



MANAGEMENT COMMITTEE – 21 JULY 2016

PROGRESS UPDATE

REPORT OF THE DIRECTOR

Purpose of Briefing Note

1. The purpose of this update is to inform Members of the actions and progress made since the last Management Committee meeting held on 2 March 2016.

Overall Financial Performance

2. Overall financial performance for the 2015/16 year is outlined below:
 - Total sales to 31 March 2016 are £88.6m compared to a budget of £96.1m. The key adverse variances being in store sales and gas.
 - Rebate income is £6.1m which is up 4% from last year.
 - Overall costs as a percentage of sales have increased from 19.2% last year to 19.4% due to the fall in sales. Total expenditure is £17.2m.
 - Overall surplus is thus £3.3m but is subject to audit.
3. Key figures underlying the total sales to 31 March 2016 are as follows:

Combined Preliminary Results

	<u>YEAR TO DATE</u>		
	ACTUAL £m	BUDGET £m	PRIOR YEAR £m
<u>SALES</u>			
STORES	41.674	46.006	43.403
DIRECT	19.274	19.651	20.508
GAS	20.450	24.267	22.711
CATALOGUE ADVERTISING	0.904	0.955	0.800
REBATE INCOME	5.871	5.045	5.871
MISCELLANEOUS INCOME	0.120	0.150	0.172
<u>TOTAL SALES</u>	<u>88.293</u>	<u>96.074</u>	<u>93.465</u>

4. The balanced scorecards for March (2015/16 full year) and May are attached as appendices.

Specific Reserves

5. At the last year end, included in specific reserves, was a provision for £400k for Strategic Review. This provision has been in place for four years and to date has been unspent. As part of the journey towards achieving the £6m surplus in 2018/19, it is anticipated that there will be reorganisation costs including redundancy. Permission will therefore be sought at the Management Committee for the reclassification of this reserve as a reorganisation reserve.
6. Also, as a follow on from the building refurbishment project, there is some available capital headroom to double the mezzanine floor at ESPO, and so facilitate further much needed operational capacity in house. Further detail is provided in the report on Managing Change & Business Development elsewhere on this agenda.

External Activities and Developments

PBO and beyond

7. During this period, I attended the BESA Executive Council, at which we discussed industry relationships, legal changes facing educational suppliers and the BESA five-year strategy review. It is informative to participate in this group, providing context for overall market performance and positioning.

'Brexit'

8. In the immediate aftermath of UK's referendum on 23 June, sterling has fallen to its lowest level for over 30 years, and the UK's credit rating has been downgraded. It is anticipated the markets will remain volatile until the terms of decoupling from the EU, and what will replace it, become clearer. A high level impact assessment for ESPO follows.

Prices

9. A sustained fall in the value of sterling against other currencies will eventually lead to increased prices of products and raw materials imported to the UK and, therefore, price inflation.
10. In the short term, some fluctuation in currency rates is a constant, and suppliers with significant exposure to currency volatility should contractually be hedged against it to provide a degree of certainty, providing protection to ESPO from a short term impact. Smaller suppliers are the most likely to seek to renegotiate terms the earliest with us.
11. Fuel prices are likely to increase as the pound (GBP) weakens against the dollar (USD). As oil is traded in USD, this means it will cost more, which will affect everyone, so, if significant and sustained in the short term, it could lead to price

increase requests from suppliers across the supply chain and sector. Although this could erode ESPO's margin in the current year, the aim will be to resist accepting increases, particularly where a competitive marketplace still exists.

12. In the longer term, and particularly in relation to the next catalogue year (2017-18), it is anticipated that suppliers will seek to exercise clauses allowing for increased prices if the fall in the value of sterling and price inflation is sustained.
13. Conversely, if ESPO were to start exporting through a Limited Company, a fall in the value of sterling over a longer term period could make ESPO more competitive to international schools.
14. In the energy markets, the UK's ability to secure much-needed investment in new energy infrastructure will be decided on the way in which 'Brexit' is managed and a large amount of investment will almost certainly be put on hold until then. The downside for the UK energy market is that capacity margins (the ability for supply to meet demand), which were already tight, will become more so in future. New power stations take years to construct so further delays in that investment could have a detrimental effect on security of supply and, in turn, prices.

