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Challenges for the childcare market: the implications of COVID-19 for childcare providers in England

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Preface

In this report, we analyse the financial implications of the COVID-19 crisis for the providers of early years childcare.

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Executive summary

The closures of childcare providers to most families during the COVID-19 crisis have underlined the importance of access to childcare, both to support paid work and to help shape young children's environment. However, the crisis has had severe consequences for the finances of childcare providers, which were already weak in several parts of the sector going into the crisis. Despite a range of government support programmes, many providers lost income during lockdown. In the medium term, a longer-lasting fall in demand for childcare or an increase in costs related to social distancing could seriously hamper financial sustainability in the sector going forward.

In this report, we assess the consequences of the pandemic – and the resulting public health response – for the finances of early years childcare providers. The pandemic has hit demand for childcare hard: during the lockdown, when only vulnerable children and those with key worker parents were able to access childcare, fewer than 250,000 children aged 0 to 4 were attending childcare on a given day, compared to around 1.4 million before the pandemic. Since June, the sector has been allowed to serve all children in England, but even before the summer holidays, take-up peaked at 420,000 children.

We summarise the packages of support available to providers to help them cope with the loss of demand during the lockdown and over the next few months, and we model how these have interacted with the loss of income due to the crisis and with providers' pre-existing finances. We also discuss how the changes to providers' finances might affect capacity in the sector, and whether and how the government might intervene to support providers.

We find, unsurprisingly, that lockdown is likely to have damaged the financial health of many childcare providers, even after accounting for major government support programmes. Assuming that providers were not able to take in any income from parent fees, we estimate that a quarter of private-sector nurseries might have run a significant deficit during the lockdown (with at least £5 of costs for every £4 of income). Even if providers did manage to retain 15% of their normal fee income,

either through retainers or by providing childcare to eligible families during lockdown, we still estimate that one in five are likely to have run a significant deficit during lockdown.

Of course, these figures reflect not just the pandemic, but also the pre-existing weakness in some providers' finances. Even before the pandemic, 11% of private-sector providers were running a significant deficit; this could have been an unusual (and temporary) state of affairs, or a prelude to exiting the marketplace.

Childminders, who are mostly self-employed, have also been badly hit by the crisis. Even if all childminders received self-employment grants, the total loss of parent fees could see an additional almost 30% of childminders now earning less than £4 of income for every £5 of costs (counting what they usually pay themselves in the costs). In practice, many childminders will see their earnings take a hit, which could jeopardise their ability or desire to stay in the market.

Over the next six to 12 months, the key question for the sector will be how much demand for childcare recovers, and how quickly it returns, as government support is phased out. We have no special insight into this: it will depend on the paths that the economy and employment take, as well as the wider health concerns of parents. But, over a range of scenarios that we model, we estimate that, compared to the pre-crisis baseline, each 5 percentage point fall in income from parent fees and charges might see another 3% or 4% of providers tip into significant deficit if they do not make adjustments to their business, such as reducing the number of staff.

We also consider how providers might respond to these short- and medium-term financial risks. The financial pressures of the pandemic could lead more providers to raise fees, adjust their business models to reduce costs, or exit the market altogether.

Even before the pandemic, the childcare market experienced quite a bit of turnover each year as some providers left and new businesses opened up, meaning that the market was able to adjust to changes in parents' preferences. But policymakers should keep a close eye on whether the pandemic has blunted some of these market forces, and whether the resulting landscape of provision is consistent with the government's objectives for childcare to support working parents and reduce socio-economic inequalities.

If the government does wish to intervene to support the market, there are broadly two approaches it could take (which are not mutually exclusive). The first is to focus support on the otherwise viable businesses that slipped into significant deficit during the lockdown, helping them to adjust to the new post-crisis landscape. To do this, the government would need to focus support on providers who are mostly funded by parent fees, as they were less well protected during the lockdown, and may be the most susceptible to falls in demand over the medium term. Given the large numbers of providers that seemed to be experiencing significant deficits going into the crisis, the goal should not necessarily be to ensure that every provider keeps its doors open, but rather to offer temporary support to otherwise healthy businesses.

Another approach would be to prioritise support towards publicly funded childcare (through the free entitlement for children aged 2, 3 and 4). While public funding for childcare was protected through the crisis, most providers combine public and private income and so were often still vulnerable during the lockdown. Going forward, funding during the spring and summer terms in 2021 will be based on January 2021 pupil numbers, risking a loss of capacity if take-up is low at the start of the year but recovers quickly in the spring and summer. An increase in the funding rates paid for free entitlement hours would reduce the trade-off some providers face between offering lower-paid publicly funded hours and higher-paid privately funded hours and might therefore help to ensure that all eligible children continue to be able to access their entitlement to free early education.

Key findings

- 1 During the lockdown, childcare providers have had access to continued funding for the directly publicly funded hours they deliver, as well as programmes such as business rates holidays, the furlough scheme (for employees) and the self-employment grants (for the self-employed). **The decision to restrict providers to make furlough claims only for privately funded childcare was sensible** as their public funding continued at normal levels through the 2020 summer term. However, the way that this was implemented could have left **some providers unable to access the furlough programme fully**.
- 2 On average, and despite the furlough scheme and self-employment grants, the lockdown period is likely to have significantly damaged the finances of many childcare providers with income from parent fees. Under the pessimistic assumption that all fee income from parents dried up, we estimate that **a quarter of private nurseries might have been operating at a significant deficit** (with more than £5 of costs for every £4 of income). This compares to 11% of providers pre-crisis. Even if providers were able to retain 15% of their pre-crisis fee income, one in five are still likely to have run a significant deficit during lockdown.
- 3 Providers that rely mostly on public funding have seen their income largely protected. For providers with income from parent fees, support through the furlough scheme and self-employment grants was a significant help but provided far from full protection: we estimate that the median furlough payment was worth 55p for every £1 of lost fee income, and self-employment grants covered 64% of baseline fee income at the median.
- 4 Childminders, who are mostly self-employed, have also been badly hit by the crisis. Even if all childminders received self-employment grants, the total loss of parent fees could see **an additional almost 30% of childminders now earning less than £4 of income for every £5 of costs** (counting what they usually pay themselves in the costs). In

practice, many childminders will see their earnings take a hit, which could jeopardise their ability or desire to stay in the market.

- 5 In our data, we find that smaller providers, those with more highly qualified staff or **those from more deprived areas are no more likely to have run at a significant deficit during lockdown**. This contrasts – but is not necessarily at odds – with surveys of providers which find that those in disadvantaged areas are more worried about their financial future.
- 6 The key question in the medium term is how much demand for childcare recovers, and how quickly it returns. We estimate that, for every 5 percentage point drop in fee income between 5% and 25% compared with pre-crisis levels, an additional 3–4 percentage points of providers are likely to face a significant deficit. These results are driven by childminders. If, in addition to low fee income, take-up of funded places is still below pre-crisis levels in January 2021, voluntary providers and nursery classes will be hardest hit.
- 7 The extent to which government support for the sector will be needed going forward depends on how the market adjusts to changing levels of demand. Before the pandemic, **the childcare market featured significant turnover and there was some spare capacity at around 70% of providers**, suggesting that the market is mature and could potentially adjust to rises and falls in demand (at least at the national level). But the current fall in demand is unprecedented and the blow to providers' finances could force some to close or shed places. So **policymakers will need to monitor whether (and where) capacity comes back** when demand starts to return. There are also risks around losing capacity for particular age groups or at particular provider types.
- 8 If the government does wish to provide more support to the childcare market, the fact that many providers were running significant deficits going into the crisis means that **the goal should not necessarily be to keep every provider's doors open** regardless of demand. If the government wants to focus on preventing the closure of otherwise viable businesses that tipped into a temporary deficit as a result of the

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pandemic, it should focus on providers that are largely funded by parent fees (including many childminders and private providers).

- 9 Although most of the providers who largely rely on free entitlement funding were financially cushioned from the impact of the lockdown, they could see their incomes hit in 2021 if demand remains low in January – when take-up of funded childcare is measured to determine future funding levels. Of course, there could also be other reasons for the government to prioritise this part of the market, such as to support local authorities to fulfil their duty to ensure there are enough childcare places for every eligible child to be able to access their free early education entitlement.

1. Introduction

Childcare is crucial to many parents' ability to work. The growth in the availability of flexible childcare has also played a crucial role in making it easier for mothers with young children to remain in employment, underpinning progress on reducing gender inequalities in the labour market.

Formal childcare settings (i.e. nurseries, playgroups and childminders) are also the route through which the government's free early education offer for all children aged 3 and 4 – and children aged 2 from disadvantaged backgrounds – is delivered in England.¹ Around two-thirds of children take up this offer in settings run by private or voluntary providers (as opposed to state-run settings).² The health of the childcare market is therefore vital both to enable parents to work and to ensure that the government can fulfil its commitments to early education.

Even before the COVID-19 pandemic, the childcare market saw significant turnover as providers left the market and new settings entered. The finances of providers also varied considerably; while 22% had more than £6 of income for every £5 of costs (before tax), another 28% were operating at a significant deficit, with less than £4 of income for every £5 of costs.

The COVID-19 pandemic will hinder the financial sustainability of the sector, and so potentially the number, type and location of providers, in both the short and medium term. While the restrictions in place during lockdown meant that many providers remained open, they typically faced dramatic reductions in the number of children they were looking after; for most, this meant a significant fall in their income from parent fees. While public funding continued more or less

¹ All children aged 3 and 4 are entitled to 15 hours a week of free early education during term-time, rising to 30 hours a week for children in working families. Two-year-olds from poorer families are also eligible for 15 hours a week of free early education during term-time.

² The two-thirds figure refers to children aged 3 taking up the universal (15 hours per week) offer and comes from Department for Education statistics, available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/811683/Provision_for_children_under_5_2019_-_text.pdf. A comparable figure for 4-year-olds is not reported here.

uninterrupted and providers were able to access a range of government financial support programmes (most notably the furlough scheme, self-employment grants, and business rates holidays), providers – whether open or closed – were largely still responsible for costs such as rent, even as many lost out on income.

While the use of childcare has increased steadily since lockdown restrictions were eased, by mid-July it was still only at 30% of pre-lockdown levels. The uncertainty for providers is whether and when demand will return to pre-crisis levels – and whether they can afford to stay in business until then.

In this report, we discuss the financial support offered to childcare providers in England during the COVID-19 crisis, as well as the substantial financial risks they faced both during and immediately after lockdown, and are likely to face over the next six to 12 months.

Our results point to the challenges facing many childcare providers over this period. We estimate that, during lockdown, half of childcare settings were at risk of running a significant deficit, even after accounting for government support through the furlough scheme and income grants to the self-employed.

Over the medium term, there is tremendous uncertainty about when, and to what extent, the demand for childcare will return. We do not offer any prediction for this; instead, we analyse how providers' finances might be affected under several different scenarios for demand over the next year. In our central scenario (which sees private demand fall by 15% while income from publicly funded childcare is unchanged), around four-in-ten childcare providers could face a deficit next year if they do not make adjustments to their business, such as reducing the number of staff.

We consider the risks for the sector as a whole, as well as illustrating how those risks vary across different types of providers that cater for children of different ages and backgrounds. We also consider the potential implications of these risks, which might result in large numbers of provider closures or significant reductions in childcare capacity, and we discuss whether the government may need to intervene in order to support the market.

We start in Chapter 2 by describing the childcare market during lockdown, focusing on the take-up of childcare, and the financial support available to the sector. In

Chapter 3, we describe the financial position of providers going into the crisis, while in Chapter 4 we discuss the likely implications of take-up and government support during the lockdown for providers' finances. In Chapter 5, we focus on financial risks to providers over the medium term (i.e. the next six to 12 months) when financial support from the government is likely to be withdrawn at the same time as demand remains highly uncertain. In Chapter 6, we discuss the potential implications of these risks translating into large reductions in both the availability of childcare and free early education places and, in Chapter 7, we discuss whether the government may need to intervene to support the market and, if so, how best to do so. We conclude in Chapter 8.

2. Operation of the childcare market since lockdown

When the UK entered lockdown on 23 March 2020, the majority of parents were required to keep their children home from school and childcare. In this chapter, we offer some background context to the early years childcare market pre-crisis, and summarise the take-up of childcare during and immediately after lockdown, and the potential implications of these changes in take-up for children's development. We end the chapter by discussing the package of programmes available to support the finances of childcare providers since March.

2.1 Childcare before the lockdown

There were 72,000 providers offering 1.7 million Ofsted registered childcare places in England in spring 2019: around 20% were private (for-profit) group-based providers, around 12% were voluntary (not-for-profit) providers, 12% were school-based (mainly maintained) providers and over half (54%) were childminders.

However, because childminders look after far fewer children per setting, childminders delivered only 14% of the childcare places, while private providers delivered almost half (44%), with voluntary and school-based providers delivering around a fifth of places each. Hence, while childminders play a dominant role in terms of provider numbers (as used in the analysis presented in this report), their role in total provision in terms of place numbers is much smaller.

Childcare funding before the pandemic

The childcare sector is unusual in relying on both public and private funding. In spring 2018 – the last year for which detailed data are available – the childcare sector received just over a quarter of its income from free entitlement funding for children aged 2, 3 and 4. Including the fees paid on behalf of school-age children,

parent fees accounted for an average of 64% of income for each setting.³ The rest came from other sources of income, such as additional charges for parents, fundraising or specific local authority grants.⁴ While privately paid, in many cases these parent fees also attracted significant subsidies through the tax-free childcare and employer-sponsored childcare voucher programmes, or through subsidies through the in-work benefits system.

While per-hour public funding rates received a 7% boost in 2017–18, they have been largely frozen in cash terms since then.⁵ Meanwhile, private fees rose by 3% on average in 2018–19 and 5% on average in 2019–20, but with large variation across the country.⁶

Cattoretti, Paull and Marshall (2019) compare how average hourly fee and funding levels compared with the unit cost (per child, per hour) of delivering childcare. They find that, across all types of providers and all the children they serve, the median unit cost was £2.58 and the average was £3.70. Costs were lower at childminders and considerably higher in maintained nursery schools (reaching a mean of £7.23).

In comparison, providers reported that parent-paid fees averaged just over £5 per hour for children aged 0 to 2, and around £4.90 for children aged 3 and 4. Average public funding rates for early education entitlements were also reported to be just over £5 per hour for disadvantaged 2-year-olds, and somewhat lower than parent fees for children aged 3 and 4, at around £4.30 per hour.

Of course, simply comparing the average levels of fees and funding to the average unit cost gives only a crude indication about the finances of the sector. These averages conceal a considerable amount of variation across different age groups and different provider types. For example, Cattoretti, Paull and Marshall (2019) show that 10% of providers charged fees for children aged 3 and 4 that were more than 50p per hour less than the public funding rate they received, rising to 40% of providers in a similar position when comparing fees and funding rates for 2-year-olds. And, for any individual provider, what matters most for financial health is

³ Cattoretti, Paull and Marshall, 2019.

⁴ Blainey and Paull, 2017.

⁵ Britton, Farquharson and Sibieta, 2019.

⁶ Coleman and Cottell, 2019; Coleman, Dali-Chaouch and Harding, 2020.

how their own income stacks up against their own costs. We return to some of these questions in Chapter 4.

2.2 Childcare during lockdown

While most parents were required to look after their children at home during the lockdown, childcare providers were asked to remain open if possible to provide care to the children of key workers and the most vulnerable children. While the eligibility requirements to access childcare during the lockdown appear highly restrictive, in practice there were perhaps 1.5 million children aged 0 to 4 in England – over 40% of the total – who were potentially eligible for childcare during the lockdown. This is mostly because around a fifth of working-age people in the UK were considered key workers,⁷ and the guidance applied to all children who had at least one key worker parent and whose parents judged they could not be cared for safely (e.g. by grandparents). Of course, in practice the actual eligibility of these children depended on judgements about the alternatives they had to formal childcare.

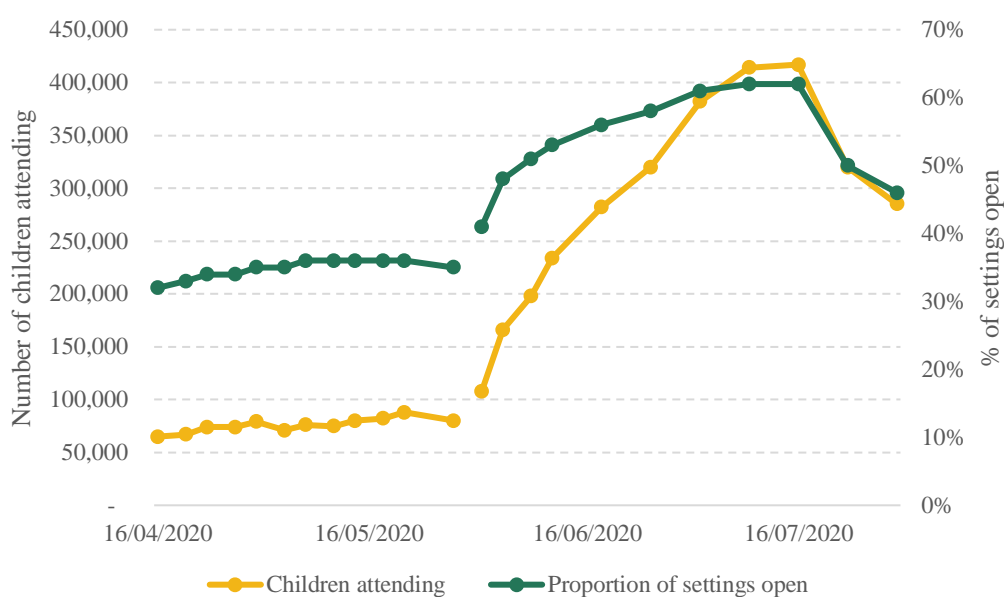
However, the actual take-up of childcare during lockdown was considerably lower. During the lockdown period, around a third of childcare settings remained open. These settings were serving very few children: the gold line in Figure 2.1 shows that, in mid-April, just 65,000 children attended childcare.

