

Cabinet

4th October 2011

Report of the Cabinet Member for Corporate Services

Establishment and Governance of the Local Authority Trading Company

Summary

1. The former Executive agreed in February 2011 to establish a Local Authority Trading Company (LATC), focused primarily upon the services currently provided by the CBSS Directorate. It also agreed the board of directors. Details of the outline business case and risks were presented in that paper. The report made it clear that at this stage no staff would transfer to the company, rather, that any work undertaken for the company by council employees would be recharged into the company on a full cost basis.
2. The drivers behind the establishment of the LATC include the need to address the pace and direction of change being seen in the current climate and the impact of public expenditure reductions. More than ever we, as a local authority, need to provide flexible, service solutions in the most cost effective and appropriate way that will deliver year on year cost efficiencies and increase income in the light of overall reductions being faced across the public sector.
3. This report takes forward the establishment of a local authority trading company; in particular it seeks approval for the governance structures under which the company will operate. It also outlines that the broad scope of services to be traded through the company will be wider than just those provided by CBSS.
4. The *Articles of Association* of the LATC are set out in a background paper (**paper 1**). These set out the rules by which the company will be governed and the decision making processes that will be operated. They have been

developed to comply with the requirements of the Companies Act 2006 and aim to provide the appropriate controls for the council as the shareholder whilst at the same time providing the required independence, flexibility, and commercial decision making for the company. In drafting these documents, expert legal advice has been sought to minimise the risk to the council and to maximise learning from elsewhere.

5. A *Shareholder Agreement* has been drafted which is available as a background paper (**paper 2**). An executive summary of the agreement is included as an Annex to this document. This sets out the rights of the council as the sole shareholder and how it can exercise those rights. It details the powers of the board of the company and how and when the shareholder might influence those powers. It is important to note that the Shareholder Agreement is capable of being developed and added to as the company develops.

Background

6. The power to establish an LATC derives from The Local Government (Best Value Authorities) Power to Trade Order 2009 (the 'Trading Order') which was made under sections 95 and 96 of the Local Government Act 2003. The trading order provides that a 'best value authority' is authorised to do for a commercial purpose anything which it is authorised to do for the purposes of carrying on any of its ordinary functions.
7. Through the establishment of an LATC, a new legal entity is created under the Council's ownership, but with the ability to trade. This is different to only charging for our services in that charging is limited to recovery of the cost of providing those services, while trading can be at a profit. Under the legislative framework, trading is only exercisable through a company.
8. The initial paper in February 2011 outlined that the CBSS Directorate services lend themselves to the development of commercial opportunities in that they are primarily focused on business support activities. However, since then it has become clear that there are a range of other services that could potentially be traded and that the trading company

should be a vehicle for any Council service to potentially trade.

9. The paper presented to the former Executive in February 2011 demonstrated that the formation of an LATC gives the council a range of new opportunities, namely:
 - Delivering services differently by creating a dynamic and entrepreneurial environment that will increase diversity in the range, choice and delivery of public services;
 - Under the legislation, surpluses on commercial operations will be available to use how the council sees fit. In some authorities this has been used to support other services within the authority, invest in new commercial ventures via the company, or to help to keep increases in Council Tax to a minimum.
 - The LATC will create new opportunities for staff to both grow in their current roles and to learn new skills (e.g. customer services, commercial awareness and risk management skills) which may not be open to them elsewhere in the public service.

This compliments the council's stated intentions to achieve efficiency and explore new methods of working with other organisations. The trading company does not preclude the Council from other models of service delivery e.g. shared service, co-operatives, but rather it is seen as adding to the mixed delivery of services based upon business cases.

10. There are a number of examples, especially in private industry where "back office" and/or "business support" services have been divested of the main company and successfully traded. Two such examples are:
 - WNS, which was formed in June 1996 as a "captive" (i.e. a wholly owned subsidiary set up within the company structure to provide services to the parent organisation – in this case, British Airways). By June 2006, WNS was listed on the New York stock exchange. WNS Global Services has, in just a few years, evolved from being a captive company operating in a single industry segment to a flourishing third-party

provider servicing clients across multiple industries and functions.

