Commercial Councils

The rise of entrepreneurialism in local government

Richard Carr

Foreword by Rob Whiteman, Chief Executive of CIPFA

LOCALIS

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We believe that power should be exercised as close as possible to the people it serves. We are therefore dedicated to promoting a localist agenda and challenging the existing centralisation of power and responsibility. We seek to develop new ways of delivering local services that deliver better results at lower cost, and involve local communities to a greater degree.

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Foreword

Local authorities have experienced a turbulent Parliament, bearing the brunt of austerity, and they are facing an equally torrid time in the next. The future funding of local authorities seems to be at best unpredictable, but what is certain is that new thinking is needed to revolutionise the way local authorities operate both to protect and improve services for their communities.

In this context, this report successfully outlines how local government can secure its finances and boost local growth prospects by developing entrepreneurial approaches. Many councils are already doing an excellent job in exploring these commercial spheres to mitigate against the pressures, but this report recognises that more needs to be done. One of the key ways of doing this is allowing councils to earn their own way by acting more commercially where they can. This new focus would mean services would have to be reassessed and adapted to see how they can both make savings and also generate revenue.

The key recommendation within the report is that the expectation for entrepreneurial councils to generate £2bn additional revenue by 2020 should be extended. This ambition would, of course, require a certain level of pragmatism from local authorities, and also an open-minded approach, which many councils are already demonstrating. But to succeed in this, Localis has correctly identified that Central Government would have to introduce new vehicles to encourage and support such entrepreneurial behaviour. The recommendations include policies that could stimulate growth in municipal endeavours, such as: three year corporation tax holidays for council owned trading companies and giving authorities 'Earn Back' powers. If these initiatives are introduced then a mind-set of growth could replace one of simply cutting services to achieve the targets of fiscal consolidation. Many councils are already on this track, but hopefully if government does more to encourage this then an increasing number of local authorities will follow in their path.

These entrepreneurial local authorities across the country have brought in a combined profit of £1.5bn between 2008 and 2013. This report showcases the new models of service delivery and collaboration that bring in substantial income, while improving services for communities. It also recommends that there should be an annual survey that would highlight these best practices and explore the challenges being faced, an ideal platform to give credit where credit is due.

The message underpinning this report is that entrepreneurial changes will benefit local communities and sustain their access to services, as well as generating income. We are greatly looking forward to seeing local authorities continue to do this by exploring and realising the potential of enterprise to help communities. As now is the perfect time for councils to use the imperative of austerity to modify their services and improve the local government landscape for the long-term.

Rob Whiteman, Chief Executive of CIPFA,
the Chartered Institute of Public Finance and Accountancy

Chapter 1

Executive summary

Local government is facing a perfect storm. The combination of austerity – in the form of falling central government grant – and rising demand, in particular from ageing local populations, is bringing to the fore questions about the long-term viability of the services councils provide. This situation is common across the sector, affecting local authorities of all political colours, geography and type.

Given this context, councils are quite rightly undertaking a range of activities to generate revenue and make savings. Be it spinning out mutuals or setting up joint ventures with public or private partners, the sector is increasingly thinking entrepreneurially about the services it provides and how it does so. They have been aided in this shift by this Government and the one before who both brought in policies to make it easier for councils to operate in a commercial environment.

This burgeoning entrepreneuralism should not be underestimated. Indeed, the sector's combined profits of externally traded services of £1.5bn between 2008 and 2013 exceeded that of companies like JD Wetherspoons (£353m), John Lewis (£885m) and Waitrose (£1.25bn) over the same period. As part of our research into this phenomenon Localis has conducted a survey of 150 key local government figures – including chief executives, leaders, cabinet members and chief finance officers, and the results show that councils are behaving innovatively in a number of ways:

- 94% of authorities share some services with another council;
- More than half of councils (58%) own a trading company, and at the rate it is increasing, full coverage by 2020 is a possibility;
- A majority of councils (57%) operate a joint venture with the private sector;
- Over a third of councils are using entrepreneurial methods in areas such as waste (46%), leisure and tourism (38%), IT/back office (38%) and housing (36%);
- **Without these entrepreneurial activities, eight out of ten councils say they would have to cut services and raise taxes**

However, despite this undeniable shift towards a more commercial outlook, changing the ethos of local government is far from plain sailing. Our research highlights various challenges to facilitating greater municipal enterprise, including the need to ensure that council staff have the skills necessary to enable them to maximise commercial opportunities. And crucially, rising commercialism in councils has to be seen as a positive development, rather than a reluctant reaction to austerity.

With no sign of the financial pressures on local government relenting whoever forms the next government, and demographic change inexorable, we contend that councils should further this entrepreneurial agenda. To facilitate this, we recommend that:

- Government departmental underspends fund a **three year corporation tax holiday for new council owned trading companies**. 73% of councils back this, and we estimate it would cost no more than £72m, £86.4m and £103.4m in successive years up to 2018;

- A **counterparty clause is added to the General Power of Competence** whereby other public sector bodies become subject to its purview when trading with councils;

- Councils are **given 'Earn Back' powers to stimulate particular markets** (including child care and transport); they should also press for a 'Right to Earn Back' all receipts above an agreed budget line threshold;

- Councils and appropriate professional bodies **increase the focus on commercial and financial skills** as part of officers' professional development;

- An annual best practice audit is established to assess local authorities' municipal endeavours and highlight the scale of the sector's entrepreneuralism.

What does the future hold?

Our survey showed that at present entrepreneurial activities currently make up 6% of council budgets – equivalent to approximately £10bn in 2012/13. However, our respondents indicated that by 2020 this figure will rise to 18% - a sum potentially worth upwards of £27bn. We estimate that this would generate up to **£2bn of additional savings each year; a sum equivalent to £100 off each 2019/20 council tax bill**.

Beyond the potential for reduced council tax bills for the nation, there are a number of other benefits to be grasped by furthering the entrepreneurial council agenda.

- Firstly, the citizen-council relationship will improve to be increasingly two-way, whereby local residents understand, support and take part in the innovative new approaches to service delivery that their councils introduce;

- Secondly, we can also expect a more upbeat and reinvigorated local government sector formulated to grow and prosper, rather than just cut and compromise;

- Thirdly, we envisage a more diverse market place with local authorities using the skills derived from public sector partnerships to think creatively about what they do and how they do it;

- And finally, local government becoming the engine room of the public sector by leveraging their positive brand, knowledge and experience, and links to other parts of government, to increase their presence in markets such as facilities management, IT, and back office functions.

Chapter 2

Introduction and policy context

Few areas of the state have borne the consequences of austerity in the past few years more than local government. Spending by local authorities is expected to have fallen almost 30% over the course of the 2010 parliament, largely a product of the reduction in central grant.[1] The LGA has projected that by 2019/20 councils will face a combined annual funding gap of £14.4bn – mainly through the increased funding pressures around child and adult social care squeezing resources (and, in the short term, reserves) elsewhere.[2]

This is in the much broader context of ongoing austerity for the nation – all parties are now in agreement that the spending squeeze will continue into the next Parliament.[3] Indeed the Chancellor's 2014 Autumn Statement and the 2015/16 Local Government Grant Settlement which followed – cutting council's spending power by an average 1.8% – have starkly highlighted the fiscal challenge that local government faces.

This squeeze on spending is set against an ageing population, with the number of over 85s to quadruple by 2064, with the resultant increase in pressure on services.[4] This perfect storm for local public services has acted as a catalyst for local public service reform and put councils under increasing pressure to boost local growth prospects.

In response, the Coalition Government's wider Open Public Service programme, combined with a plethora of new models of local service delivery – extensively surveyed in our earlier report, *Catalyst Councils*, but briefly including strategic commissioning; sharing services; joint delivery vehicles; mutualisation; and trading services – has taken root and is leading to more efficient services. But it is unclear what the future holds, what the drivers of future service reform will be and how councils will grow beyond their shrinking budgets.

By outlining opportunities for councils to think and act commercially where appropriate – in short, to help earn their own way – this report forms a positive intervention into this space. It suggests that new thinking is needed about how local government raises revenue and details how this approach might mitigate some of the pressures outlined above. It draws on new data from a survey sent to council leaders, deputy leaders, cabinet members for business and the economy, chief executives and chief finance officers. It offers a range of views from interviews conducted with such figures, and builds

1 http://www.publicfinance.co.uk/news/2014/08/council-spending-cut-by-nearly-one-third-since-2010/

2 http://www.local.gov.uk/finance/-/journal_content/56/10180/4057616/ARTICLE

3 http://www.local.gov.uk/c/document_library/get_file?uuid=b9880109-a1bc-4c9b-84d4-0ec5426ccd26&groupId=10180

4 http://cdn.budgetresponsibility.org.uk/41298-OBR-accessible.pdf

on a roundtable discussion held with key local government stakeholders. As one participant put it, the key question is 'what does the local authority need? Finance is clearly a driver, but how do we leave the community better than we found it?'[5] Entrepreneurial councils, we argue, can be a strong part of that process.

Importantly, all this doesn't reinvent the wheel. Councils raise some £11.3bn through fees and charges each year, and £1.1bn more through externally traded services. Without the former, council tax bills would have to be 50% higher to make up the shortfall. Without the latter underpinning their salaries, 31,751 teachers would have their jobs at risk.[6] Municipal enterprise is therefore already present across the country. In 2011/12 one in three district councils saw revenue from fees and charges exceed that of local council tax receipts.[7] There is much on which to build for councils of all political persuasions.

Residents also broadly get the point here. In an August 2010 YouGov survey, 56% of people believed that 'it is fair for councils to charge for certain service, providing this money helps protect other services.' A further 19% argued that councils should charge 'a lot more for services than they do at present and use the money to cut council tax.' Less than one in seven plumped for a council tax rise as an alternative method of plugging funding gaps.[8]

Such pragmatism is clearly necessary. As we have seen, markets can fail, global downturns happen, and central government can cut expenditure. If local authorities want to future proof themselves against these realities, such a proactive and open approach will be needed. As David Laws has argued, it is in councils' interests to 'take responsibility for themselves.'[9]

Municipal enterprise has long term precedent in British politics, and not just in the oft-cited example of Joseph Chamberlain. In 1955 the Labour MP Tony Crosland's famous book *The Future of Socialism* encouraged councils 'to branch out into new spheres since there are some which seem eminently suitable for local enterprise.'[10] There he built on Harold Macmillan's 1938 backing for the 'economic and social importance' of municipal trading.[11]

Until recently however, legislative support for this agenda has been limited. Historically, councils could not act *'ultra vires'* – i.e. beyond their powers as specified in statute. The 1970 Local Authorities Act gave councils powers to trade with one another and with other public bodies. Legislation in the 1970s and 1980s then allowed local authority encroachment into other commercial undertakings, but this was always strictly limited to centrally mandated areas. The 2000 Local Government Act then granted a general 'well-being power', providing general license to undertake functions which promoted the 'economic, social and well-being' of the inhabitants in their area. This was soon followed by the 2003 Local Government Act's permitting councils to trade 'ordinary functions' for 'a commercial purpose'.

The 2000 and 2003 Acts certainly helped, but it has taken the post-2008 downturn to fully shift perspectives. All the major parties now recognise the need for further devolution of both powers and funds to help meet the coming challenges. The Coalition's 2011 Localism Act included a General Power of Competence which expanded the remit of councils to undertake any action that was not explicitly prescribed by existing law – fully and finally overturning the 'ultra vires' restrictions.

5 Roundtable participant (hereafter RTP)

6 Average teacher's salary via http://www.telegraph.co.uk/education/educationnews/10141810/Teachers-in-England-paid-higher-salaries-than-those-in-most-other-countries.html. Also factoring in 20% of on-costs.

