Education LATC Business Plan

2016/17

Version: 3

Revised: June 2016

take part, take pride

Sutton

1. EXECUTIVE SUMMARY

This is the draft of the company's first business plan. Its objectives are aligned with those of its shareholders: London Borough of Sutton and a number of Sutton school governing bodies and academy trusts. The plan sets out the financial forecasts for the first three years of operation of the proposed joint venture trading company, majority owned by LB Sutton, with minority shareholdings held by Sutton school governing bodies and academy trusts.

The company is forecast to trade at a loss in its first year, before moving into profit in year 2. The company will require a loan of £500,000 from its principal shareholder (LB Sutton) to finance its operations. It is expected that by the end of the first three years of trading the company will have been able to have repaid £250,000 of that loan, with its cash balances approximately equalling the outstanding debt.

The company faces a challenging period, during which there is expected to be a significant amount of change in the way in which education in England is funded. This represents both an opportunity and a threat.

2. OBJECTIVES

The objectives of the company are to:

- Maintain and extend the exceptionally high quality of education provided by schools in Sutton
- Maintain close and effective working relationships with schools
- Aligning itself with the strategic direction of local schools and national education policy
- Break-even

3. BACKGROUND

The Council has commissioned the development of a business plan for a potential trading company to deliver education services to the Council and to Sutton schools and academies.

The favoured model for delivering services in the future was agreed by the Council's Children, Families & Education Committee in February 2016 to be a local authority trading company, owned jointly with Sutton schools and academies, of which the Council would retain a majority shareholding. This decision was subject to the development of a plan that showed how the company would be financially viable with reduced costs to the Council in line with agreed savings plans and limited Council exposure to financial risk.

4. GOVERNANCE

The company is to be majority owned by LB Sutton, with minority shareholdings held by those Sutton academy trusts and Sutton school governing bodies that wish to participate in the company.

LB Sutton will ensure that the company operates in line with the Council's strategic objectives through two main approaches:

- Contract management – the Council will contract with the company for the provision of a significant proportion of the company's activities. In managing these contracts the Council is expected to require its company to co-operate in all relevant activities.
- Appointing directors to the company's board – the Council will ensure that it is able to exercise a decisive influence over both strategic objectives and significant decisions through a voting majority on the company's board of directors.
- The shareholders will reserve certain matters for decision, for example sign-off of annual business plan. In particular they are expected to want to keep the balance of the company's activities under strategic review, in order to ensure that the contracting arrangements continue to be compliant with Public Contract Regulations

5. OPERATIONS

The initial staffing of the company will be comprised of staff transferred under TUPE arrangements, complemented by new recruits who will bring additional commercial experience.

The incoming managing director and operations director are expected to rationalise the management structure and other staffing structures to ensure that the company makes rapid progress towards being financially sustainable on an ongoing basis, as required by the financial plan.

Schools' part ownership of the company represents an excellent opportunity to ensure that schools' requirements are built into the design of services that the company will offer to schools. This will be important both for securing income from Sutton institutions, but also for developing profitable services for sale to institutions beyond the borough boundary.

