PCF
PUBLIC CHAIRS'
FORUM

INSTITUTE FOR GOVERNMENT

MUTUALISATION

AN ALTERNATIVE MODEL FOR ALB'S

CONTENTS

INTRODUCTION

Public sector workers are being encouraged to form mutuals to take over public services and, in turn, improve the quality of outcomes. This short report provides information and guidance on how this could work in Arms Length Bodies (ALBs).

The exploration of alternative models of service delivery forms part of the Government's drive to realise the Big Society. With the Big Society comes a greater role for private companies, charities and employee-owned co-operatives.

ALBs are urged to think creatively about how they might be able to deliver their services differently, both in the interest of improving the efficiency and effectiveness of their organisations and as part of the Government's philosophical drive for devolution. By opening up public services in this way, it is hoped that it will lead to a more motivated and effective workforce with a vested interest in the way that public services are run.

As part of this approach, the Government announced last year a pathfinder programme for mutuals and employee-led organisations. The pathfinders signal a commitment to new organisational forms to allow greater innovation and entrepreneurialism within front line service delivery, paving the way for many more similar endeavours.

As the Government encourages all aspects of the public sector to take a proactive approach and seriously consider different types of reorganisation, this joint guide identifies the options that different ALBs could potentially adopt in the context of mutualisation.

Of course, moving from idea to reality involves extensive work and research and inevitably there will be risks and challenges along the way. But there are also great opportunities.

Comment pieces from the Public Chairs' Forum and the Institute for Government identify some of the broader issues relating to the development and application of ALB mutuals. *Mutualisation – new thinking in public services* considers the opportunities that employee led organisations could bring as part of the drive towards more efficient and effective delivery of public services, whilst *A tale of two mutuals* looks at the benefits and potential pitfalls that can arise from 'going mutual'.

Barry Stimpson, Partner at law firm Reynolds Porter Chamberlain LLP, closes this guide by providing information and advice on what the legal structures could look like, according to the type of organisation that you work in.

If you would like to follow up on any of the contents of the report, please contact Amy Noonan, Manager of the Public Chairs' Forum.

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MUTUALISATION OF PUBLIC SERVICES

SUMMARY OF RECENT PUBLIC CHAIRS' FORUM AND INSTITUTE FOR GOVERNMENT SEMINAR

Part of the inspiration for this publication was the seminar that the Public Chairs' Forum (PCF) and the Institute for Government ran at the end of last year. Chaired by PCF Chair Chris Banks, the seminar explored mutual options for Arms Length Bodies (ALBs). Attendees heard from a panel of experts who offered varied perspectives on this area based on their experiences.

Barry Stimpson, Partner at law firm Reynolds Porter Chamberlain LLP (RPC), started the seminar by providing the facts on what is and isn't possible for ALBs in the context of legal structures. His presentation built on a seminar that the PCF had run previously with RPC, which considered alternative models for service delivery in more general terms. An extended version of Barry's advice can be found in this guide.

The planned closure of the Audit Commission was announced last year, with a new set of arrangements being put in place for the audit of new public bodies. Employees of the Commission are currently exploring mutuals as an option for service delivery post closure. Chris Westwood, Director of Professional Practice at the Audit Commission, talked through some of the challenges and issues that they had encountered to date.

Dr Martin Hurst, Director, Defra Estates & Arms Length Bodies, drew on lessons from the mutualisation of British Waterways. He closed the presentations by offering some helpful lessons learned:

- Converting your organisation to a mutual practice is more resource and time intensive than you can possibly imagine. Complexity is multiplied when property is involved.
- There is a need for clarity on why you are doing this early on – set success criteria up front.
- It is necessary to do as much due diligence as you would do in the private sector.
- It can be hard to work out what you are getting for your money in terms of risk transfer.

The seminar generated much interest in mutual options for ALBs, with a clear appetite for further learning. This guide builds on these initial discussions and provides information and advice to ALBs and Departments on this increasingly important area.

MUTUALISATION – NEW THINKING IN PUBLIC SERVICES

A huge penny dropped for me when I was MD of Coca-Cola. One of the many business 'gurus' I got to meet told me, 'Your organisation is perfectly aligned to the results you are achieving'. It is so simple, you may feel it is a statement of the blindingly obvious. Yet I have found the implications to be quite profound. If you want to achieve a different result, you have to change the organisation; if you want a very different result, you have to change the organisation a lot.