7 http://www.audit-commission.gov.uk/wp-content/uploads/2013/09/Fees-and-charges-VFM-briefing-FINAL-for-web-23-Sept-2013.pdf

8 Via http://static.bdo.uk.com/assets/documents/2010/09/Revenue_and_Charging.pdf

9 http://www.telegraph.co.uk/news/politics/liberaldemocrats/10706278/David-Laws-Councils-should-charge-for-services-like-bin-collections.html

10 Crosland, A. *The Future of Socialism*, (London, 1955), 383.

11 Macmillan, H. *The Middle Way*, (Basingstoke, 1938), 138-139. During the 1930s indeed, English and Welsh local authority trading services raised £100m each year – equivalent to around £4.5bn today, or over four times the present externally traded figure of £1.1bn.

More recently, the city deals and local growth deals agendas have given England's cities and counties the opportunity to negotiate a bespoke devolution of powers from Whitehall – a process that has gained enhanced momentum in political spheres since the Scottish independence referendum and its aftermath. And, since 2013, the new business rates system has allowed councils to keep a percentage of the growth in their local rates.[12] Arguably, both the opportunities and rewards for entrepreneurialism are growing.

The philosophy behind public service delivery is changing too. For their part, the Opposition has pointed to 'new ways of working, improving procurement and working with the private sector to get better value for money' in their 'zero-based' spending review.[13] This is not rhetorically so far removed from the Government's 2011 Open Public Services White Paper which aimed to avoid the 'ideological presumption that only one sector should run services: high-quality services can be provided by the public sector, the voluntary and community sector, or the private sector.'[14] In an *inward* looking sense then, the end goal must be about delivering on the needs of local residents, not appeasing either private, public or any other vested interest.

But there is also a tremendous *outward* looking opportunity. Councils spent £154bn in 2012/13 and own assets worth £170bn.[15] Including their pension funds, this is a potential half-trillion pound industry which can borrow cheaply and is trusted by local communities. In business terms, it would be surprising if councils *weren't* looking for commercial opportunities.[16]

Importantly, by 'entrepreneurial' and 'commercial,' we often mean producing bankable returns for the public purse. But this is not the only goal. Developing new markets or influencing existing ones, creating jobs, equipping residents and/or council staff with skills, or using commercial means to forge positive relationships with private, public or voluntary sector partners – these are all returns, and ones councils would reap some profit from.

With all that in mind, this report is structured in three main sections:

- The first reviews the current lay of the land – what authorities have and are doing in a commercial vein.
- The second outlines the issues and potential barriers our research has thrown up, and some reforms to help address them.
- And the third looks to what this entrepreneurial future augurs, what the world of 2020 could be like and the wider benefits – financial and social – this may bring.

12 (though still subject to a centralised formula of levies and top-ups)

13 http://www.yourbritain.org.uk/uploads/editor/files/Zero_Based_Review.pdf

14 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/255288/OpenPublicServices-WhitePaper.pdf; 'Equally,' the paper notes, 'it is clear that poor-quality services can occur in any sector.'

15 http://www.audit-commission.gov.uk/2014/06/can-local-governments-2-5-billion-surplus-assets-be-put-to-better-use-2/

16 £178bn under management.

Chapter 3

The current state of play

Where are we now?

Local authorities have adapted and are ambitious to react to tough economic times in a positive way, often a good deal more flexibly, sensibly and imaginatively than Whitehall. Councils across the country have reassessed their methods of public service delivery in the interests of efficiency, adaptability, and value for money. The sector has looked beyond incremental efficiencies and instead developed a range of innovative methods of service delivery, which have generated significant cost savings and/or income generation. The result has been that they have continued to achieve positive outcomes for local people despite the shrinking of traditional sources for funding. This process, our survey illustrates, is taking many forms.

Survey data

Our survey points to **significant existing entrepreneurial activity**:

- 94% of councils currently share a service with another council
- 91% use assets such as land in an entrepreneurial manner
- 62% operate joint ventures with a neighbouring council, as well as 57% with the private and 54% with the voluntary sector
- 38% invest money in private sector enterprises

Our research also shows that **no sector is off the table. There were no areas we surveyed where a majority of councils could not at least see the case for greater entrepreneurialism**.

Across the board, between two–thirds and four-fifths of councils do or would provide energy (73%), facilities (75%), IT/Back Office (73%), legal services (67%), and waste commercially (77%).

Future boom areas look likely to be[17]:

- Legal services (24% of authorities currently, 43% considering)
- Facilities (25% of authorities currently, 50% considering)
- Waste (46% of authorities currently, 31% considering)

17 The survey had 150 respondents from local government stakeholders across the country.

In previous reports *Commission Impossible* (2011) and *Catalyst Councils* (2012), Localis offered a range of recommendations on such innovative ways of working. Not only do the models that have begun to take root exemplify entrepreneurial theory, they also indicate the various ways in which councils are modifying their operation in practice. We highlight the latest such initiatives in the rest of this chapter.

i. Commissioning

Localis suggested in *Commission Impossible* that today's councils have a 'once in a generation' opportunity to take a more strategic approach towards commissioning. The report defined strategic commissioning as 'the process of identifying needs within the population and developing policy direction/service models and the market to meet those needs in the most appropriate and cost-effective way'. This report acknowledged that there is no one correct way to conduct strategic commissioning, but rather that each council's efforts should be consistently tailored to the unique requirements of their local area.

Since *Commission Impossible*'s publication, a growing number of English councils have entered partnerships with organisations spanning the private and third sector; indeed, a 2013 memorandum to the Department of Communities Local Government recorded that 82% of council leaders and chief executives want to take on a greater role as strategic commissioners.[18] This transition to strategic commissioning is also contextualised in our survey data, with 57% of councils operating joint ventures with the private sector and 54% with the voluntary sector.

Strategic commissioning is about delivering the best outcome through whatever means can achieve this – be it keeping the service in-house or by commissioning the service from the public, voluntary or private sectors. As detailed in the Localis pamphlet *Meeting the challenge in Barnet*, Barnet Council has developed partnerships with all three sectors, as well as keeping some services in-house.[19]

The tri-borough of Hammersmith & Fulham, City of Westminster, and the Royal Borough of Kensington & Chelsea is another example, in this case of local government pooling resources in order to commission a voluntary sector partner – ADVANCE – to assist their efforts to rehabilitate offenders.[20] The point is that it is the end and not the means that matter most in service delivery.

ii. Community or Whole Place Budgets

Community budgets – introduced in 2010 as a means of pooling resource across siloed departmental boundaries – have increased in profile since Localis analysed their effect in *Catalyst Councils*. In January 2013, another report by Ernst & Young in association with the Local Government Association (LGA) estimated that community budgets could deliver a net benefit of between £9.4 and £20.6bn.[21] The LGA has also suggested that community budgets be one of the three principles that underpin the next government's work.[22]

18 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/79079/Mutuals.pdf

19 http://www.localis.org.uk/images/loc_barnet_commissioning_web.pdf

20 http://www.advanceadvocacyproject.org.uk/#/advance-minerva/4545402738

21 http://www.lgcplus.com/Journals/2013/01/10/c/l/x/LGA-and-EY-Community-Budgets-Report-.pdf

22 http://www.local.gov.uk/documents/10180/6341755/LGA+Campaign+2014+-+100+Days/8255560f-7c96-432f-bbfe-514d3734a204

Central government indicated its support for the community budget model by granting an extra £4.3m of investment to ensuring the model reached 100 new areas.[23] Despite the potential benefits of community budgets, however, there is a sense across local government that Whitehall is unwilling to devolve the powers and funds necessary to let community budgets become a truly successful alternative means of delivering public services. Ernst & Young's report noted that those responsible for the pilot community budgets had 'consistently pointed out that to deliver change on the scale they envisage there has to be change not only at a local level but also in Whitehall.'

iii. Traded services

The 2003 Local Government Act granted local authorities the power to trade in activities related to their functions through a trading company. Since the 2011 Localism Act, they have been permitted to generate a profit through external trading in all services (excepting those they have a duty to provide for free) and, at the same time, to charge for any in-house discretionary service on a purely cost recovery basis.

In 2010 a BDO-IPSOS MORI survey of council chief executives suggested that 15% of all local authorities had started a trading company, and 25% were considering doing so.[24] If projected across all 353 English authorities this would equate to 53 trading councils in 2010 and a further 88 considering joining that group.

Survey data

Our survey indicates that previous projections regarding take up of trading powers may have significantly under-estimated their appeal. **Over half (58%) our respondents indicated their council currently operates a trading company which, if reflective of the national picture, would indicate 205 authorities are currently utilising these powers**.

In September 2013, Leeds City Council established Civic Enterprise Leeds Ltd – a new company sitting alongside the authority's existing commercial arm and capable of providing services for the council.[25] With 3,000 staff and a turnover of £90m, the service is ambitious and hopes to attract business from both national and multinational customers. Leeds City Council is not alone in its efforts to become more enterprising, commercially-minded, and profitable. Over the course of 2014, multiple councils (both upper and lower tier) have either launched trading arms or announced their intention to do so.[26] For example, in March of this year Nuneaton and Bedworth BC launched a trading arm that intends to rent out properties on a commercial basis for a projected profit of £50,000 per annum.[27]

Such activity adds up. Externally traded services have largely ridden out the economic downturn successfully, and have proven a stable income stream in tough economic times.

23 http://www.local.gov.uk/community-budgets/-/journal_content/56/10180/3691921/ARTICLE

24 http://static.bdo.uk.com/assets/documents/2010/09/Revenue_and_Charging.pdf

25 http://www.themj.co.uk/Leeds-plan-to-set-up-trading-firm/194609

26 http://www.localgov.co.uk/Leeds-Council-to-set-up-trading-arm/28640

27 http://www.themj.co.uk/Council-uses-grant-to-launch-new-trading-arm/196492

Income, expenditure and profit of English local authority external trading services (£m)[28]

	Income	Expenditure	Profit
2006-7	1093	799	**294**
2007-8	1104	792	**312**
2008-9	1139	828	**311**
2009-10	1158	886	**272**
2010-11	1130	838	**292**
2011-12	1131	815	**316**
2012-13	1092	791	**301**
Average	**1121**	**821.3**	**299.7**

As this data shows, traded services are generating a much needed £1.1bn each year for English local government, and £300m in profit (the latter figure equivalent to that generated by energy giant E.ON in 2013).[29] Councils are trading successfully.[30]

Case study: Kent Commercial Services[31]

Kent County Council has operated an independent, market-facing commercial services arm since the 1960s. As of 2014 its market penetration extended to most of the South East of England (from Essex to Berkshire and 70% of London Boroughs). It is increasingly reaching out to other parts of England however – notably the West Country, Jersey and Guernsey. All in all its procurement, facilities, staff care, bulk buying energy (Laser and Lumina) and other public sector facing services are sold to over 20,000 customers in public and private sectors.

Kent Commercial Services (KCS) is entirely self-funded – a long-term exemplar of an independent funding stream. It is required to deliver a 'significant' dividend to the council from its revenue and broking fees of around £500m a year – and in excess of £7m was achieved in 2012/13 alone (the equivalent of 1.5% off every council tax bill in the county). Almost 700 council staff were employed by KCS and its various subsidiaries. Last year all staff transferred from the council to KCS Ltd.

Having raised £1.5bn in profit between 2008 and 2013 local government can bullish about its trading record. This amount exceeds, for example, the profit of JD Wetherspoons (£353m), Waitrose (£1.25bn) and John Lewis (£885m) over the same five year period.[32] Local government can do business, and do it consistently well.