6. FINANCIAL SUMMARY

6.1. Context

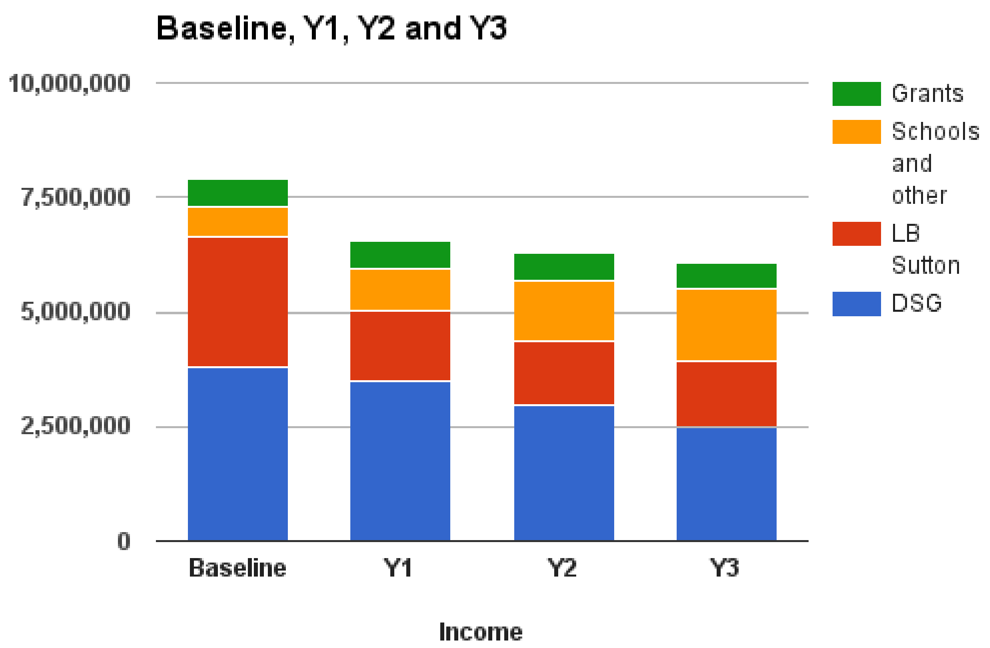
The company is being established in the context of significant uncertainty about future funding for education services. This uncertainty comes from

- The ongoing downwards pressure on UK public sector resources overall
- DfE changes to funding of schools (consultations underway or anticipated on national funding formula, high needs funding formula and early years funding formula)
- Emerging DfE policy in relation to academisation and the degree of compulsion involved
- Local pressures in certain areas of education spend, in particular budgets for special educational needs

This is not a coincidence. The establishment of the company is partly a response to the anticipated financial environment, with the Council recognising that setting up a commercial delivery vehicle to be able to respond swiftly to both opportunities and threats represents an intelligent way of seeking to manage the uncertainty that it will inevitably face over the short to medium term.

6.2. Income streams

The chart overleaf sets out the forecast income streams for the company, based on the figures in the profit and loss forecasts below.



The company will have four principal income streams – LBS core funding for statutory duties, Central DSG for a mix of statutory duties and discretionary functions which schools collectively through the Schools Forum have agreed to fund, income from trading activities (currently predominantly with Sutton schools and academies), specific grant income.

Over time the balance between these streams is expected to shift.

LBS has reduced its funding to the amount required to comply with its statutory duties, removing approximately half of its education funding as a consequence. There may be some redefinition of statutory duties over time which will potentially change the amount that the company receives. No assumption is made about this in the forecasts.

Central DSG budgets continue to be under pressure, with increases in the costs of Education, Health and Care Plans in particular. In the current year this is likely to result in reductions in other centrally-funded DSG items, and it is assumed that in excess of £400k is removed in-year in 2016/17, and that the same happens in years 2 and 3, until such time as Special Educational Needs costs are stabilised – a necessity if Sutton schools' budgets are not to be increasingly top-sliced to pay for these centrally-funded pressures.

Trading with schools is expected to increase, both with Sutton schools and academies, and with schools and academies outside the borough boundaries. Reductions in central DSG budgets will leave Sutton schools and academies having to seek alternative ways of securing support. The company will seek to provide high quality and good value offers in that context, but it is assumed that the lost income will not all be able to be recovered through trading – some schools will choose to go without support, whilst others will make their own arrangements. It is assumed that no more than 50% of any reductions in central DSG funding can be replaced by trading with schools and academies. Similar pressures are likely to apply in neighbouring authority areas and the company will seek to trade profitably with institutions beyond the boundary. An estimate of £80k growth in such external income has been included in year two, and a further £20k in year three.

Two significant grants are received. First, Pupil Premium grant for children looked after who are attending Sutton schools is administered and allocated by the company on a quarterly basis. The grant is ring-fenced and any changes in its value would be reflected in what is allocated. Secondly the company receives funding from the Arts Council, England, to deliver the Sutton music hub. The grant funds around half of the activity delivered by the service and its removal (either through deletion of the funding or through another provider winning the hub delivery role) would trigger a fundamental review of the delivery of music services by the company.

