



ALTERNATIVE SERVICE DELIVERY MODELS IN LOCAL GOVERNMENT

Spreading their wings
*Building a successful local
authority trading company*



NOTICE TO READERS

THE REPORT'S SCOPE

THIS REPORT WAS COMMISSIONED BY THE LOCAL GOVERNMENT ASSOCIATION

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We would like to thank Brownie Jacobson for their contribution to the legal aspects of this report.

Executive summary

Austerity has made a significant impact on local government. Our report 'Responding to the challenge: alternative delivery models in local government' looked at the increased use of alternative models to protect and develop services. This trend has continued over the last year.

This follow-up report focuses on local authority trading companies (LATCs) and is the first in a series looking at alternative service delivery models (ASDMs) in more detail.

While some councils have always had a commercial approach, many traditionally avoided commercial considerations. This is no longer the case. As councils have come under financial pressure, they have considered how to reduce costs, generate income and improve efficiency by introducing commercial structures. For many councils, the use of LATCs is a step towards becoming self-financing.

The level of innovation has been impressive

Over the last five years, we have seen a significant increase in the use of different service delivery models by local government. The introduction of LATCs has been a key part of this innovation.

LATCs now cover an ever-widening volume of services

While restricted initially to areas such as entertainment or airports – for example Birmingham's NEC and Manchester Airport – they have grown into new areas such as highways, housing and education. More recently, LATCs dedicated to the delivery of social care services have emerged.

We predict that the number of LATCs will grow in the next five years

The main reason for this growth is local government's desire to generate income to protect other services. Secondary drivers include:

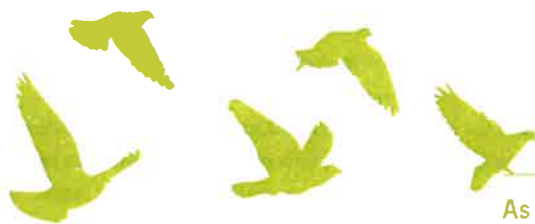
- the need for certain services to be separate from councils to allow them to compete in a wider geographical area
- a view that greater commercialisation will drive efficiency
- a view that certain services are non-essential to the council and would be better managed separately.

There are other reasons and there does not appear to be a common view on the reasons for setting up LATCs.

“Increasing financial pressure on local councils has meant that they are having to evaluate different and sometimes radical ways to deliver their services. This has led to them considering a number of models, offering a variety of advantages and addressing a range of objectives.

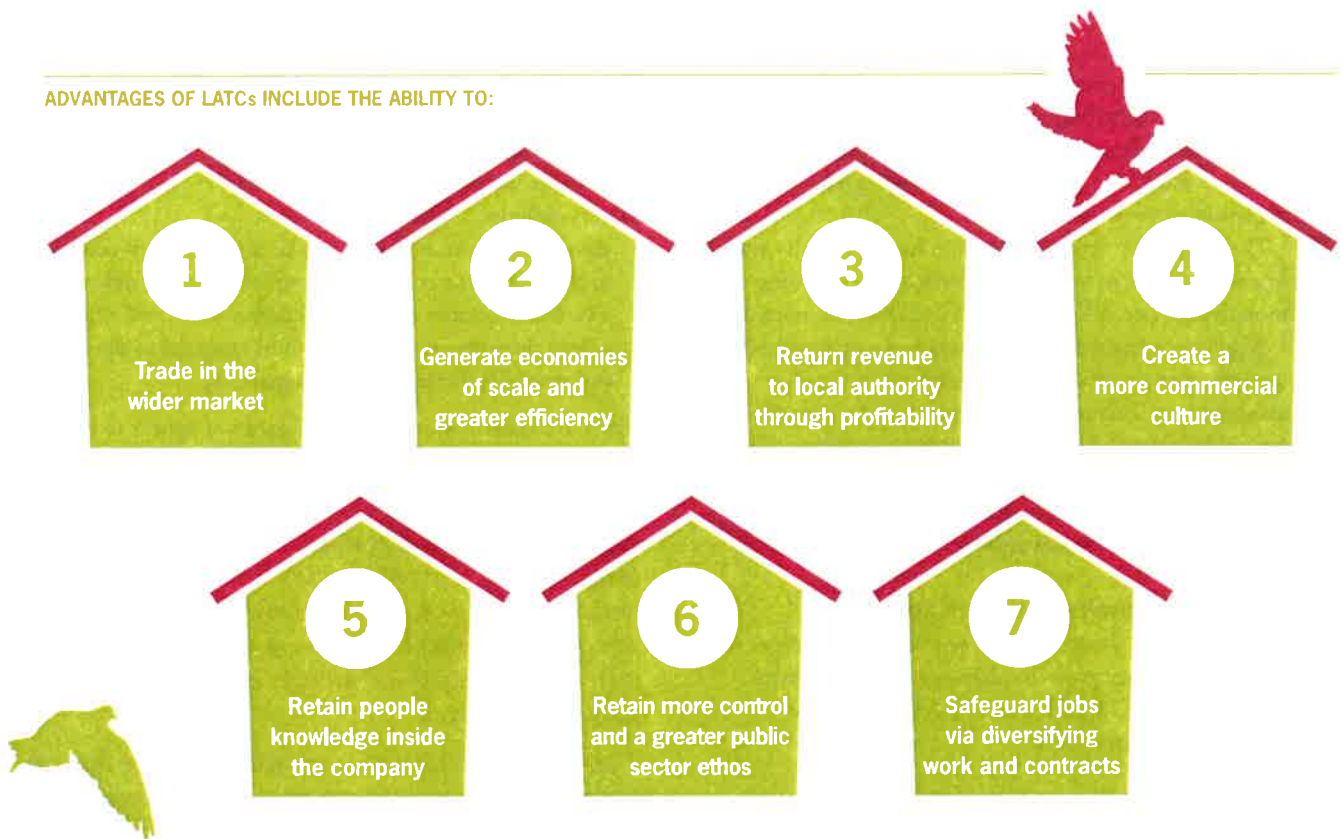
The main drivers for local councils to change the way services are delivered are: achieving cost savings; adding social value; increasing economic activity; improving management skills and capacity; and being flexible enough to meet changing priorities. All these objectives can be met with a separate trading company.”

Peter Hawes, Board Member Norse Group, and Managing Director Norse Commercial Services



As councils have come under financial pressure, they have considered how to reduce costs, generate income and improve efficiency by introducing commercial structures.

ADVANTAGES OF LATCs INCLUDE THE ABILITY TO:



LATCs can be successful

There are already many examples of success such as the CORMAC, Essex Cares, KCC Commercial Services and Kingstown Works Limited. Our work with the sector confirms that councils and LATCs can be successful. If managed effectively, they can also provide significant opportunities for councils to provide better services and drive efficiencies. We believe that, as financial pressures continue, more councils will establish LATCs; and these LATCs could add significant value to the sponsor councils in the generation of income and efficiency. There does remain a risk of multiple LATCs competing for the same work. So some thought needs to be given to both the opportunity and the competition.

Resistance can be expected

There is a resistance from some stakeholders who see LATCs as privatisation. Senior leaders, who need to ensure that the delivery model is appropriate and provides the right results, can also be hesitant. Their concerns are not unfounded. Moving services into the commercial world carries risk and is not easy. There are examples where inadequate planning has resulted in LATCs becoming loss making and leaders should take care before setting one up. However, these issues can be overcome with the right preparation and business processes.



Effective LATCs build their success through a number of principles

Key principles are:

- the council and the company being clear on what they want to achieve, and having a clear vision of the future and how the company will grow
- creating a culture of trust between the council and the company
- making effective engagement with people a reality
- ensuring the company structure, governance and its operations are established appropriately
- obtaining professional advice and support where needed in specialist areas including finance, legal, tax and people
- creating the right business leadership, with the right commercial and market facing skills
- promoting cultural change and creating a commercial mindset in the people transferring to the new company.

It is possible for LATCs to make a loss

A number of adult social care service LATCs have slipped into deficit or have been brought back in-house following concerns over service delivery and value for money.

A trading company entered into a large catering contract resulting in a substantial loss that required funding by the council.

A supplier of council house windows did not have a business plan outside of the 'decent homes' standards requirements. When this ended, the company required significant levels of interim financial support and restructure.

A company set up to tender for a large contract did not win the work. With no other strands to its business plan, it eventually became dormant and never managed to repay the initial working capital loan.

“The overriding theme throughout the project was the need to be grown up. When issues arose we resolved them with grown up conversations and a constant reminder to keep our eyes on the prize.”

Strata

This report sets out the initial stages that local councils need to follow before deciding to set up a local authority trading company; what to do when setting it up; and, probably more importantly, how to build a successful LATC.

Grant Thornton has worked with many LATCs and continues to support growth in this area. We have based this report on our own experience of working with LATCs, supporting councils to establish LATCs, market research and interviews with councils and LATCs. We have included case studies of new and long established LATCs. Taken as a whole, the report can be used as a handbook for practitioners looking to establish an LATC.

We believe that, as financial pressures continue, more councils will establish LATCs; and these LATCs could add significant value to the sponsor councils in the generation of income and efficiency.

Deciding to set up a local authority trading company

It is not possible to talk about LATCs without considering the initial decision making process. Our research identified three essential steps in this process.

1 Consider the strategic fit of the company with the council's vision

Our research indicates that, at the start of the decision making process, it is essential that councils are clear on what they want to achieve, and have a clear vision of the future and how the company will grow.

For most of the LATCs reviewed, councils had thought about what they wanted to achieve, with income generation being the key focus. However, they neither had a particularly clear vision of the future – beyond the general aim of income generation – nor ideas about exactly how the companies would grow. In some cases, the lack of a vision and agreement had resulted in contention around the company's future strategy. At its most extreme it had resulted in LATCs 'going rogue', taking actions councils did not agree with, and being brought back in-house.

Our discussions with councils indicate that an essential part of the initial decision making process is determining a 'strategic fit'. In certain instances, establishing an LATC may not fit with a council's overall strategy and vision. For example, establishing a leisure company on the basis of income generation may not fit with a strategy of improved public health. Councils also need to think about whether a company structure would support or hinder a move to a combined authority or other forms of devolution.

Strategy and vision

Nuneaton and Bedworth Borough Council established NABCEL recently. A key factor in determining whether to set up the company was its strategic fit with the council's self-sufficiency agenda and the potential for income generation.

We also found that it is essential to determine what is culturally and politically acceptable. We identified examples where councils had initially considered an LATC even where it did not sit well with the council's culture or would not be politically supported and carried through. This had resulted in considerable delay in some instances in finding a solution for challenged services.

To overcome these issues, it is important that councils undertake a strategic review at the start of the LATC process. A fundamental question that many ask in this process is 'what sort of council do we want to be and will this change help deliver it?' They often supplement this by considering:

- what are the strategic benefits of implementing a new delivery model?
- how will this affect other parts of the strategy?
- do members and senior officers believe it is worth investing time?
- what are the objectives of the new service delivery model?



It is important that councils undertake a strategic review at the start of the LATC process. A fundamental question that many ask in this process is 'what sort of council do we want to be and will this change help deliver it?'

2 Appraise options

An LATC is not the only ASDM. Other models include shared services, outsourcing and joint ventures. Different ASDMs have alternative characteristics and benefits. For example, they have different risk profiles and afford alternative levels of control to councils.

Option appraisal is a mechanism for assessing these different characteristics. This is an essential stage of the process and allows members and officers to debate the characteristics and risks fully. In all of the examples researched, councils did this appraisal fairly and objectively. Many councils commissioned external bodies to undertake the appraisal to ensure that expertise in tax, finance, legality and governance was driving the right decision.

Option appraisal

Different service models offer different benefits. It is important that councils recognise and consider these as part of the option appraisal process.

Our research noted one point of concern. In some cases, there were indications that councils could have appraised options earlier and thereby avoided delay further into the process.

3 Develop an outline business case

The next stage of the business planning process is the production of an outline business case (OBC). This includes outline commercial strategies and business, financial and marketing plans. Councils have improved their business planning processes over the last five years and many of the successful case studies included in this report reflect this.

More generally, for many councils the establishment of an LATC will be a first step into a more commercial world. This increases the risk of producing an inadequate OBC. It perhaps explains why some LATCs have unplanned deficits in the first few years. Our research also identified that some LATCs had spent their first year developing business plans and had made little headway against their objectives. Other common issues identified by our research included heroic performance targets, and excessive levels of anticipated savings. There are also examples of councils having to bail out or dissolve failing LATCs where a good OBC process would have resolved the issues in advance.

Another issue arising from our research is the significant gap between what new LATCs can deliver in their first few years and the expectations of council members and officers. Given that the people, structures and policies will be essentially the same during the first six to 12 months, over-optimistic performance targets are unhelpful. This lack of realistic expectations is often a failure in the business planning process.



Business planning process

Common failings from our review include: the lack of a clear business plan for the transfer of other council services into the company; the lack of planning with regard to long-term or working capital financing; and the lack of clear plans with regard to the alignment of terms and conditions within the company.

While we have highlighted some concerns in this process, all of them can be overcome if there is appropriate strategic alignment, option appraisal and business planning.