- In the 1990s General Electric established a support services enterprise called GECIS (GE Capital International Services). They became one of the first companies to offer voice and internet support services from a location outside of the holding company's own borders. In 2004 GECIS was spun off as a separate legal entity by GE, called GENPACT. GE has retained a 40% stake and sold a 60% stake for \$500 million.
11. Whilst the scale of our proposal is somewhat smaller than these enterprises, the basic principle of creating a "back office/support" offering, and applying business practices to it, with a view to then trading those services to other organisations, is one that has proved to be successful.
 12. Research has shown that around 72% of local authorities are considering or are actively engaged in trading activities. The most common services being offered tend to be around grounds maintenance, cleaning and facilities management services and highways and vehicle maintenance.
 13. In terms of the customer base, the latest research available shows that:
 - 75% of LATC's that trade sell to other parts of the public sector, mainly other local authorities (67%);
 - 46% of those LATC's sell to the voluntary and community sector;
 - 34% sell to the private sector.

With the advent of developments such as academy status for schools and the impact of the government spending reviews on other public sector bodies, opportunities to develop traded services are on the increase. It also allows us to fill a niche in the geographical area that no other authorities have yet addressed.

Consultation

14. A paper setting out the intention to establish an LATC was presented to the previous Executive in February 2011 and was approved. The work that has taken place since then has

been to take the steps towards establishing the company as a legal entity. A range of other authorities who have already established trading companies have been consulted in this venture; these have included Kent County Council, Gateshead Council and Stockport Council.

15. Ideas for the name of the company have been sought from the staff of the CBSS directorate – a short list of preferred names was circulated and the name City of York Trading (CYT) Limited is the preferred choice.

Analysis

16. A local authority trading survey conducted by APSE showed that of the authorities that are trading:
 - 72% returned an income (i.e. profit) from trading – while some of these returns were modest, especially in the first year of trading, in order to realise the potential in a trading company it is crucial that it is given time to grow and establish its' presence;
 - There is over £1billion worth of activity in trading by English local authorities;
 - The average annual income from trading (of those authorities that reported trading income) is just over £3 million;
 - Kent Commercial Services which is one of the longest established LATC's had a turnover in excess of £800Million in the last financial year. £400Million of that was in direct sales which yielded just over £8.8Million in post-tax profit. They have over 20,000 trading accounts approximately split as follows:
 - 120 LAs including most of the London Boroughs
 - District, Borough & Parish Councils = 400+
 - Voluntary & Community Sector = 300+ some of these are in partnership agreements.
17. In the baseline survey on the local government procurement agenda (ODPM 2005) nearly half (49%) of the trading authorities responding to the trading survey said that they developed their traded products or services in collaboration with other organisations. So there are clearly opportunities for shared services (where there is the opportunity and it makes commercial sense to engage).

18. The LATC will need to undertake a range of activities to generate business opportunities. In those authorities that are already trading successfully, the key methods of winning business are as follows:
- 49% of authorities win new business by responding to invitations to tender competitively for work;
 - 49% of authorities provide catalogues or menus of services from which prospective customers can make choices;
 - 44% of authorities use advertising with more than 90% having a web presence.
19. One of the main public tender sites currently has nearly 19,000 open tender notices with around 1,700 new ones added each month.

Benefit opportunities of an LATC

20. Besides the potential for a range of new income streams that an LATC will create there are a number of other benefits to the stakeholders of the company:

For the council these will include:

- Reduction in service and delivery costs – as the company will have to cover all of its own costs, any secondment of resources or facilities to the company will be subject to full cost recovery for the council.
- Making surpluses to re-invest - the council is the single shareholder of the LATC, so any dividend is paid back to the council for further investment in services. The increased income streams could also help to off-set council tax burdens in the longer term.
- Service improvement – as the LATC will need to be competitive in order to compete in the marketplace, there is an added incentive to continuously improve service performance and service offerings. As the services would also be free from some of the constraints of the public sector – they can become more adaptable and responsive to ever changing market needs. This will encourage innovation and discourage complacency.

