In good company

Latest trends in local authority trading companies

September 2018

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Introduction

Austerity and the need to do more with less have driven local authorities to consider different ways of working. However, there is a growing recognition that this is not just about cutting costs – the generation of revenue must also play its part.

One option for local authorities to help support the achievement of financial sustainability is to continue their drive to be more commercial and find new collaborative ways of working, including generating revenue through the setting up of arm's length companies. However, commercialism should not be thought of as panacea. Growing business rates and council tax rises will almost always generate more income than commercialism and should be taken into account when considering options.

Councils have had powers to trade for many years. However, since the 2011 Localism Act gave local authorities in England revised trading powers, there has been a surge in new companies being created across different types of both authority and service in response to the combined challenges of reduced funding and increased service demand.

Although austerity has been the trigger for increased commercialism, it has also awakened an interest in the adoption of alternative delivery models such as local authority trading companies (LATCs) as a proactive measure to support sustainable futures. These range from wholly owned companies, joint ventures with either the public or private sector, to social enterprises where ownership is shared across a wider stakeholder group. All of these offer an alternative to the more traditional forms of outsourcing and are on the rise.

Companies continue to be created both for the delivery of services and for investment purposes. The latter remain the most common but the former are steadily growing in number.

As a result of this type of activity, the landscape of local government service delivery has changed forever. Even if austerity were to end tomorrow, the general view across the sector is that it is unlikely that the drive to create local authority trading companies will go away. It is therefore important to understand what makes them work well and draw on current experiences to help shape the future not only for the benefit of the local authorities and the companies involved but also for the people they seek to serve.

Through our research and interaction with the local government sector in recent years we have identified patterns of development for local authority trading companies. This report now explores the rise of local authority trading companies (LATCs) since the 2011 Act. We explore:

- the reasons for their growth and what has made some successful while others have failed to live up to their promise and, in some cases, been dissolved
- what the future might hold for these models in the light of continued austerity
- the failures of some of the more high profile outsourcing models including the collapse of Carillion
- the impact of both Brexit and local government reform.

We have referred to our database of companies owned by local authorities across the UK and tapped into our significant experience of setting up and restructuring companies.

We have also gathered commentaries from key individuals across the local government and trading company network through interviews, as well as a number of intermediaries such as law firms and banks. Integral to this was a roundtable held on 14 February 2018 bringing together a number of key people in the sector. The quotes included within this report are taken from the debate held at this event around the alternative delivery model (ADM) market.

Key messages

Since the change to legislation in 2011 regarding powers to trade, there has been a significant increase in the number of companies being set up with varying degrees of success

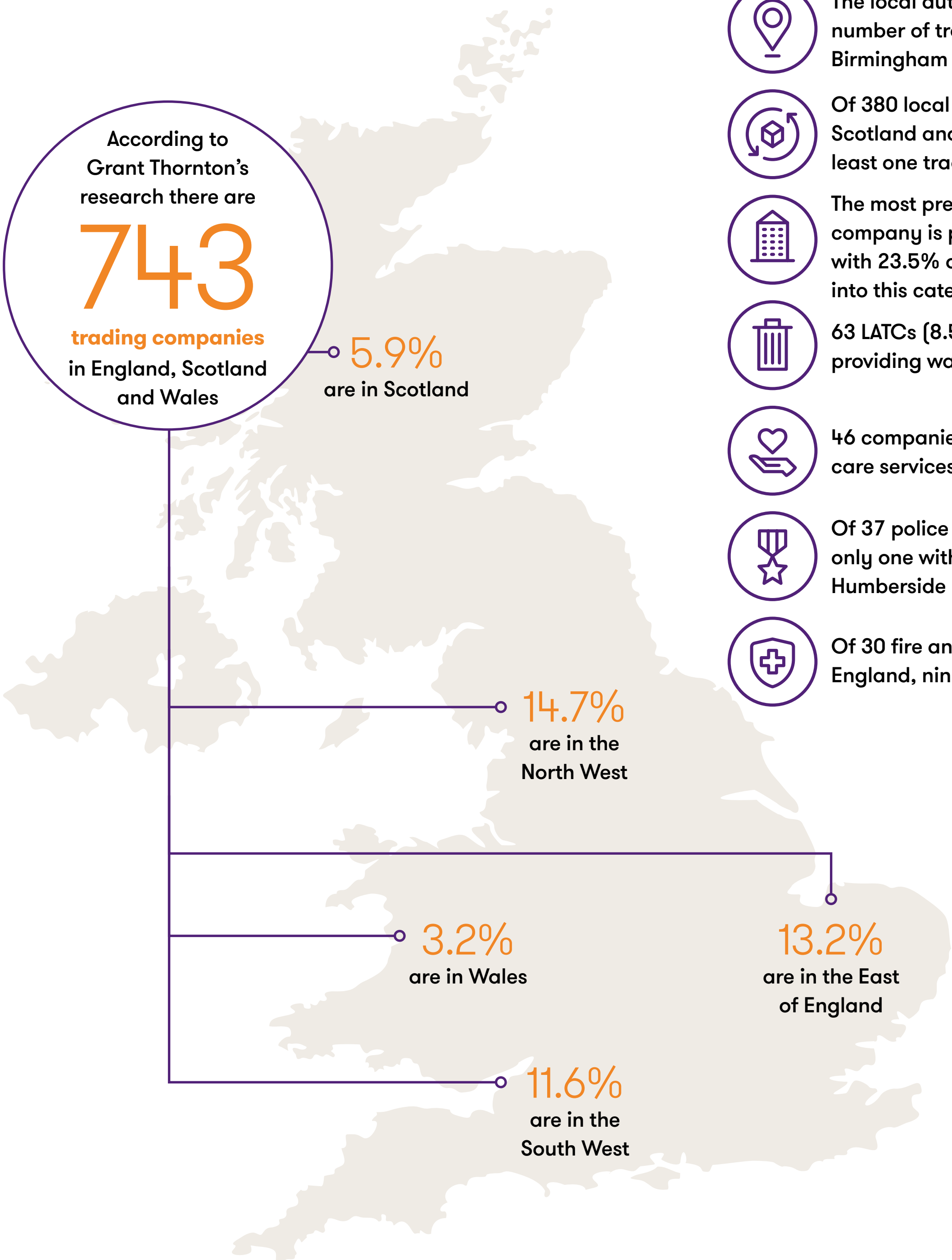
Although outsourcing continues to deliver savings, it has fallen out of favour with a number of authorities after some very public failures characterised by long inflexible contracts and issues with cost and quality

