

Shops and related activities

12.1. In this chapter we deal with the South Board's appliance sales and its servicing and contracting activities.

12.2. The South Board has 74 shops and 18 service centres which provide one of its main links with customers. The principal activities of the shops are appliance sales, receiving payment of electricity accounts and customer enquiries about all facets of the Board's activities. The service centres are operational units consisting of offices, workshops and store buildings. Staff in service centres are engaged in the general range of distribution activities. Each centre has its own customer enquiry section and carries out contracting and appliance repair work.

12.3. The appliance sales and contracting activities are seen as supporting the Board's main business of electricity supply both by giving priority to selling products, notably storage heaters and cookers, which help to build up demand for electricity and by the provision of an efficient service to customers. But at the same time these activities are expected to operate as independent cost centres which must be run on profitable lines without cross-subsidisation among them or from the main electricity business. The total cost of operating the shops and service centres is allocated between each activity on the basis of identified or estimated usage. At present staff costs of shops are allocated 40 per cent to appliance marketing, 25 per cent to customer services and 35 per cent to meter-reading, billing and collection. Other shop costs are allocated 35 per cent to appliance marketing, 25 per cent to customer service and 40 per cent to meter-reading, billing and collection.

12.4. Turnover from appliance sales in 1984-85 was £24.6 million and for appliance servicing and contracting turnover was £7.3 million. This compares with sales of electricity and other operating income of £774.4 million and amounts to 4 per cent of the South Board's total turnover. Profit before interest (and before special adjustments) for the three activities was £0.9 million in 1984-85 compared with £175 million from electricity supply and amounted to 0.5 per cent of the total. Figures (before adjustments) for the past five years are given in Table 12.1.

12.5. At our request, the South Board prepared a current cost version of Table 12.1. We were told that in some cases judgments had to be made on the allocations of net assets between contracting (including appliance repairs) and sales of appliances. The current cost figures are set out in Table 12.2.

Appliance sales

12.6. In volume terms the South Board's sales of appliances peaked in 1972-73. Sales of most major appliances fell until the early 1980s but there has been a recovery in recent years as can be seen from the sales data in Table 12.3. The change in sales pattern is in part a reflection of increased competition in the

TABLE 12.1 Appliance sales, servicing and contracting—profitability*

| | 1980-81 | 1981-82 | 1982-83 | 1983-84 | 1984-85 |
|--|---------|---------|---------|---------|---------|
| | | | | | £'000 |
| <i>Contracting and appliance repairs</i> | | | | | |
| Turnover | 4,197 | 4,781 | 5,961 | 6,435 | 7,308 |
| Net profit | 222 | 460 | 835 | 715 | 893 |
| Estimated capital employed† at 31 March | 1,328 | 1,426 | 1,298 | 1,060 | 1,049 |
| <i>Sale of appliances</i> | | | | | |
| Turnover | 18,728 | 16,140 | 17,176 | 21,147 | 24,642 |
| Net profit | -1,627 | -2,054 | -1,757 | -1,115 | 77 |
| Estimated capital employed at 31 March | 6,553 | 3,109 | 2,779 | 5,466 | 6,458 |
| <i>All activities</i> | | | | | |
| Estimated total capital† employed at 31 March | 7,861 | 4,535 | 4,077 | 6,526 | 7,507 |
| Return on capital employed (historical cost) | (17.9) | (35.1) | (22.6) | (6.1) | 12.9 |

* Statement is on historical cost basis as used for the published accounts.

† Capital employed values are estimates and include allocations of net assets between activities on a judgmental basis.

