



INNOVATION BRIEFING

ESTABLISHING A TRADING COMPANY

JULY 2017

NLGN Innovation Briefings are for our members only, and are focussed on the practicalities of leading innovation. The briefings use active case studies and provide lessons learned from those at the vanguard, and are designed to promote sharing and expertise within our network of leading local authority innovators.

OVERVIEW

Increasingly, councils are considering how commercial activity has the potential to diversify revenue streams and contribute to self-sufficiency. One option is setting up a local authority trading company, which remains wholly-owned by the local authority, but is able to provide their services commercially to a wider market within the public sector and

beyond. This is a potential route to achieve a number of objectives, including market-shaping; making existing services more efficient through reducing costs; improving services for those who use them; and above all to generate revenue through profits.

What do councils need to consider when setting up a new trading company? This Innovation Briefing sets out some useful resources and active case studies which look at how different councils at different stages have approached this. The first section considers pre-trading and how to understand what services could be traded, and the second section considers the experience of establishing a local authority trading company – how to bring them to market and how to compete successfully within the market once established.

1. PREPARING TO TRADE

When considering setting up a trading venture, it is necessary to determine whether it would be acting according to what the legislation defines as a ‘commercial purpose’ – this requires councils to do this as a company. Setting up a trading company is one of several different commercial approaches, which include shared services, joint ventures, a limited or a community interest company. A clear understanding of what you are trying to achieve and what is driving the change will determine which different commercial model would be most appropriate.

The benefits of pursuing a trading company include greater scope for income generation or cost reduction, which can be reinvested locally; more freedom and flexibility; greater control than outsourcing, greater potential to innovate. Yet there are also disadvantages, which include greater levels of risk; less control for the council than in-house delivery; more complexity, time and cost for set-up.

From interviews and research for this briefing, the following considerations are identified as key when deciding whether to pursue trading as a separate company:

- **What are the clear objectives?** All case studies in this briefing identify clear guiding objectives, which inform the model pursued. These may be primarily income-generating or cost-saving, but may also include an objective of improving a service or making it sustainable.
- **Is there strong political support?** It is important that members understand the benefits and trade-offs, including the risks and their role in new governance arrangements.
- **Has market research been conducted into growth potential and local market conditions?** This should involve a robust business plan based on existing finances, and incorporate intelligence into the marketability and demand for the services traded. This in turn would inform a competitive pricing structure.
- **What level of investment is required and where will this come from?** There will likely be upfront investment required to cover an initial deficit period of operation in which extra costs are incurred which do not exist for in-house services. These include overheads, staff transfer, new tax liabilities and implementation costs such as recruitment or legal fees.
- **What are the legal and technical hurdles?** For example, a new company will find it difficult to tender for OJEU contracts in the first three years due to qualification criteria.
- **What level of management skills is required?** It may be that outside expertise is required to complement existing capabilities, because operating as a company requires a different skillset to in-house. It is important to understand what level of appetite exists for this.
- **What is the local reputation of the existing direct labour organisation?** This will affect the opportunity and potential for trading externally.
- **What is the diversity of services offered?** The scope of services involved may

not necessarily be the same as the in-house model. This would inform the USP of the company, which might be more specialised.

■ **Have other options been considered?**

Has there been a clear options appraisal process before arriving at the decision, including alternatives such as stopping delivering the service, other providers stepping in or other delivery models?

■ **Is there an appetite for cultural change?**

A change in internal culture is recognised as necessary in the shift from in-house to commercially trading – for example increased staff autonomy, speedier decision-making and reduced hierarchy.

For more information on developing a commercial strategy, the LGA has produced guidance [Enterprising Councils: Supporting councils' income generating activity](#). This explores overarching considerations and details to support options appraisal, business case and decision-making in general. For trading in particular, it sets out legal and governance considerations when preparing to trade. Grant Thornton have also published further detail on [Legal considerations for a local authority trading company](#).

How do you identify which services are ripe for the potential to trade? One way of approaching the challenge of identifying viable business ideas and preparing services to trade, is the example of Essex County Council's Business Accelerator. Case Study 1 sets out how this process works with services from idea, through planning and to potential trading.