Trading companies provide an alternative delivery model, giving the opportunity for more control to respond flexibly to funding challenges, cut costs where needed, improve quality of service and generate revenue if required. However, they are not a panacea and other revenue mechanisms must also be considered

The most popular type of company is for strategic investment purposes, but increasingly they are being used for the delivery of services using the Teckal exemption, with many contracts being in-sourced in this way in a move away from traditional outsourcing

As the UK market becomes more saturated with these companies, it will be important for authorities to ensure theirs is set up and managed correctly so they can react and adapt to the changing landscape in local government. We are likely to see consolidation in the market as a result, through joint ventures and mergers

Local authority trading companies in England, Wales and Scotland



- The local authorities with the highest number of trading companies are Birmingham and Newham
- Of 380 local authorities in England, Scotland and Wales, 59.2% have at least one trading company
- The most prevalent type of trading company is property and investment, with 23.5% of trading companies falling into this category
- 63 LATCs (8.5%) are focused on providing waste services
- 46 companies (6.2%) provide social care services
- Of 37 police authorities in England, the only one with a trading company is the Humberside Police
- Of 30 fire and rescue authorities in England, nine have a trading company

The above has been compiled from data held on Grant Thornton's database of local authority trading companies. This database is not an exhaustive list due to the dynamic nature of the sector but does present a clear picture of the sector across England, Wales and Scotland.

A shift from outsourcing to insourcing

Part of the reason for the recent rise of trading companies is the decline in popularity of outsourcing to the private sector. When increased funding pressures on local authorities emerged in 2010, the obvious answer seemed to be outsourcing where a private sector provider could bring scale, expertise and the latest technology to deliver guaranteed efficiency savings from day one.

However, many outsourced contracts were long term and inflexible. They had a short term focus on the profitability of the provider and delivering immediate cost savings to the local authority, but sustainable resilience was not always built in.

This situation has not been helped by a market dominated by relatively few large players and procurement processes that resulted in fierce price competition where providers have front-loaded savings in a bid to make their offer compelling. Local authorities have also not always had the contract management capability to deal with these relationships and service quality has suffered as a result. If contracts are poorly drafted, this causes problems for the authority, but equally service providers suffer when the relationship is based purely on contract compliance. In many cases, they too have found these contracts difficult to navigate. This is further exacerbated by the fact that outsourced services tend to have a higher staff turnover than local authorities, which hinders continuity and impacts on the commitment to public service – an essential ingredient of success.

It is likely that these problems will remain unless public sector procurement is overhauled and price is assessed as a secondary factor to collaboration, mutual respect and strong boardroom ethics. Contracts also need to be flexible so that changes can be made if there are further funding cuts from central government. There is evidence of movement on this front with changes to the award criteria and the statutory introduction of life-cycle costing under the Public Contracts Regulations 2015 (which heralded a shift away from use of the "price is king" lowest price methodology). Other changes include an increased use of more collaborative contracts, such as the UK government's adoption of the New Engineering Contract forms. In addition, the law permits changes to public contracts to make them more flexible and collaborative – this also supports more collaborative approaches to service delivery.

Although many outsourced contracts are successful and deliver the savings required by local government, the more high profile cases of failure have shaped a narrative that outsourcing has fallen out of favour and the days of large scale outsourcing are gone. Public sector confidence has been affected in relation to the more commercial approaches and this is impacting on willingness to enter into new arrangements with private sector providers for fear of resistance from stakeholders and the possibility of failure. This means that, notwithstanding the changes in price relevance already noted, the sector has sought out other, innovative ways of delivering services.

This has led many to use LATCs as a mechanism for insourcing, ie putting services into a wholly owned company or joint venture. Unlike keeping (or bringing back) the service into the authority itself, this provides the opportunity to trade externally as well as delivering services on behalf of the owning authority. However, creating a company takes time and money both in terms of set up and running – for example accounts need to be prepared and corporation tax is payable on any profits in the same way as any other company. It is, therefore, important that this approach is considered carefully.

There is a current trend for local authorities to insource statutory services, in particular waste. As experience delivering such contracts grows, this trend will probably continue and accelerate which means that local authority trading companies could (if run successfully) become major players. If this happens, although there is a risk that the market might become crowded, it may also generate more competition and better outcomes for public services. But, given the supply-side of the market is still immature, it remains to be seen what the positive impact of having more public sector service providers in the market may be. However, for the time being local authority trading companies represent a viable alternative to traditional forms of outsourcing.

Local authorities should ask themselves the question: *"are we using commercial activity to prop up other services that would otherwise be cut?"* **It is important to think about what type of authority you want to be. It is also important to understand demand – part of the aim may be to reduce that demand, such as fire prevention in order to reduce pressure on services**

Whilst traded services are on the increase, LATCs remain most commonly used for investment purposes (as illustrated by the map and facts on page 5). Local authorities can hold investments themselves but the advantage of maintaining them at arm's length enables the company to operate with more freedom and take forward development opportunities with social or commercial objectives.