The most notable example of success is the Norse Group established by Norfolk County Council. The company has expanded significantly since it was established and now has a turnover in excess of £300 million. Good business planning, a shared ethos and commitment from the council and the company have delivered success. In an interview with the New Local Government Network, the managing director said: “The benefits to the local authority of separate trading companies can be significant. But the path there needs careful planning, thorough and robust assessment of the objectives and, most of all, commitment on all sides.”

Setting up a local authority trading company

Councils need to consider many areas in Setting up a local authority trading company. Based on our market research, our experience and discussions with LATCs and councils, we have highlighted a number of key steps.

1 Obtain the right professional advice

All of the councils we interviewed emphasised the need to engage with advisers that they could understand and trust. They saw this as essential to managing a number of risks and strengthening commercial skills, particularly in the areas of legality, finance and tax.

2 Company registration

The next step is to register the company. LATCs are registered under the Companies Act 2006. LATCs tend to be companies limited by shares or companies limited by guarantee. Our interviews indicated that the process of setting up the company was easy. Interviewees did indicate that they needed to give some thought to the articles of association because these steer the future direction and governance of the company.

It is important to agree at this stage what action the council would take if the company were to make significant losses. On paper, the 'limited by shares/guarantees' structure limits councils' liabilities. However, we are not aware of any councils that have allowed LATCs to fail without meeting their liabilities. Clarity is needed with regard to what interventions the council will make should the LATC make significant losses. An exit plan should also be agreed at this stage.

3 Trading

Step 3 is to consider whether the company will be set up to deliver council services or to trade, or both. This decision will guide compliance with procurement law.

Most LATCs begin with a period where contracts are awarded directly. This allows them time to increase their commerciality before entering markets that are more competitive. The so-called Teckal exemption allows councils to award contracts directly to LATCs and gives the company freedom to trade commercially for up to 20% of its turnover. Both the council and the company need to have clarity in this area.

State aid rules also apply where the company is trading. Some thought needs to be given to any support given, particularly with regard to the issue of grants, and charging for the use of assets and support services.

Teckal or trading

NABCEL was established immediately as a full trading company so that it would be able to trade externally in the private rented housing market and in any other markets deemed necessary.

Acivico was initially established as a 'Teckal' company with a five-year protected contract with the council.

ip&e Ltd has been set up with two trading arms to ensure that business can be placed in the most appropriate vehicle to benefit the council.



4 People

The motivation and development of the people transferring to the LATC was a recurring and vital theme in our interviews. Most LATCs cited this as a key factor in creating a successful company. Key aspects include creating a commercial culture, building commercial skills, developing staff, removing management layers, and developing a shared sense of purpose and creativity. In most LATCs these changes are made after the company is established but in our experience the process of change can take a considerable period and should be started as soon as possible. We consider the changes made in more detail in the section on ‘Building a successful company’.

For most of the LATCs interviewed, the transfer of people was a key stage in establishing the company. In most instances, the Transfer of Undertakings (Protection of Employment) Regulations 2006 as amended (TUPE) applied. This protects terms and conditions and is a complex area. In all instances, councils sought human resources and legal advice to ensure compliance.

Similarly, all the councils/LATCs had to manage the initial impact on morale of the people transferring. At a later stage, some also had to reorganise structures, and had needed to introduce change leaders and commercial training to improve productivity and to create a more commercial culture.

Cheshire East Council made a point of communicating to its people that it was looking at all ASDMs for its waste services and not just outsourcing. Ensuring proper engagement with the workforce on options and considering their views was important in getting people to buy in to the company model.

“Engagement with the workforce is key. If you don’t keep them on board and work closely with their representative, you’ll never get there.”

Ansa

Terms and conditions featured prominently as a key business tool in all of the LATCs we researched. Most had reviewed, and many had altered, their terms and conditions. Some offered new contracts to people on the establishment of the company. More commonly, they offered different contracts with revised terms and conditions to new starters with the company.

All of the changes to contracts focused on making the LATCs competitive. Common changes included revised pension schemes and sickness absence policies. Not all of the changes were negative. In one instance, pay was increased to make it comparable to that offered by other firms. In another, a shorter working week was offered in exchange for transferring pensions schemes. Whatever the change, the key component is the need – especially where there is an objective of business growth – to benchmark contract terms against the market.

“We haven’t made any radical changes to terms and conditions but we are now able to focus on getting the employee mix right and doing things differently. For example, we have focused on wellbeing measures and employee recognition schemes; and introduced an apprentice programme to recruit and train new people.”

Ansa

5 Pensions

Nearly all the LATCs we interviewed saw pension costs as a significant hurdle. Most viewed the cost of funding pension deficits as prohibitive. In all cases, any pension deficit remained the responsibility of the council; or the council issued a guarantee indemnifying the company. Some treated pension contributions as ‘pass through’ costs and added them to contract rates with the council. There was a clear message from LATCs that pension costs needed to remain with the council if the company was to be competitive.

Occupational pensions do not transfer under TUPE. However, transferring people are entitled to access a similar pension scheme to their current one. Most LATCs had therefore gained ‘admitted status’ to the Local Government Pension Scheme (LGPS). While the process to gain admittance is surmountable, the length of time it takes should not be underestimated.

Most of our interviews cited the local authority pension scheme as a significant commercial disadvantage. To overcome this issue, some of the LATCs had introduced new defined contribution schemes for new starters and anticipated reduced costs over time.

An important learning point from the councils we spoke to was to gain early pension advice to understand the full costs and to build these into any financial plans.

6 Governance

The next step is to put in place appropriate governance arrangements for the council and the company.

There are a number of practical steps that need to be taken before and after the company is established to ensure appropriate governance. These include agreeing the board chairman, board composition, operational plans, service and financial reporting, risk management processes and legal and human resources processes. LATCs and councils did not flag any of these areas as particularly divisive.

A theme emerging from our interviews was the balance needed between council influence and excessive interference. Striking the right balance can prove difficult and we identified a number of areas of contention between councils and companies. These included:

- whether company profits will be repatriated to council, invested in the company or some halfway house
- what role the council will play in major commercial decisions
- what role the council should take in evaluating the effectiveness of the board and its delivery of strategic objectives
- what the LATC will report to the council and how frequently
- what is the agreed level of internal audit and procurement reviews
- how directors who are also employees of the council should manage their conflict of interest.

Our work identified a variety of solutions available to councils including: procurement controls; shareholder committees or boards; and group reporting arrangements. In our experience, shareholder committees are the most effective means of council governance.

Case study

Norse Group

Effective governance is key to protecting Norse and the councils working with Norse. Over time, Norse has established a clear governance structure that supports its business and provides surety to Norfolk County Council in risk management. Key factors are:

- the two council appointees on the board have double votes and therefore control of company decisions
- a shareholder committee has oversight of the company and receives a quarterly report
- advisory boards are used in key decision making
- each group company has a liaison board that holds the company to account.

7 8 Financing and taxation

Most LATCs we reviewed needed some form of working capital loan initially. Without this facility, most would not have been able to operate. In general, this was not contentious and the council made a ‘commercial rated’ facility available. Of more concern to LATCs was the lack of initial investment in the company to enable them to tackle longstanding productivity issues. While this had not stopped the establishment of the LATCs, it had delayed the speed at which they could improve productivity.

Many LATCs interviewed also took advice on taxation issues such as corporation tax, impacts on the VAT 5% ‘test of insignificance’ rule and dispensations and salary sacrifice schemes. However, while most LATCs flagged this as an area where they needed advisers, none considered it to have caused significant operational problems.

“Don’t make it harder than it needs to be. It could easily have taken three years to make this transition from council services to a company structure.”

Ansa

9 Transfer of assets and support service costs

The next step is to agree where the company will operate from and what other assets and support services it will provide.

A common solution is for the council to retain any assets and for the company to pay a fee for their use. This may be a pragmatic solution, but it leaves the cost of maintaining and replacing the assets with the council, and the company without any non-current assets on its balance sheet, which can affect its viability when tendering. Longer-term solutions applied by companies to this issue include cash generation to fund investment and the use of ‘order books’ as collateral on borrowing.

Our research indicates that support service costs are a significant area of contention between councils and LATCs. This is because, perhaps fairly, most LATCs consider council support services to be unresponsive and more expensive than commercial services. As a result, LATCs are keen to divest themselves of the support services to become more competitive. To avoid contention at a later stage, the council and company need to reach clear agreement as to the transition away from council support services. In most of the case studies, there were initial costs to the council in absorbing additional support service costs or related redundancies as part of this transition.

10 Performance management and contracting

The final step is to consider the performance and contract management arrangements.

This was another highly contentious area with a number of LATCs raising concerns around excessive contract management from councils. In some instances, this was considered to have affected service delivery and innovation. Significant contract functions are not always necessary. An alternative model is stakeholder committees supported by ‘light’ (reduced) client functions. These appear to strike a better balance between council governance and commercial freedom.

The 10 steps above provide a guide to key decisions. There will be other more localised issues, but a clear focus on the steps above will provide a good foundation for the council and the new company. While these steps are complex, they are manageable and all of the LATCs interviewed had taken a pragmatic ‘can do’ approach.

Building a successful local authority trading company

There are clear examples of successful LATCs such as CORMAC, Essex Cares, KCC Commercial Services and the Kingstown Works Limited. The newly formed LATCs that we include later in this report as case studies also give hope of further success.

There are examples of failure and some councils have brought LATC services back in-house. Reasons that tend to be cited in such cases include lack of clear leadership of the company, lack of market research, poor business planning and lack of clarity around the council's role as the shareholder.

A key part of our research and case studies focused on the key steps to building a successful local authority company.

“At times, it feels as if you are trying to change the engine of a car while it's still moving.”

Strata

1 Put the right leadership team in place

The overriding determinant of a company's success is the drive and ambition of the people running the business. All of the LATCs we looked at took care in choosing the right leader. In a number, the CEO also needed to change the leadership team to create the right focus.

2 Create the right culture

As highlighted earlier, the motivation and development of people was a key theme in our interviews. Promoting a commercial mindset in the people transferring to the LATC is fundamental to its success, and can be difficult to create. In particular, an environment needs to be created where people are creative (identifying ways to develop and strengthen the business), where they are both accountable but are free to make decisions, and where they are trained, supported and developed. All of the LATCs we visited promoted a culture based on commercialism, learning and a shared sense of purpose.

We identified various methods used by LATCs to create this change. These included the use of 'change agents' (commercial and organisational development managers), restructuring of posts, revised (more commercial) job specifications, and reduced management layers. Others had employed commercial trainers and managers with a commercial background to establish a more commercial approach, or had applied lean systems to refresh and reduce processes.

Whatever technique is used it is clear that building good relationships with people can have a profound impact on the success of businesses. Where there is trust and flexibility, people are more willing to assist and help the company when it needs support. A number of LATCs have embraced this concept, for example, by introducing 'talent management' and business coaching alongside appropriate benefit packages for staff.

ASPECTS OF A SUCCESSFUL COMMERCIAL CULTURE



3 Reconsider reward

In all industries and organisations, reward including associated terms and conditions is a key mechanism for attracting and retaining people. LATCs used a wide range of tools to reduce costs and to motivate and retain staff. These included improved rates of pay, revised pension schemes, changes in sickness policies to promote the right behaviours and improved benefit packages. More detail of the decisions made by LATCs are included in the case studies included later in this report.

In our experience, there needs to be a continued transition to more commercial reward packages – particularly with regard to pensions – if LATCs are to be successful.

4 Build a customer focus

The transition from an internal department to an external supplier held accountable for delivery of performance measures can be difficult for new LATCs. In particular, treating the council as a client can be difficult for transferring people. All the LATCs we looked at had renewed their focus on the delivery of high quality, customer-focused services.

5 Build an appropriate vision and gain the commitment of the local authority

An appropriate and shared vision is fundamental to the success of LATCs. Even at the most successful companies, we identified tensions between the company and local authority over future growth strategies, efficiency expectations and people terms and conditions. LATCs need to keep focusing on refreshing and building this vision throughout their lifetime. To be successful, this requires a continuing dialogue between the council and the LATC, co-operation, mutual understanding and trust.

6 Prepare for the future

LATCs need to be able to diversify and grow to gain the full benefits available. The council and the LATC therefore need to agree at an early stage on:

- the council's support for growth
- whether they intend to expand into new areas by offering services to other local councils and the private sector
- whether they intend to break into new services or remain with existing service streams
- what processes or supply chains need to change.

While most LATCs want to grow, there is a lack of clarity with regard to these areas. In some cases, there is also a lack of clarity on how to achieve sustainable growth.

7 Creating and promoting the brand

Commercial companies invest significant amounts into marketing strategies, brand and market research into growth areas and competition. Some LATCs had already invested in these areas but many were at an early stage. These market processes are just as relevant to LATCs as any commercial operation. As LATCs look to expand, they will need to consider their approach to brand promotion and marketing.

Grant Thornton has worked with many LATCs and continues to support growth in this area. We believe that LATCs have a significant role in supporting local government to become more efficient and will support the move towards self financing councils.

We remain confident that local government will build on the examples of success we are seeing throughout the country.

8 Get to grips with costs

We have talked about reward and the actions needed to ensure that terms and conditions are commercially comparable. Many LATCs subjected both non-pay costs and support costs to similar scrutiny. They considered improved accountability, through agreed and delegated budgets and better management information to be essential to reducing pay and non-pay costs. They also saw reducing support service and pension costs as central to becoming competitive.



