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An Analysis of Child Care Center Budgets

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Purpose of the Study

How does an industry that provides a service that costs more to produce than a majority of its high demand consumers can afford to pay survive? Factor in that current costs do not yet reflect adequate compensation or high quality, then consider a turnover rate of 40% or greater, and the problem goes from hard to believe to impossible to resolve. Despite "Bermuda triangle" financing practices, where money comes in, and child care comes out, but what happens in between is still, for the most part, unmapped territory, early care and education (ECE) is one of the largest industries in the state of Connecticut. With the help of innumerable in kind revenues, foregone wages, and countless off-the-clock hours, ECE is an industry that continues to expand and evolve attempting to meet continuously growing demands.

The purpose of this study was to explore, in brief, the elements that contribute to the cost of doing business in the ECE industry in Connecticut. The primary focus of this analysis is to cover the expense and revenue sides of a child care center program budget. The secondary focus is to investigate the act of program budgeting, such as methods used for fee setting and wage enhancement. The data collected suggests that the ECE industry does not function, in many ways, like a typical small business market does. Regulated by mandated staff to child ratios, the education level of their employees, and a highly mobile consumer base, child care center administrators find it difficult to run a business governed by the typical laws of supply and demand.

Rationale for the Study

It is clear now, more than ever, that the demands placed on children as well as the changes in our economy underscore the importance of recognizing that affordable, high quality child care is a critical support for children, for families, for employers, and for the future of our economy. And the need for these services is growing. In 2000, 79% of Connecticut children under the age of six lived with at least one working parent.

With the public school systems as the most recognized model of financing education for children, one might assume that most funding for early care and education services also comes from the government, but that is not correct. In 1990, 70-75% of the total national expenditure for child care was paid by consumers, most often parents, with the balance largely contributed by government resources. [1] Public support increased over the first half of the 1990s. By 1996 public funding for early care increased to 39% of total estimated child care expenditures, with parents picking up 60% and the private sector contributing 1%.[2]

The cost of child care represents a family's second largest expense, just behind housing costs. It can cost over $600 per month for just one child. The average price of child care in CT is about $8,000 per year. This is 60% of the yearly salary of a full-time minimum wage worker. Even for families earning an average self-sufficiency income in Connecticut of about $47,000/year, child care fees for one child can consume 25% to more than 40% of their annual gross income.

Knowing that the costs of funding the ECE industry fall primarily on parents, it is imperative that we understand what the true costs of providing quality early care and education services are, and how to most efficiently provide high quality child care without creating a cost prohibitive service that families most in need, namely low-income working parents, can not afford.

This investigation collected data to help begin to define the "typical" child care center budget, as well as describe budgeting practices, strategies, and methods used by administrators of ECE programs.

Various data on *revenues* and the *expenditures,* or costs of *center based care* for, children of all ages, was collected. It is informative, first, to distinguish between *expenditures* and the *full cost of providing care*. Expenditures comprise centers' actual outputs for one year. These are typically less than the full costs incurred for center care because most centers function with the help of resources at below-market rates, such as rent. Child care centers can also be subsidized in other ways, such as through the receipt of donated services, like maintenance, or through forgone wages, meaning the difference in the salaries of child care providers, compared to comparable degrees in other professions. Full costs include the true cost of these additional resources. According to data from the Cost, Quality and Child Outcomes in Child Care Centers Study[3], donations -- including goods, space, volunteer hours, and foregone wages of workers -- account for more than one-fourth the full cost of care. It is important to take full costs, as well as expenditures into consideration in order to understand the true cost of providing child care. Though not possible to analyze in a comprehensive way in this exploration, these additional inputs must be noted.

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[1] Cohen, Abby. A Brief History of Federal Financing for Child Care in the United States. In The Future of Children: Financing Child Care, 1996. Published by the David and Lucile Packard Foundation. Summer/Fall 1996. P. 26

[2] Groginsky et al, 2000.

[3] *Cost, Quality and Child Outcomes Study Team*. (1995). Public Report, second edition. Denver: Economics Department, University of Colorado at Denver.

The analyses described here are only step one in a much needed, much more complex evaluation of ECE budgeting practices. Ultimately, our goal is to engage in a budget analysis and learning process that will enable us to do the following:

1) Calculate the true cost of providing ECE;
2) Lead us to strategies of how to generate revenue and potentially reduce expenses;
3) Define guiding principles necessary for administrators of ECE programs to be well-informed about the financial status of their business;
4) Define how to communicate with various audiences about cost and other financial matters pertinent to ECE; and
5) Describe clearly the financial status of ECE operations to support educated policy proposals for improvement.