A recent trading survey by the Association for Public Service Excellence (APSE) showed that, of authorities operating a trading vehicle, 72% are returning a profit.[33] The report also argues that '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.' We agree – and touch on potential reforms in our next section. Given the precedent, the sector can afford to be confident and ambitious in its future trading plans.

iv. Shared services

Commission Impossible cited the sharing of services as a means by which councils could reduce inefficiency in the delivery of public services. *Catalyst*

28 All via DCLG, Local Government Financial Statistics 2010, 2011 and 2014.

29 http://www.theguardian.com/business/2014/mar/12/eon-uk-profits-cost-energy-big-six

30 Major revenue spinners currently include investment properties (generating a £152m net profit in 2012/13), toll bridges and roads (£7m profit), and car parks (£4m profit). Assets which are losing money include museums (£2.2m in 2012/13), theatres (£2.6m), and civic halls (£3.7m). Such cross-subsidy is of course part and parcel of government, though opportunities to improve this position should not be blindly dismissed.

31 Information supplied by Kent County Council.

32 http://www.jdwetherspoon.co.uk/home/investors/latest/final-annual-report-2013.pdf and http://www.johnlewispartnership.co.uk/financials.html

33 http://democracy.york.gov.uk/documents/g6676/Public%20reports%20pack%2004th-Oct-2011%2017.30%20Cabinet.pdf?T=10

Councils concurred, stating that shared services 'offer a locally-responsive and flexible way of working with neighbouring councils...in order to secure efficiencies'. It also emphasised that the sharing of services delivered efficiency by disregarding arbitrary administrative boundaries that are often no more than 'historical-political bureaucratic constructs.' This chimes with recent experience. A survey by the LGA found that some 96% of councils were involved in some kind of shared service agreement, and that such agreements were estimated to have saved councils around £357m over 2013.[34] Our survey indicates a similar take-up (94%).

Councils are taking shared services in bold directions that promise significant savings and improved efficiency. Kensington & Chelsea, Westminster City, and Hammersmith & Fulham Councils have been sharing adult care, children's services, and library services since 2011 as part of their tri-borough agreement.[35] This goes beyond London; for example, in May 2014, Cheltenham, Cotswold, Forest of Dean, and West Oxfordshire DCs established a jointly owned company to provide services for all four councils.[36] If this plan advances, then all four councils may soon cease to directly employ any of their own administrative staff.

v. Mutuals

The Cabinet Office has defined mutuals as organisations that have 'left the public sector to provide public services (under contract) and in which employee control plays a significant role in its operation'. Both *Commission Impossible* and *Catalyst Councils* interpreted mutuals as a promising and novel form of service delivery. *Commission Impossible* remarked that they were suitable models for delivering community-led services in areas where potential for profit is limited, or where existing arrangements had proven ineffective.

Alongside the creation of the Mutuals Taskforce in 2011, and the Mutuals Support Programme in 2012[37], Parliament has passed laws to facilitate the process by which employees can take over the services they deliver. The 'right to provide' powers afforded council staff 'new rights to provide services as staff-led enterprises and bid to take over the services they deliver' from March 2011.[38] In particular, they require councils to consider suitable proposals from front line staff who want to take over and run their services as mutual organisations. We argue for a more proactive stance in this report.

More recent support has come via the creation of a £1m fund launched by central government last year to support extending the mutual model.[39] The success of mutuals is reflected in the July 2014 announcement that the 100th public service mutual has been created, a dramatic increase from just nine mutuals in 2010.[40] Some of these mutuals have become large and promising organisations. For example, the 'Leading Lives' mutual in Suffolk, dedicated to providing council care and support services, now employs 500 staff of whom 70% are members of the mutual.[41] It is estimated that, all told, mutuals currently deliver services worth almost £1.5bn.[42]

Survey data

Our survey shows **24% of local authorities have spun out employee owned mutuals**

34 http://www.localgov.co.uk/Shared-services-save-councils-357m/36169

35 http://www.lgcplus.com/news/london-tri-borough-shared-services-to-be-reviewed/5071307.article

36 http://www.lgcplus.com/news/four-districts-plan-to-cease-employing-own-staff/5071368.article

37 https://www.gov.uk/government/news/mutuals-support-programme-2-years-on

38 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/330615/Right_To_Provide_-_EOI_Guidance___Template.pdf

39 https://www.gov.uk/government/news/central-and-local-government-team-up-to-improve-local-service-delivery

40 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/79079/Mutuals.pdf; http://www.lgcplus.com/news/social-enterprise/nearly-100-social-enterprises-work-in-public-sector/5072637.article

41 http://www.theguardian.com/social-care-network/2014/apr/30/social-care-mutuals-experience-spin-out

42 https://www.gov.uk/government/news/cabinet-office-mutuals-reach-century-success

Mutuals are important for commercially minded councils because they offer a potential way around prescriptions of what local authorities may charge for, or trade for profit in. Setting up a staff-owned mutual in an area that would fall under a council's statutory service provisions is a means many authorities are using to generate a new income stream – particularly rent and business rates. The council may well wish to forgo elements of both these revenue streams in the first year of any mutual to aid with the start-up process. We deal with a version of this in the next chapter.

vi. Today's commercial councillor

Before we turn to the future it is worth dealing with one falsehood. There is something of a caricature that councillors can be either inflexible or somewhat out of touch with the realities of modern, business life. These types could not, so the argument goes, assume the role needed of them in this new world of joint ventures, trading companies and so forth. Supporters of that view may point to the fact that the percentage of councillors who are retired has steadily increased from 37% in 2001 to 47% in 2013. And yet, leaving aside the lengthy business acumen, contacts and local know-how such retirees can bring, there is the important matter of the thousands of councillors with some form of ongoing commercial activity.

In terms of those councillors currently in work, there has been a marked 'entrepreneurialisation' of local government in recent years. With an increase of 36% to 39% of those in managerial and executive roles, and a rise from 28% to 33% of 'professional or technical' types, over seven in ten (73%) of councillors in work currently juggle their electoral responsibilities with entrepreneurial positions of one form or another. In-work councillors are more often working in the private (65%) or voluntary (8%) sectors than they were in 2001 (61% and 6% respectively). And, interestingly, councillors in the East Midlands, East of England, South East, South West and Yorkshire and the Humber are more likely to have a private sector background than their London equivalents. Commercial acumen is not limited to the capital.

Councillors tend to be highly qualified individuals – almost six in ten (59%) hold at least a degree level qualification or equivalent, far exceeding the general English average (35%). There is some regional divergence here – 3 in 4 councillors in London hold an NVQ level 4 compared to just over 1 in 2 in the East Midlands but, by this measure at least, councillors hold higher qualifications than the average citizen in every region of the country.[43]

As Localis has argued previously in Catalyst Councils, Councillors must continue to exert influence, as well as fulfil the role of community champion and primary representative of local residents.' The Government's Open Public Services White Paper was quite clear on this: 'the state has a key role in defining outcomes, and in setting standards for public services and ensuring that they continue to rise.' Councillors are therefore moving from a world in which their local authorities are monopoly providers of services to one where the quality of outcomes increasingly trumps the means of delivery. We deal with this, and the environment it may produce, in the following chapters.

43 All data via Kettlewell, K. and Phillips, L. (2014). *Census of Local Authority Councillors 2013* (LGA Research Report). Slough: NFER http://www.nfer.ac.uk/publications/LGCL01/LGCL01_home.cfm

Chapter 4

Challenges, issues and barriers to a more entrepreneurial approach

4.1 The challenge of entrepreneurialism

While not short on innovation, the approaches outlined in the previous chapter are still maturing. And despite the reforms of the Coalition Government, England remains one of the most centralised countries in the western world- as a percentage of GDP, sub-national revenue raising in England is less than a third that of the next-nearest major OECD country.[44] Momentum for devolution is growing however with the zeitgeist of the Scottish Referendum debate. And the announcement that Greater Manchester will gain a directly elected mayor with powers and budgets regarding transport, housing, planning and policing, as well as the combined authority receiving control over a £6bn health and social care budget, is clearly a major step forward for decentralisation.[45] More devolution deals are proposed for other parts of England.

In the context of this push back against decades of centralisation, combined with the harsh reality of what public sector delivery would look like in 2020 were local government to continue to simply salami slice their services to meet ever dwindling budgets and ever increasing pressures – never in living memory has there been such a case for an entrepreneurial approach.

This report is positive on municipal entrepreneurialism – both currently and at the increased scale that we predict it will reach in coming years – but three overarching principles articulated by our interviewees must be stressed:

1. It must be a managed process which builds on the good, works with existing cultures, and doesn't take a sledge-hammer to every existing practice. As one interviewee put it, 'staff need a lot of support [and time] to develop an entrepreneurial mindset.'
2. As another suggested, 'it's important that in taking products and services to market that we only seek to trade where it meets our core priorities.' Profit and revenue generation is only a means to an end: better outcomes for residents.
3. Equally, as an officer from a Labour-led council put it, 'our entrepreneurial

44 Tony Travers, p.7 http://www.local.gov.uk/c/document_library/get_file?uuid=25a4547d-bc7e-415f-b1eb-7ed57070d66e&groupId=10180

45 https://www.gov.uk/government/news/manchester-to-get-directly-elected-mayor and http://www.bbc.co.uk/news/uk-england-manchester-31615218

> activities are an inherent part of the way we do business, [and] are having a benefit in the local community as well as generating income for the Council. As central government funding reduces, this helps to offset the impact and continue services for local people.'[46]

There will be no one-size-fits-all template for the future entrepreneurial council. As the LGA notes in its 2012 guidance on trading councils, there are at least three different potential goals for this form of entrepreneurialism alone: delivering value for money for users; sustaining communities' access to services, and providing greater choice.[47] Given this multiplicity of outcomes, it is perhaps no surprise that the methods of achieving such ends will differ from across the country.

What we can say with some certainty is that councils will be doing more of these activities. Indeed, given the size and immediacy of the fiscal challenge ahead, it is hard to believe that the pace with which councils are adopting entrepreneurial approaches won't quicken further. Without such entrepreneurial endeavour, after all, eight in ten respondents to our survey indicated they would be forced to cut services or raise taxes – the entrepreneurial council is already proving something of a third way between these choices. However, as detailed below, there are several issues and barriers to overcome.

4.2 Changing the ethos of local government

As one of our interviewees noted, a return to 'municipal enterprise' is a difficult challenge, but one worth taking on: 'it's about reclaiming the language for local government. It's almost as if you are committing a sin to talk of private sector involvement. But when you look at the way things used to be done you saw some great local enterprise.'[48]

They continued: 'cultural change is happening. Let's be clear: the language of shared services, joint ventures etc. would have been totally alien to the public sector forty years ago. Yes – we still have problems around siloed thinking, but local government should get the credit for adjusting to the new world.'[49]

This is certainly true. But three challenges remain:

1. up (or re-) skilling council staff to maximise commercial opportunities,
2. changing the way local government works to make such enterprise possible;
3. and winning the internal battle that both of these can fundamentally be positive developments.

Improving skills to maximise commercial opportunities

On the first, as a northern councillor put it to us, 'staff need knowledge. At a basic level, short term business courses would put them in the right mindset. But, at a more fundamental level, we need to think creatively about council hierarchies. How do you think creatively in a council where everything has to be signed off five times? This is a trust issue: we should be saying, commercialism is what you'll live or die by, so here are the tools to do just that.'[50] Another noted that 'the conditions of local government have been designed to keep a steady state, and not to change. Structures, budgets and processes are all designed to keep councils on an even keel, and not to innovate.'[51]

46 Survey.

47 http://www.local.gov.uk/c/document_library/get_file?uuid=f8aaa25f-81d6-45c9-aa84-535793384085&groupId=10180

48 Interview E.

49 Interview E.

50 Interview B.

51 Interview D.

This all suggests a degree of initial hand holding is necessary. As one respondent noted, 'staff need a lot of support to develop an entrepreneurial mindset. We have had to invest a lot of time on this.'[52] This report is positive on municipal entrepreneurialism, but it must be a managed process which builds on the good, works with existing cultures, and doesn't result in taking a sledgehammer to every existing practice.