CASE STUDY 1: IDENTIFYING TRADEABLE SERVICES – ESSEX COUNTY COUNCIL'S BUSINESS ACCELERATOR

Essex County Council established a Business Accelerator to create a more systematic approach to developing business opportunities that could be applied across the whole council, which had previously been done on an ad hoc, project basis. The objectives which drove the initiative were threefold: first and foremost, to generate income, then also to make services become more sustainable, and finally, to take some risks.

The Business Accelerator is an accelerated learning process for service leads with a commercial opportunity, designed to give them commercial confidence and skills, and develop a robust business plan. This involves:

- **A series of masterclasses in commercial development:** these cover core areas including sales; marketing; people and change; systems and processes and financial management. They use relevant tools and methodologies such as value curve; market segmentation and routes to market. The sessions are structured to involve lots of peer-to-peer learning, insights and constructive challenge within each cohort.
- **Account management sessions:** Participants receive coaching and support during this phase – a key message is that this is a process done with you not

to you. Support for the development of business plans comes from an informal business partner network drawn from across the council – with expertise from teams such as finance, communications and marketing.

- **A two-day assessment centre:** the process culminates in a two-day assessment centre which assesses both the business product or service opportunity and team capability. The assessment panel includes the Section 151 officer or their representative, commercial expertise, and the head of the relevant service. A recommendation is made, with an evaluation of the opportunity and next steps. These might involve moving to trading, or some further support or mentoring before this stage, and in some cases plans are not approved or are stopped.

The initiative began with a pilot for three services together, and now several years on, each cohort is 7-8 services. Cohorts are relatively balanced between three types, reflecting the core objectives:

- A third have a high chance of becoming income-generating
- For a third it is more about becoming sustainable – this might be a service that does good but needs to become viable for the future
- The final third comprises those it is possible to take a bit of a risk with and see what emerges.

Because of this element of taking a risk to innovate, the Business Accelerator has resisted being measured on KPIs to create space to protect that element. But there has been significant impact in the four years of being in operation – over a dozen business units are now successfully trading. Although there are no typical business units that enter the process, one example which represents a median level in terms of improved financial performance is Place Services, an environmental and planning consultancy business who participated in the early pilot. By embedding commercial practice Place Services have moved from an overspend of £620k in 2012/13 to delivering a healthy and growing surplus, with a turnover of £2m in 2016/17.

LESSONS LEARNED

For other councils considering embarking on this approach, some key factors to consider are:

- Understand what you want to achieve. Essex CC identified three objectives – income-generation, sustainability and risk-taking – which have guided the model.
- Related to this, then understand your methodology for identifying opportunities – how you will identify services to participate.
- Understand the overall process that will work for your council.
- Everyone wants to be a seller, but understanding who would be the buyer is key – identifying what buyers want is essential. The process needs to be market-driven and not everyone is – there may be a good idea but demand does not exist.

CONTACT: For more information or to discuss the Business Accelerator, which is now a traded service itself, contact Caroline Adlem, Head of Traded Development, Essex County Council on caroline.adlem@essex.gov.uk or call 07501 228744.

2. SETTING UP A TRADING COMPANY

While a separate trading company structure may not be the right approach for all services facing a challenge of sustainability, when a decision has been reached about setting up a separate company, what is the experience of doing this successfully?

A helpful list of six learning points are identified in this article [How best to set up a local authority trading company](#) from Grant Thornton. This sets out how local authorities can maximise the benefit of wholly owned subsidiaries, particularly with regard to governance responsibilities, summarised as follows:

- **Allow operational freedoms** – as the local authority is the shareholder it should not have an operational lead role, and this freedom is key to acting commercially.
- **Place less reliance on performance measures** – the nature of the relationship is changing to a partnership between council and company, and monitoring performance could stifle innovation.

- **Place more focus on future business planning** – review future goals to ensure that both company and council are aligned and their goals are both served, ensuring clarity and the use of governance documentation such as memorandum of understanding and joint risk registers.
- **Be clear on members' roles** – for those with board directorships ensure their duties to the council and the company are clear and any conflicts of interest are identified.
- **Encourage external challenge** – Use expertise from the business world to provide challenge and use independent non-executive directors on boards to bring different perspectives.
- **Ensure proper strategic oversight by creating a shareholder committee** – where an authority has several arm's length companies, a separate committee could sit above all company boards as a single point of access to the council via the cabinet.

