THE FUTURE OF CHESHIRE SHARED SERVICES

STRATEGIC OPTIONS APPRAISAL & HIGH LEVEL BUSINESS CASE

Updated 13 December 2012

CONTENTS

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DOCUMENT APPROVAL

		Date
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1. Executive Summary

Since their creation in 2009, Cheshire East (CE) and Cheshire West & Chester (CWaC) Councils have been successfully sharing services and to date has achieved significant savings of £6.7m in the areas of ICT and HR & Finance.

With the formation of two new local authorities, each with their own cultures and identities, combined with the impact of an economic recession and austerity measures, it is understandable that the development of shared services has been of one of learning and maturity. There have been teething troubles, and difficulties along the way, but what has been achieved is remarkable. Both authorities have been able to fully depend on back office shared services to deliver high quality services to their citizens while reducing costs.

Over the last 18 months Cheshire Shared Services have been on a journey of continuous improvement to ensure the Councils receive the level of service they expect. These shared services have been benchmarked against peers to understand their market position. This baseline position have been used to inform new ways of working including operating models, financial and performance management, governance, and culture change to raise customer satisfaction and promote confidence in service delivery.

Through shared service governance, it was recommended in November 2009, pending outcome of further investigation, that these shared services are developed into a company which has the capability to reduce costs and generate income. Achieving this aim requires a change in the business model from one of constitutional governance to a commercial company model referred to as a separate legal entity (SLE). As an SLE, "The Company" will have greater autonomy to run its business affairs, but will be accountable to the local authorities as shareholders and also as a supplier of goods and services.

In 2010 Price Waterhouse Coopers (PWC) were commissioned to assist in this analysis. A programme of comprehensive research was undertaken and the following key outputs were produced; Strategic Options Appraisal for Shared Service [1]; Collaboration & Trading – High Level Business Strategy [1]; Market Analysis for Shared Services [1]; Due Diligence Outputs [1].

This document does not seek to replace this detailed analysis, but to review the original decision to provide reassurances that this remains credible given the passage of time. It is intended to provide a high level summary of the strategic delivery options that are available for the councils to take; the strengths, weaknesses and implications of each option; and to examine in closer detail the recommended way forward proposed by the Joint Officer Board – to create a separate legal entity (SLE).

A key objective of this document is to establish the basis for the council to take the decision on whether to proceed with the externalisation of these services. A formal decision is scheduled for early January 2013. It is also intended to confirm the scope and phasing of any externalisation option and authorise officers to commence implementation activity.

[1] These are large documents and can be made available on request

2. Strategic considerations for Externalisation

There are numerous national drivers for change and an increasing focus on Local Authorities to externalise service provision. This section does not attempt to provide an exhaustive list of external drivers. It merely seeks to serve as a reminder of two of the most current drivers for change.

Localism Act 2011

The Localism Act 2011 introduces a new General Power of Competence (GPC), which explicitly gives councils the power to do anything that an individual can do which is not expressly prohibited by other legislation and to carry out activity for a commercial purpose and could be aimed at benefitting the authority, the area or its local community. By giving councils the flexibility to act in their own financial interests, the GPC will allow councils to do more than was previously sanctioned under wellbeing powers. Councils, on their own or working with other public bodies, can be enterprising by increasingly trading and charging. However activities for a commercial purpose must be carried out through a company.

Public Sector spending

[In the decade ahead public services will need to adjust to significantly lower levels of central funding than in the past. The Chancellor of the Exchequer confirmed in Budget 2012 that significant cuts to departmental spending can be expected at least through to 2016/17. As it is, local authorities are absorbing a 28 per cent cut to their core funding while facing mounting pressures across service areas like adult social care, safeguarding children and waste management. Cuts to Government grants have been further exacerbated by a loss of revenue from existing fees and charges.

At the same time, councils are facing tough decisions about their council tax rates. Given that all services are effectively paid for by the taxpayer, the service user or both, it makes sense to consider whether it would provide more fairness to the taxpayer to ask those who benefit from a service to cover part or even all of its costs.

Across councils, officers and members are becoming more and more commercial in their acumen, outlook and skills to meet future funding challenges. **Trading (i.e. to generate efficiencies, surpluses and profits) and charging (i.e. to recover the costs of providing a discretionary service)** are important options on the menu of innovative ways of working to meet local needs through delivering value for money, sustaining communities and providing choice.

Councillors are playing a critical role, providing leadership to their councils and local partners during these much tougher times. In this context, there are no easy choices. But where choices have to be made they are best made locally by elected representatives who are in daily contact with the people they serve.]

[Reference Source: Local Government Association (LGA) paper - Enterprising councils - Getting the most from trading and charging 2012 edition]

3. Future Delivery - Options Appraisal

Background

In August 2012, the Shared Service Joint Committee requested that the Joint Officer Board revisit a wide range of strategic delivery options to ensure that the Joint Committee had all the pertinent facts and information to make an informed decision on whether an SLE was the best option for both authorities to take.

This Section 3 of the document looks at the baseline position (Do Nothing) and contrasts this with 6 other delivery options.

1. Disaggregate
2. Transfer Model (split hosting)
3. In House Trading
4. Outsource
5. Joint Venture
6. Separate Legal Entity

The appraisal for each option includes the following detail:

- What the option entails
- What this means for CE & CWaC Councils
- Assumed drivers for each option
- Examples of each of these Delivery Models (where appropriate)
- Analysis of the Strengths, Weaknesses, Opportunities & Threats (SWOT) associated with each option
- Financial Illustrations
- High Level Risks
- Summary Overview

3.1 Do Nothing (stay as is)

This option is included to provide a baseline position in which to consider future delivery options.

