INDIRECT POLICY TOOLS: DEMAND-SIDE FUNDING AND LESSONS TO BE LEARNED: EARLY CHILDHOOD EDUCATION AND CARE

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Abstract

This paper notes the increased use world wide of indirect tools of government policy and the growing international interest in government support for early childhood education and care (ECEC). It outlines the emergence of government support for childcare in Australia, noting in particular the shift in the 1990s to demand-side government funding as a means of marketising and expanding childcare services, and that the level of government subsidies became a political and election issue. Rather than a market, monopoly-like conditions emerged with one dominant corporate childcare provider (ABC Learning), and childcare prices spiralled. Shortly before ABC Learning's collapse in late 2008, it was the world's largest listed childcare provider and in the process of replicating its business model internationally. This paper provides a case study examination of ABC's business model. Most of ABC's operations have since been transferred to a hybrid organisation (the Goodstart consortium), newly established by a consortium of charities and private equity companies for the purpose of taking over the ABC centres. Goodstart's stated aspirations for childcare have received widespread public acceptance in Australia. It should be noted, however, that key features of ABC's business model remain in place. Lessons may be learned from this Australian experience of demand-side funding in ECEC.

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Internationally, the economic and public sector reforms of the past 30 years have developed within the wider context of efforts to liberalise international trade in services via competitive markets (Henisz, 1999; Hood, 2000, p. 3-4). For all services, including services provided by governments, competitive markets have been promoted as the most efficient means of service provision. Users of those services have been conceptualised as customers with the ability to select for themselves from the competing range of services on offer those that most closely meet the customer's requirements and budget (Niskanen, 1975; Drake and Nicolaides, 1992; Mintzberg, 1996).

Accompanying these economic and public sector reforms has been extensive rethinking of the role of government and the policy tools available to a government to pursue its policy objectives. (Hood, 1986; Salamon, 2002). Providing services directly represents just one of a proliferating range of policy tools that include "loans, loan guarantees, grants, contracts, social regulation, economic regulation, insurance, tax expenditures, vouchers, and more." These other increasingly popular policy tools allow governments to rely on various third parties "to deliver publicly financed services and pursue publicly authorized purposes" (Salamon, 2002a, p. 2).

One service that has recently experienced a surge of interest from governments and policy makers throughout the OECD is early childhood education and care (ECEC). While the precise nature of this interest and the reasons for it have differed from country to country, common themes include the growth in women's labour force participation, an expectation on the part of many governments that both mothers and fathers should participate in paid work, and increasing evidence about the importance of the early years for children's later intellectual, social and emotional well-being.

In a paper about ECEC prepared for the OECD, Canadian economists Gordon Cleveland and Michael Krashinsky (2002) classified the policy tools available to governments into supply-side and demand-side support. Supply-side support includes the direct provision of ECEC services by public sector bodies, as well as various indirect policy tools to assist particular services operated in the private sector. These tools may include funding support via operating grants, wage-assistance, capital assistance and tax concessions. Demand-side support involves indirect policy tools to assist parents with the cost of ECEC services they choose to purchase. Such policy tools rely on the existence of a market, and they include vouchers, tax deductions and credits, and subsidies paid to families to offset the cost of fully priced childcare services (Cleveland and Krashinksy 2002, 24). Cleveland and Krashinsky noted the paucity of research on the relative merits of supply-side and demand-side policy tools in ECEC.

This paper provides some evidence about the operation of indirect policy tools in ECEC in Australia where initial government support involved supply-side subsidies but shifted to demand-side during the late-1990s. Following this shift, share market-listed corporations emerged and the price of child care services spiralled. The largest of these companies, ABC Learning Limited (ABC), expanded rapidly to dominate the Australian childcare sector and the world's largest listed child care operator before collapsing in 2008. ABC's collapse sparked renewed debate in Australia about the merits of corporatised childcare and a Senate inquiry into the government's role in child care. In 2010, ABC's receivers sold most of ABC's Australian child care operations to a newly-established nonprofit company, the Goodstart consortium (Horin, 2009). This was promoted as social entrepreneurship, whereby "private equity firms, big-end-of-town law firms and corporate finance have come together to work with not-for-profits on a deal" (Connors, 2009). This disposal, however, transfers to Goodstart ABC's former dominance of the childcare sector, while making available to Goodstart tax concessions that are not available to listed companies. Further, although there are signs of awareness that demand-side policy tools may stimulate price inflation, continued reliance on such policy tools is likely to continue (Henry, 2010, p. 590). In light of Goodstart's continued dominance and continued reliance on demand-side policy tools to support child care, it is useful to review ABC's emergence, growth and the business model it developed, and its interaction with demand side funding, so that lessons may be learned from this experience.

The Australian experience is of international research interest for three reasons. Shortly before ABC's collapse, it was the world's largest listed childcare company having expanded its operations into the United States, the United Kingdom, and New Zealand as well as commencing entry into Canada and Japan. ABC's business model was being replicated internationally. Secondly, the evidence presented here suggests that in the absence of a competitive market and close supervision of the operation of demand-side policy tools, costly and dysfunctional outcomes may be produced. Thirdly, while the emergence of a hybrid nonprofit organisation such as Goodstart may allay public concern, in the absenced of other policy changes the size of the “pot” of demand-side funding available must surely provide an incentive to make opportunistic use of the nonprofit organisational form (Cleveland and Krashinsky, 2002, p. 45). With hybrid organisations now emerging internationally in other social services areas besides ECEC (see, for example, Lapsley, 2008; Hellowell and Pollock, 2009; Thomasson, 2009), ongoing research attention to these organisations will be important. The findings reported here may assist with understanding of one form of business model and its interaction with demand-side funding.