- Developing partnerships with the voluntary and community sector – thereby providing new opportunities for local companies while at the same time increasing competition and contestability in the local economy.
- This in turn encourages a ‘mixed economy’ of supply that enables local authority clients to make the best use of the marketplace to obtain the most appropriate supply solution.

21. While no staff will work in the company in the first instance, there are still benefits to be had for staff which will include:

- Opportunities for staff development and acquisition of new skills.
- The LATC will provide new outlets for the knowledge, skills, and expertise that our staff already possess.
- This should lead to greater job retention, enabling the council to meet its challenging savings targets while preserving employment opportunities for staff. Studies have shown that it is common with many local authority trading companies, that staff who work for those companies have been more motivated with morale increasing and sickness absenteeism decreasing - in one case (Essex Cares) sickness and absenteeism fell in the first twelve months from 16% to 4%.
- Potential opportunities in the longer term for staff to take advantage of pay/rewards models that move away from the constraints of the public sector – encouraging higher performing staff to commit to the organisation rather than seek opportunities elsewhere.
- Providing staff with enhanced motivation and satisfaction through preservation of their commitment to the public service while benefitting from the advantages of private sector terms and conditions.

22. For the customer these will include:

- More effective and efficient services resulting from the need to be competitive, flexible and innovative in their approach.
- Increased opportunities in the local economy, which could lead to greater job creation and employment prospects.

- An LATC encourages a ‘mixed economy’ of supply that enables local authority clients to make the best use of the marketplace to obtain the most appropriate supply solution.
- It creates new opportunities for supply and support services from local companies, especially smaller businesses;
- It has the potential to introduce new providers into the market for local authority services which serves to increase competition and contestability;
- It has the potential for supporting relationships between local government and the voluntary and community sectors;

Proposed structure and mandate of the new company

23. The LATC would be a limited company by shares with the council retaining a 100% shareholding. All decisions regarding business development and any consideration of commercial opportunities which may arise, would be a matter for the board of the new LATC. However the council as the shareholder would be required to approve any decisions which would have an effect on the shareholders’ rights – this will normally be done at a meeting called by the directors of the company.

24. The council, as the sole shareholder will also have certain powers such as removing a director from office or changing the name of the company. In general, the shareholders main role is to ensure that the directors do not go beyond their powers.

25. The *Shareholder Agreement* (**Annex 1** with the full agreement available in **background paper 2**) sets out in detail the powers and responsibilities of the council as the sole shareholder of the company, which will be exercised through the formation of a Shareholder Committee. The Shareholder Committee will be chaired by the Leader of the council and consist of the Leader plus two other appointed members. The committee will be convened at least four times per calendar year. Representatives of the company will attend the committee meetings in order to present management information and other papers as relevant and appropriate.

26. All other aspects, and in particular the day to day operation of the company, development of new business opportunities, staff terms and conditions and the development and implementation of its internal procedures, would rest with the board of directors as detailed in the *Articles of Association* (**background paper 1**).
27. In addition to the above powers, the council will need to consider the transfer of any activities or services from the council control into the company. Such activities are likely to consist of the following:
- **Work done for the council itself** – such work is only likely to be transferred to the company if a decision is made to move a whole activity from the council into the Company. Any such proposal would involve TUPE transfer, and at this stage no proposals are being recommended to the Cabinet. However this situation will be kept under review and be subject of further reports to Cabinet if that situation arises.
 - **Existing services provided to external organisations (new opportunities to trade)** – in respect of work done for other bodies already, this could be “transferred” to the company, with the costs/income going through the company, but without any staff transfer. Instead, as outlined earlier the costs of such staff would effectively be recharged into the company. One example would be the provision of payroll services.

The advantage of moving such work into the company is that it would increase the turnover of the company, develop the brand of the company, and also bring consistent charging/customer services to the variety of trading activities already provided by the council. There are likely to be many potential examples, often small in nature, where existing trading could be moved into the company. Rather than each one having to be reported to the Cabinet, it is recommended that the Cabinet agrees that the Director of CBSS should prepare a business case for any such current trading activities to move into the company, with the approval process to

include :- Council Management Team, the Board of Directors, and the Shareholder Committee.