9 Build appropriate risk management and group governance

All business activities come with risk. A key element of making a company successful is understanding what the risks to the business are, and which of those risks can be tolerated. This is no different for LATCs. Both the council and the company need a good understanding of risk if they are to create an atmosphere of trust and suitable support. Some councils and LATCs had not achieved this and continued to be in dispute. Others had appropriate risk management and governance structures and worked in relative harmony.

LOCAL AUTHORITY COMPANIES BUILD THEIR SUCCESS ON A NUMBER OF PRINCIPLES



Section 1

Deciding to set up a local authority trading company

Over the past few years, councils have seen considerable reductions in government funding, fees, charges and grants. Some are now reaching a point where they will have to reduce the level of service delivered, re-think how to provide services or find other means of generating income.

LATCs offer an opportunity to improve efficiency and income generation, to embrace enterprise and innovation, and to move quickly. Perhaps unsurprisingly, LATCs are becoming a more commonly used structure.

This section of our report details the process that councils should consider using in deciding to set up a local authority company.

1 Getting the right strategic fit

In establishing an LATC, councils need to be clear on what they want to achieve, and have a clear vision of the future and how the company will grow.

Councils should make any decision to change a service delivery model in the context of their strategy and vision. The strategic assessment should initially consider “what sort of council do we want to be and will this change help deliver it?”

The council should also consider:

- what are the benefits to the strategy of implementing a new service delivery model?
- how will this impact on other parts of the strategy?
- do members and senior officers believe it is worth investing time in?
- what are the objectives of the new service delivery model?

Establishing an ASDM may not fit with a council’s overall strategy and vision. Our research indicated that a key part of the initial decision making process is determining what makes sense in terms of the strategy. For example, establishing a leisure company to generate income may not fit with a strategy of improved public health. Councils also need to think about whether a company structure would support or hinder a move to a combined authority or other forms of devolution.

Councils vary significantly in their focus and there are conflicting objectives that they need to manage, such as:

Income generation	generating profits that contribute to service delivery
Social value	impacts of growth on communities
Financial savings	delivering comparable or improved services at a reduced cost
Improved services	delivering better or more comprehensive services at the same cost
Increased flexibility	being able to adapt quickly to future developments by using private sector vehicles
People welfare	maintaining the living wage and terms and conditions of people
Control	maintaining control over services to ensure that the council can manage future changes

Discussions with LATCs and councils that had worked through this process indicated a need to prioritise these conflicting objectives if they are to ensure a strategic fit.

Strategy and vision

Nuneaton and Bedworth Borough Council established NABCEL recently. A key factor in determining whether to set up the company was its strategic fit with the council’s self-sufficiency agenda and the potential for income generation.



It is essential to determine what is culturally and politically acceptable. Some councils had considered models such as outsourcing, even where they did not sit well with the council's culture or would not be supported politically and carried through.

Case study

ip&e Ltd

The overall mission of ip&e Ltd is to deliver better outcomes ... designing everything around meeting customer needs. Retaining a focus on outcomes for local residents has enabled the council and the company to align their strategic vision closely.

Councils should also consider the long-term nature of ASDMs. Certain alternative models can remain contentious for considerable periods. An example of this is Service Birmingham which continues to receive both praise and criticism several years after its establishment. Councils may also consider other services such as leisure, museums or theatres to be central to the council and would not welcome the perceived loss of control from an ASDM.

The success of the chosen model is highly dependent on commitment from all sides. If any particular model is not culturally acceptable it should be excluded from the assessment.

Councils therefore need to be clear about what they want to achieve and which service delivery models are appropriate to their culture and community. In making this decision, engagement with members is key to ensuring that there is political will for change and to avoid embarking on detailed options appraisal for schemes that lack support.

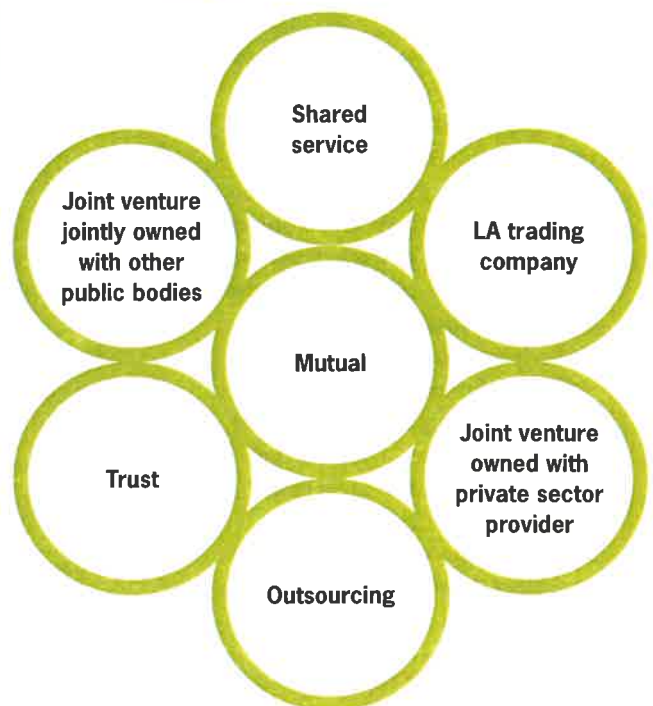
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Option appraisal – which alternative service delivery model is right?

An LATC is not the only ASDM. Other models include shared services, outsourcing, joint ventures and the status quo. Different ASDMs have alternative characteristics and benefits. For example, they have varying risk profiles and give different levels of control to councils.

Below we have listed some of the most common models that councils use.

TYPES OF ALTERNATIVE SERVICE DELIVERY MODELS



Each ASDM has certain characteristics that councils need to assess before making a decision (see table overleaf).

Key characteristics of LATCs

Key features	Financial	Quality	Risk	Control
Creation of a wholly-owned company	Potential to reduce costs but likely to take two or more years to drive change	Potential to improve quality but is dependent on creating cultural change in organisation	Limited risk if providing services solely to council	High level of control retained
Greater freedoms	Savings of approximately 10% to 15% after two years		Greater risk exposure as services are traded to different bodies	
Risk and reward relatively low/slower to achieve	Some risk of loss if business planning is inadequate			
Preferred cultural fit where control or employees are factors				
Used for catering, building control, HR, housing, highways, facilities management, building design, social care, etc				

Option appraisal is a mechanism to assess these different characteristics. This is an essential stage of the process and allows both members and officers to debate fully the characteristics and risks. In all of the examples researched, we identified that councils had done this fairly and objectively.

Due to the level of scrutiny often involved in setting up an ASDM and the significant costs of making the wrong decision, many councils use external advisers to undertake this review. This ensures that expertise on tax, finance, legality and governance is driving the right decision.

Options appraisal

Standard options appraisal processes usually include an assessment of the:

- financial cost of the option
- contribution to strategic objectives
- future commissioning decisions for council requirements
- market for services in the present and near and longer term
- impact on service outcomes
- impact on other services
- extent to which risk can be managed.

Councils need to spend more time at the option appraisal stage. After the initial identification of an issue – which is usually financial – many councils begin to look at ASDMs but do not obtain senior officer and member buy-in and do not undertake sufficient preparations such as site visits or trade union negotiations. Consequently, they need to revisit option appraisals at a later stage, which can create significant delay.

A key message from our research is that, getting the right advice, appropriate buy-in and undertaking appropriate planning of the option appraisal process can avoid months of delay.

Case study

Buckinghamshire Care

The council paused the outsourcing process and considered a wider range of options for the delivery of services at day opportunity centres. The options appraisal recommended the preferred model of an LATC, with an expanded scope beyond day services.

3

The outline business case

Where a council decides to establish an LATC, the next stage in the process is commonly the production of an OBC. Without an adequate OBC, the council will struggle to determine whether the business is likely to be a success and the LATC is likely to spend its first year developing business and finance plans instead of making headway on its objectives.

Councils have generally improved their business planning processes over the last five years. Many of the successful case studies in this report reflect this.

Some risks do remain. In particular, for many councils the establishment of an LATC will be a first step into a more commercial world. This increases the risk that the councils will produce an inadequate OBC. For example, some of the LATCs we looked at:

- had needed a council bail out or been dissolved
- had unplanned deficits in the first few years. A common issue flagged by LATCs was the inclusion of heroic performance targets or high levels of anticipated savings
- flagged significant expectation gaps between what they considered to be deliverable and the expectations of councils. Our research indicated that there is often increased expectation of improved performance in the first six months of a company's life. Given that the people, structures and policies will be essentially the same, this is over-optimistic.

All of these issues are avoidable with better business planning processes and due diligence of plan assumptions. Where managed successfully, the 'pay back' can be significant.

Areas and questions often used in OBCs

Key areas	Key questions
Strategic direction	Are the objectives of the business model set out clearly and are these aligned with the strategic direction of the council?
Business activity	What service activities are included in the scope of the new company?
Employment matters	Have management capacity, TUPE, pay inflation and pension issues been considered appropriately?
Support services	What agreement has been reached over the provision of support services?
Assets	Does the business case identify significant assets and their proposed treatment?
Governance arrangements	Have the council and LATC reviewed governance arrangements and legal implications?
Financial planning	Are appropriate financial plans in place, and are they aligned with council spending plans? Have key financial assumptions been assessed?
Markets	Have market and growth assumptions been revised for reasonableness?
Measuring outcomes	How will success be measured?
Exit strategy	At what point should the council exit the arrangement?

Without an adequate OBC, the council will struggle to determine whether the business is likely to be a success and the LATC is likely to spend its first year developing business and finance plans instead of making headway on its objectives.



Successful OBCs can pay significant dividends

Birmingham Airport has made significant dividend payments to the West Midlands Councils.

Norse delivers an average 10% saving on service delivery costs.

Kingstown Works Limited, owned by Hull City Council, has returned over £3 million to the council in surpluses.

Essex Care was established in 2009 and was the first adult care provider. It delivered significant surpluses up to 2013.

Ubico delivers environmental services. Since it began trading in 2012, Ubico has delivered savings of £2.5 million and the company is on target to achieve the forecast saving of £5 million in the first five years of trading.

LATCs can make a loss

Common forms of failure arise due to: over optimistic growth assumptions; lack of sensitivity analysis with regard to future council budget assumptions; lack of modelling of revised contract terms, for example from block- to activity-based; and changes in methods of service delivery, for example from direct care to preventative services.

In particular, where LATCs have not diversified services, this can leave them highly exposed. In some instances, councils have needed to liquidate LATCs and bring services back in-house.

While we have highlighted some concerns in the initial decision making process, all of them can be overcome if there is appropriate strategic alignment, option appraisal and business planning. We highlight four case studies for Buckinghamshire Care, NABCEL, Streetwise and Mersey Gateway Crossings Board, who have successfully overcome these challenges.

Case study 1

Buckinghamshire Care

Buckinghamshire Care was set up in October 2013 to provide day care and reablement services in Buckinghamshire.

In 2012, Buckinghamshire County Council took a decision to outsource the Day Opportunity Centres and a market testing exercise resulted in a muted response from providers. The council paused the outsourcing process and considered a wider range of options for the delivery of services at day opportunity centres. The options appraisal concluded that there was no ideal model for the delivery of day services alone and recommended a preferred model of an LATC with an expanded scope beyond day services.

The LATC aimed to address three challenges. Services needed to adapt to demographic pressures alongside increasing personalisation. Financial constraints required an ambitious and innovative approach. It needed to develop options for income generation.

Subsequently it developed a strategic business case. This set out a clear rationale for the establishment of an LATC that would:

- deliver the required savings in the medium-term financial plan without having to cut services through the LATC's ability to improve performance, productivity and income
- be able to trade with self-funders and direct payment users
- grow more commercially to generate more income and share benefits with the council
- enable the council to fulfil its responsibilities as provider of last resort
- enable the council to reduce in a planned way the support service overhead
- enable the council to reduce the value of the contract over time as direct payments increase and therefore avoid double running costs
- support the creation of a more commercial service that is able to compete with other providers, enabling a future market test.

The first phase focused on undertaking due diligence, defining the strategic direction of the LATC, developing company governance and management arrangements and specifying the support services required by the LATC.

The council remained 100% shareholder, thereby retaining a role in scrutiny and a level of control.

The council also obtained legal advice on its Teckal exemption.

In establishing the governance structure, the council wanted to offer the LATC directors sufficient control to drive the growth and development of the company. It aimed to maintain strong links between the council and the company through the shareholders' scrutiny group, thus ensuring the company's direction is in line with the council's objectives, particularly regarding reablement and working with health services. The council also wanted to have the flexibility to incorporate additional services in the future.

The structure it established was as follows:

- LATC board managing two separate companies. One is a service delivery company and one is a support function company
- The board reports to the shareholder scrutiny group and this covers the shareholder scrutiny relationship
- The council support services and contracts unit have a contract monitoring and support services management relationship with the support company
- Both companies are limited by shares and the sole shareholder of both companies is the council. The structure provided the flexibility to add another company to deliver additional services in future if required. The governance and scrutiny is conducted through the board
- The support company is unregulated and includes the management and back office support people
- The care company is regulated and covers the day opportunity services, employment services, laundry services and reablement.

Continues ...