Challenging Times

The Coalition Government has now laid out how it intends to cut public expenditure to reduce the UK's deficit; and to reform the management of public services to ensure they are delivered more efficiently and effectively and with greater accountability and transparency. This represents change on an unprecedented scale, neatly summarised as 'more for less', and hugely challenging for those responsible for delivery. So how should we respond?

Need For New Thinking

Albert Einstein gave us a clue when he said, 'We cannot solve our problems with the same thinking we used when we created them'. In other words, we are going to have to come up with some new - even radical - ways of thinking about how to deliver public services, if we are to achieve the objectives laid out by the Government. The Coalition is not just giving us permission to do things differently; it is actively encouraging us to innovate throughout the public sector.

That is why the Public Chairs' Forum (PCF) worked with law firm Reynolds Porter Chamberlain LLP to produce its recent report, 'Alternative models for service delivery'. The PCF has also worked with RPC and the Institute for Government, to do this follow-up report specifically on mutualisation. Both reports contain practical advice on radically reorganising public services.

Of course, there is no 'one size fits all'. The right solution for one organisation may be radically different from that for another.

Employee Mutuals As Part Of The Answer

Some public bodies will respond positively to the challenges they are facing and will take the opportunity to review all aspects of the way they operate, focus their mission, become stronger and more independent institutions, maybe develop alternative income streams to reduce their dependence on the public purse. They may need access to private capital to enable them to invest in service improvements.

Mutualisation may be part of the answer. It is unlikely to be the whole answer, but it empowers staff and incentivises them to work efficiently and effectively, encouraging them to focus on the success of their organisation and to share in its success.

I have worked up the detail of how this could work for Colleges of Further Education and you can find out more about it at **www.vocademix.com**. In time, there will be many alternative models to consider.

Opportunity

The key will be to see the opportunities in the current changes and challenges. To let go of those things which have been preventing us from providing the service in the way we know will work better. To build, from the bottom up, a new public service based on new models. We can improve both the efficiency and effectiveness with which public services are delivered, by harnessing the passion and commitment of our staff to national and international best practice and new approaches. That seems to me like a big opportunity!

Chris Banks is Chair of the Public Chairs' Forum . He is former Chair of the Learning and Skills Council and Managing Director of Coca-Cola GB.

A TALE OF TWO MUTUALS

It is the best of times, it is the worst of times. The best of times because for those in the public sector who are entrepreneurially minded and willing to take a few risks then the government has never been keener to help you form your own mutual. The worst of times because this also happens to be a time of massive public sector cuts so be under no illusion that this is going to be a tough journey.

Reasons To Be Cheerful

Francis Maude is clear about the benefits of public sector mutuals. They will “challenge traditional public service structures and unleash the pent-up ideas and innovation that has been stifled by bureaucracy”. The logic runs that when people work in an organisation in which they have a real stake then their motivation and productivity improve. Freed from the restrictions of the state, public sector mutuals should be also more innovative and able to challenge out-dated thinking.

The vision is enticing, and certainly has attractions for a public sector trying to make savings wherever possible. It also sounds appealingly romantic from the employees’ point of view. Gone are the upper echelons of management and all the frustrations and bureaucracy of being part of a large organisation. Welcome to a world of new freedoms to pursue your vision with like-minded colleagues.

Of course, it’s not quite as simple as that. In fact, the truth is quite sobering and will require careful thought before taking the plunge. To describe what I mean I’ll use two different types of mutuals as examples. These have deliberately chosen as ‘pure’ models to illustrate the point.

Spinoffs

The first type of mutual is what we might call a spinoff. This is the straightforward case in which a service, which was previously part of a larger, public sector organisation decides to ‘go it alone’. The existing management team will remain largely intact, as will most of the staff, and the types of service being offered will remain the same. The benefits of spinning-off will presumably be a combination of reduced overheads, greater control over assets and increased freedoms.

The logic of the spinoff implies that the basic business model remains the same, which implies that it wasn’t broken in the first place. This might be a poor assumption, especially when revenues are likely to be increasingly squeezed and costs could increase if the mutual now has to pay for shared services that used to be ‘free’ and is now subject to VAT. The lesson here is to draw up a solid business plan in advance. How certain are you of those numbers?

The relationship between newly formed mutuals and their commissioners is being hotly debated. To what extent will commissioners be able to ‘guarantee’ contracts? Competition law makes this difficult and in reality there may be nothing to stop other providers (including other newly formed mutuals) from swooping in and stealing business away.