The following two case studies set out examples of setting up a trading company in practice. Case Study 2 considers the practicalities of bringing a company into market, considering the experience of Kent Legal Services transitioning into Invicta Law. Case Study 3 explores the experience of Norse Group, a mature trading company wholly-owned by Norfolk County Council, and the conditions that have enabled its successful longevity.

CASE STUDY 2: SETTING UP AN ALTERNATIVE BUSINESS STRUCTURE – KENT LEGAL SERVICES AND INVICTA LAW

In 2012, Kent Legal Services embarked on an ‘Evolution Efficiency Enterprise’ change programme, which sought reinvention to respond to external challenges. Although a successful service, there was recognition that the context of reduced public finances, changing regulation, new technology and shifting client demand meant a new model could provide more opportunities to adapt. There were four objectives driving the approach:

- **Better** – perform better than existing arrangements
- **Cheaper** – for the council than current service
- **Quicker** – provide a more efficient service for clients
- **More profitable** – to generate more revenue for the council.

KLS initially went through procurement to find a joint venture partner, on the basis that private sector collaboration could get a new model up and running quickly. But when the market didn’t come up with a partner, the team decided they could achieve what they wanted alone. The decision was taken to move KLS into an alternative business structure (ABS), and Invicta Law Ltd was the outcome – a new company established as a wholly-owned trading arm of Kent County Council.

Guided by the four “tests” for the move to an ABS, key features involved:

- An intensive phase of business planning, lasting approximately 6-9 months. This involved detailed and specialist planning to scope out a realistic assessment of costs and unforeseen circumstances.
- The Solicitors Regulation Authority (SRA) rules prevent in-house teams from trading widely, so Invicta Law was established as an independent operation rather than a bolt-on to an existing in-house team. All but five of KLS’s 125 lawyers and 35 support staff were moved into the ABS. The five who stayed at the council form a commissioning group and provide high-level governance advice to the council.
- Invicta Law started full operation in spring 2017, with Kent CC as the sole shareholder and all of Kent CC’s legal services are provided directly by Invicta under a 10-year contract.
- The new operating model is significantly technology-led, with an investment in IT to strip out staff time and costs on processes. This digital model also enables a more accessible, simpler client interface through a portal, which is geared towards the needs of its public service market – cost effective and attuned to local government priorities.

Although it is early days, Invicta Law has successfully secured a number of contracts, including a place on the Universities Procurement Consortium framework, and is subcontractor to major law firms doing public sector work.

LESSONS LEARNED

Having identified a tradeable service, some tips for those considering the transition to an ABS are:

- Don't enter this with rose-tinted spectacles – it is harder and much more complicated than you can imagine at the outset. The importance of thorough, specialist business planning in advance cannot be overstated. This needs to scope the myriad of unforeseen costs that wouldn't be incurred as an in-house service, and identify profit margins over and above this.
- Make sure you select a management team carefully, one which includes commercial skills. The skillset required in the private sector is different to those required in the public sector, so be aware of this when selecting a balanced top team that can match the public service ethos with private sector mentality.
- Be conscious of the need to bring staff with you when TUPEing over. KLS went through a phase of double the normal rate of staff turnover during the transition. Although the move to an ABS was a lifeline to a service that may otherwise have been under threat, don't underestimate how this might unsettle staff. Take great care to ensure constant communication and be aware of this.

For more information contact Geoff Wild, previously Director of Governance and Law at Kent CC and now Chief Executive of Invicta Law on geoff.wild@invicta.law or 0300 041 6840.

CASE STUDY 3:

ESTABLISHING A FULLY AUTONOMOUS TRADED COMPANY – NORSE GROUP

Norse Group is wholly owned by Norfolk County Council, and is made up of three trading companies: Norse Commercial Services, NPS Group and Norsecare. All primarily deliver services to local authorities, and a high proportion of turnover is generated through joint ventures with councils using the Teckal Principle, in which local authority wholly-owned companies are not subject to EU procurement rules.