Case study 1

Buckinghamshire Care (continued)

The shareholder scrutiny group includes two council members, section 151 officer, director of adult services, commissioning director and contracts manager. The group meets quarterly and aims to hold the company directors to account for the quality and value of the services provided to the council. The group is an essential component for the council to exert control and influence over the company and therefore meet the requirements of the Teckal exemption. The structure aims to achieve a balance between the council's need to control and influence and the space the company needs to develop to achieve the council's aims.

The company board is legally accountable to the shareholder – that is, the council – for the operations of the company. The board is responsible for setting the strategy and operational decisions to meet the objectives of the company. The board consists of an independent part-time chair, managing director, finance and commercial director and two or three part-time, non-executive directors, with the potential to include a service user representative.

The reporting structure is:

- the board to the commissioner (the commissioning director and the contracts manager) covering routine contract management
- the board to the shareholder scrutiny group covering quarterly performance reporting
- the board to the cabinet covering formal presentation of the annual accounts and report.

The LATC was established to buy back council support services for a minimum period of two years to minimise disruption to business. For each support service, a service level agreement was put in place covering outline costings and service specification.

In establishing the LATC, the council's forecast is that the company will secure savings of £2.25 million over five years, which are delivered through a reduced contract price.

The company started trading in October 2013 and the initial focus was on setting up appropriate internal governance while establishing the company in the marketplace. This involved establishing relevant management structures to deliver a good quality, safe service to customers and ensuring that the company operates within appropriate revenue and cost targets.

The company's future strategy aims to expand the services it offers and transform service delivery to meet the needs of the rapidly changing social care marketplace. The strategy intends the company to grow the customer base by providing services designed to offer choice, inclusion, independence and support opportunities for both individuals and their communities. Future growth of the company is anticipated through three main areas:

- additional service contracts with its major customer – the council. Two additional services have already been delivered by the company since April 2014
- retail growth of its supported employment services. For example, the farm (see below) is now open to the public for longer
- growth of private client numbers across all services – there has been a steady monthly growth since the beginning of April 2014.

The supported employment services included a farm which is open to the public who pay to visit. There is a café and garden centre on the site. The company changed the opening hours to include weekends and bank holidays. To do this, the company had to negotiate revised contracts with the TUPE people to cover seven day opening. The company provided clear business reasons for the change. As a result, the farm is showing increased revenues with employees offering suggestions on potential future improvements.

The company has expanded its activities and is now offering a gardening service. With the growth in activities and private client numbers, the company has had to assess its Teckal exemption earlier than expected. Work is ongoing with advisers to create a structure that enables the company to expand in a way that complies with tax and legal requirements.

The company continues to use the council's support services as it is within the initial two-year period. It has renegotiated the specification of the services to reflect the flexibility and agility of support that the company needs.



The LATC was established to tackle three issues: personalisation of services, financial constraints and the need for income generation.

Case study 2

NABCEL

NABCEL is a recently established, wholly-owned company of Nuneaton and Bedworth Borough Council. The council has set itself the long-term goal of being self-financing. NABCEL is part of this wider strategy and was established to provide the council with income streams that it may otherwise not be able to achieve.

The first income stream that the council has developed is the provision of housing in the private rental market. The council purchases properties through its general fund and then leases the properties to NABCEL (operating lease), which rents the properties out at market rates. The portfolio includes a mix of new and older properties in need of improvement. For the latter, the council is responsible for bringing them up to standard and can therefore reclaim the VAT on the works completed. An initial allocation of £1 million has been included in the capital programme to fund acquisitions. The properties are not subject to right to buy.

The council completed an options appraisal and a sensitivity analysis as part of the business case for the lettings business stream. It will also do this for the other business streams when they consider starting them up. The next business stream to consider as a trading operation is building control services. It is preparing a five-year business plan.

The company's board structure comprises two non-executive directors – the council's director of finance and director of housing – and three executive directors who are councillors. NABCEL has an AGM, which takes place at a full council meeting, as the council is the only shareholder in the company. NABCEL has board meetings but there is no review by the council's scrutiny or audit committee.


The council sought legal, accounting and tax advice before setting up the company.

Performance of the lettings income stream is managed through reports to the board on indicators such as income, number of tenants, voids and bad debts.

So far, the company has achieved the council's aims, although development of the business has taken longer than planned as NABCEL does not yet employ people to focus purely on the company. The ultimate aim is for it to have a company director once it has established additional business streams. The council currently provides support services to NABCEL and charges for these.

The key actions that the council have needed to take so far have been:

- ensuring appropriate officer and political buy-in across the council and showing how important NABCEL is to its strategic self-financing vision
- creating a commercial mindset about how the company should function and how it differs from other council services
- dealing with the logistics such as how its accounts are put together, Companies House requirements, VAT and corporation tax requirements
- ensuring that appropriate marketing of the properties are in place. Interestingly, while some potential tenants were put off renting a property due to links with social housing, others have welcomed the association with the council and its quality standards.



The council completed an options appraisal and a sensitivity analysis as part of the business case for the lettings business stream. Both officers and members see the company as key to becoming self financing.

Case study 3

Mersey Gateway Crossings Board

The Mersey Gateway Crossings Board Ltd is a wholly-owned subsidiary of Halton Borough Council. It operates as a not-for-profit organisation, set up with the delegated authority to deliver the Mersey Gateway bridge project and to administer and oversee the construction and maintenance of the new tolled crossings. These include the tolling of the existing Silver Jubilee Bridge.

The board's terms of reference and delegated authority are expressed in a governance agreement with the council. The purpose of the Mersey Gateway Crossings Board is to manage the contracts between Halton Borough Council and the Merseylink project company throughout the construction and subsequent operation of the infrastructure project over a 30-year contract period.

Before the company was established, the council had already worked with other local councils and businesses to get the project approved, to obtain funding and to progress the scheme through the procurement phase. As the project moved into the construction phase, the drive for the company structure came from the Department for Transport, which stipulated this as part of its grant offer.

Unlike other local authority companies, the Mersey Gateway Crossings Board is set up neither to provide greater flexibilities nor to secure savings, but to deliver and manage a specific scheme with a small team of people and some technical advisers, working at arm's length from the council. When the project enters its operational phase, this independence from the council is thought to be key. This is because the tolling arrangements designed to fund the project require commercial decisions which may be perceived to conflict with social and economic considerations.

Establishing the company at this earlier stage gave the project team time to deal with the growing pains and learn from their experiences at a stage in the project when independence from the council was not so critical. The management team recognise that, when setting up the company, it was difficult to know what they would be doing and when financial close would be, so they needed to adapt to change.

At times, they 'have had to sprint when they would have preferred to jog'. For example, procedures are working but management acknowledge that they are not as well defined and documented as they would have liked. The formal contractual and governance documentation is in place and is necessary but the success of the project relies on key relationships and flexibility of the partners to make things work.

With the transition into a company structure, the council's chief executive is to act as interim CEO of the Crossings Board for two years. This continuity has been important as it provides a

'foot in lots of camps' and helps to ensure that the pragmatic and informal discussions, which are key to the relationships between the different parties, can continue through this transition period.

This does, however, mean that all parties have to be mindful of the perceived threat to independence. The leader of the council and the portfolio holder for resources are also members of the Mersey Gateway Crossings Board along with two other non-executive directors and the two executive company directors. To avoid any conflict of interests arising, the council has amended its officer delegations, and members are required to declare their interests and withdraw from any decision making associated with the project.

No people transferred into the new company under TUPE. Instead, some people gave up their jobs at the council and took on a new role in Mersey Gateway Crossings Board. As a result, the company has the freedom to set terms and conditions that are appropriate to its business plans. Pension arrangements provided for former council employees to continue to participate in the local government pension scheme. This is because the company operates as an admitted body to the scheme but there is a new defined benefit scheme for new people not previously employed by the council.

The management team highlight a number of factors that they consider are critical for success:

- Set up a new venture well before you need the company to start operating. It takes more time than you think to address teething problems, so it is far better to have it up and running before you reach any critical milestones
- Invest in good quality financial and legal advice that offers some independence from the sponsor council and can reflect the commercial nature of the new venture aside from the social implications that are aligned with the council's responsibilities
- Focus on the practical impacts of ASDMs on the public. Remember that the public generally do not care who is providing the service. They may not draw a distinction between the responsibilities of the different organisations, nor attribute any communications to the right party. But the public will nevertheless expect you to route their questions, concerns or complaints appropriately and deal with them promptly
- Above all, ensure you have the right people to run the organisation.

Case study 4

Streetwise

Rushcliffe Borough Council is pursuing an innovative social franchise model for its long-standing Streetwise service, which provides a growing range of environmental, grounds maintenance and on-street services.

Since Autumn of 2014, Streetwise has operated as a wholly council-owned trading company subject to a Teckal exemption. This protects the core contract with Rushcliffe while allowing the company to demonstrate its competitiveness in the marketplace by trading work with the public and private sectors.

While continuing to clean and maintain the borough on behalf of the council, Streetwise has branched out to offer new services to businesses and public bodies including schools, parishes, sports clubs and voluntary organisations. It is still early days for the company, but there are promising signs for the future including a major contract about to be announced in the Nottingham area and work being commissioned by neighbouring boroughs.

The Streetwise workforce has benefited from the transition through access to a wider range of work and training opportunities, as well as flexible working and reward schemes that it has implemented successfully.

Social values and principles of local growth and employment are central to Streetwise. Through seeking to partner with small businesses, employing locally and offering routes to work for homeless and long-term unemployed residents, the company hopes to provide increasing social as well as economic and environmental benefits.

The Streetwise brand is also important. As well as providing a distinct identity for existing and future employees, Streetwise is already a visible and respected brand within the borough and Rushcliffe is recognised as one of the cleanest places in the country.

Building on this brand, the bold next step for Streetwise is to develop a social franchise model. This will enable other organisations to partner with Streetwise and provide services under a recognised banner while accessing the supporting infrastructure that Rushcliffe intends to provide.

The franchise model is seen as a way of de-risking and managing the cost of expansion for Rushcliffe, while offering other organisations a way to potentially reduce costs and improve service quality.



Section 2

Setting up a local authority trading company

Based on our market research, our experience and discussions with LATCs and councils, we have highlighted a number of key steps to consider when setting up an LATC.

1 Obtain the right professional advice

All of the councils we interviewed emphasised the need to engage with advisers that they could understand and trust. For many councils, the process of setting up a company will be unfamiliar so the right advisers are seen as essential to managing a number of risks and strengthening commercial skills – particularly in the areas of legal, finance and tax.

“Make sure you invest in proper legal advice, as this is essential. Employ the right people and then trust their decision. It was important for us to recognise that, as local authority officers, we don’t necessarily have the right skills to set up companies, so we needed to use people who do.”

Strata

2 Company registration

LATCs are ‘registered’ companies under the Companies Act 2006. The company is responsible for its activities, and its finances are separate to the finances of the council(s). LATCs tend to be companies limited by shares and companies limited by guarantee.

As part of the registration process, the company will need to prepare a memorandum of association and articles of association. Our interviews indicated that these are essential documents that will drive the strategy and governance of the LATC. Those involved need to spend sufficient time on getting these documents right.

On paper, the ‘limited by shares/guarantee’ limits councils liabilities. However, we are not aware of any councils that have allowed LATCs to fail without meeting their liabilities. Councils should consider at this stage what action they would take if the company did make significant losses and have an appropriate exit plan.

Characteristics of LATCs limited by shares and guarantee

Companies limited by shares	Companies limited by guarantee
The council is the main shareholder holding the majority of the share capital. The council’s responsibilities for the company’s financial liabilities are limited to the value of the shares it owns.	There is no share capital. Companies are guaranteed, usually by a nominal amount. The company must have one or more members, (rather than shareholders).
A company limited by shares: <ul style="list-style-type: none"> • is registered at Companies House • has articles of association and directors • is subject to all the requirements of the Companies Act. 	A company limited by guarantee: <ul style="list-style-type: none"> • is registered at Companies House • has articles of association and directors • is subject to all the requirements of the Companies Act, except those relating to shareholding.
Company directors are not personally responsible for debts the business cannot pay, although this exemption does not apply where the law has been broken.	Company directors are not personally responsible for debts the business cannot pay, although this exemption does not apply where the law has been broken.
Unless the company is a public limited company (PLC), it may not offer shares or debentures to the public. There are few examples of LATCs that are PLCs.	

Case study

Birmingham Airport

One of the main examples of a company limited by shares is Birmingham Airport. This company is partially owned by the West Midlands Metropolitan Councils but also has private sector ownership. The company continues to innovate, for example, by expanding runways, and continues to make a significant contribution to local councils through dividends and the support of business growth in the area.

3

Trading

Councils have significant powers to trade with each other and with other sectors. They can use the Teckal exemption in the early stages of a company’s life to establish a market foothold. The key advantage of Teckal is that the company can enter into partial competition and retain the right to have contracts awarded directly by the council without competition.

Step 3 is to consider whether the company will be set up to deliver council services or to trade, or both.

In England and Wales, councils have powers under the Local Government Act 2003 to set up companies to trade with a view to making profit in areas relating to any of their existing functions. The Localism Act 2011 includes a general power of competence, which allows councils to do anything an individual or company may do, as long as other legislation does not prohibit it. Potentially, councils in England can trade in a wide number of service areas across the UK.

The impact of the ‘procurement legislation’ on the trading company differs depending on who the company trades with and the level of trading activity. We have summarised some of the key considerations in the following table.

