# Early Years – BUSINESS RESOURCE TOOLKIT
# ASSESSING THE SUSTAINABILITY POSITION OF A SETTING
# WHERE TO START!

## 1. Is the Setting Breaking-Even at the moment?

Firstly, you need to ascertain if from its ordinary trading the Setting is breaking-even, making surpluses or making losses. To do this you need to carry out a 'Break-Even exercise'.

- The childcare business should make a list of all Estimated Costs that will come in during a whole year of operating:
    - Remember to multiply weekly, monthly and quarterly costs into their annual equivalent, and also add on any one-off annual costs
    - Previous Annual Accounts can be used as a starting point and for comparison as a 'reality check', providing there has been no significant variation in occupancy, staff costs and operating expenses since the time they were prepared
    - Allow for inflation and likely wages, prices & fee increases
    - Include something for routine replacements and maintenance, and cover for sickness.
- Leave out of the calculations all significant 'one-off' Payments (e.g. *major* equipment purchases and premises refurbishments). Likewise leave out any 'one-off' Grant Income.
- Deduct any Revenue Grant or other subsidies the Setting will receive specifically to support routine Operating Expenses.
- Divide the resulting 'Total Estimated Annual Costs' by the number of weeks in the year the Setting will actually be trading - this gives you the 'Average Weekly Cost' for running it.
- If the Setting operates more than one type or pattern of childcare (e.g. an after school *and* a holiday club) it's best to calculate them separately, to make sure each one covers its own costs from an appropriate fee rate. Where costs can't easily be separated between the operations (e.g. rent) they should be split in suitable proportions.

| Table 1 | Annual Cost |
|---|---|
| Staff Pay and On Costs | £ |
| Premises Costs (Rent, Mortgage, etc.) | £ |
| Finance Costs (Loans, Repayments) | £ |
| Operating Expenses | £ |
| **Sub Total** | **£** |
| ***Deduct*:** Revenue Grants & Subsidies Receivable (if any) | -£ |
| **Total Estimated Annual Costs** | **£** |
| ***Divide by .....*** Trading Weeks, to give **Average Weekly Costs** | **£** |
| | |

You can now use this 'Average Weekly Costs' figure and the Setting's Register to find out whether current fee levels are enabling the Setting to break-even, make a surplus or are causing a shortfall:

**Average Weekly Costs ÷ No. of Weekly Hours/Sessions typically / actually Sold = Break-Even Cost Per Hour/Per Session**

**Question:**

**Do the Hourly Fees (or Session Fees) *presently* being charged to Parents actually cover that "Break-Even Cost per Hour or Session"?**

- **If they don't cover it**, the Setting is already loss-making and becoming unsustainable. If this isn't reversed then going out of business is usually only a matter of ***"when", not "if".***

- **If they "just about" cover it,** then the Setting is only "just about" breaking-even. It may not actually be losing money at the moment - ***but as soon as any problems arise it will be facing sustainability challenges straight away!***

- **Ideally the Fees should be covering it *plus a margin*** – that margin is then the 'surplus' or 'profit' which allows the Setting to build-up reserves to cover any future problems and save-up for replacement equipment and new projects. How big that margin should be is a matter for business judgement – but bearing in mind these sums are mostly only estimates to start with, anything less than 10% isn't leaving much allowance for chance!

## 2. Working-out the Impact of Changes

You will then need to **assess the impact of any proposed changes to income or expenditure**. These could be anything that will clearly have a significant impact upon some of the Setting's income or costs - just for instance, things like: changing premises, expanding or reducing the number of places, taking-on or laying-off Staff, etc. - to see what impact they have on the Setting's position of surplus, shortfall or break-even.

**In this example it is assumed you want to look at the impact of a proposed 5% pay increase, but the wording in the Table can be changed to suit other circumstances.**

Into Table 2 below insert figures as follows:

- **Line A** - what the Staff Costs are now (as in Table 1 above) as our starting point

- **Line B** - amount of the proposed Staff Costs increase – remember, Staff Costs are not just the wages but also the Employer's National Insurance and (where applicable) any Pension Contributions as well. (For simplicity, you could assume these costs go up proportionate to the pay rise increase – for example, by 5%. This isn't always strictly correct, but will usually be 'near enough'. Don't forget Holiday Pay, where applicable).