Methods of Data Collection

About one year ago, we began to address the need for data regarding child care center financing with a small survey to child care centers requesting information on their budgeting practices, and where they receive technical assistance regarding financing. Since these surveys, we have followed up with a brief analysis of child care center budgets. The results from both investigations, as well as recommendations for next steps, follow.

The ECE industry has several sectors: home-based and center-based programs, part-day school year programs (i.e., nursery schools) and full-day full-year programs (i.e., child care), nonprofit and for-profit programs, as well as secular and faith based. All sectors were sampled for each investigation.

Child Care Center Fee Survey Results

Licensed child care centers in Connecticut were surveyed and asked how they set their fees, if they thought their fees adequately cover the cost of providing care, and if they are satisfied with their fees. We received responses to our survey from 342 child care centers in the state and, generally, have learned that centers would like to improve their revenue, especially in order to provide higher wages to their employees, but do not do so because they know that the increase would need to be picked up by parents, and they believe that parents would be unable to afford increased rates. Results of our survey follow:

How do you set your fees?

A majority of providers (63%) report setting their fees according to a budget. Many centers, however, are not using a budget but rather set their fees according to what they think they can collect. Many providers consult with other centers (43%), and some (29%) base fees on their parents' ability to pay or on the combination of different revenue sources they receive (21%). It appears that, even when trying to adhere to a budget, other factors that preclude budgetary demands must also be taken into account when setting fees.

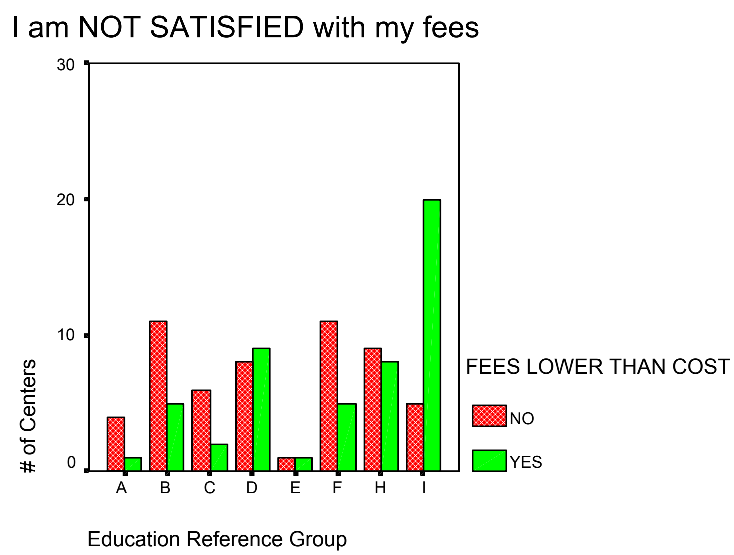
Are your fees lower than your actual costs?

It is understood, regardless, that basing fees on a budget is an appropriate way to set fees so that fees are not lower than costs, creating a deficit. Indeed, this survey found that of providers that do use a budget, only 25% report that their fees are lower than their costs. In contrast, 55% of the centers that do not use a budget report that their fees are lower than their costs.

Are you satisfied with your fees?

There were significant differences in reported satisfaction based on the ages of the children being served. It is clear from this survey that serving infants and toddlers is not financially beneficial to child care centers. For centers that do not serve infants and toddlers, the majority (73%) report they are satisfied with their fees, and 27% report they are not. Centers serving infants are fairly evenly split on satisfaction; about 55% report they are satisfied with their fees, and about 45% report they are not. The high cost of serving infants and toddlers appears to be a financial burden to centers.

Finally, when examining responses by Education Reference Group, important and striking differences emerge in the satisfaction with and adequacy of fees. The State Department of Education developed Education Reference Groups (ERGs) to group together school districts similar in socioeconomic status, indicators of need, and enrollment. First, in all ERGs significantly more providers reported being satisfied with their fees than dissatisfied, except in ERG I. ERG I is composed of Bridgeport, Hartford, New Britain, New Haven, New London, Waterbury, and Windham. In this ERG, responses were somewhat evenly split, with 54% of centers stating that they are not satisfied with their fees, and 46% stating that they are satisfied with their fees.