Focus of local authority trading companies

Key focus	Key considerations
Delivery of services to the council	A council or councils may set up a wholly-owned subsidiary company, which is solely concerned with delivering a service back to that council(s) but does not trade with other organisations. This is likely to qualify for the Teckal exemption (now codified in the Public Contracts Regulations 2015) from procurement rules, which means that the council(s) can pass work to the company without having to put it out to competitive tender.
Delivery of services to the council and some commercial services	A council or councils may set up a company, which, in addition to delivering a service back to the council(s), will undertake a level of additional trading with other councils, public bodies or the private sector. Within certain trading limits (see Table 6), the company is also likely to qualify for the Teckal exemption.
Delivery of all services on a commercial basis	A council may set up a company to deliver services on a commercial basis to both the public and private sectors. The company is subject to European Union procurement regulations and the council can only give it work in compliance with those regulations. In all likelihood, the LATC will win all work via competition.

The Teckal case established that, under certain circumstances, a contract let to a company will not count as a public service contract if “the local authority exercises over the person concerned [that is, the company] a control which is similar to that which it exercises

over its own departments and, at the same time, that person carries out the essential part of its activities with the controlling local authority or councils”. These two elements are known as the control and function tests.

The Teckal control and function tests

Test	Key considerations
Control test	The control test has been interpreted through various court cases. Essentially, there can be no private ownership of the company, the council(s) must have decisive influence over the strategic objectives and decisions of the company, and the constitution must be such that the purpose of the company is similar to that of the council(s). In summary, the council must be able to demonstrate that it can exert control in a similar way to that exercised over its own departments.
Function test	The function test concerns the level of activity undertaken for the local authority owner(s) and that carried out for other bodies. The case established that the majority of the company’s activities must be carried out for its public sector owners. The activities carried out for others must be of marginal significance. The procurement directive requires that at least 80% of the activity of the Teckal company – that is, over 80% of its total turnover – must be for its public sector owners. Any contracts with other public sector bodies or private sector entities will not benefit from the Teckal exemption and the company will have to tender in the ordinary way for such contracts in accordance with any applicable procurement legislation.

The Teckal exemption has been codified into a new EU Directive 2014/24, which has replaced Council Directive 2004/18. This has been transposed into UK law by the Public Contract Regulations 2015. Recital 32 of the directive confirms that: “...the controlled legal person carries out more than 80% of its activities in the performance of tasks entrusted to it by the controlling contracting authority or by other legal persons controlled by that contracting authority.”

The use of the Teckal exemption is complex and is subject to challenge. All of the LATCs and councils that we spoke to had sought legal advice before awarding work directly to their wholly-owned company, and before deciding to trade commercially. Some were monitoring their commercial trading activities closely to remain within the trading limits. Others had used group structures to set up joint ventures with other councils to allow work to continue to be awarded directly to the LATCs. A key consideration as LATCs grow and become more successful is whether they can continue to demonstrate the control test.

Advantages of the Teckal exemption

The Teckal exemption potentially allows councils to:

- (in comparison to trading companies) establish new companies with reduced risk to the council and employees
- initially protect the company from market pressures
- generate income that can be used for other public services
- increase competition locally by allowing the companies to test the market via competition
- work co-operatively to identify economies of scale and service improvements.

Step 3 is to consider state aid legislation. State aid rules prohibit state aid, in whatever form, that could distort competition and affect trade by favouring certain undertakings or the production of certain goods. Examples of state aid include providing loans or grants or provision of support services below market rates.

In most of the cases we reviewed, LATCs considered that they were paying a commercial rate for all of the services received from the council. Our discussions with many newly established LATCs indicate that they could procure support services at a cheaper rate than those charged by their sponsor council. None considered that there was a risk with regard to state aid.

Case study

ip&e Ltd

Shropshire Council has ensured that it has not provided state aid to its trading company ip&e Ltd by charging for all support services including accommodation. This is in contrast to its provision of free accommodation to some of its other suppliers. However, the decision has ensured that the council is free from legal challenge.



The use of the Teckal exemption is complex and is subject to challenge. All of the LATCs and councils that we spoke to had sought legal advice before awarding work directly to their wholly-owned company and before deciding to trade commercially.

4 People

The motivation and development of the people transferring to the LATC was a recurring and vital theme in our interviews. Most LATCs cited this as a key factor in creating a successful company. Key aspects include creating a commercial culture, building commercial skills, developing staff, removing management layers, and developing a shared sense of purpose and creativity. In most LATCs these changes are made after the company is established but in our experience the process of change can take a considerable period and should be started as soon as possible. We consider the changes made in more detail in the section on 'Building a successful company'.

For most of the LATCs interviewed, the transfer of people was a key stage in establishing the company. In most instances the Transfer of Undertakings (Protection of Employment) Regulations 2006 as amended (TUPE) applied, protecting people's terms and conditions. This is a complex piece of legislation and, in all instances councils sought human resources and legal advice to ensure compliance. Under TUPE law, the contracts of employees must be transferred in full with all terms and conditions of employment remaining the same, from pensions to holiday entitlement.

There remains some flexibility within TUPE. People can voluntarily opt to change terms and conditions, and some LATCs had taken this opportunity to offer revised terms and conditions to transferring people. There is also an option to vary the terms of the contract one year following transfer. Also TUPE does not apply to new starters. In many cases LATCs had taken the opportunity to review terms and conditions of new starters. Our research indicates that changes to terms and conditions had helped the LATCs reduce costs, become more competitive, and safeguard jobs.

The decision to alter contracts and the continuation of contracts is not always simple. Companies need to consider any changes against equal pay and other legal requirements. They also need to consider them against policy initiatives such as the living wage. Companies should also benchmark the terms and conditions against the market as this will heavily influence the ability of the LATC to drive savings and compete for commercial contracts.

Case study

CORMAC

Cost savings have been achieved by being able to set different terms and conditions. The initial TUPE transfer of staff to CORMAC gave employees the opportunity to move to CORMAC contracts. Take up of the CORMAC contracts was significant. Key changes were on the sickness policy, with CORMAC not paying the first three days of sickness. This was mitigated with increases in rates for overtime pay and unsocial hours, where the council was struggling to offer competitive industry rates. In addition, a small bonus based on a profit share of the company was also part of the new CORMAC contracts.

Case study

Norse

In consultation with people and trade unions, service provider Norse has, where necessary, made a number of changes to terms and conditions. Norse is clear that this is not a pre-requisite to establishing a company but it can make the company more competitive and recognise market conditions. In some instances, this has resulted in increased salaries where the market conditions allow. For council contracts, many staff continue to have the same local government terms and conditions. However, Norse is clear that on commercial contracts it is not possible to offer people final salary pensions.

Norse has negotiated national agreements with four trade unions and its recent people surveys indicate a 94% people satisfaction rate for the company.

All of the LATCs interviewed were clear on the importance of good people relationships. They spent a significant amount of time communicating with people at the start of the project to ensure buy-in to the company. Many had also maintained strong trade union relationships, and offered significant benefit packages such as training, people consultation and social funds.

5

Pensions

Pension costs are a significant hurdle in the establishment of an LATC. New LATCs saw the cost of funding pension deficits as prohibitive. In all of the cases we looked at, pension deficits remained the responsibility of the council or it issued a guarantee. In some cases, the LATC treated increases in pension contributions as ‘pass through’ costs and added them to contract rates with the council. There was a clear message from LATCs that pension costs needed to remain with the council if the company was to be competitive.

Occupational pensions do not transfer under TUPE. However, transferring people are entitled to access a similar pension scheme to their current scheme. Most LATCs we looked at had therefore gained ‘admitted status’ to the local government pension scheme (LGPS).

Regulations require that to obtain admitted status the company must operate for a purpose other than gain and have sufficient links with a scheme employer to have a community interest; or provide a service or asset in connection with the exercise of a function of a scheme employer. The LATC may also be required to enter into an admission agreement with the trustee authority for the local scheme. While this is surmountable, our experience is that the length of time it takes to get the arrangements in place should not be underestimated.

In the short to medium term, most LATCs move to defined contribution schemes for new people. They see this as a pragmatic way to manage costs and to ensure their competitiveness. However, it takes time to fully transition to all people having a defined contribution scheme. A number of the LATCs we interviewed were clear that while people remained in the LGPS they were unlikely to be fully competitive in the market.

Case study

Norse

Norse requires that past and future pension liabilities arising from final salary schemes remain the responsibility of the council. These are significant costs and it is not possible for companies to manage these liabilities. Norse agrees a contribution level as part of the contract and changes in liabilities remain the responsibility of the council. Any changes in pension contributions are a pass through cost of the contract. On many contracts this has enabled staff to remain within the LGPS.

Pensions – key considerations

- Where the pension scheme is in deficit, who is responsible for the deficit funding and how will this affect employer contributions in the future? This can have a significant impact on a company's viability or leave the council with large unfunded costs
- Who is responsible for any potential pension liabilities that would arise should the company fail?
- Who is responsible for any potential pension liabilities that would arise should the company not undertake the specific contract that was a condition of employees being admitted to the LGPS scheme?
- How will any pension liability be treated on the opening balance sheet of the company? It may result in a deficit balance sheet, which may present difficulties when bidding for additional work or raising additional finance
- What form of pension scheme will be offered to new starters to the company?



People and pension considerations

- Are you clear on the costs associated with the transferring workforce?
- Are there sufficient skills and expertise in the organisation to manage the transfer? Is additional legal or professional advice necessary and what are the costs?
- Who will manage the process and has sufficient time been allowed for all the necessary workforce consultation?
- How will communication with transferring people be managed?
- How will pension arrangements be made?
- Have discussions been held with any new pension scheme regarding admission criteria?
- Has sufficient time been built into the plan for admission agreements to be granted?
- Has the impact of any pension liabilities upon cessation been considered? How would these be mitigated?
- Has the impact on morale and people performance been considered?

6 Governance

Appropriate governance arrangements are important to both the council and the company. Our recent reports, 'Governance steps up a gear' and 'Plotting a new course to improved governance', provide practical information and guidance on ensuring appropriate governance of commercial bodies.

“An effective board develops and promotes its collective vision of the company’s purpose, its culture, its values and the behaviours it wishes to promote in conducting its business.”

Financial Reporting Council ‘Guidance on board effectiveness’

“The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company’s auditor.”

UK Corporate Governance Code, main principle C.3

There are a number of practical steps that need to be taken before the LATC is established. These include agreeing the board chairman, board composition, division of responsibility between board members, meeting frequency and auditors. After establishment, it becomes important that the company develops an appropriate strategy, operational plans, service and financial reporting,

risk management processes and legal and human resources processes. LATCs and councils did not flag any of these areas as particularly divisive.

In all the cases that we looked at, the council had membership on the LATC board to enable it to influence the activity of the company. In some cases, the council board members had double votes to ensure that the council retained control of the company – a Teckal requirement.

Case study

Ansa

The company's board includes council elected members appointed as directors. The challenge to the board is to ask the right questions of management to get the best out of the business.

A theme emerging from our interviews with LATCs and councils was the balance between council influence and excessive interference. It is important that the company board is allowed to deliver the strategic and operational plans of the company without excessive interference from the council, audit or procurement. It is equally important that appropriate governance structures are established to safeguard councils from excessive risk taking or poor performance.

The parties need to strike a balance between the LATC's rights and those of the council.

Operational management, corporate reporting, risk management, internal control and audit are the responsibility of the LATC board. The LATC is under no obligation to appoint the same external auditor, to have an internal audit service – or, if it does have one, to share internal audits reports – nor to report to council audit committees. However, councils need oversight of LATC activities and assurance that the LATC is following the strategic direction agreed, is not taking excessive risks and is delivering its service and financial performance.

In our experience, shareholder committees are an effective means of council governance. They provide:

- an effective focus for the contact between the company's management and the council
- a mechanism to communicate the shareholders' views to the company
- a means to evaluate the effectiveness of the board and the delivery of the company against strategic objectives.

If there is no shareholder committee, then group governance arrangements should operate to safeguard the council.

Governance solutions

Our research identified a variety of solutions available to councils including:

- **procurement controls** – some councils had retained significant procurement oversight of the LATC. We discuss this further in step 10 but note that this was often seen as contentious by LATCs
- **shareholder committees or boards** – these are subcommittees of the council, comprising elected members and key officers reporting to cabinet
- **group reporting arrangements** – these are operated in a similar way to those in the commercial sector and ensure regular reporting of performance and financial information to officers within councils and to cabinet. For larger LATCs, we anticipate as a minimum narrative reporting on its strategy, business models, key performance indicators and key risks.

Case study

Ansa

The governance structures put in place include a holding company and board to review the company's performance, consider the wider consequence of the board's decisions and to approve developments outside of the company's business plan.

The LATC is under no obligation to appoint the same external auditor, to have an internal audit service – or, if it does have one, to share internal audits reports – nor to report to council audit committees.

7

Financing a local authority company

Agreement needs to be reached as to how the company will be financed – in particular, what working capital it will need to trade and whether the overall cashflow is sufficient to sustain trading/delivery of services.

Most LATCs that we reviewed had needed some form of working capital loan initially. Without this facility, most would not have been able to operate. In general, this was not contentious and the council made a ‘commercial rated’ facility available.

An area raised by some LATCs was the lack of initial investment in the company to enable it to tackle longstanding productivity issues. While this had not stopped the establishment of the LATC, it had delayed the speed at which it could improve productivity.