6.3. Outline forecast profit and loss account years 1-3

£'000	**Sep 16-Aug 17**	**Sep 17-Aug 18**	**Sep 18-Aug 19**
	Year 1	**Year 2**	**Year 3**
Income			
DSG	3,513	2,959	2,509
LB Sutton	1,488	1,423	1,423
Grants	594	594	594
Schools and other income	944	1,303	1,548
TOTAL	**6,540**	**6,280**	**6,075**
Expenditure			
Staffing	4,832	4,235	4,035
Other	2,030	1,961	1,881
TOTAL	**6,862**	**6,196**	**5,916**
Loss	**322**		
Profit		**83**	**158**

The company is forecast to make a loss in year 1, reflecting set-up costs and the difficulty in achieving significant cost savings immediately, given lead-in times on staffing reductions and in securing income from schools. By year 2 the company is forecast to be profitable.

6.4. Outline forecast cashflow projections

Cashflow forecast		2016				2017							
£'000		Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
Receipts													
	Shareholder loan	500											
	Schools and other trading	0	57	144	32	67	34	170	74	51	203	97	144
	Grants	0	70	78	0	0	149	0	70	78	0	0	149
	LBS inc Central DSG	0	533	533	533	533	491	491	491	479	479	479	479
	Total	500	661	756	565	600	673	661	635	609	682	576	772
Payments													
	Shareholder loan												-100
	Staff	-231	-231	-231	-230	-204	-197	-197	-194	-194	-194	-194	-194
	HMRC, Pensions	0	-218	-218	-218	-216	-192	-185	-185	-182	-182	-182	-182
	Non-staff	-16	-225	-219	-211	-203	-200	-200	-200	-193	-193	-193	-193
	VAT	0	0	0	0	-127	0	0	-193	0	0	-190	0
	Total	-248	-674	-668	-658	-749	-588	-582	-772	-569	-569	-759	-669
Net cashflow this month		**252**	**-13**	**88**	**-93**	**-149**	**85**	**78**	**-136**	**40**	**113**	**-183**	**103**
Cumulative cashflow		**252**	**239**	**328**	**235**	**86**	**170**	**249**	**112**	**152**	**265**	**82**	**184**

Cashflow forecast		2017		2018				2019	
£'000		Sep-Nov	Dec-Feb	Mar-May	Jun-Aug	Sep-Nov	Dec-Feb	Mar-May	Jun-Aug
Receipts									
	Shareholder loan								
	Schools and other trading	281	269	418	549	342	343	491	634
	Grants	149	149	149	149	149	149	149	149
	LBS inc Central DSG	1,348	1,303	1,303	1,303	1,213	1,168	1,168	1,168
	Total	1,778	1,721	1,870	2,001	1,704	1,660	1,808	1,951
Payments									
									-150
	Staff	-546	-546	-546	-546	-511	-511	-511	-511
	HMRC, Pensions	-524	-513	-513	-513	-491	-480	-480	-480
	Non-staff	-568	-611	-611	-563	-553	-548	-548	-548
	VAT	-188	-181	-173	-180	-180	-173	-161	-168
	Total	-1,826	-1,851	-1,843	-1,802	-1,736	-1,713	-1,700	-1,857
Net cashflow this quarter		**-49**	**-130**	**27**	**199**	**-32**	**-53**	**108**	**94**
Cumulative cashflow		**136**	**6**	**33**	**232**	**200**	**147**	**255**	**349**

7. TAX

7.1. VAT

The company will be VAT-registered. Its supplies are predominantly standard-rated.

7.2. Corporation Tax

The company's profits will be liable to Corporation Tax.

7.3. PAYE

The company intends to contract with LB Sutton for the provision of payroll services, including making of all PAYE returns.

8. LONG TERM FUNDING PROFILE

8.1. In year 1 the company is forecast to require access to working capital funding amounting to £500k, provided by its majority shareholder, LB Sutton. The financial projections assume that interest on such loans is charged at 5% p.a.

8.2. The overall impact on LB Sutton's cashflows is expected to be broadly neutral compared to if it were still employing the company's staff – instead of making payments to employees in month 1 it will instead lend cash in month 1 to the company.

8.3. It is forecast that by the end of its third year of trading the company will have been able to repay 50% of the shareholder's loan.