Start-ups

The mutual described above is perhaps a little too far from Francis Maude’s vision in that it is not really challenging public service delivery models. If the model is broken then a totally new approach may be required, for example, by combining previously independent services or completely redesigning the operations. I call this kind of mutual a start-up because it is much closer to a brand new enterprise.

Start-ups will have fewer ‘legacy’ issues to deal with than spinoffs because they will be predominantly ‘new’ organisations. This also means they will need to fight harder to gain access to assets and contracts. Commissioners will need convincing to take the risk on something new and unproven, as will bankers and other backers.

The risks will also be higher for the staff. If a genuinely new model is being adopted then there is likely to be reasonable chance of failure. This kind of risk-taking is not for everyone and might be especially difficult for those used to the relative safety of the public sector. Of course, the payoff, if the enterprise succeeds, could be all the greater in terms of the public outcomes achieved.

Looking Ahead

Of course, most mutuals will fall somewhere between a ‘pure’ spin-off or start-up and therefore face some combination of the challenges identified. What is clear is that whatever the model, establishing a mutual will require a number of tough choices and difficult management issues to be addressed. Don’t let misty-eyed romanticism get in the way.

Recognising the challenges ahead the Cabinet Office has recently established a Mutuals Taskforce and is helping to support a number of ‘Pathfinder’ mutuals. Capturing the early lessons from these pilots and making sure prospective mutuals have access to the appropriate levels of support will be vital if we are to move beyond a few dozen examples to the hundreds or thousands required to truly transform our public services.

Adrian Brown is a Fellow at the Institute for Government where he leads research on public service reform. He formerly worked for Tony Blair as a policy adviser, and as a management consultant at McKinsey & Company.

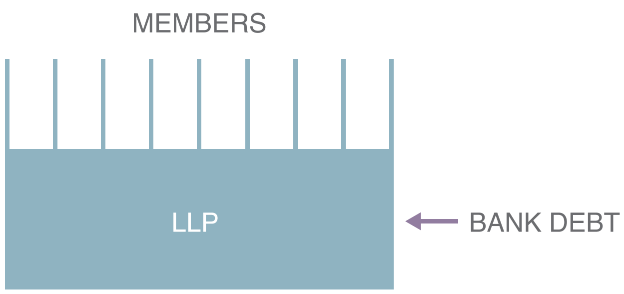
MUTUAL OPTIONS FOR ARMS LENGTH BODIES – A LEGAL PERSPECTIVE

Introduction

There are a range of legal structures that could be used as vehicles for alternative models for service delivery. These include the limited liability partnership (**LLP**), the traditional UK company, (perhaps in conjunction with share option schemes and with or without external debt and/or equity funding), the charity/not for profit company, the community interest company (**CIC**) and the co-operative/industrial provident society.

All of these vehicles have different structures, legal parameters, tax ramifications and other characteristics and choosing the vehicle which will be most appropriate in specific circumstances will depend upon the mix of considerations which are relevant.

Limited Liability Partnerships

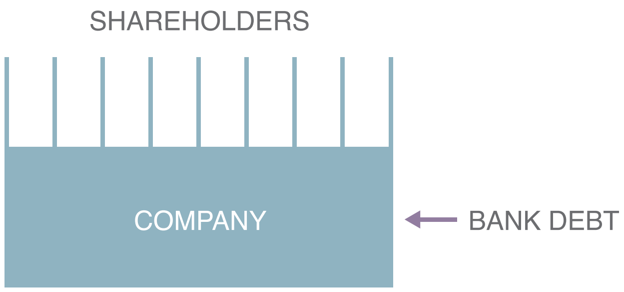


LLPs are particularly suited to "people businesses" where the members will own and be involved day to day in the business and where profits will usually be paid to members and not retained in the LLP. The LLP must be established for the purpose of carrying on a business with a view to profit.

As a body corporate, an LLP offers limited liability to its members, because the LLP is liable for its debts and obligations rather than the members themselves. An LLP can enter into contracts and employ staff and borrow money from funders in its own right.

Another advantage of an LLP is that it is tax transparent. With a company for example, the company will pay tax on its own profits (income and gains) and will then pay remuneration and/or dividends and other benefits to its employees/ directors/ shareholders who will be taxed on them in turn. This will usually result in two layers of tax and will often result in a higher tax burden than would be the case with an LLP. An LLP is generally looked through for tax purposes. It is not itself liable to pay tax on its profits and its members are taxed as if they had received their share of those profits direct.

