

# Arms Length Bodies: Alternative Models for Service Delivery



## ARMS LENGTH BODIES (ALBS): ALTERNATIVE MODELS FOR SERVICE DELIVERY

### A Summary of Current Drivers of Change and Options for the Future



#### Foreword

The Public Chairs' Forum (PCF) is a network of Chairs of public bodies, working to improve the efficiency and effectiveness of public services. The PCF enables Chairs to work together to identify how things could be done better, in their own organisations and across what is now called 'Arms Length Government'.

The Coalition Government is committed to reforming Arms Length Bodies (ALBs) and to significant reductions in the amount of money spent on public services. They have told us that they want to see major improvements to transparency, accountability and efficiency. Chairs of ALBs have a unique and important contribution to make. Their relative independence allows them to look objectively at what could and should change.

By harnessing the expertise and experience of its members, the PCF has the potential to make a real and positive difference to the delivery of key public services, at a time when there is real urgency for change within Government.

Chairs will want to take a positive, proactive and imaginative approach to the challenge to reform and reduce costs.

As part of this, they will want to consider a range of alternative models. One of the questions they are asking themselves is, 'How else might we organise ourselves to deliver the Government's objectives more efficiently, with greater transparency and clearer accountability?'

That is why we asked leading law firm Reynolds Porter Chamberlain LLP (RPC) to make us aware of alternative models of organisation which Chairs should be taking in to account. What follows is RPC's response and something practical for Chairs to consider and think about with their Chief Executives and sponsoring Departments. RPC's response is designed to be a high level review of the current background situation (sections 1 and 2), the options available (sections 3 and 4) and the drivers that might guide Chairs when considering their own organisations (sections 5 and 6). At the end of this document you will find a checklist of points to consider.

I am very grateful to Barry Stimpson and his colleagues at RPC for carrying out this work and hope that by offering fresh and innovative perspectives on alternative models of delivery and the different means of achieving improvements, this paper will provide potential solutions to some of the challenges that Government and ALBs are facing at this time of change.

**Christopher N Banks CBE**  
Chair, Public Chairs' Forum

1.

## GOVERNMENT REVIEW OF WHETHER THE ACTIVITIES OF AN ALB HAVE TO BE PROVIDED BY AN ALB

The Government has published the factors it will consider when addressing the issue of whether the activities of an ALB have to be provided by an ALB. The first and most fundamental question is, of course, whether the work has to be carried out. After that, the key factors are:

1. whether the ALB performs a technical function
2. whether there is there a need for political impartiality in performing the role; and
3. whether the role brings a need to act independently to establish facts.

Any ALB will need to meet at least one of these three criteria in order to justify its continued existence.

2.

## FINANCIAL PRESSURES IMPACTING ALBS

In addition to the above, other factors are also contributing to pressures for a restructuring of ALBs.

The Government has announced that it is seeking to cut the budgets of most Departments by 20% - 40% by 2014/15 and Departments are being asked to make proposals to achieve these cost savings.

In the Spending Review framework document (June 2010) the Government set out nine criteria which Departments should apply to their activities to ensure that they are getting value for money. These questions are:

1. Is the activity essential to meet Government priorities?
2. Does the Government need to fund this activity?
3. Does the activity provide substantial economic value?
4. Can the activity be targeted to those most in need?
5. How can the activity be provided at lower cost?
6. How can the activity be provided more effectively?
7. Can the activity be provided by a non-state provider or by citizens, wholly or in partnership?
8. Can non-state providers be paid to carry out the activity according to the results they achieve?
9. Can local bodies as opposed to central Government provide the activity?

Clearly, routes such as abolishing ALBs, merging them or simply reducing their role and funding are ways in which the Government may seek to achieve such savings.

Indeed, plans for the abolition of some Regional Development Agencies, the Qualifications and Curriculum Development Agency and the Structure Planning Commission have already been announced and on 24 May 2010 emergency budget measures announced savings of £500m in this sphere. However, as the Institute for Government (IFG) said in a recent report "a simple cull of ALB numbers does not always amount to major reductions in cost" and there are other ways in which to structure the delivery of ALB activities which would save money for the Government.

3.

### ALTERNATIVE MODELS FOR SERVICE DELIVERY OF ALB ACTIVITIES

Alternative models for service delivery of ALB activities include:

#### Empowering ALB staff to undertake the activity themselves (outside of the public sector) by way of employee mutualism

There is significant research which indicates that mutual undertakings can release the energy, innovation and loyalty in staff to the benefit of an undertaking. In addition, research also indicates that mutual enterprises can be more resilient in economic downturns and perform well over economic cycles.