Supply Chain

15. Depending on the extent to which sterling depreciates against other currencies, this could limit opportunities to re-source products from overseas, and may therefore reduce opportunities to secure savings to boost catalogue margins. However, this could still be offset through successful re-sourcing of a significant spend category.
16. More challenging trading conditions are likely to lead to a higher risk of business failures, particularly companies that are largely operating in the domestic markets and in market sectors most affected by an economic downturn, such as construction/building, or where suppliers tend to operate on very low margins, such as furniture. This will need to be reflected in procurement strategy, through increased monitoring and dual or multi-sourcing for example, to provide resilience.

Operating Costs

17. Aside from general inflation, operating costs could be impacted in the current financial year through increased fuel costs and increased cost in the supply of goods and services.

Regulatory change

18. Public procurement legislation is derived from EU Directives but is incorporated in UK law through the Public Contracts Regulations 2015 so will not be immediately affected even at the point the UK leaves the EU. Whether and at what speed public procurement regulation develops after the UK exits the EU will probably depend on the terms of exit and in particular the terms of any trade deals with the EU.

Staff

19. It remains to be seen what the arrangements will be for EU citizens already in the UK. Employees from other EU states represent 13% of ESPO's total number, 24% of ESPO's operational workforce and 4% of its office staff. The inherent uncertainty and a significant and sustained fall in the value of sterling may in any event lead to some EU citizens deciding to return to their country of origin, depending on the extent to which they are settled and have put roots down in the UK. This will impact on ESPO's workforce planning.

MTFS Implications

20. In the short term (FY 2016/17) the primary threat is to margins through increases in buying prices (moderate to low risk) and increased operating costs (moderate risk). In the longer term, whilst buying prices may increase, these would be reflected in selling prices to protect margins, balanced with the need to remain competitive. There is a higher risk of supplier failures, which would require re-sourcing (potentially at higher prices) which could be offset to an extent by dual/multi-sourcing where feasible.

Internal Communications

21. The ESPO Leadership Team issued the following communication into the business:

“As we woke this morning, to the unparalleled news that the UK has voted to leave the EU, the full impact of the referendum conclusion is too early to establish. However, ESPO is a strong organisation that has thrived for over 35 years, adapting and changing to the challenges of the day; consistently emerging successfully. It's 'business as usual' as far as we are concerned.

“We are a multi-cultural business, with staff members originating from all corners of the globe, many from our European neighbours; we're stronger because of our diversity and the contributions of each and every one of you will continue to ensure our strength for the future.

“As the senior team and as an organisation, we haven't been focused on Brexit or Bremain, but on delivering 'Brexculture' – and we believe that even more strongly this morning. The only secure route to our continued success in an uncertain, turbulent market and world is to focus on being the best version of ourselves – and this is what we will continue to do.”

Treasurer Comments

22. The Governor of the Bank of England hinted on 30 June that interest rates could be cut from their record low of 0.5%, perhaps as soon as July. The UK economy is already showing signs of strain and the economic outlook for the UK has 'deteriorated', he said, as a backdrop of uncertainty takes its toll.
23. The Institute for Fiscal Studies (IFS) has concluded that exiting the EU will cause a reduction in GDP of between 2% and 3.5% by 2019. These GDP declines would lead to the public finances being £20 to £40 billion less healthy than if the UK had remained in the EU.
24. While further funding reductions to the public sector are not likely to be increased over those put in place prior to the referendum, the period of austerity is likely to lengthen into the next parliament with one to two additional years. Where we have already seen a strain on customer budgets and a marked decline in spending by corporate customers, this trend will be exacerbated by the uncertainty generated by the UK's exit from the EU and extended by the elongated process of withdrawal.