UK Company



A company also confers the benefit of limited liability for shareholders and staff. Again, a company is a body corporate which is itself liable for its own debts and obligations.

A company can of course be established with a view to making profits and paying distributions to shareholders but need not be established with a view to profit and can therefore also be used for charitable and not for profit purposes, as will be discussed below. A company limited by guarantee is often the preferred entity for a charity and a company limited by shares for a community interest company.

As noted above the tax treatment of companies may or may not be more suitable to the new service provider, depending upon the exact circumstances of the case. Use of a company does create two layers of tax instead of one, but the retention of profits in the business and other factors can still mean that a company is more tax efficient than other types of entity.

A particular issue that also impacts on companies with relatively large numbers of employee shareholders is that of employees joining or leaving the firm. Will new joiners automatically be entitled to shares in the company or will this depend upon length of service or individual contribution? Will staff who leave be entitled to keep some or all of their shares or will they be required to sell them either to other employees or to a trust set up for the purpose (an Employee Benefit Trust, **EBT**)? Decisions made in this regard will have legal, administrative and tax implications for all concerned and may necessitate regular valuations of the company and its shares. It is also possible to establish an employee trust to hold all of the shares allocated to employees on their behalf. This will simplify matters considerably but may also have the effect that employees feel more remote from the shares that are to incentivise them.

Share Option Schemes

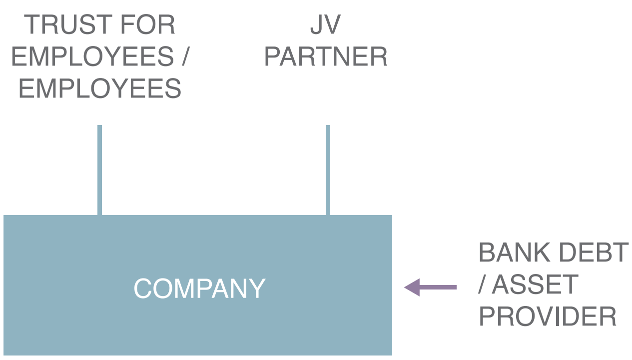
Whatever the shareholding situation regarding employees at the time of establishing the new service provider, share option schemes can be used to incentivise staff, align their interests with those of the company and assist with staff retention.

The most broadly based type of scheme is probably the "Sharesave Scheme" which allows staff to save with a building society for 3 or 5 years and then 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).

Other more focused and/or performance based types of scheme also exist. 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 the shares are ultimately disposed of.

Joint Venture Model

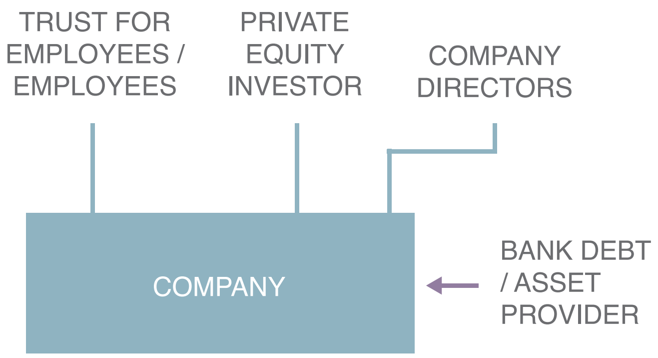


It may be the case that the company taking over the service delivery requires outside resources in order to provide sufficient working capital or development investment, know how, facilities or other expertise in order for it to achieve its objectives.

Short term or long term monies might be raised as loans provided by a bank or other financial institution and/or new shares issued by the company in return for investment.

It may be that a shareholding is necessary or desirable to incentivise another organisation (**JV partner**) to provide other types of resource that are required such as know how, facilities or other expertise. This situation can result in a joint venture, where those establishing the new entity and the joint venture partner all have shares in it. In these circumstances a joint venture or shareholders agreement will be necessary to set out who can make what types of decision and what will happen should those involved wish to exit the arrangement in the future.

Private Equity Model



As noted above, it may be necessary to issue new shares to a private equity (or other financial) investor to supplement equity from employees and directors and bank debt made available to the company. This might provide funds for new facilities, expansion or other strategic objectives. Private equity companies would normally require priority income and capital returns above the other equity investors and protections similar to those common in joint ventures.

