Executive Summary

Services for looked after children and those with special education needs are registered, operated and regulated based on national statute. It is wholly appropriate that our central government maintains a clear focus on the needs of these cohorts and acts to improve their futures.

Much of the execution of national statute, guidance and standards is delegated to local authorities and regulators. The funding of the activities almost exclusively follows this delegation.

It is therefore both necessary and understandable that policy and procedures in this public sector driven domain are usually considered from that national or local authority perspective.

The following chapter accesses and discusses an alternative perspective. The evidence base used is from the very organization's that ultimately deliver the services directly to the children and young people.

The source of information is one of the few independently audited sources in the sector, and was first studied by the Commissioning Support Programme in 2009/2010.

The study identifies that there is one sector that appears at greatest risk from exposure to volatile public sector demand, and yet it is also the sector that tends to be looking after the most vulnerable, complex and challenging members of the cohort. The Children's Homes sector is clearly more vulnerable than the parallel segments of Fostering or Residential Special schools, and appears to move from one crisis to another, rarely attaining periods of stability. Children's Homes are also the subject of particular central government focus at the moment, with a particular focus on geographical factors.

This chapter suggests that significant changes need to be made in the way that Children's Homes services are commissioned. The goal is to create a sector where longer term investment, sustained operating excellence, and fostering of know how and innovation are encouraged.

Introduction

There are many and varied views and opinions of the Children's Homes sector; the breadth of the differences in perspectives being rooted in the complexity of the needs of the children and young people being met. Caution must therefore always be applied when describing any aspects of the sector on a generalized basis, as there are often many singular examples that potentially disprove generalizations.

This complexity also creates a challenge for policy makers in that data and evidence about Children's Homes and their utilization can be scarce, fragmented, incomplete and inconsistent. Central government statisticians charged with collection of performance indicators about Children's Homes, and about outcomes being experienced in and by those homes have also experienced the challenges of limited datasets.

There is however one parameter that consistently acts as a significant influence on the sector. Money: be it the totality of national spending on Children's Homes, the amount allocated by local authority budgets, or the weekly cost of a Children's Home service purchased from a provider organization; money occupies a central place in the ongoing story of Children's Homes.

The exactness of measuring financial impact in an environment where other measures can be more difficult to access brings a risk that the financial aspect can assume an overly dominant role in decision making. However, used intelligently, the exactness, consistency and reliability of financial measurements also offer decision makers an insight where less reliable forms of evidence simply muddy the waters.

This study goes to a source of independently audited financial information to examine what value it may have to policy makers, commissioners and commentators on the Children's Homes sector.

Background

The reason that this analysis is possible is a corollary of the entry of private sector interests into the provider sector. Many Children's Homes companies have the operation of Children's homes as their sole or dominant interest. Hence when one of these private companies reports its financial results it gives us a snapshot view of some aspects of its performance. For Children's Homes owned and operated by local authorities similar visibility is usually unavailable, and certainly not required by statute as it is for private sector companies.

The years covered in this study are set against a macro-market trend of decline in overall use of Children's Homes in the last decade.

