# CommBank Early Learning Insights.

In partnership with the Australian Childcare Alliance

**December 2018**

Australian Childcare Alliance

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# Contents



# Key insights

## Responding to operational pressure points

In this edition of the Early Learning Insights Report we look at the operational and financial performance among Australian Early Learning service providers and examine the way these organisations are adapting to challenges and trends within the sector.

# Key Insights

Welcome to the inaugural edition of the *CommBank Early Learning Insights Report*, an analysis of sector trends, performance, and key challenges among Australia's early learning service providers.

It is clear from this year's research that the early learning sector as a whole continues to come under pressure on a number of fronts.

Early learning services across the country are now running at an average occupancy rate of 75%, down marginally from 2017, and while average revenues have risen, so too has the operating cost base. Service providers continue to report substantial upward pressure on wages, and almost one in two centres said profits had fallen over the past six months.

Despite these factors weighing on sentiment for some service providers, and a third of the sector adopting a pessimistic outlook, sector-wide confidence has experienced a moderate year-on-year uplift.[1]

However, confidence levels vary across service types, sizes and location, with positive sentiment more prevalent among the 72% of centres that operate only one centre when compared to their multi-centre peers.

According to the research, those operating more than one centre are more likely to be experiencing falling occupancy in recent months and as a result, just over one in 10 has a positive outlook for the sector.

From a day-to-day operational standpoint, most in the sector have been busily preparing for, and managing, the implementation of the new government funding package - the Child Care Subsidy (CCS).

This has been one of the largest changes to the government funding model since the Childcare Benefit (CCB) was introduced in July 2000, replacing Childcare Assistance and the Childcare Cash Rebate. Centre owners had voiced their uncertainty in the lead up to the scheme's introduction on 2 July 2018, identifying the change as a threat.

Many service providers are also concerned about new market entrants and rising competition within the sector, however, we are seeing many respond with a heightened focus on quality improvement as centre operators seek avenues to drive higher occupancy.

This includes more centres prioritising the government's quality benchmarking program, the National Quality Standard (NQS), as many seek to ensure they can secure an 'exceeding' rating to attract families to their centres.

In further evidence of the sector's resilience, our research this year revealed a more positive medium-term outlook for both organic growth, and respondent's plans to acquire new centres.

This is particularly pronounced among multi-centre operators who may have more capital to deploy to upgrade their centres, and suggests the potential for further sector consolidation.

This emerging growth orientation, a greater focus on the quality of facilities, staff and care, demonstrates that many in the industry are seeking to proactively improve their market position and deliver better educational outcomes for children. With a backdrop of falling average occupancy rates and margin pressure, this is an encouraging sign and a trend we hope continues into the future.

**Sachin Kumar**
National Director Healthcare
Business and Private Banking
Commonwealth Bank of Australia

**About the CommBank Early Learning Insights Report**

The CommBank Early Learning Insights Report is a joint initiative between the Commonwealth Bank of Australia and the Australian Childcare Alliance (ACA). The report comprises a quantitative and qualitative analysis of the outlook, financial performance, operational priorities and challenges facing the Australian early learning sector. The findings contained within the report are based on a survey of 176 ACA members operating a total of 266 centres across Australia. Online survey responses were sought between March and June 2018, with the data analysis conducted by ACA Research in July 2018.

[1] **Bankwest National Childcare Barometer 2017**

# Key insights

### Number of centres owned

| | 2017 | 2018 |
|---|---|---|
| 1 | 65% | 72% |
| 2 | 17% | 11% |
| 3 + | 19% | 16% |

### Occupancy rate – industry average

| | 2017 | 2018 |
|---|---|---|
| 85% + | 36% | 37% |
| 70 - 85% | 36% | 27% |
| < 70% | 28% | 36% |

### Single centre vs multi-centre operators

| | Single centre | Multi-centre |
|---|---|---|
| Occupancy rate (increasing) | 30% | 21% |
| Occupancy rate (decreasing) | 26% | 37% |
| Confidence (optimistic) | 31% | 12% |
| Growth mindset* | 37% | 56% |

### Industry confidence

| | 2017 | 2018 |
|---|---|---|
| Optimistic (4-5) | 23% | 26% |
| Neutral (3) | 42% | 41% |
| Pessimistic (1-2) | 35% | 33% |

### Top threats – industry average

| | |
|---|---|
| Change to government funding model via the Child Care Subsidy | 73% |
| New centres and competition | 66% |
| Wage pressures | 55% |
| Finding staff | 27% |
| Access to quality staff training and professional development | 24% |

### Current operational business focus

| | 2017 | 2018 |
|---|---|---|
| Increasing occupancy | 76% | 75% |
| Preparing for Child Care Subsidy | - | 70% |
| Quality improvement | 42% | 51% |
| Staff training and development | 50% | 47% |
| Upgrading facilities | 40% | 44% |

# Operational forces driving outlook

### The impact of occupancy trends and financial performance

Despite a moderate uplift in average confidence across Australia's early learning sector in 2018, occupancy pressure and rising operational costs, particularly for multi-centre operators, is driving a varied outlook on future performance.

# Mixed sector signals

With a backdrop of increasing competition within many parts of the Australian early learning sector, service providers are also tasked with keeping pace with an ever-changing operating environment. Having to prepare for one of the biggest ever shifts in government funding through the newly introduced Child Care Subsidy (CCS), optimising centre occupancy levels and improving service quality while managing rising costs, presents an imposing task.

