
An Interview with KinderCare's CEO

KinderCare Looks to the Future

by Roger Neugebauer

In July of this year, KinderCare Learning Centers, Inc. celebrated its 25th anniversary. Being the nation's largest child care organization, operating nearly 1,200 centers serving over 100,000 families, KinderCare is frequently in the spotlight. We thought our readers would be interested in the insights of KinderCare's CEO, Tull Gearreald. A graduate of Harvard Business School, Gearreald worked for over a decade on Wall Street in the turbulent world of mergers and acquisitions. He was appointed president and CEO of KinderCare in February 1991.

Exchange: KinderCare has gone through quite a roller coaster ride in recent years. Prior to 1989, KinderCare was growing at an annual rate of nearly 20%. Since 1989, it has experienced a reorganization, a bankruptcy, and some downsizing. Could you walk us through this chain of events?

Gearreald: KinderCare's growth period ended in 1989, but it began to waver in 1986, when it tried to create a diversified portfolio of businesses — all the rest of which were totally unrelated to child care. Once the company made that decision to diversify, most of management's attention was devoted to these other businesses. Profits from the child

care business were then drained off and invested in other businesses.

So while the company kept getting bigger, it didn't keep getting better. This created the opportunity for difficulty. By 1989, the underfunding of the building maintenance and the lack of new programs on the educational side had begun to have an impact on the child care business.

The decision was made to sell the child care business for \$200 million in cash. KinderCare, although at that point saddled with a huge debt, \$350 million, was able to return to a complete focus on child care. Over the next few years, it was able to get out from under most of its debt by converting it into equity, although this did require going through a four month period of bankruptcy.

As a result, we were able to reinvest the \$45 million we would otherwise be devoting annually to interest payments back into the centers. We invested in educational programs, automation of bookkeeping systems, replacing the vans at every center, and bringing up the playgrounds and facilities to their best level ever. This created the platform upon which the company could move forward.

Exchange: Since 1989, the number of centers operated by KinderCare has actually declined. Why is this?

Gearreald: If you pick just the right location to put up a center today, for some proportion of the centers it will no longer be the right location 15 years later — neighborhoods change. For its first 20 years, KinderCare had never closed significant numbers of its centers, and we found that about 20% of our centers no longer had the right market base. So we have sold the majority of those centers — most of them in smaller cities in the Southeast.

Exchange: With all the negative publicity received during the recent difficulties, did this cause parents to lose confidence in KinderCare?

Gearreald: Not really. At most, our occupancy rates dropped by 1% or 2%. At the center level, our directors and teachers worked incredibly hard to maintain the confidence of parents.

Once we were able to start putting substantial resources into the centers, directors were able to show parents that our troubles were behind us. As a result, our occupancy rates are strong. This spring, our occupancy rate topped 80%. We

should finish the year with an annual rate approaching 77%. Next year, we look to move this up another point or two.

Exchange: What about your bottom line? How do KinderCare profits stack up for last year, this year, next?

Gearreald: Using operating income as a measure of profitability, KinderCare expects to be just above \$45 million in the fiscal year recently completed (June 3, 1994). This represented a gain in the area of 10% to 15% over the comparable prior year. I am hoping that we can maintain a similar rate of income growth in the coming year, even though the pre-opening expenses for new units are rising as new center openings increase.

Exchange: Having come through this difficult reorganization period, what is your vision for KinderCare over the next five years?

Gearreald: Perhaps we're back to the aggressive growth mode. In most of the major metropolitan areas where KinderCare operates, there has been very little in the way of new center development in the past five years. In virtually every metropolitan area, we find one or two new communities which have sprung up that don't have adequate child care. This presents tremendous opportunities for growth.

On the other hand, many of these new communities have the most strict zoning and land use ordinances. We're finding that where it used to take us one and one half years to put up a center, it now requires two to three years. We have the financial ability to grow, but it will take a while for this new expansion phase to show results. While we could have managed the addition of 40 centers this year, we are only going to open 15 or 20. Next year,

we may double this number, and perhaps the year after that we will reach 50 to 75.

Exchange: What do the next five years hold for center care in general? Is the rest of the child care world going to grow at the same pace as KinderCare?

Gearreald: We don't know if this will happen. Certainly the demand for child care services will increase, but I'm not sure who will have the capability to respond.

The centers we now put up, with a capacity of 150 to 200 children, require \$1 to \$1.25 million for the building, equipment, and land in a prime location. Commercial banks, the major financiers of new centers, have moved to a 70% and sometimes a 60% mortgage.

But even if we assume that they move back to the 80% mortgage level, that would still leave an equity investment upwards of \$200,000. I think the number of people that can make that kind of investment has diminished. So without a change in the financing mechanism for putting up new centers, it is hard to see how rapid growth will return.

Exchange: The building prototype KinderCare was employing in the 1980's provided a capacity for about 125 children. Your new building design provides a capacity for 150 to 200 children. What caused you to make this change?

Gearreald: The facility that you can provide at that larger size works better. The economics of putting another 50% on the size of your building is much improved. The first two-thirds will cost you quite a bit per square foot, but the additional third doesn't cost you very much, so you end up with a much lower cost per square foot. We also

are able to do a significantly better playground at this size. One of the recent buildings we opened in Texas has a three acre lot, including a two acre playground. The kind of experience you can have on that playground is really vastly improved.

Exchange: I also see that your plans call for opening a center in England in September.

Gearreald: KinderCare believes that part of progressing as a child care company is to try a number of possibilities that are directly related to child care. Certainly one of these would be overseas expansion.