As of 1 June – illustrated by the break in Figure 2.1 – childcare providers have been encouraged to open to all children. There has been a significant increase both in the provision of childcare – compared with full lockdown, twice as many childcare providers were open in the first half of July, before summer holidays – and in the take-up of childcare places. However, despite this rapid growth, the childcare sector is still operating well below its pre-pandemic capacity; 40% of childcare settings were still closed in mid-July (before the start of summer holidays), and the 400,000 children taking up childcare places fill only around a quarter of the registered places

⁷ Farquharson, Rasul and Sibieta, 2020.

that the sector provided in 2019 (and 30% of the take-up on any given day).^{8,9} As many settings tend to close for the summer holidays – and hence may have decided not to reopen again until the autumn term – it remains to be seen how much this picture may change in September.

Figure 2.1. Share of childcare settings confirmed open and number of children attending



Source: Table 4 of Department for Education (2020c) and Table 3 of Department for Education (2020d).

Guidance for providers on operating during lockdown

Over this period, childcare providers have been given guidance on changes to their operations that can reduce the spread of infection. Up until 20 July, childcare providers were asked to reduce contact between people as much as possible, with children and staff, where possible, only mixing in small, consistent groups ('bubbles'), which were to be kept at a safe distance from one another. It was

⁸ Department for Education, 2020a.

⁹ According to the Department for Education's Childcare and Early Years Providers Survey, around two-thirds of providers are open for more than 39 weeks each year (i.e. they would be expected to be open during the summer holidays). The percentage of childcare settings that we see open in Figure 2.1 (46%) therefore represents roughly two-thirds of this expected level, meaning that the percentage of settings open during the summer holidays is running at roughly similar levels relative to expectations.

recommended that temporary caps were introduced to restrict the numbers of children being looked after if necessary in order to adhere to these conditions.

This was challenging for childcare providers and, for some, it had a significant effect on how they structured care and on their financial model. These restrictions have been relaxed somewhat since 20 July, as we discuss in Chapter 4.

2.3 Risks to children's development

An important goal of publicly funded childcare in England is to help children to develop school readiness. There has been widespread discussion of the potential implications of the disruption to learning opportunities faced by school-aged children while their schools were closed during and immediately after lockdown, but similar concerns might also apply to pre-school children missing out on early education opportunities. In this section, we consider the risks this poses for all children, as well as how these risks vary for children from different backgrounds.

Risks to school readiness

Children who are not vulnerable and whose parents are not key workers have, at a minimum, missed roughly half a term of early education between 23 March and 1 June. But, as shown in Figure 2.1, the take-up of childcare remained well below typical usage rates until the end of the summer term, and it is possible that this might continue into the autumn as well, either because providers close or because parents decide not to send their children.

The evidence on the impact of attending early education on children's outcomes at school is mixed. There have been some very positive findings for programmes in other countries, especially if they are intensive and focus on the most disadvantaged children. A longitudinal study of children who attended nursery in England in the 2000s also found substantial benefits.¹⁰ However, these data were collected before the entitlement to free part-time early education came into effect in England, and they are likely to capture differences in the types of families who chose to use (and pay for) formal childcare, as well as the impact of the care itself.

¹⁰ Sylva et al., 2004.

To address this, two recent studies compare children who are quasi-randomly given more or less access to free early education.¹¹ They find some benefits to children's test scores for children who started using formal childcare as a result of being offered free early education, but the effects are relatively small at age 5 and fade out by around age 7. This agrees with studies that have investigated the effect of universal early education on children's development in other countries.¹²

Risks to widening inequalities in school readiness

Even if the overall benefits of early education fade out by the end of infant school, policymakers might still be concerned if there are inequalities by family background or ethnicity in the take-up of childcare during and after the lockdown, and if these translate into inequalities in children's outcomes at school. Such differences could be particularly damaging to inequalities in school readiness if, as some evidence suggests, the effectiveness of early education is higher for children from more disadvantaged backgrounds.

We do not have direct evidence on differences in the use of formal childcare by children from different backgrounds since 1 June, or on how parents' intentions to use formal childcare from September may vary. However, Pantelidou and Huskinson (2020) found that, in mid-May, when parents were asked about a potential return to formal childcare on 1 June, there were some differences across families in terms of those who were keenest for their children to return. For example, respondents who were in paid work were more likely to report wanting their children to return than those who were not in paid work; ethnic minority respondents were also less likely to want their children to return than white respondents. This may be particularly important for the subset of ethnic minority children learning English as an additional language, for whom there is some evidence of stronger benefits to participating in early education.¹³

¹¹ Blanden et al., 2016, 2019.

¹² Cascio, 2015.

¹³ See, for example, Blanden et al. (2016).

2.4 Government support for the childcare sector

During lockdown, public funding continued uninterrupted: the government confirmed on 17 March that providers would continue to be paid in full for the publicly funded free entitlement hours they expected to deliver, regardless of actual take-up or even of whether the setting remained open.

However, only around one in ten childcare settings that serve pre-school aged children are exclusively publicly funded. Others are heavily or wholly reliant on private income from parent fees, much of which dried up during lockdown.¹⁴ These childcare providers were able to access UK-wide programmes of support such as the Coronavirus Job Retention Scheme (CJRS; also known as the furlough scheme) and the Self-Employment Income Support Scheme (SEISS), as well as the other supports outlined in Box 2.1

Box 2.1. Major elements of the government's support package

Continued funding through the Dedicated Schools Grant (free entitlement funding):

Childcare providers delivering publicly funded childcare hours for children aged 2, 3 and 4 continued to receive their regular government funding for these hours during lockdown.

Coronavirus Job Retention Scheme (furlough scheme): Providers were allowed to access the furlough scheme for any 'privately paid' employees when the income that would usually support their salaries had dried up. In practice, this meant that providers were allowed to use the furlough scheme to cover staff costs in proportion to the share of income they lost during the lockdown. Because providers were still receiving full funding for publicly provided hours, they were not allowed to use the furlough scheme for these staff costs.

Self-employment Income Support Scheme: Self-employed childcare providers (mostly childminders) can receive a taxable grant based on the average profits they reported between

¹⁴ Some providers sought to preserve some of their private income by charging parents retainer fees while their children were not attending childcare. The National Day Nurseries Association (2020) estimates that 30% of settings are charging some fees to children who are not attending, with most asking for up to a quarter of their normal fees. But the very low take-up of childcare places during the lockdown, coupled with the low share of providers charging retainers worth 25% or more of their usual fees, suggests that income from parent fees will have largely dried up during lockdown.

2016–17 and 2018–19, up to £2,500 per month. For the first three months, this was worth 80% of average profits, dropping to 70% for the following three months. To be eligible, providers need to report that their income has been negatively affected by the crisis (so those with exclusively free entitlement income may not be eligible), but they are still allowed to earn income over and above this grant (so those with some private fees could claim SEISS while also continuing to receive free entitlement funding).

Business rates holiday: Private and voluntary childcare providers will not be charged business rates for 2020–21. While childminders are included in this, most do not pay business rates to start with (as they already pay council tax on their homes).

Universal credit: The government also announced a range of temporary giveaways through the benefits system. Most of these will affect individuals rather than childcare businesses. However, self-employed childcare providers might benefit particularly from the suspension of the minimum income floor in the universal credit system, allowing more low-earning self-employed people to claim universal credit (which has also been made temporarily more generous) in proportion to their actual earnings.

Other forms of support: Providers were also eligible for general programmes of business support, such as, for example, Small Business Grant funding of £1,000 for private providers eligible for small business reliefs, the Business Interruption Loan Scheme, Bounce Back Loans, and deferrals of VAT owed.

Local support packages: Most local authorities ensured that, when children accessing the free entitlement needed to move setting during lockdown, both their regular and their temporary setting received free entitlement funding. A small number of local authorities also used some of their emergency funding to support childcare. For example, Birmingham City Council provided all childcare providers with a retainer of £100 per week per child they were caring for, and an additional retainer of £300 for all nurseries and maintained nursery schools that stayed open during the lockdown.

Combining free entitlement funding with the furlough scheme

Providers that offer both publicly and privately funded childcare hours continued to receive their free entitlement funding, but were allowed to use the CJRS to furlough employees not involved in delivering these free entitlement hours. This is a sensible distinction to draw in theory: it means that providers with (uninterrupted) public

funding available to pay staff wages were not allowed to access additional public money through the CJRS to cover those wages.

In practice, though, drawing a distinction between publicly and privately funded staff is challenging. Providers with a mix of funding streams were asked to calculate the share of their income that came from private sources; they were then able to access the furlough scheme to cover up to the proportion of its wage bill that was notionally paid from private income.¹⁵

While the interaction between these two funding streams was always going to be challenging, the design of the furlough scheme left gaps in the support for staff costs, as it initially prevented employees from being furloughed for part of their hours. This meant that some providers with an employee ‘almost-but-not-quite’ eligible for furlough, because a small part of their wages was covered by public funding, would not have been able to claim any money from CJRS for that employee.¹⁶ (As of 1 July, employers have been able to bring back furloughed employees part-time, which will relax some of the constraints on how providers can use the scheme.¹⁷)

Another challenge for the sector was how the guidance was delivered. The furlough scheme was first announced on 26 March, but it took over three weeks before the

¹⁵ Providers were also asked to take into account any private income that they continued to receive, for example from any vulnerable children or children of key workers attending the setting. More details on how these programmes were administered can be found in the Department for Education’s official guidance of 17 April (<https://www.gov.uk/government/publications/coronavirus-covid-19-financial-support-for-education-early-years-and-childrens-social-care/coronavirus-covid-19-financial-support-for-education-early-years-and-childrens-social-care#sector-specific-guidance>).

¹⁶ For example, imagine a provider with four equally paid employees that received 55% of its income from the free entitlement in February 2020. The provider would continue to pay two employees from its (uninterrupted) free entitlement funding. It would be eligible to claim support for 45% of its wage bill from the CJRS. But, in practice, it would only be allowed to furlough one employee (25% of its wage bill); the other employee would be partially paid through free entitlement funding, and so not eligible for furlough.

¹⁷ Under the rules for flexible furlough, employers are only able to claim support for part-furlough in respect of employees who had been fully furloughed at some point before 1 July 2020. This means that this new flexibility will only address the issues of ‘almost-but-not-quite’ eligible employees where providers have previously rotated which employees they furloughed. For example, a provider with two employees and one full-time furlough slot would now be able to part-furlough the other position only if they had previously fully furloughed each of the individual employees at least once.

Department for Education issued guidance clarifying how it would interact with continued free entitlement funding.

Where was the government package more and less generous?

The support offered to the early years sector differed significantly by provider type and their main sources of income.

Providers that were entirely or almost entirely publicly funded were generally financially protected (relative to their financial position before the pandemic).

Providers that rely mostly on private income were able to offset most of their staff costs using the furlough scheme. However, there was little opportunity to offset high fixed costs, such as rent or insurance – with the exception of support through the business rates holiday and, for small businesses, potentially grants through the business rates system. Access to government supported loans at low or no interest will have helped private-sector providers somewhat, but these packages are not designed to relieve businesses of the entire burden of their fixed costs while they are closed, and of course loans need to be repaid. So, all else equal, providers for whom these fixed costs make up a larger share of their total costs will have suffered more from the lockdown.

For self-employed childminders,¹⁸ the SEISS initially offered a taxable grant of 80% of usual pre-pandemic profits. For some childminders – especially those with a high share of public funding and those making significant gross profits before the pandemic – this could have been quite generous support. The grant was paid in full regardless of the size of the pandemic-related hit to profits, so childminders who lost a small share of their income from parent fees or charges could have claimed the grant while continuing to receive funding through the free entitlement (plus any income from parents that continued during lockdown).

¹⁸ In general, most childminders are self-employed and most group-based providers and nursery classes are businesses. While it is useful to discuss the different packages of support in the context of these two provider types, eligibility is based on the individual provider's legal type, rather than the type of provider they are. It is also possible for a provider to fit into both groups – for example, a childminder who is self-employed but employs an assistant, who can be furloughed.

However, for childminders who have lost most of their regular income and typically run at a low profit margin, the grants would only partly offset lost income while leaving them responsible for most of their other costs. And not all providers are eligible for the grants in the first place. Most importantly, childminders who started their business in the last year are not eligible for any benefits.¹⁹ Figures from the Ofsted Early Years Registers suggest that this might have applied to around 10% of childminders as of March 2020. This group may still be eligible for enhanced support through the benefits system, but this is aimed primarily at supporting them as individuals rather than supporting their business.

¹⁹ Providers who receive less than half of their income from self-employment and those whose annual pre-tax profits were more than £50,000 are also ineligible for the SEISS grants. Adam, Miller and Waters (2020) estimate that the former group includes around a quarter of those in the UK with some self-employment income, and the latter group includes 4%. However, these conditions are less likely to apply to childminders, as they tend to rely on childminding as their main source of income and usually earn profits well below the threshold.

3. Financial risks before COVID-19

In Chapter 2, we summarised the different types of government support available to childcare providers during the crisis and how these varied based on providers' legal form and their main sources of income. The size of the financial hit that providers have taken since March, and the extent to which it has been offset by government support, will be key determinants of providers' financial resilience during the crisis. But the overall health of their pre-crisis finances will also be crucial to their ability to weather both the lockdown and the continued effects of the crisis.

In this chapter, we discuss the financial situation of providers in 2018 – the latest year for which detailed data are available – to give a baseline measure of the financial health of the sector.²⁰ There are many dimensions of financial resilience, but we focus on one of the most basic: the ratio of a provider's income to its costs (see Box 3.1 for further details).

Box 3.1. Data and methodology

Data: In this report, we use data from the 2018 Survey of Childcare and Early Years Providers.^a The survey collected data from a large representative sample of 8,604 childcare providers; a subset of these were asked detailed questions about their regular sources of income and their costs.

In this chapter of the report, we reproduce figures from Cattoretti, Paull and Marshall (2019), which are based on an unweighted sample of 1,377 providers. In Chapters 4 and 5,

²⁰ This chapter draws heavily on analysis of the 2018 Survey of Childcare and Early Years Providers, conducted by Cattoretti, Paull and Marshall (2019).

we focus on the 1,341 providers with sufficient data on cost breakdown for the analysis presented here.^b

Methodology: Throughout the report, we focus on the income-to-cost ratio, which divides a provider's self-reported total income by its self-reported total operating costs. This is a measure of a provider's financial health that broadly captures whether they are in surplus or deficit. For childminders, we include the amount that they typically pay themselves (which may cover both the childminder's 'wage' and the return to capital as a business owner) as an operating cost, assuming that it is unchanged in order to be consistent with other types of providers.

Significant surplus and significant deficit: We follow Cattoretti, Paull and Marshall (2019) in describing providers with income-to-cost ratios above 1.2 (i.e. having at least £6 of income for every £5 of operating costs) as being in surplus and those with income-to-cost ratios below 0.8 (i.e. having at least £5 of costs for every £4 of income) as being in deficit.

This is a relatively conservative choice of cut-off point; it means that, despite the potential for measurement error in the reporting of costs and incomes, we can be reasonably confident that providers who fall into these two groups are actually in surplus or in deficit. We refer to these providers as being, respectively, in 'significant surplus' or 'significant deficit'. However, it also means that the middle group includes providers with a wide range of financial situations, with income-to-cost ratios between 0.8 and 1.2.

^a The analysis was undertaken using unbanded data held by Frontier Economics.

^b Of these, 415 are private providers, 405 are voluntary providers, 113 are nursery classes and 285 are childminders. The remaining 121 are maintained nursery schools and other unclassified group-based providers.

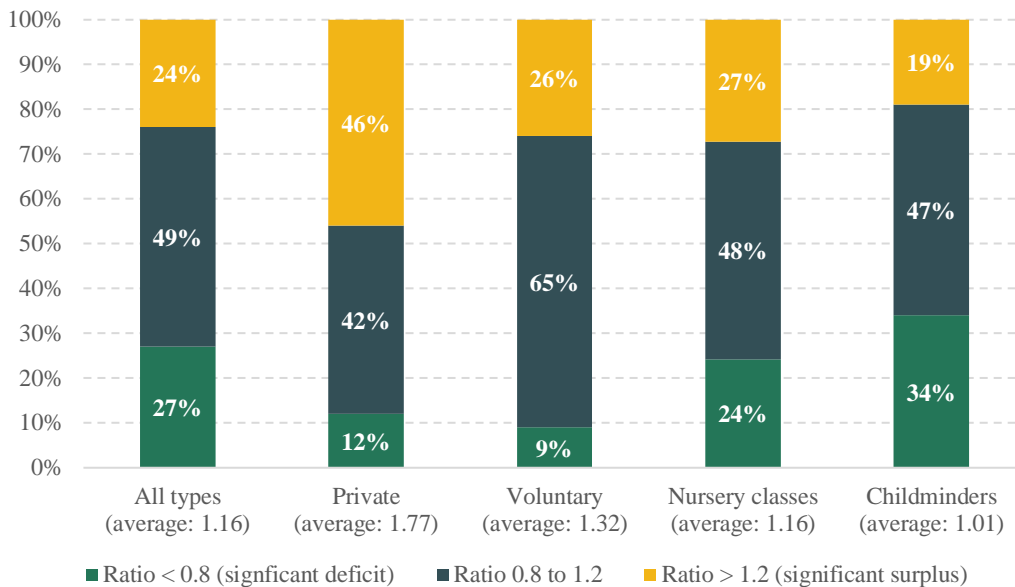
Figure 3.1 shows that, in spring 2018, around a quarter of providers were estimated to be running a significant surplus (in gold) and around a quarter were estimated to be in significant deficit (in light green). The other half (in dark green) had income-to-cost ratios between 0.8 and 1.2.