Across the sector nationally, our research showed that while confidence levels have marginally increased year-on-year, optimism remains subdued at an average of 2.9 out of 5 in 2018, up slightly from 2.8 in the prior year.

Operational pressures appear to be weighing on confidence levels. Our research revealed that one in three respondents adopted a pessimistic outlook on the sector's viability, outweighing the 26% that hold a positive view of the industry's future. The largest proportion of centre operators (41%) currently maintain a neutral outlook.

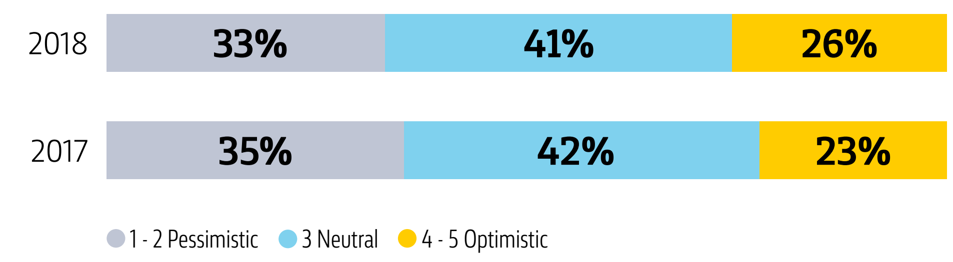
Confidence levels also vary widely depending on the type of centre, with those operating a single centre reporting far higher levels of optimism than their multi-centre peers. While 51% of the service providers operating more than one centre took a neutral stance on the sector's outlook, the level of pessimism seen among 37% of those operators was more pronounced than the 12% of those with a positive view on the sector. Conversely, almost a third of single centre operators are confident about the future of the sector, while the same number have adopted a negative view.

It is clear from the research that occupancy remains a crucial factor informing confidence levels, with the more pessimistic centre operators averaging a 71% occupancy rate, which rises to 82% for those service providers with an optimistic outlook.

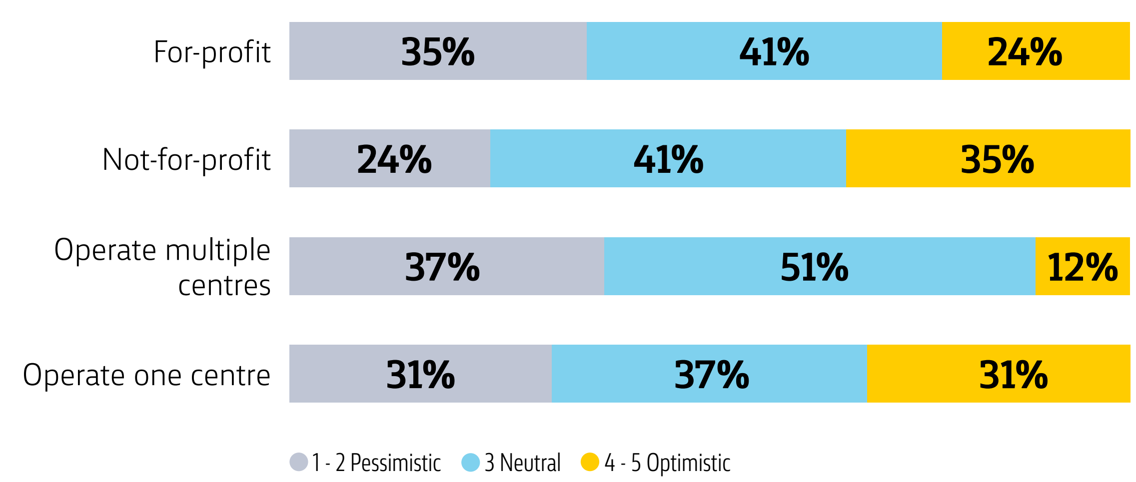
**"Against a background of increased competition and a set of revised National Quality Standards, the anticipation of the new Child Care Subsidy created an additional source of stress and uncertainty across the whole sector."**

**Paul Mondo**
President, Australian Childcare Alliance

## Industry confidence




## Confidence by operator type



# Occupancy softens

Australia's early learning sector has experienced oversupply in some locations as competition has increased and new centres are established or developed. This has the potential to weigh on average occupancy rates per centre and as our research suggests, centre operators are prioritising operational strategies that can help them attract parents and families.

Our research showed that during the past 12 months, average sector-wide occupancy rates have softened slightly, falling from 77% in 2017 to 75% in 2018. While over a third (37%) of service providers are experiencing occupancy levels beyond 85%, there has been a distinct increase in the proportion of those with sub-70% occupancy rates.

When considering occupancy trends over the past six months, a higher proportion of service providers are reporting rising occupancy when compared to the same period last year. This is offset by the 31% of service providers citing decreasing occupancy levels over the same period, while the largest proportion (43%) have experienced neutral occupancy conditions.