Other advantages of LATCs include:

- Providing the authority with more direct strategic control over the service than a third party would
- Being politically more appealing as the authority is the shareholder
- The opportunity to generate profits which may be ploughed back into the authority to support wider public service delivery
- The opportunity for cost reduction by moving away from local authority terms and conditions towards more commercial ones, particularly with regard to pensions. This can reduce the cost base of the service, often quite significantly
- The creation of a separate company enables the service or activity to move away from being constrained by the local authority's decision-making processes and become more operationally agile. Decisions just need board approval which can be achieved relatively quickly, compared to the committee/cabinet structure of local government
- Wider powers to trade are available through the 2011 Localism Act providing the opportunity to win contracts elsewhere. This increases the opportunity to generate additional revenue using spare capacity

Case study:

The London Borough of Enfield

Housing Gateway Ltd was formed in 2014 as a wholly owned company of The London Borough of Enfield to take responsibility for the acquisition and management of the council's property portfolio. Establishing a wholly owned company was an innovative response to the budget pressures faced by the council and a way of providing more affordable accommodation for Enfield residents in the private rented sector.

The idea behind Housing Gateway Ltd was to address homelessness through a simple, straight forward efficient company, with minimal staffing. Housing Gateway Ltd works with other boroughs to manage the housing market and attract/undertake ethical investment. It has around 520 properties and is now considering undertaking new initiatives, in addition to refurbishment and minor development. So far the company has saved £4 million and seen high customer satisfaction levels.

Steps for success

In order for these benefits to be realised, it is important to take the time and effort to set up a company correctly. To be successful it is necessary to:

Adopt the right process	Carry out an options appraisal to select the most appropriate model (see "Choosing the right model") and develop a business case following best practice to ensure robust thinking, challenge from stakeholders, and transparency. This will assist in determining the most appropriate structural model and whether or not a vehicle is necessary. A detailed outline of how to develop an effective business case is set out in Appendix 1. However, before any specific actions are undertaken appropriate legal advice should be sought.
Be clear on the offer and desired outcome in order to assess impact and manage stakeholder expectations	This means having clarity about whether the desired result is to make a profit, take the service into public management, to make it more efficient – or a combination of these factors. Commercialism should always be about making a step-change rather than an incremental one. There is no point if the gains are marginal or just being commercial for the sake of it.
Allow plenty of time for benefits to be realised	This is particularly important when there is no input from the private sector. Financial gains take time to secure unless there is already an established service operating in-house. Successful companies take a long term view and evaluate themselves over a period of time, especially when a large investment is needed at the set up stage. This includes recognising that profits are unlikely in the first three years. Some of the biggest and most successful businesses have been operating for a long time, often before they have been transferred into a LATC, such as Norse, Cormac and Oxford Direct Services.
Don't expect an inefficient service to turn around automatically	If the service is operating sub-optimally, it will continue to do so whatever form it takes unless remedial action is taken. Looking at what causes the inefficiency, eg high levels of sickness absence, and introducing ways to address it, is essential before transferring the service into another model.
Start small and build the business	The most successful LATCs started with one service and grew from there, ensuring that a valid business case supported each growth phase. Attempting to transfer everything in one go is usually too much of a challenge without the proof-of-concept first.
Understand market demand	Knowing the local area and its strengths and weaknesses is critical and whether or not there are opportunities in the local area or demand further afield. As the market becomes increasingly saturated with companies, this is a key consideration.

There is the need to get recruitment right: delivery is only as good as people on the front line. The commercial skills needed in a LATC may be different from those in a local authority and if you can't recruit the right people, the company will fail

Keep the politics away	The governance structure should enable the company to trade freely and compete with the private sector. Elected members and local authority officers are likely to sit on the board of any company it owns, but balancing this with the appointment of non-executive directors and the use of shareholder committees helps to keep the local authority's input at a strategic rather than operational level. It is important to manage tensions between members who focus on electoral cycles and officers who need to consider longer term sustainability. This means effective governance is essential to ensure there is the right balance between commercial freedoms and the need for transparency with a willingness in the company to challenge if the local authority is too risk-averse. Very few companies have been dissolved and in most cases, when this has happened, it has been due to the politics rather than the viability of the business.
Be aware of the particular challenges of commercialising statutory services	The authority will always be the provider of last resort and will need to keep a degree of control to meet that requirement. This is particularly important for social services, with the added layer of regulation from CQC and Ofsted. The longer term view here is even more important.
Develop a commercial culture	This can be challenging if the whole service is transferred into the company with no external hires to drive change. Culture change takes time to take effect but can be accelerated with incentives that reward good business behaviours. These can be built into different terms and conditions. Companies need to be attractive places to work, engendering openness and trust. It should start with co-producing the vision and values as that provides the basis and the buy-in from which change can happen.

Case study:
Optalis

Optalis is a wholly owned LATC of Wokingham Borough Council and The Royal Borough of Windsor and Maidenhead. It employs 700 staff and supports adult social care customers at home and in their communities across Berkshire and Oxfordshire.

It was established in June 2011 by Wokingham Borough Council to provide care services (older people and adults with a disability) as a response to developments on personalisation, sustainability and council transformation.

In April 2017, the Royal Borough of Windsor & Maidenhead became a co-owner of Optalis and transferred its entire statutory adult social care service into Optalis. Both councils remain strong and at the heart of current practice, whilst working with Optalis to deliver opportunities for refinement, value for money, innovation and continual improvement.

It is important to think carefully about what you want to achieve: to borrow from Stephen Covey's book Seven Habits of Highly Effective People, 'begin with the end in mind'

Choosing the right model

Making the right decision regarding model can make all the difference to success. It is important to be clear at the outset what is intended to be achieved and what the outcome will be.

An effective options appraisal, which considers all relevant models, will increase the chances of selecting the right one. This may turn out to be keeping the service in-house if it is possible to achieve the desired outcomes in this way. This will save significant time and effort.