The next section considers in more depth the selection and use of indirect policy tools. Subsequent sections outline the history of Australian commonwealth government assistance for ECEC, before explaining the emergence of ABC Learning Limited, a company that throughout its existence acknowledged its economic dependence on government policy and funding. The segmented corporate business model for childcare that ABC developed led to a growing array of other organisations all dependent,, via ABC Learning, on the government’s demand-side subsidisation of childcare. The collapse of ABC and the disposal of most of its childcare centres to Goodstart is then outlined before the discussion section considers lessons to be learned from this Australian experience with demand-side funding in ECEC.

INDIRECT POLICY TOOLS

Indirect tools allow governments to pursue public policy purposes without themselves performing the services required. In the environment of hostility to government that has characterised the last 30 years of economic and public sector reforms, indirect policy tools have allowed governments to constrain or shrink their bureaucracies while at the same time extending their reach to include emerging policy areas, hence their growing popularity (Savas, 1982; Salamon, 2002a). The advantages to governments of using indirect policy tools include their ability to help overcome public sector resource limitations, to foster support for policy initiatives by involving others outside government, and to muster a wider range of skills and resources to address public problems than is available from within government.

The range of indirect policy tools from which to select may be narrowed for ideological reasons. Some indirect policy tools such as vouchers or tax expenditures carry a pro-market bias. These demand-side tools require beneficiaries to choose and purchase from the market the services they want. In contrast, supply-side tools such as loans or grants to particular organisations might suggest some scepticism about market mechanisms (Salamon, 2002a). Cleveland and Krashinsky (2002, p.38) made the same observation in their comments about ECEC:

> "Those who believe in markets – and they are not limited to those on the political right …believe that parental choice will maximise the effective use of scarce public resources. …Those who are suspicious of markets – and they are not limited to those on the political left …– are concerned that private organisations may waste public funds, diverting them to uses that were not those originally intended. Further, parents may not be able to accurately measure quality, or may have goals that differ from those that motivated the subsidy programmes in the first place."

Political strategy also plays an important role in the selection of particular indirect policy tools. Few policies come into effect fully developed, and the choice of a particular policy tool privileges some players over others in determining how the policy will be developed and who will gain as a result (Salamon, 2002a; 2002b; Posner, 2002). The ideological and strategic aspects of tool selection can be so strong that a tool's appropriateness for its operational role becomes a secondary matter (Posner, 2002, p. 533). Each policy tool has its own operational dynamics and each tool may therefore require different administrative skills and techniques (Salamon, 2002a). Because indirect policy tools grant discretion to parties outside government the selection (for ideological and/or political strategy reasons) of a tool that increases operational difficulties in a particular policy area may leave the agencies responsible for administering programs unable to control those programs. Opportunism on the part of the parties outside government risks undermining the legitimacy of both the program and the government (Salamon, 2002b, p. 604).

When increased use of indirect policy tools was advocated internationally from the 1970s, there was little or no acknowledgement of the experience already gained with them in the United States, or of “the immense difficulties that these instruments entail” (Salamon, 2002a, p.7). As these policy tools are introduced and applied internationally, there is good reason to proceed with caution and to review their use in light of experience.

RESEARCH METHOD

This research seeks to contribute to understanding about the operation of policy tools of government, and this Australian experience with ECEC, where one major company emerged to dominate the childcare sector offers scope for a case study exploring what has happened (Yin, 1989). This exploration has been undertaken largely through literature review, knowledge of events from the news media and archival analysis, especially of published financial information and annual reports. The archival material drawn on includes government material that helps to track developments in the subsidisation of childcare, as well as investor-oriented material published by ABC Learning Limited and some of the other organisations with which ABC was associated.[i] The published investor-oriented material includes annual reports, stock exchange announcements, public offering documents and published material used in presentations to investors and prospective investors. The objective is to track the emergence and growth of ABC Learning and to understand the business model ABC Learning adopted in an effort to identify the interaction of that business model with government policy towards ECEC and subsidisation of childcare.

Emerging information raises questions about the regularity of ABC’s business activities and the extent to which reliance may be placed on ABC’s audited annual financial reports (Ferrier Hodgson, 2010). The focus of attention in this paper is not on possible financial irregularities. Rather, the focus is on ABC’s business model and its interaction with demand-side funding so that lessons may be drawn from this experience.

AUSTRALIAN GOVERNMENT ASSISTANCE FOR ECEC AND GROWTH OF THE CHILD CARE SECTOR

Centre-based child care in Australia was, until the early 1970s, provided by a mix of philanthropic organisations and small private businesses. These childcare services were subject to regulation by State governments but received no financial assistance or support from the Commonwealth government (Spearitt, 1979).

In 1972, following pressure by employer groups, the Australian Pre-School Association and Liberal Party women, the commonwealth government passed the *Child Care Act*, which enabled the commonwealth government to make capital and recurrent grants to non-profit child care organisations, these organisations also benefiting from income tax exemptions. From then, the commonwealth government took the lead in devising policy and providing funding for various forms of child care. It introduced its own staffing standards (which overrode State/Territory regulations) and paid 75 per cent of the award wages of the required staff directly to the non-profit childcare services. The *Child Care Act* thus utilised supply-side subsidies drawing on three principles that would later become controversial: (i) it set staffing standards at the Commonwealth level and provided funds to support the employment of appropriately qualified staff; (ii) it subsidised the supply of childcare services rather than demand for them; and (iii) it ensured that Commonwealth funds could be paid only to non-profit providers. These principles underpinned Commonwealth child care funding for approximately a decade and a half.

With the growing demand for child care, the potential cost of expanding these supply-side subsidy arrangements became a matter of concern to Treasury (Keating 2004, 90). During the 1980s, as new forms of public management gained ascendancy in the Australian public service, the Labor government paid increasing attention to the possibilities of a market-oriented funding system. Interestingly, the government seemed to accept the view that shifting to a market-oriented approach would contain costs and save the Commonwealth money. In 1985, the commonwealth government revised its child care funding model, ending the link between subsidies and the award wages of qualified staff, cutting operational assistance by about 50 per cent, and restructuring it so that it was paid to the nonprofit childcare centres on the basis of the number of children enrolled in a service, not on the basis of the staff employed.