TABLE 12.2 Appliance sales, servicing and contracting—profitability (current cost)

| | 1980-81 | 1981-82 | 1982-83 | 1983-84 | 1984-85 |
|--|---------|---------|---------|---------|---------|
| | | | | | £'000 |
| <i>Contracting and appliance repairs</i> | | | | | |
| Turnover | 4,197 | 4,781 | 5,961 | 6,435 | 7,308 |
| Trading profit/(loss) | (7) | 261 | 582 | 490 | 556 |
| Average capital employed* | 3,157 | 3,330 | 3,525 | 3,774 | 3,642 |
| % return | (0.2) | 7.8 | 16.5 | 13.0 | 15.3 |
| <i>Sale of appliances</i> | | | | | |
| Turnover | 18,728 | 16,140 | 17,176 | 21,147 | 24,642 |
| Trading loss | (2,576) | (2,460) | (2,053) | (1,349) | (243) |
| Average capital employed* | 12,524 | 9,691 | 7,251 | 6,323 | 6,590 |
| % return | (20.6) | (25.4) | (28.3) | (21.3) | (3.7) |
| <i>All activities</i> | | | | | |
| Turnover | 22,925 | 20,921 | 23,137 | 27,582 | 31,950 |
| Trading profit/(loss) | (2,583) | (2,199) | (1,471) | (859) | 313 |
| Average capital employed | 15,681 | 13,021 | 10,776 | 10,097 | 10,232 |
| % return | (16.5) | (16.9) | (13.7) | (8.5) | 3.1 |

Source: SSEB.

* Capital employed values are estimates and include allocations of net assets between activities on a judgmental basis.

energy market in the 1970s from gas which also affected sales of electrical appliances. Electricity is now becoming more competitive and the South Board regards this as a positive factor in assessing market potential in the retail field. A notable feature in Table 12.3 (page 144) is the decline and subsequent recovery in sales of storage radiators.

The main competitors

12.7. The South Board's main competitors for appliance sales are Dixons/Currys, Comet, Clydesdale and co-operative shops. Competition is vigorous and there have been considerable changes in retailing practices in recent years. Estimates of the Board's market shares for particular appliances are shown in Table 12.4 (page 144). It regards its market shares of refrigerators, washers and vacuum cleaners as relatively low and capable of being improved.

TABLE 12.3 Sales of main appliance's

| Appliances | numbers sold | | | | | |
|---|--------------|---------|---------|---------|---------|---------|
| | 1972-73 | 1980-81 | 1981-82 | 1982-83 | 1983-84 | 1984-85 |
| Cookers: Free standing | 60,300 | 25,400 | 18,100 | 19,900 | 23,600 | 24,300 |
| Other | — | 3,100 | 3,100 | 3,400 | 3,700* | 5,700 |
| Washing machines | 18,400 | 14,000 | 14,500 | 15,700 | 16,500 | 18,000 |
| Driers | 7,200 | 8,200 | 5,000 | 4,800 | 4,700 | 4,700 |
| Refrigerators (incl fridge/freezers) | 24,500 | 15,800 | 12,900 | 13,400 | 15,600 | 14,200 |
| Freezers | 1,400 | 3,000 | 3,900 | 3,100 | 2,600 | 2,900 |
| Storage radiators | 40,500 | 5,500 | 15,500 | 25,100 | 46,100 | 46,800 |
| Vacuum cleaners | 18,810 | 13,574 | 10,629 | 11,669 | 11,686 | 16,186 |
| Direct heaters | 36,263 | 24,162 | 26,079 | 22,128 | 27,115 | 44,366 |
| Water heaters | 9,441 | 2,242 | 1,172 | 1,167 | 1,154 | 1,426 |

Source: SSEB.

* Henceforth including microwave ovens.

TABLE 12.4 Estimated market shares of major appliances

| | | | | | | per cent |
|------------------|---------|---------|---------|---------|---------|----------|
| | 1972-73 | 1980-81 | 1981-82 | 1982-83 | 1983-84 | 1984-85 |
| Cookers | 70 | 81 | 51 | 31 | 48 | 52 |
| Refrigerators | 24 | 18 | 13 | 13 | 17 | 12 |
| Washing machines | 19 | 14 | 13 | 13 | 14 | 15 |
| Vacuum cleaners | n/a | 10 | 9 | 10 | 9 | 11 |

Source: SSEB.

Note: The South Board states that some variations in the figures appear to be due to the small sample size in Scotland which forms part of a national survey.

