable historically.

114 However, these initiatives could pose a risk to the current market and to market development if not handled and communicated appropriately. Although the impact to date has been limited, there is concern amongst private providers about threats to their businesses and amongst voluntary and local authority providers about the sustainability of new capacity.

115 Our suggested improvements are based around ways of ensuring that these risks do not materialise and that the developments, such as children's centres and extended schools, support market development rather than oppose it.

116 The key risks of poorly implemented initiatives, locally, are:

- Local authorities could be faced with the cost of in-house, under-occupied capacity,
- Not all expanded capacity will be sustainable without substantial long-term central funding'
  - This may be the case for some capacity regardless, but the amount should be minimised,
- Some capacity in the PVI sector could be lost due to competition from schools and children's centres, and losses may not discriminate between high and low quality settings,
  - This would hamper market development,
  - This could leave the local authority footing the bill for a larger proportion of child care than is necessary,
- The capacity developed may not suit the nature of local demand, e.g. in areas where cultural factors impact demand for childcare,
- A proportion of the market may remain under-served, i.e. working families unable to afford higher cost childcare places, but without new capacity entering the market to capture this audience.

117 The key areas to focus on for improvements are:

- Ensuring that local authority needs assessments are granular enough and robust enough. This will be particularly crucial during the next phase of children's centre development. Key issues to consider are:
  - The availability of adequate, but possibly temporary resources at local authority level to conduct the needs assessment,
  - The availability of best practice informing local authorities of all the factors to consider,
  - The availability of clear regulations and guidance which make clear mandated aspects of the needs assessment,
  - The availability of either funding to develop, or the provision of appropriate software,

- Ensuring that the needs assessments take place before capacity is laid down or contracted,
- Ensure the local authorities are able to monitor the impact that new capacity has on local supply and demand patterns,
- Developing a culture of continuous dialogue and communication between the local authority and the local supply base, be it private or voluntary,
  - Encourage providers to register with Ofsted to qualify for funding for free entitlement for 3 and 4 year olds places.
- Improving visibility of government plans, the reasons for them and what opportunities they present,
  - Make sure that providers are aware of the potential opportunities to capture some of the additional funding coming into the system. There may be an argument to support some providers in delivering education elements – e.g. in partnerships with schools,
- Ensuring a strong link between school activity, local authority activity and the current supply base within the overall strategy for delivering childcare,
  - To ensure this, the individual driving the delivery of a childcare strategy need significant influence in all the elements involved, i.e. PCTs as well as the local authority,
- Developing plans or models for sustainable provision, e.g. children's centres, for local authorities to use to:
  - Understand the costs thoroughly,
  - Ensure cost efficiency,
  - Define and capture potential revenue streams,
  - Consider what other revenue streams may subsidise provision,
- Understanding which areas may not be sustainable without significant on-going funding and quantifying it,
- Child care capacity has the opportunity to deliver different outcomes in different areas. Clear understanding of the key aims of additional capacity may help local authorities to take a view on sustainability and resource allocation,
  - Overall, one key outcome is better early education and improving the life experiences of children at a crucial age in their development. In some areas, however, the opportunity may be to get parents into work and change the local employment culture, e.g. in areas of 3rd or 4th generation unemployed families,
- Understand whether a proportion of demand will remain underserved, i.e. those not in disadvantaged areas who cannot afford full day care,
  - Consider a means tested extension to the free entitlement for 3 and 4 year olds,
  - Consider the role of schools in providing this,

- Local authorities should ensure they have taken full account of the impact on other forms of provision before commissioning further childcare in children's centres or changes to the free entitlement to 3 and 4 year olds. Commissioning activity should build on solid needs assessment,

- The control and approach to childcare strategies may be dispersed within an authority area, which can prevent a true a joined up approach and limit communication – e.g. schools, voluntary organisations, local authorities.

118 There are some broader themes which may warrant further investigation:

- Children's centres offer what appears to be a higher cost, higher quality, but lower price place – what effect will this have on the market in terms of parental expectation, competition with other providers and staff costs? What quality level is actually necessary to deliver good outcomes?

- What is the most cost effective setting for delivering childcare with education (with good outcomes) for 3 or 4 year olds – schools, children's centres, or traditional private provision?

- How can children's centre capacity in disadvantaged areas be made sustainable or self-funding?

- What should the total funding contribution from central government be to support a high level access for all levels of society?

- How are schools developing services and what will their approach be going forward?