Although still paid directly to the nonprofit child care centres, this changed form of Commonwealth assistance linked the money to children attending each nonprofit centre, and it became framed as ‘fee relief’ for the parents. The amount of fee relief depended on the parents’ income but the childcare centres claimed the fee relief on parents’ behalf. It seemed to imply that childcare had become a commodity for purchase in the market-place, rather than a social good in which the society has a collective interest.

Other childcare operators challenged as discriminatory the subsidisation of the services provided by non-profit childcare services but not the services provided by others. Those families that chose (or had no options other than) for-profit services could not benefit from the subsidy. From 1991, the commonwealth government extended eligibility for fee relief to the users of private, for-profit care and established a system of accreditation to take effect from 1994. The number of child care places in the for-profit sector grew rapidly, increasing from 36,700 to 122,000 between 1991 when the extension first took effect and 1996 (Brennan 1998, 214). In contrast, community-based, non-profit provision effectively stagnated with the number of places increasing from around 40,000 to 45,000 places in the same period.

Such growth in the childcare sector meant increased need for appropriate properties from which to provide childcare services. Although property-specific requirements for childcare services remained bound by state regulations, other changes introduced by the commonwealth government prompted business analysts to note the extraordinary commercial opportunities that had been opened in the childcare sector and that the opportunities extended beyond parents and those providing the childcare:

> Generous federal government funding of child care, a variety of government financial assistance schemes for parents, tax loopholes and even exemption in some areas from fringe benefits tax are underwriting the success of this 1990s phenomenon … *For many property owners and developers, including foreign residents*, the flood of government money is a lifesaver, and possibly a license [sic] to get rich (Ferguson 1995, 50, emphasis added).

In July 2000, as part of a package of measures surrounding the introduction of a value added tax (Goods and Services Tax), the commonwealth government announced the replacement of the fee relief subsidies with a new subsidy called Child Care Benefit (CCB) designed to reduce the costs to parents of using approved child care[ii]. In comparison with the fee relief subsidies, CCB extended parental eligibility for Commonwealth assistance both vertically (up the income scale) and horizontally (increasing the hours of subsidised care available to the children of parents not in paid employment). Families became eligible for up to fifty hours of CCB per week if they met a work/study test and up to twenty hours (since extended to twenty-four hours) of CCB per week if they did not. The amount of benefit depended upon family income, the ages of children in care and the number of hours of care required.[iii] Following this change, larger corporate childcare operators emerged.

The price of childcare services increased rapidly and its affordability became a political and election issue. In 2004 (an election year), the Commonwealth government introduced an additional form of support via tax expenditures. The Child Care Tax Rebate (CCTR) allowed eligible families to claim a tax rebate of 30 per cent of their out-of-pocket child care expenses (net of CCB) up to a maximum of $4,200 per year per child.[iv] Similarly, in the lead-up to the 2007 election, competing election promises of increased funding for childcare resulted, in 2008, in CCTR being extended to cover 50 per cent of out of pocket child care expenses (net of CCB) up to a maximum rebate per child of $7,500 per year. Parents eligible for the rebate are those working, training or studying and who use 'approved' child care.[v]

In the five years to 2007, the price of child care grew much faster than the price of other goods and services. For example, in the 12 months to June 2007, child care prices rose by 12.8 per cent – the fifth successive year that prices had risen 10 per cent or more. Over those five years, the cumulative increase in the price of child care was 88 per cent (ABS 2007). The reasons for these spiralling prices were unclear. Some believed the entry of corporate providers affected prices, a view Michael Keating (2004), then head of the Department of Prime Minister and Cabinet, thought unlikely. He acknowledged an 'ongoing tension' between affordability of childcare services, the provision of high quality education and care for children, and the financial viability of services, but argued that the childcare market was "so heavily regulated by government, this tension is unlikely to be affected much one way or another" by the specific means of childcare provision, ie private or nonprofit providers (2004, 91). Others, Gittins (2008), for example, linked the spiralling prices with the extensions and increases in demand-side subsidies, suggesting that childcare providers would increase their prices so they could "share" in the increased subsidies. In the section that follows, we seek to contribute to an understanding of this issue by exploring the emergence and growth of the dominant corporate childcare operator (ABC), the business model it developed, and the manner in which that business model interacted with the demand-side subsidies.

ABC LEARNING'S EMERGENCE AND CORPORATE MODEL OF CHILDCARE

The beginnings of ABC Learning may be traced to 1988 when Eddy Groves and his wife Le Neve established a for-profit childcare centre in a suburb of Brisbane. With the extension from 1991 of fee relief to those using for-profit services, the Groves saw an opportunity for expansion, and bought some properties on which to establish other childcare centres in low income areas of Queensland. In 1997, they established ABC Learning Centres Limited, a company with three directors: Eddy and Le Neve Groves, plus William Bessemer of the Austock Group, a fund manager and corporate finance adviser.

In 2000, shortly after the government's announcement that CCB would replace fee relief, the Austock Group issued and underwrote initial public offering (IPO) documents for ABC Learning Limited and a newly established property investment fund, the Australian Social Infrastructure Fund (ASIF). That these IPOs were linked is apparent from the disclosures in them that the success of each offering was conditional on the success of the other, and that ABC sub-underwrote ASIF's IPO (ABC, 2000; ASIF, 2000). Both offerings were successful, and ABC Learning listed on the stock exchange in March 2001. This prompt response to the commonwealth government's announcement of CCB was advantageous for both Austock and ABC. Austock later identified this as its point of entry into property management, social infrastructure property in particular, and ABC gained "first mover" advantage in corporate childcare (Tabakoff, 2005; Austock, 2007).