Other issues raised by LATCs were:

- the need to buy stock relating to its business and its trade debtor book from the council. This also needs to be financed
- the need to manage cash balances effectively. Most local councils hold significant cash balances so cash management is not an area of concern. This is not the case for new LATCs and thought needs to be given to cash management policies and processes, especially as delaying payments to suppliers may not be politically acceptable.

While an important step, the majority of LATCs we interviewed did not see their initial financing as an area of significant concern.

8

Tax

The main taxes affecting business decisions for LATCs are corporation tax, value added tax and employer taxes. The LATCs interviewed did not consider this a particularly contentious area. However, they said that they did need external advice in this area.

Key tax considerations

Corporation tax (CT)

CT is levied on the profits made by LATCs. Not all LATCs are subject to CT. Where the LATC is trading solely with the council, there is potential to apply to HMRC for a CT dispensation. However, as the company moves away from trading solely with the council this will become harder to retain. There is also some potential, where the council owns more than one LATC, to reduce tax liabilities through group relief, the offset capital gains or by considering inter-company charges and transfer pricing. Given the high profile nature of taxation, LATCs need to consider what is acceptable to the council and the public.

Value added tax (VAT)

Most LATCs will need to register for VAT. Key considerations are the VAT treatment of the goods or services provided, the ability to recover the VAT charged and the 5% ‘test of significance’ rule for exempt supplies. For example, LATCs cannot normally recover VAT on costs associated with the provision of welfare services, whereas councils can. Inappropriate planning can leave councils with unexpected costs.

Employer taxes

Councils are used to managing their employment tax obligations. For employment tax, the rules applying to councils are the same that apply to LATCs. However, there are practical considerations such as the need to: run separate payrolls (separate PAYE and CIS references should be used); agree any dispensations and settlement agreements with HMRC separately to the council; set up salary sacrifice schemes independently; and review any tax implications arising from changes in terms and conditions – particularly those arising from TUPE.

9 Transfer of assets and support service costs

Councils should consider what assets, if any, should transfer to the LATC. In many instances, we found that the local authority retained the assets – such as accommodation, vehicles or equipment – with the company paying a fee for using them.

While this may be a pragmatic solution, it leaves the cost of maintaining and replacing the assets with the council, and the company with a balance sheet without any non-current assets. LATCs also need to think about how they can generate capital to self-fund replacement assets or what collateral they can use to support borrowing. Longer-term solutions that companies have applied to this issue include cash generation to fund investment and the use of ‘order books’ as collateral on borrowing.

Our research indicates that support service costs are a significant area of contention between councils and LATCs. This is because, perhaps fairly, most LATCs consider council support services to be unresponsive and more expensive than commercial services. As a result, LATCs are keen to divest themselves of the support services to make themselves more competitive. To avoid contention at a later stage, the council and company need to agree on the transition away from council support services.

In most of the case studies we looked at there were initial costs to the council in absorbing additional support service costs or related redundancies as part of this transition. These costs are an inevitable part of the LATC process.

Acivico has a three- to five-year arrangement allowing it to move away from council provided support services.

Norse provides support services directly to any newly established company and does not continue with council provided support services. At times, it may accept the transfer of some support people, but in general, it is the council's responsibility to restructure support services within the council and to absorb any financial impacts.

10 Performance management and contracting

Performance management arrangements often cause conflict and it is important that these are designed to promote behaviours that benefit both parties. This was a significant area of concern for LATCs. Reasons for this include insufficient time allowed to implement changes before contract terms are enforced, or excessive assessment from procurement. One company indicated that it had five full-time procurement people dedicated to contract management. In some instances, this was considered to have affected service delivery and innovation.

Significant contract functions are not always necessary. An alternative model is to use stakeholder committees, liaison boards and ‘light’ client functions. These appear to strike a better balance between council governance and commercial freedom.

This is not to say that contracts and contract monitoring should not be in place. The more difficult question is the level of scrutiny and the period of grace granted to LATCs to improve performance.

While there are numerous steps that need to be considered in setting up an LATC, they can all be overcome with good planning. The following case studies – ip&e Ltd, Strata and Ansa – show how they have successfully overcome these challenges.

Case study 1

ip&e Ltd

In May 2012, Shropshire Council committed to becoming a strategic commissioning council. ip&e Ltd was established to support the council in its vision to grow and develop out of the financial restraint it found itself in. ip&e Ltd stands for inspiring partnerships and enterprise and is a company wholly-owned by the council and limited by shares.

The overall mission of ip&e Ltd is to deliver better outcomes by creating and delivering top quality services and designing everything to meet customer needs and maximise public profit. Retaining a focus on outcomes for local residents has enabled the council and the company to align their strategic vision closely.

The directors of ip&e Ltd and the chief executive of the council consider that the greatest benefit of the company is the ability to work closely together to redesign services around the customer. This leads to savings and improves overall outcomes. Experience has shown that working together has led to a clear, shared understanding of goals in relation to outcomes. The company has the freedoms and flexibilities to embrace new and interesting ways of working while retaining the public sector ethos.

While the company is keen to progress quickly, it has been careful and measured in its approach to date. In August 2013, the council's media, PR and marketing team moved across under the title 'ip&e Communications'. From April 2014, the business design team was created, comprising Shropshire Council's programme management office and business design team. By March 2015, ip&e Ltd had 21 employees.

The ip&e communications team has supported customers in the local government and housing sectors, while also providing communications for the local office of the police and crime commissioner. Since its transfer to ip&e Ltd, the team has enjoyed steady growth and delivered improvements to clients in the fields of reputation management, emergency communications and brand development.

The business design team has led the redesign of many council services to date, most notably adult social care, transport and waste. In these cases, the business design

team supported existing council employees to think differently and change their own processes and systems to orientate around the whole needs of the customer. This has resulted in:

- a more efficient pathway for the service user or more efficient way of delivering the service
- greater impact on longer-term outcomes, for example, public health and education standards
- reduced call on council services by reducing demand or engaging other providers within the health or voluntary sectors
- smaller teams, which the company has managed through natural turnover of people so far.

It has measured success by improved outcomes or service targets, and by listening to the customer. An example of this success is the national acknowledgement that Shropshire Council has the lowest spend on adult social care services in the country, while maintaining the highest levels of satisfaction with the members of the community they work with.

The approach has bucked the national trend of cutting services in response to financial pressures, and instead focused on proactively helping and encouraging people to live healthier lifestyles, reducing or delaying the need for formal social care services. ip&e Ltd's business design and communications teams worked closely with Shropshire Council, concentrating on outcomes for customers and not just how to cut budgets.

They helped design and communicate the service from scratch, using an evidence- rather than opinion-based approach to finding out what works. This delivered tangible outcomes for residents and the council so that 73% of people calling its customer service point had their enquiry dealt with in the first instance, far outperforming other local authorities in the country. Together, an operating model was created that understood local residents' demands and responded rapidly to their needs.

Continues ...

Case study 1

ip&e Ltd (continued)

ip&e Ltd is keen to expand the business design team's capacity, so that it can increase the speed at which it supports the council's services. This will also develop spare capacity so that it can market and sell their service redesign expertise to other providers.

While the company does want to drive to further efficiencies and deliver profits, these are seen as 'profits with a purpose' as they will all be reinvested in Shropshire on projects to improve wellbeing and outcomes for people in the county. Initially, to support the council in meeting its cost saving targets, the services have been transferred with contracts that reduce in value. This ensures that savings are delivered. It will direct anything in excess of this, as set up in the annual business plan, to support investment and dividends to the council, as appropriate.

While still a relatively new venture for the council, ip&e Ltd is aware that it still faces challenges to enable longevity and sustained delivery. The cabinet has been supportive of ip&e Ltd and had realistic expectations on the speed of services transferring and the financial return expected. There have been honest conversations and both sides are aware that this is a journey to become sustainable and not just a hasty, ill-thought-out rush to get to market. There is clear thinking and an agreed approach to success.

The ip&e Ltd directors confirmed that they have learned lessons in the early operation of the company. Areas where they have strengthened or are strengthening their performance include:

- **business planning** – while there is a rolling three-year business plan in place, the company also prepares an annual plan, which is approved by cabinet. This plan has and will continue to remain live to enable a rapid response when opportunities present themselves
- **individual business cases** – each service has a business case to support its transfer. Initially, these business cases only included service costs. However, ip&e Ltd and the council are working to develop a costing approach that includes overheads and on-costs to strengthen the information. Overheads and accounting for pension on-costs have been a significant cost for the company to date. Understanding the full cost is crucial when marketing and selling a service to others and it affects overall profitability
- **maintaining a strong balance sheet and I&E** – any organisation considering a contract with ip&e Ltd will undertake due diligence, so it is imperative that the financial health of the company is not compromised and significant liabilities, for example LGPS pension transfers, are supported appropriately and proactively by the owning authority. ip&e Ltd and the council are still working out how they manage these

- **TUPE** – legislation makes the transfer of people complex. While it is not uncommon for delays in transfers, the council has been able to second some people into ip&e Ltd while TUPE issues are worked through in a timely and supportive manner. This has provided more time to consider the issues while maintaining the momentum for transition, which is positive for driving the cultural change necessary
- **governance arrangements** – it is a fine balance to remove the unnecessary public sector bureaucracy in a private sector setting but maintain arrangements that still meet the corporate governance code and ensure that sufficient, robust, timely information is reported to provide the necessary assurance to the council. This will develop over time as a greater proportion of the council's services transfer, increasing the financial value and risk relating to the arrangements.

ip&e Ltd will receive the majority of Shropshire Council's services and the council will transform into a commissioning organisation estimated to require around 400 employees. Both parties have made steady progress with tendering and winning work outside Shropshire with particular success within Inspire to Learn, a joint initiative between the council and ip&e Ltd. This growth will support the council in delivering its vision to be financially self-sufficient.

Council services that are scheduled to join ip&e Ltd over the short term include:

- **business support and regulatory services** – to include a full range of planning, building control, environmental health, trading standards and licensing services
- **Inspire to Learn** – a partnership between Shropshire Council and ip&e Ltd, bringing experience in providing education services, such as school meals, education advice, library and music services together
- **Help2Change** – a range of health services to prevent illness and improve wellbeing, including: NHS health checks; Help2Quit; and Help2Slim.

Challenges will include the development of commissioning skills within the council. Another will be ensuring that contract negotiations remain flexible and focused on the overall vision. This vision is to deliver top quality services and focus on outcomes for local residents.

Case study 2

Strata

Strata was formed as a collaboration between Exeter City Council, East Devon District Council and Teignbridge District Council. The three councils own and control it equally and have set it up to provide ICT services to all partners. The company has a turnover of £6 million and employs 70 people across the three council sites. It also owns all the ICT infrastructure required to deliver the services. The project was also awarded a Transformation Challenge Award of £970,000.

The biggest driver in the formation of the company was the need to reduce costs while retaining a skilled group of people with a degree of resilience for the service. IT professionals across the county recognised that, with the current funding pressures, they were looking at having to make cuts to areas such as maintenance or insurance of ICT. These changes would increase the risk profile for the service, at a time when many other areas of the efficiency agenda were looking to IT to help them achieve savings in the medium to longer term.

Discussions with other public bodies across the county evolved over two years, until a natural partnership between the three district councils emerged. Various initial business cases were produced, looking at collaboration with other bodies and outsourcing as options. However the strongest case was for the formation of a mutual trading company. Officers and members of the three councils were quick to embrace the formation of the company. Final approval was granted on 31 July 2014, and the company started trading on 1 November 2014.

The key factors in getting to this point have been:

- a high level of commitment from all three councils at both officer and member level. Throughout the project, chief executives, leaders of the councils and directors have all worked together effectively to achieve the overall aim. Key decisions were made early in the process, and these have formed a solid foundation on which to build the business. Where issues have arisen, the key principles that have been followed are “the need to be grown up and keep your eyes on the prize”
- procuring the right specialist advice has been crucial, particularly around legal issues, but also for corporation tax and VAT. Officers recognised early on that, given their backgrounds and skill set in local government, it was important to gain access to the appropriate knowledge and support. A key part of this advice was the correct formulation of the company, which would ensure that the corporation tax liability was limited and that the company could pass maximum savings back to the three councils over the long-term

- the three councils have shared provision of support services, with each taking a lead on a particular stream. This helped improve the level of engagement and continued the commitment of the councils to the company
- all the people TUPE-transferred across to the new company remain members of the LGPS. The new company has only taken on responsibility for pension arrangements for future years. The original employing councils have taken on the deficit associated with these members. Effective communication with all people involved has helped ensure that the project has been implemented with few issues.

The company is in its infancy and some issues remain as work in progress, most notably the governance arrangements and performance monitoring. The governance arrangements were considered and included within the initial business case and this has been carried through.

The company board consists of an officer from each council involved and the chief operating officer. The board reports to the joint executive committee (JEC), which in turn consists of the three leaders of the councils involved with the three chief executives co-opted on.

All decisions must be unanimous and there is a framework that outlines the roles and responsibilities of those involved. It is also clear on the types of decisions that need to go back to each individual council for consideration and approval. The JEC has yet to meet, so the arrangements have not been put into practice.

Prior to the formation of the company, the performance of the individual ICT services was based on a custom and practice approach with no formal measures in place. In setting up the company, officers are keen that a framework is in place, including how prioritisation of projects and day-to-day activities are made from the resources of the company across the three partner councils. This is a key area that is currently under review.