Also, of the centers in all ERGs who report dissatisfaction with their fees, most centers state that fees are still not lower than costs. Vast differences emerged in this measure, however, between ERG's A and B and ERG I, as illustrated here. In ERGs A and B, few centers (20%-30%) report that their fees are lower than costs; most centers (70%-80%) report that fees are not lower than costs. In ERG I the complete opposite is true. In ERG I, 80% of centers who state they are not satisfied with their fees report that their fees are lower than costs; only 20% report that their fees are not lower than costs. Centers in the largest poorest cities appear far less able to charge the "true cost" of providing quality child care in their city.

Conclusions

The results of this survey suggest that centers serving infants and toddlers, and those in Connecticut's largest and poorest cities are greatly challenged by the inadequacy of revenues from fees. Important to note is that many providers, even among those that report a satisfaction with fees, indicate that if fees were higher, they would choose to spend more on wages and other quality enhancements. In addition, many providers comment that in kind donations, volunteers and free rent often supplement low fees. It also is clear that budgeting helps and that centers may benefit from technical assistance in setting and following a budget. Responses to this survey do support the proposition that providers do not charge the true cost of care because they believe it would be unaffordable to parents.

"Program Budget" Case Study

For the primary purpose of the study, that being to investigate the expense and revenue sides, a "program budget" analysis was undertaken. Though a cross section from all sectors was sampled, responses for this part of the study were received only from the non-profit community. This prohibited any between sector analyses, and such investigations will be suggested in recommendations and next steps. Seven non profit program budgets were analyzed as "case studies". Aggregate data was used to begin to do some within-sector analyses.

An ad hoc committee of child care center directors was convened to identify key issues to be addressed and the appropriate questions to ask. Following recommendations from the committee, descriptive data on center *revenues* and the *expenditures,* or costs of *center care* for children of all ages was collected. These data describe general center characteristics, enrollment, staffing, sources of income, and expenditures. The data come from information collected from center directors and from examining the child care centers' budgets. The findings are based on 7 non-profit, accredited centers in the Greater New Haven area.

Revenues and expenditures were grouped in the following categories[4]:

Revenues were classified as:

- Parent fees
- State subsidies: Care4Kids, School Readiness, food subsidy
- Sponsoring organization contributions
- Fundraising and foundation grants

Expenditures were classified as:

- Labor: wages, fringe benefits and payroll taxes
- Occupancy: rent or mortgage and cleaning costs
- Professional Development

Revenues

Average *total revenues* per hour of care:

- Ranged from $182 - $497 for all centers; $233 being the median.
- Neither the number of children served, nor the time the center is open have any effect:

[4] The methodology was adapted from: Wellesley Centers for Women. (2001). *The Massachusetts Cost and Quality Study.*

- The center averaging the least per hour of care served half as many kids as the center averaging the most; the opposite would be expected.
- Both the center averaging the least per hour of care and most per hour of care was open 35-50 hours per week for 45-50 weeks per year; centers open for less time also fell within this range.

Average *revenue from parent fees* per hour of care:

- Ranged from $54 - $248 for all centers; $88 being the median.
- Neither the age of the children served nor the time the center is open have any effect:
  - Both the center averaging the least in parent fees per hour of care and the center averaging the most in parent fees per hour of care served about 60 preschoolers for about 50 hours per week for 50 weeks per year.
  - Centers serving infants/toddlers and school-age children, as well as centers open for less than full time, fell within this range.

State subsidies:

- State subsidies contributed between 4% and 54% of total revenues. For most centers, total state subsidies either contributed an extremely low proportion (4% - 9%) or a relatively high proportion (45% - 54%) of revenues.
- School Readiness Grants provided between 3% and 47% of total revenues; 25% being the median.
  - The number of preschoolers did not affect this proportion, as both the center with the least percent contribution from SR grants and the center with the greatest percent contribution from SR grants both served only preschoolers, and both served more preschoolers than all other centers.
- Care 4 Kids child care subsidies provided between less than 1% and 21% of total revenues; 17% being the median.
  - There does not appear to be a correlation between revenues from the child care subsidy and SR grant subsidies; in fact, the center receiving the greatest percent of revenue from the SR grant received the least from the child care subsidy.

Expenditures

Average *total expenditures* per hour of care

- Ranged from $151 - $302 for all centers; $214 being the median.
  - Revenues per hour were correlated with expenditures per hour, as expected.