ABC's (2000) IPO stated that the newly-announced government support for childcare (CCB) signalled a growth in demand for childcare that the pre-existing largely 'cottage-based' childcare sector of small community-based services and individual owner-operators would struggle to meet, and further that 'increasingly stringent' regulations would drive out smaller operators (ABC, 2000, 3.2). Industry rationalisation would therefore provide 'growth opportunities for ABC through carefully selected acquisitions' (ABC, 2000, 3.2). ABC predicted that childcare would 'mature' into a 'structured segment of the services sector in which properly resourced and administrated (sic) companies manage a portfolio of branded centres, have appropriately financed and staffed administrations and adopt forward looking corporate programs such as formal off-site staff training and employee equity participation' (ABC, 2000, 3.1).

ABC sought to lead this structuring and maturing of the childcare sector using an aggressive two-pronged growth strategy. It intended to increase the number of childcare centres ABC operated, either by establishing new centres or by acquiring centres established by others; and it intended to lease childcare properties rather than owning them. Those childcare properties it already owned, and those it found and wanted to occupy, would be delivered to ASIF (ABC, 2000). Over time, this second prong of ABC's growth strategy evolved into the segmentation and shifting outside of ABC various other activities involved in providing childcare. These growth strategies are explained in more detail as a means of understanding ABC's structured corporate business model.

Growth strategy 1: increasing the number of ABC childcare centres

When ABC listed on the Australian stock exchange in March 2001, it operated 31 childcare centres, 21 in Queensland and 10 in Victoria, and was committed to acquiring another nine in Queensland. By December 2007, just over six years after listing, ABC's pursuit of its strategy to increase the number of childcare centres had been so aggressive that the company operated 2,323 childcare centres, comprising 1,095 childcare centres in Australia and a further 1,228 internationally (in the United States, New Zealand and the UK) (see Table 1).

TABLE 1: ABC Learning: growth in the number of childcare centres operated

Centres operated	**Australia**	**New Zealand**	**United States**	**United Kingdom**	**Total number of centres**
-/3/2001	31				**31**
30/6/2001	43				**43**
30/6/2002	94				**94**
30/6/2003	187				**187**
30/6/2004	327				**327**
30/6/2005	660				**660**
30/6/2006	905	28	324		**1257**
30/6/2007	1084	104	1015	35	**2238**
31/12/2007	1095	116	1000	112	**2323**

Within Australia, this expansion was achieved partly by acquiring other child care operators and partly by establishing new child care centres, sometimes forcing out of business smaller operators nearby (The Senate Education, Employment and Workplace Relations References Committee, 2009). Although other corporate providers emerged during this time, ABC acquired several of them, and remained by far the largest single childcare operator in Australia.

The Australian competition authority imposed conditions on ABC's further expansion via large takeovers within Australia when, in late 2004, ABC acquired the Peppercorn Management Group Ltd, its then-largest Australian competitor (Courier Mail, 2004). By this time ABC already so dominated childcare that parents in some areas had little choice but to use an ABC-branded childcare centre, regardless of any preference they might have for a different form of centre-based childcare. Further, as may be seen in Table 1, although this may have ended major takeovers within Australia, the number of ABC child care centres in Australia continued to grow. In 2006, ABC's chief executive, Eddy Groves, claimed ABC held at least 30 per cent of the Australian market but this share appears to have been higher in some States. In Victoria and Queensland, ABC is thought to have held 50% of the childcare market (Gittins, 2008). This dominance troubled childcare policy analysts and child development experts who held reservations about the quality of ABC's childcare services and the policy model that underlay the company's expansion (Brennan, 2008).

Tables 2 and 3 summarise the effect of ABC's aggressive expansion on its income statements and balance sheets published during its existence as a listed company. As may be seen in Table 2, the expansion in the number and size of childcare centres ABC operated, as well as the increasing prices it charged meant that, with the exception of 2003, ABC's service revenues doubled, or more than doubled, annually.

TABLE 2: ABC services revenue, total revenue and reported net profit after tax

Year ended	Services Revenue ($ millions)	% increase over previous year	Total Revenue ($ millions)	Reported net profit) after tax ($ millions)
30 June 2001	11.8	-	28.5	3.2
30 June 2002	22.8	93%	29.5	6.8
30 June 2003	39.8	75%	45.4	12.1
30 June 2004	77.9	96%	96.4	21.4
30 June 2005	230.6	196%	292.7	52.3
30 June 2006	592.2	156%	631.5	81.1
30 June 2006 (change in policy)#	753.3		790.8	81.5
30 June 2007	1,615.7	114%	1,696.4	143.1
31 December 2007 (6 months)	985.0		1,106.9	37.1

Until 2006, the revenues from childcare centres was reported net of their operating costs, but this policy changed to reporting gross revenues from 2007, with new comparative figures provided for 2006. Both pre- and post-policy change figures are provided for 2006 to allow comparison.

Table 3 shows the increase in ABC's total assets from $28.6 million in 2001 to $4,528.1 million in December 2007. As may be seen from the analysis of the major categories of the assets, a key feature of this balance sheet growth is that throughout its existence as a listed company, ABC's intangible assets represented between 71% and 81% of ABC's total reported assets.