The biggest driver in the formation of the company was the need to reduce costs while retaining a skilled group of people with a degree of resilience for the service.

Case study 3

Ansa

Ansa is a company owned and controlled by Cheshire East Council, set up in April 2014 to provide environmental services.

In 2012, the Council had originally approved a procurement route for household waste and recycling services, driven by the need to make efficiency savings and to plan for the renewal of waste contracts. In 2013, the Council set out its move towards strategic commissioning and an ambitious programme of service transformation, exploring ASDMs. With a renewed impetus for change, the Council approved a Teckal exempt, wholly-owned company limited by shares encompassing waste and recycling, fleet management and streetscape services.

Whereas the prospect of outsourcing had unsettled staff, this new direction along with a focus on effective engagement with the workforce, meant that the launch of a new arms-length company was better received. Noting the engagement with the workforce to be key, management are keen to encourage a 'can do' culture within the business, with all staff playing their part in identifying opportunities and ways of doing things differently to maximise the value of the services they provide.

Although Ansa has not done anything radical to employee terms and conditions, they can now do some things differently without exposing the Council to any significant risks. For example, the company has focused on wellbeing measures, employee recognition schemes and introduced an apprentice programme, one step in getting the staff mix right for the new business.

For the first few years, the company is committed to buy its support services from the Council, which provides stability during the transition as the company ensures its financial systems are fit for purpose and establishes more commercial practices in areas such as income collection. The challenge though is to ensure that the company's service needs are well defined and if costs are higher than they might be from an external provider, the company is able to drive efficiencies out of other aspects of its operating costs.

The company needs to grow its income stream in order to maintain and invest in the quality of its service but this strategy is within the framework of the Teckal company structure. Early developments have focused on identifying where the company has capacity within its existing resources, for example, introducing a pilot scheme for commercial waste collection and providing large goods vehicle training solutions. These services may be on a relatively small scale but, as well as covering costs, serve to build the reputation and brand awareness of the company, and establish networks to promote future service developments.

Reflecting on the process to set up the company, Ansa's management recognise that the project team were focused on managing the council's risks rather than the company's needs. They made sure that the project governance arrangements were in place, such as gateways for review and approval, but these processes needed to be carefully balanced against the need to progress the scheme and to be flexible and responsive.

The governance structures put in place include a holding company and board to review the company's performance, consider the wider consequence of the board's decisions and to approve for developments outside of the company's business plan.

The company's board includes council elected members appointed as directors. The challenge to the Board is to ask the right questions of management to get the best out of the business. The board is finding an appropriate balance for engagement at the right level, information to monitor and direct strategy and sufficient detail to inform decision making. Performance indicators are included in the contract but management have different and wider measures of success (eg staff survey results, health and safety performance, workforce statistics) that are being developed.

Throughout, management consider it is important to demonstrate how well they are doing, and that this is through their own efforts – not something that the council is doing for them. One year on, the challenge is to keep the momentum going.



For the first few years, the company is committed to buy its support services from the council, which provides stability during the transition as the company ensures its financial systems are fit for purpose and establishes more commercial practices in areas such as income collection.

Section 3

Building a successful local authority trading company

There are clear examples of successful LATCs such as CORMAC, Essex Cares, KCC Commercial Services and the Kingstown Works Limited. The newly formed LATCs included in this report as case studies also give hope of further success.

There are examples of failure and some councils have brought LATC services back in-house. Reasons that tend to be cited in such cases include the lack of clear leadership of the company, the lack of market research, poor business planning, and lack of clarity of the council's role as shareholder.

There are a number of key determinants to making a successful company. The drive and ambition of the people running the business is an essential characteristic of successful LATCs. This also needs to combine with the establishment of the right culture in the company and positive support and commitment from the local authority. Furthermore, if the company is to grow it needs to focus on innovation, expansion into new markets and diversification.

We have summarised the key steps that will affect the success and growth of LATCs below.

1 Put the right leadership team in place

The overriding determinant of a company's success is the drive and ambition of the people running the business. All the LATCs we looked at had taken care in choosing the right leader.

For a number of LATCs, the introduction of a new CEO was not sufficient, and they needed additional changes to the leadership team to create the right commercial focus. Where this occurred, it was supported by some form of re-organisation to introduce new management structures and/or the employment of managers from the commercial sector.

One interview described the management re-organisation as 'untypical' to the public sector. Instead of allowing voluntary redundancy to all people, the company decided to retain those best fitted to the roles. It rewrote management job descriptions to fit a more commercial approach, and required those in management positions to re-apply. While the cost was significant in terms of redundancy, the LATC established a reduced and more focused commercial management team.

Making this transition takes a bold and courageous leader. It has to be managed well and communicated effectively to all levels of the organisation to ensure that people understand the rationale for why their management team has changed.

Common reasons for failure

It is possible for LATCs to make a loss. Common causes of failure are: weak leadership; poor business planning; lack of council support; over optimistic growth assumptions; lack of sensitivity analysis with regard to future council budget assumptions; lack of modelling of revised contract terms, for example, from block to activity based; and changes in methods of service delivery, for example, from direct care to preventative services. In particular, where companies have not diversified services this can leave them highly exposed. In some instances, councils have needed to liquidate companies and bring services back in-house.

2

Creating the right culture

Promoting cultural change and creating a commercial mindset in the people transferring to the LATC is fundamental to its success. All of the LATCs we visited promoted a culture based on commercialism, learning and a shared sense of purpose. They used the following methods to do this:

- **promoting a commercial culture** – a common thread from our review was concern about inheriting low standards of quality and productivity and poor processes. One company director described an ‘active resistance’ amongst some parts of management and people in reaction to change. This ‘active resistance’ is unsustainable and has resulted in a robust response from leadership teams. One company we spoke to had employed change agents to create the necessary cultural change. Others had looked at restructuring of posts or reviewed job specifications to introduce more commercial objectives into roles. Whatever the action taken, it is clear that establishing a commercial culture is critical to success
- **building commercial skills** – the change to a more commercial environment is a significant one. Some public sector employees may not have worked in a commercial setting before. Thought needs to be given to how to create a commercial mindset and an entrepreneurial approach to service delivery. Some of the LATCs we visited had employed commercial trainers and managers with a commercial background to establish this. Others had applied lean systems to refresh and reduce processes
- **removing management layers** – local government is a hierarchical system. The LATCs we interviewed indicated that removing management layers and devolving authority to frontline managers can improve performance significantly by increasing the speed of decision making and by allowing improvements in customer focus and innovation

Case study

Shropshire Council

Shropshire Council has identified that shifting people into its company, ip&e Ltd, enabled many to flourish and feel less constrained by perceived bureaucracy. Employees were more confident to make suggestions for innovative changes to services. This benefited the service as they had a greater appreciation of the user’s experience.

- **improving information** – providing clearer management and financial information is essential in creating a commercial culture. A number of LATCs had strengthened both financial and performance information, enabling faster decision making and clearer accountability
- **performance management** – our experience is that objective setting and regular performance reviews are irregular in the public sector. Some of the LATCs reviewed took a more active approach to areas such as sickness management and underperformance
- **develop a shared sense of purpose** – building good relationships with people can have a profound impact on the success of businesses. Where there is trust and flexibility, people are more willing to assist and help the company when it needs support. A number of LATCs have embraced this concept. For example, one LATC introduced ‘talent management’ where emerging talent was identified and additional freedoms delegated alongside coaching. The development of new managers aligned to the vision had significantly benefited the business.

ASPECTS OF A SUCCESSFUL COMMERCIAL CULTURE



“The staff now have a ‘can do’ attitude and are less risk averse, thinking about what the business can do to maximise the value of the services we provide.”

Ansa

“We believe that, from an employee’s perspective they found it easier to align with a growing company, and get on board with the vision. Many see the company as more stable than the council environment they came from which was frequently undergoing cuts and restructures. Now the workforce is getting cost of living increases which is something council workers are not getting. There is a real sense that everyone throughout the organisation is on board with the key objectives. Business unit managers are given more flexibilities, which is enabling growth and, as a company, we are starting to see some real entrepreneurs. People are genuinely excited to be given opportunities to grow their areas of speciality and are enjoying new challenges.”

CORMAC



3 Reconsider reward

In all industries and organisations, reward – including associated terms and conditions – is a key mechanism for attracting and retaining people. We have seen LATCs use a wide range of tools to reduce costs and to motivate and retain staff. These included improved rates of pay, revised pension schemes, changes in sickness policies to promote the right behaviours and improved benefit packages.

Over its lifetime, an LATC may employ staff with different terms and conditions. This can be difficult to manage. LATCs with these arrangements will need sound human resource support to ensure that they treat employees in accordance with their contracts.

A key message from the interviews is the need for freedom for LATCs to move to more commercial terms and conditions if they are to offer comparable costs to the private sector and drive efficiencies.

4 Building a customer focus

The transition from an internal department to an external supplier held accountable for delivery to performance measures can be difficult for new LATCs. In particular, treating the council as a client can be difficult for transferring people. All the LATCs we looked at had renewed focus on the delivery of high quality, customer-focused services.

Our case studies also indicate that there is a shift in relation to ‘who is the customer?’ Traditionally, the customer has been the service user, but LATCs also need to regard service commissioners as customers. The main commissioner will usually be the council, but this could also include other public sector bodies and private companies as the portfolio base is expanded.

Based on our research, it can take considerable time to create this customer-focused mindset in people. The renewed focus on the customer needs to start as soon as the LATC gets the green light, rather than waiting until it starts trading.

5 Building an appropriate vision and gaining the commitment of the local authority

As we have discussed, establishing an appropriate strategic vision and the commitment of the council to the vision is fundamental to the success of LATCs. Our research showed a significant tension between some LATCs and their sponsor council.

We have already highlighted a number of areas of contention such as concerns over growth strategies and repatriation of profits. Our research into more established companies also highlighted that the initial vision may include the provision of a single service with a view to provide the services to other councils or commercially. Some councils have chosen to add other services in later, which has affected the risk profile and business knowledge of those running the LATC. While this is not necessarily the wrong thing to do, it does need appropriate planning.

Some of the costs of established LATCs are linked to decisions about the terms and conditions of people including the living wage and pension costs. In certain instances, this will result in the company being more expensive than the private sector. It is important that both sides understand this clearly as policy decisions can significantly impact on the commerciality and future of the LATC.

As the LATC develops, its vision and strategy and those of the council need to be refreshed. To be successful, this requires a continuing dialogue between the council and the LATC, co-operation, mutual understanding and trust.

“While still a relatively new venture for the council, ip&e Ltd is aware that there are still challenges facing them to enable longevity and sustained delivery. The cabinet has been supportive of ip&e Ltd and had realistic expectations on the speed of services transferring and the financial return expected. There have been honest conversations and both sides are aware that this is a journey.”

ip&e Ltd

6

Preparing for the future – growth, diversification and innovation

As LATCs develop, they are often presented with opportunities to diversify or invest in new ideas. If the strategy is to expand, it is important to have a clear view on:

- whether they intend to expand into new areas by offering services to other local councils and the private sector
- whether they intend to break into new services or remain with existing service streams
- what processes or supply chains need to be changed
- the council's support for growth.

Our research indicates that, while most LATCs want to grow, there is a lack of clarity with regard to these areas including council support for diversification.

For a council to gain the full benefit of the LATC, it will need to diversify and grow. Where opportunities do arise, each opportunity should be considered as a standalone proposal, supported by its own business case and financial plan. The LATC should show how each proposal will integrate with existing structures and governance arrangements.

“The company needs to grow its income stream in order to maintain and invest in the quality of its service, but this strategy is within the framework of the Teckal company structure. Early developments have focused on identifying where the company has capacity within its existing resources.”

Ansa

“The strategy intends the company to deliver growth in the customer base by providing services designed to offer choice, inclusion, independence and support opportunities for both individuals and their communities.”

Buckinghamshire Care

In considering plans for growth, diversification and innovation, our research indicates that companies also need to think about company structures, access to finance, the market and support. Areas to consider include:

- **the structure of the company** – as some LATCs have grown, they have created a number of wholly-owned subsidiaries which in turn hold investments in a number of joint ventures. Careful thought needs to be given as to the most appropriate structure
- **researching the market** – understanding the market is essential. Research into council markets (for example, the appetite of other councils to outsource services), commercial markets and competition (for example, how many suppliers are already in existence) will provide a sound platform for growth
- **ensuring appropriate access to finance** – our research highlighted this as a contentious area. For example, is the expectation that the company will reinvest its profits to allow expansion, or repatriate them to support the local authority? If it repatriates them, what borrowing will the company undertake to finance the business, and how will the local authority support it in raising this finance. LATCs are likely to need investment to replace capital equipment, invest in new products or to take on new contracts. Thought needs to be given to the development of business plans that show clearly how investments will be financed
- **connect with a network of ambitious business leaders** – we identified numerous support mechanisms available to LATCs including Local Enterprise Partnerships and various government sponsored programmes such as Growth Accelerator and Manufacturing Advisory Services. Connecting with the business community and obtaining the support available is a key factor in successful LATCs.