Prices

12.8. Prices of electrical appliances sold by the Board's main competitors are regularly monitored as part of a national market research exercise to which it subscribes. A price audit in October 1984 showed South Board prices generally to be above the averages for all electricity boards and many of the groups participating in the survey were selling below South Board prices for most of the main appliances. A comparison with selected competitors trading in the South of Scotland showed that the South Board was offering the lowest price for three out of 15 products surveyed.

Purchasing

12.9. The South Board participates to a minor extent in the Electricity Council's central purchasing of appliances under the Electra brand name and in exclusive deals which the Council negotiates for all the boards. It is also a member of the Northern Consortium of electricity boards which purchases appliances on behalf of four English and the two Scottish boards. Centralisation of its own appliance purchasing has enabled it to obtain keener prices from suppliers.

Special arrangements

12.10. The Board has had longstanding agreements allowing a company to rent out television sets in the Board's showrooms. This agreement is currently with Focus and has now been extended to cover sales as well as rentals. Focus

has recently taken over the sale of all audio products in the Board's showrooms. The Board expects to secure commission income from Focus over the next three years of at least £1.3 million. The Board has also recently established 'shop-within-a-shop' arrangements with Goldbergs in Glasgow and Edinburgh. The Board provides its full range of sales, service and account collection within Goldbergs' larger retail operation and pays the lower of a fixed rent or a commission on sales. An initial comparison of costs shows the Goldbergs arrangement making a greater contribution to overheads than the comparable Glasgow showroom.

12.11. Since 1981 the Board has offered a credit scheme in showrooms which is financed and administered by the Royal Bank of Scotland, with the Board receiving a commission. This personal loan scheme produced very disappointing results and showroom turnover on credit sales fell to an unacceptable level. In 1985 therefore it introduced an in-house credit scheme which, it believes, will overcome these difficulties. Credit sales under the scheme are expected to rise from £1.7 million in 1984-85 for the old scheme to £5 million under the new scheme in 1987-88. The new scheme is offering credit at an APR of 38 per cent which the South Board regards as being in the middle of the market. By 1987-88 it hopes to be making a profit of £0.75 million on credit financing.

Appliance sales—recent reorganisation

12.12. In 1982 in the light of continuing losses on appliance sales, a number of studies were undertaken resulting in significant changes to the organisation of appliance marketing. The management of the appliance marketing activity was transferred from the area offices to the Chief Commercial Officer at Headquarters, although the day-to-day running of the shops (and the consumer service functions in the shops) remained the responsibility of Area Managers. The three area stores were disbanded and one central appliance store, programming and purchasing unit was established for the whole of the South Board at Moodiesburn. This prompted the establishment of a central sales accounting section within the Chief Financial Officer's Department. The effectiveness of the reorganisation is under continuing review and proposals are currently being developed for further improvements.

12.13 Following this reorganisation, the appliance sales account has made substantial progress towards profitability over the last two years. Turnover has increased by 45 per cent, indirect costs have been held steady in money terms and have declined from 33 per cent to 23 per cent of turnover and a net profit of £77,000 (on an historical cost basis) was made in 1984-85 after losses in each of the previous six years. In current cost terms a loss of £243,000 was made in 1984-85 but the Board has told us that the account has moved into profit on this basis in 1985-86. The principal improvements have come from the reorganisation of area stores described above. Delivery and stores costs have fallen from 11 per cent to 8 per cent of turnover.

The strategy for appliance sales

12.14. The South Board's present strategy is to maintain competitive price levels and to improve net profitability by cutting costs. The introduction of an in-house credit scheme is expected to increase turnover by about £1 million in

1986-87, but thereafter sales volume is expected to remain broadly unchanged in the Plan period. Forecasts of turnover and profits (on an historical cost basis) including an allowance for inflation are in Table 12.5. This shows the Board reaching its target of a profit in excess of £0.7 million in 1988-89. Targets are not set in terms of a return on capital. Profit as a percentage on turnover is considered to give a clear signal to managers concerning pricing and cost control targets. There is, however, an overall requirement to earn a return on capital, and the present target is expected to produce a return of 7.8 per cent in CCA terms by 1988-89 after inclusion of profit on instalment credit.