28. Several of the services in the CBSS directorate lend themselves to trading activities. As was identified in the February paper to the previous Executive, these included:

- Recruitment Pool
- Learning and Development
- Supply agency to schools
- Schools HR/Payroll SLA
- Payroll
- Health and safety
- Customer services
- IT

29. As an example, in 2005 Kent set up a recruitment pool organisation known as Kent Top Temps. Initially, they provided temporary staff and care workers to a range of public sector bodies. Within 12 months they had 600 fully employed agency staff on their books, which generated a £600K saving in Kent CC Social Services alone.

30. Across the council there are a range of services that are either already engaged in a level of charging for their activities or are potentially looking at the opportunities that may exist. The following table (Table 1) summarises the current known position. It should be noted that there is no expectation that all of these would trade through the company, and that in the early stages of the development of the company a step by step approach would be needed, however it gives an indication of potential opportunities over coming years:

Area	Notes
Recruitment Pool	The Pool is currently taking on work that was previously managed by an external firm, and this provides an opportunity to further develop the recruitment pool and develop a commercial approach. This will allow the council to achieve significant savings as well as provide a marketable service to other

	organisations.
Services to Schools	The current Schools Business Services team has traded a range of financial services to schools since the council's inception in 1996. The business manager service, piloted in 2004, is a market leader nationally. A business case is being prepared to show how this could be developed into a commercial model.
Learning and Development	There is a corporate review looking at learning and development across the Council. There exists potential for this to be developed into a trading activity for other organisations – especially in the public sector, but potentially expanding to the private sector in terms of delivering certified courses in recognised subjects or methodologies.
Customer Services	The York Customer Centre (YCC) is being developed towards the delivery of a world class service, in line with the new Customer Strategy. If efficiencies can be achieved to create capacity then the scope for providing contact services, particularly telephony, could be a viable proposition.
Health and Safety	Our Health and Safety Officers have achieved qualifications which would allow them to train other H&S Officers and to carry out assessments on a range of subjects. These services could be attractive to other public sector bodies.
HR and Payroll	The Council is currently running the payroll for 9 organisations, (1 district council - Ryedale, 2 schools - Scalby School/Norton College, the Museums Trust and 5 non profit making organisations - RB Kids Club/Unison/Selby AVS/Community Leisure). With the implementation of

	i-Trent, the ability to offer a comprehensive HR and Payroll solution is significantly increased.
Financial Services	Considering opportunities to trade services through the new Local Authority Trading Company - e.g. debt management services and revenue collection services.
Civils	Services are provided to other council departments and schools on a traded basis. These include specialist craftsman skills and maintenance activities all of which have the potential to be traded.
Highways Infrastructure	City Strategy commission work and CYC bids for it along with other providers. We could bid for work outside CYC area.
Building Maintenance	Mainly for council houses but covers other council buildings (e.g. EPHS, schools) and is provided on a traded basis to other housing associations with homes in the York area.
Building cleaning and general facilities management	Several other councils already trade in these services – it is one of the most common traded services. As far as York is concerned this whole area is subject to an ongoing review.
Grounds Maintenance	Services are provided to other council departments and schools on a traded basis. Could provide these services to other organisations.
Vehicles	Could cover vehicle maintenance for other organisations, or provide MOT service for taxis, the general public, etc.
Commercial Waste	Currently acting as a traded service so could be developed more formally.
Pest Control	Provided to individual members of public and external organisations – could be developed further on a more commercial basis, but is quite a competitive area.
Drainage	Currently acting as a traded service

	so could be developed more formally.
Property Services	Has been developed as a traded service in other councils.
Building Control	Has been developed as a traded service in other councils.
Parking - enforcement	Have previously carried out parking enforcement for the hospital and university so could offer services to other organisations.