TABLE 3: ABC balance sheets

Date	**Childcare licences $m**	**Goodwill $m**	**Other intangible assets $m**	**Total Intangible assets**	**Other assets $m**	**Total assets $m**	**Total liabilities $m**	**Total Equity $m**
30/6/2001	20.2	-	-	20.2	8.4	**28.6**	15.3	13.3
30/6/2002	41.2	-	-	41.2	14.7	**55.9**	28.3	27.6
30/6/2003	119.8	-	3.0	122.8	34.2	**157.0**	67.9	89.1
30/6/2004	235.7	-	1.0	236.7	77.3	**314.0**	111.5	202.5
30/6/2005	772.7	170.1	.7	943.5	221.9	**1165.4**	319.9	845.5
30/6/2006	1,343.4	313.7	31.5	1,688.6	635.0	**2323.2**	485.5	1,837.7
30/6/2007	2,614.7	269.0	7.4	2,891.1	1,176.0	**4,067.1**	2,165.5	1,901.6
31/12/2007 half year	Not disclosed	Not disclosed	Not disclosed	3,055.2	1,472.9	**4,528.1**	2,305.0	2223.1

By far the greatest portion of ABC's intangible assets was childcare licences. These grew from $20.2 million to $2.6 billion in the last annual report ABC published (for the year ended 30 June 2007). At the end of each financial year until 2005, ABC revalued (increased the reported values of) its childcare licences. Most of the growth in the child care licences, however, occurred when ABC reported acquiring childcare licences from others and when it acquired the business of other childcare operators, some of whom operated multiple childcare centres. With corporate childcare having just emerged as a new industry, these licences were new to the share investment community and, with some exceptions the growth and amounts reported seemed to be accepted. It did, however, puzzle some childcare operators from the "cottage-based" childcare sector that ABC sought to supplant (The Senate Education, Employment and Workplace Relations References Committee, 2009).

Childcare licences are not transferable from one childcare operator to another. A childcare operator acquiring a pre-existing childcare centre run by another childcare operator must obtain its own childcare licence directly from the relevant state's licensing authority before it can offer childcare services from that centre. The granting of a childcare licence creates a barrier to entry because it depends on the availability of suitable premises from which to provide childcare services, and the premises must conform to regulated space and safety requirements, but there is no externally imposed limit on the total number of childcare licences issued that might give them a scarcity value (as occurs with taxi licences, for example). Further, the initial application fee is minimal ($250), as is the annual cost of a childcare licence. Why would ABC pay so much for something that it had to acquire directly from the regulatory authorities and for which it would pay only a nominal amount?

One clue to the perceived value of ABC's childcare licences and their importance in ABC's business model is provided by ABC's revaluation policies applied until 2005 when international financial reporting standards (IFRS) came into effect. Until then, ABC revalued its childcare licences annually on the basis of expected future cash flows attributable to each childcare place it was licensed to provide. Table 4 extracts from ABC's published financial reports the number of childcare places ABC was licensed to provide and the amounts at which the childcare licences were reported. From that data it calculates the dollar value attributed to each childcare place. Clearly, ABC's valuations attributed increasingly higher future cash flows to each childcare place. During the five years to 2005, the average value attributed to each childcare place trebled (from $5,115 to $16,738). The biggest jump in the licence value per childcare place occurred in the 2005 financial year (from $10,264 per place to $16,738 per place), this jump coinciding with the introduction of the CCTR.

TABLE 4: Childcare places and reported value of childcare licenses to 2005

Date	**Number of childcare places**	**Childcare licenses reported $m**	**Value of licence per childcare place $**
30/6/2001	3,956	20.2	$5,115
30/6/2002	7,626	41.2	$5,406
30/6/2003	13,607	119.8	$8,806
30/6/2004	22,969	235.7	$10,264
30/6/2005	46,164	772.7	$16,738

The licensing process for operating childcare centres suggests that subject to the availability of properties suitable for child care, the regulatory environment would support a diverse and competitive market. Such a market did not exist when the demand side funding of childcare commenced. Further, the parental eligibility extensions accompanying the introduction of demand side funding may have so stimulated demand for childcare that pre-existing shortages were exacerbated. While such stimulation of demand may have encouraged the establishment of more childcare services, it may also have strengthened ABC’s first mover advantage. ABC’s aggressive expansion meant that ABC rapidly assumed and maintained a dominant position, thus gaining some monopoly power.

There seems little doubt that the value of childcare licences to ABC derived from ABC’s expectations of the increasing childcare prices it could charge. Neither is there much doubt that those expectations were linked closely to government policy, especially to the increasing childcare subsidies and extensions to eligibility for the subsidies and childcare hours covered. As Table 4 suggests, the government’s 2004 announcement of increased childcare subsidies seems to have been impounded directly into the values reported for ABC’s childcare licences as evidenced by the significant (63%) increase in value of childcare licences in 2005 when that value is expressed as a value per childcare place (from $10,264 to $16,738). Arguably, the increasing values attributed to childcare licences relate to perceived shortages in childcare services and ABC’s dominance of childcare and ability to command increasing prices. In other words, ABC’s growth strategy to increase the number of ABC childcare centres seemed to encompass an effort to capture the childcare market.

Growth strategy 2: childcare properties held by other parties

The second prong of ABC’s announced growth strategy involved ASIF, the property investment fund with links to ABC and to Austock. This prong involved ABC leasing childcare properties rather than owning them. In its IPO, ABC (2000) reported an arrangement whereby it would sell those childcare properties it did own to ASIF and then lease them back. New sites ABC identified would be referred to ASIF for purchase, development and lease to ABC. Should ASIF wish to sell any of its childcare properties, it would offer them first to ABC (ABC, 2000; ASIF, 2000).

While this property-related prong of ABC’s growth strategy helped ABC to channel its financing demands into its first growth strategy to increase the number of ABC childcare centres, it also contributed to ABC’s dominance of the childcare market by securing the leased childcare premises to ABC. Other providers could not take over the lease of a childcare property held by ASIF, or purchase the property from ASIF without ABC’s acquiescence.