Average *labor* expenditures:

- Total labor costs ranged from 63% to 94% of total expenditures; average at 81%.
- Wages ranged from 55% to 84% of total revenues; average at 75%.
- Benefits almost unanimously accounted for between 3% and 5% of expenditures, regardless of the benefits provided.

    - One center reported spending 27% of total expenditures on benefits. This center had a relatively low percent spending on wages, apparently accounted for by expenditures in benefits.
- Professional Development: about half of centers surveyed budget in professional development costs, at less than 1% of total costs; others consider it to be a bonus when funds are available

Average *occupancy* expenditures*:*
- Most common subsidy found was in occupancy costs.
- Rent or mortgage costs ranged from 4% to 21%.

Full Costs
The annual expenditures described do not cover the full cost of operating a child care center. Other studies have found that factoring in the in-kind donations that centers receive raises the average cost of care by about 21%.[5]

Conclusions
While the majority of the literature on the cost of child care reports that the bulk of centers' revenues are from parent fees, with subsidies providing the second highest input, in this sample there was a fairly equal split between centers reporting parent fees as the greatest source of revenues, centers reporting subsidies as the greatest source of revenues, and centers reporting an equal contribution from parent fees and subsidies. The size of the sample prohibits us from assuming that this distribution is reflective of the state, on average. However, it does tell us that there are parents that can, and do, afford to pay the majority of the bill for the financing of their child's care; but there are also centers that, unable to rely on parent fees, have been aggressive about drawing from state subsidies.

The highest expenditure, by far, was labor, with little effect from the provision of benefits. Though not possible to examine in this sample, administrative costs and the salary of the director may have a significant impact on overall labor costs, as well as the ability to spend remaining funds on other program expenses.

Occupancy costs were difficult to compare across centers because some centers include "in kind" donations of rent as an income, while others consider rent as an "in kind contribution" not accounted for in the budget.

[5] Nancy L. Marshall, Cindy L. Creps, Nancy R. Burstein, Frederic B. Glantz, Wendy Wagner Robeson, Steve Barness. 2001. *The Cost and Quality of Full Day, Year-round Early Care and education in Massachusetts: Preschool Classrooms*. Wellesley Centers for Women and Abt Associates Inc.

Summary and Recommendations

This investigation began by proposing that financing an ECE center is an unsolvable equation: a venture with all the difficulties of a small business in a market that does not follow conventional rules, yet, on average, overcomes all odds of failure, surviving on the backs of an elastic workforce.

The data collected supports the proposition that the ECE industry does not function, in many ways, like a typical small business market does. However, strategies for increased revenues and more efficient spending of existing revenues did emerge.

Increasing Revenues

ECE is unlike most other markets in that a higher quality product does not, necessarily, ensure higher revenues. According to the Cost, Quality and Child Outcomes Study, while high quality care costs more to provide, there was little difference in parent fees at centers providing high or low quality care. In addition, although parents report that they value good quality care, they substantially overestimate the quality of care their children are receiving. This lack of consumer knowledge and the fact that there is little difference in fees at centers providing high or low quality care suggest that there is little financial incentive for centers to improve quality, and quality improvement is not the direct path to higher revenues, as is true in most other industries.

As such, how does a center, attempting to function like a business, increase revenues? The present analyses suggest the following options be investigated: maximization of state subsidies and sliding fee scales.

Maximization of state subsidies. With very few sources of revenue, and with the two greatest sources being parent fees, followed by state subsidies, it seems obvious that the best target for increasing revenues is a maximization of possible inputs from state subsidies. However, the data collected does not suggest that those centers with the greater input from state subsidies have neither lower parent fees, nor greater per child expenditures.

Sliding fee scales. Responses to the fee survey support the proposition that providers are not charging the true cost of care because they believe it would be unaffordable to most parents. Centers defining parent fees according to a sliding fee scale appear to have more parent revenues than those with set fees, and yet are still able to provide School Readiness spaces and serve child care subsidy eligible families.

From a policy perspective, encouraging the use of sliding fee scales may bring us closer to an accurate definition of the true cost of care, when setting reimbursement rates based on the “price” of care in a region. Department of Social Services regulations require Child Care Assistance Program (Care 4 Kids) reimbursement rates to be set at the 75^{th} percentile market level. This does not mean that reimbursements are equal to 75% of the mean cost of care. This means that rates are set so that parents receiving the subsidies will be able to afford 75% of the available child care spaces with the help of the reimbursement. In order to determine these reimbursement rates, a market rate survey is conducted, asking all licensed providers what they charge for care. DSS then assures that, with the subsidy, parents will be able to afford 75% of the care in their area.

