WIRRAL

POLICY & RESOURCES COMMITTEE

Wednesday, 12 July 2023

REPORT TITLE:	**EDSENTIAL DRAFT ANNUAL BUSINESS PLAN REVIEW AND OPTIONS**
REPORT OF:	**DIRECTOR OF FINANCE**

REPORT SUMMARY

This report invites Policy and Resources Committee to consider and review the Draft Annual Business Plan submitted by Edsential CIC setting out the current position of the company, its view of the immediate future and steps that it proposes to take to continue trading successfully and compliantly. It seeks approval for the Director of Finance to negotiate any detailed changes to the draft Annual Business Plan and present an agreed version for approval by Policy and Resources Committee.

The Wirral Plan 2021 - 2026 sets out the Council's vision to secure the best possible future for the Council's residents. The proposals within this report are relevant to the following themes of the plan:
- Brighter futures for all regardless of their background;
- Safe and pleasant communities that our residents are proud of; and
- Healthy and active lives for all, with the right care, at the right time.

The proposals within this report affect all wards.

This is not a Key Decision.

EXEMPT INFORMATION

The appendices to this report contain exempt information as defined in Schedule 12A of the Local Government Act 1972. It is in the public interest to exclude the press and public under Paragraph 3 'Information relating to the financial or business affairs of any particular person' (including the authority holding the information).

RECOMMENDATION/S

Policy and Resources Committee is recommended to:

(1) Endorse option 5 as detailed within this report and allow Edsential CIC to continue to trade in the manner proposed in the Draft Annual Business Plan which is attached as exempt appendix 1 to this report);

(2) Authorise the Director of Finance in consultation with the Director of Law and Governance and, so far as is practicable, with appropriate representatives of Cheshire West and Chester Council to agree and approve the content of the Annual Business Plan

SUPPORTING INFORMATION

1.0 REASON/S FOR RECOMMENDATION/S

1.1 After detailed consideration of all the options set out in this report it is considered that Option 5 has the most realistic chance of leading to the repayment of the currently outstanding loans. Consideration should be given to encouraging Edsential to diversify its service offer, where practicable, to include services not currently provided directly to either shareholder. This will drive revenue growth which could ultimately be used to fulfil the shareholder ambitions around employee remuneration.

1.2 The options for the company to cease trading (option 1 and 3) will ultimately negatively impact on both customers and staff and will guarantee that the outstanding loans will not be repaid. The option for either shareholder to take full control (option 2) is also unrealistic as it would require one shareholder to recognise significant losses and the other to take an increased financial risk from trading activities and without the material changes to the financial arrangements offered by the company as outlined in option 5, will not address the current financial stresses on the company.

2.0 OTHER OPTIONS CONSIDERED

2.1 A number of alternative options including in-house delivery, transfer of ownership winding-up and expansion of the company are considered within the paper below.

3.0 BACKGROUND INFORMATION

3.1 Wirral's Cabinet 10th September 2015 agreed to the establishment of an educational services company to be known as Edsential. This was following the submission and review of a full business case developed with support from the national government's Cabinet Office, Price Waterhouse Coopers and the two partner councils under the national 'Delivering Things Differently' programme. The company was set up as a community interest company (CIC) with equal joint ownership between the Council and Cheshire West and Chester Council.

3.2 Local management of schools provided schools with independence to determine how and who provided service arrangements. There was significant growth in schools choosing to receive services from non in-house providers. This created financial difficulties for in-house services and there was less control over standards and terms and conditions from external providers. The belief was that as a not-for-profit company Edsential could compete and maintain a public sector ethos with all profit invested into improving outcomes for children. Schools would benefit from receiving higher quality services with both a commercial approach and improved value for money. The Councils would retain a strategic role in the shaping and delivering of high attainment in schools. The new company would support the local economy through the creation of a thriving local business generating employment and skills.