-Table 1-

31. The proposed approach is that a gradual phased approach to trading will be developed. This could consist of two to three main activities which are initially developed, and successfully traded through the company. Only once these services are established would further services be considered, as it is felt important to grow gradually and ensure the early services are a success before considering new one.
32. If over time more of these services were to be developed in terms of trading, then it is most likely (but not absolute) that we would look to develop a range of brands that would help to identify, in the customers mind, the place to look for their desired service. This approach would also help us to develop combined and comprehensive offerings which could prove more attractive to potential customers. So, for example, rather than offer services to schools, IT support to schools and HR and Payroll services to schools all as separate offerings, we could look to provide a more comprehensive offering covering all of these options.
33. The council has many brands, the main one, itself, demarked by the council badge. There is also YorOK, Yortime, Energise, and Explore. An important consideration when setting up a brand is to make it future and re-structure proof so that it develops an identity that people become instantly familiar with.
34. Purely as an example of how this may take shape, under the banner of CYT Limited, we could develop branded businesses such as:

- YorBusiness – Business support services covering e.g. financial services, customer services, fleet management, etc;
 - YorPeople – Covering HR and Payroll, learning and development (including training), Health and Safety, and any other people specific services;
 - YorEducation – Around services to schools as described above;
 - YorRecruitment – For the development of the recruitment pool offering;
 - YorDirectServices – Offering a range of commercial services around current CANS services that have trading potential as described in Table 1 above.
35. These ideas would need more formal development and it is anticipated that, due to the time it is expected to take to establish the businesses, it is unlikely that any formal structures, other than the LATC itself as a legal entity, would come into existence within the first twelve months.

Governance and Management structures

36. The governance and management structures and processes are clearly stated in the *Articles of Association* and the *Shareholder Agreement* both of which are available as **background papers (paper 1 and 2 respectively)**. An *Executive Summary* giving the details of the *Shareholder Agreement* is included as **Annex 1** to this paper.
37. Besides the four directors who will make up the Board of the company (as agreed in the paper to the previous Executive in February 2011) it is proposed that a non-executive director also be appointed to the Board to act as Chairman of the board and to represent the shareholder interests. As the company will be wholly owned by the council as the sole shareholder, and due to the anticipated nature of the services that the company will offer, it is proposed that the non-executive director post is filled by the Executive Member for Corporate Services.
38. It is anticipated that further appointments to the Board in the future will need to be considered, both to reflect the type of services being provided, and to provide commercial expertise.

39. **Annex 2** to this document sets out the guidance notes on director duties for those appointed to run the business.
40. **Annex 3** sets out some key operating principles that will be employed to support the successful running of the company.
41. **Annex 4** sets out the intended approach towards staffing and personnel issues that may arise during the establishment and early years of the company's existence.
42. **Annex 5** sets out the business plan for the company, which will be developed/refined on an ongoing basis, and reported to/approved by the Shareholder Committee.

Steps to Start Trading

43. In order to maintain control and ensure that due consideration is given to all potential trading activities –once the company is established as a legal entity and the company board is in place, they will need to approve all new services that trade via the company, subject to necessary Cabinet approvals, and also Shareholder approval via the Shareholder Agreement/business plan of the company. .
44. The process will be as follows:
 - Service area develops a formal business case and business plan detailing the justification for trading and the means by which it will be achieved.

The business case which will need to include details of:

- The current business and any current charging/trading activities that are in place;
- An analysis of the current market including details of any known competitors and the available market share;
- The scope and nature of the proposed business;
- Analysis of the key stakeholders
- A financial analysis showing any required investment appraisal and anticipated financial performance figures;
- A timeline for implementation showing key milestones and resource commitments required to achieve it.

- Legal and staffing implications.
- Both Council Management Team, and the Board of the company will consider the business case and decide whether or not to pursue the proposal. There may be a number of iterations of the business case before a final decision is made. For a defined service area to be accepted as trading via the company will require the Board to sign off the business case, and submit it to the Shareholder Committee for approval.
- If required, the approval of Cabinet will be sought also – this is likely to be in the case of a major decision involving the company e.g. a transfer of a whole service area.
- Once the service is accepted as being traded through the company, the Board of the company will oversee the business development and progress, working with the relevant service area. This will not change the overall managerial responsibilities in most cases, but will require the service area to be accountable to the board of directors for any trading activities.