3.1.1 Baseline Position

The current constitutional model for shared services has delivered significant financial and efficiency savings in back offices services - £6.7m to date, but it has not been without its challenges.

There are a number of issues that need to be addressed which drive the decision to move forward with a different delivery option that is examined in this document.

A significant issue facing the current shared service arrangement is the limited opportunities to "deliver more for less". Other issues that need to be addressed in a future delivery model can be summarised as follows:

- The gradually reducing level of core business
- Developing a commercial client focused culture within local authority context.
- Perception that the host Council has undue influence on the shared service.
- Time consuming financial management arrangements. A full cost recovery model needs to be implemented
- Staff are seconded and employed on different terms and conditions.
- Governance is perceived as costly & bureaucratic and an alternative governance structure would be required when working with additional partners.
- Perceived lack of control and trust by client services.
- Lack of unique identity – disparate services corralled under single branding.

3.1.2 Examples of Delivery Models

Other examples of successful constitutional shared services do exist, most notably LGSS, a sharing arrangement formed by Cambridgeshire and Northamptonshire County Councils in 2011. Primarily focused on the sharing of core systems this shared service offers a range of corporate services (HR, Finance, Audit, Legal, Pensions, Procurement, Asset Management and transformation). LGSS are now offering their services to District Councils in the area.

3.1.3 SWOT Analysis

Strengths	Weaknesses
• Minimal disruption. • Clear ownership. • Not governed by contract – in control.	• Retains separate T's & C's. • Continues perception of poor service. • Lack of revenue opportunities. • Duplication of roles and responsibilities. • Lack of commercial acumen. • Fosters perception of lack of transparency and equity between authorities within sharing arrangement.
Opportunities	**Threats**
• Does not preclude the addition of extra factories into the current arrangement. • Permits a focus on standardisation to achieve savings/efficiencies. • Able to provide certain services to other public bodies	• Represents a missed opportunity to develop and exploit asset. • Doesn't attract talent • Does not address the retraction of income into the shared services

3.1.4 Financial Considerations

Key factors contributing to the existing position & future forecast of income:

- The income from schools and academies significantly contribute to the overall cost of network & payroll to both councils. There is evidence of some schools not buying back from the current SBSA Proposition notably when schools move to Academy status.

- Declining headcount across both authorities as budget pressures continue to unfold reducing the level of support activity required

- With both councils strategy to move to commissioning delivery models and exploring other SLE/Outsourcing/Joint Venture opportunities, the existing staff establishment which will in turn reduce the core business of the shared service and increase the cost per unit for each council

3.1.5 High Level Risks

If we maintain the status quo it will present the following risks.

- Continuation of the downward volumes of core business
- Danger of focusing on doing the 'wrong things' for example cost cutting -v- developing propositions to generate income commercially
- Quality of service deterioration
- Increases cost per unit

3.1.6 Summary Overview

For the reasons set out above, "do nothing" is not a recommended option. Other strategic delivery options must be considered.

3.2 Disaggregation

This option involves dissolving the current sharing arrangements to allow CE & CWaC to autonomously decide on the future delivery models to recreate the existing and future service provision. There is a 12 month notice period to withdraw from the current arrangements. This is the most costly and potentially disruptive of all the delivery models assessed.

3.2.1 What this means for the councils

In this event CE & CWaC will need to "replicate" the service delivery for each authority – essentially duplicating the current business model.

The key areas to be that would need to be replicated by each Council are:

- Service Desk and field engineers (there are diseconomies of scale issues associated with disaggregation and an assessment of skills gaps that this option would create is essential to understand true impact/costs to each authority
- Application Support: including Microsoft Infrastructure
- Oracle Infrastructure
- Networks (noteworthy of mention: we are currently committed to jointly procuring a Public Sector Network solution along with other partners)
- Data Centre, servers and storage equipment and on-going management
- Key line of business systems
    - Small number of these are joint
    - Some are same product but different instances
    - Majority are different products e.g. CRM's, Revs & Bens, Social Care
- 3rd Party spend

Undoubtedly each authority would consider different delivery options for different services e.g. consider collaboration with different partner, enter into outsource/JV for some or all of service delivery.

3.2.2 Assumed Drivers for this Option

- A desire for sovereignty & independence
- Simplified governance & commissioning processes to assist in decision making
- Alignment of future service delivery models to own organisational strategy
- Control of change agenda & risk management

3.2.3 SWOT Analysis

Strengths	Weaknesses
• Independence/sovereignty. • In control of own destiny. • Simplified decision-making process. • Avoid commissioning process.	• Substantial one-off and on-going costs. • Split of existing TOM into two authorities – duplication of current position. • Loss of opportunity for new developments during transition. • Staff morale.
Opportunities	**Threats**
• Potential for service redesign. • Opportunity to remove management layers. • More responsive to own organisational and local stimuli. • Less complex governance.	• Delivery costs increase – rebuilding to pre-LGR level. • Staff attrition. • Loss of skills/talent. • Potentially lengthy and acrimonious process. • Perceived as sharing failure – negative reputation and political cost.

3.2.4 Financial Considerations

Disaggregation would incur high one-off and on-going costs as set out below to duplicate the infrastructure and to create separate instances of current shared systems. There is also significant loss of economies of scale.