3.3 Services and staff transferred to Edsential included:

- School Catering;
- School Cleaning;
- Outdoor Education;
- Governor Support;
- Music Services;
- School Development / Improvement.
- Learning outside the Classroom; and
- Data Support

3.4 The company intended to be self-funding and not require subsidy from either council. The business plan did assume that Edsential would incur set-up costs and incur losses in early years and therefore require repayable cash flow funding. Both Councils agreed to provide up to £2m each of repayable cash flow funding charged at a deemed market rate of interest.

3.5 Financial Performance

3.5.1 As expected the company made an initial loss on establishment due to required payment of set up costs but then began to produce small profits each year. Business plans aimed to generate around £100k-£200k per annum with surpluses either reinvested in the business or in the community through grants to schools.

3.5.2 The covid-19 pandemic had a significant detrimental impact upon Edsential. The closure of residential centres and reduction in school activities severely reduced the level of income receivable whilst at the same time incurring unavoidable fixed costs. The table below shows the significant loss of revenue income from a 'normal' pre-covid year in 2019/20 to 2020/21 and 2021/22 which were impacted by covid-19 restrictions. Revenue levels have somewhat recovered in 2022/23 but are now being impacted by the cost-of-living crisis which has slowed down the level of recovery of discretionary spend areas such as residential course income.

Table 1

	2019/20 £000s	**2020/21 £000s**	**2021/22 £000s**	**2022/23 £000s***
Revenue income	18,744	14,085	15,345	18,262
Profit/(Loss)	210	(1,520)	(1,667)	(553)

*2022/23 forecast outturn position subject to audit

3.5.3 The latest reported financial position for the company shows a forecast loss for 2022/23 of £553,000 (subject to audit). The latest external audit report for Edsential confirmed that the company was a going concern. This opinion was on the basis of the ongoing loan support from shareholders.

3.5.4 Edsential provides a number of services to schools. The company operates in a very competitive market and schools have the choice who to contract with for services. The draft 2023/24 business plan assumes an overall break-even position. Appendix 2 (which is exempt due to commercial confidentiality) provides a breakdown of forecast income and expenditure across the individual service areas.

Covid-19 Pandemic

3.5.5 The Covid-19 pandemic resulted in losses to the company as outlined in table 1 above. Residential course income was severely curtailed due to lockdown restrictions, whilst similarly restrictions to schools limited service provision and the ability to generate income at a time the company had various fixed costs. A series of meetings took place between the company and shareholders during the pandemic to review the situation and to receive updates on what was a dynamic situation.

3.5.6 Policy and Resources Committee of 11th November 2021 agreed to a package of support to assist the company. This consisted of a grant of £643,000 (based on an approximation of what the company may have received from the governments fees and charges support scheme if it had been an in-house operator) and an interest bearing loan of £857,000. The loan principal repayments begin from the end of year 2. The arrangements included measures to be taken by the company to generate the necessary returns to finance repayments, which would require some time for implementation. The Council's grant and loan package was mirrored by Cheshire West and Chester Council with the exact same terms applying.

3.5.7 The covid support loan was in addition to the cashflow facility which was previously renewed by both Councils in late 2020 (Policy and Resources 20th December 2020). This provided up to £2m per shareholder in a cash flow loan facility. The loans were interest bearing and even during the most financially challenging times of the pandemic were never fully utilised.

3.5.8 Edsential has made good progress in reducing loan balances. Part of this will be due to the application of the covid grants advanced. The balance on the outstanding loans with Edsential is currently (as of June 2023) £982,000. This comprises of £125,000 of cashflow drawdown and the full covid support loan of £857,000. There has been a reduction in loan balances and as at 1st April 2022 loan balances were £2,357,000. This loan position is matched by Cheshire West and Chester Council.

3.5.9 The ability to repay outstanding loans will be predicated upon Edsential's ability to generate the necessary level of return to service debt. Further losses will inevitably curtail the scope for repayment. This would then risk impacting upon the Council's budgetary position.

3.6 Management Review

3.6.1 A visit was undertaken in April 2023 to Edsential offices to review the financial position of the company, the business plan and discuss the issues and challenges that the company faces. This meeting was attended by officers from both shareholders.

3.6.2 The review undertaken considered the proposed business plan and longer-term strategy for recovery post Covid. It looked at the income generation across each service area, potential for growth and a sensitivity analysis around the assumptions. Consideration was also given to any potential areas for cost savings, such as overheads within the company.