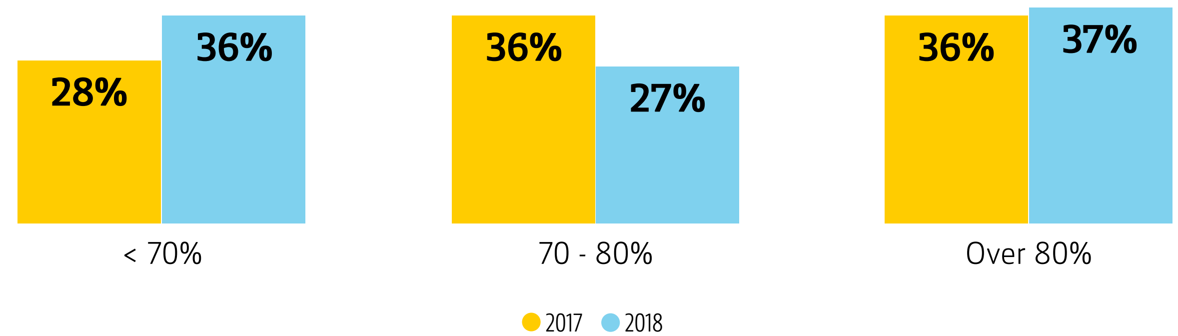
Occupancy rates varied by operator type, with downward pressure felt more strongly among multi-centre operators, and those with a greater number of approved places or a larger workforce.

As multi-centre operators are also more likely to focus on growth – organically and through acquisition – occupancy levels could also be impacted should these operators be building up occupancy rates in newer centres within their broader portfolio.

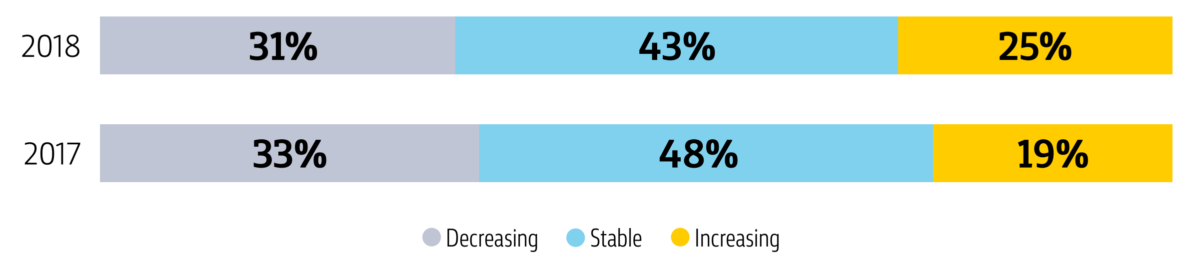
**"With few barriers to entry, oversupply is becoming increasingly problematic in certain geographic pockets. This is a serious issue which will form part of our ongoing advocacy."**

**Paul Mondo**
President, Australian Childcare Alliance

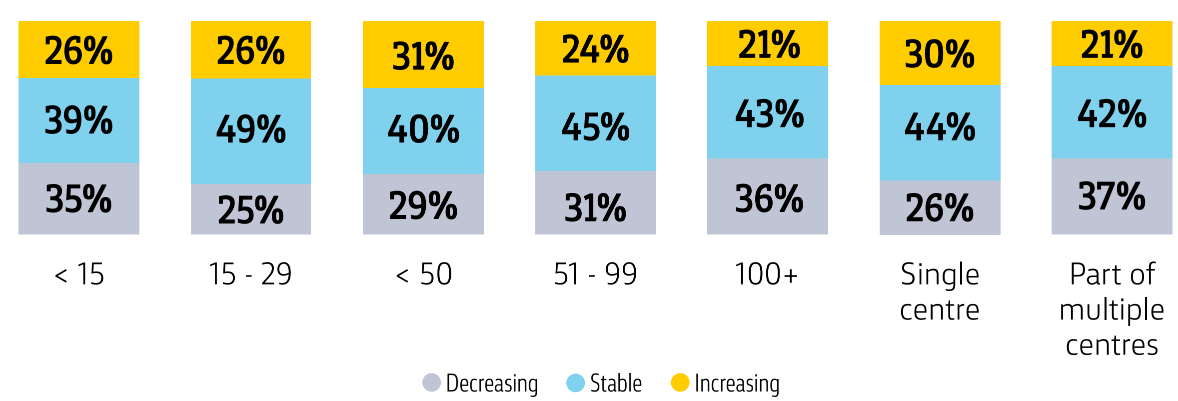
## Occupancy rate – sector




## Occupancy trends – sector (last six months)




## Occupancy – operator type (last six months)



# Refining real estate strategies

Over the past five years, the fundamentals of the commercial property market have remained robust, particularly for assets with strong, long-term leasing covenants in major CBD and metropolitan locations across Australia. As demand from both operators and investors has increased, and yield compression has occurred, the expectation for healthy returns on freehold centre sales has prevailed.

Our research showed that in 2018, the average confidence in rising real estate values across the sector has remained consistent with the sentiment in 2017, recording a steady reading of 3.2 out of five and an average estimated value per centre of $1.5m.

Thirty-nine per cent of centre operators across the sector believe the value of their real estate will rise, with the same proportion adopting a neutral stance. This leaves less than one in four with a negative view on future property values.