Annexes

Annex A – Methodology

- Our approach to this study has combined a series of activities to analyse the market for childcare market at both the national level and within six selected local authority case study areas as follows:

National Level Analysis

- We have undertaken a programme of desktop research and analysis to gain an understanding of:
  - The overall structure of supply within the market;
  - The profile of market demand; and
  - Key supply and demand side issues at a national level.
- A list of sources consulted as part of this exercise is provided at Annex C.
- We have also met with a number of DfES officials to understand the overall policy context surrounding the market.
- In addition, we have conducted a number of interviews, some over the telephone and some face to face, with national independent and voluntary providers working within the childcare market, and spoken with c. 10 market observers.
  - A list of organisations that we have interviewed is provided at Annex B.

Case Study Analysis

- We have worked with six different local authority case study areas, selected to provide a mix of urban and rural, southern and northern locations in England as follows:

LA Number	Population Density	Geographic Location
1	Urban	North
2	Urban	North
3	Rural	North
4	Urban	South
5	Rural	South
6	Rural	South

- Our primary method of data collection within each case study area has been to conduct a number of face to face interviews with key local authority personnel to:
  - Understand the overall structure of supply within the local market;

- Understand the profile of local demand;
- Identify key supply and demand-side issues at a local level; and
- Where possible, identify examples of best practice at a local level.

- A list of personnel interviewed within each case study area is provided at Annex B,
  - It is important to note that we have had better access to key personnel and therefore achieved better coverage in some case study areas than in others.
- We have also undertaken a programme of primary research within each case study area (in the form of interviews with private and voluntary providers) to gain a better insight into the key concerns of the private, voluntary and independent sector. Further details about the approach taken to this programme of primary research are provided in the section below.
- Our recommendations for market development and future improvements have been developed in conjunction with relevant DfES policy officials.

Primary Research Undertaken Within Each Case Study Area

- Approximately 90 interviews were undertaken with private and voluntary providers in the six local authority case study areas.
- The focus of our research was to explore:
  - The key issues and concerns facing private and voluntary providers;
  - Fees and funding;
  - The local demand and supply picture.

Annex B – Interviewees

Private Providers Interviewed

We carried out in depths interviews with 12 PVI childcare providers (in addition to the 90 surveyed as part of the primary research programme)

In each case, the interviewee was a member of the senior management team – usually Chairman, CEO, MD, COO or Business Development Director.

Market Experts and Commentators

Expert	Roles
Ivana LaValle	Head of Families Research Group, NCSR
Professor Edward Melhuish	Professor of Human Development, Institute for the Study of Children, Families & Social Issues
Professor Peter Moss	Director, Thomas Coram Research Center

Daniella Reale	Analyst, Daycare Trust
Graeme Cook	Liaison, 4Children
Professor of Childhood Development (anonymised)	Leading UK Research University
Professor of Early Years Social Care (anonymised)	Leading UK Research University
Editor (anonymised)	Leading UK Childcare Publication
Childcare Journalist	Leading UK Childcare Publication
M Scanlan	Liaison, National Family and Parenting Institute

Case Study Interviews

During our case studies we held discussions covering looked after children at various levels within the authority. The DfES asked that responses from the case study authorities be anonymous, and as such we have not named the authority and have listed roles or generic, equivalent titles rather than specific titles, which may enable identification of responder.

Expert	Roles
Case Study 1	Head of Early Years
	Childcare Development Officer
	Head of Training
	Children's Centre Lead
	Children's Centre Manager
	Children's Information Service Manager
	Local School Headmaster
Expert	Roles
Case Study 2	Head of Early Years
	Childcare Development Officer
	Children's Centre Manager
	Children's Information Service Manager
	Children's Centre Manager

Expert	Roles
Case Study 3	Head of Lifelong Learning
	Senior Education Officer
	Head of Sure Start
	Senior Joint Commissioner
	Children's Information Service Manager
	Director of Leading Local Childcare Provider
	Director of Leading Local Childcare Provider
Expert	Roles
Case Study 4	Children's Services Manager
	Senior Education Officer
	Early Years Development Officer
	Childcare Discussion Session with 11 Local participants including Children's Information Manager
	Children's Information Service Manager
Expert	Roles
Case Study 5	Head of Early Years
	Head of Children's Centres
	Extended Schools Officer
	Early Years Assistant
	Head of Adult and Community Learning
	Children's Information Service Manager
Expert	Roles
Case Study 6	Head of Early Years
	Children's Information Service Manager
	Head of Regional Jewish Childminders Association
	Children's Centre Manager

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