YEAR									
1 £000	2 £000	3 £000	4 £000	5 £000	6 £000	7 £000	8 £000	9 £000	10 £000
2,406	**2,899**	**5,082**	**5,082**	**4,831**	**4,831**	**4,831**	**4,831**	**4,831**	**4,831**

Using a discounted cashflow mechanism the 3, 5 and 10 year position is:

No of Years	£000
3	9,117
5	16,753
10	31,959

It concludes that there is no financial business case to support a decision to disaggregate.

3.2.5 High Level Risks

- Highly disruptive to service delivery and to staff

- High degree of staff attrition which leave the authorities vulnerable to loss of key operational skills to run & manage critical business systems. Covering skill gaps at short notice is highly likely to come with significant additional costs.

- The huge costs associated with this option will provide budget challenges elsewhere in the organisation to fund this option.

- A negative perception of sharing failure could potentially damage any future sharing options/arrangements. Other partners may exploit perceived vulnerabilities – the authority's negotiation leverage may start from a weak position as there will be a need to quickly replace the current arrangements.

3.2.6 Summary Overview

This option is (highly) not recommended for the following reasons:

- Huge cost
- Creates unnecessary duplication
- Highly disruptive
- Reputational damage - potentially undermines any future sharing plans

3.3 Transfer Model / Split Hosting

The current Cheshire Shared Service arrangements for ICT and HR and Finance are "hosted" by CWaC underpinned by a formal Administrative Agreement and Financial Memorandum both of which are legally binding. The costs of these services are shared on a 50:50 basis and there is a 12 month notice period to withdraw from the sharing arrangement.

At LGR there was no appetite to transfer employees destined for the shared services to the host authority. Therefore staff working in the shared services are currently employed by either CWAC or CEC under the auspices of a formal Secondment Agreement with associated cost being equally shared. In effect this arrangement means that each employee retains the Terms and Conditions (T's & C's) of their employing authority. However in practice it has been necessary to develop a series of HR Scenarios to help manage day to day HR issues arising in the shared environment. The scenarios aim to ensure consistency in the treatment of individuals and a balance of employees between the councils

The current operations for both ICT and HR/Finance are located in Chester, where the majority of staff are based (there is a small presence of staff in Winsford). This situation predominantly reflects that pre-LGR and therefore relocation of staff and jobs was not an issue when setting up the sharing arrangements between the two new councils.

Since the shared services were set up both Councils have reviewed T's & C's of employment and it is evident that the consequent divergence is having an impact in shared services. An example of a material and vexatious issue is the policy decision CE has taken to freeze incremental pay increases, whereas CWaC have continued to award. This is estimated as an avoided cost for CE in 12/13 of £42,822.

3.3.1 What this means for the councils

The implementation of a transfer model would require that one or other of the Councils become the lead authority and effectively employ all the staff working in a shared service therefore putting everyone on the same T's and C's. However it is considered unlikely that either Council would be in a position to take on the lead for **both** the ICT and HR and Finance functions and all that this entails. Therefore splitting the functions and assigning a lead authority for each service might be considered as a workable way forward.

The Lead Authority (transfer) arrangement would require a new Administrative Agreement and Financial Memorandum but the Secondment Agreement would no longer be necessary as TUPE regulations would apply. The new arrangements would need to be drawn up to reflect the changes and the delegation of functions between the councils e.g. buy back from the lead council would need to be agreed through a contractual relationship with SLA's.

However a transfer situation is not an immediately fix to the T's & C's issues in the current shared services. The financial quantification of the differences in T'S & C's is estimated at (based on actual spend to Sept 12):

Expenditure	HR / Fin £000s	ICT £000s	Total £000s
Staff Mileage (excl relocation)	4	24	28
Overtime	3	17	20

The real issue is the dissention within the ranks which differing T's & C's creates, which impedes the creation of a solid base to create one culture. A Transfer Model will not eradicate this issue, in fact both councils will inherit staff on differing T's & C's and will need to undertake a review of the workforce terms and conditions or operate with a two-tier system.

The key to the success, or otherwise, of this being a viable delivery option is to reach an amicable & timely decision on which service transfers to CE. CE would be likely to want to reserve the right to exit current buildings and to relocate staff within the CE borough but it should be recognised that such a move will build in cost e.g. relocation expenses.

3.3.2 Assumed Drivers for this Option

- To provide equity in a future sharing arrangement
- To eradicate the perception that the current host has undue influence on the current shared service
- Provides clarity of ownership and service delivery as it presents an opportunity to create a unique identity and strong culture for the service.

3.3.3 Examples of this Delivery Model

Whilst there are examples of staff transferring through Joint Venture or Outsourcing arrangements none appear to exist in public sector sharing arrangements. One of the primary reasons for this appears to be a reluctance (although perhaps unfounded) to be seen to be moving jobs out of one area to another.

3.3.4 SWOT Analysis

Strengths	Weaknesses
• Clarity on Shared Service ownership/responsibilities. • No procurement issues if functions properly delegated • Relatively flexible • Public sector ethos, rules and procedures	• Represents a holding pattern. • Not appropriate for partnership working with private sector • Can be bureaucratic
Opportunities	**Threats**
• Politically acceptable.	• Threat to staff morale as differing T's & C's continue. • Fragmentation of Target Operating Model. • Duplication of client functionality. • Realignment of perceptions of bias in-line with recalibrated service hosting. • Danger that services become viewed as internal departments of and driven by the host authorities organisational agenda.