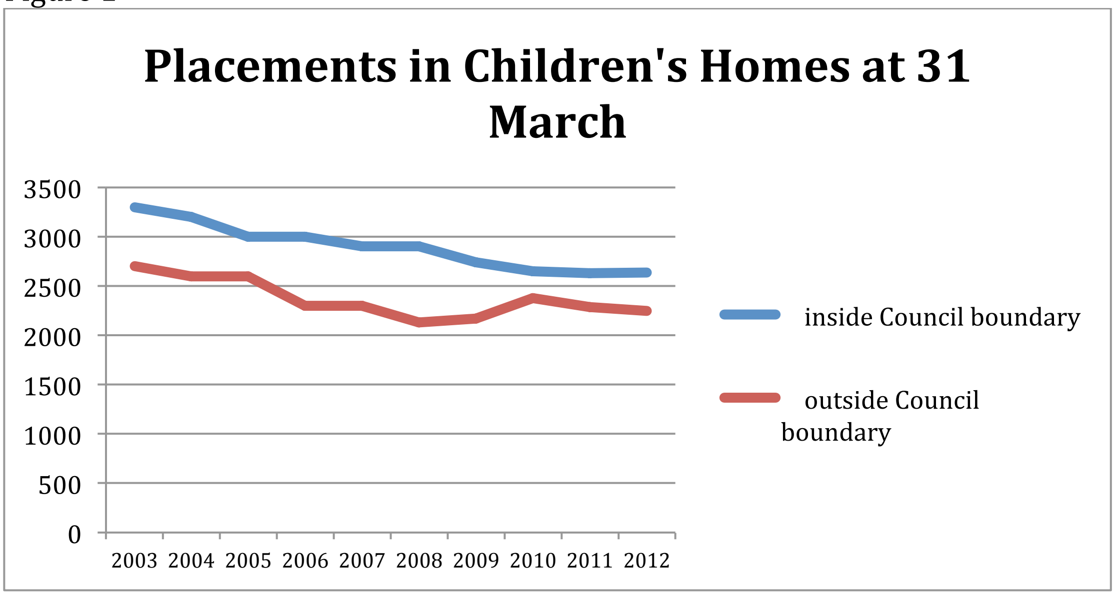
Figure 1 illustrates this decline.

In the 10 years from 2003 to 2012 use of Children's Homes has reduced by 18.5%.

Use of homes outside of a Council's own boundary is the sub-sector dominated by private sector provision, although private sector interests will also present in the inside Council boundary sub-sector.

A declining market would typically offer significant commercial challenges to the private sector providers. It is therefore not surprising that there have been several corporate failures during the last decade with administrators appointed at more than one large provider.

Figure 1



Source: DfE statistics:Children looked after at 31 March

Information Source

Private Limited liability companies registered in the UK are mandated to comply with the Companies Acts. Company Law requires the financial results of a company to be prepared by the company and for those results to be filed within set timescales at Companies House where they become public record and available for scrutiny. Registered Charities have parallel statutory accounting and reporting requirements and those accounts can also be accessed via Companies House. With most organizations filing accounts up to 9 months after the end of the relevant accounting year it is important to note that information accessed at Companies House is always historic in nature.

The information presented and disclosed in the accounts of companies and charities is similar and largely defined in statute and through accounting and disclosure standards from the accountancy profession.

In addition, the larger organizations must arrange an independent audit of their accounts before they are filed at Companies House.
The combination of this application of accounting standards, and an independent audit of results renders the information that can be accessed amongst the most reliable available to the sector.

Small and medium sized companies (for example those with less than £6.5m of turnover are likely to be classified as medium sized) are granted an exemption from some of the more detailed reporting and auditing requirements. As the majority of children's services providers in the private sector are relatively small organizations, the full accounts for those smaller providers are not publicly available.

This study has therefore concentrated on the larger scale service provider organizations who file full, audited accounts. Care must however be taken before extrapolation of the results of the sample analysed to the whole sector. However, being the larger providers they of course represent significant proportions of the whole picture.

From accessible data to information

Accessing independently audited accounts of companies at Companies house is akin to the collection of raw data. Further analysis is required allied to some professional accounting knowledge and sector specific know how.

It is not the intent to labour this point here but Figure 2 lists the considerations that must be given in converting the raw account data into potentially useful information:

Figure 2

- Which companies operate mainly in the sector to be analysed?
  Note that some trading names are not the same as the names of the companies themselves.

- If the operating company is part of a larger group of companies, how, and at what level in the group structure are the accounts accessed?
  Note that some companies have ultimate parent ownership outside of the UK and the whole group picture may not be available.

- Some companies and groups include more, or less, of their full economic picture in the accounts than others.
  A typical example is that properties used by the operating business may be owned outside of the operating business that then pays a rental for the property that can affect the profit levels shown in the operating company.