The company commenced trading in 1988, and today has an annual turnover of £300m, with around 10,000 employees (and is responsible for a further 3,000 including suppliers' and sub-contractors' staff). There are several guiding objectives which the Norse Group aims to meet:

- The prime objective is to return money to its shareholder, Norfolk County Council, through rebates for services delivered and dividends.
- More broadly, through partnerships they aim to return cash through profit-share arrangements, and to provide more efficient services which save councils money.
- There are additional objectives both to deliver wider financial benefits to communities in which they operate, and as a result of their public sector ownership, to deliver a high level of social value,

particularly with regard to employment practices, environmental management and support for good causes.

About ten years ago, Norse Group's board decided to bring in more commercial practices and disseminate them throughout the organisation. This was based on the understanding that the ability to grow through winning external contracts becomes more important over time – profits generated from external work replaced efficiency savings as the major financial benefit. Key features of Norse Group's model which have been conducive to its success have since involved:

- Clear separation and conscious distancing of the company from its parent and shareholder Norfolk County Council. This included rebranding and running its own backroom services, most notably finance and HR.
- Developing a commercial culture, through for example employment practices, with a profit-related and performance-based management approach, and recruiting from the private sector to fill senior positions.
- Significant investment in sales and marketing to win work competitively.
- Developing the partnership model which led to geographic expansion, and diversifying services.
- Constant investment in commercial IT systems and a focus on increasing productivity.

Norse Group has commissioned assessments from SQW to measure its impact. Over

the last five years, it has saved the public purse £90 million, through a combination of operational efficiencies; reduced procurement and management costs; profit share with joint venture partners and payments to Norfolk County Council. Annual GVA is identified at £286m a year GVA nationally, and £129m in Norfolk, based on spending on goods and services locally and the value of wages of direct and indirect employees. This is set to top £300m during 2017/18.

LESSONS LEARNED

Based on 29 years of trading, evolving its model during that time, and based on discussions with local authorities who are considering setting up their own commercial operations, the following key considerations are identified from the experience of Norse Group:

- Lack of clarity about what you are trying to achieve can be a big stumbling block. Operating in a highly competitive market dominated by large, well-established players is not for the faint-hearted, and it is where most local authority trading companies fail.
- Cultural change is often the most difficult hurdle, but is an essential ingredient for long-term success. It is important to develop a commercial culture throughout the organisation. This includes recognising the benefits of growth in cultural as well as financial terms, and having a focus on profit.

For further information, contact Geoff Tucker, sales director, Norse Commercial Services, on Geoff.Tucker@ncsgrp.co.uk or 01603 894 383.

CONCLUSIONS

The existing guidance and the lessons from the case studies reveal the consistent message that setting up a trading company is not a decision to be taken lightly, nor without risks and complexity. Robust business planning with identification of risks and costs is an absolute prerequisite, because the transition needs to be entered into on the basis of the fullest information and intelligence available.

A recurring theme of the case studies is permissive leadership, from both politicians and senior management, which need to be aligned over absolute clarity on objectives. These then inform the nature of the model and can involve compromises or hard choices in pursuit of the outcomes agreed. The ability to invite and respond to external advice and challenge, and to bring in new skillsets is also crucial. This requires full awareness that setting up a trading company will fundamentally overhaul existing practice, but may, if implemented intelligently, yield considerable benefits – in this way both the risks and the rewards are potentially higher.

FURTHER READING:

For councils considering establishing trading activity, some useful background reading includes:

Local Government Association (2017):

[Enterprising Councils - Supporting councils' income generation activity](#)

Vivien Holland, Regional Head – Local

Government Advisory (2015): [How best to set up a local authority trading company](#)

Grant Thornton (2015): [Spreading their wings - Building a successful local authority trading company](#)

Grant Thornton (2016): [Legal considerations for a local authority trading company](#)

Localis (2015): [Commercial Councils - The rise of entrepreneurialism in local government](#)

This Innovation Briefing is the first in a series from NLGN for our members. If you have any feedback, or ideas for topics to be covered, please contact Jessica Studdert, Deputy Director on jstuddert@nlgn.org.uk.

Disclaimer: This Innovation Briefing is based on a literature review and interviews with practitioners and is intended as a starting point for deeper exploration. The information provided in the briefing is not a substitute for the necessary due diligence or professional advice required when engaging in commercial activity.