Structures can be changed over time, and indeed many have. But it is more cost effective to get it right from the beginning if possible. Some companies, such as East Cambs Trading Company, began with a single entity company for East Cambridgeshire District Council, its shareholder, in 2015. It has since extended into a group structure to accommodate the insourcing of waste and a range of other services, as well as allowing the possibility of partnership working with other authorities.

A number of different models can be adopted but the most common are wholly owned companies, joint ventures and social enterprises. In most cases they are companies limited by shares, which enable the distribution of profits. Limited liability partnerships (LLP) are open to local authorities as an alternative, provided the primary driver for the project is not a commercial one. These are much less common and tend to be used for joint venture partnerships for investment purposes with one or more third party. If a single authority is considering an LLP, a second member will be required (usually a subsidiary company of the local authority which holds nominal rights) – in such cases, care must be taken when identifying the local authority representatives as members of the LLP in order to avoid any conflicts of interest. An LLP is generally transparent from a corporation tax perspective, such that the local authority's share of income and gains arising to the LLP should fall within the local authority exemption – placing the local authority in the same tax position as if it had carried out the activities itself. This cuts out any potential corporation tax complexities or actual charges which a company may give rise to. However, it is important to be clear that any conflicts are cleared and that the potential tax simplicity is not outweighed by other factors such as the ability to trade widely externally.

Over the past few years numerous wholly owned trading companies have opened up their shareholding to other local authorities, or companies owned by other authorities. This is a result of the increased degree of insourcing as the sector looks to identify greater economies of scale and growth potential.

We might see the emergence of LATCs being owned by two or more local authorities, as a key part of the evolution of these companies. This will be particularly important where scale is needed to bring resilience

When deciding which model is the most suitable, consideration must be given to the objectives and the extent to which criteria such as financial returns compare to risk appetite. Local authorities will be more risk averse than commercial companies and this may mean that some opportunities are deemed unacceptable. During the lifetime of the LATC this is an important factor to recognise and the company must challenge back if the local authority's attitude to risk is jeopardising commercial opportunities.

Case study:

High Peak, Staffordshire Moorlands and Cheshire East – Alliance Environment Services

Alliance Environmental Services Ltd

This is a joint venture partnership (group of companies limited by shares) between High Peak Borough Council, Staffordshire Moorlands District Council and Ansa, a wholly owned subsidiary of Cheshire East Council. It provides waste collection, street cleansing, grounds maintenance and fleet management services to High Peak and Staffordshire Moorlands.

The company was created in June 2017 when High Peak's contract with Veolia ended. Staffordshire Moorlands had an in-house provision and the two authorities, who operate as a strategic alliance, decided to take this opportunity to review the delivery of these services to identify efficiencies. Veolia transferred staff on the High Peak contract via TUPE; Staffordshire Moorlands staff were transferred on local government terms and conditions; and any new staff are employed on commercial terms and conditions.

The decision to merge with Ansa enabled all three councils to benefit from economies of scale given they are geographically close together, and could benefit from the expertise and scale that Ansa had built up since its creation in 2012. The new company has a demanding savings challenge of £1.25 million in ongoing savings. It is focused on rationalising its assets both in terms of staff and estate, and has commissioned a review of fleet which identified that a purchase rather than lease decision would be the most cost effective.

Wholly owned companies

Wholly owned companies continue to be very common because they mean local authorities retain the risk and reward. Governance is less complicated than a shared model and any profits can be returned back to the local authority as the sole shareholder. The risks are higher where there is an unproven business idea, but in cases where the service is already trading this can be a good way to grow the business further. Direct labour organisations such as Cormac and Oxford Direct Services have both transferred out in this way.

Case study:
Oxford Direct Services

Oxford Direct Services (ODS) was already operating within Oxford City Council as a direct labour organisation with a large skilled workforce, infrastructure, plant, equipment and a strong brand. As part of the council's wider plans to become commercial, it undertook an options appraisal to determine whether or not to create an arm's length company. The decision was taken to set up a new organisation in order to realise greater potential in particular to boost income from business-to-business trading. Two companies were set up. One to focus on commercial work, the other to provide services directly to the council – its main shareholder and customer. There was no requirement to set up a holding company. ODS takes advantage of the Teckal exemption for trade back to the council.

Approximately 700 staff were transferred via TUPE to ODS. The pensions liability was retained within the council, keeping it off ODS' balance sheet to demonstrate financial strength in competitive bidding. Based on a track record of success, ODS will expand and grow with this involving a number of options such as acquisitions or joint ventures.

Key features	• Creation of a wholly owned company • Greater freedoms • Risk and reward relatively low/slower to achieve • Preferred cultural fit • Typical for catering, building control, HR • From a legal perspective, the company should meet the 'control' test for Regulation 12 of the Public Contracts Regulations 2015, which might exclude the need to follow a regulated procurement process before a contract can be awarded (the Teckal exemption)
Financial	• Potential to reduce costs but it is likely to take 2+ years to drive change • Savings approximately 10-15% after two years • From a legal perspective, less than 20% of services/supplies can be delivered to third parties if relying on Regulation 12 • There are direct and indirect tax implications. Inappropriate planning could result in VAT costs for the customer and/or local authority
Quality	• The potential to improve quality is dependent on creating cultural change in the organisation
Risk	• Limited risk if providing services solely to the local authority • Greater risk exposure as services are traded to different bodies
Control	• High level of control retained
Key success factors	• Appropriate business planning process needed • Some cultural change needed to increase viability of service • High level of staff support and engagement to reduce employee and union challenge

Case study:

Norse

Norse Group is a wholly-owned subsidiary of Norfolk County Council and is by far the largest LATC in the country, with a turnover in excess of £300m. The group brings together NPS (property consultancy), Norse Commercial Services (facilities management) and NorseCare (a social care provider). These companies are all wholly owned subsidiaries of Norse Group. Both NPS and Norse Commercial Services have a significant number of joint venture companies, most of which are 80% owned by the Norse Group and 20% owned by the partner council. Any profit share is 50/50 between partners. This growth has been to a large extent triggered by austerity, which encouraged councils to look to alternative methods of outsourcing; the JV model provides greater flexibility than the traditional long term fixed contract outsourced model.