Charities

Charities can be established as unincorporated associations, trusts or companies limited by guarantee.

The objectives (**Objects**) of the charity must qualify as "charitable" under the relevant legislation. The main heads of charitable Objects are relief of financial hardship, advancement of education, advancement of religion and benefit of the community.

Charities cannot distribute profits (**surplus**) to their members/trustees/shareholders. Any surplus must be reinvested for the benefit of the charitable Objects or distributed to other charities.

Charities are subject to significant regulation by the Charities Commission and in practice a significant amount of time can be devoted to establishing the charity and ensuring ongoing compliance. Nevertheless, once established, charities do benefit from various tax advantages and may be largely exempt from all taxes (except VAT) If a charity is trading, careful planning can prevent tax from arising on the profits of that trade.

Community Interest Companies

A community interest company (**CIC**) is a limited company carrying on a social activity. This is in many cases similar to a charitable purpose but the definition is a wider and more flexible one.

The assets of the CIC are locked into the company and cannot therefore be stripped out by shareholders. In addition, there is a cap on the dividends that can be paid by the CIC. However, the ability to pay dividends can be a very useful element to take into account when considering corporate entities as it does allow those involved to have some financial reward for their contribution.

A CIC is liable to corporation tax on its trading profits and chargeable gains in the same way as any other company. There are no specific CIC exemptions or reliefs.

Industrial and Provident Societies

The first type of industrial and provident society is the "bona-fide co-operative society" (**cooperative**). A cooperative must be for the mutual benefit of its members and its members must receive benefits mainly from their participation in the business of the cooperative. Decisions must be taken on a one person one vote basis and interest may only be paid on the cooperative's capital to the extent that it is necessary to retain sufficient capital in the organisation. The benefits which are distributed to members must be calculated in relation to the amount of trade that they carry on with the business rather than any other basis.

The other type of industrial and provident society is that operated for the benefit of the community. Such societies are run primarily for the benefit of people who are not their members and in the interest of the community at large. There may be no distribution of profits and upon the dissolution of the society, its assets must be passed to a successor society. The philosophy and purpose of these types of society are therefore similar to those of charities and CICs in many ways.

A special tax regime applies if the society is "mutual trading" with its members. Otherwise, it is subject to corporation tax on its profits in a similar way to a normal company. Special tax rules apply to benefits distributed to members.

CABINET OFFICE PATHFINDERS

In August last year, the Government announced a pathfinder programme for mutuals and employee-led organisations. The pathfinders signal a commitment to new organisational forms to allow greater innovation and entrepreneurialism within front line service delivery, paving the way for many more similar endeavours. The pathfinders are listed below:

- An awarding body setting up as a mutual by a consortium of FE colleges;
- The London Partnership – creating a 'reducing multiple disadvantage' community interest company
- The Department of Health's London and South East learning disability team forming a regional community interest company;
- Hammersmith and Fulham Children's Services exploring new models of delivery with staff, possible commercial partners and neighbouring local authorities;
- North East Essex Primary Care Trust spinning out into a community interest company;
- The creation of a social enterprise for delivery of housing support services to vulnerable people in Mansfield, bringing together a range of public sector workers;
- The Lambeth Resource Centre exploring options for co-producing services with employees, service users and third sector organisations to provide rehabilitation support for people with physical and sensory impairment;
- NHS employees forming a social enterprise to provide joined up services for homeless people in Leicester;
- Teaching and administrative staff planning to set up a Trust to run Newton Rigg Agricultural College in Cumbria;
- The Royal Borough of Kensington and Chelsea working with employees to examine the potential for different models of employee led youth support services;
- Integration of Community Health and Adult Social Services in Swindon into a cooperative; and
- Westminster City Council working with employees in Children's Services and neighbouring local authorities to move towards creating an arms-length mutual organisation.

FURTHER INFORMATION

- Alternative Models for Service Delivery, Public Chairs' Forum and Reynolds Porter Chamberlain, 2010
- 'The Feeling's Mutual', Adrian Brown, Institute for Government
- Employee Ownership Association
  Mutuals helpline:
  Phone: 020 7922 7737
  Email: info@employeeownership.co.uk
- Watch a video explaining the John Lewis Partnership model (YouTube, 2m:43s)
- Mark Easton's BBC blog: John Lewis model for government
- For further information about the legal structures referenced in this report, contact report contributor Barry Stimpson: Phone: 07788598001