- If group accounts are accessed, has the group made acquisitions or disposals during the year of the report?
  Part year impacts of businesses bought and sold can dramatically change the trajectory of a set of accounts compared to earlier periods.

- In the group accounts setting, how are corporate level costs allocated, if at all, to the operating company level?

- Charity accounting standards and disclosure rules have some differences from Company accounting standards and rules.

- Full accounts of small and medium sized provider organizations are not available at Companies House and currently can only be accessed via voluntary disclosure by those organizations.

- The challenges raised by such issues cannot always be overcome. However it is still possible to use the data so long as rigorous care is taken to work with any data shortcomings.
  Data that may deficient in some element may still offer analytical value if it is at least consistently prepared in the same way over a number of periods. The trend may still have utility.

- These same issues apply when credit checking is performed on an organization. Great care is needed in considering the financial sustainability of key trading partners. The credit rating of an operating subsidiary that has the direct contract with its customer local authority may not be of any use whatsoever.

Two key measures

This report primarily focuses on two of the more straightforward measures from the plethora of indicators that are available.

Again, it is not the intent here to enter into a detailed technical discussion of the measures, but it is useful to have a clear understanding about what the measures represent in this particular context.

1. Turnover.

   Typically this is the aggregated annual amount that a provider organization has invoiced for its services, primarily to local authority customers. It is unfailingly found at the top of profit and loss account statements in the statutory accounts.

   It represents the first indicator of the scale and size of the organization, and comparison of successive periods in time indicates growth, contraction and volatility over a period.

   It is also important to consider that turnover is influenced by an agglomeration of factors. Those factors include: the volume of activities performed, the price charged for those activities, the mix of different activities, activities acquired or disposed of during a period of reporting.

2. EBITDA.

   Technically this is a measure of profitability = Earnings before interest, tax, depreciation and amortization.

   It is a much-used measure that has to be derived and calculated from information available in statutory accounts.

   EBITDA is the measure of profitability (or loss) that has eliminated the major non-operational factors from it. So for example, the funding structure of the business, it's corporation tax position and the technicalities of accounting for charges related to the tangible and intangible assets of the business are all removed from this profit measure. Eliminating those factors aims to produce an EBITDA measure that gives an indication as to whether the core activity of the business or charity is producing a return over and above the cost of the service, and the scale of that return.

   Businesses that cannot produce regular profits would be unlikely to be sustainable in the longer term.

   Short term losses can occur for many reasons and can be tolerated for example if they occur as a result of investment for future (profitable) growth and if the owners and funders of the business support the longer term plan.

Benchmark comparisons

Although the analysis that follows has a focus on Children's Homes organizations the context is enhanced by the ability to compare the sector alongside two parallel sectors of children's care, Fostering and Residential Special Schools.

These three sectors are in fact not strictly discreet and separate from one another. Children and young people do move between the services of all three. However, whilst there are many similarities, the models of service offering, and the regulation of each of the three sectors are different.

Finally, whilst there is clear evidence of a growing group of provider organization's that now straddle multiple sectors, many of the largest providers remain concentrated in one sector to a degree that ensures their accounts are dominated by the performance in just one sector.

Results (1): Turnover trends.

Figures 3,4 and 5 show the trend in turnover of four of the largest providers in each of the three service segments.