Survey data

Our survey indicates that in-house skills are certainly an issue. Over half our respondents indicated that in-house skill sets were the biggest barrier to councils being entrepreneurial. That said, they also indicated that these were already improving. 8 in 10 suggested that 'prior experience of the entrepreneurial activities' this report discusses had 'helped [their council deliver better outcomes during subsequent commissioning processes.' Likewise, 9 in 10 believed improving in-house skill sets to be a key factor when considering 'a more entrepreneurial approach.'

Adequate commissioning skills are vital, as Localis argued in *Catalyst Councils*. The perception that local government commissions ineffectively when it comes to private sector involvement is one half of a pincer movement that can stifle creativity. The other, which we discuss with relevance to the General Power of Competence later, is that councils remain on shaky legal ground when attempting anything commercial.

This can lead to passing up important opportunities. As one council officer noted, 'how do you get people to see we want to work with business and that there is nothing wrong with profit? This is a big cultural challenge. You have to be able to spell that out to decision makers in the private sector – and, at present, it's just not seen as a priority.'[53]

As noted by the Society of London Treasurers, if local government is to receive more financial powers, it is important that councils have the capacity and skills to make best use of those powers.[54] We therefore recommend that:

- **councils and appropriate professional bodies increase the focus on commercial and financial skills as part of officers' professional development**

Reforming councils within to promote enterprise

A related issue our interviews have highlighted is that 'the bureaucracy of "we've always done it this way" is hard to budge.' Local authorities carrying out statutory powers X, Y, and Z to the prescribed lines – no more, no less – is something that will have to shift. And part of this may lie in moving beyond traditional structures. As a council leader noted, 'people aren't thinking of expanding. But they should. Local government can be smaller but bigger.'[55] Rather than one hundred percent control over all undertakings – in any case, as said councillor noted, 'always under the old central strait jacket' – local government both can and should begin to conceptualise a wider role where private and public combine. An interesting area is credit unions – and such low-risk, relatively press-friendly activities may form a useful way for local government to dip its toe commercially.

52 Survey

53 Interview C.

54 Society of London Treasurers (2014), *Capitalising on the Boroughs*

55 Interview E.

Case study: Local authorities and credit unions

Credit unions are mutual institutions which offer a series of retail finance products – principally savings and loans. From 1979 until 2012 membership of a credit union was restricted to individuals, all of whom had to have a 'common bond' – usually geography or employment related. Since 2012 however, credit unions may reach out to organisations including businesses and, crucially, local authorities. Such non-individual membership may account for 10% of a union's total loans, and 25% of non-deferred shares.

Many councils have taken advantage of this new opportunity for two reasons.[56] The first is to combat the growing market (at £2.5bn per annum in 2013[57]) for high-cost, short-term credit (commonly known as 'payday lending'). Salford Council has announced its plans to run its entire payroll through its local credit union – dubbed "the Bank of Salford" – and is encouraging local businesses to do likewise to help its credit union build its asset base.

With three lenders accounting for more than half the payday loan market and APRs reaching 4000% and upwards, there is a clear opportunity to undercut this position (credit unions are constrained by the 2012 legislation at 42.6% APR). Some councils are seeking to curb payday lender's advertising and high street footfall, but they may also seek to provide market additionality themselves.[58] In November 2014 the Financial Conduct Authority introduced a total cost cap on debt repayments at 100% of the sum borrowed – such increased council endeavour would complement this position.

Secondly and importantly, all this is not mere charity. Credit unions provide an annual dividend between 2% and 3%, sometimes higher. The wider benefits are also clear. A report by the University of Salford noted that for every £1 invested in financial inclusion in Leeds, '£8.40 is generated for the regional economy…on this basis it should be seen as an economic issue and not exclusively a social one.'[59]

Changing mindsets within local government

Much of this remains cultural. It is clear some internal reticence remains regarding unleashing the commercial power of local authorities. Given their successes in areas such as trading, the multi-million pound savings delivered through various joint ventures, and the wider positive externalities municipal enterprise has and is producing there is a pressing need to publicise such success stories. 'Confidence' has been a word used by several respondents to our survey, and it does seem to be the nub of the matter.

As one roundtable participant noted, 'people don't want to own brave decisions. They see the risk of commercialism at odds with why they joined the public sector in the first place.'[60] Some are getting around this conundrum through language shifts: 'the word profit would never be used. We're always *earning* £Xm extra.'[61] Others are noting that 'over the past four years, we have become less risk averse. Yes, not everyone who joins local government is a commercial whizz, but they do have skills the previous benevolent financial situation perhaps kept buried.'[62]

56 Over the past twelve months Ipswich and Dudley councils have invested the maximum of £15,000 in their local credit unions, whilst Liverpool City council has put a £1m grant into 7 local credit unions.

57 http://www.fca.org.uk/news/fca-proposes-price-cap-for-payday-lenders

58 http://www.telegraph.co.uk/finance/personalfinance/borrowing/loans/10198397/Plymouth-City-Council-bans-payday-loan-adverts.html

59 http://usir.salford.ac.uk/19122/1/ec_impact_report_final_web_version.pdf

60 RTP.

61 RTP.

62 Interview F.

To help alleviate this concern, when commissioning a joint venture with/procurement of a private sector firm, councils should look to build in skills training elements for existing staff. As the Audit Commission noted in 2008, 'councils will need improved leadership and negotiation skills in order to lead a multitude of partners in a complex setting.'[63] This is truer than ever as entrepreneurialism picks up pace. Several respondents to our survey pointed out that, over time, the nature of the local government workforce would have to evolve.

The Audit Commission also noted that 'many councils face intense competition from the private sector and other public services for skilled people. They need to respond by becoming an employer of choice and by improving the local government brand.'[64] Initiatives such as the National Graduate Development Programme are a commendable start, but until local government is able to offer the opportunities for career development seen in the big private sector firms it will struggle to compete.

This is not just about salary – but about what ambitious graduates can do with the first ten to fifteen years of their career. When bright graduates from a particular area do not return to work for the council but instead join, for example, a leading consultancy this should not be simply viewed as 'local man/woman makes good,' but a potential brain drain from the authority's talent pool. With 68% of the population of England living outside London and the South East, northern authorities in particular have a wide base on which to call. We discuss both issues later, but sharing services and working in partnership with other authorities is a clear opportunity in this regard – rather than being pigeon-holed into maintaining provision in district council Y, there are opportunities to create exciting and dynamic positions which look beyond a particular geography and service area.

Local government remains uncommercial in some ways. On average, less than one day was afforded to council workers for off-the-job training in 2012/13. According to the same LGA survey, less than a third of councils have a formal mechanism for spotting talent amongst employees. Over two thirds of councils surveyed use time served as the major mechanism for increasing pay, rather than performance (less than a quarter).[65] At the very least, councils should be using the current need for financial innovation to assess how their workforce can become more dynamic. Local government can be building on current best practice.

To help highlight such achievements (and give advocates of municipal enterprise an annual boost), the National Audit Office could be charged with producing an annual survey to all 353 English local authorities asking them a set of uniform questions on their municipal endeavours. These could include quantitative estimates such as aggregate profit/losses from joint ventures, in-house charging, trading companies, and other endeavours discussed in this report (and beyond). It could also ask for qualitative interpretations of the annual performance and value for money of each method. Given its importance (local government spending constituting a third of the national), at the very least the Chancellor could publicise the findings from this survey each November/December at the Autumn Statement. The mere repetition of £300m+ of annual trading profit, after all, would be a positive development. We therefore recommend that:

63 http://archive.audit-commission.gov.uk/auditcommission/sitecollectiondocuments/AuditCommissionReports/NationalStudies/TomorrowsPeople.pdf

64 Ibid.

65 http://www.local.gov.uk/documents/10180/11627/Workforce+Survey+2012-13+report+FINAL.pdf/0fc54739-7fe6-41db-8cea-57deab587bc8

- **local authorities' municipal endeavours be assessed in an annual survey to highlight best practice**

4.3 Raising the capital

It is worth briefly noting the advantages councils hold when it comes to launching a new entrepreneurial endeavour. The first is their combined reserves which currently stand at £21.4bn – though with significant variance in size of authority.[66] The second is the implicit subsidy they enjoy due to the widespread perception that central government is unlikely to let a local authority go bust – indeed local authorities are required by law to run a balanced budget. This implicit subsidy is not of the gargantuan scale of that afforded to major financial institutions like high street banks (tens of billions a year according to the Bank of England[67]), but it is true that councils can borrow at a cheaper rate than many businesses because, in effect, they have a parent company (central government) who lenders believe would step in in the case of ultimate default.[68] The rate of the Public Works Loan Board (PWLB), discussed below, also sets something of an upper limit on the terms banks are likely to successfully demand.

And banks are indeed part of this overall picture. Since 2003 councils have been able to borrow money from the private sector as long as the terms are 'affordable and prudential.' To facilitate this many councils maintain competitive credit ratings. Compared to the UK Government's current Aa1 (the second highest rating behind Aaa), Moody's list Cornwall (Aa1), Guildford (Aa1) and Lancashire County Council (Aa2) as well placed.[69] Similarly, Woking Borough Council (A), the Greater London Authority (AA+) and Royal Borough of Kensington and Chelsea (AAA) are all competitively rated with Standard and Poors.[70] The London Borough of Wandsworth maintains an AA+ with Fitch.[71]

That said, a majority of up-front capital for any entrepreneurial activity still comes from the centre. 75% of long-term local authority borrowing is currently from the PWLB, an arm's length extension of the Treasury.[72] This compares to about one pound in eight borrowed from the banks, and one in twenty-five from the bond markets. Bonds are a growth area – moving from around a 1% share of council borrowing in 2007 to the present 4%. As of the end of the 2013/14 tax year, councils had some £84.2bn in long term borrowing, up about a fifth since 2010.[73]

New forms of lending are at hand however. According to our survey, around 1 in 6 authorities are currently lending to another council – a process that has recently been given its own formal hub in the form of the United Kingdom Municipal Bond Agency (UKMBA). Since the ratings hike of the PWLB to 1% in 2010, the LGA has pursued the idea of a municipal bonds agency in order to create a local government owned and led lender of last resort. The Agency will reduce councils' long-term capital costs, lending to eligible councils at a rate lower than the PWLB and will take its first bond to the market in early 2016.[74] With almost 40 authorities – of all types, sizes and political colours – investing in the Agency so far[75], the model has echoes of Localis 2012 report, *Credit Where Credit's Due*, which argued for such activity.

With greater certainty over its income (through greater business rates retention, plus community infrastructure levy and New Homes Bonus streams[76]), new powers to borrow (including Tax Increment Finance – the ability to leverage

66 https://www.gov.uk/government/news/100-councils-set-to-freeze-council-tax-as-authorities-sit-on-30-billion and http://www.local.gov.uk/c/document_library/get_file?uuid=b9880109-a1bc-4c9b-84d4-0ec5426ccd26&groupId=10180. In 2012/13, 21 districts had less than £4m in reserves whereas every London borough had over £20m, and the majority over £80m.