Subsequently, other property investors emerged that also engaged in exclusive arrangements with ABC, some of these also extending Austock’s property management activities. Following ABC’s acquisition of a major corporate competitor (Peppercorn) in late 2004, a listed property trust, the Australian Education Trust (AET) (previously called the Peppercorn Investment Fund) became ABC’s preferred property purchaser/owner and lessor. This arrangement commenced with AET holding “115 freehold and leasehold childcare centre properties” all leased to ABC (AET, 2007, p. 16). An agreement between ABC and AET provided for ABC to receive a fee for finding childcare properties for AET to purchase, and to undertake to lease those properties from AET. By 30 June 2007, AET’s property portfolio consisted of 388 freehold and leasehold childcare properties located in both Australia and New Zealand, all holding long term leases or subleases to ABC, which guaranteed payment of the leases. Another significant childcare property investor that engaged in similar arrangements with ABC is the Orchard Childcare Property Fund (OCPF).

While the property investors identified above were not the only lessors of childcare properties to ABC, they were major ones in Australia, and the exclusivity of the leases seemed to bolster ABC’s dominant position. Because a childcare licence is specific to particular childcare premises which must meet detailed safety and space regulations, those safety and space regulations also limit the ready availability of alternative childcare premises suitable for operating childcare services. The more complex and specific to childcare the regulations are, the higher the barrier to market entry becomes for potential competitors, especially in the presence of a dominant and aggressive childcare operator. As ABC expanded internationally, so too did this childcare property-related prong of its growth strategy along with Austock’s fund management and property management involvement (Cummins, 2007).

With ABC economically dependent on the government policies and subsidies, it becomes apparent that so too were the property trusts, at least indirectly dependent on those same government subsidies. As with ASIF, the exclusivity of the arrangements between ABC and AET made AET almost totally dependent on ABC for its lease revenues (AET, 2007). OCPF similarly acknowledged its 99% dependence on ABC for its revenues. AET drew the link to the government policies and subsidies more directly in its presentations to investors, emphasising as investor selling points the "low risk profile, (almost zero direct exposure to discretionary spending)" of its childcare properties, the "generally increasing market rental levels", and the "expanding market with a committed government budget plan for the next 4 years" (Austock Property Management, 1 Feb 2008).

Increasing market rentals contributed to rising values reported for the childcare properties. A feature of accounting requirements for investment properties is the linkange of valuations to current and future expected rental income (AASB140, paras 33-40). This is exemplified in AET's accounting policy for valuing its childcare properties which refers to market rentals as a basis, these being determined at least in part by an amount for each childcare place in a childcare centre. The implication is that AET could pass on the increases in market rentals, thus increasing ABC's leasing costs. This would, in turn, reduce ABC's reported profits unless, of course, ABC were to increase its childcare fees. The effect seems to be that a childcare property investor anticipating that increasing government subsidies for childcare would flow through into increasing market rentals would impound these expectations in the reported value of the childcare properties.

ABC's segmented business model

ABC's early vision of the childcare sector as a "structured segment of the services sector" (ABC, 2000) involved various close relationships and supply arrangements between ABC and other organisations. In addition to the leasing arrangements with the property trusts outlined in strategy 2, there were arrangements with private companies operated by close colleagues and family members, and the propriety of some of these arrangements has been questioned.[vi] As a means of understanding ABC's business model and the way it functioned one segmented arrangement that has not received such attention for propriety reasons may serve as an example. This arrangement was with Funtastic Limited, a share market listed company that pre-dated ABC.

In the 2005 financial year, ABC reported the acquisition for $5 million dollars of Judius Pty Limited, a company from which it obtained toys and equipment for its childcare centres. In January 2007 ABC sold Judius to Funtastic for $53.2 million. In

Funtastic's analysis of the fair values of the assets and liabilities it had acquired for this $53.2 million, Funtastic attributed a $40 million fair value to an agreement granting Funtastic global exclusive access for 20 years to supply to all of ABC's existing and future childcare centres products covering "the complete spectrum of childrens development, including literacy, maths, motor skills, arts & craft and music" (Funtastic, 2006). Funtastic attributed the remaining $13.2 million of the $53.2 million acquisition price for Judius to goodwill ($14.2 million) and negative $1 million for the remaining tangible items (Funtastic, 2007, Note 34). In other words, Funtastic's acquisition of Judius was little more than a payment to obtain global exclusive access to the subsidised childcare market that ABC seemed to dominate.

At the heart of ABC's growth strategy appears to have been its drive to dominate the childcare sector, and in doing so to sequestrate the demand-side subsidies for childcare services on which it depended, and then to grant selected others access to this taxpayer funding source. In such circumstances, the value of childcare licences to ABC becomes apparent. So too does the rising value of childcare properties and the value of Funtastic's global exclusive access agreement. In the case of Funtastic where the propriety of arrangements between ABC and Funtastic have not been questioned, ABC seems to have extracted a significant price for granting access to the child care market it dominated.

There is no doubt that ABC's segmented business model meant that ABC's ongoing success was important to the success of a growing array of other companies, some of which acknowledged their economic dependence on ABC. Further, ABC, the property trusts and Funtastic all reported asset at values that seemed to be derived from the future cash flows anticipated from their access to demand-side subsidy-supported childcare fees. In other words, ABC's business model meant that these companies, including ABC, all reported assets, the values of which came from a single source – demand-side subsidies for childcare, and expectations that increasing subsidies would increase prices and asset values. While government announcements of increases in childcare subsidies tend to be well received as supportive of parents, the increasing demand-side support seems to be implicated in spiralling child care prices and impounded rapidly in rising asset values determined by expectations of future cash flows. At the same time, because that support was funnelled through one dominant company (ABC) via club-like arrangements and artificial conditions.

ABC'S COLLAPSE AND THE EMERGENCE OF HYBRID ARRANGEMENTS FOR SOCIAL ENTREPRENEURSHIP

After its early success as a share market star, ABC's star began to wane as it pushed ahead with its aggressive expansion and as questions began to emerge about the propriety of some of its arrangements with other parties. As a share market listed company, ABC needed to demonstrate its profitability. Although in dollar terms ABC's reported net profit after tax did increase significantly, this did not satisfy investment analysts. Table 5 draws on ABC's total assets and total equity figures reported (as previously shown in Table 3) to calculate average annual figures for both total assets and total equity. Table 5 then uses ABC's reported net profit after tax figures (previously shown in Table 2) to calculate percentage returns on average total assets and average total equity. The heavy loading of ABC's balance sheet with intangible assets (see Growth Strategy 1) meant that ABC's rapid expansion delivered reducing percentage returns. These falling returns disappointed some investment analysts (for example, Wisenthal, 2005; Tyndall, 2006).