Figure 3

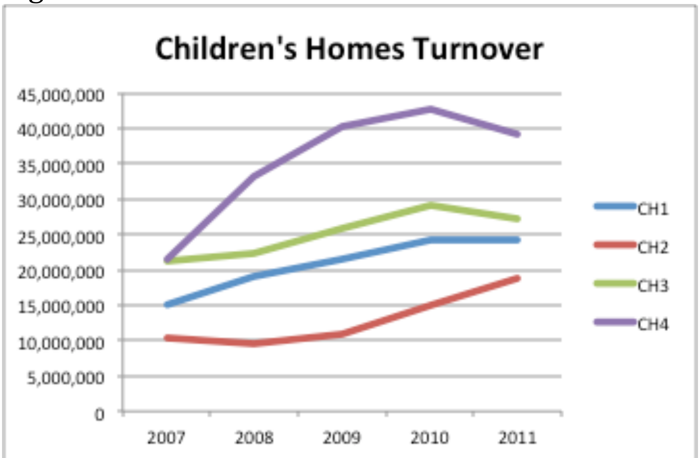


Figure 4

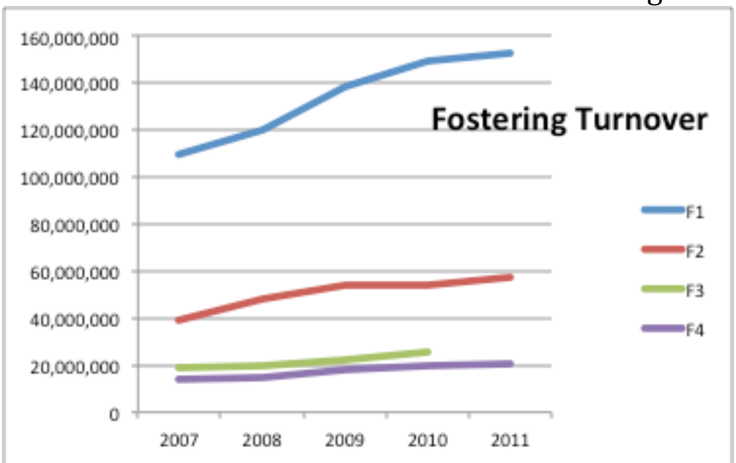
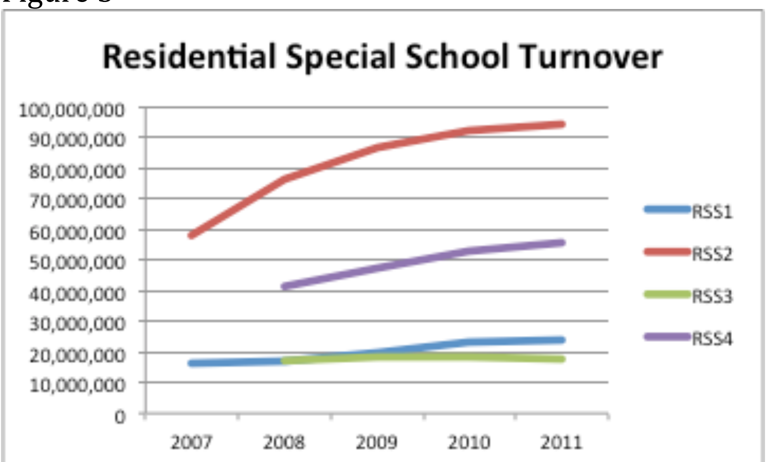


Figure 5



Source: Revolution Consulting. Data extracted from statutory accounts accessed at Companies House Spring 2013.

Explanations (1)

- Turnover is plotted on an annualized basis. Where accounts of the provider are made up to 31 December this provides an exact match. However, where year-ends differ then the turnover for the calendar year is taken from the set of accounts covering most of the year (e.g. accounts to 30 September 2010 provide the 2010 turnover for that provider).

- Where a provider organization was sold during the year but accounts were made up covering a substantial part of the year then the annual turnover has been estimated pro-rata. Only one instance of this was encountered in this study.

- If a provider organization was acquired during the year and its results have been subsumed into the new owner's group accounts in a fashion that does not allow reliable estimates to be made for the year then that data point is excluded from the study. Note that this applies to just one Fostering provider in the final year of the study period.

- As at the date of the study most providers have not yet filed accounts for a year substantially covering 2012. Hence 2011 is the year of most recent information.

Observations (1)

- The largest Children's Homes providers are substantially smaller than the largest Fostering and Residential Special Schools providers.

- Fostering and Schools organizations have consistently experienced growth in their turnover across all 5 years of the study with the exception of just one provider where turnover has remained mainly flat throughout.