3.3.5 Financial Considerations

The following financial profiles look at two options for split hosting and comprise mainly of redundancy and relocation costs. The figures do not include any future costs that the current host may incur due to unoccupied office space.

Net impact per year based on ICT moving East

YEAR									
1 £000	2 £000	3 £000	4 £000	5 £000	6 £000	7 £000	8 £000	9 £000	10 £000
0	**429**	**252**	**252**	**0**	**0**	**0**	**0**	**0**	**0**

Net impact per year based on HR/Finance moving East

YEAR									
1 £000	2 £000	3 £000	4 £000	5 £000	6 £000	7 £000	8 £000	9 £000	10 £000
0	**986**	**188**	**188**	**0**	**0**	**0**	**0**	**0**	**0**

Using a discounted cashflow mechanism the 3, 5 and 10 year position is:

	HR East	ICT East
No of Years	£000	£000
3	1035	593
5	1184	793
10	1184	793

3.3.6 High Level Risks

- Potential for staff attrition if staff relocate – plus associated costs of VR and CR.
- Potentially protracted decision-making - who decides which service goes where?
- Each council would have TUPE issues and differing Terms & Conditions issues to resolve.

3.3.7 Summary Overview

This option is not recommended for the following reason:

- There is a significant imbalance between cost/risk and benefit that can be achieved.

3.4 In-house trading

This type of delivery model entails setting up a joint In-House trading operation similar to the former Direct Services Organisations (DSO) which operates as an 'arms length' part of the council. It is effectively a pooling of staff, resources and support services. The In-House trading service is still legally part ofthe Councils for approval of its activities and the setting of its targets, fees and charges. The Councils still provides the revenue budget for which officers are responsible and accountable. The budget – income and expenditure – is ringfenced to the DSO and is not used to sustain other Council budgets or activities.

3.4.1 What this means for the councils

This can be quickly delivered with a modest level investment. The clear limiting factor with a DSO type delivery model is that it cannot be truly commercial to external clients. It cannot act as a trading company (SLE) that is wholly owned by a council and cannot generate any profits to pass back to the council through dividends or service charges. Surpluses cannot therefore be used to hold down council tax and/or be invested into frontline services.

A DSO provides potential to generate additional income from selling additional discretionary services but it is restricted to full cost recovery. A DSO can trade with other public bodies but commercial/for profit trading with the private sector must be via a company.

Pooled budgets can be established to add a new partner to the arrangement to share costs and revenues with another public sector organisation.

A DSO would have complete flexibility to create its own identity & brand and it does not prevent the removal or addition of other in-house business units.

Commercial or contractual framework/incentives could be applied to the DSO including notional penalties to make the relationship feel more commercial.

The DSO has complete flexibility to change scope & service standards at short notice; subject to normal rules such as staff consultation.

The DSO could also use existing corporate services and to commission on a more commercial basis through use of Service Level Agreements (SLA's).

All current and future employees have the right to join the Local Government Pension Scheme (LGPS).

3.4.2 Assumed Drivers for this Option

It would provide minimal disruption to business as usual service provision.

It could be seen as an incremental step change to drive more commercial culture behaviours and culture.

There is complete flexibility to change the legal structure. Service would continue indefinitely until the councils decided to:

- Outsource some or all of the service

- Convert to an SLE owned by the Councils
- Convert to a staff mutual or Joint Venture

3.4.3 Examples of this Delivery Model

Essex Cares is an in-house company operated by Essex County Council providing Adult Social Care services. It generates income for non-discretionary services which are then re-invested to improve services. The opportunity to work on a more commercial footing has created greater responsiveness and accountability. Essex Cares competes with Private Sector providers whilst safeguarding frontline services from cut-backs or the loss of control associated with outsourcing.

3.4.4 SWOT Analysis

Strengths	Weaknesses
• Move to a commercial charging model – full cost recovery basis. • Transparency of full cost recovery. • Creates a more customer-focused culture. • Set-up cost low. • Clear ownership.	• Negative perception born of awareness of full-cost. • Legal restrictions to trade commercially.
Opportunities	**Threats**
• Repeatable process; we have done this before e.g. CBS. • Development of own branding. • (Limited) trading opportunities.	• Harder sell – prospective clients see real cost and withdraw. • Danger that this model becomes a permanent holding pattern.

3.4.5 Financial Considerations

This shows modest investment requirement with relatively low set-up costs which will in turn provide a return on investment in the medium term.

YEAR									
1 £000	2 £000	3 £000	4 £000	5 £000	6 £000	7 £000	8 £000	9 £000	10 £000
115	**727**	**-283**	**-333**	**-333**	**-333**	**-333**	**-333**	**-333**	**-333**

Using a discounted cashflow mechanism the 3, 5 and 10 year position is:

No of Years	£000
3	518
5	6
10	-1,042

This can be seen as a low risk option which will deliver financial benefits over the medium term providing the income targets ca n be achieved.

3.4.6 High Level Risks

- Achievement of softer benefits such as improved staff motivation, attendance, creativity and commercial focus may prove difficult as staff will remain Council employees.
- No opportunity to transfer risk from the Councils.
- Ability to trade may be limited by lack of expertise, unless an investment is made at a similar level to what is required to set up an SLE.
- A jointly owned DSO will require similar levels of governance to those we have now.