This is based on a snapshot of providers' income and costs at one point in time. We do not know how these figures changed over time; providers running significant deficits might have been on the verge of shutting down, or they could have been going through temporary circumstances and might have been able to draw on their

reserves to continue operating. Still, the fact that around a quarter of providers were operating with a significant deficit suggests that there is a large group of providers at risk of serious financial disruption from an unexpected shock.

Figure 3.1 also highlights the very different levels of financial resilience that different types of providers had going into the crisis.²¹ Around 90% of private- and voluntary-sector providers had income-to-cost ratios above 0.8, with almost half of private-sector providers estimated to be running a significant surplus (though they might have had costs, such as payment of dividends, that are not included here). This is borne out by an average income-to-cost ratio of 1.77 amongst this group.

Figure 3.1. Providers’ income-to-cost ratios before the pandemic



Note: We classify providers as running a significant deficit if their income-to-cost ratio is below 0.8 (more than £5 of costs for every £4 of income) and as running a significant surplus if their income-to-cost ratio exceeds 1.2. ‘All types’ includes maintained nursery schools (and other unclassified group-based providers), though this group is not shown separately as it represents a small and unrepresentative portion of all providers.

Source: Table 8 in Cattoretti, Paull and Marshall (2019).

²¹ Nursery classes running a significant surplus or significant deficit were presumably, respectively, subsidising or being subsidised by resources from elsewhere in the school.

By contrast, a third of childminders are estimated to have been operating at a significant ‘deficit’ pre-crisis. This is after accounting for income that childminders typically personally earn, which proxies the childminder’s own ‘wage’ from self-employment as well as the returns to capital as the business owner. On average, the income-to-cost ratio among childminders is very close to 1, meaning that the average childminder is just about breaking even. This would be expected if childminders generally use their income first to pay for other costs, and then withdraw what is left (the gross profits) from the business.²²

Our results focus on the financial health of the childcare providers operating in England. However, as discussed in Chapter 2, childminders are typically much smaller than other types of provider, so the share of childcare *places* at providers in deficit will be lower than the 27% of childcare *providers* shown in Figure 3.1.

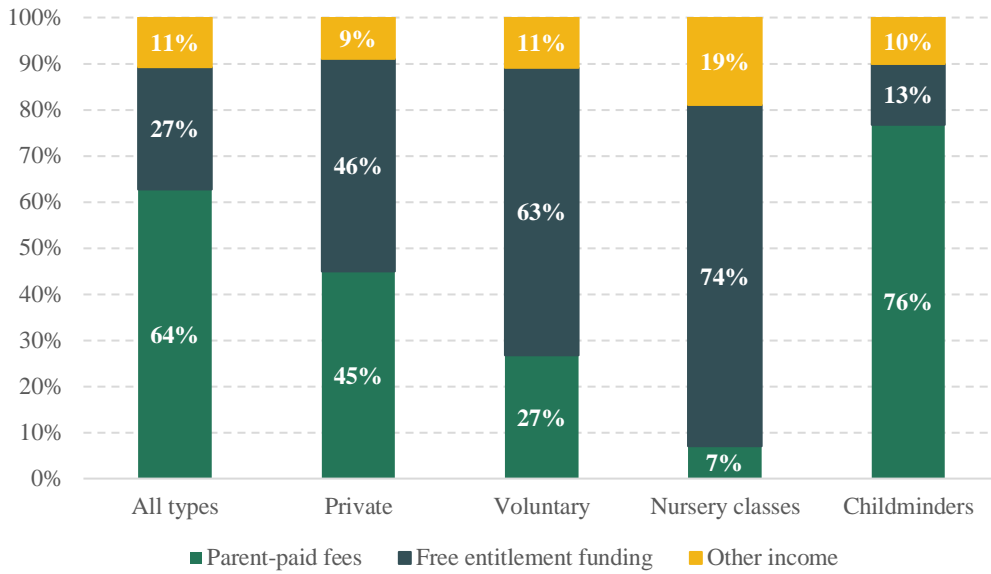
Figures 3.2 and 3.3 give a sense of some of the differences between provider types that may be driving their very different overall finances. As we saw in Chapter 2, on average, providers receive just under two-thirds of their income from parent fees, just over a quarter from free entitlement funding, and a tenth from other sources. But providers run on very different business models; while nursery classes receive an average of three-quarters of their funding from the free entitlement, childminders receive an average of three-quarters of their income from parent fees.

Providers look more similar in their sources of costs than their sources of income. Staff costs are, by far, the biggest outlay for all provider types.²³ After including food and materials costs, the ‘variable’ costs of providing childcare account for three-quarters of total costs or more for all provider types, and for 90% of the costs of nursery classes. The rest is made of costs that are harder to adjust to the number of places being used, such as rent or mortgage costs and other costs (e.g. insurance).

²² Of course, the amount of withdrawn income could be very different even amongst businesses with an income-to-cost ratio very close to 1. If childminders are paying themselves an implied wage rate below the minimum wage, for example, then even businesses with an income-to-cost ratio around 1 may not be sustainable.

²³ For childminders, this includes the income they withdraw from the business.

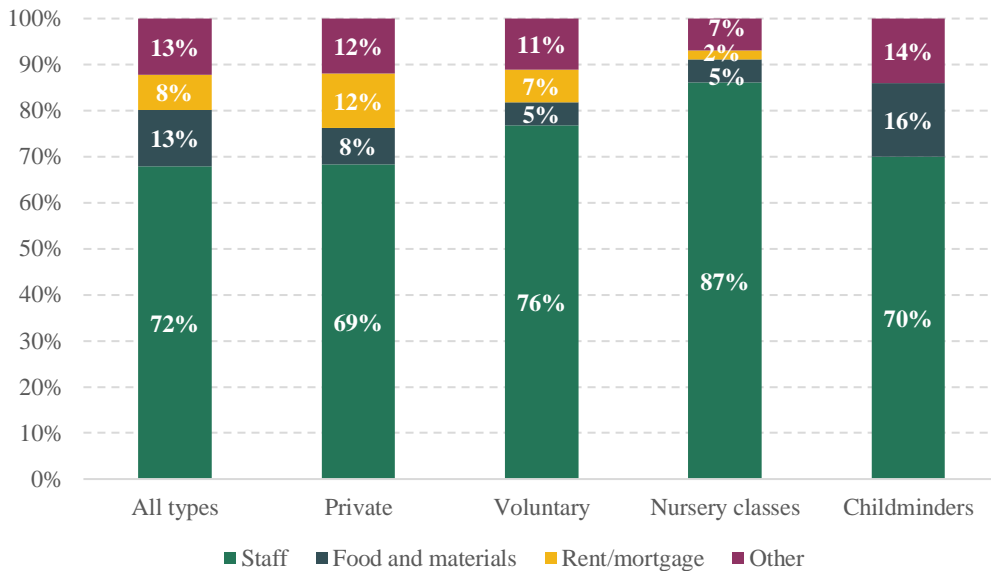
Figure 3.2. Sources of income, by provider type



Note: See notes to Figure 3.1.

Source: Figure 1 in Cattoretti, Paull and Marshall (2019).

Figure 3.3. Breakdown of costs, by provider type



Note: We include usual personal earnings from childminding in staff costs for childminders. Childminders were not asked about rental/mortgage costs. See also notes to Figure 3.1.

Source: Table 4 in Cattoretti, Paull and Marshall (2019).

4. Provider finances during lockdown

While providers entered lockdown in very different financial circumstances, the financial shock of the lockdown itself has also hit providers unequally. Continued free entitlement funding meant that free entitlement hours were funded more or less under the status quo. For hours funded by parent fees, the situation was more complicated. Providers that employ staff will have been able to access the furlough scheme to cover (most) employee costs that would have been paid for out of this income, but they were largely still responsible for other fixed costs such as rent or mortgage payments and insurance as well as any top-ups to their furloughed staff's wages. Meanwhile, most self-employed providers were eligible to receive grants for (most of) their pre-crisis profits, but not direct support for most of their costs.

In this chapter, we model the impact that lockdown may have had on the income-to-cost ratio of different providers in the sector, taking into account the major government support programmes discussed in Chapter 2. This modelling is based on the same data as Chapter 3, which were collected in 2018 as part of a representative survey of providers. This means that it represents our best estimates of the financial situation of different types of providers during lockdown, but these are estimates rather than real-time data. Box 4.1 has more details on our modelling.

Box 4.1. Modelling the lockdown scenarios

To model providers' finances during the lockdown, we consider separately what happens to providers' income and costs from publicly and privately funded childcare. We consider the following two scenarios.

- **'No fee income'**: Our central scenario makes the conservative assumption that providers take in no income from parent fees and charges during lockdown. This means excluding any income from retainers or children who continued to access childcare during the lockdown.

- **‘Small retainer’:** To check how sensitive our results are to this assumption, we run a second scenario that assumes all providers continue to receive 15% of any pre-crisis income from parent fees and charges. While we call this a ‘small retainer’ scenario, the income could also come from continuing to provide childcare to key worker families and vulnerable children.

For both scenarios, we also model government support through free entitlement funding, the furlough scheme and self-employment grants.

- We assume that public funding continues at the same level as before the pandemic.
- We assume that group-based providers and nursery classes^a are able to offset a share of their wage bill through the furlough scheme, based on how much of their income they have lost. We assume that they do not top up their staff’s wages and we ignore issues where members of staff are ‘almost-but-not-quite’ eligible for furlough.
- We assume that childminders are all self-employed and are all eligible for the self-employment grant. We calculate the SEISS payment as 80% of gross profits (total income less total costs, before withdrawn earnings), capped at £2,500 per month. We do not observe when a provider started operating, so we cannot adjust for childminders who entered self-employment too recently to be eligible for SEISS; statistics from Ofsted suggest that this could be around 10% of childminders.

We assume that all providers are still responsible for all non-staff costs, such as rent and mortgage payments, and other costs, such as utilities, insurance, food and materials.

See Appendix A for a more detailed discussion of our methodology.

^a Since nursery classes are mainly publicly funded, most of their income will be intact and so they will be mostly ineligible for the furlough scheme. However, our reading of the guidance is that nursery classes will be able to access the furlough scheme in respect of any (private) income they have lost.

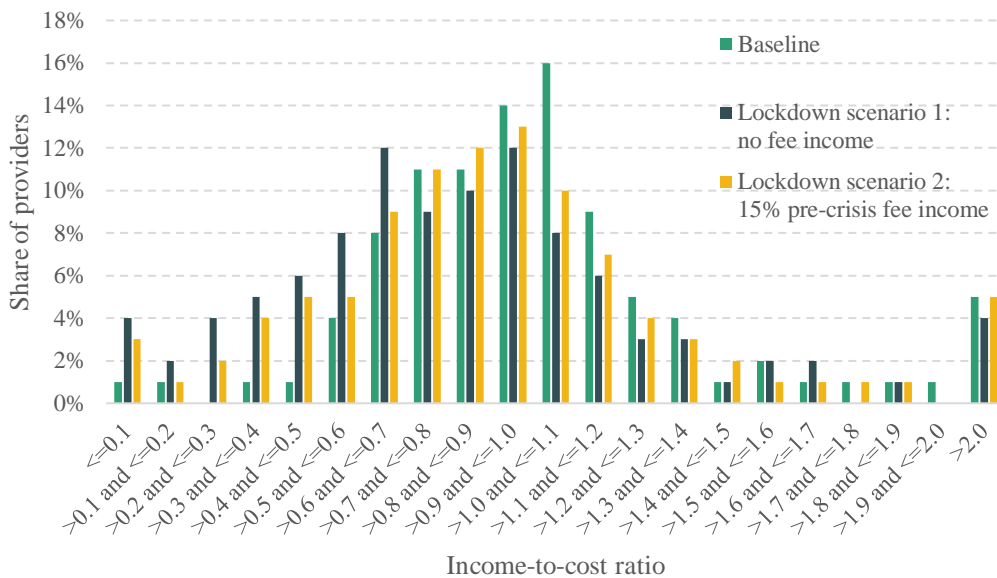
4.1 Overall impacts of the lockdown on providers’ finances

The financial situation of providers during lockdown depends both on their pre-existing financial circumstances and on their experience during lockdown. Figure 4.1 shows the distribution of providers’ income-to-cost ratios, both in 2018

(‘baseline’) and under the two lockdown scenarios described in Box 4.1. There is little change in the share of providers in very good financial health as a result of the lockdown; above an income-to-cost ratio of about 1.3, the distribution looks similar in all scenarios.

But our modelling suggests that lockdown is likely to have significantly reduced the proportion of providers who are very narrowly breaking even (with an income-to-cost ratio between 1.0 and 1.1). In the no fee income scenario, the share of providers narrowly breaking even would halve, from 16% to 8%; even on the more optimistic assumption that providers were able to maintain fee income worth 15% of pre-crisis levels (the small retainer scenario), the proportion narrowly breaking even would fall by about a third, to 10%.

Figure 4.1. Distribution of providers’ income-to-cost ratios



Note: This sample differs slightly from the analysis in Catoretti, Paull and Marshall (2019) used in Figures 3.1–3.3. See Box 3.1 for details.

Source: Authors’ analysis of the 2018 Survey of Childcare and Early Years Providers.

At the same time, the share of providers with very large deficits is likely to have increased sharply, with the proportion of providers whose income is less than half their costs (an income-to-cost ratio of less than 0.5) estimated to increase five-fold

(from 4% to 21%) in the no fee income scenario, and to almost quadruple (to 15%) in the small retainer scenario.

4.2 Impacts of the lockdown on different types of providers

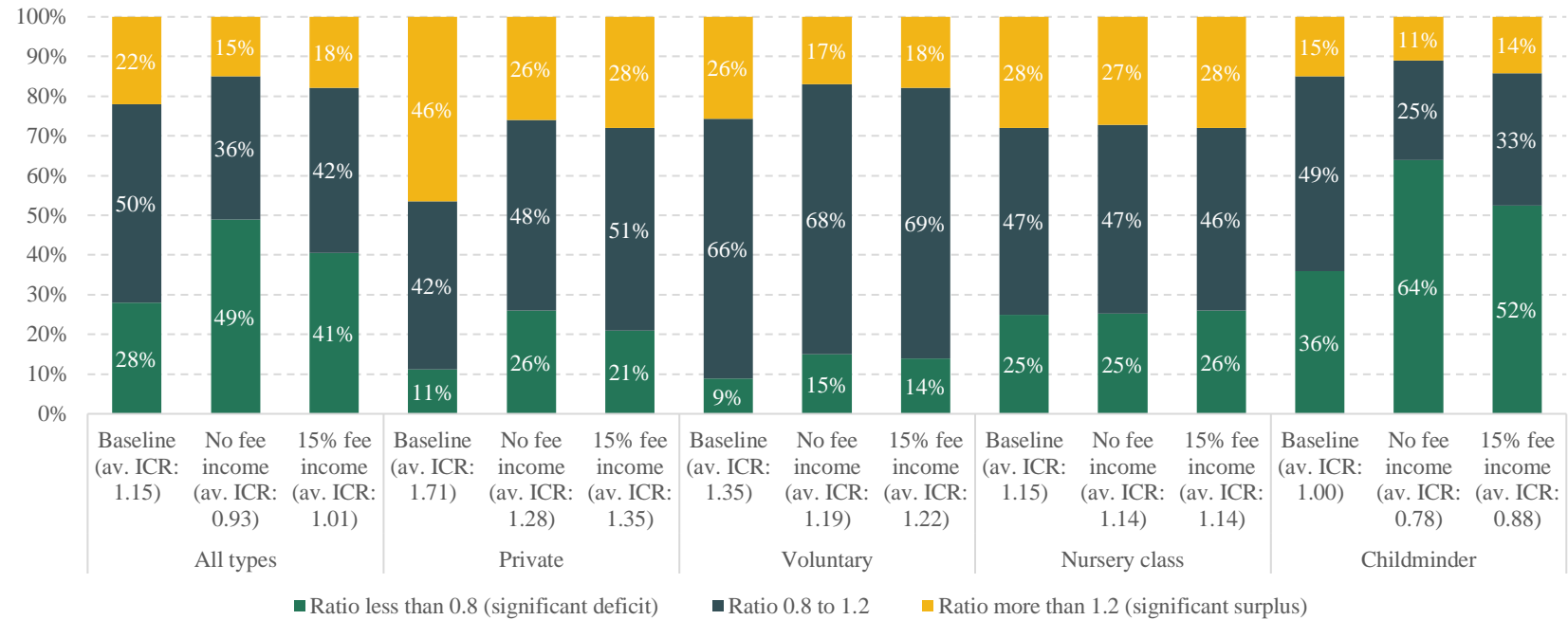
Figure 4.2 shows how financial pressures during lockdown differ across provider types. It splits providers into the three groups used in Figure 3.1 (in significant deficit, with an income-to-cost ratio of 0.8 or less; in significant surplus, with an income-to-cost ratio above 1.2; and those in the middle, with an income-to-cost ratio between 0.8 and 1.2).

In our no fee income scenario, we estimate that around half of providers are likely to have been in significant deficit (with an income-to-cost ratio less than 0.8), nearly twice as many as before the pandemic. The share of providers tipped into deficit falls by more than a third, from 21% to 13%, if we assume that providers are able to bring in 15% of their regular income from parent fees.

Figure 4.2 also highlights how finances across the sector deteriorated. Across the childcare sector as a whole, the average pre-pandemic surplus stood at 15% (an average income-to-cost ratio of 1.15). If all providers were able to retain 15% of their fee income during lockdown, on average the sector would have been almost precisely breaking even. Under our first, more pessimistic, scenario in which providers are assumed not to retain any fee income during lockdown, on average the sector as a whole would be running a 7% deficit.