3.6.3 It is evident that the company has undertaken scenario planning and a sensitivity analysis in relation to all the expected factors. It has looked at back office and overhead costs and can demonstrate that these have been reducing as a proportion of the overall costs over time. The company is considered lean from a management and overhead perspective and appears to be operating efficiently.

3.6.4 The impact from Covid on the business was significant and has had a long-term impact on the financial performance. This has been further impacted by the macroeconomic factors more recently and the sharp rise in inflation in key areas, such as food. The rapid increase in costs can not immediately be reflected in pricing to customers and has therefore inevitably impacted on the in-year financial performance. Recovery in some areas of activity has been slower than others but there is a clear trend of recovery.

3.6.5 The Company is looking for additional opportunities within the market and is trying to expand into neighbouring areas in a controlled fashion. It holds detailed cost information around each individual contract and has reviewed all current provision to determine those which are performing adequately from a financial perspective.

3.6.6 Management recognises the challenges that the Company faces and are trying to enact changes in key areas to ensure that the company continues to operate efficiently and profitably.

3.6.7 It must be recognised by the shareholders that the approach being taken by the company is based on the commercial reality of the position that they face. The majority of the company turnover is from low margin services such as school meals and cleaning.

3.6.8 The service being provided by Edsential must operate differently to that which Councils may be familiar with when these services were provided by internal traded services. It was previously very common for Councils to provide school meals based on a universal meal price, fixed across the Council area. This essentially meant that cross subsidisation existed between school sites. The larger sites with the greatest economies of scale were profitable and subsidised the additional costs that were naturally incurred for small schools and special schools, were the costs of delivery were much higher.

3.6.9 As schools gained greater freedoms and the ability to become academies this flexibility within the provision of the service has been lost. There is no collective purchasing by schools in this respect and no evidence of any willingness within the sector to cross subsidise.

3.6.10 This has led to the fragmentation of provider services as larger schools in particular have chosen private sector providers who will deliver the service at a lower cost. This has ultimately led to Councils reviewing their service provision and pricing model.

3.6.11 Edsential is no different to a private sector provider and competes directly with them. This requires them to price their offer to schools based on the individual circumstances rather than a sector wide price. Tender pricing reflects the priorities of the client around price, quality and the social value factors that they determine to be important.

3.6.12 The company is entirely dependent on the enhanced contributions from a small proportion of higher margin services to repay the outstanding loans to shareholders and to potentially differentiate between the terms and conditions it is able to offer to its workforce.

3.6.13 The offer of the Local Government Pension Scheme is a significant differentiator between Edsential and its private sector competitors. Edsential's pension employer contribution rate is between 22% and 23% of salary. This is a significant additional cost on top of pay and will be significantly higher in comparison to the contributions generally made by employers to alternative schemes. The payment of the living wage in place of the minimum wage adds an estimated further 1.5% per cent to the cost base before any consideration of further favourable employment terms such as sick pay and holidays.

3.6.14 All of these additional costs in totality are currently unsustainable within this business model.

Options considerations

3.7.1 Following the Policy and Resources Committee meeting on the 22nd March 2023 a review of the potential options open to shareholders has been conducted based on the feedback received. This has led to an assessment of possible options for the Company that are considered in more detail below.

Option 1 : In-house delivery model

3.7.2 The potential option to bring the service back in house has a number of significant issues that make this both difficult and problematic to achieve, even if there was an appetite to do this.

Advantages / Benefits

3.7.3 The potential benefits of this model are that the staff employed in providing the service would be subject to Wirral MBC terms and conditions. This would mitigate the issue that has been identified in relation to payment of the living wage.

Disadvantages / issues

3.7.4 The Council would firstly need to create a new traded service to accommodate the services to be delivered. This would include the recruitment of a suitably qualified management team able to both bid for work within the sector and setup the necessary staffing structures to efficiently deliver the services. Contracts for the required supplies and services would also need to be procured. This would require a lead in time of a number of months and would incur initial one-off costs that would likely never be recovered.