3.4.7 Summary Overview

This delivery option is not recommended.

It requires similar investment levels to that of an SLE but does not offer the same commercial opportunity as an SLE to monetise offerings; partnering and trade opportunities to increase income and achieve efficiencies & economies of scale; or provide the opportunity to create value.

3.5 Outsource

For outsourcing, an external private sector partner is paid to provide the service to or on behalf of the Councils.

3.5.1 What this means for the Councils

Outsourcing the shared service would require an OJEU procurement following the competitive dialogue process as this type of procurement would be almost certainly deemed to be complex procurement. A particularly complex contract means a contract where the contracting authority is not objectively able to define 'the technical means' in terms, or specify and identify the legal/financial make up. As there is the potential for several phases of dialogue with three or more participants, the time taken can vary significantly from one project to another. The resource available to the project will also impact on the time taken, as updating and controlling the versions of schedules; documenting and responding to points of clarification; and arranging, attending and following up actions taken from meeting, are resource intensive activities. Where limited resource is available the time taken to move through the phases of dialogue will be protracted.

Based on experience, the time expected for a potential outsourcing of this kind would be 12 to 18 months from the publication of the notice to contract signature. It should be noted that a considerable amount of work is needed pre-procurement to base line the current position. The costs of a procurement of this scale, particularly given the specialist nature of ICT services are estimated at £490K, approx 50% of this is notional as the councils' do have some in-house expertise. However, due to the complexity of the ICT service it may be necessary to retain specialist technical expertise from an external source at an additional cost in the region of £80k.

In terms of potential to add other business units within the final arrangement, this is possible with the agreement of the outsource company, but potentially restricted if not included in the scope of the original procurement. Similarly a new partner cannot be added to the arrangement unless this was covered in the OJEU notice.

3.5.1.1 Illustrative approach an outsource company would take

Outsourcers would assess the viability of the shared services in 3 key stages and carry out levels of assessment, due diligence and negotiation:

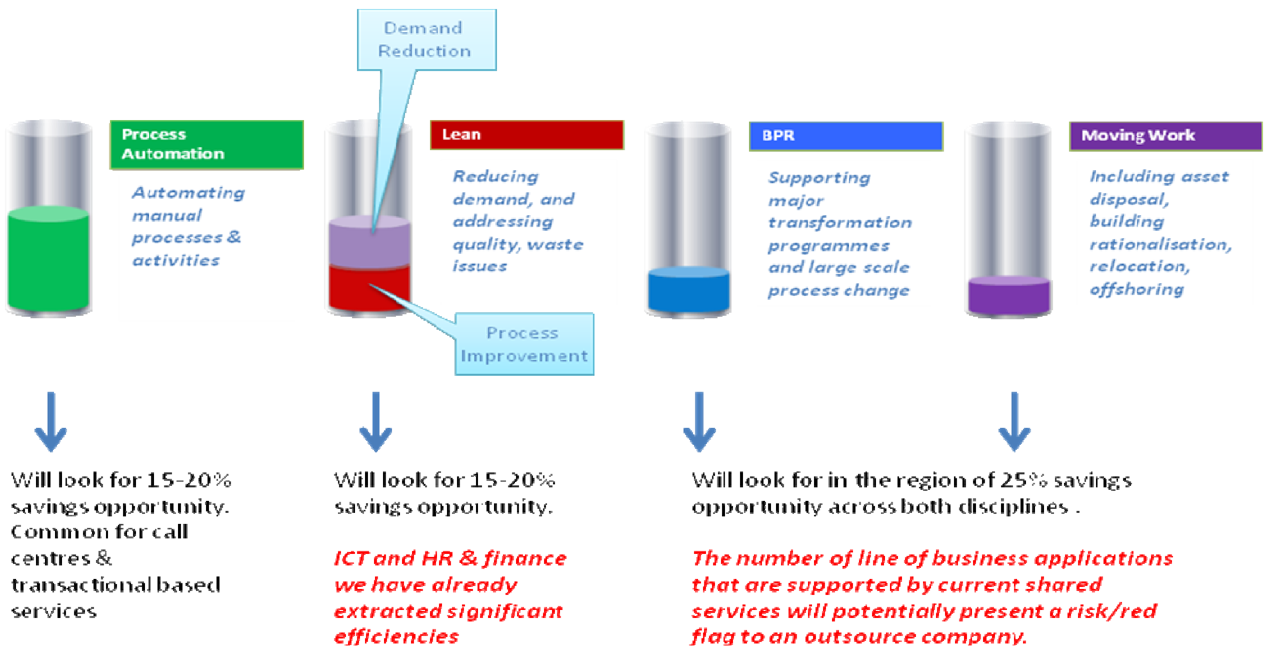
- Bid team (often called the Black Team) – to respond to the ITT
- Contract Team (often called the Red Team) – to make the full & final offer
- Post award – a team carries out detailed due diligence

Outsource companies will assess:

Area of Assessment	Typical approach
Assets	A relevant example would be the approach to People. They typically will cherry pick people, likely to only TUPE management team and staff considered to be key knowledge holders. Look to agree a secondment model for remainder of staff for an infinite period likely until the end of contract. (subject to the Legal Position on TUPE)
Age Profile - All assets including people	Looking for tenure liabilities and end of life risks. Noteworthy of mention is the approach to staff retention. High staff retention is viewed as a poor risk, whilst high staff attrition is attractive so as to provide more future flexibility to the outsourcer.
Liabilities	Likely to only underwrite any buildings liabilities for a short period but will seek to reserve right to exit our existing properties
Budget Structure	Looking for savings/realignment opportunities within their organisation
Associated overheads	Looking for savings/realignment opportunities within their organisation
Existing contractual commitments	They will factor these into the "pot" – particularly will be looking at the impact of any change/transformation commitments will affect their bottom line targets.
Operational Assessment	They will look for a % improvement gains in productivity and cost