However, while Figure 4.2 shows that many providers are likely to have faced challenging financial circumstances during lockdown, it is also worth noting that around a third of private providers and nursery classes, and a fifth of voluntary-sector providers, are still estimated to have run a significant surplus during lockdown, regardless of what happened to their fee income. Indeed, among all three groups of providers, we estimate that there are likely to have been more providers in significant surplus than in significant deficit during lockdown, even if fee income fell to zero.

Figure 4.2. Providers' income-to-cost ratios comparing baseline and lockdown scenarios



Note: We classify providers as running a significant deficit if their income-to-cost ratio is below 0.8 (more than £5 of costs for every £4 of income) and as running a significant surplus if their income-to-cost ratio exceeds 1.2. 'All types' includes maintained nursery schools (and other unclassified group-based providers), though this group is not shown separately as it represents a small and unrepresentative portion of all providers. Sample as in Figure 4.1.

Source: See Figure 4.1.

Both the overall increase in the proportion of providers in deficit and the differences between the two scenarios are driven by two groups of providers: private-sector providers and childminders. In the first scenario (assuming no fee income), around a quarter of private providers and almost two-thirds of childminders are likely to have been in significant deficit during lockdown (counting what childminders usually pay themselves in their costs). This compares to 11% and 36% before the pandemic. If providers successfully retained 15% of their pre-pandemic fee income, this drops to 21% among private-sector providers and a still-substantial 52% for childminders.

The income-to-cost ratios of these two groups are very different, however. Private-sector providers are, on average, still making a surplus of around 30% in our two lockdown scenarios, while childminders face an average deficit of between 10% and 20%. But private-sector providers started from a much higher base: before the pandemic, they made, on average, a surplus of around 70%, while childminders were more or less breaking even, on average. This means that private-sector providers have seen their income-to-cost ratios fall further in absolute terms than childminders (a fall of around 40 percentage points, from roughly 1.7 to roughly 1.3, compared to a fall of 10–20 percentage points, depending on the scenario, for childminders), and indeed than any other provider type.

Why does the impact of lockdown vary by provider type?

So far, we have seen that the lockdown unambiguously worsened the financial position of the childcare sector as a whole, but that these effects are concentrated most among private-sector providers and – especially – childminders. We now explore three reasons why the lockdown might have affected providers differently: the state of providers' baseline finances; the extent to which their income was disrupted during the lockdown; and the types of government support on offer.

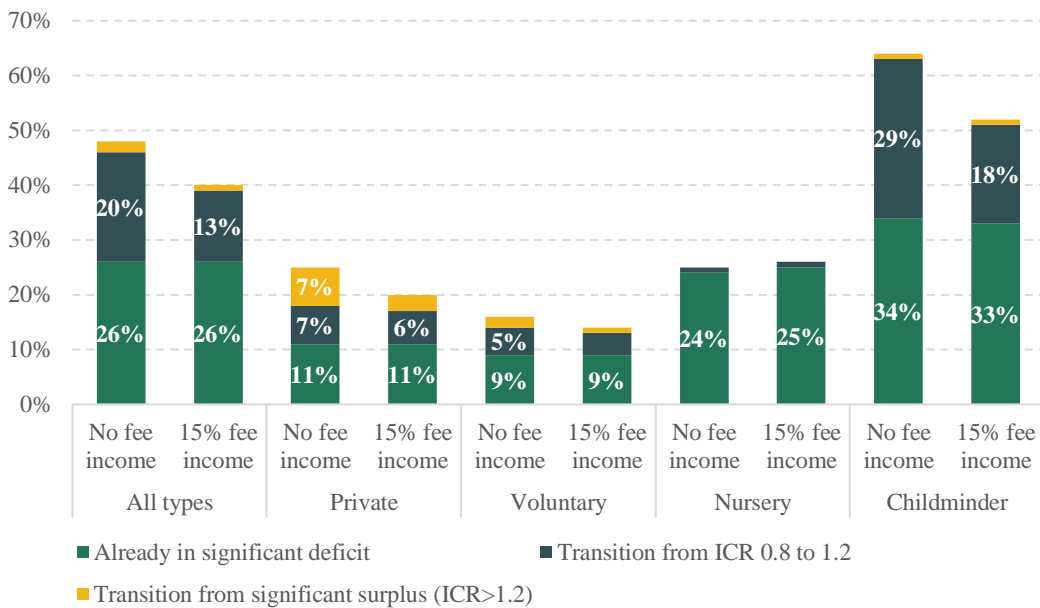
Baseline finances

To explore the relationship between baseline financial position and the financial position of providers during the lockdown, Figure 4.3 looks at the baseline financial position of the providers who we estimate could be running significant deficits in each of our two lockdown scenarios.

The figure shows that, unsurprisingly, most of the providers who were in deficit at the baseline continue to be in deficit during the lockdown: over half of the providers

in significant deficit in our no fee lockdown scenario, and two-thirds of them in our small retainer scenario, were already in deficit going into the crisis. While the lockdown certainly hurt providers' finances, a substantial share of these providers were already in financial trouble going into the crisis.

Figure 4.3. Providers estimated to be in significant deficit (with an income-to-cost ratio <0.8) under lockdown scenarios, by baseline financial position



Note: A small number of childcare providers who were previously in significant deficit saw their finances improve during the lockdown. Other notes as for Figure 4.2.

Source: See Figure 4.1.

However, very few of the 22% of providers who entered the crisis with a significant surplus fell into deficit during the lockdown. The exception is private-sector providers; here, half of those newly falling into significant deficit in the no fee lockdown scenario started from a position of significant surplus (although this is a relatively small proportion of the private-sector providers in significant surplus at baseline). This scenario is likely to be more common for private-sector providers because of the larger average falls in income-to-cost ratios that they have experienced.

While we have focused on providers running a significant deficit during the lockdown, worsening finances that do not quite put providers in this category could

still be a cause for concern. Even though this may not put them in immediate danger of exiting the market, it might reduce these providers' ability to build up reserves (e.g. to support future expansions in capacity or to weather future shocks).

Funding streams

Figure 4.4 illustrates the importance of providers' funding sources for their financial position during lockdown. It divides providers into the 33% of providers in our sample receiving 'fees only' (no free entitlement funding), the 7% relying on 'funding only' (no income from parent fees or charges) and the 50% with a mix of both sources of funding.²⁴

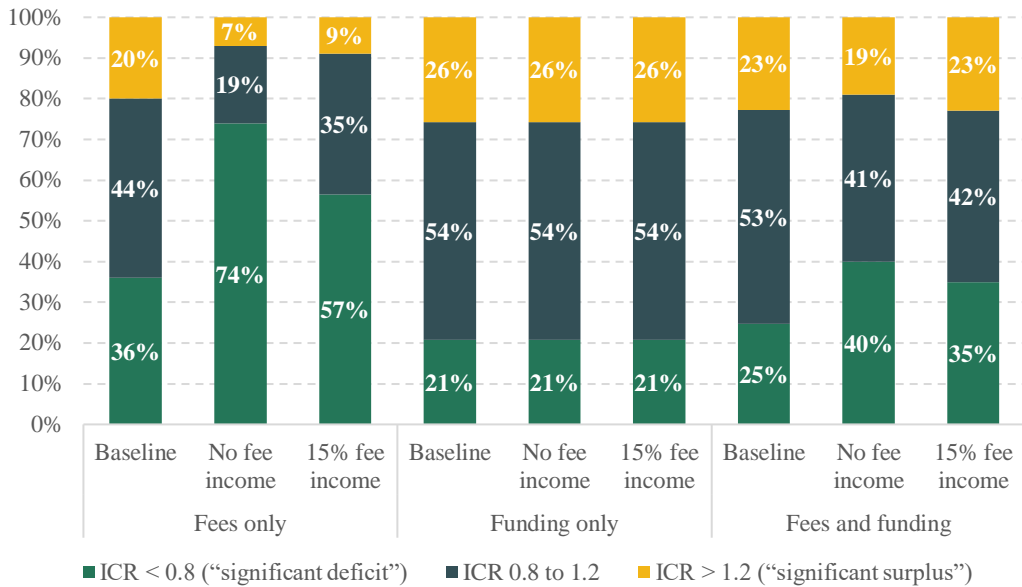
Because public funding for free entitlement hours continued on the basis of expected rather than actual take-up during lockdown, the income of providers relying entirely on public funding should not have changed over this period, as the middle panel of Figure 4.4 highlights.²⁵

While some settings continued to receive income from retainer fees or fees for childcare delivered through the lockdown, surveys of the sector make clear that income from parent fees was far from uninterrupted. Providers with private income were able to access the furlough and self-employment schemes, but these generally only partly cover providers' costs, so settings reliant entirely on private income were at far greater financial risk. Under the assumption that income from parent fees fell to zero during lockdown, we estimate that the proportion of non-publicly funded providers in significant deficit is likely to have roughly doubled, from 36% to 74%. This increase would have been half as large if providers had continued to receive 15% of pre-crisis income from fees during lockdown, rising by around 20 percentage points (to 57%).

²⁴ For 9% of providers in our sample, it was not possible to conclude which type of funding applied, and so these providers are excluded from Figure 4.4.

²⁵ Of course, it is possible that their costs may have changed (e.g. as a result of any adjustments made to ensure the safe delivery of care), but we do not take this into account in our modelling.

Figure 4.4. Providers’ income-to-cost ratios under lockdown scenarios, by income source



Note: ‘Fees only’ refers to providers with no public free entitlement income. ‘Funding only’ refers to providers with no income from parent fees or charges. Other notes as for Figure 4.2.

Source: See Figure 4.1.

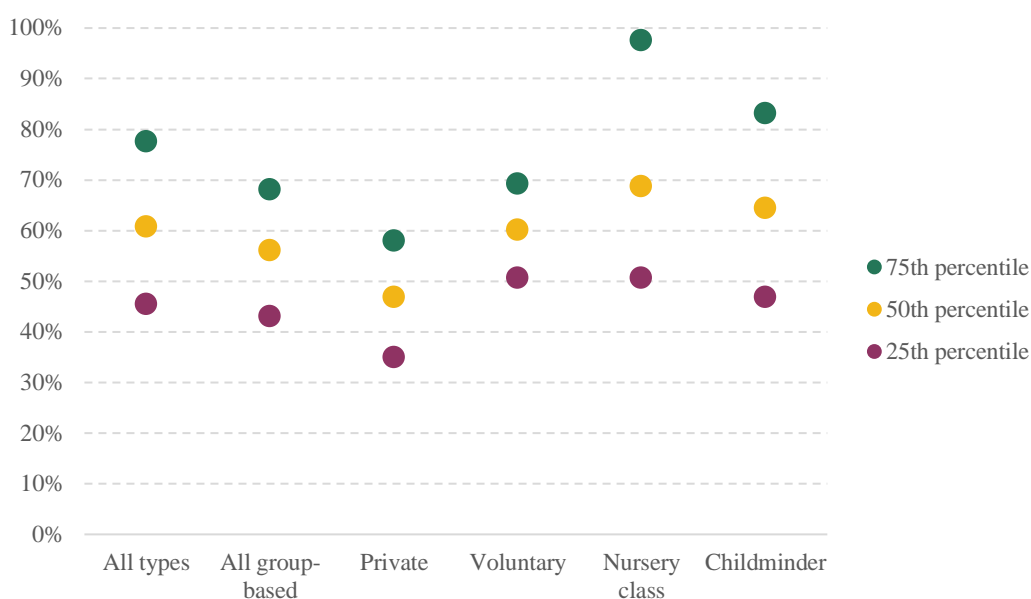
Differences between employer and self-employment support

Another factor in how providers’ finances were affected by the lockdown is the extent to which government support programmes replaced their lost income. Because public funding continued uninterrupted, in this section we consider the extent to which private income was replaced through the furlough scheme and self-employment grants.

We calculate the extent to which providers were protected from drops in their income from private fees by comparing their furlough or SEISS payments (assuming they took in no private income during lockdown) to their baseline income from private fees. In essence, this shows how much of the private income that providers lost during the crisis was replaced by the government’s support programmes. We then line up providers according to this proportion, from lowest to highest, and, in Figure 4.5, report the replacement share of the providers one-quarter, halfway (the median) and three-quarters of the way along the line.

Overall, the median provider whose private income was entirely erased during the lockdown could expect around 60% of it to have been replaced by the furlough scheme or SEISS. Some providers were better off than this; providers in the top quarter had at least 77% of their income replaced. Those in the bottom quarter saw 45% or less of their fee income replaced through government support.

Figure 4.5. Furlough or SEISS payments as a share of baseline fee income, assuming no fee income during lockdown



Note: The figure shows the ratio between the SEISS payment (for childminders) or the furlough payment (for other provider types) under the no fee lockdown scenario and the provider's baseline private fee income. The figure is restricted to providers with some private income at baseline. 'All group-based' providers includes all types except childminders (i.e. all provider types broadly eligible for furlough payments rather than SEISS payments).

Source: See Figure 4.1.

However, there are significant differences in the generosity of the support across provider types. Among group-based providers, the replacement rate of the scheme was lower for private-sector providers and much more generous for nursery classes (with those in the top quarter seeing virtually all of their fee income replaced). This is largely to do with the types of costs they face. Compared with other group-based providers, private-sector providers spend a greater share of their income on food, rent and other non-staff costs, which are not reimbursed through the furlough scheme. A greater share of their baseline fee income therefore went on covering

these larger non-staff costs, meaning that a smaller proportion of their baseline fee income would be replaced by the furlough scheme.

Of course, childminders are supported under a different scheme entirely, which is unrelated to their costs. While Figure 4.5 suggests that SEISS and the furlough scheme replace a similar share of fee income for childminders and all other providers near the bottom of the distribution, towards the top of the distribution SEISS payments could be more generous than the furlough scheme. For the quarter of childminders whose SEISS payments were estimated to be most generous, the scheme replaced at least 83% of their baseline fee income. By comparison, among all other providers, a replacement rate of 68% was enough to be in the quarter of providers best supported by the scheme.²⁶

4.3 Impacts on other provider characteristics

So far, we have discussed how different types of providers were financially affected by the lockdown. The lockdown hit childminders the hardest, both because of their pre-existing financial weakness and because of their reliance on fee income. Private-sector providers suffered some of the largest absolute falls in their income-to-cost ratios, and a small group even fell from running a significant surplus to running a significant deficit.

These differences are likely to affect the types of providers who stay in the childcare market, and so the types of provision on offer going forward. It is therefore important to understand whether the providers most at risk of a worsening financial position during lockdown serve particular children or are based in

²⁶ These figures assume that all group-based providers were able to take full advantage of the furlough scheme and that all childminders were eligible for SEISS payments. Figures from the Ofsted Early Years Registers suggest that around 10% of childminders joined the register in the 12 months leading up to 31 March 2020, suggesting that they would have been ineligible for SEISS. It is not possible to say exactly what implications this would have for the distribution of childminders' replacement rates, because we do not know where in the distribution of fee income these childminders were located. But even if we were to assume that they had the 10% highest replacement rates, and changed those replacement rates to zero, the proportion of fee income covered by SEISS still looks to be a little higher for childminders at the top of the distribution than the proportion of fee income covered by the furlough scheme for all other providers.

particular areas, which might raise concerns about capacity amongst those groups going forward.

To address this, Figures B.1–B.4 and Table B.1 in Appendix B show how the likelihood of being in significant deficit, significant surplus or having an income-to-cost ratio between 0.8 and 1.2 as a result of our two lockdown scenarios differs by youngest age group served²⁷ (Figure B.1), average staff qualification level (Figure B.2), provider size (based on the number of registered places; Figure B.3), area deprivation level, as measured by the Index of Multiple Deprivation (Figure B.4) and region (Table B.1).

We find clear patterns among some of these groups. For example, providers who offer places to children aged under 2 are more likely both to be in deficit and to have entered deficit during the lockdown (compared with providers who only take older pre-school children). This probably reflects the complete reliance on private fee income for these younger age groups. We also find that the share of providers in significant deficit nearly doubled in the East Midlands even in our scenario with 15% of fee income retained, while the South West – whose providers were already the most likely to be running significant deficits – saw relatively few additional providers slip into deficit.

In other cases, the evidence is less consistent with other sources, or with some of the concerns that policymakers and the sector have expressed. For example, we do not find any evidence that smaller providers are more likely to run a substantial deficit than larger providers; in fact, mid-sized providers seem to be most at risk (although this was also the case before the pandemic). Similarly, despite concerns that high-quality, high-cost providers might have suffered more, we find that providers that employ more qualified staff were, if anything, less likely to be in significant deficit during the lockdown.

There are at least two explanations for this latter finding. Part of the story is likely to be driven by the relationship between qualifications, provider type and funding sources. Nursery classes typically have higher average staff qualification levels and are also much less reliant on private fee income than other types of provider, for

²⁷ We use this rather than the average age of children in the setting as most providers serve children aged 3 and 4, so the age of the youngest child gives the best summary of the range of age groups that a provider serves.

example. Another explanation is that providers were well supported with staff costs; while these providers had higher wage bills, they also received more support from the furlough scheme to cover them. Of course, staff qualifications are only one proxy for centre quality, so there is still a concern that providers that focus on other inputs (such as rent for large and/or well-equipped spaces, or the quantity or quality of toys available) to deliver high-quality care will face financial pressure.