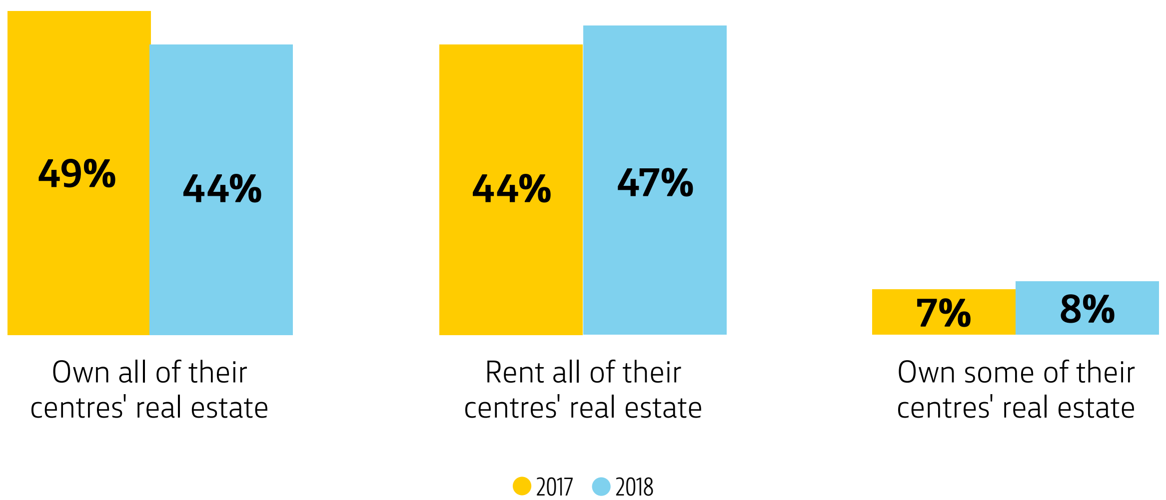
Sentiment relating to future real estate values also varies among centre types, with single centre operators more likely to be confident of value appreciation (41%) than those operating multiple centres (33%).

This mixed outlook on centre values, rising rents and yield considerations also appears to be driving a shift in the real estate strategies employed by some service providers. The research showed an increase in the number of operators that rent all their centre's real estate – rising from 44% in 2017 to 47% in 2018. Meanwhile, the proportion of centre operators with freehold ownership of all their centre's real estate has fallen 5% to a total of 44% in the year to date.

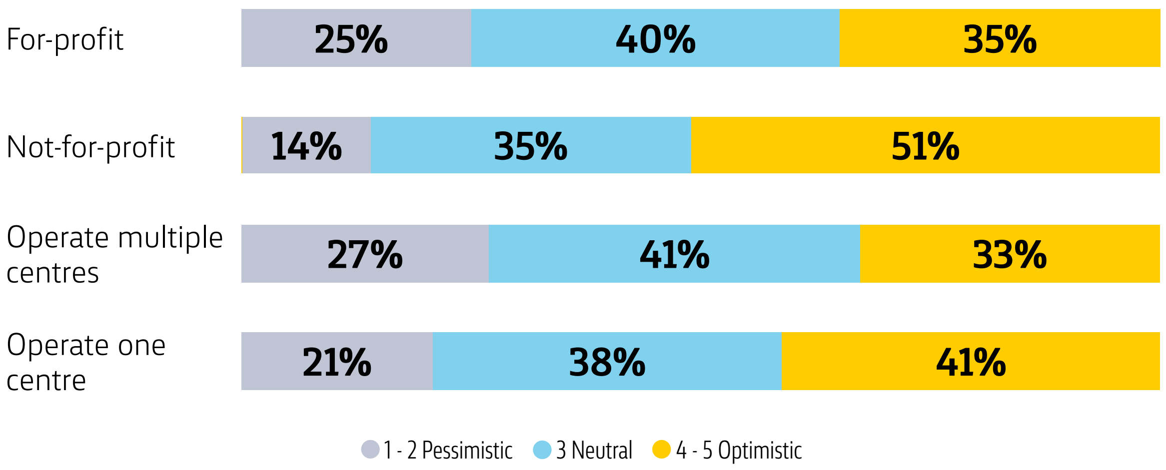
**"The real estate market for early learning centres has experienced strong growth for many years which appears to be buoying further positive return expectations among many property owners. Given yield compression continues apace, this may be driving some in the sector to reconsider their longer term real estate strategies."**

**Sachin Kumar**
National Director Healthcare
Business and Private Banking
Commonwealth Bank of Australia

## Ownership of centre real estate




## Outlook for centre real estate value



# Flight to quality

**Adapting to significant sector change**

Despite falling occupancy, increasing competition and a newly instated government funding package, many centre operators are not only moving to address key threats but are actively targeting growth.

# Proactive approach to managing headwinds

With the introduction on 2 July 2018 of the Federal Government's Child Care Subsidy (CCS) package, most centre operators have focused on preparing from an administrative perspective, whilst also educating families about the new activity test, eligible activities and how their new subsidy payment would be calculated.