- **Line D** - what the **current surplus, shortfall or breakeven position** is expected to be for the year/month (this figure should either be known from the Provider's current business forecasts, or else it can be worked out by calculating the expected Fee Income for the year and then deducting from it the 'Total Annual Costs' figure in Table 1)

From this you can work-out on **Line C** what 'Future Staff Costs' will be (i.e. the total of 'Now' [Line A] plus 'Future Increase' [Line B]. And from this in turn you can work out the impact on your surplus, shortfall or break-even position for the future, if you implement these proposals and nothing else is changed **(Line E):**

| | Table 2 | Monthly Average | Annual Average |
|---|---|---|---|
| A | Staff Costs **Now** | £ | £ |
| B | Proposed Increase in Staff Costs (i.e. 5% of A) **Future** | £ | £ |
| C | Staff Costs **Future** (A + B) | £ | £ |
| D | Estimated Surplus (+) or Shortfall (-) **Now** | £ | £ |
| E | Estimated Surplus (+) or Shortfall (-) **Future** (D – B) | £ | £ |

## 3. Ensuring Future Sustainability

To ensure these ***future costs*** are sustainable to the Setting you can now revise the earlier table with the revised, increased costs:

| Table 3 | Annual Cost |
|---|---|
| Staff Pay and On Costs *(as increased)* | £ |
| Premises Costs (Rent, Mortgage, etc.) | £ |
| Finance Costs (Loans, Repayments) | £ |
| Operating Expenses | £ |
| **Sub Total** | **£** |
| ***Deduct:*** Revenue Grants Receivable (if any) | **-**£ |
| **Total Estimated Annual Costs** | **£** |
| ***Divide by ….*** Trading Weeks to give **Average Weekly Costs** | **£** |

Revisit the Break-Even cost (not forgetting also to amend the 'Hours/Sessions Sold' figure, ***if*** the proposed changes to the Setting will affect how much childcare will be sold):

**Average Weekly Costs ÷ No. of Weekly Hours/Sessions typically actually Sold = Break-Even Cost Per Hour/Per Session**

. . . and then, if needs be, the Provider can revise the Fees that actually need to be charged to Parents, to meet that Break-Even Cost ***plus*** a margin.

## 4. What To Do if the Setting Appears Unsustainable?

If current fee income doesn't cover current costs, basically there are only two things that **can** be done:

- Increase Income
- Reduce Costs

. . . or a combination of both.

A Setting cannot ultimately help the Community it serves by being *so very* "affordable" it's actually "unsustainable" and has to cease operating.

Because the major factor in any Setting's costs is always **Staffing** (typically between 70 – 85% of total costs), this is an area that should be given very close scrutiny. And having 2 or 3 employees running a Holiday Club at Half-Terms when only 3 or 4 children are booked-in for most days is only affordable as a "service to working parents" if the Setting is financially strong – if it's weak, this sort of thing can be disastrous.

Do you actually ***need*** all the staff you have (subject to Ratios), for the child numbers you have and especially for the quieter times of day? **It is preferable to try and increase Occupancy first – but if that fails, there may be no realistic alternative but to reduce staff hours or numbers.** This is always a most difficult and emotive process, but it is also full of legal pitfalls and Settings should always be advised to seek professional guidance (e.g. from ACAS or your legal representatives etc.,).

Once it has been decided what steps to take to restore Sustainability, the impact upon the finances has to be worked out and then the figures need re-calculating as above to see whether they have the desired effect. Hopefully the Setting will now be sustainable - or the owners and management may decide it's not cost-effective and sustainable to implement the changes under consideration - or the Setting may even need to consider whether it has a future at all.

If significant changes are made to the current budget, a revised forecast should be calculated for the rest of the year, and monitored closely.

If a Setting feels somewhat de-motivated and cannot see how to become sustainable, it can often be an 'eye-opener' to work-out how much income they **could** generate each week, if they were full:

| **No. of Registered Places** | **X** | **No. of Hours/Sessions *Offered* per Week** | **X** | **Fee per Hour/Session** | **=** | **Potential Income if Full** |
|---|---|---|---|---|---|---|

Of course, in the 'real world' no Setting is ever 100% full, 100% of the time - but even 80% Occupancy is usually a very profitable figure, and many manage to 'get by' without undue pressure on 60%. Somehow, ways have to be found to get there!

**And of course, once the Total Costs have been covered by the Income, any additional Income that comes in over and above that is *almost pure 'surplus' or 'profit'* – you have *already* covered your Costs and *are* sustainable ... because you have beaten Break-Even.**