Perhaps surprisingly, we also find that providers in the most affluent areas are more likely to have fallen into deficit than those in the most disadvantaged areas. This contrasts with the results of a recent Sutton Trust report based on a survey of providers by the Early Years Alliance (EYA), which found that settings in more deprived areas were more pessimistic about their prospects of remaining in business over the coming months than those in less deprived areas.²⁸ This apparent difference in results could potentially be explained by a number of factors, such as:

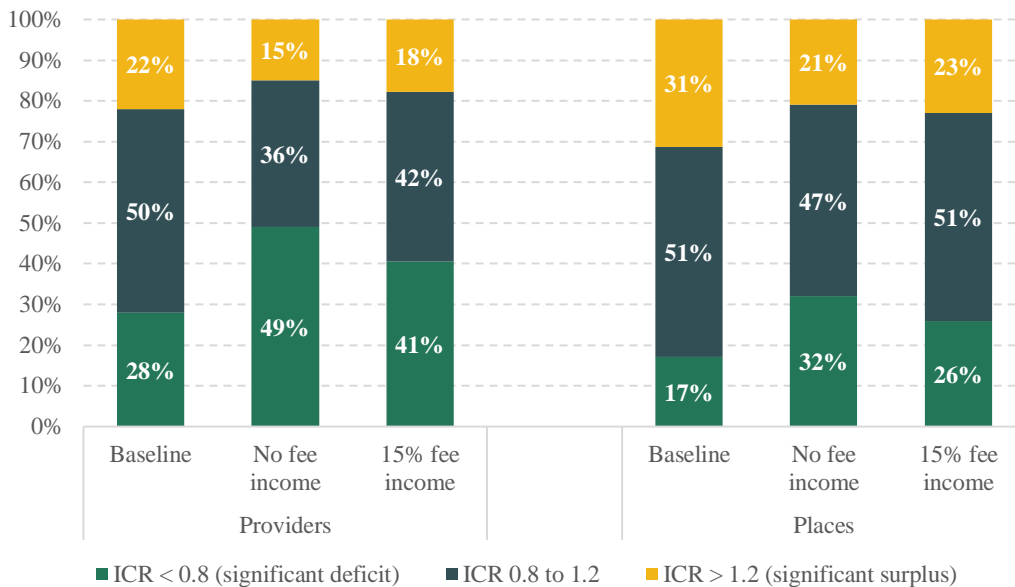
- The outcomes are different: one relates to an estimated financial position during lockdown and the other relates to expectations about future operation, which are likely to be driven by a range of factors alongside current financial position.
- For example, providers in more deprived areas may be more pessimistic about future demand and/or their ability to raise prices to help cover costs than providers in less deprived areas.
- Providers in more affluent areas might be more reliant on fee income in ‘normal’ times, either because of higher demand for private childcare hours or because they are able to charge higher fees per hour.
- However, these providers may also have been more likely to (be able to) charge retention fees during lockdown than those in more deprived areas, which our scenarios – in which we assume income changes in the same way for all providers – do not take into account.
- Similarly, if there is greater turnover among childminders in disadvantaged areas, eligibility for the SEISS would be lower (which we do not capture in our modelling).
- Finally, it could be because the nationally representative sample of providers used in our analysis is different to the providers that responded to the EYA survey.

²⁸ Pascal et al., 2020.

4.4 Impacts on registered places

So far, the analysis in this chapter has focused on the financial position of a representative sample of providers. But, as we set out in Chapter 2, providers can be very different sizes. In particular, while over half of providers are childminders, they deliver just 14% of registered childcare places in England. So, while the severe financial impacts on childminders that we document in this section will affect a large share of the providers in the market, they will directly affect a much smaller share of children.

Figure 4.6. Income-to-cost ratios for providers and for registered places in providers



Note: 'Providers' data are weighted by the number of providers, and replicate the first panel of Figure 4.2. 'Places' data are weighted by the number of registered places at each provider as well as the provider weights, and so reflect the share of places at providers that are in these three financial groups.

Source: See Figure 4.1.

In Figure 4.6, we show the overall finances of the market across all provider types. The first panel is taken from Figure 4.2, and shows the share of providers in significant surplus, significant deficit, or in between. The second panel is weighted by the number of registered places and so shows the share of places in providers that are in these three groups.

Figure 4.6 shows that, while half of providers could be in significant deficit under our no fee income scenario, these businesses offer just a third of registered places. If providers were able to take in 15% of their regular fee income, a quarter of registered places are offered by providers who were at risk of a substantial deficit during the lockdown (up from 17% before the pandemic). So, while the impacts on provider numbers are greater than the impacts on places, the lockdown is still likely to have had a substantial impact on the share of places offered by providers at significant financial risk.

4.5 Summary

Not surprisingly, the analysis in this chapter has suggested that it is childcare providers that rely more heavily on parents' fees who are likely to have felt the greatest financial pressure during lockdown. Childminders and private-sector childcare providers are the most likely to fall into this category. Under the assumption that income from parent fees and charges fell to zero during lockdown, the percentage of these settings that are likely to have run a deficit roughly doubled during lockdown (compared with our 2018 baseline).

Relaxing the assumption about income from parent fees slightly – allowing for this income to be 15% of its pre-crisis level, for example – undoes some of the estimated damage to the finances of private-sector childcare providers and childminders. Even so, childminders, especially, remain vulnerable to the prospect of significant deficits, with the proportion estimated to be facing a significant shortfall half as high again as at baseline (52% versus 36%).

At face value, we might therefore expect childminders to be the most likely to have exited the market – or at least to have temporarily ceased trading – during and immediately after lockdown. However, it is important to remember that our model assumes that childminders continue to pay themselves the same amount each year as they did in 2018.

It might be that, before the pandemic, most childminders were able to pay themselves a healthy amount, and so there might have been room for them to reduce this during the lockdown in order to help sustain their business. In this case, our estimate of the increase in the proportion of childminders in significant deficit will overestimate the vulnerability of this group to the lockdown.

However, if childminders had low gross profits even before the pandemic and so were only able to pay themselves relatively small amounts (e.g. an amount close to the minimum wage), they might not have been able to take a hit to their personal finances during lockdown in order to protect the financial health of their business. In this case, the estimates discussed in this chapter are more likely to be a reasonable indication of the risks of temporary closure or permanent exit faced by this group of providers, under the assumption that they were all eligible for SEISS. Of course, for the roughly 10% of childminders who entered the market in the 12 months prior to lockdown, the SEISS would not have replaced any of their business income, making them especially vulnerable to temporary or permanent exit from the market.

These interactions between pre-pandemic financial health and lockdown experiences are also likely to affect the longer-term consequences for childcare providers – those with sounder finances going into the crisis have more room for margins to fall before they slip into deficit. Further, even if they operate at a deficit during lockdown, they might have larger reserves to allow them to absorb an acute but temporary financial shock. In comparison, providers who entered the crisis in poor financial shape and who are expected to move deeper into deficit may find it more difficult to recover. In the next chapter, we look at the implications of some potential scenarios for changes in fee income and public funding that providers might experience over the coming months, to further explore the vulnerabilities of childcare providers to the ongoing consequences of the COVID-19 pandemic.

5. Financial risks in the medium term

Since the start of June, childcare providers have been allowed to open to all children, not just those who are vulnerable or in key worker households. However, this does not mean that the sector is now back to normal; the most recent statistics, from mid-July, show that only about 400,000 children were attending full- or half-day childcare sessions on a given day, compared to around 1.4 million before the pandemic.

In this chapter, we discuss some of the financial risks that providers might face in the next six to 12 months. The scale of these risks is enormously uncertain and will depend on how the health crisis, the economic crisis, and parents' attitudes evolve over the coming months. We therefore cannot offer predictions of how these risks will affect providers' finances; however, we provide a range of illustrative examples to show how particular reductions in public and private income could affect the financial health of childcare providers.

5.1 The end of government support

So far, the financial impact of the crisis on childcare providers has been cushioned by continued public funding and by the range of government support programmes outlined in Chapter 2. However, during autumn and winter 2020, some of this support is due to be rolled back.

Funding for childcare entitlements

Funding for the free entitlement in England follows a two-step process: the Department for Education funds local authorities (LAs) to deliver the free entitlement in their area, based on the number of children taking up the entitlement. These pupil numbers are measured in the January of each academic year, to average out the autumn term (when relatively fewer children are eligible) and the summer

term (when more children can claim a place). LAs then allocate funding to individual providers, based on their own local funding formulas.

For the autumn 2020 term, the allocation of funding from central to local government will be based on pre-crisis pupil numbers (from January 2020), rather than pupil numbers in January 2021. This recognises that take-up of childcare might not be back to pre-crisis levels during the autumn term. However, the current expectation is for funding for the spring and summer terms to be based on January 2021 pupil numbers, suggesting that – at least for the moment – they expect pupil numbers at this point in time to be a good reflection of demand over the spring and summer terms. However, areas in which take-up of the free early education entitlement is recovering at a slower rate could see their early years funding cut sharply over the course of the year, while take-up of childcare places is likely to move in the opposite direction. Separate arrangements would presumably also have to be made for any areas in lockdown at the time of the January 2021 census.

The way in which LAs fund individual providers will change, however. So far, all settings have seen their public funding protected. From September, LAs will continue to fund open settings and those that are forced to close for public health reasons at ‘broadly the levels they would have expected’ had the pandemic not happened.^{29,30} Settings that are closed for reasons other than public health will lose their public funding.

Other government programmes

This autumn, many of the other government programmes to support businesses will also begin to wind down. Since August, employers have been required to pay employer pension and National Insurance contributions for furloughed employees; from September, they will also need to start paying towards employees’ wages before the scheme ends on 31 October 2020.³¹ The second, and final, grant under

²⁹ Department for Education, 2020b.

³⁰ LAs will have discretion to reflect known changes to local demographics in their funding to individual providers. They will also be able to use any extra free entitlement funding (e.g. from not funding providers closed for non-health reasons) to ensure that local childcare provision is sufficient, or to support other early years priorities.

³¹ These wage employer contributions are being phased in. Employers will have to pay 10% of the wages of furloughed employees from September, rising to 20% in October.

the SEISS will be paid on 17 August, covering 70% of three months' worth of pre-crisis profits.

The end of these programmes will affect childcare providers in two ways. First, as businesses, providers will lose a large part of the safety net that has supported them through the fall in private income during the spring and summer. From the late autumn, providers will be responsible for most of their wage costs. This will sharpen the incentive to reduce staffing levels, and could potentially lead to some providers going out of business entirely.

However, while the withdrawal of government programmes means providers will have less help with their costs, it might also help to boost their income relative to the lockdown. Many parents have been furloughed so that they could look after their children during lockdown; there is growing evidence that others, who have been working from home while looking after their children, are finding the balance between work and childcare unsustainable.³² To the extent that these parents' employers now start to recall them to their workplaces or impose stricter requirements on having childcare while working from home, providers might see an uptick in demand (and private income) relative to the summer.

Impact on providers

Taken together, the removal of public funding for closed providers and the phase-out of support through the furlough and self-employment schemes means that providers will need to make decisions about whether it is viable for them to continue operating. Open providers that are entirely publicly funded should be able to continue operating along broadly the same financial lines as they did before the pandemic, at least for autumn 2020. But providers with mixed or mostly private income streams will need to decide what share of their income from parent-paid fees they can afford to lose, and for how long.

³² Andrew et al., 2020a.

5.2 The decline in demand

So far, parents have been much less likely to use childcare than they were before the pandemic. A crucial question for the sector is how quickly, and how high, demand might rebound.

Health concerns

The uncertainty around this is partly driven by health concerns; survey evidence collected during lockdown found that around half of parents of children aged 0–4 who used some form of childcare (either formal or informal) before the pandemic intended to use an early years setting once they re-opened to all children on 1 June.³³ Amongst those who did not intend their child to return, around two-fifths cited health concerns as a reason for this.³⁴

While the broader return to school and, potentially, to the office will presumably shift these attitudes, childcare providers report that health-related concerns continue to factor into parents' take-up of childcare, both privately paid and publicly funded.

Impacts of the recession

However, demand for childcare – especially when paid for out of pocket – is also tied up with parents' working patterns. Not only is childcare a strong complement to work for many parents, but working parents in England also receive a range of childcare subsidies, such as tax-free childcare and additional funded hours.

The ongoing economic crisis triggered by the pandemic will therefore be a major factor in how the demand for childcare changes. Estimates of how unemployment might change over the coming year are wide-ranging; the OECD predicts that UK unemployment will rise from 4% at the start of 2020 to between 10% and 15% in the last quarter of the year.³⁵ Importantly, a given increase in unemployment might have even larger consequences on demand for childcare, for at least two reasons.

- In two-parent households, if one parent loses their job, the family might choose to have that person look after the children rather than using (and paying for)

³³ Pantelidou and Huskinson, 2020.

³⁴ The share of parents intending to return their child to formal childcare was slightly higher (55%) amongst those whose child had used formal childcare before the pandemic.

³⁵ Organisation for Economic Cooperation and Development, 2020.

childcare. The same could potentially also be true for other family members (e.g. grandparents). It is more likely that a family is hit by unemployment than that a specific person becomes unemployed, so the rate of families with someone unemployed will likely be larger than the overall unemployment rate.

- Unemployment figures do not capture people who have become ‘discouraged’ out of the labour market and have stopped actively looking for work. This effect might be particularly important for mothers with young children. With a recession in which women’s jobs have been particularly likely to disappear, and some parents fearful about using childcare, it might be increasingly attractive for some mothers with young children to stay at home and look after their children themselves.

We cannot offer definite predictions about the path that unemployment will take in England or about childcare demand over the coming year. But in the next section we model the impact on providers’ finances using several illustrative scenarios for a drop in private and public income. Our central scenario sees private income drop by 15%. This figure could turn out to be too high: even in the OECD’s more pessimistic scenario, unemployment would rise by 11 percentage points, and providers could conceivably raise fees to try to replace some of the income that might be lost as a result of lower demand for places. This figure could also be too low, both because unemployment is not straightforwardly related to childcare use and because the lockdown might have made parents less keen on childcare or more able to use other arrangements, such as flexible working, in the place of paid childcare.

5.3 Provider finances in the medium term

In this section, we model the impact that a reduction in demand across different sources of income could have on the income-to-cost ratio of providers in the sector. Because we cannot be at all certain about how the demand for childcare will change over the coming year, we model the effects of a range of different scenarios, set out in Box 5.1. These scenarios assume that providers face the same costs as they did at the baseline, so they show the financial pressures providers face, which might lead them to make changes to their business model (such as shifting the types of care they offer or laying off staff), but before they make any such changes.

Box 5.1. Data and methodology for medium-term modelling

As in Chapter 4, we use data from the 2018 Survey of Childcare and Early Years Providers and focus on the income-to-cost ratio. However, to reflect the end of government support programmes such as the furlough scheme and SEISS, we assume that all providers continue to face the same costs as they did before the pandemic.

Of course, providers are able to adjust some of their costs in response to lower demand, most notably by laying off staff. Our scenarios do not capture this; instead, we focus on the financial pressure that providers could be under if they do not adjust on this margin.

We model a variety of scenarios to capture a range of possibilities that the sector could face in the coming year. Our central scenario assumes the following.

- Private fee income drops by 15%.
- Providers continue to receive the same free entitlement funding and income from other sources as they did before the pandemic (and that they continue to employ the staff that had been delivering these hours). This is based on the guarantees for the autumn 2020 term, and assumes that either this support will be extended for subsequent terms or demand for publicly funded childcare will return to pre-crisis levels by January 2021.

We also model four alternative scenarios for what happens to fee income:

- two smaller drops in private fee income (5% and 10% of pre-crisis levels);
- two larger drops in private fee income (20% and 25% of pre-crisis levels).

An additional five scenarios assume that each of the reductions in private fee income is accompanied by a commensurate drop in free entitlement income (i.e. a 5%, 10%, 15%, 20% and 25% reduction in both fee income and public funding for the free entitlement). The idea of these scenarios is to reflect the risk that some parents may decide not to take up their child's funded early education place if they continue to have health concerns.

All of these are illustrative scenarios only.

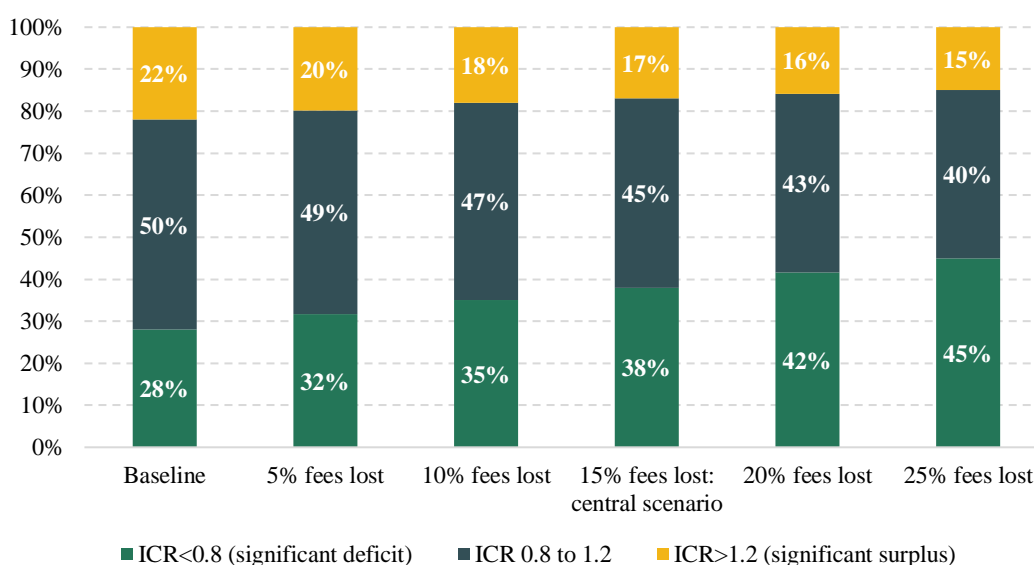
The impacts of a fall in private income

Figure 5.1 illustrates the financial position of providers under the five scenarios relating to reductions in private fee income, holding other income sources constant at pre-crisis levels. Relative to the pre-crisis position of providers (on the left), a

15% drop in income from parent fees could see the share of providers operating at a significant deficit rise by 10 percentage points, from roughly three in ten to roughly four in ten providers.