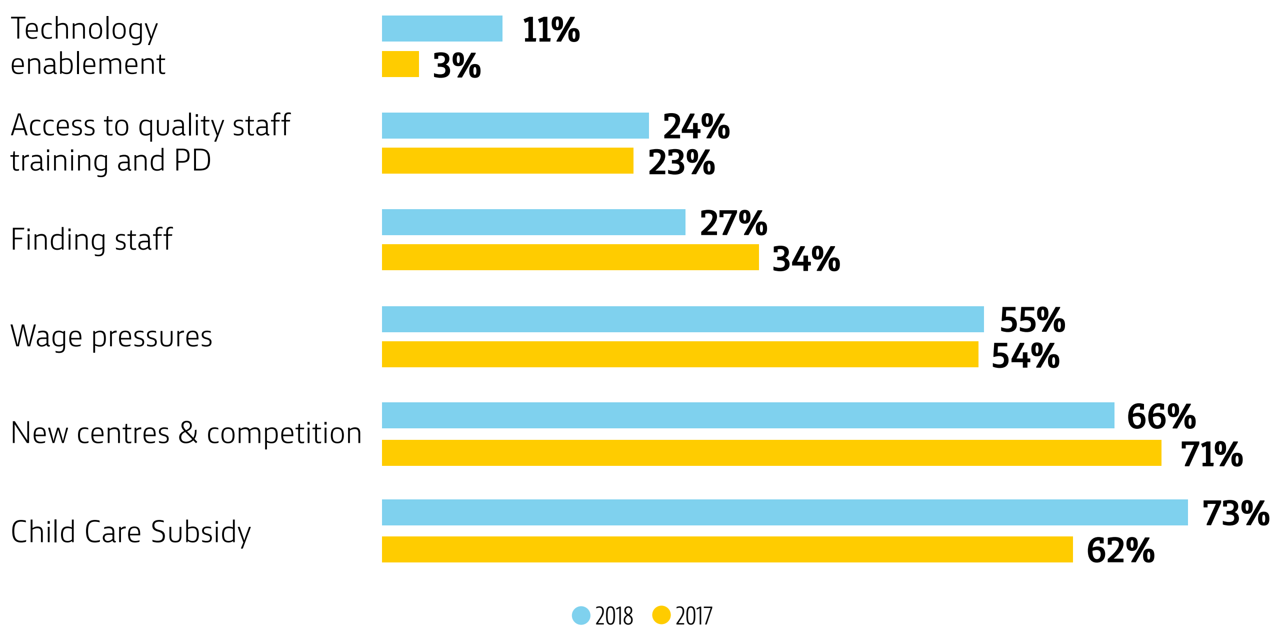
Our research showed that the vast majority (70%) of the sector was operationally focused on preparing for the CCS at the time the survey was conducted (just prior to the scheme coming into effect). The changes to the funding model were also noted as a sector threat by almost three in four centres, ranking it as a higher threat than the establishment of new centres and rising competition (71%) and wage pressures (55%).

Spurred by downward pressure on occupancy and rising competition, the research showed a rising operational focus on quality improvement among 51% of service providers, up from 42% in 2017. This is accompanied by more providers seeking to upgrade their facilities (44% in 2018 up from 40% in 2017), and a sharpened focus on the National Quality Standards (NQS) assessment (37% up from 22%).

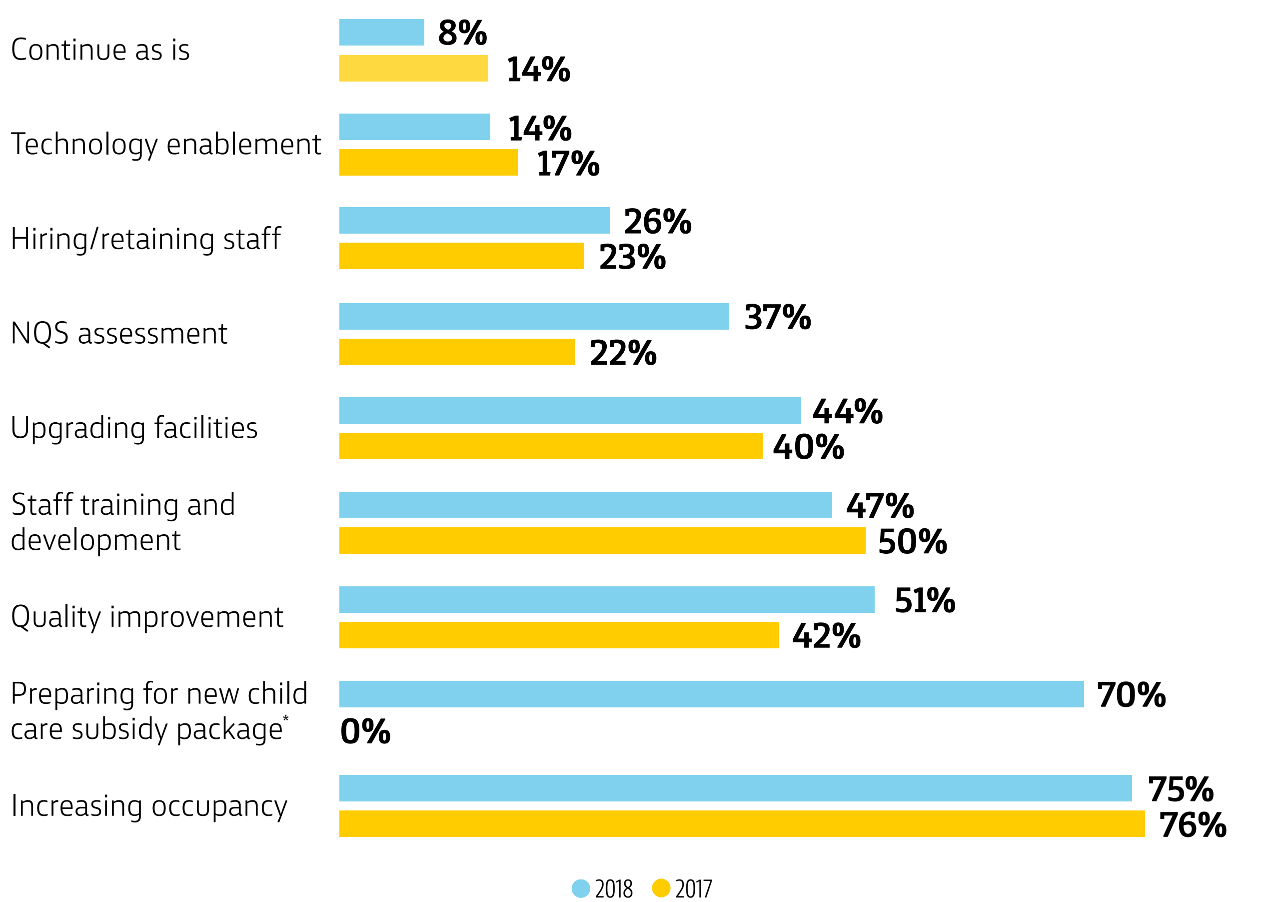
This focus on increasing quality for many centre operators aligns with the rising demand among parents for increased service offerings and in some cases an 'exceeding' rating when assessed against the National Quality Standard (NQS).