9. SENSITIVITY TESTING

9.1. In the first year of operations an increase in other income (traded) of nearly £160k is forecast. It is recognised that this is a challenging target, part of the strategic response to a challenging budget position for the Council.

9.2. In developing the cashflow and profit and loss forecasts consideration was therefore given to how the company would respond if it were not able to secure this level of additional income. The strategic response would be to change the balance of savings, so that more would be delivered by reducing costs, and less by reducing income.

9.3. This has a limited adverse impact on the company's forecast cashflow position and profit and loss figures, because the company would seek to respond quickly to emerging failure to secure income, although there would be an adverse impact on the Council through its funding of redundancy payments for transferred staff – because of the higher numbers of redundancies compared to a situation where the company traded successfully.

10. SWOT ANALYSIS

10.1. Strengths

- Creditworthiness of principal customers
- Skilled workforce, with good relationships with majority of customers
- Significant proportion of income (77% in year 1) is earned through contracts with the majority shareholder, giving a degree of certainty about income, compared with, for example, trading one-off pieces of work with multiple smaller customers.
- Principal customers (LB Sutton, Sutton schools, Sutton academies) have a stake in the company's success
- Strong reputation of educational performance in Sutton schools, providing the company with an important selling point when looking to trade beyond Sutton's boundaries

10.2. Weaknesses

- Limited commercial experience within the staff transferring to the company from LBS.
- Substantial uncertainty about future income streams
- Limited amount of time to establish the operations from Committee approval to launch.

10.3. Opportunities

- To sell services profitably to institutions beyond the borough boundary
- Academisation – change across the schools landscape creates opportunity for a business that understands the challenges schools face and the differences and similarities in the challenges that academies face.
- An increasingly open market to provide services to schools, supported by government strategy around multi-academy trusts
- Instability in neighbouring local authorities' education services over the coming years – budget reductions and staff departures could leave significant local authority functions under-resourced with difficulties in recruiting to fill the gaps. The company would seek to position itself as a potential solution.

10.4. Threats

- Financial position of customers, facing downward pressure on resources over the medium-term, thus limiting their ability to buy additional services
- Financial position of potential new customers, who will be facing similar downward pressure.
- Impact of national changes to funding of schools – detail is not yet certain and the company will need to keep itself updated on the emerging picture, and plan for the implications.
- Longer-established spin-outs operating close to Sutton's borders (AfC – Richmond & Kingston; Octavo – Croydon). To date AfC have not featured as a competitor for

Sutton schools' business, but this is not expected to continue forever. Octavo have attempted, apparently with little success so far, to compete to win Sutton schools' business. Their longer track record and experience of trading, combined with the specific schools focus of their business, makes them a key competitive threat.

11. RISK REGISTER

There is a risk that…	Mitigation	Current Status
The company fails because of a lack of commercial expertise	Recruit a managing director and operations director with relevant experience and skills Ensure managers have a degree of commercial understanding in advance of transferring to the company	Initial conversations with search consultants prior to formal commissioning of the search One day "commercial countdown" courses delivered by CIPFA trainer to 20 managers
The company's income forecasts are optimistic	Company monitors closely income earning and takes corrective action to reduce costs if necessary	
The company does not have a suitably skilled workforce	TUPE applies to staff working within the existing service.	High levels of staff engagement to ensure that staff understand the changes ahead and are motivated to help the company succeed
The company fails to collect income due	Establish a finance team within the company with clear focus on debt collection and cashflow management	
Employer pensions contribution rates add significant extra costs which cannot be recovered through price rises	Seek to negotiate price increases with customers	Initial assessment of contribution rate based on February staffing implies cost pressure of £106k

12. CONCLUSION

The company has an opportunity to establish itself as a robust local provider of services to organisations with education responsibilities – in particular LB Sutton, but also schools and academies.

To succeed the company will need to be able to respond quickly both to opportunities and to threats, recognising that it will be operating on tight margins, with no room for complacency.

It will initially be focused on Sutton, but has the opportunity to use the successful Sutton education brand to expand into other areas. It is expected that this will predominantly be in south west London, but the company will not limit its ambition to this geography.