67 http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9295880/Banks-received-implicit-taxpayer-subsidy-of-up-to-220bn-Bank-of-England-says.html

68 http://www.bankofengland.co.uk/research/Documents/fspapers/fs_paper15.pdf

69 Via www.moodys.com

70 Though Woking is on a negative outlook. Woking's current A rating – the lowest of the three authorities outlined here – illustrates 'the obligor's capacity to meet its financial commitment on the obligation is still strong.'

71 www.fitchratings.com

72 A slight decline from the 78% in 2007.

73 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/340708/Local_Authority_Borrowing_and_Investments_UK_2013-14.pdf They also maintain around £500m of temporary borrowing (mostly from private sources) to plug day to day funding gaps.

74 http://www.local.gov.uk/finance/-/journal_content/56/10180/3684139/ARTICLE

75 Ibid.

76 Although there is some uncertainty over the future of the New Homes Bonus scheme, depending on the result of the General Election.

future tax receipt to fund current projects), and an increasing number of lenders to local government outside the traditional PWLB, there is every reason to think entrepreneurially. Creative minds will be necessary.

4.4 Starting Viable Mutuals

Part of inculcating entrepreneurialism is about giving staff the chance to spin a service out of the council altogether – mutualisation. Characterised by a shared community purpose, collective ownership and similar democratic bases, mutuals are a concept that fits well with local government. They also bring key commercial advantages; giving the opportunity to innovate in services where profit is traditionally difficult to generate and the ability to take business decisions out of the legislatively strait-jacketed world of the council – something touched on elsewhere. Greenwich Leisure Limited, spun out of Greenwich Council's leisure department in 1993 and now managing a turnover of £80m, is one example of how successful mutuals from local authorities can be.

As set out earlier and in Localis' 2012 report *Catalyst Councils*, the Coalition Government has been keen to push mutuals – setting a target of having one in five public sector employees working in one by 2015. Indeed mutuals formed a key facet of the Coalition Government's reform programme, with the Mutuals Taskforce set up to promote public services mutuals and key legislation such as the 'Rights to Provide' and the 'Community Right to Challenge' brought forward. While the aforementioned target is unlikely to have been met – public service mutuals employ 35,000 people[77] out of 5.4m public sector workers – our survey suggests that mutuals are increasingly popular across the country, with employee-owned mutuals spun out of 24% of local authorities.

While this upward curve of mutualisation is to be welcomed, there is clear work to be done to encourage more council staff to consider taking the service they provide out of house. An LGA survey indicates that in 2012/13 over half of authorities (58%) said they would not be promoting employee-led organisations.[78] Councils should be more proactive in their approach to mutualisation, as detailed below.

Our interviews indicate that the major issue with starting a mutual is generally a perceived lack of expertise and worries about up-front capital. Authorities are working around this in three ways: skills training/a degree of 'hand holding' before mutualisation, the provision of up-front capital to help the new business grow, and the creative use of business rate and rent relief.[79] Another option would be for the private sector to assist some mutuals in their start up by providing investment and relevant skills. This would perhaps involve a deal based on the private firm withdrawing their involvement as they make a return on their investment, so leaving the fully fledged mutual entirely staff-owned.

Just as we note below the potential waiving of a central levy (corporation tax) to encourage municipal enterprise, so too can councils think creatively about the tax environment they lay in front of any potential spun-out mutual. Finance Directors should operate and publicise an open-door policy when it comes to mutualisation – rather than innovative ideas having to wait until some formal prompting, it should be made clear that where an effective service can be run in a mutual form to mutual benefit, help would be afforded.

77 https://www.gov.uk/government/news/cabinet-office-mutuals-reach-century-success

78 http://www.local.gov.uk/documents/10180/11627/Workforce+Survey+2012-13+report+FINAL.pdf/0fc54739-7fe6-41db-8cea-57deab587bc8

79 Interview G.

On the financial side, where a would-be mutual sits at the border of business rates relief (which currently tapers between £6,000 and £12,000) a sympathetic approach to relief for the first two years of any staff mutual was highlighted by one respondent as a 'potentially constructive' approach.[80] With £2.4bn of compulsory rate relief (and £94m at council's discretionary) in 2012/13 this already occurs to some degree.[81] The Portas Review's recommendation of allowing businesses – mutuals or otherwise – to pay their rates over twelve months instead of ten may have some merit in this area.[82] Similarly, seed money to incubate a new mutual should be discussed in an open manner amongst staff – mutualisation saves thousands in avoiding lengthy procurement processes, and this should be factored in to any potential start-up help. The prospect of locking down a medium term rental income stream (if, again, potentially tapered for the first one or two years) is another attractive carrot. As well as the city deals agenda forming a spur to local government therefore, councils should be considering their own 'local deal' approach.

In accord with the Government, we believe that the mutualisation of public services should be encouraged. We therefore recommend that:

- **Councils should seek to lay out financial incentives to spinning out a mutual, be it through business rates relief or offering seed money**

4.5 New Ways of Working with the Private Sector

Another issue to overcome in councils' pursuit of entrepreneurialism is their relationship with the private sector. To date, councils have tended to see private sector clients as suppliers delivering a specified set of service outputs. For both council and constituent, it will be beneficial for this model to change. Our research suggests that there is an appetite from both the local government and private sector for new models of partnership which are more flexible and much more outcome-focused, and where both parties see each other as 'business partners'.

Joint ventures

Joint ventures, in varying forms, are a great example of this new relationship which combine public and private sector expertise and capacity. They give councils the opportunity to bring in additional income from providing services to other councils and other parts of the public sector. With the council sharing ownership of joint venture companies with their private sector partners, the partnership offers both shared risks and shared rewards. One such example is Barnet Council's partnership with Capita, as detailed below. This represents a fundamental shift away from the one-way client relationships of old.

Case study: Barnet Council and Capita Joint Venture

Barnet's innovative Joint Venture (JV) with Capita to provide the council's planning, regeneration and regulatory services combines public and private sector expertise to enhance Barnet's built environment. This arrangement delivers £39m in guaranteed savings and income over 10 years, invests over £8m in new technology, improving facilities and training staff. The JV – named Regional Enterprise (Re) – provides a regional platform for the company to trade its services to organisations across the public and private sector, with clear incentives to grow the

80 Interview G.

81 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/316772/LGFS24_web_edition.pdf

82 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/6292/2081646.pdf

business. As a partner in the business, the Council receives a share of all income generated, meaning that Barnet's taxpayers will benefit from the success of the enterprise. Re expects its workforce to grow from 260 employees to more than 500 over the next five to 10 years, with a turnover growth target of £154 million.

Commercialisation of land and property

Another area of council activity where new relationships with the private sector will increasingly be forged is local authority owned land and property. As detailed in Localis's recent report *Public Land, Public Good* (2014), councils are increasingly acting as developers in their own right rather than simply selling assets, driven in part by a desire to generate ongoing revenue streams in preference to one-off capital receipts. This approach also allows for a more nuanced balance of short (financial) and longer term (wider place-making) priorities. However, the report did find that many authorities needed to leverage in private sector skills to ensure best value is gained from council assets.

Local Asset Backed Vehicles

One widely used form of joint venture for the commercialisation of council owned property is Local Asset Backed Vehicles (LABVs). These generally involve a local authority providing land or buildings, and a private sector firm the capital to stimulate development. The advantage here, as law firm Trowers and Hamlins note, is that 'the public sector is not selling "the family silver", it is creating a development portfolio of assets which is fit for purpose and ensuring that it receives maximum financial, regeneration, and economic returns from any disposal or revenue income.'[83]

LABVs are also useful means to skirt potential conflicts of interest when it comes to local authority pension funds. In two recent studies taking in pension fund investment – including Localis' own *Credit Where Credit's Due* (2012) – the prospect of a council fund investing directly in its local area has been shown to be difficult (due to the potential for conflicts of interest).[84] The creation of a new vehicle has proven a useful way to leverage funds and get around this impasse.

The Greater Manchester Pension Fund and Manchester City Council have recently signed a £30m LABV under the umbrella Matrix Homes to deliver 240 new homes across five sites. This sees the pension fund invest £25m, whilst the council puts up £5m worth of land (including a Homes and Community Agency site).[85]

With £178bn worth of assets under management in councils' pension funds, there is good reason to be creative.[86] The Manchester deal will, after all, generate over £330,000 of new council tax revenue each year.[87] With Greater Manchester due to control a £300m Housing Investment Fund from 2017 – providing the private sector loans and long-term equity from a public sector body[88] – and given the Chancellor's emphasis on pension fund infrastructure investment, it is likely such deals will grow and grow both in Manchester and across the country.

Land is no prerequisite to structuring a joint venture however. In more than one instance amongst our interviews, an existing joint venture with private sector

83 http://www.trowers.com/uploads/Files/Publications/2013/Bulletins/Local_Asset_Backed_Vehicles.pdf

84 http://www.localis.org.uk/images/LOC1358_Infrastructure_report_WEB.pdf; http://www.smith-institute.org.uk/file/local%20authority%20pension%20funds%20-%20investing%20for%20growth.pdf

85 http://www.socialhousing.co.uk/manchester-pension-fund-invests-25m-in-council-joint-venture/7003315.article

86 FT, 2 May 2014: http://www.ft.com/cms/s/0/d8704b1a-d1fe-11e3-8ff4-00144feabdc0.html#axzz3C58qv3g2

87 Band D properties in Manchester charged at £1382.21 in 2014/15.

88 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/369858/Greater_Manchester_Agreement_i.pdf

firm had created the conditions for further collaboration outside the initial agreement. One interviewee mentioned that the creation of a joint venture construction company had facilitated a more positive working relationship than would have been the case if done through a traditional contracting relationship, with the result being to ensure this partner delivered an on-time and on-budget delivery of a major infrastructure project. Whilst this project eventually cost £10m, the external contractor sent from Westminster to assess the project had initially projected a £14-15m set of costings to Whitehall. Joint ventures must be commissioned as efficiently as any other, but their utility must be weighed against the potential for central government waste too.

Case study: Kier Kent Initiative

Kent County Council (KCC) and Kier have agreed on a land deal that will deliver more than 150 new homes. The Initiative has packaged together KCC owned sites that would have struggled to deliver housing on an individual basis, and introduced institutional funding to finance the building of the new homes. The new homes will be a range of affordable rent, intermediate, private rent and open market sale, enabling new affordable homes to be delivered without the requirement for Government grants.

The Initiative represents a novel model of funding housing delivery that leverages in significant private sector investment as well as using public land assets that would have otherwise lay dormant.

Shared benefits between public and private sectors

The point is that a joint venture should not *just* be about a given deal (important though ensuring the right terms for that clearly are), but also better relations with a potential long term partner down the track- as with any partnership, it's about what both council entrepreneurs and their partners can bring to the table. 85% of respondents to our survey believed 'developing a positive relationship with private' or other partners was an important or very important part of the commercial councils' agenda. And there are interesting things going on around University Technical Colleges (UTC) in this regard. Harlow's UTC, for example, has involved business (both local and national – the latter in the form of GlaxoSmithKline) in the design of its curriculum, as well as Anglia Ruskin University.[89] Such hubs for public-private co-design can help foster both increased skills for pupils (and increase the chances they will stay and work locally), but also build bridges for other forms of cooperation down the road.

Much, as noted, will hang on how local government decides to conceptualise itself. One participant at our roundtable noted the joint ventures were largely about combining councils' three big unique selling propositions (USPs) – 'capital assets, a positive brand, and local knowledge' – with four benefits of private sector involvement – 'up-front capital, a willingness to take risk, additional resources and access to markets.'[90] Another pointed out that 'in the private sector you can get a meeting in one week and a decision in two. That's the major difference – that's why we use J[oint] V[enture]s.'