Norse have a low margin but high scale business approach with a focus on efficiency and growth to support the creation of jobs. Council staff who join Norse usually remain on council terms and conditions, but where Norse wins commercial contracts the staff are employed on the prevailing market terms and conditions. They look to be competitive with private firms and constantly develop their commercial skills and demonstrate an ability to operate in a commercial environment. They remain by far the largest of all local authority trading companies but welcome competition from others who are steadily growing in size and in due course may become disruptors.

Norse has grown through partnering with other local authorities using their JV model, and has put its success down to a range of factors including:

- flexibility in approach: it is important to recognise that a one-size fits all approach does not work. Every company is different
- recruitment from commercial world – a deliberate strategy to bring in required skills which leads to a change in the culture of the organisation
- rebranding – opportunity to move away from being too closely associated with the local authority, which improves the perception of the company in a commercial world. Marketing and branding is important in changing an organisational culture.
- positioning itself as a commercial organisation rather than an LATC
- running the company's own systems itself rather than relying on the council's, ie HR, accounting and, sales and marketing
- promoting growth, being more flexible in negotiation for the most mutually beneficial deal
- being prepared to challenge the council where necessary
- awareness of the political environment and ensuring members support the rationale of the company
- keeping the pensions liability within the council as this avoids a negative balance sheet and promotes the ability to tender externally.

Joint ventures

Joint ventures (JV) have become increasingly popular as a means of leveraging growth, in particular between public sector entities. This model has been pioneered by Norse (see case study) and is being developed by others such as Corserv and Vertas (see the Vertas case study). Using a JV model to partner with other local authorities or local authority trading companies could mean that public procurement is not necessary when it falls under the provisions of Regulation 12 (the Teckal exemption) – when this occurs and the fit between the two parties is right, a contract may be directly awarded. For further information see our report Better together: How to build a successful JV company.

Key features	• Establishment of a venture jointly owned by more than one body • Local authority retains less control but there is shared risk and greater opportunities • Cultural fit better than outsourcing • Typical for investments, waste, highways, facilities management and social care • From a legal perspective, they must meet the 'control' test for Regulation 12 (Teckal exemption) which allows exclusion from regulated procurement in awarding of contracts to a JV partner
Financial	• Ability to drive cost efficiencies is dependent on skill set and sector knowledge of JV • Savings approximately 10-15% after 18 months • From a legal perspective, less than 20% of services/supplies can be delivered to third parties if relying on Regulation 12 • Partnerships and companies are treated differently for direct tax. A VAT cost sharing group could be achieved, but inappropriate planning could result in VAT costs
Quality	• The potential to improve quality is dependent on the maturity of the organisation
Risk	• Limited risk if providing services solely to the local authority • Greater risk exposure as services are traded to different bodies • Some risk of contract creep • May not be of interest to some vendors
Control	• Low to medium level of control retained depending on split
Key success factors	• Appropriate business planning process needed • Vendor due diligence critical to selection process • Some contract/relationship management effort required

Case study:

Vertas Group Limited

Vertas Group Limited is a wholly owned subsidiary of Suffolk County Council, operating in the facilities management sector. It has set ambitious growth targets and the route to achieving this is through a combination of new business, acquisition and the creation of joint ventures with other authorities.

Prior to Verse Facilities Management Limited (Verse) being set up as a joint venture company (JV), the two partner councils – Forest Heath District Council (FHDC) and St Edmundsbury Borough Council (SEBC) were operating five different facilities management contracts with different suppliers for the provision of the services. FHDC was also self-delivering in some of its key buildings. Creating the JV company provided the opportunity to create efficiencies through harmonisation of terms and conditions, growth through economies of scale, removal of duplication of work created by multiple suppliers and differing service standards.

To achieve the establishment of a successful and innovative alternative service delivery model, a careful piece of work needed to happen to ensure the right model was pursued. This meant a full review of current operations by all parties to ensure that the development and implementation of the final model was fit for purpose; providing benefit to all three organisations. A full options appraisal was approved prior to the company being created, followed by a detailed business case which set out the principles. These included:

- generating savings and efficiencies through integrating services across West Suffolk Councils' facility management spend
- maximising the needs of both organisations to be more commercial – allowing for the JV to expand through new business and maximise future opportunities
- removing the areas where both parties competed against each other in the local services market place
- diminishing the need for day-to-day client involvement and contract management
- reinvesting profit share back into the JV and the councils' front-line services – providing benefit for local residents
- retaining and monitoring 'control' over the performance of any new contract, within the scope of the agreement, through the JV.

To enable Verse to meet its targets it was imperative that the right general manager was appointed. This role needed to be bought in from outside the TUPE transferees. To generate a transformational change the JV needed:

- a strong leader, not afraid to make and execute difficult decisions
- a fresh perspective, without any of the historical baggage and perceived limitations
- someone who could deliver the new Services Specification through clear direction and team work with a solid understanding of what 'good looked like' and how to achieve it
- high standards without compromise and the knowledge and experience to work with the existing team to bring in new equipment and ways of working to create better results; be that cleaning standards, attention to detail, timeliness of security patrols or the Café West catering staff dealing with customer queries
- commercial acumen
- patience, drive and huge resilience
- ability to work with the new business development team to bring new clients into Verse once the JV was operating efficiently and effectively.