  Coming as it does against a background of severe public sector spending cuts across the whole period this represents a significant commercial achievement. Scrutiny of the detailed accounts of the providers in the samples confirms very little acquisition activity by the providers themselves, which allows us to conclude that the growth experienced has been driven by organic development of the businesses themselves.

- By contrast the Children's Homes sector is a more volatile picture.

  One of the sample companies shows substantial growth. Analysis of the detailed accounts reveals that this provider is on an active acquisition track and growth is most likely to have been fuelled by the aggregation of the acquired businesses.

  The other three providers in the sample all show a decline of turnover in the last period, following previous years of growth. Again, some of that historical growth was acquisition related, with one of the sample companies becoming adept at acquiring businesses that had run into financial problems.

The decline in turnover may be a function of both price pressures and lower levels of placements and serves as the first warning point about the sector. A dip in turnover alone may not threaten the sustainability of the businesses, but it is likely to lead those businesses to consider how to make corresponding cost efficiencies. These may typically include the mothballing or closure of homes (reducing choice), and cost cutting measures that are always difficult to make in businesses looking after some of the most challenging young people.

Results (2): EBITDA

Figures 6,7 and 8 show the trend in EBITDA of four of the largest providers in each of the three service segments.

Figure 6

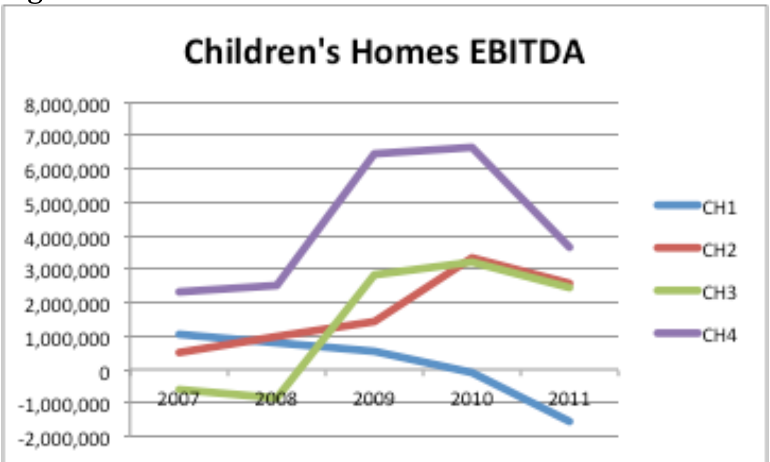


Figure 7

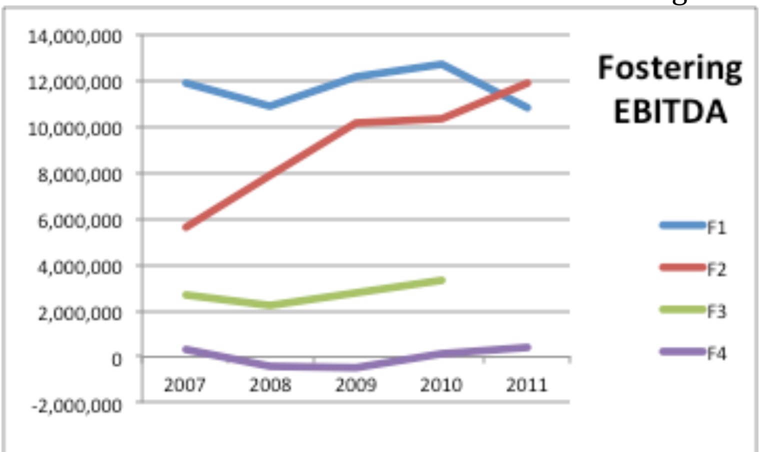
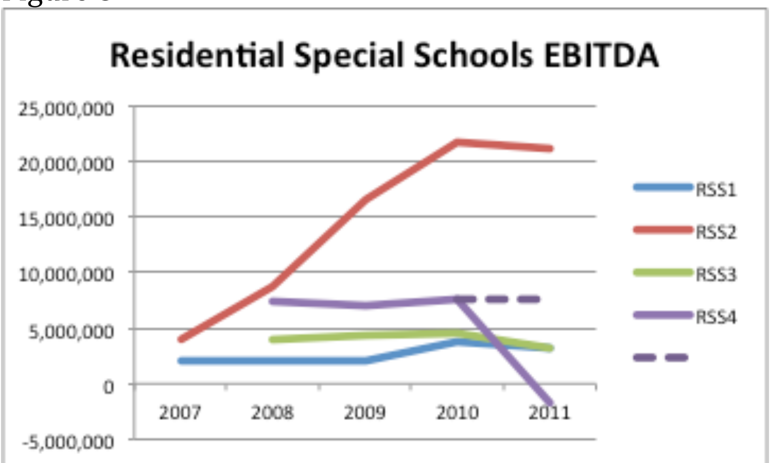