However, this rating is challenging to obtain in an assessment environment that only rates services every five years. This is compounded by recent changes to the National Quality Standards (NQS) which have moved the goal posts, making it even more challenging for services to achieve an 'exceeding' rating.

## Key sector threats




## Current operational business focus



# The emerging growth mindset

Despite subdued sentiment among some Australian service providers, the research suggests a considerable increase in the proportion of centres seeking to grow organically or through acquisition over the next 12 to 24 months.

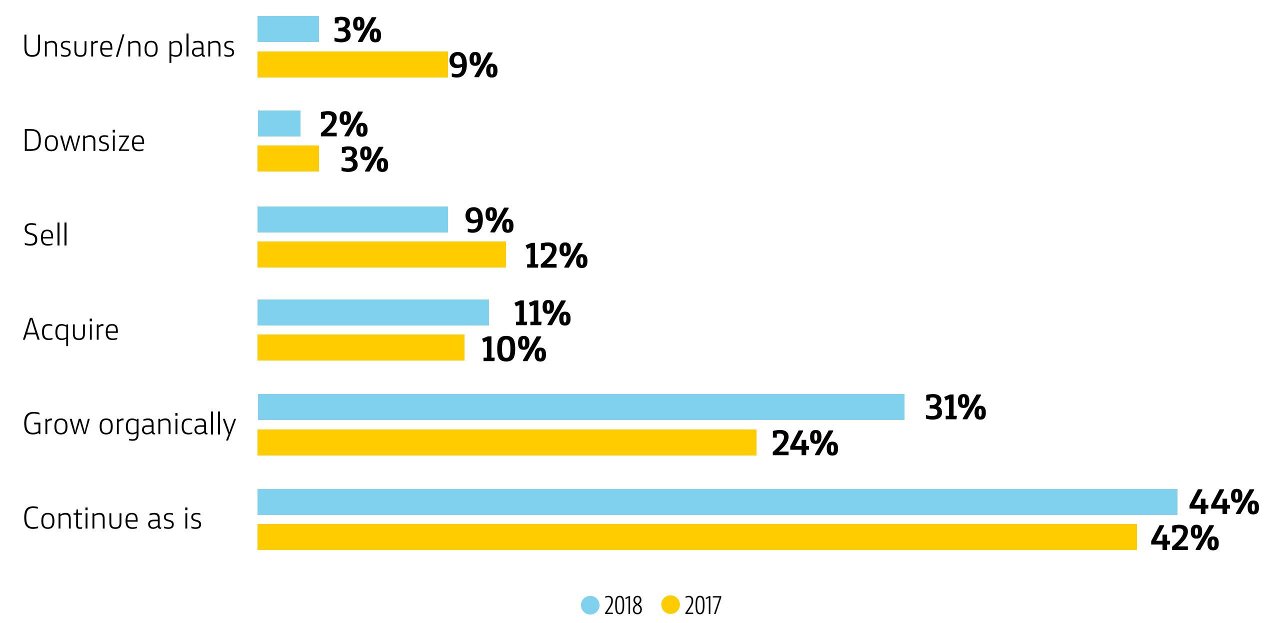
Overall, our research showed that the number of centres targeting organic growth has risen from an average of 24% in 2017 to 31% in 2018, adding to a marginal increase in the proportion of operators looking to acquire new centres over the next two years, a trend that may suggest that consolidation within the sector will continue. This growth orientation is most evident among multi-centre operators, as 56% of these service providers look to either enhance their organic growth strategies or acquire additional centres.

While this trend points to an emerging growth mindset, particularly amongst larger operators, 44% of service providers said they will continue to hold the course in terms of their strategic intentions over the medium term. In addition, just 3% of all service providers are unsure of their strategy over the next 12 to 24 months, down from almost one in 10 a year ago, and only 2% are expecting to downsize.