To ensure that there will be sufficient margin of opportunity between cost & price, Outsource companies will use an Operational Assessment model similar to that shown below:

A typical example of an Operational Assessment approach:



Outsourcers will operate a gain/share mechanism in realising savings opportunities e.g. they will underwrite a % of the predicted savings and they will seek to achieve the remainder of the savings in a risk/share basis, often resulting in outsourcers retaining 50%.

3.5.1.2 Disciplines used to drive cost improvement

In terms of cost improvements Outsourcers will use the following disciplines:

Cost savings: The lowering of the overall cost of the service to the business. This will involve reducing the scope, defining quality levels, re-pricing, re-negotiation, cost re-structuring. Access to lower cost economies through offshoring called "labour arbitrage" generated by the wage gap between industrialised and developing nations

Cost restructuring: Operating leverage is a measure that compares fixed costs to variable costs. Outsourcing changes the balance of this ratio by offering a move from fixed to variable cost and also by making variable costs more predictable

3.5.1.3 Typical Pricing Structures

Outsource arrangements use cost savings/restructuring disciplines described above to determine Output & Outcome pricing structures.

Output Pricing: Fixed/tangible unit costs – tends to be based on known usage; e.g. Network, data, utilities, volume metrics such as no of payslips.

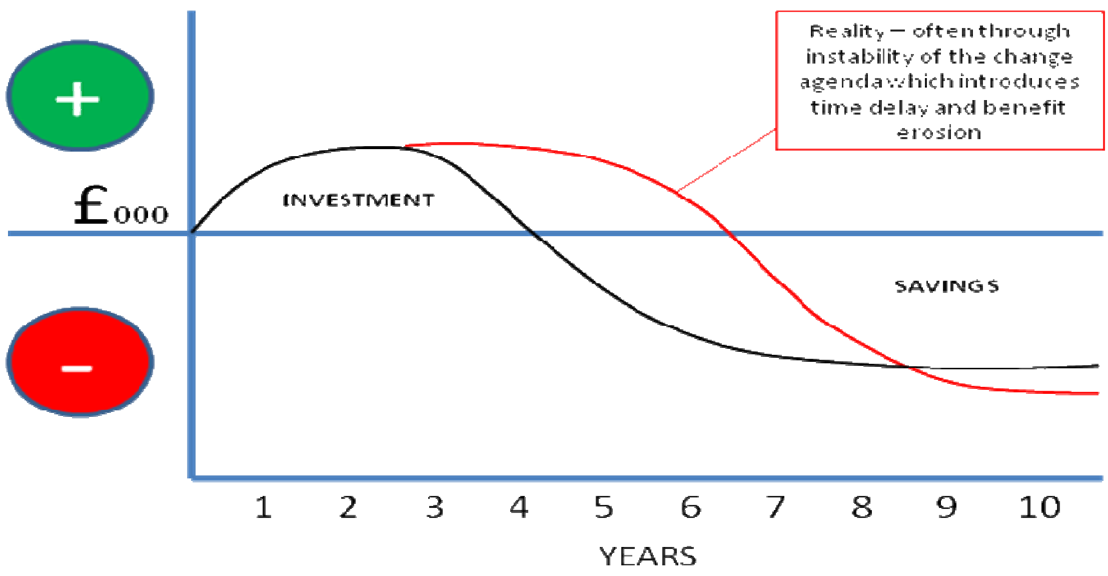
Outcome Pricing: Intangible costs based on an agreed outcome e.g. merge revenues services. The approach will look specifically at People, Systems and Processes with the view of generating same output with fewer people; or, generating higher output as capability is optimised. Outcomes will need to be clearly defined at the outset of the contract.

Negotiating Outcome pricing is attractive to an outsource company as it is a way for the outsourcer to further drive the “change” agenda. It is often how outsourcers incentivise organisations to extend deals by constantly renegotiating the goalposts and shifting the “honeypot” further out as “change” introduces time delay and benefits erosion.

3.5.1.4 Typical Investment & Savings profile of Outsourced arrangements

The purpose of the model is to illustrate from an Outsourcers point of view (black line) the attraction of a contract that provides investment up front with planned savings based on contractual obligations based on no changes to the contract. The red line is introduced to depict the often “reality” as outsourcers drive the change agenda to push out savings realisation.

Illustration of the financial profile – view of attraction from an outsourcer / joint venture partner perspective



If an external partner is contracted to both CE & CWaC via an outsource or JV, they may well bring partially or fully constructed solutions (assets) with them to perform the change – but still at a cost. They will also need to secure a profit from their work, as well as fund their own staff to manage the contract. The sum of these costs forces the realisation of return / cash savings for Cheshire much further into the future

3.5.2 Assumed Drivers & Expected Benefits from this Option

- **Cost Savings & cost restructuring:** predictability of returns
- **Improved quality** - Achieve a step change in quality through contracting out the service with a new service level agreement.
- **Knowledge**: Access to intellectual property and wider experience and best practice knowledge.
- **Contract**: Services will be provided to a legally binding contract with financial penalties and legal redress. This is not the case with internal services.
- **Operational expertise**: Access to operational best practice that would be too difficult or time consuming to develop in-house.
- **Staffing issues**: Access to a larger talent pool and a sustainable source of skills.
- **Capacity management**: An improved method of capacity management of services and technology where the risk in providing the excess capacity is borne by the supplier.
- **Catalyst for change**: An organisation can use an outsourcing agreement as a catalyst for major step change that cannot be achieved alone. The outsourcer becomes a Change agent in the process.