Figure 8



Source: Revolution Consulting. Data extracted from statutory accounts accessed at Companies House Spring 2013.

Explanations (2)

- EBITDA is plotted on an annualized basis. Where accounts of the provider are made up to 31 December this provides an exact match. However, where year-ends differ then the EBITDA for the calendar year is taken from the set of accounts covering most of the year (e.g. accounts to 30 September 2010 provide the 2010 EBITDA for that provider).

- Where a provider organization was sold during the year but accounts were made up covering a substantial part of the year then the annual EBITDA has been estimated pro-rata. Only one instance of this was encountered in this study.

- If a provider organization was acquired during the year and its results have been subsumed into the new owner's group accounts in a fashion that does not allow reliable estimates to be made for the year then that data point is excluded from the study. Note that this applies to just one Fostering provider in the final year of the study period.

- There is one voluntary organization in the Fostering sample and deriving a comparable EBITDA to those of the private sector bodies is not always possible with accuracy.

- One particular anomaly (RSS4) was contacted directly and offered clarification that some accounting policy adjustments had impacted the way the figures were collected and that the true profitability picture is represented by the dashed line.

- As at the date of the study most providers have not yet filed accounts for a year substantially covering 2012. Hence 2011 is the year of most recent information.

Observations (2)

- In the two segments, Fostering and Schools, that experienced the consistent turnover growth, the profit pictures begin to diverge.

- In Fostering profitability trends experienced have shown some volatility but with overall maintenance of profits reported or consistent growth in profits year on year. This would be consistent with a sector protected from the spending pressures by an increasing demand (rising looked after children numbers) and continued undersupply in many regions.

- Schools profits show a more mixed pattern with some pressure on profits in the most recent period leading to a flattening or small decline in returns, albeit at relatively healthy absolute profit levels.

- Children's Homes again contrast significantly against the other two segments.

  The greater volatility of profits for this segment is clearly demonstrated.

  All companies in the sample report profit decline in the most recent periods, indicating that the falls in turnover observed in the first results section have not been immediately offset by efficiency measures.

  Absolute losses are reported. One of the sample reports a loss making position in the most recent period and another has experienced substantial losses earlier in the period but appears to have been able to trade out of that position. That recovery occurred at the same time that the sector saw a slight increase in the use of homes outside of the local authority (2009/2010 – see figure 1).

  Clearly the 2012 results (and indeed current trading indications) need to be watched carefully and with caution as this segment is the most susceptible to market pressures as demonstrated by these observations about the evidence.

Funding and risk

The examples of Children's Homes providers falling into loss making positions at a trading EBITDA level is a scenario in which the funding of the business and the attitudes of funders and owners becomes of heightened importance.

Irrespective of whether funders and owners of businesses are private individuals, other corporate bodies, banks, or private equity/venture capital houses, if the underlying operating business is underperforming against targets, or failing to produce returns required then the pressures on that operating business will increase. This may be applied via the need for increased third party (e.g. bank) reporting, increased pressure on management via boards of directors and shareholder meetings, or simply through reduced income flow to the owners (equivalent to salary cuts).