Council Priorities

45. The LATC will help to support the economy in York by providing new opportunities for staff and companies in the city. Additionally, as a result of increasing competition and competitiveness in the local marketplace, it is usual for the quality of services to improve, providing direct benefits to the customer-base.
46. The LATC may, in the longer term, also provide new prospects for employment either directly in the company, or in the supporting suppliers and customers of that company. This is as well as preserving current staffing roles and enabling staff to develop new skill sets and gain new experience which they may not otherwise have access to within the public sector.
47. The LATC will embrace the council's commitment to:
 - Delivering what our customers want;
 - Providing strong leadership;

- Supporting and developing people;
 - Encouraging improvement in everything we do.
48. The *Key Operating Principles* presented in **Annex 3** will sit alongside these commitments and together they will help to deliver the business objectives of the company.

Implications

49. **Financial** - The Company will need to comply with the regulatory requirements of the Companies Act 2006 and additionally with the regulatory regime for local authority companies under the Local Government and Housing Act 2003. The council must recover the full cost of any accommodation, goods, services, employees or anything else it supplies to the company in pursuance of any agreement or arrangement to facilitate the power to trade
50. **Human Resources (HR)** - As the company will not employ any staff initially, TUPE will not apply to employees. This needs to be monitored on an ongoing basis and would need to be considered further if the trading company were to employ people directly, or council employees were to be transferred to the Company or one of its subsidiaries, at a later date.
51. **Equalities** – A full Equalities Impact Assessment (EIA) will be prepared for the company itself and as part of any business case submitted for services to be considered for trading.
52. **Legal** – Set out in this report. The Assistant Director for Governance and ICT will ensure all legal implications of setting up a wholly owned company are considered and addressed.
53. **Crime and Disorder** - There are no crime and disorder issues arising from this report.
54. **Information Technology (IT)** – The appropriate financial structures will need to be established on the council financial systems. Any new IT applications that the company identifies will be procured through the company but will be hosted on the council's IT platform.

55. **Property** – There are no property implications initially, any property requirements of the company going forward will need to be established and/or funded through the company itself.

Risk Management

56. There will be a need for clear operational control procedures and monitoring. All risks and uncertainties affecting the council's and the Trading Company's position will be identified and mitigation will be put in place. An initial risk assessment was defined in the original paper to Exec in February 2011. A full risk log is now maintained and constantly monitored via the LATC board.

Recommendations

57. Cabinet are asked to approve:

1. The establishment of the local authority company (CYT Ltd), the approval of the Business Case (**Annex 5**) and the general principles of governance and operation as set out in the report. This includes the appointment of the Executive Member for Corporate Services as a non-executive director to act as Chairman of the Board.

Reason: To allow the establishment of the company.

2. To grant delegated power to the Executive Member for Corporate Services to approve the final *Articles of Association*.

Reason: To formally agree the detailed *Articles of Association*.

3. To grant delegated powers to the Leader of the council to formally agree and sign off the *Shareholder Agreement*.

Reason: To enable the establishment of a Shareholder Committee that will regularly review the activities of CYT Ltd., and to monitor its performance.

4. To approve the establishment of a Shareholder Committee, to be made up of the Leader of the Council,(who will chair

the Committee) and two other Members of the council as chosen by the Leader of the Council.

Reason: In order to properly exercise the council's powers and responsibilities as the sole shareholder of the LATC.

5. To agree that the Director of CBSS prepares proposals on which **current** activities provided to external organisations should be considered for trading through CYT Ltd. All such instances will be subject to business case approval by the Council Management Team, the Board of Directors, and the Shareholder Committee.

Reason: to allow a mechanism for existing trading activity with external organisations to move into the Company.

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Wards Affected Not applicable			All
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Background Papers

- Paper 1 - City of York Council local authority trading company articles of association
- Paper 2 - City of York Council local authority trading company shareholder agreement

Annexes

- Annex 1 Shareholders agreement executive summary
- Annex 2 City of York Council guidance notes on directors duties
- Annex 3 Key operating principles
- Annex 4 Staffing, personnel and employment issues
- Annex 5 Initial Business Case