The JV was created in August 2015 with the performance of services from September, the first financial year consisted of six months. The company broke even during this period, as a result of the various set up costs, mobilisation expenses, Verse Company legal and one-off costs that are required with any new business start-up. Verse has out-performed its budget in the first full year and is ahead of target at period six in the second full year.

Since the JV was established, the West Suffolk Councils have made a 5% direct cost saving through the creation of the JV in the first year. For the first full financial year (1st April 2016 to 31st March 2017), Verse has exceeded the budget expectations and is now a £1m business generating a profit of £80k for the shareholders. Turnover is 6% greater than budget, with profitability 7% more than budget. The West Suffolk Councils will receive £32,000 (40%) profit share.

Social enterprises

If there is a social motive rather than a profit one, a social enterprise is often the preferred option. The term covers a range of models including trading companies, community interest companies and charities, but the organisation must demonstrate that it has a social purpose. A community interest company is a common model because it enables access to grant funding which can help grow the service, as well as allowing a capped level of return via dividend if any profits are made.

For further information on social enterprises please see our report "Setting up a social enterprise".

Key features	• Opportunity for staff to control some or all of the service • Potential for extra funding sources • Efficiencies slower to achieve than other more commercial models • Typical for traded services • Regulation 77 of the PCR2015 provides the ability to reserve procurement processes to 'qualifying organisations' for certain services
Financial	• Potential to reduce costs and increase commerciality but not in the short term • No return for the local authority • CICs are subject to direct tax
Quality	• Potential to improve quality but is dependent on creating cultural change in the organisation
Risk	• Limited risk if providing services solely to the local authority • Greater risk exposure as services are traded to different bodies
Control	• Low level of control retained by the authority
Key success factors	• Strong business case required including market analysis • Cultural change required for staff

Case study:
Streetwise

Streetwise Environmental was established by Rushcliffe Borough Council in 2014. It delivers environmental, grounds maintenance, estate management and on-street services to a wide range of customers which it has steadily built up over the past four years, including housing associations, land-owners, private individuals, other councils, voluntary organisations and schools. The company was originally set up under the Teckal exemption to enable it to trade back to the council, whilst taking on additional external contracts. The company has recently established a trading arm that gives it the opportunity to expand beyond the limits of the Teckal arrangement and take on a wider range of work both within the current geographic area and beyond. This provides the perfect opportunity for other councils to partner with Streetwise and open up the opportunity to expand delivery, utilising this trading arm within their communities. As part of this restructure, governance has been strengthened too, with the recruitment of a paid Streetwise Non-Executive Director and the establishment of a Rushcliffe Borough Council owned holding company, with plans in the near future to add to the portfolio of Rushcliffe Borough Council companies.

Generating revenue is important for the growth of the companies, but of equal importance is the social ethos of supporting the local environment and sustainability. To do this, Streetwise performs a range of public services such as community pride projects with at-risk young people and community allotments, increasing engagement with local employers, as well as carefully considering the use of its fleet and its carbon footprint.

All these attributes combined with up-skilling relevant personnel with the Institute of Directors Certificate in company direction has led to Rushcliffe Borough Council being recognised though the awarding of the Commercial and Entrepreneurial Council of the year by the Municipal Journal and Local Government Chronicle.

Developing a robust business case

An effective business case is critical to developing a successful local authority trading company.

The business case sets out the rationale for the proposed company and presents evidence to support the concept of the LATC. This is essential to allow stakeholders the opportunity to review and robustly challenge the concept. This strengthens the proposal and supports buy-in from members, staff and the local community. Thorough business planning is required before the company is created – the business plan is the document that brings the business case into reality and sets out the intention of the company.

Overall, it is important to have a business case to provide:

- accountability to stakeholders
- visibility of the process
- comparability of the proposal to "business-as-usual"
- a catalyst for change
- justification for the investment.

The five case model set out below is based on the government's Green Book[1] approach which is recommended for all local authority proposed companies. Following the full Five Case Model may feel too onerous for smaller scale organisations. But, regardless of how structured or unstructured a business case may be (the latter being a lighter touch approach with more informal documents and a simple approvals process), it is still important that best practice is followed.

The Green Book Approach

Strategic Case: What precisely is being done, why, what will the outcome be and how does it fit with other polices? – **Applicable**

Economic Case: What is the public benefit in this? – **Appropriate**

Commercial Case: Can the things needed for delivery be purchased at an affordable price? – **Attractive**