The flaw in this methodology is that child care fees are depressed. Providers are unable to charge the true cost of care, because they believe it would be unaffordable for most of those using the service. As such, basing reimbursement rates on the "price" charged for care rather than the "true cost" of care to providers may be contributing to a cycle of suppressed fees, and resulting inadequate reimbursement rates. However, if parent fees were based on a sliding scale, more accurately reflecting the true cost, rather than price of care, this could begin to abort the cycle of depressed fees.

Efficient Spending

Labor. Child care is a labor intensive industry, with wages, benefits, and related expenses accounting for 80% or more of expenditures for most centers. In this sample, wages were consistently the greatest contributor to labor costs, and yet, compensation is nowhere near adequate, nor competitive relative to wages in comparable fields. Findings from the fee survey tell us that many providers, even among those that report a satisfaction with fees, indicate that if fees were higher, more would be spent on wages and other quality enhancements. Labor costs incurred for administrative functions varied, and as such, may be a place for targeted education on more efficient spending. The uniform spending of about 4% on benefits, despite variability in what benefits are being offered, suggests that some technical assistance around what options can most economically benefit a center may be useful.

Reduced turnover. Though not an objectively measured "expenditure" in this analysis, there are many costs of turnover. Some costs include loss of director's productivity, low staff morale, and interruption in program initiatives. Monetary costs tied to turnover include the fees related to a new hire, director's time, support staff time, and new program staff time, and have been estimated to total $1,451.75 to replace one ECE employee.[6] The ability to invest in labor and professional development in the present may be an added expense that can save in the long term.

Recommendations for Next Steps

Ultimately, the long term goal of this, and subsequent analyses of child care center financing, was defines as:

1) Calculate the true cost of providing ECE;
2) Lead us to strategies of how to generate revenue and potentially reduce expenses;
3) Define guiding principles necessary for administrators of ECE programs to be well-informed about the financial status of their business;
4) Define how to communicate with various audiences about cost and other financial matters pertinent to ECE; and
5) Describe clearly the financial status of ECE operations to support educated policy proposals for improvement.

[6] Taylor, B. (1998). *The true cost of staff turnover*. National School Age Child Care Alliance News.

True cost of care. Findings about the economic environment of running an ECE business, from The Cost, Quality and Child Outcomes in Child Care Centers Study suggest that characteristics of the market -- competition and subsidy dependence -- affect center finances, with for-profit and nonprofit centers facing different competitive conditions that affect their performance. As such, a broader sample more representative of the industry, would contribute greater knowledge to the differences of funding the variety of existing classifications of centers.

State funding process. Further investigations into the process and timing of state sources of income may contribute to less spending on administrative functions and more efficient influx of resources. Two highly reputable centers reported a temporary loss of accreditation due to the arduous process and paperwork necessary to maintain this status. First, the difficulties represented by the accreditation process exemplify problems related to the multi-step processes true to obtaining all state ECE funding, such as the SR grants or the child care subsidy program. Second, if, in the future, reimbursements for School Readiness funds or other state subsidies are to be based on accreditation status, then this process must be made more fluid.

Learning seminar. One defined goal of this, and future subsequent analyses of Connecticut ECE program budgets is to lead us to strategies of how to generate revenue and potentially reduce expenses. It is recommended that the ECE provider and policy community conduct a learning seminar, to share their problems and solutions that make financing centers more or less difficult. An introduction to budgeting for small business would also be an integral component, as it is clear from the fee survey that budgeting helps and that centers may benefit from technical assistance in setting and following a budget. Such a forum would also contribute to the goals of defining guiding principles necessary for administrators of ECE programs to be well-informed about the financial status of their business; defining how to communicate with various audiences about cost and other financial matters pertinent to ECE; and describing clearly the financial status of ECE operations to support educated policy proposals for improvement.

Invited to the learning seminar would be representatives from the child care industry, as well as informed consumers of the industry, namely parents. Included should also be financial analysts, executives from small business. Also useful would be representatives from other similar small service industries with both large labor costs, such as health care, cleaning services or home visiting nurses, as well as with high turnover, such as the fast food industry.

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