ESPO Internal Developments

25. ESPO is working with the Servicing Authority to review and re-set the resourcing of the HR Business Partner model. This will be to allow working with the ESPO Leadership Team to support a realistic workforce plan to support the delivery of the MTFs over the next four years. It is anticipated that this will require significant support, and aspects of this work may require action plans to identify and realise savings, and introduce new skill sets.
26. All sickness absences at ESPO are being managed in line with the Attendance Management policy and procedure which has shown a reduction in the last six months from 12.05 to 10.88 days lost per FTE as at 31 March 2016. It is expected that these figures will continue to decrease, as the impact of management action is realised.
27. The first Employee Engagement Group took place in March 2016 with a representative from each part of the organisation. This meeting was considered a success with members making constructive contributions about improving employee engagement within the workforce. A plan has been created based on the Investors in People principles and we are currently engaging with the group on how the standards are currently being met and can be improved as part of ESPO's People Strategy.
28. An ILM Level 3 Programme is being delivered to 17 Category Managers within the Commercial division with the intention to roll this out wider to other departments.

Local Government Pay 2016

29. Leicestershire County Council, and hence ESPO, has implemented the National Living Wage from 1 April 2016. Therefore employees on pay points 3, 4, 5 and 6 will be paid £7.20 per hour which equates to £13,891 per annum (based on working a 37 hour week). This figure should continue to be paid until such time as Leicestershire County Council implements the National Joint Council finalised pay agreement.
30. The grading structure is currently being reviewed by Leicestershire County Council due to the effects of the national living wage on their pay structure.

Campaigns, activities and newsletters

31. All of our existing customers have now received the new ESPO catalogue. To support this, ESPO held an internal launch to staff giving everyone the opportunity to view new products and talk to product managers. Communications featuring our key messages were also emailed to customers in advance of them receiving the catalogue, with online and social media promotions to further increase interest.
32. Selected non-customers in key development areas also received the new catalogue in April, accompanied with a 10% discount off their first order, the low priced paper offer and a price comparison leaflet across twelve core lines. Following this, Account Managers have been telemarketing to schools in their areas to secure appointments and spend, with dedicated telesales following up outside of Account Manager areas. Across selected development areas we will also be running a campaign with the Education Company utilising their datasets.
33. Our loyalty campaign was well received by customers during May. With discounts of up to 10% available for large orders, the offer was designed to offer a unique saving to our highest spending schools, while also encouraging large orders to be placed through the warehouse. With average customer spend of around £2k and the average order value of over £500, this promotion met its expected targets.
34. The low priced paper offer has received strong sales since its launch, with over £70k worth of sales. This promotion serves as a useful introduction for new customers to ESPO's everyday low pricing and helps to bring in more sales from existing customer currently not buying paper from us.
35. To complement ESPO's main catalogue we also produce a number of mini-catalogues which are subject specific and are targeted at 'department' managers within organisations, these mini-catalogues were distributed throughout May and include Art and Craft, Early Years, Site Manager and Office Manager. These mini catalogues are also available alongside our main catalogue for customers to order on request via our website espo.org.
36. Immediately following half-term our ever-popular School Holiday Offer will start being promoted to schools, this promotion gives customers a discount if they

choose to receive their order during the school summer holiday break. With many schools placing large orders in the run up to the end of term, in anticipation of the new school year in September, this promotion has significant benefits for the warehouse as it helps to shift demand away from our busiest time of the year, towards one of the quietest.

37. During June, ESPO will be exhibiting at the Chartered Institute of Housing Show, the Public Sector Show and the Association of School and College Leavers Show. Representing ESPO at these three shows, our Account Managers will target new customers with our frameworks and catalogue products.

ESPO Operational Progress

Operations

38. Looking back on the year ending 31 March, the operations team has picked and shipped 14m kg of orders comprising 10.8m units, 406,000 orders and 2.4m order lines. Whilst the volumes were down 7% on 2014/15, the average order lines picked per employee have risen from 26 lines per hour to 35 lines per hour. This is a reflection of the Lean logistics protocol under ESPO's continuous improvement process. This includes deployment of enhanced warehouse systems management, re-designed pick routines, picking, packing and staging equipment together with a performance management process.
39. Stock availability has averaged 98.75% reflecting the improved visibility provided by the in-house stock control system. Customer orders are therefore completed on-time and in-full (OTIF). Customer Feefo feedback on ESPO services has averaged 96% indicating that that they rate the service as good to excellent. Operational costs to end of February were £171k below budget at 21% of sales.
40. Following a tender exercise, a new fleet of ten DAF large goods vehicles have been delivered, comprising 7.5T and 12T gross vehicle weight. These vehicles will carry the new attractive ESPO livery, featuring products from the catalogue. All vehicles have been fitted with the CTrack tracking and telemetry system which provides feedback on driving behaviour. This enables management to provide our drivers with feedback on their driving styles and journey management that we anticipate will improve route planning and fuel efficiency.