TABLE 5: ABC return on assets/ return on equity

Date	**Total assets $m**	**Average opening and closing assets**	**Total Equity $m**	**Average opening and closing equity**	**Net profit after tax (NPAT) $m**	**Return on average total assets**	**Return on average total equity**
30/6/2001	28.6		13.3		3.2		
30/6/2002	55.9	42.25	27.6	20.4	6.8	16.1%	33.3%
30/6/2003	157.0	106.4	89.1	58.3	12.1	11.4%	20.7%
30/6/2004	314.0	235.5	202.5	145.8	21.4	9.1%	14.7%
30/6/2005	1165.4	739.7	845.5	524.0	52.3	7.1%	10.0%
30/6/2006	2323.2	1,744.3	1,837.7	1,341.6	81.1	4.6%	6.0%
30/6/2007	4,067.1	3,195.1	1,901.6	1,869.6	81.5	2.6%	4.4%
31/12/2007 half year	4,528.1	4297.6	2223.1	2,062.3	37.1	0.9% Half year	1.8% Half year

In publications and presentations targeted specifically at investors and potential investors, ABC sought to satisfy and attract them in other ways, especially by emphasising the increasing childcare subsidies. In early 2008, however, soon after the appointment of new auditors, the release of disappointing results for the half year to 31 December 2007 and increased attention to ABC's practices and accounting policies, it became apparent that ABC was in financial difficulties. The release of

ABC's financial reports for June 2008 was repeatedly delayed until early November 2008 when the group of banks with security over ABC's assets appointed receivers .

A public outcry over the possibility that more than 1,000 of Australia's childcare centres might close suddenly resulted in the commonwealth government spending some $60 million to keep ABC's childcare centres operating and allow an orderly disposal. A Senate inquiry into the role of government in childcare was forced on the government amid debate about various matters, including the appropriateness of allowing childcare to be dominated by one corporate operator.

The late 2009 announcement by ABC's receivers that almost 700 of ABC's childcare centres would be sold to a newly established hybrid organisation established by a consortium of well-regarded charities and private equity (the Goodstart consortium) was accompanied by reassurances about Goodstart's intentions (Horin, 2009; Kruger, 2010). Those involved in Goodstart promoted this event as social entrepreneurship, and explained Goodstart as an arrangement whereby "private equity, philanthropy, big business and government have combined with non-profit organisations … on a deal that will generate profits and have a transformational social impact on the Australian childcare industry" (Cotton, 2010). It should be noted, however, that while Goodstart's corporate form differs from ABC's, Goodstart's acquisition of so many of ABC's Australian child care centres puts Goodstart in a position where it can dominate child care. Goodstart's future social and financial impact on Australian child care will be matters of future research interest.

DISCUSSION: LESSONS TO BE LEARNED

Australia began the gradual shift from supply-side to demand-side funding of childcare by recasting operational grants to non-profit childcare operators as if they amounted to fee relief for some parents using those childcare centres. While that recasting may have helped to reframe childcare services as a commodity for purchase in the market, it also provided an opportunity to reduce the amount paid to pre-existing non-profit childcare operators in an effort to spread that funding more widely.

Cleveland and Krashinsky (2002, p. 41) recognised that "the debate over demand-side and supply-side subsidies is often a proxy for a quite different debate over standards and quality… Demand side subsidies usually cost less…" At the time in Australia, demand for childcare services was increasing and the supply of childcare services was perceived as inadequate. Continuation of the previous supply-side system did seem likely to increase significantly the costs to government, not least because expanding the provision of childcare services could be achieved only by expanding the number of properties from which childcare may be provided.

The extension of demand side funding to encompass for profit childcare services and the addition of taxpayer-funded support so that childcare properties might find favour with property developers does seem to have helped stimulate growth in the provision of both childcare services and childcare properties. While this may, at least initially, have been less costly for the commonwealth government, there was no childcare market when demand-side funding was introduced and ABC's efforts to dominate childcare helped to ensure that a market in childcare could not emerge.

A recent tax review (Henry, 2010) reveals that demand-side support for child care remains the preferred approach, although it notes both transparency and equity differences arising from particular forms of demand-side funding (via tax expenditures in the form of income tax deductions allowed, or via subsidies paid to parents). Henry (2010, p.590) acknowledges that demand-side support can put "pressure on child care fees and government expenditure, particularly if the supply of child care providers is constrained." This experience of demand-side funding in child care bears out such reservations, showing that with the introduction of demand-side funding, childcare prices spiralled and the cost of childcare became a political, and election, issue. Pre-election announcements of increased subsidies for parents may help to win votes, but as the level of government subsidies increased, childcare prices spiralled even higher. This research suggests the competition authority's powers to prevent monopoly-like conditions from emerging are limited and were ineffective in the child care sector. Cleveland and Krashinsky (2002) observed that monopoly-like conditions should be expected in child care, thus suggesting a need for ongoing administration and supervision of demand-side funding programs. With Goodstart commencing its operations from a position of dominance, some means of monitoring developments in all aspects of child care services seems essential.

As could be seen from the rising per child care place amounts that underpinned the reported value of ABC's childcare licences, increased subsidies seemed to be impounded immediately into increased values reported for childcare licences, those values determined by expectations of future cash flows from childcare. Similar patterns also seemed apparent in the child care properties tied to ABC, and the arrangements with Funtastic suggested ABC was so dominant it could impose significant access charges. This might suggest that demand-side funding may, under some circumstances, not only contribute to "pressure on child care fees and government expenditure" (Henry, 2010, p. 590), but also to asset bubbles because future expectations of cash flows have become such an important component of asset valuation in financial reporting.