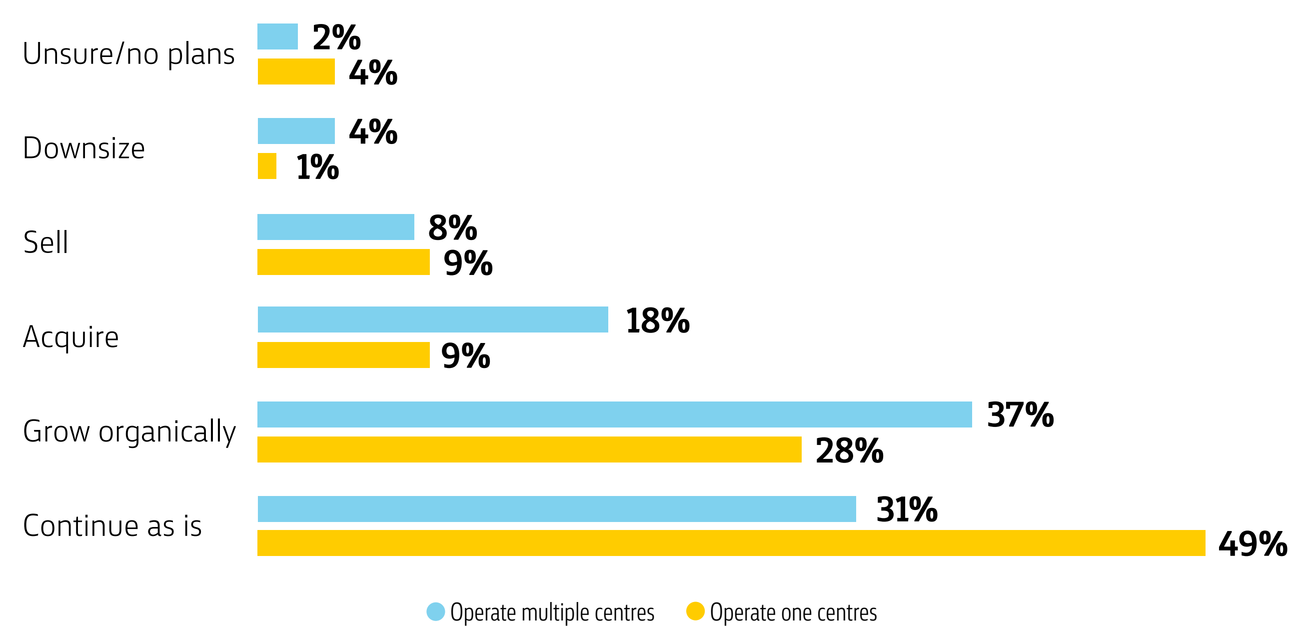
**"Whilst increasing competition and falling occupancies impact the sector, there are still a number of operators, particularly multi-centre operators, keen to grow their reach either through acquisition or organically within their current services. The survey clearly shows that more providers are clearer about their strategic intentions, whether that be growth or maintaining the status quo, than the previous year which may be linked to greater certainty once changes to funding have been implemented."**

**Paul Mondo**
President, Australian Childcare Alliance

### Strategic intentions – sector




### Strategic intentions – centre operator type



# Insights in action: KingKids

**Commercial performance follows a child-centred approach**

From starting out in 2012 with an objective to acquire and turn-around one underperforming centre in Melbourne's South East, KingKids now operates three thriving centres and attributes its success to a focus on people and culture.

Today, KingKids' centres run at around 350 approved places and operate with high occupancy levels and minimal staff turnover, and Founding Director, Jo MacKenzie-King,

operates the business with an unwavering passion for making a positive impact on the lives of kids, their families and her team.

After taking control of the first centre in Berwick, KingKids set in place a strategy to prioritise engagement with their Educators to create a conducive environment for the children attending the centre. Since then, KingKids has seen the influence of staff happiness on their children, and in turn, a positive impact on occupancy and feedback from parents.

"I focus on keeping the Educators happy because then they come to work with a positive mindset. This positivity transfers to the children and when they are happy, parents are happy and advocate for our centres - that's why I have a thriving business, by keeping my Educators happy and engaged."

For KingKids, this focus on developing a strong team culture also extends to identifying and recruiting the right people. "We have a great relationship with the TAFEs and select RTOs where we have suitable students placed at our centres," Jo says.

"We gather feedback on their performance from our Room Leaders and Co-Educators, and ultimately, the KingKids team choose the Educators they think will be the best fit rather than go through a traditional employment process."

At times they also get assistance from the children. Recently when employing a Kindergarten Teacher, they had a few applicants participate in a one-hour trial with the children. They then asked the children who they would prefer, and employed that teacher based on the children's instincts.

"The introduction of the Assessment and Rating process has been really positive overall for the industry." Jo adds. However, the priority for KingKids is happy children that are engaged and want to be at the centre."

"Too many service providers worry too much about Assessment and Rating and people's perceptions and other associated factors. We focus on happy children, happy Educators and great community engagement.  For us positive word-of-mouth is the best form of advertising for our centres."

Jo acknowledges that the industry does face some headwinds particularly managing oversupply and higher rents in certain locations.

"A lot of developers are seeing high rental returns in early learning centres and building centres in outlier areas which has its own risk attached as the centre is marketed. As new entrants pay higher rents to establish a foothold in the industry, this is driving rents higher across the board. This means that families have to pay higher fees and there are less funds available to pay deserving Educators more."