3.7.5 The Council would then need to bid / offer the service to schools. As each school is a separate legal entity it would be for each individual school to make the decision as to whom they wish to purchase the service from. Schools are also subject to public procurement rules and would normally be required to tender the service. The Council's newly created traded service would need to subsequently bid for the work. The Council would need to bid at a price that would be expected to recover its operating costs. Given the terms and conditions of internally employed staff it is likely that the service would struggle to compete on price against other potential providers.

3.7.6 Soft market testing with Wirral schools would need to be undertaken in advance to determine the appetite they would have in procuring the services from the Council. There is a significant risk that the Council will not be able to provide an attractively priced service that would generate sufficient business to trade cost effectively. There would be a risk that the Council would not be viewed as favourably as the existing Edsential brand which will have a level of 'good will' attached.

3.7.7 It is highly likely that in addition to the setup costs that the traded service would be loss making from the outset and would struggle to attract sufficient business to ever deliver the necessary economies of scale. The company is able to gain economies of scale from provision to more than one Council. These would be lost if each shareholder had to provide its own management and administration of these services.

3.7.8 Given the underlying budget challenges currently facing the Council this is not considered to be ether a prudent or viable option.

Option 2: Transfer of ownership

3.7.9 The company could be transferred in full to either of the current shareholders. This would require the agreement of both shareholders which may include financial compensation of some description.

Advantages / Benefits

3.7.10 It would simplify decision making in that there would only be one shareholder opinion to take account of. It would also ensure that the financial implications of any decisions are then borne solely by the shareholder taking the decision.

Disadvantages / Issues

3.7.11 This does not change the underlying position of the company or the responsibility of the Directors of the company. It will still need to demonstrate that is a ‘going concern’ from an accounting perspective and will still be subject to the rules around state aid.

3.7.12 If either Council is the sole shareholder they will still need to take account of all the issues and considerations that the company currently faces. The company will still be operating in the same competitive marketplace with a customer base that chooses the terms on which it wishes to procure the service(s).

3.7.13 For the Council to acquire the company, assuming that Cheshire West and Chester Council was willing, it would require some sort of indemnity or payment in relation to the likely dilapidations costs in respect of the outdoor education centre. It would also require the debt between Edsential and Cheshire West and Chester Council to be written off given there is insufficient equity or assets within the company to justify the transfer of the debt in addition to the shares. It is highly unlikely that Cheshire West and Chester Council would be agreeable to such terms.

3.7.14 For Cheshire West and Chester Council to acquire the company it would need to pay the Council the outstanding loan that it has to Edsential, or, the Council would have to write off the loan. Neither of these scenarios are considered likely.

Option 3: Winding up the company

3.7.15 Another option would be for the company to cease trading in a managed fashion with a future date agreed by both shareholders. This date would need to be sufficiently far into the future to provide existing customers with sufficient time to identify alternative providers.

Advantages / Benefits

3.7.16 The risk of incurring future and ongoing trading losses would be negated. The issue around nonpayment of the living wage by a company associated with either Council would also be removed.

Disadvantages / Issues

3.7.17 The outstanding loans to Edsential would need to be written off and accounted for as soon as the decision was taken. This would impact on the outturn position for both Councils in 2023/24. The Council would need to identify either in year savings or reserves of £982,000 to cover the outstanding loans less the current bad debt provision.

3.7.18 Additional in year losses would be inevitable as the company worked towards closure. No bids for new business could be made and schools would look to make alternative provision as soon as possible. This would lead to an increasing uncompetitive trading model. Redundancy costs for the management team are also likely to be incurred.

3.7.19 Cheshire West and Chester Council would likely have to realise the dilapidations position in respect of the outdoor education facility.

3.7.20 There is the potential to consider the sale of the company to a third-party provider, however the value within the company is limited. There are limited physical assets and the income streams are linked to the current contractual arrangements in place. The valuation of the company would effectively be limited to the value of the existing contracts. The value of which could be determined through a measure of the length of contract remaining, their relative profitability and an assessment of any goodwill.