If local government can assimilate the best of the private sector – including a healthy degree of risk management and speedier decision making –

89 http://www.harlow-college.ac.uk/about-us/sir-charles-kao-utc

90 RTP.

alongside its community functions that would prove a positive development. And respect for cultures should of course go both ways. Several interviewees and roundtable attendees expressed a view articulated most pithily in the following terms: 'when are we going to get to a point where failure is acceptable?' He went on to note that 'it should be about risk management; not risk avoidance. Risks happen in business, that's life and we need to face up to that.'[91] The notion that 'we need to be 100% right all of the time needs challenging.'[92]

A blended approach

Local government essentially has a choice: it can either undergo an internal shift where entrepreneurialism becomes more accepted, it can outsource the risks of entrepreneurialism (but most, if not all, of the profit), or it can adopt a blend of these. It is to be hoped that new models of working – including those outlined in the previous section – can contribute to this opening of minds. Theoretically, there should be no limit as to which sectors joint ventures can function in – the criterion must remain getting the best deal for service users and the public purse. Where sufficiently rigorous public scrutiny can be maintained, areas such as health and social care could be part of that picture, though many authorities may wish to test their entrepreneurialism in less sensitive areas.

Part of all this is about reframing the debate. For there is also a tremendous external opportunity of local authorities forging and leveraging their role to be both pro-business and pro-worker. As one officer at our roundtable put it, 'we're going to see a blurring of public and private sectors, and that's a good thing.'[93] Emphasising the local benefits of commercialism is clearly a big point. As one Chief Executive told us, 'it is hard to convince a section 151 [Chief Finance] officer to invest halfway up the country. Local is much easier.'[94] Another council in the South strongly emphasised the merits of 'diving into your supply chain. Don't just be a passive recipient of services but be active in plugging in the local business community. When procuring a JV, think a) can local business benefit from our economies of scale? and b) can they help us design the system better?'[95]

As Lord Heseltine noted in his 2012 report *In Pursuit of Growth*, local government can be doing more to knit itself into local business communities. Our survey suggests that relationships with local chambers of commerce – Heseltine's favoured vehicle for council-business co-operation – are generally reasonable, but in some areas remain patchy.

Survey data

Whilst 21% councils are in constant and 45% in regular contact with their local chamber, 13% have limited or almost no contact with their local chamber. 21% of councils maintain 'sporadic contact.' A third of authorities had the potential to increase their contact, therefore.

One interviewee for this report noted that 'despite the fact that we have incredible businesses in the area…there is a real lack of networking by council staff with innovative, creative organisations.'[96] This is likely to be particularly the case in areas where local enterprise and British Chamber of Commerce branch coverage does not align.[97] Both LEPs and the BCC should explore means to merge these spatial geographies.

91 RTP.
92 RTP.
93 RTP.
94 RTP.
95 Interview E.
96 Interview D.
97 In some cases a chamber serves more than one LEP (as with the North East chamber) whilst in some areas there are two chambers inside a single LEP (including Liverpool). The UK possesses around 600 town chambers which are not-affiliated to the British Chambers of Commerce itself.

4.6 Sharing the proceeds of growth…

Many of the recommendations in this report address how councils function, but incentives to operate entrepreneurially also need to be laid out. As it stands, there are little to none financial or fiscal incentives for authorities to deliver growth. Our research shows that there is great appetite within local government for this to change. Asked whether greater devolution of tax powers should be part of the city deals programme, one Conservative respondent argued 'if we're given the fiscal powers, we'll deliver the growth'.[98] A Labour counterpart agreed: 'we need more devolution of powers and money. I am very ambitious about that. We've said to the government: if you give us the right package, we will give you a return. This is not about adding to the deficit. In one or two years you could see significant uplifts for the Treasury.'[99]

The issue for local government is to demonstrate genuine additionality. It is clear that the economy is growing again, albeit with regional and sectoral variation. What will be more difficult for local authorities to evidence is the extent to which any uplift they may be about to experience will be locally driven, and not just their riding a generally rising economic tide. There has to be some carrot and stick here – not least because central government's ability to borrow cheaply is predicated on the certainty of its future income – but in areas where additionality can be evidenced the centre should look favourably on this approach.

Crucially, the example of Greater Manchester is suggestive that the conversation is shifting. In their 'devolution deal' with HMT, Greater Manchester Combined Authority (GMCA) earn back deal – originally secured for the combined authority in their 2012 City Deal allowing it to keep £30m worth of additional annual tax receipts after investing £1.2bn in improving infrastructure[100] – was both extended to a 30 year period from 2015-16 to 2045-46 and revamped to give them greater certainty over future funding streams by scrapping the complicated formula by which the model operated.[101]

Both the original Deal and its revamping were important steps. A combined authority has been able to use prudential borrowing against its revenues to stimulate £1.2bn worth of infrastructure investment. Given both the fiscal incentives for growth that the 'earn back' model provides and the positive noises being made with regards to other devolution deals for other combined authorities across the UK, we contend that the model can and should be extended.

Extending the 'Earn Back' model

Our research reveals both the appetite for greater Earn Back powers and several areas in which they could be implemented. Importantly, this can be done in two ways – namely by,

- Extending the current range of bespoke deals between an individual authority or authorities and Whitehall; and/or
- Local government negotiating en masse for a greater share of additional tax take in specific areas

The first is mostly self-explanatory. Where individual authorities demonstrate

98 Interview B.

99 Interview E.

100 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221014/Greater-Manchester-City-Deal-final_0.pdf

101 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/369858/Greater_Manchester_Agreement_i.pdf

a rigorous business case for local retention of additional receipts, this should be looked on favourably by Whitehall. Other think tanks have previously argued for transport, housing and welfare Earn Back deals to be accorded to combined authorities.[102] Combined authorities may be best placed to deliver on these in many cases, but there is no reason – our respondents suggest – to not accord such opportunities across the board. If, for example, a partnership of county and district councils believe they can deliver a saving to HMT through a creative waste partnership, they should be allowed to make the case for the local retention of a percentage of the additional receipt.

But the broader question is could Earn Back be increased to all English councils? And in what form? We contend there is significant cause for local government to negotiate for a guaranteed slice of future additional income. We touch on two examples in this light: transport and child care.

The transport Earn Back

Transport is an area where there is significant potential for Earn Back. In 2011 the National Audit Office found that 26 of 31 local transport schemes it analysed had delivered double (or more) the benefit of any initial cost, with a quarter achieving a 5:1 ratio.[103] Equally, since Manchester's Earn Back in part involves an extension of the tram network there is concrete precedent here. As mentioned, Greater Manchester is being allowed to retain an annual £30m from an initial £1.2bn investment – equating to an annual return of 2.5% of the initial investment. This beats recent returns on five year gilts, and is similar to those of a ten year issue.

English principal authorities spent around £6bn on transport and highway capital expenditure in 2012/13 (half related to Crossrail, and £1bn via counties).[104] As a minimum, by applying the Manchester ratio to this figure there may be scope for the Treasury to look sympathetically on £150m of annual Transport Earn Back receipt for local government. Equally, we may note that the Greater Manchester Combined Authority spent a total of £22.5bn in 2012/13, some 15% of all English local government spend.[105] Using these ratios and scaling its £30m Earn Back upwards to reach a national figure, it would suggest a figure £205m for local government en masse. A transport Earn Back somewhere in the £150-200m region may therefore be useful starting point for any conversation.

Councils may however look to go further and, using Tax Increment Financing powers, the new UKMBA, and the generally improving economic picture press for further devolution. The £1bn the Office for Budget Responsibility (OBR) estimates is currently being contributed by private developers to overall local authority capital spend may also assist in this process.

The child care Earn Back

Another area which we contend could be ripe for Earn Back powers is child care. Although under the terms of the 2006 Childcare Act the local authority is deemed to be the provider of last resort, the rising costs of child care and the rising population of young children in the UK make this an area where intervention offers social and potential economic returns for councils.[106] Indeed, Section 3 of the 2006 act further permits them to supersede private or voluntary provision 'if it is appropriate for them to do so.' In some localities – given child care prices are exceeding wage rises by up to ten to one – it may well be, and these authorities should press for powers to enable them to provide additionality here.

102 http://www.ippr.org/assets/media/publications/pdf/the-condition-of-britain_June2014.pdf

103 http://www.nao.org.uk/wp-content/uploads/2011/05/Local_Authority_major_capital_schemes.pdf The remaining five still achieved between 1.5 and 2:1 returns.

104 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/316772/LGFS24_web_edition.pdf

105 http://www.ft.com/cms/s/0/4b04932a-3bfe-11e4-a6ce-00144feabdc0.html#axzz3ELXle1yN

106 By 2020 the ONS projects there will be 42,565 more 0-4 year olds in England than there are today, bringing the total to 3,469,259

There is also a clear fiscal justification for extending Earn Back powers to child care, with nursery workers contributing substantially less to the Treasury in income tax than the average worker[107]. The extra tax receipt generated by having more parents in work more quickly would likely outweigh the costs of tax revenue decentralised to local government.

Child care is a national priority all parties have been keen to expound open. Allocating Earn Back monies to encourage increased local authority-supported provision would be a welcome step – both in providing a dividend to entrepreneurial councils, and allowing market forces to deliver for the public good. With the Treasury having devolved £755m to help local authorities fund fifteen hours of child care for those on free school meals, there is good reason to influence this market in an entrepreneurial fashion, and lower the cost of that endeavour alone.

Giving the 'Right to Earn Back'

Transport and child care are two areas where there seems significant potential for a LGA wide agreement with the centre. And yet it is worth asking the logical extension of the Earn Back experience – could local authorities bet a percentage of their total budget, or at least a budget area, on achieving a given outcome? Could there be, in other words, a 'Right to Earn Back' where councils are confident they can deliver growth?

A relatively easily quantifiable example is capital spending (of which the aforementioned transport investment forms about a third). In 2012/13 local authorities spent a combined total of £18.9bn in this area which, crucially, has a significant economic impact.[108]

Recent OBR reports suggest the likely fiscal multiplier of capital spending is between 1 and 1.3.[109] That is to say, a 1% cut in national capital spending would reduce GDP (i.e. overall economic activity) by 1-1.3%, with the opposite effect for investment. This may be on the conservative side – the ONS has previously put the multiplier for construction investment at 2.09.[110] But what is clear is that capital spending can generate significant economic returns, particularly for central government.

There is then a case for allowing local government a chance to retain some of the income it helps produce through a new 'Right to Earn Back'. Permitting councils to use a percentage of their capital budgets on meeting a series of agreed outcomes, retaining any receipt above and beyond an agreed baseline, would be a radical extension of the entrepreneurial council. Of course, if a council fails to exceed the baseline, the Treasury could claw back the amount by which it undershoots.

It is therefore likely that some may prefer to wait before putting their chips on the table. But for those who wish to take the risk, the power should be there. This would align with the notion argued in this report that council workers are both more commercially aware and experienced than perceived, and thus are well placed to assess the relevant risks. We therefore recommend that:

- **Councils are given 'Earn Back' powers to stimulate particular markets (including child care and transport);**
- **Government should consider the case for a broader 'Right to Earn Back'**

107 In 2014/15 the average full-time English worker generates precisely £5709.60p for the Treasury in income tax and national insurance. The average nursery worker generates less than a quarter of this figure (£1,269.28p).