- **Reduced time to market**: The acceleration of the development or production of a product through the additional capability brought by the supplier.

- **Commoditisation**: The trend of standardising business processes, IT Services and application services enabling businesses to intelligently buy at the right price. Allows a wide range of businesses access to services previously only available to large corporations.

- **Risk management**: An approach to risk management for some types of risks is to partner with an outsourcer who is better able to provide the mitigation.

3.5.3 Examples of this Delivery Model

Many outsource models of service delivery are evident across the public sector e.g:

- Avarto / Bertlesman providing IT, Revs and Bens and front office support to East Riding and Sefton Councils
- BT providing IT, consulting, business process services to ,Rotherham, South Tynside, Suffolk and Sandwell councils
- IBM providing IT, consulting, business process, outsourcing services to South West One and Essex CC
- Serco providing consultancy and facilities management to Glasgow City Council
- Steria providing back office services to the NHS

Suffolk CC have been the most ambitious in this area with a vision to outsource the majority of services and to propel them into becoming the ultimate commissioning council. However the vision lacks public support has been slow to materialise.

3.5.4 SWOT Analysis

Strengths

- Can utilise companies with proven track records – access to private sector delivery capability.
- Risk transferred.
- Immediate return on investment/asset.
- Aligns with local governmental commissioning models.
- Highly predictable returns (but they may be under-ambitious).

Weaknesses

- Cost of OJEU – plus at least 18 month timescale.
- Potentially rigid contract – hard to renegotiate, lengthy – typically 5-8 years.
- 'One size fits all' solutions – not locally bespoke or imbued with public sector ethos.
- Outsourcers tend to sweat assets – client becomes outdated and slow to change.
- Client/customer dissatisfaction grows over time – frustration levels at lack of change/competitive edge.

Opportunities

- Opportunity to create a core vender management skill base within client.
- Improved quality of service.
- Opportunity to remove legal and cultural issues out of the organisation.

Threats

- Already cashed in significant – potentially not an attractive proposition to an outsource company.
- Likely to operate an aggressive revenue generation/saving model to achieve targets.
- Danger that revenue generation culture supplants public representation/service.
- Governance purely contractual.
- Outsource company will respond to most active/lucrative client – we could be neglected.
- Political sensitivities to pure outsourcing – trend of in-sourcing evidence.
- Success dependant on financial stability of the outsource company.

3.5.5 High Level Risks

The risks below are not by any means exhaustive but are presented as the key high level risks to consider.

3.5.5.1 Handing over efficiencies

The current "package" of ICT and HR & Finance services will more than likely be viewed as a limited opportunity for Outsource companies to make an acceptable return. They are likely to seek a long term tie-in and include other services. Their interest would undoubtedly lie in transactional services which are ripe for transformation/automation. CE & CWaC's Customer Contact Centres and Revenue Collection services would be seen as lucrative areas for Outsourcers to make their returns as there is scope for removal of duplication, downsizing capacity and standardisation. To illustrate this, the estimated savings from merging two Councils' Revenues services is circa £360k, which the Councils would in effect be "handing" to an outsourcer as part of a deal and they are likely retain at least 40% as contribution to their profit target. It is important to note that this is an, informed, illustration. Accurate % retention can only be determined via a competitive dialogue process and subsequent due diligence phases.

3.5.5.2 Dissatisfaction & loss of control

In outsourcing arrangements there is a high degree of risk that is particularly pertinent to ICT as it is usual practice to novate existing contracts to the Outsource Company. The Outsourcers tend to push one of two agendas; to sweat assets or push for standardisation. The former has a high degree of risk of products going beyond "end of life", the latter may not provide satisfaction in the medium/long term as the Outsourcer will not be driven by the councils change agenda. Evidence shows that dissatisfaction and loss of control of the change agenda are key factors in why a number outsource arrangements are deemed to be failing. This position could be improved by the councils through robust commercial and contract management skills and practices.

3.5.5.3 Approach to assets & liabilities

It is crucial to understand the structure of the long term contract and the approach the Outsource Company intends to take with future investment of assets and mitigation of liabilities. Key areas of risk for the councils are:

- Outsourcers are minded to only TUPE senior management team and "key knowledge" staff and push for a staff secondment model over an infinite period. Future liabilities for staff remuneration, redundancy and pensions would therefore remain with the employing authorities. They would also seek to ensure that the unfunded deficit of the pension fund remains with the councils.
- Outsourcers will more than likely factor in existing property liabilities but would seek to limit their underwriting, typically for no longer than 2 years, and reserve the right to exit existing property/locations. This would leave the councils with properties to sell/lease/sublet in the future.

3.5.5.4 Step in rights & Exit Arrangements

It is critical to agree robust step-in rights within the contract and clear exit arrangements & associated costs. This is often the maximum point of leverage between the customer/outsourcer. There are a number of arrangements we could learn from, notably the arrangement between Sainsbury's Bank and Bank of Scotland where the exit costs run into £100m's.