3.7.21 The valuation would be negated by the required TUPE transfer of staff, many of whom are potentially within the Local Government Pension Scheme which would require the new employer to gain admitted body status.

3.7.22 It is highly likely that there would be no material net value within the contracts currently held by Edsential to offset the losses from writing off the existing loans.

3.7.23 This option would also create increased uncertainty for the staff currently employed by the company. It would create issues for schools who would need to procure alternative contractors and could also force schools to take the service in-house if no alternative supplier was forthcoming.

Option 4: Expansion of Edsential

3.7.24 Edsential is currently in the process of trying to extend its operations to other neighbouring local authority areas – particularly in relation to the provision of school meals and the opportunities for outdoor education. Successfully expanding and diversifying the business is key to ensuring that the loans from shareholders can be repaid in the future.

3.7.25 In order to help secure this potential there is an option for Edsential to look to expand their range of services, particularly in those areas which could feasibly be provided directly to the shareholders.

3.7.26 This could include services such as building cleaning, which would be an extension of the services currently provided in some schools, covering Council owned or operated buildings within the corporate estate.

Advantages / Benefits

3.7.27 This would enable the company to diversify its income stream and increase economies of scale. This would enable the Company to employ more staff on the basis of the values held by the shareholders. It would also enable the Company to potentially use the margins generated from this element of the business to effectively cross subsidise other parts of the business in lieu of providing returns to shareholders.

Disadvantages / Issues

3.7.28 Based on the current company structure it is not possible for either shareholder to simply award work to Edsential as it is not set up as a Teckal company.

3.7.29 It does not qualify for Teckal exemptions as it does not primarily provide services to a single Council. It actually provides very few, if any, services directly to either of the shareholders.

3.7.30 This would mean that Edsential would need to bid competitively for any suitable work offered by either local authority. There would be no guarantee of success, but it would likely incur additional costs to generate suitable tender submissions.

Option 5: Continue Trading (as is)

3.7.31 The final option is to support the company to continue trading, in line with the proposed business plan from Edsential, and for each of the shareholders to recognise the difficulties it will face and the commercial decisions that will need to be taken to ensure it remains competitive within the markets it operates.

Advantages / Benefits

3.7.32 This option enables the company to continue making repayments on the outstanding shareholder loans. The company is projecting to be able to repay the covid loan over a period of approximately 15 years (per covid loan agreement of 30th March 2022). The cash flow facility agreed in December 2020 was for a five-year period at which point any outstanding balance would require repaying.

3.7.33 This does not require any loans to be written off in 2023/24 and therefore does not have a negative budgetary impact for either shareholder. This could still include expansion into services provided directly to LA's.

3.7.34 This option enables the company to continue trading and bid for new business to potentially expand its operations and deliver revenue growth.

Disadvantages / Issues

3.7.35 It is recognised that both Councils support payment of the Living Wage to directly employed staff and employees of their contractors. The Council has included such requirements and expectations in relation to contracts that have been commissioned for a wide range of services.

3.7.36 This approach has been largely successful, however there are still some areas of Children's social care for example, where this has not been possible due to the approach and position of the providers rather than as a consequence of the rates paid for the services received.

3.7.37 In the case of Edsential, the Council is not the recipient of the services provided and therefore can have little influence over the rates paid for these services. Schools control the procurement of these services and could choose to effectively mandate payment of the living wage by their provider as part of this process. The majority of schools choose not to do this and simply seek the lowest price.

3.7.38 If Edsential continue to pay the Living Wage rather than the Minimum Wage, where it has not been requested / mandated, then they are unlikely to secure further contracts and are at risk of losing existing contracts. Due to the significant proportion of income (c.54%) that is generated from the catering element of the business, a loss of market share will impact on the economies of scale and likely lead to a steady decline of the business.

4. FINANCIAL IMPLICATIONS

4.1 Edsential currently has outstanding interest-bearing loans with the Council of £982,000. This comprises £125,000 of cashflow loan and Covid support loan of £857,000. The cash flow facility allows for up to £2m of loan.

4.2 The report outlines options for the company which would have different financial impacts dependent upon the option chosen. The recommended option is believed the best to minimise any impact.