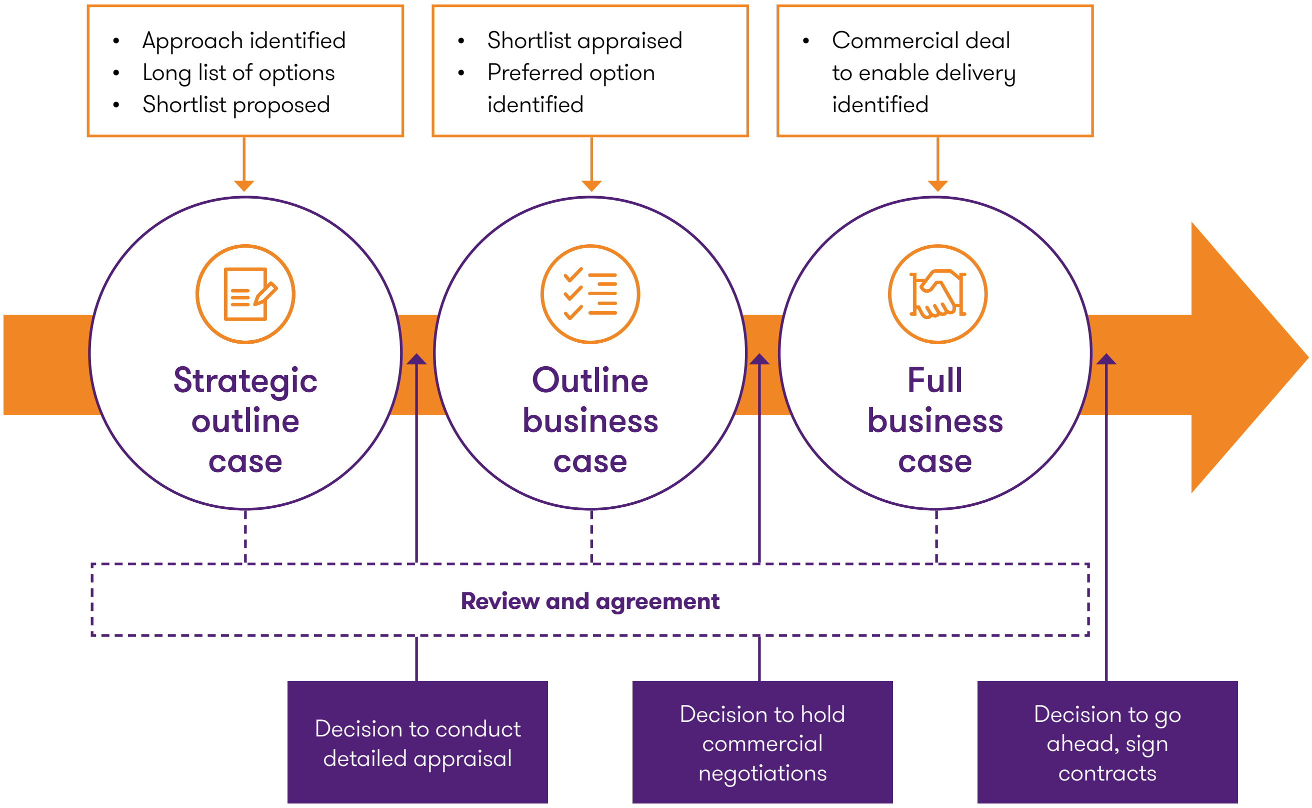
Financial Case: How will it be paid for and what will it cost? – **Affordable**

Management Case: How can it be delivered and what delivery plans are in place? – **Achievable**

For more information on The Green Book, please visit: https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-governent

1 The Green Book is a guidance by HM Treasury on how to appraise and evaluate policies, projects and programmes.

The process comprises three key stages:



Issues to consider:

Where will the information come from? Business-as-usual information and benchmarking data is a good place to start

Where will income growth come from? Knowledge of the market is essential here

Consider the full impact of the service, eg on back office sercvices and overheads – how these will be delivered must be factored into the calculations

Strategic outline case

This is the scoping phase that establishes the case for change and indicates the preferred way forward. Key headings for the Strategic Outline Case include:

Strategic case
- Organisational overview
- Business strategy and aims

Strategic needs
- Key objectives for proposed spending
- Existing arrangements
- Business needs – current and future
- Scope and service requirements
- Benefits criteria
- Strategic risks
- Constraints and interdependencies

Outline commercial case
- High level assessment of possible deal

Outline management case
- High level assessment of achievability

Economic case
- Critical success factors
- Main business options (long list)
- Short listed options
- Preferred way forward (conclusion from initial assessment)

Outline financial case
- High level assessment of affordability

Outline business case

This is the planning phase (pre-procurement) that identifies a preferred option and assesses potential value for money, affordability and achievability. Key headings for the outline business case (OBC) include:

Strategic case
- Update as required
- Develop detailed description of business scope and high level service outputs/requirements

Outline commercial case
- Scope/services
- Risk allocation
- Charging mechanisms
- Contractual arrangements
- Personnel implications
- Implementation timescales
- Accountancy treatment

Outline management case
- Procurement strategy
- Method of procurement (including EU requirements, evaluation methods)
- Outline arrangements for project management, risk management, change management, benefits realisation, post project evaluation

Economic case
- Update as required
- Economic appraisal of each option (eg NPV, NPC)
- Benefits appraisal
- Risk assessment
- Sensitivity analysis
- Preferred option

Outline financial case
- Possible capital requirement
- Net impact on balance sheet
- Net impact on income and expenditure account
- Overall affordability

Full business case

Procurement phase following completion but pre-contract. Selects the service solution and finalises post procurement arrangements.

Strategic case
- Update as required

Commercial case – for recommended deal
- Scope/services
- Risk allocation
- Charging mechanisms
- Contractual arrangements
- Personnel implications
- Implementation timescales
- Accountancy treatment

Management case – agreed arrangements for
- Project management
- Risk management
- Change management
- Benefits realisation
- Post project evaluation
- Contingency plans

Economic case
- Summarise OBC conclusions
- Short-listed options including service providers' best and final offers
- Economic appraisal
- Benefits appraisal
- Risk assessment and sensitivity analysis
- Preferred option following procurement

Financial case – for recommended deal
- Capital requirement
- Net impact on balance sheet
- Net impact on income and expenditure account
- Overall affordability

Once these stages have been completed and approved, the company is ready to be set up and become operational. The business plan then becomes operational, supporting the company to implement the intention of the business case.

Future direction

It is the general view across the sector that local authority trading companies are here to stay.

There is still plenty of growth potential for existing and new companies to tap into if they follow the right steps. As well as insourcing, one of those steps is to explore further public sector collaboration and options for scaling up by going beyond local boundaries. This potential for collaboration brings benefits both for the local authority trading companies that want to expand and the local authorities looking for partners (with a public sector ethos) to deliver their services. Such growth could provide disruption to the market which has traditionally been led by commercially-owned organisations.

Another factor likely to affect future development is technology. Making a success of a business often relies on new technology, particularly in challenging competitive environments, and investment here will be critical. As some local authorities may find this impossible to do alone, they may need to partner with others who have the established platforms and can provide the immediate benefits.