In the samples in this study funding information can be tortuous to obtain:

Figure 9

Segment	Ownership	Funding & Transparency
Fostering	Ontario Teacher's Pension Plan Graphite PE Individual/Corporate Charity	Reasonable visibility 2 carrying heavy debt
Residential Special schools	Advent International PE Qatar Investment Authority GI Partners PE ISIS PE	Three offshore/inaccessible information All likely to be carrying substantial debt.
Children's Homes	GI Partners PE 3i (subsequent sale to GI PE) Private individuals Not known/ Isle of Man Company.	Reasonable visibility Varying levels of debt. Debt management for all an issue if downturn in trading continues.

If a business begins to produce operating losses then the pressures mount further. The additional need to pay funding costs (e.g. interest, capital repayments), taxes, and to renew capital assets will put further strain on cash resources. If losses are sustained across months or years then this can lead to the need for additional funding. In the worst case scenarios where funders no longer believe that a management team can improve the underlying trading then a closure of the business, sale, or administration may be considered.

The Children's Home sector has not been immune to these crisis situations in the last 15 years. The need for quick sale of homes in crisis, or sudden closure is a wholly unedifying prospect and potentially very disruptive to the lives of the children and young people in placement.

Whilst, equally, it would be difficult to imagine any exceptional underwriting of returns for the providers on the sector by the public sector, it is suggested that policy makers and commissioners need to apply market management approaches that work to decrease the risk of corporate failures.

Indeed it would be safe to say that commissioners would be advised to go beyond trying to avoid a system where provider failures regularly occur, and instead be looking to encourage providers to invest more in innovative approaches that have the needs of the young people as their primary aim.

Some examples of activities that would promote a healthier Children's Home market:

- Development of outcomes based approaches to counter the dominance of price and cost in decision-making.

- Encouragement of competition and choice through reduction in closed tendering systems (e.g. framework contracts only open once every three years).

- Free sharing of information on a consistent basis across geographical areas about demand levels for specific needs.

- Recognition that finding placements is about intuitive assessment of needs by experienced professionals with years of acquired know how and a human based activity rather than a business process.

- National and regional mapping of specialist provisions.

- National standards for reporting and monitoring of full financial position of all providers of services in the sector.

- New forms of contracting including open book accounting allied to contractual cost-plus returns and outcomes.

- Shared ownership and risk models and joint ventures between public and private sector.

- Local authority owned homes placed on the same footing in placement decisions as homes out of authority control.

- Aggregation of special needs demand across regions and commissioning for specialist needs at regional and/or national level where appropriate.

Summary

The last study of this type for the Commissioning Support Programme (2008/9) concluded that the Children's Home segment was the lowest profit making segment of children's services.

This study has tracked the period since that report.

An increase in the use of private sector homes in 2009/10 appears to have helped the providers in that sector to improve their financial performance during that period.

However, with continued pressure on public spending and a particular focus by central government on reduction of out of authority use of Children's Homes there are again clear signs that the sector is experiencing a downturn again.

Given the historical nature of the information it is possible that the downturn evidenced in 2011 may have continued into 2012 and indeed to the current period. Close monitoring of the financial sustainability of private sector provider partners by local authority purchasers would seem especially necessary at this time.

The study again highlights the areas of strengths and weaknesses in the information available, and suggests that national and regional commissioners work towards further improvement in information, especially in further transparency.

The relative volatility and fragility of the Children's Homes sector is not an environment designed to foster long term stability, development of know how and operational innovation. There would appear to be a need to call upon policy makers at central government levels and commissioners at regional and authority levels to develop truly national strategies for this sector to get away from cycles of pending crisis and to create an atmosphere where innovation and investment are attracted to a sector looking after the most complex and challenging young people in our society.

Appendix: The organizations studied

Children's Homes:

- Advanced Childcare
- Bettercare Keys
- Continuum Group
- Northerncare

Fostering:

- NFA
- FCA/Core Assets
- Pathway
- TACT

Residential Special Schools:

- Priory
- Witherslack
- Cambian
- Senad