108 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/316772/LGFS24_web_edition.pdf

109 http://budgetresponsibility.org.uk/wordpress/docs/23690-OBR-Web-Only.pdf

110 http://www.nasc.org.uk/NASC/files/ea/eabc21b4-91d3-4e44-8f0f-ab27a7a0a4b1.pdf

4.7 Local government as the engine room of the public sector

There are several high profile examples of councils already offering services to other parts of the public sector, and there are significant benefits to doing so. As one of our interviewees noted, 'they know we are in it for the long haul and for the benefit of everyone.'[111] Education is a good example where this type of trading is normal. 83% of councils surveyed by BDO in 2014 sold some services to schools outside the local authority area. Likewise, over 97% of maintained schools bought back at least one traded service from their local council, and 94% of academies did the same. But, as LGFS data illustrates, this activity goes well beyond schools.

Internal Trading Account Data 2012/13[112]

The Local Government Finance Statistics delineates so-called 'Internal Trading Accounts' which are 'typically funded mainly through contracts with local authority departments.'[113] These show that councils spent £3.06bn on such contracts and generated £3.1bn in turnover. Turnover was particularly large in catering (£530m), highway repairs (£414m) and building maintenance (£308m), and construction and property services (£225m).

We believe local government, suitably empowered, can become the engine room of the public sector – delivering IT, back office, procurement, facilities and legal services to a range of public bodies. Not only could these services be more effective, they could also be more efficient, removing duplication and integrating services from the bottom up. The scale of opportunity in this regard goes beyond the status quo.

The number of councils who don't – but would – deliver such services entrepreneurially ranges between 35% and 50% according to our survey. There is potential here. And, crucially, this is already happening in several areas. Kent's Legal Services Arm generated a £2.4m profit on £12m of activity in 2012/13.[114] The London Boroughs of Newham and Havering are seeking to launch a new vehicle to 'compete for back office business in the health, education, police and charity sectors' – and are targeting £57m of annual turnover.[115]

Intra-public sector trading is part of a growing trend in joined up vehicles and increasingly blurred geographies. East Anglia provides an interesting snapshot. In October 2010 Cambridgeshire and Northamptonshire established a wholly owned joint venture to provide a range of services to other councils. By 'sharing transactional services in this way,' initial estimates suggested 'LGSS will result in a saving in excess of £25m over the next ten years.' According to their website: 'we deliver in-house, we are public sector, we are non-profit, [and] we understand you.'[116] Selling points that may well appeal to potential customers in the public sector.

What we are therefore seeing is a growing understanding that the provision of services will not just be divided between public, private or third sectors, but geographically within the public sector itself. With around half of authorities currently running some form joint venture with neighbouring and more distant councils, the increase in the aforementioned areas such as procurement and legal services (less reliant on geographic knowledge than, for example, housing or waste) may well partly be in this form.

111 Interview A.

112 LGFS 2014.

113 Ibid.

114 http://www.localgovernmentlawyer.co.uk/index.php?option=com_content&view=article&id=15233%3Akent-legal-services-delivers-record-p37m-contribution-to-county-council&catid=51%3Amanagement-articles&q=&Itemid=11

115 http://www.computerweekly.com/blogs/public-sector/2014/04/profit-lures-london-councils-i.html

116 http://www.lgss.co.uk/AboutUs/Pages/AboutUs.aspx

4.8 The combined approach – Local Enterprise Partnerships (LEPs) and Combined Authorities

Another key issue in the entrepreneurialism debate, increasingly important in 2015, is the role of LEPs and combined authorities in local government. As of early 2015, combined authorities (CAs) exist in Greater Manchester, West Yorkshire, Sheffield, Liverpool, and the North East region. There have been early successes here. The establishment of the West Yorkshire Combined Authority in April 2014 has been credited with reducing counter-productive political rivalries and maximising the impact of limited resources, particularly in areas such as transport.[117] The LGA has however emphasised that the flexibility brought by CAs is 'of limited benefit if the real issues that are holding back local economic growth are not addressed' and that their potential will only be realised 'if Whitehall is much braver about joining up and letting go.'[118]

Both LEPs and combined authorities have a role to play in creating and leveraging new forms of income, and providing the formal means to deliver economies of scale in their dispersal. As West Yorkshire's Combined Authority points out, 'in simple terms, the LEP provides the voice of the private sector and the CA is a statutory body, which is able to provide democratic accountability for devolved funding and investment that benefits the area.'[119] This perhaps undersells the LEPs public sector representation (almost half of members are councillors, after all), but it gets the general message across. Structures are being created to get the private and public sectors working together, and that is a positive development. As noted in a recent Localis report, LEPs are firmly established as the Coalition Government's key vehicle for catalysing local economic growth delivery, and will continue to be so in the next parliament regardless of who wins the election.

There are three likely future trends for combined authorities.

The first, most obviously, is that more combined authorities will exist. The Government's apparent preference for the combined authority model – articulated by the GMCA 'devolution deal' – has acted as a catalyst for areas including West Midlands, Tees Valley, Cambridgeshire and Bristol to propose the adoption of a similar CA structure[120]. Even in Greater London, an area excluded from forming CAs, there is pressure to allow sub-regional entities to form.[121]

The second is that their make-up may change. The Government has launched its consultation on '[allowing] councils with non-contiguous boundaries to join or form combined authorities or economic prosperity boards,' and is looking to accelerate legislation on this.[122] This will reverse the situation where authorities are forced to be 'non-constituent partners' of combined authorities. Given the success of councils such as Cambridgeshire, Kent and Norfolk in activity beyond the confines of neighbouring authorities, this would seem to align with the way the entrepreneurial councils agenda is going.

And the third will likely be the use of combined authority structures and relationships to open the door to two-track working methods. In Greater Manchester, Trafford is seeking to build its procurement for a street maintenance joint venture in such a manner that the other nine authorities in the GCMA can join at a later date. This 'piggy back' model may grow and grow – depending, of course, on efficacy of delivery.[123]

117 http://www.bbc.co.uk/news/uk-england-26835485

118 http://www.local.gov.uk/documents/10180/11527/LGA+response+to+CA+and+EPB+consultation.pdf/ffa269de-6394-468f-8229-8f78fd2914a7

119 http://www.leedscityregion.gov.uk/getattachment/2d14524d-1e59-4e8b-8222-911260780a57/West-Yorkshire-Combined-Authority-FAQs.pdf/?ext=.pdf

120 http://www.lgcplus.com/news/services/economic-development/manchester-devolution-deal-sparks-combined-authority-plans/5076669.article

121 https://www.barnet.gov.uk/download/downloads/id/3754/capitalising_on_the_boroughs_-_promoting_growth_through_greater_financial_devolution_in_london

122 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/307661/300414_Combined_authority_consultation_doc_FINAL.pdf

123 http://www.manchestereveningnews.co.uk/news/greater-manchester-news/manchesters-town-halls-joint-plan-7072170

4.9 The taxation of municipal enterprise

From the available data, and interviews carried out for this report, the vast majority of council-owned trading companies post profits in the low millions. Recent post-tax profits posted by Kent Commercial Services (£8.8m) and Norse Group (c.£2.7m) – two of the largest local authority trading vehicles – are suggestive of a sector which is diffuse (many authorities operating several different vehicles).[124] A recent study by APSE put the average trading vehicle income at £3m per annum.[125]

A key factor stopping more councils deciding to move such business into arms length organisations – whether a wholly-owned trading company or joint venture – is the potential to gain a new liability to pay corporation tax on their profits. This is a significant disincentive, even given the UK's competitive position in this regard. At a standard rate of 20% on profits (the old basic rate is to be formally repealed in 2015) the UK's corporation tax is comfortably the lowest in the G7 (6% below Canada, the nearest competitor).[126] This encourages inward investment from overseas – no doubt welcome – but it does not provide much help for the would-be council backed start-up.

Taking the 2012/13 external trading profits as indicative, the conversion of all externally traded services into wholly-owned vehicles would, by virtue of the new corporation tax liability, transfer £60m worth of funds from local government to Whitehall. If we assume increased trading company coverage over the next three years of 20% per annum and project from this £60m figure, we would be looking at approximately an exemption which would cost the Treasury £72m, £86.4m, and £103.4m over the next three years.[127]

There is a mismatch here. In aggregate fiscal terms, £72-104m a year is not a big loss for central government. Corporation tax has brought in between £41bn and £44bn in total for the Treasury each of the past four years. £104m would constitute less than a day's lost tax take for HMRC, but fund 86,594 council tax bills worth of annual activity.[128]

The Chancellor has already used departmental underspends of up to £500m to fund other policy pledges.[129] There is significant economic cause therefore to provide a holiday for this tax on municipal enterprise.

No tax can be ruled in or out for all time, but providing a three year period of breathing space whereby council trading companies would be exempt from corporation tax – in the same vein charities are – would seem opportune. The measure would be subject to an impact assessment towards the end of its lifetime and, if affordable, extended further.

From the Treasury's point of view, this may end up costing even less than the £262m three year total indicated above. Of the interviewees we spoke to, several suggested it had taken their trading companies two years or more to post a profit (a view consistent with APSE's findings). Others indicated that they had been able to reach favourable one-off agreements with HMRC on the taxability of such income. And at a local level, as noted, councils are extending tax breaks of their own to former council owned mutuals – there may be something of a quid pro quo here. As one interviewee based in the north noted, this policy would 'fit into our ambition to grow our area. To

124 http://www.eveningnews24.co.uk/mobile/news/business/norse_group_enjoys_a_record_year_of_growth_1_3041546 and http://democracy.york.gov.uk/documents/g6676/Public%20reports%20pack%2004th-Oct-2011%2017.30%20Cabinet.pdf?T=10

125 http://democracy.york.gov.uk/documents/g6676/Public%20reports%20pack%2004th-Oct-2011%2017.30%20Cabinet.pdf?T=10

126 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/183408/A_guide_to_UK_taxation.pdf

127 It is possible that this would fall foul of EU State Aid rules. If so, these limit financial assistance to a maximum of €200,000 per company over a three year period. In this case, the cost to the Treasury would be far less at £17.5m per year.

128 Using the 2012/13 average of £1,201 per dwelling.

129 http://www.bbc.co.uk/news/uk-politics-17499332

grow turnover and employment, and to give the best terms and conditions for our workers. This is a potential big change, and an important one.'[130] We therefore recommend that:

- **Government departmental underspends fund a three year corporation tax holiday for new council owned trading companies**

4.10 The legal boundaries of trading powers and the General Power of Competence

Retention of income is certainly a key issue, but the institutional reticence to trade is no doubt exacerbated by what councils can and cannot do for a commercial purpose. In their evidence to the 2013 London Finance Commission, London Councils encouraged that body 'to press for deregulation' and 'the freedom to set…in some cases market rate' fees in areas such as 'planning applications, building control, land searches [and] licensing.'[131] As London Councils argued, 'there are many services that local government has a statutory duty to deliver, but is required to charge for at a level determined by central government. The result is that there are a number of services which leave councils with an overall net loss each year.'[132] For their part, Westminster City Council also called for the ability 'to offer price-differentiated levels of service in order to recoup costs and to offer innovative services.'[133]

This debate in part arises from the provisions of the General Power of Competence (GPC). The GPC passed in the Localism Act of 2011 permits local authorities to do 'anything that individuals generally may do.'[134] Section 3 notes that authorities cannot 'do things for a commercial person' which they have a statutory requirement to provide, but that their commercial activities need no longer (as with the 2003 Act) be related to their functions.[135] This is a positive step. In 2009 (in the 'LAML case') the previous well-being powers afforded under the 2000 Local Government Act had been ruled insufficient to justify Brent Council's awarding of insurance contracts to a mutual it had previously helped launch.[136]

The General Power of Competence reverses this previous status quo. Rather than having to justify the legality of what they do (with, as it transpired, eminently contestable claims over 'well-being'), the presumption is now supposed to be that councils will be acting legally unless their actions are explicitly prescribed by existing statute.