Recognising the importance of technology will have a profound effect on local authorites and LATCs. This is fundamentally about transformation being the enabler not only for those we support – our customers – but also for those who provide it – our staff

Regulatory change is always a risk but the Teckal exemption (Regulation 12) is likely to continue in its current form – there are no plans to make changes to the protection of publicly owned companies. However, with the impact of Brexit, changes to public procurement rules are possible, which could adversely impact LATCs, eg the rules could become more restrictive and there could be a Teckal challenge. To date, there have been no Teckal challenges, ie from those that believe competition is compromised as a result. However, as some LATCs become larger and competition in the market increases, this may be something that privately owned market competitors might begin to consider, if they believe that it is anti-competitive. There is growing concern that this may happen in the foreseeable future.

A linked point is the operation of rules around state aid that stem from the European Union's Treaty of Rome, and which govern the circumstances in which assistance may be granted by the public sector. However, the current view of the sector generally is that there will be little change to the principles around state aid following Brexit.

Given the market risks becoming saturated with so many local authorities setting up companies, often wholly owned, there may come a point in the near future when there is not enough space for growth and new entrants. Many commentators believe this will lead to increased merger activity as further efficiencies can only be achieved through scale and growth. This will inevitably also lead to insolvencies – to date, we have seen a small number of LATCs being dissolved or becoming dormant (although in most of these cases this has been as a result of political rather than operational challenges) but many predict these will increase as the market becomes more crowded and competitive. Those that are unable to trade more widely and concentrate solely on trading back to their own (parent) authority will face the biggest challenge for survival. There may also be more involvement and investment from the private sector as it sees the opportunity. However, local authorities should be cautious as the private sector's ambitions may not coincide with their own and may be less focused on the non-financial outcomes for local areas.

We should be looking outside of parliamentary terms and set a health and social care strategy that spans forty years not four

In relation to specific services, waste and social care companies in particular are set to grow, especially with the decline in popularity of outsourcing leading more authorities to consider bringing waste contracts back in-house or into a wholly owned company or JV. Equally, social care companies provide authorities with an opportunity to rationalise a high cost service while retaining sufficient control to maintain critically important service standards. This is now moving one step further with the traditional model of delivering 'provider' services such as re-ablement, day care and homecare set

to change. This is driven in part by the market but also by local authorities who recognise the need for cultural transformation and growth whilst being able to retain robust governance oversight of such important services.

Changes to structures of local authorities in England are also on the horizon through the Local Government Reform (LGR) process, with a number of proposals for unitaries in the planning stage. Over time, this will mean a reduction in number as more unitaries are created and a change of ownership for those LATCs affected. Some of these are already in train, such as Dorset's plan for two unitaries. The political rationale for LGR is not necessarily aligned with the efficiency savings associated with commercialism, so it does not necessarily follow that LGR will act as a lever to support further commercial opportunities.

In Wales, a Green Paper on local government reform was published in March 2018, with three options for potential mergers detailed. These changes will lead to consolidation and any companies owned by authorities participating in one of these proposals will need to be transferred into new ownership, which in itself is not an onerous task. This is likely to lead to consolidation and mergers as noted.

A general power of competence may also be in the pipeline for Wales. The Welsh local government Green Paper flags the possibility of that power in order to deliver its commitment *"to ensuring that local government is equipped with the powers it needs to make life better in our communities … We intend to legislate for the general power of competence for principal councils which merge and community councils which meet eligibility criteria. This will enable them to adopt more innovative approaches in meeting the needs of their communities."* Although the exact detail around the provision is currently unknown, the existence of the power will remove some of the restrictions and shortcomings that arise for the existing Welsh regime, in particular when seeking to rely on the well-being power.

Given the continued pressure on local authorities to find efficiencies, more dynamic chief executives are likely to emerge who are more open to different ways of doing things and who could drive further developments for new trading companies.

About Grant Thornton

Grant Thornton UK LLP is a leading business and financial adviser with client-facing offices in 24 locations nationwide. We understand regional differences and can respond to the differing needs of local authorities. But our clients can also have confidence that our team of local government specialists is part of a firm led by more than 185 partners and employing over 4,500 professionals, providing personalised audit, tax and specialist advisory services to over 40,000 clients.

Dynamic organisations know they need to apply both reason and instinct to decision making. At Grant Thornton this is how we advise clients everyday and we are passionate about supporting innovative and sustainable solutions for the many challenges local authorities face. Working with local authorities for over 30 years, we are the largest employer of CIPFA members and students in the UK and our national team of experienced local government specialists, including those who have held senior positions within the sector, provide the growing range of assurance, tax and advisory services that our clients require.

Grant Thornton is the leading firm in the local government audit market, auditing 40% of local authorities in England. We also audit local authorities in Wales and Scotland via framework contracts with Audit Scotland and the Wales Audit Office. In total we have over 180 local government and related body audit clients in the UK and over 75 local authority advisory clients, including London boroughs, county councils, district councils, city councils, unitary councils and metropolitan authorities, as well as fire and police authorities. This depth of experience ensures that our solutions are grounded in reality and draw on best practice. And, through proactive, client-focused relationships, our teams deliver solutions in a distinctive and personal way, not through pre-packaged products and services.

Our approach combines a deep knowledge of local government combined with an understanding of wider public sector issues. This comes from working with associated delivery bodies, relevant central government departments and with private-sector organisations that work in the sector. We also take an active role in influencing and interpreting policy developments affecting local government and in responding to government consultation documents and their agencies.

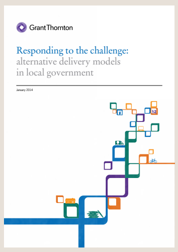
Alternative delivery model series

We have been researching and publishing national reports on alternative delivery models since 2014. Reports in this series are:

Setting up a social enterprise

Spreading their wings – Building a successful local authority trading company

Better together – Building a successful joint venture company



Responding to the challenge – Alternative delivery models in local government

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