4.3 There is risk that further support could be required should plans not be achieved.

5. LEGAL IMPLICATIONS

5.1 The Company was established with the appropriate Certificate of Incorporation for a Private Limited Company/Community Interest Company with associated articles on 20 April 2015. The Shareholder Agreement was agreed on the formation of the Company.

5.2 The Company was established to provide and carry on activities which benefit all the inhabitants of the administrative areas of Cheshire West and Chester and Wirral Council and elsewhere, and, in particular, schools, educational facilities, children, young people, parents and adults by the provision of educational support services. In addition, the Company may conduct such other business as is set out in its Business Plan.

5.3 The Company is required to produce an Annual Business Plan to the Shareholder Board for approval in accordance with the terms of the Shareholder Agreement.

5.4 The company and its board of directors have legal responsibilities in respect of the running of the company's financial affairs. The company can operate at a loss as long as there are reasonable grounds for believing these losses can be recovered in future trading periods.

6. RESOURCE IMPLICATIONS: STAFFING, ICT AND ASSETS

6.1 Edsential is a Community Interest Company employing its own workforce and with its own ICT and asset arrangements. Resources from the Council involve loan finance.

7. RELEVANT RISKS

7.1 There is financial risk that further finance may be required to support the company should forecast activity plans not be realised. Without a successful delivery plan, the company will find it difficult to repay existing loans.

7.2 There is a reputational risk to the Council should the company fail. This would be over a number of areas including workforce, suppliers and clients.

7.3 Without a detailed Annual Business Plan the Council as shareholder does not have a clear set of objectives against which to monitor the performance and effectiveness of the Company generally and in particular against the Shareholder Agreement and the Company's Strategy.

7.4 A comprehensive Annual Business Plan is an important tool in mitigating these risks.

8. ENGAGEMENT/CONSULTATION

8.1 Policy and Resources Committee in March 2023 received a report on the company and requested this report be produced. Shareholder Board and have Cheshire West and Chester Council been engaged in briefings with the company in respect of the business plan and the company's financial position. The directors and senior employees of the Company have had an opportunity to comment on the content of this report prior to publication.

9. EQUALITY IMPLICATIONS

9.1 Wirral Council has a legal requirement to make sure its policies, and the way it carries out its work, do not discriminate against anyone. An Equality Impact Assessment is a tool to help council services identify steps they can take to ensure equality for anyone who might be affected by a particular policy, decision or activity.

9.2 There are no equality and diversity implications arising out of the proposals set out within this report.

10.0 ENVIRONMENT AND CLIMATE IMPLICATIONS

10.1 There are no direct environment and climate implications arising from the subject matter of this report.

11.0 COMMUNITY WEALTH IMPLICATIONS

11.1 The company employs a work force comprising of many local Wirral residents. Edsential strives to be an employer offering terms and conditions which exceed competitors in the challenging market it operates in. This supports community wealth.

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APPENDICES

Appendix 1 – draft Annual Business Plan (exempt)
Appendix 2 - Edsential Income and Expenditure Forecast 2023/24 across Service Areas (exempt)

BACKGROUND PAPERS
Shareholders' Agreement
Edsential Monitoring updates
Edsential Statutory Accounts
Loan agreements

TERMS OF REFERENCE

The Shareholder Board, as a Sub-Committee of Policy and Resources Committee, has delegated authority to exercise responsibility for the Council's functions as corporate shareholder of a company.

Policy and Resources Committee in March 2023 resolved that the Director of Finance, in consultation with the Director of Law and Governance, be requested to engage with the company to establish a deeper understanding of the company's functioning with a view to suggesting revisions to the Annual Business Plan for 2023 – 2024 and to report back to a future meeting of this committee with recommendations relating to such a revised annual business plan. This report to include a list of and details around the options available to the council regarding the future provision of services provided by Edsential.

SUBJECT HISTORY (last 3 years)

Council Meeting	Date
Policy and Resources	**20th December 2020**
Shareholder Board	**28th October 2021**
Policy and Resources	**10th November 2021**