A comparison of the different scenarios suggests that the relationship between the percentage of fees lost and the percentage of providers in significant deficit is roughly linear. For every additional 5 percentage points of fee income lost, the share of providers likely to be in significant deficit increases by roughly 3–4 percentage points. Since it seems highly unlikely that private income over the next 12 months will equal its pre-crisis level, this analysis suggests that the market is going to see a larger share of providers in deficit compared with the baseline – but that the extent of this will depend critically on what happens to parents' demand.

Figure 5.1. Estimated provider income-to-cost ratios in the medium term, assuming different reductions in private fee income with no change in costs



Note: Each of these scenarios assumes that providers lose the relevant percentage of their private fee income, while their public free entitlement funding and other income remains unchanged at the baseline level. All scenarios model providers' income-to-cost ratios before making any adjustment to their costs (e.g. by laying off staff). Other notes as for Figure 4.2.

Source: See Figure 4.1.

The impacts of a fall in private and public income

The demand for publicly funded childcare might be more resilient than the demand for private childcare, both because parents are not paying for it out of pocket, and

because they might consider these places ‘early education’ rather than ‘childcare’. Even so, survey data suggest that parents are most concerned about health risks, and so might also choose to keep their children away from publicly funded childcare. To the extent that parents stay away from publicly funded childcare in January 2021, providers will receive less public funding than before the pandemic for the spring and summer terms.

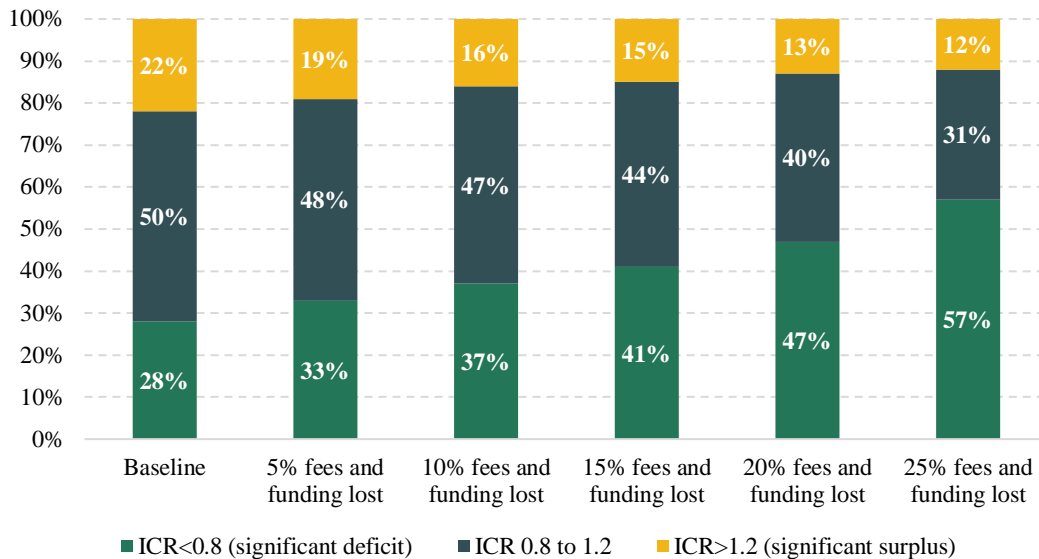
Figure 5.2 therefore illustrates the effect on providers’ finances if both public and private income fall by the same amount. The additional impact of losing public funding in addition to private fees is relatively small at low levels of lost income: a loss of 5% of public funding in addition to a loss of 5% of parent fees increases the percentage of providers estimated to be in significant deficit by just 1 percentage point.

The loss of higher proportions of public funding has a cumulative effect on the likelihood of providers being in significant deficit: a loss of 15% of public funding on top of a 15% loss of parent fees increases the share of providers estimated to be in significant deficit by 3 percentage points. And a loss of 25% of public funding in addition to a loss of 25% of parent fees could see almost six in ten providers operating at a significant deficit, an increase of 12 percentage points compared with the scenario where only private income falls by 25%. Because the range of income-to-cost ratios is narrower for providers with mostly public funding, there are groups of providers with very similar finances. So, when one of these thresholds is reached, it is possible to see a number of providers tipped into deficit at the same time.

Impacts on different types of providers

There are considerable differences in how a loss of income would affect providers of different types. Figure 5.3 compares the proportion of providers in significant deficit, significant surplus and with an income-to-cost ratio between 0.8 and 1.2 at baseline (in 2018) and under two potential scenarios for the medium term: our central scenario of a 15% loss of fee income, and the corresponding scenario showing the impact of a 15% loss of both fee income and public funding.

Figure 5.2. Estimated provider income-to-cost ratios in the medium term, assuming different reductions in public and private income with no change in costs



Note: Each of these scenarios assumes that providers lose the relevant percentage of income from fees and public free entitlement funding. All scenarios model providers' income-to-cost ratios before making any adjustment to their costs (e.g. by laying off staff). Other notes as for Figure 4.2.

Source: See Figure 4.1.

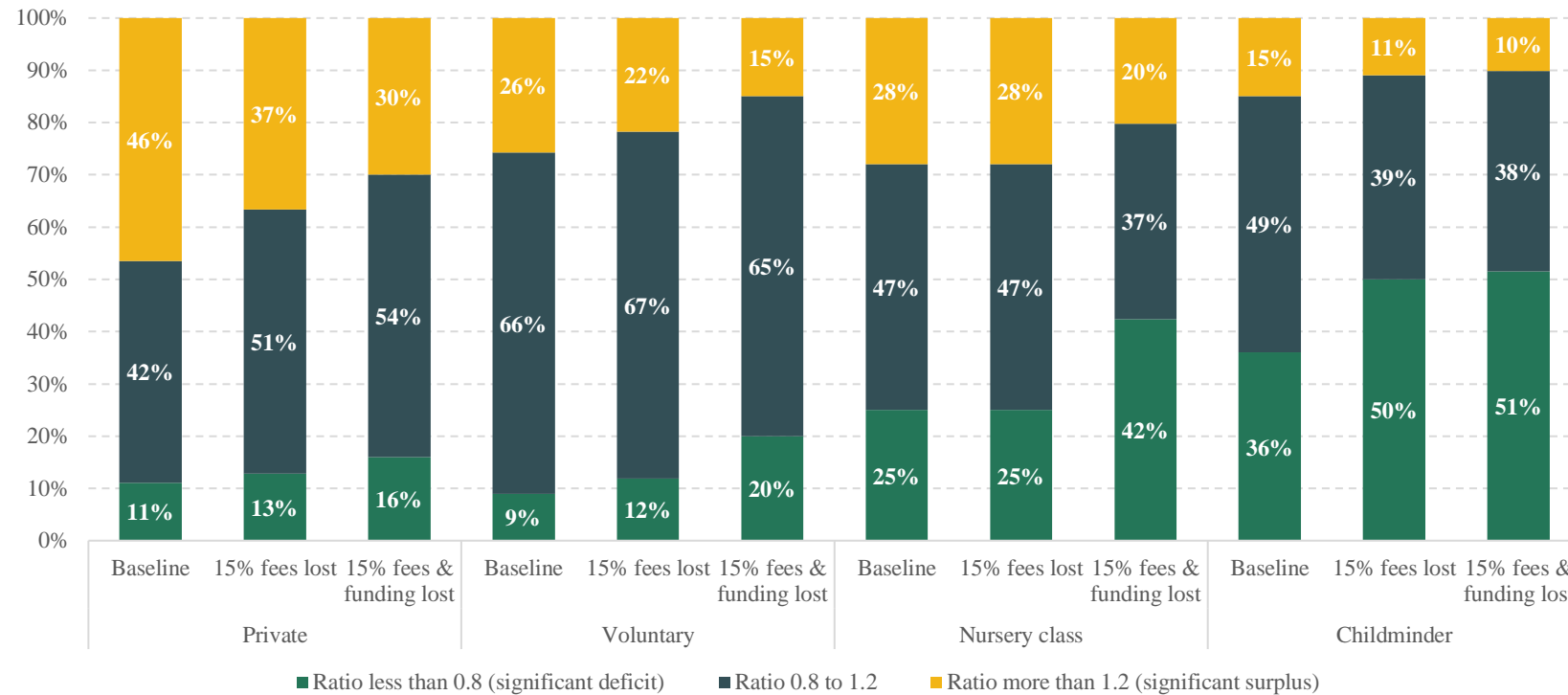
Perhaps surprisingly, given their dependence on private fees, the share of private-sector providers likely to be operating a significant deficit rises only slightly from the baseline if private income were to fall by 15% (though many more are estimated to have an income-to-cost ratio between 0.8 and 1.2 rather than above 1.2). With the additional loss of 15% of public funding, there is another small increase in the share of providers at risk of significant deficit. These small changes reflect private-sector providers' relatively healthy financial position going into the pandemic.

By contrast, childminders – who are also heavily reliant on parent fees, but entered the crisis in a much worse financial position – would be hit particularly hard by an ongoing drop in parents' demand for childcare. If income from parent fees were to see a permanent reduction of 15%, half of childminders might earn less than £4 of income for every £5 of costs (including what they usually pay themselves) in the medium term, compared to around a third in 2018.

This picture is virtually unchanged with an additional 15% loss of public funding, highlighting that this is not a particularly important income source for this group. Meanwhile, the impact of a loss of public funding is greater than the impact of an equivalent loss of fee income for both nursery classes and voluntary providers, which are much more reliant on public funding.

These scenarios make clear some important points about where risk lies in the sector. A 15% fall in parent fees is a substantial income hit for many providers, particularly private-sector providers and childminders. The very different effects in these two groups highlight the importance of taking into account providers' pre-pandemic financial circumstances when assessing risks to the sector.

Figure 5.3. Estimated provider income-to-cost ratios in the medium term, assuming different reductions in income with no change in costs, by provider type



Note: See notes to Figure 4.2.

Source: See Figure 4.1.

6. Longer-term implications of COVID-19

The preceding chapters have highlighted the financial risks that childcare providers in England are likely to have faced since lockdown began, and those that they may face going forward as government support comes to an end and demand remains highly uncertain.

In this chapter, we summarise the range of risks that the childcare market faces in the longer term, including the potential for ongoing loss of income, shifts in preferences, and the impact of social distancing measures on the cost and quality of care that providers can deliver. We then discuss how childcare providers' responses to these risks could have further impacts on the market.

6.1 Risks to the childcare market from COVID-19

The analysis in Chapters 4 and 5 highlights risks that the COVID-19 pandemic has posed for the finances of the childcare sector during lockdown and in the medium term. These risks have implications for the longer term, together with some additional challenges which may emerge.

Temporary loss of income during lockdown

Chapter 4 highlighted that the average gap between providers' income and operating costs is likely to have dropped sharply during the lockdown, resulting in very large increases in the proportion of providers – especially childminders – estimated to have been in significant deficit, as well as lower operating surplus across the board. Even if this loss of income were only temporary, providers may still need to find ways to try to recover these losses in the longer term in order to

remain in business – for example, if these temporary losses of income were sufficiently large that providers had to go into debt in order to keep their business afloat.

Permanent loss of income from lower demand

While the lockdown mandated that much of the demand for childcare collapsed, there are signs that demand for childcare places has not yet fully recovered even as lockdown measures have eased. A more permanent fall in demand, for privately paid hours or funded free entitlement hours, or both, could mean a longer-term loss of income and a longer-lasting challenge to which providers will need to adjust.

Changes in demand for different types of childcare

Even if overall demand does not fall in the long run, it may be that preferences for different types of childcare change, either temporarily or permanently. This means that there might be a mismatch between the supply of and demand for different types of childcare, at least in the medium term, before providers are able to respond to these changes in demand.

For example, one could imagine that childminders – who typically serve fewer children and can be more flexible – might become a relatively more attractive option than group-based settings in the short run. In the long run, however, parents might prefer their children to re-enter larger group settings, which may be problematic if capacity in those settings has fallen in the meantime and cannot be easily replaced.

Impacts on cost, quality and demand from the ongoing need to manage COVID-19

As long as some social distancing measures remain in place, the pandemic is also likely to have a direct impact on the quality and cost of care that providers can deliver. While the specific guidance on COVID-19 safety measures for childcare settings has changed (and likely will continue to change) as the pandemic progresses, the current guidance gives an indication of what some of these impacts could be. For example, the guidance states that visitors to the setting should be avoided wherever possible. This affects providers' ability to interact with three groups in particular: support services (e.g. speech and language therapists); parents and carers, including potential new families to the setting; and agency staff.

Limited access to face-to-face support from specialists may have implications for the quality of care children receive, particularly for children with special educational needs or disabilities. More limited interactions between staff and parents might also affect the flow of information between home and setting.

Restrictions on the use of agency staff and recommendations to staff settings on a weekly rather than a daily basis may have financial implications for providers by reducing their ability to flexibly control staffing costs. This could be a particular issue with high variation in occupancy rates from week-to-week, for example, if they have to hire permanent staff who might be periodically (but not predictably) underutilised. It may also have implications for settings that experience staff absences, which may be higher than usual in current circumstances (e.g. in cases of staff needing to self-isolate). Providers may no longer be able to rely on agency staff to fill these short-term gaps and hence may need to reduce capacity temporarily and forfeit some parent fees.

In addition, restrictions on parents' ability to visit childcare settings may affect providers trying to attract new business – and hence their future income – for two reasons.

- Parents may not be able to assess the quality of the setting – or the match between the setting and their child – as well as in 'normal' circumstances. Some settings are finding substitutes such as allowing parents to visit out of hours or are offering virtual tours. But to the extent that parents feel less comfortable with sending their child to a setting that they haven't seen first-hand 'in action', this could affect the take-up of places by new families.
- A child's ability to 'settle in' to a new setting may also be compromised. When a child first attends a new setting, they typically go only for short periods, with their parents remaining on the premises. If this is no longer an option – and parents are concerned that the new arrangements may be more difficult for their child – then those with alternative childcare options, such as informal care from friends or relatives, may choose not to go through this process right now.

These effects on the ability to recruit new families could be particularly damaging to providers during the autumn term, when providers tend to have lower occupancy because the 4-year-olds who attended their setting the previous year will have left to start school.

Future local or national lockdowns

The possibility of future local or national lockdowns also brings an added element of uncertainty to providers' decisions about whether it is financially viable for them to remain in operation. So far, in the areas of the country that have been subject to local lockdown restrictions, childcare settings have been asked to remain open only for the children of key workers and vulnerable children, as was the case during the national lockdown. While all elements of government support for the sector (as described in Chapter 2) remain in place, the main financial risk of such lockdowns is to income from parent fees.

However, from this autumn, the end of many of the government support programmes (such as the furlough scheme and the self-employment grants) means that the safety net that many providers relied on to cover losses in private fee income during the national lockdown will no longer be available. Even if providers continue to receive free entitlement funding, the loss of these other programmes may mean either that parents are asked to continue paying for childcare that they cannot use, or that providers will have to absorb what may be large losses of private income for uncertain amounts of time.

6.2 Provider responses

There are a number of ways in which providers could respond to these challenges. While fee increases may be the most immediate and easiest reaction for providers, there may also be options to adjust business models in other ways. Ultimately, however, the risks from the pandemic may bring about a reduction in overall capacity of the market.

Fee increases

The most immediate and potentially easiest to implement response for providers is to increase parent-paid fees and/or to introduce or increase additional charges (such as for lunches, nappies or trips). Such increases could be used to make up for the temporary income loss during lockdown or to address any permanent loss in income or increase in costs.

The possibility of increasing fees was the most common response cited by providers in qualitative work investigating how they might adapt their business models in

response to expected increases in costs or reductions in income.³⁶ Introducing or increasing additional charges was also a common response, especially amongst providers in the voluntary sector.

However, current circumstances may limit the ability of providers – or at least some providers – to rely on increases in fees to raise income and hence enable them to stay in business. Large-scale job losses, reductions in hours and, in particular, the possibility of salary cuts – leading to lower hourly wages amongst working parents – mean that parents might have become more sensitive to prices, and more willing to scale back their childcare use in response to fee increases, since the start of the crisis.

It seems likely that increasing fees would be a more feasible response for providers located in better-off areas (where parents might be less sensitive to price changes), in areas with few alternative childcare options (where parents might have less of a choice to take their business elsewhere), or in areas that are least likely to experience large-scale reductions in labour demand (where parents' need for childcare to cover their working day might not change as much). While the sectors most at risk of job losses or salary cuts over the coming months will not overlap perfectly with those most affected during lockdown, they may provide a reasonable indication. Davenport et al. (2020) identify the labour markets most exposed to industry shutdowns as being in London and the South East, the North West and the South West (all of which had above-average shares of providers in deficit going into the crisis, though their experiences during lockdown varied quite a bit).

Taken together, this means we might expect to see different responses to the crisis from providers in different areas, serving different communities – a point we return to in the next section discussing the case for government support for the childcare sector.

³⁶ Paull and Xu, 2019.

Adjustments to business models

Providers could also change the way they operate to improve the profitability of their provision, for example by:³⁷

- **Changing the mix of funded and private provision they offer.** For example, providers could increase income by offering more parent-paid places and fewer funded places if the funding rates for entitlement hours are lower than the parent-paid fees they can charge (the discussion in Chapter 2 suggests that this is the case for the majority of providers).
- **Changing the age mix of provision they offer.** For some providers, there will be particular age groups who are more profitable, and increasing care for these ages can support the bottom line of the setting as a whole. For example, there is anecdotal evidence of nurseries opening baby rooms when the extension of the free entitlement for children aged 3 and 4 to 30 hours per week for working families was introduced in 2017.
- **Reducing provision for children that they judge to require more costly care,** such as those with special needs (particularly if parent fees or funding rates do not cover these additional costs).
- **Adjusting staffing to reduce the unit cost,** for example by reducing the number or hours of existing staff, or by employing less experienced or lower qualified (and less expensive) staff.
- **Reducing the flexibility of hours offered** to try to increase occupancy during those hours, or simply closing at times with lower occupancy rates.