TABLE 12.5 Appliance marketing business forecast, 1986-87 to 1988-89

| | 1984-85 (actual) | 1985-86 | 1986-87 | 1987-88 | 1988-89 £'000 |
|---|---------------------|------------------|------------------|------------------|------------------|
| Turnover | 24,637 | 25,000 | 27,000 | 28,100 | 29,200 |
| Direct costs | 18,997 | 18,900 | 20,412 | 21,244 | 22,075 |
| Gross profit | 5,640 (22.9%) | 6,100 (24.4%) | 6,588 (24.4%) | 6,856 (24.4%) | 7,125 (24.4%) |
| Indirect costs | 5,588 | 5,754 | 6,060 | 6,231 | 6,407 |
| Net profit | 52 | 346 | 528 | 626 | 718 |
| Net profit as % of income | 0.2 | 1.4 | 2.0 | 2.2 | 2.5 |
| Instalment credit financing profit £'000 | 25 | 17 | 591 | 750 | 750 |

Source: SSEB.

12.15. Cost targets for the main elements of indirect cost expressed as a percentage of turnover are agreed annually with Area Managers and are monitored quarterly. Future cost reduction programmes will be targeted mainly on delivery costs and the more efficient use of personnel. Delivery costs are high relative to competitors' and the Board has stated that there is undoubtedly scope for a gradual reduction as trade union agreement to changes in working practices is secured. So far as staffing is concerned, major organisational changes to reduce numbers will be introduced where possible but the opportunities are now limited following the recent re-structuring.

12.16. During the mid-1970s 29 showrooms were closed and a further two have been closed since 1980. The number of showrooms is now planned to remain at about 70 but the retention of each shop will continue to depend on its ability to make a contribution towards overheads. At present each shop is given an annual turnover target and is also assessed monthly on its overhead contribution. Profit targets are not set for individual shops. Recent market research has indicated that showrooms are more attractive to customers in the older age groups and the less affluent social classes. The Board's aim is to make the showrooms more attractive to all social groups and, particularly, to young people by improving the standard of display and decor, and by changing the product range.

12.17. In its 1985 Corporate Plan, the South Board stated:

The important contribution which showrooms make to customer service is not being overlooked in the drive to improve profitability. They provide one of the main links between the Board and its consumers, as evidenced by the large volume of enquiries they receive and the number of consumers using

them to pay their accounts. The importance of this consumer service role inevitably places a limit on the rate at which cost reduction can be achieved by closing or relocating unprofitable showrooms. Where closures do take place, every effort will be made to ensure that satisfactory alternative facilities are made available.

12.18. The Board has told us that its appliance sales activity operated profitably in 1985–86 and that the situation will get better year by year. It therefore sees no need to consider withdrawing from this sales activity although levels of profitability continue to be the subject of discussion within the Board. At our request the Board estimated that if it did withdraw from appliance sales there would be unavoidable costs, probably in excess of £0.6 million per annum, which would have to be borne by customer service and account collection facilities which are provided by the shops and service centres. This would be in addition to the costs already allocated to these activities. The Board told us that without a full review of possible alternative formats for the customer service activity it was not possible to give a firm estimate of the unavoidable costs. These include staff costs, rent, rates and depreciation on the shops. The estimate assumes that shops would remain open as a service to customers although in the longer term some relocation to smaller premises might be possible.

Servicing and contracting

12.19. The contracting activity (including appliance repairs) acts in support of appliance sales as well as supporting the main business of electricity supply. The Board states that in recent years it has earned satisfactory profits with little change in the volume of business. Market prospects are related to trends in sales of both appliances and of electricity. The Board's strategy is to aim for a broadly unchanged volume of business but with net profit in excess of the 5 per cent of turnover objective. Turnover and profit forecasts for the four years 1985–86 to 1988–89 are shown in Table 12.6.