Jordan, Jo and Claudette of KingKids

# Fundamentals drive marketing and communication activity

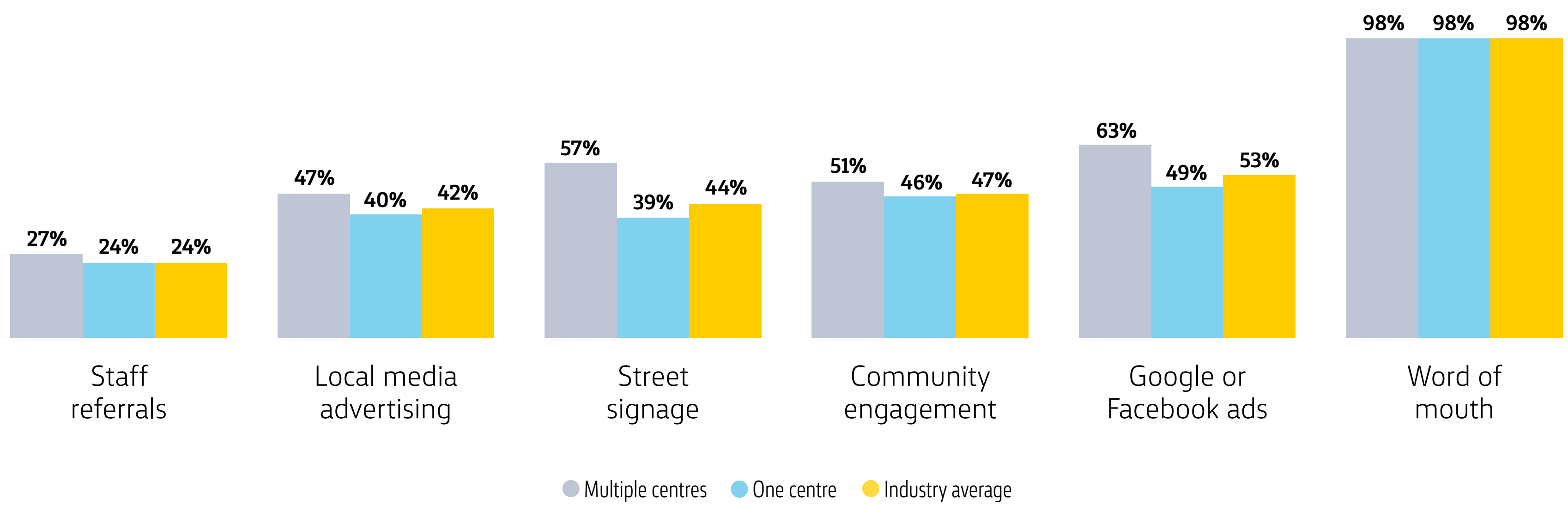
In a competitive marketplace where supply is outpacing demand in some locations, service providers continue to look at ways to develop a point of difference and attract parents to their centres. For many, this begins by ensuring that the service offerings meet the needs of the local community and by increasing the centre's appeal among parents seeking to secure a place for their child.

With lower occupancy being a common factor for many across the sector, marketing activity remains crucial for centres. Additionally, strong roots in the community and differentiation of unique services such as foreign language development or specialised food & beverage options can also influence selection decisions.

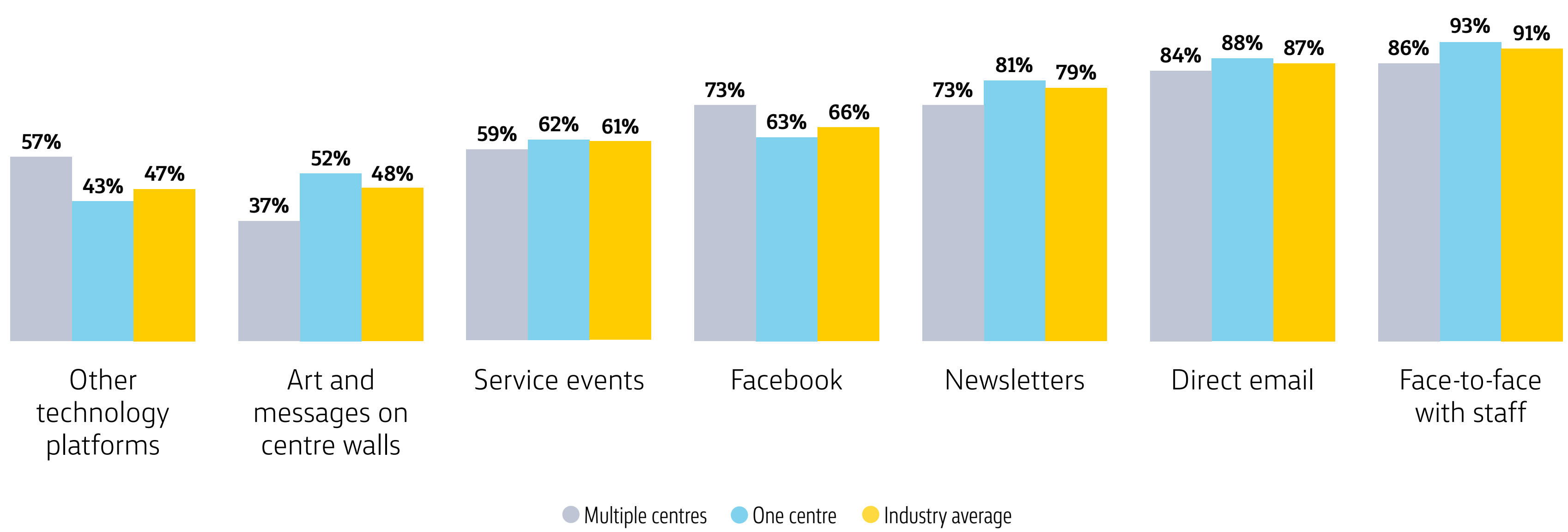
Overwhelmingly, the early learning sector relies on word of mouth as a marketing channel, cited by 98% of centre owners, followed by 53% of providers now using Google and Facebook advertisements as parents continue to leverage online search tools to inform their preferences and conduct market research. Community engagement also remains as an important marketing channel, used by 47% of centre operators.

Service providers' approach to communicating with parents has also continued to shift, with a range of options being utilised by the sector. The highest proportion of service providers said that they communicate through face-to-face interactions with parents and direct email, with social media apps such as Facebook, Instagram and other digital platforms presenting complimentary modes of communicating with parents, particularly for those operating multiple centres.

## Marketing channels




## Interacting with parents



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