Statements of Government policy regarding the Big Society and encouragement of people to provide for their own futures would also appear to be very compatible with employee mutualism in the workplace generally and its application to ALBs.

#### Establishing joint ventures between ALB staff and the private sector

There may well be circumstances where it is not possible for employees to take full ownership of their own undertakings, perhaps because they do not have the management expertise, infrastructure and/or financial resources to do so.

In these circumstances, a joint venture with the private sector may be an appropriate way forward.

#### Moving the activity entirely to the private sector by way of sale/transfer of the ALB's staff and assets to private sector entities/investors

This route would offer an effective solution if employee mutualism/joint ventures are not feasible or not the most effective solution.

#### Outsourcing the activity to the private sector

This is a well trodden path and has provided significant support to the public sector for a considerable period now.

#### Returning an ALB's activity to central Government

Returning policy making ALBs (such as the Qualifications and Curriculum Development Agency) to Departments may yield cost savings and in other cases it may be concluded that an ALB's activities simply do not meet the value for money criteria set out above and should be discontinued.

4.

### NO ONE SIZE FITS ALL

The IFG has estimated in its Report that there are 900+ ALBs accounting for over 13% of Government expenditure. There is huge variety in the activities and characteristics of ALBs.

It is arguable that a large number of ALBs do not undertake (or have functions that are not within) the criteria referred to in section 1 above and those in this category should have other options for their service delivery considered.

Given the huge variety of ALBs, a review of them will need to consider their specific activities and circumstances and we set out below some factors which may well be drivers in a decision making process.

**5.****WHICH FACTORS WILL DRIVE THE SELECTION OF AN ALTERNATIVE MODEL OF DELIVERY?****The function of the ALB**

Clearly, this will be central. Is the activity operational or advisory, people driven or asset driven? Will Government continue to have any requirement for it? Is it of application outside the public sector?

**Contract for provision of activities and current legal form**

Is there a contract for the provision of its activities which would continue to be effective going forward? Are arms length type payments made for the activity provided? Do these arrangements have change of control clauses such that they might fall away on a restructuring?

The current legal form of the ALB will also make any restructuring of it more or less complex. If the ALB is structured as a company limited by shares or guarantee (albeit under statute) and has a contract for its activities, this will clearly make its restructuring simpler than if it is a body corporate but not structured as a company and/or has no commercial type contract for the supply of its activities.

**Financial Viability**

Even if the activity is not intended to be profitable going forward, it must be financially viable over a period of time if disruptive financial failures are to be avoided.

If viable, is the ALB capable of making a profit whether from its current relationships or by widening its customer base into the private sector? Alternatively is the activity such that the making of a profit would be regarded as inappropriate?

**Government attitude to Value**

The Government will presumably wish to obtain fair value in its arrangements regarding ALBs.

In some cases (for example infrastructure such as bridges and roads), this is almost certain to eliminate some options (for example employee mutualism) and trend towards others (sale to a major commercial group or infrastructure fund for example).

In other cases (people activities such as the operational/advisory roles undertaken by many ALBs), fair value may not be prohibitive for employee mutualism and employee/private sector joint ventures. Such activities often require few tangible assets and often rely on their staff as their main asset.

In other cases (where there is little scope for profitability, or where profitability is not an appropriate goal for the activities), value may not be a factor in deciding the appropriate way forward for the activity.

**Whether the ALB has a purely local role**

An ALB having a local role (particularly where profitability is not a factor) may point the way to specific options such as the use of Community Interest Companies, charities or other local arrangements.

6.

## POTENTIAL LEGAL STRUCTURES FOR IMPLEMENTING CHANGE

### Limited Liability Partnership (LLP)

An LLP could be a very suitable vehicle for activities where employees are to play an important role in owning and managing the undertaking going forward. An LLP is a body corporate which provides limited liability for staff, is tax efficient in certain circumstances and very flexible in terms of the arrangements that can be included in its constitution. It can also be readily used as a joint venture vehicle as parties such as private sector companies engaging in the joint venture with ALB staff can be admitted to the LLP as corporate members whilst ALB staff are members in their own right. As a body corporate an LLP can also give floating (as well as fixed) charges to banks as security for loans and this may help it obtain bank funding.

However, an LLP could only be used where the entity is designed to be profit making. Partnership

A partnership would be an option in very similar circumstances to those appropriate to an LLP, but does not offer the advantage of limited liability.

### Company

A company (limited by shares or guarantee) is a structure that could be used in many circumstances. Again, a company has the advantage of conferring limited liability. It can be used where the intention is to make a profit and where it is not (for example charities are often companies limited by guarantee and companies limited by shares can be used as community interest companies).