And we believe that if you can't do it in England, which is the culture closest to ours, then you probably shouldn't try anywhere else.

We're trying it out with one center in a planned community near a former US air base where the attitude is generally pro-US. We will learn whether we can provide value for English families.

Exchange: Tell us about the child care market in England.

Gearreald: The average size of centers in England today is much smaller — about 50 children. The rates are considerably higher than they are in the US. Center care for the middle income couple doesn't really exist — that's still the family care market. It's only the elite currently who can afford center-based child care.

So one of the questions we are interested in is "Can we create child care in England for middle income families by using larger centers to provide care?" If the answer turns out to be yes, we believe that there would be room in England for 100 of our centers.

But we're a long way from 100 centers — we're talking about one center. What I'd like to emphasize is that this one center is one of many things that KinderCare is trying. KinderCare will try a first grade in one of its schools in California. We're trying a school age experiment, Kid's Choice facilities for school age children only, that's in its second stage. We now have kindergartens in over 700 of our centers. And we plan to experiment with an infant center.

So we are testing child care overseas just like we are testing a number of concepts. I would expect that some of these experiments will fail.

For example, our venture into providing after school care in public schools clearly failed. The spaces that schools were providing for school age care — gyms, cafeterias, and playgrounds — weren't ideal, and public school officials were reluctant to contract with for profit entities. But I would also expect that some of these experiments, such as our Kid's Choice facilities, will succeed.

Exchange: One of the keys to a successful classroom is the creativity and spontaneity of the teachers. How can a large bureaucracy like KinderCare, with over 23,000 employees, keep from stifling these important elements?

Gearreald: I think KinderCare needs to be much more decentralized than most companies in order to deal with individual creativity. If you have two two year olds in the classroom with different needs, you must be able to develop each one differently. If you can't do that in the child care business, then, sooner or later, you will no longer be a significant player. That forces us to be very decentralized at the care level.

The average public school system is 50% classroom teachers and 50% administrators. We're 98% people in the child care centers and 2% outside the centers. If we can maintain that, and give the center directors enough tools to use, we will be able to maintain a good level of classroom creativity. In the end, the delivery point to the children is what all the rest of management exists to support.

Exchange: How does KinderCare position itself among all the providers in a community?

Gearreald: We position ourselves to some extent by the price we charge. It's not atypical to have 30 competitors within a five mile radius of one of our centers, and among these 30 competitors we would be above average in terms of price. We are not normally at the top — there are always a few providers who focus on the very elite end of the market and charge considerable premiums for their services.

KinderCare is after the middle and upper middle income market, which we view as a very large market in every metropolitan area. We need to show that the level of quality we provide is worth the price we are charging.

Exchange: Where do you position KinderCare in terms of child:staff ratios in a community?

Gearreald: We have been sensitive to individual state differences. If a state says it wants child care for its parents to occur at a certain ratio, we have generally agreed to go along with it.

For example, we feel perfectly comfortable with a ratio of four infants per teacher or a ratio of five infants per teacher. We believe that both those systems can be operated

successfully and provide adequate care to very young children. If a state says the right thing for its parents is five infants for one teacher and that the parents then get the lower price that this enables you to charge, then we've gone ahead with that.

There are some states that have ratios that we feel are difficult. For instance, one state has had a ratio of infants as high as 8:1. We find it very difficult to ask teachers to take care of 8 infants. So in that case we operate below the state standards. But by and large we think that state requirements are somewhat reflective of what parents and the educational community in that state want.

Exchange: What about wages? Where do you peg KinderCare salaries in order to attract the teachers you want?

Gearreald: Let's talk first about center director salaries. In 90% of our markets we are above average in the salaries we pay directors. We believe that our center directors require a higher compensation level. And for several more years they will continue to receive increases above the company average, above the inflation level.

For our teachers we would like to be near average in terms of direct compensation and above average in terms of benefits.

Exchange: KinderCare has been accused of being aggressive in opposing the unionization of its teachers. What stance does KinderCare take on the unionization of teachers?

Gearreald: We believe that our teachers are not compensated as well as we would like to see them. We think the teachers do a very important job for the country as well as for

the individual parents. But we don't believe that parents are willing to pay much more for child care than they currently are paying and that's a direct translation into teacher compensation.

We don't believe that the appearance of unions, were it to happen, would improve the quality of care very much. That hasn't been the history in other industries that have gone through unionization, and we don't believe that would be the case here. We're trying to focus all our resources on the improvement in care, and since unionization would not contribute to that, it is not something that we have supported.

Exchange: In its 25 years of service, and from serving over 100,000 families currently, KinderCare certainly has its finger on the pulse of what middle income parents want. How are families' expectations for center-based child care changing?

Gearreald: Ten years ago there was much more emphasis on security, safety, and convenience. When Exchange interviewed KinderCare founder Perry Mendel 12 years ago, he said that what made KinderCare a success was locating its centers on the AM side of the street so that parents only had to make a right turn in the morning instead of a left hand turn across traffic.

I don't think that's true today. I don't think convenience is as big a factor for parents. I think safety and security are threshold questions — parents assume that you have to have high levels of safety and security. What they are looking for is a process that helps in the development of their children, that focuses on what their particular child needs.

Exchange: In your first four years, what is your proudest achievement?

Gearreald: What I'm proudest of — on behalf of the company, not a personal achievement of mine — is providing the resources to center directors to provide better care to the kids, and to focus all of the departments of the company on that single most important criteria — to do what's best for children. If there's anything I've added to the company, it's to return it to that view which I think it had in its early days.