ESPO Risk and Governance Update

Audit Reports

41. In 2015/16, the following audits were undertaken which received 'Substantial Assurance': Business Strategy, Business Strategy (Control Design), Governance Framework, Distribution Surplus-Design, General Ledger Reconciliations, IT General Controls, BACS, Business Strategy BS Control Design and Business Strategy Transformation.
42. An audit of Transparency was given no assurance opinion as it was a fact finding and consulting piece of work.
43. An audit of Trading Performance was given 'Full Assurance'.

Health & Safety

44. In the fourth quarter, there were a total of 31 reported incidents with none RIDDOR reportable. Injuries included cut/lacerations (7), strain/sprains (6), abrasions/scratches (3), bruise/bumps (2), soft tissue injury (1), whiplash (1), superficial injury (1) and no apparent injury (2). One injury related to underlying disease.
45. In the first quarter of 2016/17, there were a total of 6 reported incidents with none RIDDOR reportable. Injuries included cut/lacerations (1), strain/sprains (1), abrasions/scratches (1), bruise/bumps (1), and superficial injury/irritation (2).
46. There were seven incidents of property damage, which included four impacts with objects (the new pedestrian safety barrier being nudged, beams with slight deflection and three accidental damage.)
47. An unplanned fire evacuation took place on the morning of 1 April; this was triggered by dust in the server room. The issue has now been addressed.
48. There were various physical improvements carried out in these two quarters which will impact health and safety and a suite of training delivered to staff.
49. Manual Handling training took place with assessments continuing to be carried out throughout Operations. One such assessment has resulted in the need to elevate the sorting islands to reduce the bending and lifting risk and this is being addressed. In June, packing stations staff underwent a repetitive task assessment which was found to be satisfactory. A number of individual risk assessments have taken place for staff with existing injuries not sustained in the workplace.
50. First Aid training was rolled out in May and June and will be completed in September. Fire Marshal training will take place in September. Pallet stacker training took place in June with agency training on this and other Manual Handling Equipment ongoing.

Business Continuity

51. A Business Continuity training programme has been developed and a scenario-based training event took place in May 2016. This was supported by health and safety training as outlined above.

Corporate Risk Register

52. In March and June, ESPO's Leadership Team held its quarterly reviews of Major Risk Records (MRRs).
53. The following new risks were identified for which MRRs will be written up:
- MRR60 Non-delivery of Business Development Agenda to MTFS
 - MRR61 Stock Profile on the high-value of unsold aging stock
 - MRR62 Servicing Authority Support to highlight the requirement for adequate provision of HR, Audit and Legal support
 - MRR63 United Kingdom's decision to exit the European Union
54. There are seven high risks which are reviewed monthly:
- MRR 5 Attracting and retaining quality staff
 - MRR 6 Failure to achieve budget surplus
 - MRR 8 Potential governance failures by management
 - MRR 34 Robust business continuity in the event of an emergency
 - MRR 36 Risk of delay in migration of supply points to new energy supplier
 - MRR 37 Loss of a vetted supplier in Catalogue Procurement
 - MRR 38 Potential failure of the Optima implementation
 - MRR 48 Strategic IT success planning
55. Failure to achieve budget surplus (MRR 6) and risk in delay of migration of supply points to the new energy supplier (MRR 36) have recently become high as the risk has increased because of where they sit in their lifecycle.
56. One MRR previously reported, 'Failure to protect rebate income', has been subsumed within the risk of 'Failure to achieve budget surplus'.

Resources Implications

57. None arising directly from this report.

Recommendation

58. Members are asked:
- a) To approve the reallocation of £400k strategic review reserves to a reorganisation reserve;
 - b) To acknowledge the impact of the United Kingdom's decision to exit the European Union;

- c) To note the contents of the report.

Officer to Contact

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Appendices

Appendix 1: Balanced Scorecard 2015/16 Fourth Quarter/End of Year
Appendix 2: Balanced Scorecard 2016/17 to May 2016