Companies can also be very flexible and may well be the most appropriate choice where significant external finance is required, perhaps in the context of asset heavy activities and where the activity being transferred has value sufficient to require private equity and/or other external sources of finance.

### Management But Out (MBO) and Management Buy In (MBI)

MBOs could be employed where it is decided that existing staff can purchase the activity they are currently engaged in and it is felt that the activity has significant value that should be paid for. Essentially, a company is established which is largely funded by third parties (such as private equity houses and banks), run by management and in which management have a significant financial stake. It is also very possible for more junior staff to invest in the MBO company, either directly at the time of the MBO and/or by participating in various types of share option scheme. Where external management buys into the activity, it would be termed an MBI.

### Share option Schemes

Whatever the share ownership of employees at the time of the restructuring of the ALB, share option schemes can be used to incentivise staff, align their interests with those of the company and assist with staff retention.

Sharesave schemes allow staff to save with a building society for 3 or 5 years and use the monies saved to buy shares in the company at a price fixed when they started saving (or to simply withdraw the money saved as cash).

Company share option schemes and employee management incentive schemes allow staff to have options over a specified number of shares and to exercise them within a specified time frame, at a price fixed when the option was granted.

All of these share option schemes confer tax advantages such that, under current rules, no tax is payable on the grant or exercise of the option and capital gains tax is calculated by reference to the exercise price when shares are ultimately disposed of.

### **Not for profit companies/Charities**

Companies can be established with constitutions that bar profits from being distributed to members. In other respects, they can be constituted with the same structures as commercial companies. Such entities could be ideal in respect of activities where it is not considered desirable to undertake the activity with a profit motive.

Charities, similarly, could undertake some of the activities currently undertaken by certain ALBs.

### **Community interest companies (CICs)**

A CIC is a company established along usual lines, but where assets are locked into the company and distributions of profit to members are capped (inter alia at 35% of distributable profits). This structure would permit the incentivisation of staff and others by permitting the distribution of some profit, but within well defined limits.

### **“Co-operatives” and industrial and provident societies**

These structures have proved of value to many organisations including large scale building societies and retailers.

The form can vary widely from that of a society owned by its customers (such as a building society) to a company where a trust owns the share capital and holds in on trust for staff (such as the John Lewis Partnership).

There is research to suggest that such structures (particularly the latter) do incentivise staff although there does have to be a management structure such that strategic decisions can be taken and the organisation run on a day to day basis.

### **“GOCOs”**

In certain sensitive sectors, for example where there are security considerations, Governments have been prepared to encourage third parties to operate undertakings but have wished to retain the ability to control their activities when necessary. Government Owned/Contractor Operated entities (GOCOs) have been developed to facilitate this as the structure permits each party to perform the duties for which it is best suited and allows the Government to take back control in circumstances where it needs to.

### **Checklist and Next Steps**

Printed on the last page of this document is a checklist of matters for Chairs to consider in relation to their ALB.

Barry Stimpson and his colleagues at Reynolds Porter Chamberlain LLP have extensive experience in public sector and restructuring matters, including employee owned entities, MBOs, MBIs and the other types of structure referred to above. They would be delighted to arrange no obligation meetings with Chairs to discuss the issues summarised in this document and can be contacted on 020 3060 6434.

## CHECKLIST

1. **Is the ALB's activity still required by government?**
  - Does the ALB perform a technical function ?
  - Is there a need for political impartiality in performing the role ?
  - Does the role bring a need to act independently to establish facts ?
  
2. **Are the activities providing good value for money?**
  - Is the activity essential to meet Government priorities?
  - Does the Government need to fund this activity?
  - Does the activity provide substantial economic value?
  - Can the activity be targeted to those most in need?
  - How can the activity be provided at lower cost?
  - How can the activity be provided more effectively?
  - Can the activity be provided by a non-state provider or by citizens, wholly or in partnership?
  - Can non-state providers be paid to carry out the activity according to the results they achieve?
  - Can local bodies as opposed to central Government provide the activity?
  
3. **Issues to review when considering alternative models**
  - What is/should be the function of the ALB ?
  - Is there a contract for the provision of its activities ?
  - What is the current legal form of the ALB ?
  - Is the ALB financially viable ?
  - Will the ALB need to make a profit and could it ?
  - Does the ALB currently have a high financial value ?
  - What is the Government's attitude to that value ?
  - Does the ALB have a national or local role ?
  - To what extent is employee involvement practicable ?
  - Which of the legal models might be most appropriate going forward ?



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July 2010



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