Case study 1

Acivico

In 2012, Birmingham City Council approved the transfer of urban design and building and consultancy services into a special purpose vehicle called Acivico. This was established as a wholly-owned company of the council. As well as providing ongoing services to the council, Acivico was structured so that it could provide services to other councils and to allow other councils to transfer services into the company structure as subsidiaries.

The council aimed to identify alternative proposals for innovative service delivery that would transform the business, protect the public sector ethos and respond to the fiscal challenges facing the council. The establishment of a wholly-owned company model was seen as the best mechanism to achieve these aims.

The council identified a number of financial advantages including cost reduction and the generation of target surpluses that Acivico would return to the council from the company's profits. One of the company's main objectives was to grow its business and maximise income. Achievement of this objective was based on a five-year exclusivity agreement for council work and expanding service provision to other public sector organisations.

Acivico has been running for two years, and the management team have faced a number of challenges.

A major test has been the transition of the workforce to Acivico. The creation of a commercial culture has been essential. Acivico has re-organised management and people structures to create the needed change. While this has been costly in the short term, management consider that it needed this change to create a more commercially focused company. Alongside this, they have introduced change management agents and commercial managers to create a more customer-focused organisation.

Other challenges have been changing the methods of working and raising quality standards and customer focus. The focus has been on moving away from a 'command and control' structure to create a more open operating environment with greater delegated authority and more innovation. Spotting emerging talent and greater delegation have been important mechanisms to create the change needed.

Relationships with the council have not always been easy. At times, the focus has been on contract compliance rather than a partnership approach. The company considers that a more rigorous review of contract conditions, key performance indicators and monitoring arrangements prior to signing the contract would have resulted in a better outcome for both the company and the council.

The team has also focused on cost reduction. As well as streamlining its own internal procedures and team, the company has needed to reassess the cost of support services to enable it to be competitive. A blended outcome has resulted, with human resources and legal people transferring to the company, other services moving to a 'pay as you go' contract, and others going to external procurement.

The company is planning to take over further council services such as catering and cleaning. It also focuses on external growth and has been successful in facilities management contract tenders with Virgin Trains and Heart of England NHS Foundation Trust.

The operational director said: "There was an expectation that we would transition to a commercial company overnight. This was not possible and we have needed to deal with an 'active inertia' in some parts of the company to create change. The organisation has become more commercial over the last two years but it is a continuing journey."

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Case study 2

CORMAC

CORMAC is a wholly-owned company of Cornwall Council, which has been trading since April 2012. Having been trading as a Highways Direct Labour Organisation since 1982, and using the CORMAC brand since 1992, CORMAC was well placed to be set up as a local authority company. The company was formed as a result of a strong vision from the council, and seen as a way to make cost savings whilst also finding a way to expand its trading activities. Two companies were formed – a Teckal company for the work passported from Cornwall Council, and a trading company. The combined turnover is in excess of £100 million, with over 90% of this coming from the council. The vast majority of the work is in highways maintenance and construction, but CORMAC is a diverse conglomerate with eight separate divisions.

The Council is clear that it is not just about achieving savings. In its first two years of operation, CORMAC has increased its client base, while offering increased job opportunities for the people of Cornwall. Staff who transferred into CORMAC are engaged with the new direction, with staff surveys showing that 84% of people are prepared to go the extra mile to deliver the vision.

Getting to this point has not been easy, and as the company continues to grow there remain challenges ahead. The key factors in getting to this point have been:

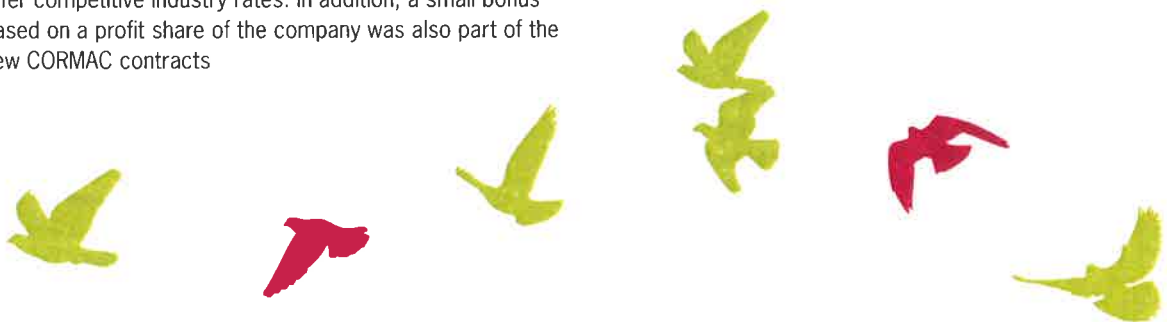
- a good understanding of the market. The current managing director of CORMAC already had good relationships with his peers and a deep understanding of the industry. This has enabled the company to build on market opportunities and grow
- cost savings have been achieved by being able to set different terms and conditions, and offer alternative pension schemes rather than the LGPS. The initial TUPE transfer of staff to CORMAC gave employees the opportunity to move to CORMAC contracts. Take-up of the CORMAC contracts was significant. Key changes were on the sickness policy, with CORMAC not paying the first three days of sickness. This was mitigated with increases in rates for overtime pay and unsocial hours, where the council was struggling to offer competitive industry rates. In addition, a small bonus based on a profit share of the company was also part of the new CORMAC contracts

- liquidity was a new issue for the company, and a working capital loan was needed from the council for the first year, and a further revolving loan in future years to ensure the company could grow. The company has also needed to balance its own need to create a working capital balance against the needs of local businesses and the council's priority of paying suppliers on time
- the pension liability remains a significant issue. The council needed CORMAC to pay for their pension liability, and to build this into their rates. However, slightly increased rates makes them more expensive which can impact on competitiveness. Accounting for the pension liability created a problem in terms of the balance sheet, but also the challenge around goodwill – the corresponding entry to having the deficit on – which caused issues around amortisation with HMRC. Eventually it was kept off the balance sheet by adding a guarantee, but it continues to create a problem as the legislation changes. This is an area that is revisited regularly in terms of how best to ensure the deficit is funded.

The continuing challenges for the council include:

- the complexities of the tax regime
- how best to deliver support services to the company and the role that the council plays in that
- developing a greater understanding of the governance issues for both officers and members
- the dichotomy of trying, at times, to operate as a public sector body in a private sector world.

Going forward, CORMAC sees commercial opportunities and partnerships with other local councils as the future, while the council describes the current position as a “nice little corridor between the public and private sector”.



Case study 3

Norse

Norse Group is a wholly-owned company of Norfolk County Council. The group brings together NPS (property consultancy), Norse Commercial Services (facilities management) and NorseCare (a social care provider). These companies are wholly-owned subsidiaries of Norse Group. Both NPS and Norse Commercial Services have a significant number of joint venture companies that are partially owned by the companies (80%) and the councils they have entered into partnership with (20%).

Norse Group is by far the largest and most successful LATC in the country and has an annual turnover in excess of £300 million. Collectively, the group's companies employ over 10,000 people nationwide. The group has made significant cost savings and efficiency improvements for the councils involved, providing a clear example of what local authority companies can achieve.

Achieving so much has not been a short-term undertaking and the board member, Peter Hawes, is clear that local authority companies should be seen as long-term ventures, should focus on growth and trade and should not be set up to simply deliver efficiency savings within council services.

Norse is also clear that it is possible for a local authority company to be competitive, to retain an appropriate focus on service and to act as a caring employer.

Norse highlights four critical success factors:

- the company needs to stand free of the council and have the ability to set its own direction and make management decisions without referral back to the council. It also needs freedom to provide its own back office services as better information and more timely support services are a key driver of change and the reduced costs are needed to compete commercially
- there needs to be an agreement that the company can transition away from council terms and conditions and move towards commercial terms and conditions that allow it to compete in the market. Norse is clear that this does not mean worse terms and conditions. Rather, the focus is on comparable market terms and conditions that allow it to compete commercially
- the company needs to be in charge of its own finances and have the ability to reinvest in its services and growth. From its inception, Norse has been able to retain 50% of its profits and has used these funds initially as working capital. Over the last few years, the profits have been used increasingly for capital projects as an alternative to borrowing

- the company must be able to bid for other work. The ability to diversify the services provided and to have a greater income base has enabled Norse to increase its service expertise, to benefit from economies of scale and to manage short-term performance issues or market downturns from a secure financial position. Norse considers that the key benefits of an LATC will only be delivered if it is allowed to grow and trade.

In Norse's experience, strategic alignment, option appraisal and due diligence are essential in deciding to set up a local authority trading company. Through experience, Norse now has a very fast take-on process for new ventures and companies. From the point of agreeing to work with a council, Norse can set up the joint venture and transfer services within six to 12 months. However, in the group's experience, most councils need to do more preparation before deciding to set up a company by themselves or before considering establishing a joint venture.

Important reasons for councils to look at an LATC are efficiency pressures or issues with contract delivery from within the council or a service provider. Norse's experience is that it can take up to three years before services are transferred to a joint venture with Norse or a local authority's own company. Causes of delay include the need to undertake a full option appraisal, getting officer and member buy-in, site visits and trade union negotiations. Norse recommends that councils undertake a strategic assessment and a full option appraisal when they start to look at ASDMs. These can reduce the timescales significantly.

Effective governance is key to protecting the councils working with Norse and the company. Over time, Norse has established a clear governance structure that supports its business and provides surety to Norfolk County Council in the management of risk. The governance structure has also ensured compliance with the Teckal requirement for Norfolk County Council to retain control. Key factors are:

- the board of Norse consists of five directors. These are the directors of the group companies and two council appointees, one of which is the chairman. The two council appointees have double votes and therefore have control of company decisions
- it has established a shareholder committee. This includes the nominated shareholder. This committee has oversight of the company and receives a quarterly report. A six monthly report is also taken to the council's policy and resources committee. Reports cover strategy, performance, investment and finance

Continues ...

Case study 3

Norse (continued)

- the use of advisory boards for important decisions. Norse is aware that a more usual board structure would include the managing directors of the companies and commercial non-executive directors. The advisory boards provide additional support on big decisions
- the group structure operates in a way that minimises risk. In addition to the wholly-owned subsidiaries, Norse group includes 26 joint ventures and eight specialist companies. The vast majority of these companies are limited by shares to protect the group and the council. The share ownership is 80% for Norse and 20% for the council entering into the joint venture
- all of the companies have a board that includes three representatives from Norse and two representatives from the council. This provides Norse with a veto over any major strategic changes that the company is considering. The need for this veto is not surprising as Norse underwrites the financial performance of the companies
- below each company board there is a liaison board. This consists of the local authority, residents, trade unions and any other interested parties. The companies issue a quarterly report to the liaison board ensuring clear accountability.
- Norse provides support services directly to the newly established company. At times, they may accept the transfer of some support people but, in general, it is the responsibility of the council to restructure support services within the council and to absorb any financial impacts
- flatten management structures. Norse considers that most services transferred into the group have more management tiers than they need. Restructuring will drive a less hierarchical approach with decision making undertaken closer to the point of delivery and without undue delay
- better information can drive significant efficiency savings. This includes system changes to achieve better budget information and more focus on targets and service performance. The company can use this to drive greater accountability and delivery
- reconsider terms and conditions to fit the market. In consultation with people and trade unions, service provider Norse has, where necessary, made a number of changes to terms and conditions. Norse is clear that this is not a pre-requisite to establishing a company but it can make the company more competitive and recognise market conditions. In some instances, this has resulted in increased salaries where the market conditions allow. For council contracts, many staff continue to have the same local government terms and conditions. However, Norse is clear that, on commercial contracts, it is not possible to offer people final salary pensions.

Norse considers that the relationships it enters into are partnership arrangements. It looks for long-term commitment from councils wishing to work together. The group uses standard 10-year contracts with a 12-month break clause. This minimises risk but also drives the core ethos of partnership. The agreement includes a 50% profit share, which establishes at an early stage how the partnership will work.

Norse recommends that councils steer away from large client functions and will not enter into a contract where there is a significant scrutiny from procurement.

Norse specifically requests a thin client and considers that the liaison boards provide sufficient scrutiny. Often the new company will take over the client function and use this to ensure appropriate reporting to the liaison board.

Norse has made a number of clear changes to ensure the commerciality and competitiveness of new companies:

- past and future pension liabilities arising from final salary schemes need to remain the responsibility of the council. These are significant costs and it is not possible for companies to manage these liabilities. Norse agrees a contribution level as part of the contract and changes in liabilities remain the responsibility of the council. Any changes in pension contributions are a pass through cost of the contract. In many instances this has allowed the people working for Norse to retain the LGPS

As a minimum, Norse considers that it can drive 10% savings. It says it would take a new start-up company two years to make similar savings. However, Norse makes the point that, if it is tied into local government pensions, it is not possible to offer market rates for services. It is honest in this conversation with councils. It is also clear that any organisation taking over these services will also have to comply with TUPE and absorb these costs.

Norse has negotiated national agreements with four trade unions indicating an acceptable way of delivering for people. Norse offers competitive terms and conditions, significant training packages, people consultation and social funds, and trade union representation. The blend of commerciality and public sector ethos appears to offer a happy balance for both people and the company. Norse's recent people survey supports this as it gave Norse a 94% endorsement rate.

The ethos is important to Norse. Being owned by the public sector means that there is no shareholder looking to capitalise on a market sale. As such, the company does not need to focus on capital growth or share value. This enables it to focus on the services it provides, its people and on managed growth.

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