Reduced capacity

Ultimately, if demand is substantially reduced in the longer term, the childcare sector as a whole may only be able to achieve financial sustainability by reducing capacity.

How could childcare capacity fall?

A reduction in capacity can come from a fall in existing childcare capacity or from new capacity, which would otherwise have been introduced, failing to materialise.

³⁷ Some of these examples were also given by providers as ways to address rising costs or falling income in the work by Paull and Xu (2019).

A fall in existing childcare capacity might see providers offer fewer hours each week or reduce the number of registered places (the number of children they can cater for at a given point in time), potentially up to the point at which they might close entirely, or they might amalgamate with other settings and reduce their total capacity.

In ‘normal’ times, new capacity is introduced to the market both through existing providers expanding, and new entrants into the market. But if this flow of new capacity dries up – for example, because of lower expected profits or higher risks – at the same time as existing providers cut hours or exit the market, it will reduce overall capacity in the sector.

Providers exiting the childcare market

It is not possible to predict in this report how many providers might leave the market in response to the risks brought about by COVID-19: it will depend on factors that are only partly predictable (such as the future level of demand) as well as those that are not captured at all in official data (such as the level of expected profits an individual provider needs to justify staying in the market).

For illustrative purposes, however, we note that, in the year from April 2018 to March 2019 – the year following the collection of the baseline data used in this report, in March 2018 – more than 10,000 providers exited the market, representing 13% of all childcare settings and 8% of all childcare places. Childminders comprised just under half of the reduction in settings and 26% of the reduction in places. This exit rate occurred in a market with deficits identified amongst 28% of all providers and 36% of childminders. Provider exits from the market are just one part of the story, however. There was also significant provider entry between April 2018 and March 2019: around 7,500 providers entered the market (of which one-third were childminders), offering an additional 88,000 childcare places.³⁸

All else equal, the worsening finances in the sector that we have documented will encourage more providers to exit the market and deter others from starting up or expanding. Providers whose expectations of future income have fallen farther, or who expect the impact of the pandemic to last longer, might be particularly likely to

³⁸ These figures relate to 2018–19. In 2019–20, the most recent year for which we have a full year of data, a similar share of providers exited the market (14%), but they were larger and so accounted for more places (13%) than in 2018. Joining the market was much rarer: 3,500 providers joined, adding 15,000 places.

leave the business. However, recessions also typically mean fewer opportunities for employees and entrepreneurs to join a different business, so providers who are less profitable but still in the black, and childminders whose income has been reduced, might be less tempted to leave the sector.

Other sources of capacity in the childcare market

It is also worth noting that, before the pandemic, almost three-quarters of childcare providers had capacity within their full day-care provision, with on average around 20% of available places not currently in use (at least on the reference day used for the survey).³⁹ This means that there may be scope amongst existing providers to take on more children (or offer them more hours) to help compensate for the loss of capacity from provider exits or changes in business model. Of course, the extent to which this spare capacity is a good substitute for capacity that might be lost elsewhere will depend on questions such as where the provider is, what ages of children it serves, what schedule is available, and what kind of experience it offers children.

Over the coming months, the biggest question for capacity in the childcare sector will be how far – and how quickly – demand will recover, and how long childcare providers will be able to sustain significant deficits before they decide it is no longer financially viable to remain in business or to continue with their current model of operation.

³⁹ Department for Education, 2019.

7. A role for government intervention?

The analysis presented in Chapters 4 and 5 highlighted the possibility of substantial increases in the proportion of childcare settings experiencing significant deficits both during and after lockdown, which – as we discuss in Chapter 6 – may lead to a larger number of providers than usual exiting the market or otherwise changing their business model in ways that might not match demand.

In this chapter, we reflect on whether these potential changes to the market warrant further government intervention in order to prevent capacity from falling significantly and, if so, the types of intervention our analysis suggests may be potentially more effective.

7.1 Should the government intervene?

Does the prospect of significant reductions in capacity in the childcare market mean that the government should automatically step in to provide further assistance to the sector? Not necessarily. Provider exit will be disruptive for the business owners, staff and families involved, but it is not always a bad thing for the market as a whole. In a well-functioning market, price signals and profitability help to ensure that less efficient, less desirable providers are replaced with settings that better meet parents' preferences, and that the overall level of supply is appropriate for the amount of demand.

But markets – including the childcare market – are often imperfect. Barriers to entry can make it harder for new providers to open, while parents and providers might not have enough information to make informed choices, or might not consider spillover effects such as the social benefits of early education. Government intervention is usually justified on the basis of correcting these 'market failures' or for equity

reasons. In times of turmoil, it might also be justified in order to ease the adjustments that markets make.

In the case of the childcare market, the government has intervened in a number of ways to make it cheaper for parents to access childcare and early education, suggesting that they believe parents might otherwise have underused childcare or early education. This may be because the government thinks parents underestimate the benefits of childcare or early education (market failure) or do not take account of the positive benefits it has for wider society (externality), or because the government might want to ensure that all children have the same opportunities to access childcare and early education (equity). Because some form of childcare is usually necessary for parents to do paid work, the government also intervenes in the childcare market in order to support its labour market objectives, such as helping mothers to work in order to address gender gaps in employment and wages.

Does the sector need additional support going forward?

The need for pandemic-specific support to the sector is likely to depend on similar issues. Are there aspects of the market that providers might not adequately take into account when they make their business decisions? And to what extent are these concerns specific to the childcare sector (rather than more general concerns arguing for a wider approach to supporting the economy)?

More specifically, the need or desirability for the government to provide further support to the childcare market is likely to depend on a number of factors including the persistence of changes to demand, the ease of rebuilding capacity once it has been lost, its pre-existing objectives in supporting childcare, and concerns about widening inequalities if particular groups or places are especially hard hit. These issues are all inter-related.

Recovery in demand for childcare

The first question is how quickly demand for childcare might recover, and how high the demand is. If demand is likely to remain low for the foreseeable future, then it makes sense that some providers will be less able to attract families and so will go out of business. (Though there might be other reasons for the government to discourage this.)

However, if the fall in demand is only temporary, the government might wish to support otherwise healthy businesses through the temporary period of hardship. This is the same logic that underpinned the furlough scheme: the process of transitioning in and out of business is costly, can be time-consuming, and can sometimes result in worse outcomes (for example, for children whose provider goes out of business or for providers who need to invest in hiring and training new staff after they start back up). It can make sense for the government to offer some support to help to bridge a period of temporary financial difficulty for the sector.

The risk of these programmes is that they end up being a bridge to nowhere, if the financial turmoil lasts longer than expected and the government ends up simply postponing providers going out of business.

Ability to scale up and down childcare capacity

Even a temporary fall in demand can have long-lasting consequences for the childcare market if it sees a sharp fall in capacity that is not easily or quickly rebuilt, for example because it takes time to (re-)register with Ofsted.

Before the pandemic, the childcare market featured high levels of both provider exit and entry, suggesting a mature market with the ability to react to changes in demand and supply. But there is a great deal of uncertainty about whether this is likely to continue during the pandemic, or whether confidence is too low or risk aversion too high for capacity to be replaced as easily in the current climate.

Of course, similar concerns are likely to apply across many sectors of the economy at the moment, so it is also important to consider whether there is a particular need for the government to provide more support to the childcare market than to other markets.

Impacts on government's other objectives

These justifications might relate to the government's pre-existing reasons for intervening in the childcare market. Over the past 25 years, the government has substantially increased the amount that it spends on childcare and early education.⁴⁰ Its aims are to support children's development and encourage school readiness (and to reduce socio-economic inequalities between children), as well as to support

⁴⁰ Britton, Farquharson and Sibieta, 2019.

working parents (especially mothers), thus reducing gender inequalities in the labour market.

The government might therefore wish to intervene if it feels that these objectives are put at risk by the pandemic. For example, if parents are not fully informed about the benefits of early education for their children or the costs to their lifetime earnings of time out of the labour market, the government might want to run information campaigns or use other incentives to try and boost childcare demand.

Impacts on specific parts of the childcare market

So far, this discussion has focused on a potential loss of capacity or significant increases in fees across the childcare market as a whole. But the government might also be concerned about how these changes are distributed across different children, attending different providers, serving different communities in different areas.

For example, if providers switch to the highest-margin age groups or to the most profitable funding streams, this could affect the ability of particular groups to access formal childcare. Or, if the types of providers that go out of business offer particularly affordable, flexible or high-quality care, their loss could hurt parents' ability to go back to work or children's early education experiences.

On the basis of the characteristics we were able to consider in Chapter 4, this latter set of possibilities may not be a major issue in practice: we find that providers with more highly qualified staff are less likely to run significant deficits than those with less qualified staff, for example. We are not able to assess the characteristics of the children or families attending the settings most at risk of closure, however, or the characteristics of those living in local areas that might see their childcare markets hollowed out. So, we cannot rule out the need for support to prevent widening inequalities in access to high-quality affordable childcare. This might be particularly important if fee rises turn out to be an important response to the challenges faced by providers, or in order to ensure a sufficient supply of places for children with additional needs.

7.2 How might the government intervene?

Before the pandemic, the government did not intervene directly to support providers at risk of going out of business, although, as outlined above, it did intervene for other reasons, which led to higher demand for childcare overall. However, the specific challenges presented by COVID-19 discussed above may justify additional government intervention, particularly if, without further support, the market may not retain sufficient capacity to deliver its early education entitlements or to support parents' demand for childcare so that they can be in paid work.

If the government did decide to intervene, then it could do so by:

- **Supporting the sector in the event of local or further national lockdowns** that occur as the existing public support programmes are winding down or after they have ended. This may be particularly important if additional lockdowns occur more frequently, cover larger areas of the country and/or last for considerable periods of time. The most obvious form of support would be to continue to fund free entitlement hours on the basis of expected rather than actual take-up, as occurred during the national lockdown, leaving public funding relatively protected (at least at new, post-crisis levels). But providers relying on private funding would be highly exposed to the effects of such lockdowns, particularly in the absence of anything akin to the furlough scheme to support staff costs.
- **Offering transition funding to meet new COVID-19 requirements**, which providers could apply for to help meet any one-off costs associated with a change to their business model or the way in which they must deliver care as a result of COVID-19.
- **Boosting private income.** Providers might try to stimulate demand for additional hours, for example by reassuring parents that it is safe for their child to use childcare and emphasising the importance of early education for school readiness, or by increasing demand-side subsidies (such as increasing the tax relief in the tax-free childcare scheme, or increasing the proportion of childcare costs that can be claimed back by universal credit recipients).
- **Reducing the costs of providing childcare**, for example, by offering start-up capital for certain types of providers, by reducing the cost and/or time taken to register with Ofsted or by relaxing the restrictions on staff–child ratios or the

qualifications that staff members have to hold (although these options may potentially reduce the quality of care on offer).

- **Boosting public income**, for example, by increasing funding for the free entitlement and/or encouraging take-up of these places, or by increasing the supplements paid for children with additional needs.
- **Investing more in maintained provision** over the longer term, in order to reduce the risks of large shocks to the market undermining capacity to deliver its early education promises in future, thereby offering more children the opportunity to take up their free entitlement in nursery classes in schools (although these places do not always offer sufficient flexibility to support the childcare requirements of working parents).

Whatever the selected approach, it will also be important to consider how any support might be targeted to specific groups of providers. If the government's main objective in providing support is to prevent otherwise viable businesses, which tipped into deficit as a direct result of COVID-19, from exiting the market, then it should try to target support to this group. As our results in Chapters 4 and 5 show, childminders, those catering for children aged 0 to 2, and private-sector providers relying exclusively on fees are amongst the groups that are most likely to have fallen into deficit as a result of COVID-19. In many cases, these providers look to be otherwise healthy: among private-sector providers, for example, while only 11% were in deficit before the pandemic, this is estimated to have risen to 26% during lockdown – and is estimated to fall back to 13% in our central scenario for the medium term (a 15% reduction in fee income). This means that these providers look to be viable, even in a post-COVID-19 world, as long as they are able to survive the lockdown period.

This type of targeting, towards businesses that were hit hard during lockdown but otherwise look to be viable, would need the government to engage with the privately funded childcare sector. Because public funding continued uninterrupted during lockdown, increasing free entitlement funding rates would be unlikely to help the providers worst hit by the lockdown period – in fact, it would target support precisely at the providers who were best protected during the lockdown.

However, there are other reasons why the government might be particularly concerned about sustainability among free entitlement providers. It is committed to ensuring that all eligible children aged 2, 3 and 4 have the opportunity to access early education. This responsibility is primarily delegated to local government,

which has a duty to ensure that there is sufficient childcare provision available to meet local demand for free entitlement places. However, given the unprecedented nature of the shock to providers and to demand, the government may decide that a more coordinated approach is required to ensure that this access is preserved for all children across all areas.

As discussed in Chapter 2, there is ongoing debate about the extent to which the funding rates for the free entitlements are sufficient to cover providers' costs of delivering it, and whether it is necessary for providers to cross-subsidise by charging parents more for other types of care. If the government believes that, as a result of the increased pressure that COVID-19 has put on their margins, providers will reduce the number of free entitlement places they offer in order to concentrate on more profitable elements of their businesses, then increasing the funding rates may help. But, as outlined above, this is unlikely to help those otherwise viable businesses most at risk of exiting the market in the short term.

8. Conclusion

A healthy childcare market offering sufficient childcare places – ideally high-quality, affordable places – is vital both to enable many parents to engage in productive paid work and to support children’s development. Yet the COVID-19 pandemic has put the operation of this market in serious jeopardy. Most settings closed during the lockdown period and a substantial minority have not yet reopened. At the same time, the take-up of places in open settings has remained well below pre-crisis levels.

While public funding has continued more or less uninterrupted and providers have been able to access a range of government financial support programmes – notably the furlough scheme and self-employment grants – most have still seen a significant knock to their income from parent fees, while they were still responsible for fixed costs, such as rent, which were less easy to offset using available government support.

This report has shown that, taken together, this is likely to have led to a substantial worsening of the financial position of many providers during lockdown. Under the pessimistic assumption that all fee income from parents disappeared, we estimate that half of childcare providers might have been operating at a significant deficit (with more than £5 of costs for every £4 of income), even after accounting for government support programmes. This compares to 28% of providers before the pandemic.

Our analysis has shown that childminders and private-sector providers are the most likely to have fallen into deficit during lockdown, experiencing some very large reductions in income indeed: we estimate that 7% of private-sector providers may have seen falls in income large enough to move them from significant surplus (with more than £6 of income for every £5 of costs) into significant deficit.

As we move out of lockdown, and the government support packages start to wind down, a key question for the childcare sector is whether demand is likely to return to pre-crisis levels and, if so, how long it will take to do so.

While it is impossible to predict exactly what will happen on this front, we have examined the potential financial implications of a range of scenarios regarding the permanent loss of different amounts of private and public income. This analysis shows that, for every 5 percentage point drop in fee income between 5% and 25%, an additional 3–4 percentage points of providers are likely to face a significant deficit if they do not lower their costs, with childminders predicted to be amongst the worst hit. If, in addition to low fee income, take-up of funded places is still below pre-crisis levels in January 2021, voluntary providers and nursery classes will be hardest hit by the loss of public funding.

The early years childcare market is mature and was able to sustain significant levels of provider entry and exit before the pandemic. Providers have also had to adapt to some quite significant changes in demand for childcare generated by the introduction of different government subsidies in the recent past (e.g. the introduction of the entitlement to early education for disadvantaged children aged 2 and the extension of the entitlement for children aged 3 and 4 to 30 hours per week for working families), demonstrating a collective ability to adapt their business models if needed. If the same were true of the current situation, then there may be no need for the government to intervene in the market.

Because childcare providers in the private and voluntary sectors are crucial to delivery of the government's early education offers, however, it is plausible that the government may wish to intervene to ensure that these entitlements continue to be delivered without further interruption – and, importantly, that they continue to be delivered to all children across all areas of the country. An increase in the funding rates for the free entitlement hours could potentially encourage more providers to offer these hours – or existing providers to expand capacity. However, this may need to be coupled with information campaigns targeted at parents to reassure them about the safety of early education settings and the value of their child attending, to ensure that there is a demand to take up these places, as well as a sufficient supply.

Such an approach is likely to come with high deadweight cost, however, and is not really addressing the main issues presented by the pandemic so far, which has put at greatest risk those providers that are most heavily reliant on parent fees. If the government wished to provide support to the childcare market to help prevent otherwise viable businesses, which tipped into deficit as a direct result of the lockdown, from exiting the market, then the deadweight costs associated with intervention would be lowest if support was targeted at these providers – largely

childminders and those catering for children aged 0 to 2. This support could take many forms, including demand- or supply-side subsidies, changes to regulations to help lower provider costs, promises of additional support in the event of a further local or national lockdown, and transitional funding to support providers in adapting to their new normal.

Appendix A: Methodology

This appendix provides further detail about the methods that we used to simulate the finances of childcare providers, both during the lockdown and in the medium term.

A.1 Definitions

We use data from the 2018 Survey of Childcare and Early Years Providers (SCEYP) on the (self-reported) income and costs of childcare providers. Providers report both total income and costs, and a breakdown into the categories set out in Table A.1.