TABLE 12.6 Contracting and servicing business forecast, 1986–87 to 1988–89*

| | 1984–85 (actual) | 1985–86 | 1986–87 | 1987–88 | 1988–89 |
|------------------------------|---------------------|---------|---------|---------|---------|
| Turnover | 7,308 | 6,747 | 7,152 | 7,581 | 8,035 |
| Direct costs | 4,596 | 4,204 | 4,457 | 4,724 | 5,007 |
| Gross profit | 2,712 | 2,543 | 2,695 | 2,857 | 3,028 |
| Indirect costs | 1,819 | 1,999 | 2,119 | 2,246 | 2,381 |
| Net profit | 893 | 544 | 576 | 611 | 647 |
| Net profit as % of income | 12.2 | 8.1 | 8.1 | 8.1 | 8.1 |

Source: SSEB.

* Including appliance repairs.

12.20. Advertising of these services will continue at about the present level—mainly in local papers—and no changes are planned in the real level of prices, except where these may be dictated by market conditions.

12.21. The Board believes there is scope for increasing its market share of

the contract maintenance of domestic appliances which it sees as profitable business. It also sees potential growth in contracts for the regular inspection and planned maintenance of non-domestic electrical installations. Priority will be given to storage radiator installation contracts in work available under competitive tenders. The Board has stated that workload peaks will continue to be handled, where necessary, by the use of staff on fixed term contracts, in accordance with the policy already agreed with the unions.

12.22. In 1984 an appraisal of the costs and administration requirements of the service centres in Fife resulted in a proposal to establish a new single service centre at Glenrothes in place of the existing Fife East and Fife West centres. The proposals are in hand with a target completion date of mid-1986.

Views of third parties

12.23. The Electrical Contractors Association of Scotland has expressed the view that the South Board competes unfairly with its member firms in the supply and installation of electrical heating appliances. These views are set out in Annex 1. In response to this criticism the Board has said that there is no cross-subsidisation involved in its charges and that it is keen to see private contractors involved in the development of storage heating schemes. No comments were received from other retailers.

Procedures for monitoring consumer satisfaction

12.24. The Board regularly monitors consumer satisfaction with its appliance repairs, contracting and delivery services. The numbers of complaints received on all subjects relating to the Board's operations are also recorded and reported in management papers. The level of complaints is low but is closely monitored.

Conclusions

12.25. In the recent past the South Board has made significant losses on its appliance sales activity although contracting and appliance repairs have been profitable. Electricity supply can be carried on without also being involved in appliance sales and contracting. To avoid imposing a burden on its electricity consumers, if the South Board wishes to maintain these separate activities it needs to run them in a way which ensures that each provides a commercial return.

12.26. Appliance sales have now moved back into profit and the South Board has set a net profit target of 2.5 per cent on turnover for 1988-89. This is expected to be matched by a similar level of profit on instalment credit financing. We think it important that this level of profit should be achieved and maintained. In addition we suggest that the Board should set a target rate of return on assets. This will enable the performance of appliance sales and contracting to be compared with other activities. We recommend a minimum return on assets of 5 per cent on a CCA basis for each of these activities. Information which will allow the achievement of these targets to be monitored should be published in the annual accounts.

12.27. The South Board has made considerable progress in reducing indirect costs of appliance sales as a percentage of turnover. However, further cost

reductions are necessary if its profit targets are to be achieved. Priority should be given to reducing delivery costs. The use of franchise arrangements such as these with Focus and Goldbergs should be further developed as a means of reducing or containing costs.

12.28. In estimating the costs of withdrawing from appliance sales the Board has assumed that shops will be retained for customer service and costs re-allocated to these service activities. We think this assumption should be open to question. We consider that the Board should review alternative ways of providing customer service which do not involve retaining shops. This will be of particular importance in assessing the true contribution of shops to the Board's profitability.

12.29. We recognise that the Board has taken steps to improve the profitability of appliance sales. It accepts that they should earn a commercial rate of return. However, if it becomes apparent that the CCA rate of return on assets is unlikely to reach 5 per cent by 1988-89, the South Board should give serious consideration to withdrawing completely from appliance sales.