This explanation of ABC Learning's business model demonstrates that the operation of demand-side funding of childcare cannot be judged simply by focusing on the financial reports of the childcare provider (ABC) itself. While rising costs of childcare service provision and the need to earn acceptable profits may help a childcare provider to defend a rising childcare prices, from the beginning, ABC Learning's segmented business model involved separating childcare properties from childcare services and then leasing those properties. With the childcare property trusts using their expectations of future increases in childcare subsidies to anticipate future rental increases which in turn contribute to their asset valuations, it becomes apparent that at least some of the childcare price spiral is driven from sources outside the boundaries of the childcare provider's financial reports. The effect is to increase the cost to the childcare provider of providing childcare services, thus supporting the need to further increase childcare prices. Not only did monopoly-like conditions emerge in childcare services, but the close links between the property trusts and ABC Learning meant that monopoly-like conditions also seemed to emerge with childcare properties, thus strengthening ABC's dominance in childcare and leading to inflated rental costs, thus inflating ABC's reported costs of providing child care.

The extension of ABC's segmented business model to other aspects of childcare services, and the adoption of exclusive arrangements, such as those with Funtastic, seem likely to help drive price spirals still higher. Further, at the time of ABC Learning's collapse, ABC (and Austock) was in the process of replicating this segmented business model internationally. Not only were ABC Learning and property trusts being established in other countries, such as New Zealand, the United Kingdom, the United States and Canada, the exclusive arrangement with Funtastic was a global arrangement. To the extent that via this segmented business model, childcare in other countries could be dominated, this business model has the potential to drive price spirals and impose pressure on governments to further increas demand-side subsidies. It also appears to have the potential to inflate asset bubbles.

As a share market listed company, ABC Learning had to show adequate returns for shareholders while at the same time defending itself from public criticism over rising child care prices. This seems to have been a flaw in ABC's business model, and investment analysts expressed disappointment in ABC's falling returns. The Goodstart consortium faces no such tension. If it does show profits, Goodstart says it will reinvest those profits in childcare. In taking over much of ABC Learning's operations, however, Goodstart has also inherited much of ABC's former dominance of childcare in Australia, including its segmented business model. In some ways, Goodstart might be regarded as even more segmented than ABC because of its reliance on debt funding, rather than share market investors. That debt funding comes from private equity and from banks, as well as a medium term loan from the federal government.

Internationally, the emergence of hybrid organisations in social services has been noted as has been the need for ongoing research attention to the structure and operation of these organisations (Lapsley, 2008; Hellowell and Pollock, 2009; Thomasson, 2009). In Australia, where Goodstart's emergence has been hailed as the beginning of a "new kind of investment boom", and the private equity involvement also referred to as social investment, this transferral of ABC's operations to Goodstart has been well received. According to Horin (2010)

> "Now the consortium's real challenge begins. The charities have little experience in childcare. They have set up a separate non-profit company and kept the ABC management team installed by the receivers. But the stakes are high. There is a big business to run, big sums to pay back to the banks, the social investors, government and the charities while ensuring a surplus to raise standards."

In Australia, there is much to learn from this experience with demand-side funding in ECEC and much to learn from continued observation of future developments under Goodstart and its social entrepreneurship.

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[i] These include the Austock Group Limited, the Australian Social Infrastructure Fund, the Australian Education Trust, the Orchard Childcare Property Fund and Funtastic Limited.

[ii] ‘Approved care’ refers to services approved by the Australian Government to receive CCB on behalf of families. Such services can include long day care, family day care, in homecare, outside school hours care and occasional care services. Families can also claim the minimum rate of CCB if their child attends ‘registered care’. This can be care provided by grandparents, relatives and friends – so long as they have registered with the Family Assistance Office.

[iii] In 2007, a family with an income below $35,478 and one child receiving care for 50 hours may be eligible for the maximum rate of $168.50 per week. The CCB tapers down to a minimum rate of about $28 per week. Users of registered care (i.e. care provided by individuals and services registered with the Family Assistance Office but not approved by the Commonwealth for the purposes of attracting CCB) are eligible for the minimum rate of CCB regardless of income, but the care must be for work-related purposes.

[iv] The Minister responsible for childcare was not re-elected in the 2004 general election. In 2005 he became a board member of ABC.

[v] This means childcare approved by the Australian government because it meets certain standards and requirements including having a licence to operate, qualified and trained staff, being open certain hours, and meeting health, safety and other quality standards.

[vi] Two key examples are ABC’s arrangements for the maintenance of childcare properties and its arrangements with childcare business developers that emerged around the time (2005) IFRS came into effect. Throughout ABC’s existence, Queensland Maintenance Services (QMS), the director and major shareholder of which was Mr Groves’s brother-in-law, performed the maintenance and property development services for ABC childcare centres. The amounts paid became very large as ABC grew, reportedly $74 million in 2006 alone, and $8 million per month by the time of ABC’s collapse in late 2008 (Walsh, 2009; Kruger, 2010). In addition to questions about the appropriateness of the amounts paid for those services that were necessary, there was also complaint of unnecessary alterations and maintenance on childcare properties (Walsh, 2009). Around the time International Financial Reporting Standards (IFRS) came into effect, ABC began to employ childcare business “developers” to establish new childcare centres. This arrangement has been described as the childcare business developer buying

a chosen block of land, having a childcare centre built, then selling them to a property trust with a long-term lease from ABC. ABC would pay the childcare centre business developer a multiple of expected future earnings for what was reported to be a childcare licence, and then reported as revenue amounts it charged back to the developer to subsidise the childcare centre's operations. This arrangement had beneficial effects on increasing ABC's financial reports (Bita, 2010)