Based on these reported figures, we define the baseline income-to-cost ratio (ICR) as

$$\text{Baseline ICR} = \frac{\text{income}}{\text{costs}} = \frac{ifund + ifee + iother}{cwages + cnonstaff + cwithdraw}$$

For childminders, we can also consider a measure of the rate of gross profits at baseline, before any withdrawn income:

$$\text{Baseline gross profits} = \frac{ifund + ifee + iother}{cwages + cnonstaff}$$

Table A.1. Definitions of income and cost categories in SCEYP

Category	Abbreviation	Explanation
Income	ifund	Income from free entitlement funding
	ifee	Income from parent fees and charges
	iother	Income from other sources
	Income	Total income: ifund + ifee + iother
Cost	cwages	Staff costs for employed staff
	cnonstaff	Non-staff costs: rent (excl. childminders), food, materials, training, etc.
	cwithdraw	Withdrawn income (for childminders)
	costs	Total costs: cwages + cnonstaff + cwithdraw

A.2 Lockdown modelling

In our two lockdown scenarios, we take account of the fall in income and the available government support through continued free entitlement funding, the furlough scheme, and the SEISS.

In our central, ‘no fee income’ scenario we assume that:

- free entitlement funding continues at the same level as it did before the pandemic, as does other income;
- fee income falls to zero;
- all childminders who had any fee income at baseline are able to access SEISS, based on their baseline gross profits;
- group-based providers (all except childminders) are able to access the furlough scheme, which covers 80% of a proportion of regular wage costs (based on the proportion of the provider’s income that has been lost);

- group-based providers accessing the furlough scheme pay out 80% of their usual wage costs for furloughed staff (i.e. no topping up wages, and no issue of staff ‘almost-but-not-quite’ eligible for furlough)

The different support programmes for childminders and group-based providers mean that we model each type of provider separately.

Childminders

We first calculate the SEISS payment that childminders are eligible to receive (based on the 80% rate used for the first three months, during the lockdown itself).

We start by calculating the raw SEISS payment:

$$\begin{aligned} SEISS \text{ raw} &= 0.8 * \text{baseline gross profits} \\ &= 0.8 * (ifund + ifee + iother - cnonstaff - cwages) \end{aligned}$$

We then apply some of the cut-offs from the policy environment.

- **Some lost income:** Childminders whose income is unchanged from the baseline are not eligible for SEISS $\rightarrow SEISS = 0$ if $ifee = 0$.
- **Capping payments:** SEISS payments are capped at £2,500 per month $\rightarrow SEISS = £577$ if $SEISS > £577$ (note that the income and costs in our data are on a weekly basis).

Finally, we calculate the income-to-cost ratio for childminders in our no fee lockdown scenario:

$$\text{Childminder 'No fee' lockdown ICR} = \frac{ifund + iother + SEISS}{cwages + cnonstaff + cwithdraw}$$

In our second lockdown scenario, we allow providers to retain 15% of their fee income (for childminders, because SEISS is based on baseline profits rather than finances during the lockdown, this does not affect their government support):

$$\begin{aligned} \text{Childminder '15% fee' lockdown ICR} \\ = \frac{ifund + iother + SEISS + (0.15 * ifee)}{cwages + cnonstaff + cwithdraw} \end{aligned}$$

Note that we assume childminders are only supported via the SEISS scheme. In reality, a small number of childminders are also employers and may have used the

furlough scheme. Childminders may or may not be self-employed – but this information is not available in the data).

Group-based providers

For group-based providers, the amount of government support they receive depends on both the share of their income that is disrupted, and the amount of their costs that are for staffing.

No fee lockdown scenario

We start by calculating the share of a provider's income that comes from parent fees and charges:

$$propfee = \frac{ifee}{ifee + ifund + iotherr}$$

As we assume that other income (from sources such as specific local authority grants) is unchanged, it does not count towards the share of the wage bill that providers are able to cover via the furlough scheme, and so it is not included in the fee proportion.

For our no fee lockdown scenario, we then work out the provider's furlough payments by splitting their staff costs according to the share of income from fees, and multiplying by the 80% replacement rate:

$$furlough = 0.8 * propfee * cwages$$

As in real life, we model that the furlough money is paid to providers, who in turn use it to pay the staff costs covered by the furlough scheme (at 80% of the normal rate).

We assume that all other sources of income are unchanged by the lockdown, and that providers are still liable for 100% of non-staff costs and for 100% of staff costs not eligible for the furlough scheme (group-based providers do not have withdrawn income as a separate cost). We therefore model the income-to-cost ratio for group-based providers in our no fee lockdown scenario as:

$$\begin{aligned} & \textit{Group-based 'No fee' lockdown ICR} \\ &= \frac{ifund + iotherr + furlough}{((1 - propfee) * cwages) + furlough + cnonstaff} \end{aligned}$$

15% fee lockdown scenario

In our second lockdown scenario, providers retain 15% of their fee income. The guidance from the Department for Education suggests that the staffing costs notionally covered by this fee income, such as the costs notionally covered by the free entitlement funding, are not eligible for furlough. We therefore start by redefining the share of the provider's income that is disrupted and so eligible for support:

$$\widehat{propfee} = \frac{0.85 * ifee}{ifee + ifund + iother}$$

We use this new ratio to recalculate the furlough payment (which is now $furlough = 0.8 * \widehat{propfee} * cwages$) and feed that, along with the 15% retained fee income, into the income-to-cost ratio for this second lockdown scenario:

$$\begin{aligned} & \text{Group-based '15\% fee' lockdown ICR} \\ &= \frac{ifund + iother + 0.15 * ifee + furlough}{((1 - \widehat{propfee} * cwages) + furlough + cnonstaff)} \end{aligned}$$

Note that, under these rules, any fee income that childcare providers did manage to retain during the lockdown is heavily offset by corresponding reductions in their ability to furlough staff.

Medium-term modelling

For our medium-term results in Chapter 5, we follow a very similar approach in calculating the income-to-cost ratio. In our central medium-term scenario, we assume that:

- income from fees falls by 15%, while income from other sources remains at the same level as the baseline;
- government support through the furlough scheme and SEISS has ended;
- providers do not adjust their costs (for example, by laying off staff, downsizing premises, or – for childminders – withdrawing less income from the business).

We use the same formula to calculate the income-to-cost ratio for childminders and group-based providers:

$$\begin{aligned} & \text{Medium term '15\% drop in fees' ICR} \\ &= \frac{ifund + iother + (0.85 * ifee)}{cwages + cnonstaff + cwithdraw} \end{aligned}$$

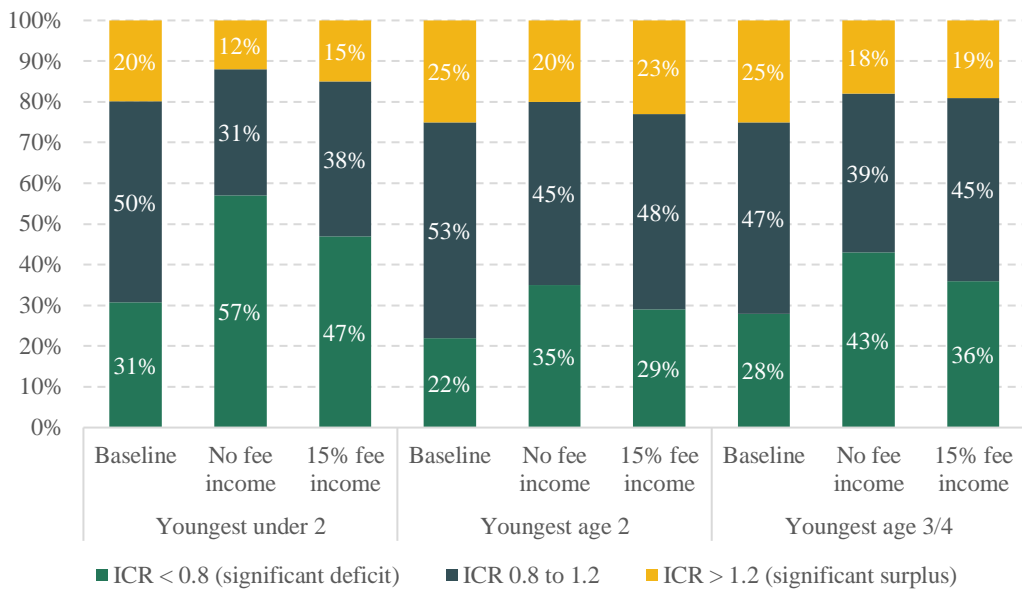
For the range of alternative scenarios where fee income falls by 5%, 10%, 20% and 25%, we adjust the 0.85 accordingly (to 1, which is the amount that fees are falling).

We also have a range of alternative scenarios where free entitlement funding also falls. In the cases where fee and funding income both fall by 15%, the income-to-cost ratio is:

$$\begin{aligned} & \text{Medium-term '15\% drop overall' ICR} \\ &= \frac{i_{other} + 0.85 * (i_{fund} + i_{fee})}{c_{wages} + c_{nonstaff} + c_{withdraw}} \end{aligned}$$

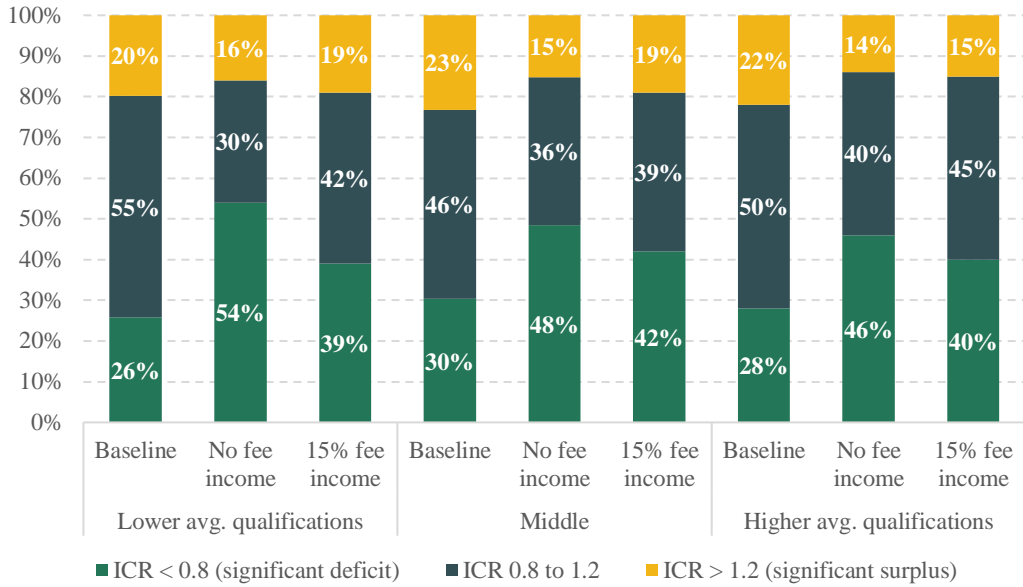
Appendix B: Additional results

Figure B.1. Provider income-to-cost ratios under lockdown scenarios, by youngest age group served



Note and Source: See Figure 4.1.

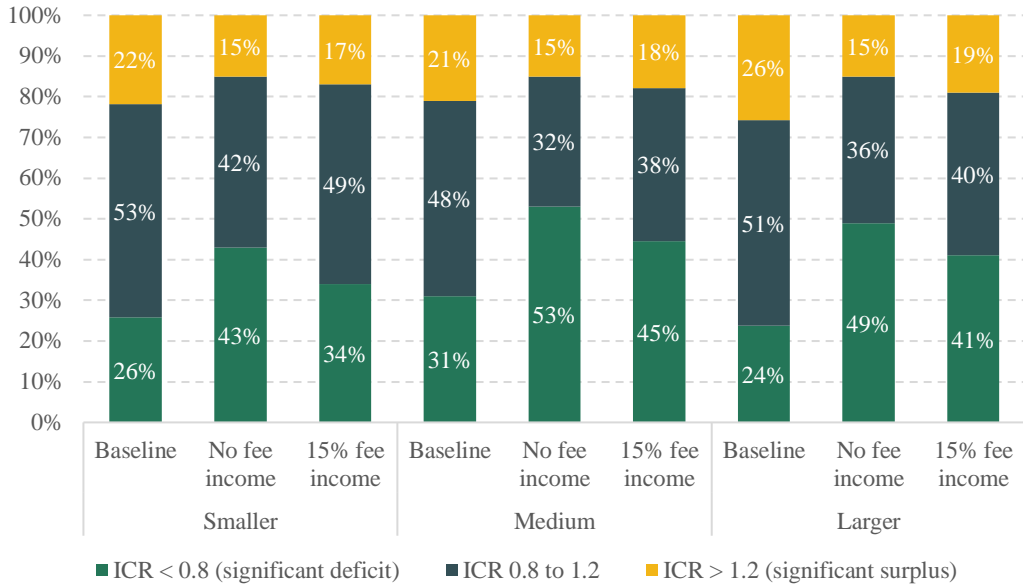
Figure B.2. Provider income-to-cost ratios under lockdown scenarios, by average staff qualification level



Note: 'Lower' qualifications are settings where average staff qualifications are below Level 3 National Vocational Qualifications. 'Middle' settings have an average between 3 and 3.5, and settings with 'Higher' qualifications have an average NVQ above 3.5. Other notes as in Figure 4.2.

Source: See Figure 4.1.

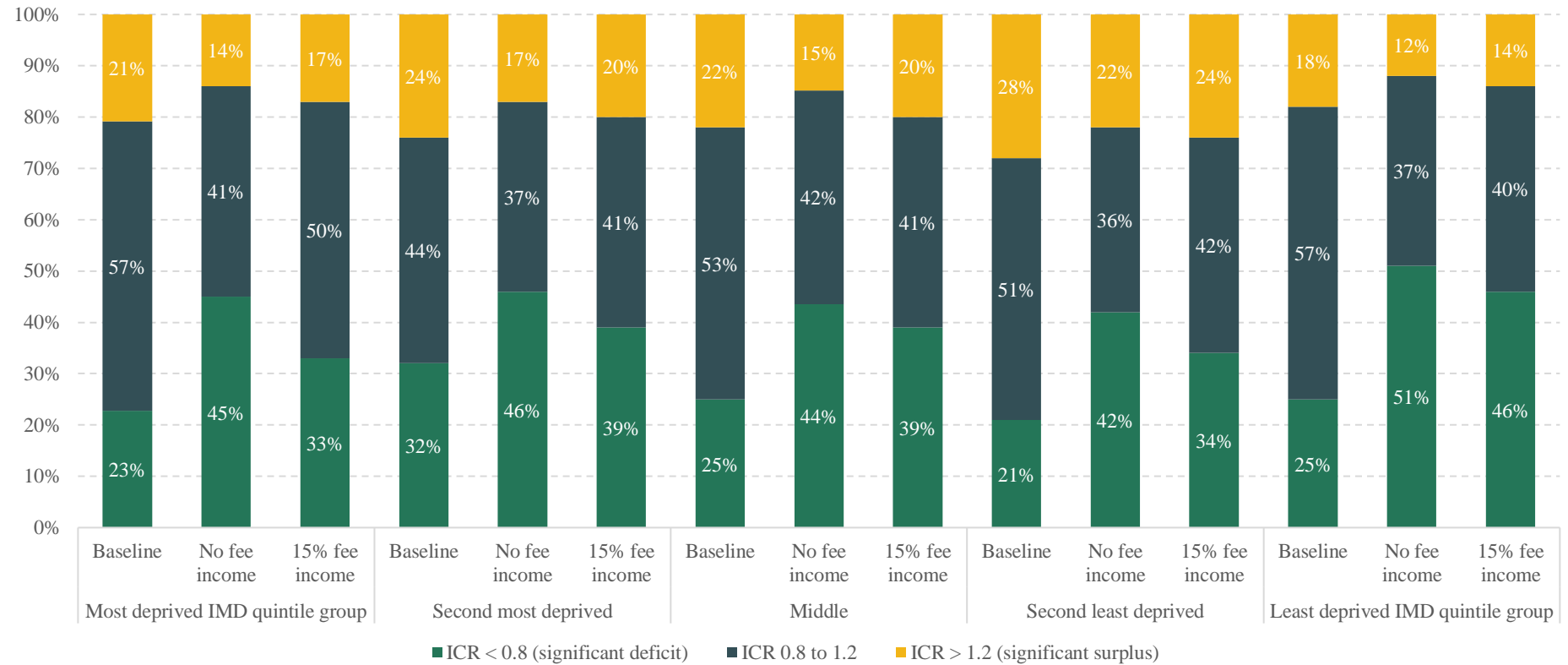
Figure B.3. Provider income-to-cost ratios under lockdown scenarios, by provider size



Note: For childminders, ‘smaller’ settings have fewer than six registered places; medium settings exactly six; and larger settings more than six registered places. For all other provider types, smaller settings have fewer than 30 registered places, larger settings more than 65 registered places, and medium settings between 30 and 65 registered places. Other notes as in Figure 4.2.

Source: See Figure 4.1.

Figure B.4. Provider income-to-cost ratios under lockdown scenarios, by Index of Multiple Deprivation level



Note and Source: See Figure 4.1.

Table B.1. Provider income-to-cost ratios under lockdown scenarios, by region

Panel A: Share of providers in significant deficit

	Baseline	Lockdown: no fee income	Lockdown: 15% fee income
East of England	31%	59%	49%
North West	31%	58%	48%
East Midlands	21%	47%	36%
West Midlands	24%	49%	45%
London	27%	49%	43%
Yorkshire and The Humber	26%	45%	35%
North East	30%	46%	33%
South East	30%	46%	34%
South West	33%	39%	37%

Panel B: Share of providers in significant surplus

	Baseline	Lockdown: no fee income	Lockdown: 15% fee income
East of England	11%	9%	9%
North West	19%	15%	17%
East Midlands	25%	20%	23%
West Midlands	25%	16%	20%
London	33%	21%	23%
Yorkshire and The Humber	15%	11%	14%
North East	19%	22%	22%
South East	23%	10%	12%
South West	19%	21%	25%

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