Case study: London Borough of Richmond upon Thames

- The GPC has given Richmond the greater confidence to innovate. One exemplary scheme is the Empty Shop Grants, adopted in late 2012, which supports temporary use of empty retail units. Up to £2,000 is made available in grant by the council which is to be used within three months. This scheme encourages entrepreneurialism and provides a relatively low cost way for the council to help increase activity on the high street.[137]

130 Interview E.

131 http://www.london.gov.uk/sites/default/files/London%20Councils.pdf

132 Ibid.

133 http://www.london.gov.uk/sites/default/files/Summary%20of%20written%20evidence.pdf

134 http://www.legislation.gov.uk/ukpga/2011/20/section/1/enacted

135 http://www.11kbw.com/app/files/Articles/PowerofCompChargCommPurpELAmended.pdf

136 (with nine other London boroughs)

137 LGA (2013) *Empowering councils to make a difference; Annex: case studies on how councils are using the General Power of Competence to bring about change and innovation*, p14

For the LGA, the GPC is a means to take on the 'instinctive caution of some in local government, by clearly showing that just about anything is possible (unless specifically prohibited)…Members may see this as an opportunity to challenge the caution of some officers…[And] the GPC may provide statutory officers the assurance they require to endorse some more innovative and radical approaches.'[138] This view is broadly corroborated by our interviews though, as one roundtable participant told us, 'we wouldn't want to be the first major commercial test case.'[139] He did however go on to note that, having undertaken several new commercial activities, 'so far we've never been challenged.'[140] Another noted that the prospect of a LAML type court case 'is too high a risk at present to challenge with our resource base.'[141]

Survey data

Our survey responses indicate that though the GPC has clearly helped some authorities, some scepticism remains. 46% of responses suggested that it had helped their authority to be more entrepreneurial compared to 54% arguing it had not. Positive replies indicated that 'it has probably made elected members more comfortable with the principle of non-traditional or entrepreneurial activities,' and that it had allowed 'wider opportunities to be considered for the future.' More circumspect responses noted that 'remaining restrictions (e.g. on trading, charging, revenue raising) make its impact more limited than it could have been,' and that it simply 'hadn't been needed for any activities that we have wanted to undertake.'

Other than its broad legal weight, the LGA have identified three specific hurdles that remain to using the GPC in a commercial manner. Firstly, the GPC still limits local authorities to creating certain types of companies – namely those limited by shares, which thereby 'prevents the use of community interest companies or similar.' Some are getting around this provision by inserting community interest functions into spun-out mutuals, but the terrain on wholly-owned community interest companies remains a little unclear. Secondly, when done through the council, fees or charges implemented under the GPC can only be applied to discretionary services and must be set at a level which merely recovers costs – thereby limiting potential revenue.[142] (Even were they to operate at half the profitability of UK firms in Q1 2014 (11.9%), the £11.3bn of sales, fees and charges of local authorities could equate to their passing up £670m each year.[143] This would not come without (political) consequence, but it remains an opportunity cost for local councils.) And thirdly, uncertainty as to what the General Power does and does not accord may produce inertia, 'the need to check for pre- and post-commencement limitations can take time, and may lead to a more specific power being used anyway.'

These are however not the end of the story, and interviewees for this study have also pointed out two further concerns. The first is that since the GPC only extends to English local authorities this greatly restricts opportunities for joint working. One interviewee noted that GPC has 'not really massively helped so far, though it could. The big question is extending it to other parts of the public sector. If it fully encompassed the police, the NHS and fire that would really help. As it stands, we come up with a scheme for joint working, back it up with the GPC internally, but then it gets blocked in another sector's legal issues.' Another interviewee from a council with

138 http://www.local.gov.uk/c/document_library/get_file?uuid=83fe251c-d96e-44e0-ab41-224bb0cdcf0e&groupId=10180

139 RTP.

140 RTP.

141 Survey response.

142 The GPC allows commercial rates and profit provided the services are provided through a trading company. If done through the council, then the limitation to cost recovery applies.

143 http://www.ons.gov.uk/ons/dcp171778_370556.pdf

a successful joint venture noted that 'if someone wants to buy HR from us, they can do that without complicated procurement procedures. If we were to sell it to the post office it would get more complicated.' At present the GPC applies to fire and rescue services when in pursuit of their statutory duties and affords them limited charging powers – but goes no further. It also does not apply in Scotland and Wales.

The second is that it is not clear how far the GPC truly frees councils to try new business models. This is not just about the inability to generate a profit through fees and charges but actually about where and how authorities can trade per se. This has recently been tested through Surrey County Council's ambition to invest in housing to help deliver a new annual £5m income stream. The Council's legal advice notes that 'there are a number of limitations and restrictions on exercise of [the GPC]…and those limitations would continue to apply to any activities of [the Council's] property companies.'[144] It is yet to be determined what an entrepreneurial council might seek to introduce under the GPC, however as boundaries become more clear and tested, opportunities such as housing investments will provide net financial benefits to councils.

We therefore contend:

- **With regard to the General Power of Competence, a counterparty clause should be introduced whereby other arms of the public sector trading with local authorities may be subject to its purview for that specific activity**

- **In the specific areas of planning applications, building control, land searches and licensing, local authorities be allowed to set fee levels to fully recoup costs.**

144 http://mycouncil.surreycc.gov.uk/mgConvert2PDF.aspx?ID=13978

Capter 5

Conclusion: A vision of commercial councils for 2020 and beyond

"Everything must change so that everything can stay the same" – Giuseppe Lampedusa, *The Leopard*

Entrepreneurialism can bring a series of interconnected benefits from delivering monetary savings which allow high-quality services to be maintained, to the provision of new skills which can arm local government for the challenges of tomorrow. The prospect of forging a more constructive relationship with reliable private and voluntary sector partners can likewise have significantly positive outcomes for local economies. All this builds on existing practice, as noted. Of course innovation is sometimes associated with risk, but a failure to innovate poses far more risks at this juncture than the process of innovation itself. The risks faced by local government are outweighed by the potential payoff that an entrepreneurial and innovative approach might grant to the sector. Having proven their commercial ability in the past few decades –as we illustrate throughout this report – we believe that local authorities are both able and ready to expand their reach into both new and existing areas of municipal enterprise within their portfolios.

In this ever changing landscape, we make some predictions for an entrepreneurial future. By 2020 we expect to see…

…a marked increase in entrepreneurialism as a percentage of local government budgets

Using a weighted average of our survey responses, we estimate that entrepreneurial activities make up 6% of total council budgets at present. In five years' time, the weighted average of our respondents indicates that entrepreneurial endeavours will treble and equate to a far higher 18% of total council budgets. This equates to a shift from around £10bn of activity to £27.4bn by the end of the next parliament.

Extracting how much of this will be additional savings is not an exact science, but we have some guiding data. Recent major joint ventures have outlined savings of 25% on a ten year contract, and another 30% of profits in an annual dividend.[145] More concretely, according to the LGA, shared services arrangements currently deliver £357m worth of savings, up 23% from

145 http://www.barnet.gov.uk/news/article/295/barnet_council_selects_capita_as_preferred_bidder_for_joint_venture; http://www.local.gov.uk/documents/10180/5785771/Income+Generation+Case+Study+-+Surrey.pdf/65fbdc7f-c94a-401a-b024-f68cb88cd7c9; Not all joint ventures will of course produce a financial return, but clearly savings are out there.

2013.[146] If that latter trend continued we would reach £1.24bn of shared service savings by 2020. Trading councils are expanding as we note below, and thus we may project a further £150m in profit from such enterprises in five years' time – particularly if the GPC is used in a creative fashion and central regulations are relaxed in certain trading areas. Localis has also previously shown how astute use of the public estate may generate £140m additional annual revenue to the public purse.[147] Should councils press for and win the forms of Earn Back we outlined in the previous chapter, it is possible to envisage £500m of additional taxes being retained locally.[148] **We therefore argue the entrepreneurial councils agenda may account for at least £2bn of additional revenue for local councils by 2020. Depending on the then priority, this could fund:**

- **£100 off the average projected 2019/20 council tax bill, or**[149]
- **subsidising the construction of 80,000 homes across England, or**[150]
- **a sum equivalent to the annual salaries of over 58,000 teachers**[151]

But all this will have wider benefits beyond the bottom line. It will also produce…

A more diverse market place with increased skill sets

The entrepreneurial councils agenda is neither about default partnership with the private sector nor an adversarial relationship with it. It is however about local authorities using the skills derived from private sector partnerships to think creatively about what they do and how they do it. This will be embedded in part through more joint ventures, but it may also see councils use their newly acquired skills to displace poorly performing private sector provision – the market, after all, goes both ways. This will help facilitate…

Local government becoming the engine room of the public sector

By leveraging their positive brand, existing knowledge, and links to various agencies, we expect councils to gain an increased stake in markets such as facilities management, IT, and back office functions. The very necessity that has driven local government to become more entrepreneurial, after all, provides it with useful experience of aligning systems, streamlining processes, and, ultimately delivering savings from which it can profit.[152] Co-location, greater intra-public sector cooperation, and sharing savings will all be part of this.

Greater trading for profit, and hence more trading companies

Our survey indicates a substantial increase in the number of councils operating trading companies, with 58% of respondents indicating they have now joined this group. If reflected across England, this would indicate 205 authorities are now operating some form of trading company and that the number of trading councils is growing by over 35 per annum (given previous estimates suggesting there were 53 in 2010). This may slow down as we approach full coverage, but the major point is that full trading council coverage is a realistic prospect for the next parliament. Our proposal for a corporation tax holiday would assist this process.

We therefore contend that **by 2020, owning a trading company will be the default position for local authorities – with at least two-thirds, and possibly approaching total, coverage.**

146 http://www.lgcplus.com/briefings/corporate-core/efficiency/shared-service-savings-reach-357m/5070365.article

147 http://www.localis.org.uk/images/LOCJ2390_Public_land_report_A4_0914_WEB.pdf

148 We outlined £300m worth of powers in two areas, child care and transport, but this may only be a first step.

149 Current figure from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/335851/Council_Tax_Levels_set_by_Local_Authorities__Revised__August_2014.pdf and working from OBR assumptions and projecting a further 2% rise in 2019/20 – http://cdn.budgetresponsibility.org.uk/37839-OBR-Cm-8820-accessible-web-v2.pdf

150 Using Labour's 2012 figure of £25,000 subsidy per unit – http://www.theguardian.com/politics/2012/sep/30/balls-labour-windfall-housebuilding-pledge

151 Using http://www.telegraph.co.uk/education/educationnews/10141810/Teachers-in-England-paid-higher-salaries-than-those-in-most-other-countries.html and factoring in 20% of on costs.

152 (and pass on competitive rates to other public bodies which in turn deliver for the taxpayer)

The future council

The considerable financial and demographic challenges which local government faces are neither easily fixed nor likely to abate anytime soon. We can therefore expect that the council of the future then will be radically different to the one we know today. What might this mean in practice? While there are likely to be fewer direct employees of the council, we do envisage that they will be better paid and equipped with a wider range of skills. There's much discussion as to the future shape of local government – even if it isn't clear if wholesale redrafting of council boundaries is a given, the barriers between adjoining local authorities and between local authorities and other parts of the public sector are certainly going to be a lot more blurred. And in this new landscape unique local geographies will dictate how and what services are delivered.

For local government specifically, as councils become ever more self-sustaining – through force or choice – they will become ever more independent of central government in terms of financial support (and therefore hopefully legislation). With such autonomy, we'll be one step further down the road towards genuinely local government that can stand on its own two feet responding to local needs without requiring Whitehall's stamp of approval.

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