Failure of the arrangement would require either transfer of service and staff in-house and re-tender. Or, sourcing new provider at short notice at, potentially, higher cost.

3.5.6 Summary Overview

This option is not recommended for the following reasons.

There is evidence that there is a "honeymoon" period with these arrangements unless there is a high degree of flexibility in the initial procurement & subsequent contract. In the honeymoon period there is a high degree of satisfaction when predicable "knowns" are delivered. Dissatisfaction tends to appear later down the line when the outsourcer fails to deliver to a Council's change agenda. This is particularly pertinent for ICT service delivery.

Other high level reasons why outsourcing is not a recommended option for the current shared services:

- In the time it takes to undertake a competitive dialogue process and OJEU procurement, the plan suggests that SLE delivery option would have started realising same level benefits.
- Inability to create future value for the councils
- Handing over efficiencies to a third party – we could redesign our approach to capacity / contract management and keep 100% of the savings.
- Lack of commercial control
- Difficulty in identifying qualified and reliable suppliers (there is a lot of evidence of insourcing & negative publicity of failure of these arrangements for complex service delivery).
- Disruption of supplies
- Potential security problems associated with the push to offshore work

Worthy of mention is that there is nothing preventing the proposed SLE to outsource some of its current provision to optimise efficiency e.g. PSN, Cloud based solutions.

3.6 Joint Venture

For Joint ventures, a legal entity is setup between the parties to jointly deliver the service for a finite period of time. Typically, the private sector partner is the majority shareholder in these arrangements. Contract tenure is a longer term tie-in, typically 8-10 years. An OJEU level procurement, including a competitive dialogue process will be needed.

3.6.1 What this means for the councils

There are a great many similarities between Joint Venture (JV) and Outsource arrangements and the methods and approach that potential partner will take.

Rather than repeat section 3.5, in this section we will look at the key differences of a Joint Venture arrangement.

JV partners will still use output / outcome based pricing (as described in the outsourcing section 3.5).

3.6.1.1 The key difference between Outsourcing & JV arrangements

Transparency in accounting

Joint Venture organisations use Open Book / Open accounting methods

Open book: e.g. income, expenditure & charges (e.g. reserve against a risk)

Open Accounting: Councils will see the construction of the all production costs. However, what isn't seen is the cost of the parent company (Costs charged between JV partner and its parent company).

To illustrate this: A Parent company currently have a 48% profit margin on their outsourcing deals – the JV partner typically realise 12-14% margin.

The perceptions of open book can be a very vexatious and learning's from the marketplace indicate that it is big cause of tension in JV arrangements when renegotiating planned delivery within the contract. As customers feel they have full transparency but actually they don't.

Tenure & Outcomes for the JV

The tenure of the contract usually has a long tie-in, often 8-10 years. In terms of shareholding it is normally 49/51 and the partner would often want the casting vote (highly dependent on financial/taxation model agreed). Also dependent on the structure of the deal dividends may be paid at different ratios – a typical model, after realising the minimum commitment in the contract, is on a 50/50 share basis.

Areas of potential future conflict are typically:

- Timing of investments – availability of funding / conflicting priorities driven by council pressure from budget cuts and wanting to postpone planned events and/or planned investments often lead to compromises being made that fuel lack of trust in the relationship.

- Conflict of interest in external market planning – Cheshire choose to sell their contact centres to SME, sales effort (introducing competition the parent company may not approve of)

- Approaches to the management of risk

3.6.2 Assumed Drivers for this Option

Undoubtedly a Joint Venture would present opportunities and it is the delivery model of choice if the key strategic drivers are:

- Diversification
- Growth
- Improvement

3.6.3 Examples of this Delivery Model

"Service Birmingham" is a joint venture between Birmingham City Council and Capita providing ICT, Customer Centre, Learning and Knowledge and project services with a view to expanding into HR and payroll services. Based on sound systems and operating models and built around investment in the local economy and job creation this successful partnership is set to continue until 2021 with a total worth of £1 billion

Edinburgh City Council recently renewed its contract with BT until 2016 after it achieved 88% of its improvement targets. The Council stands to profit from £22 million in savings. This joint venture has focused on standardising infrastructure to drive out efficiency to be reinvested in the project.

South West One is a joint venture set up with Somerset CC, Taunton Deane BC, Avon and Somerset Police and IBM providing a range of corporate services. Savings were projected at £1.7m year which enabled Somerset CC to levy below average council tax increases. However poor consideration of the commercial offering and the failure to attract additional partners have led to reported losses of £31.5m and allegations that South West One is trying to hide the extent of its bail-out of IBM, the dominant partner in the venture.

Liverpool Direct is a joint venture with BT offering customer contact support, ICT solutions and management, HR and Revenue and Benefit services. Employing 1,100 people with a net turnover of £80m p.a. it is the largest public-private joint venture in the UK. Liverpool Direct started in 2001 and despite initial problems is now attracting new partners, most notably Lancashire County Council. Its success is in delivering desired outcomes e.g. retained jobs, security & expansion in terms of high speed networks across Liverpool.

3.6.4 SWOT Analysis

Strengths

- Access to commercial skills & value proposition development.
- Access to private sector delivery capability – finance, talent, change management.
- Early commercial dividend.
- Risk transfer to partner.
- Staff perceive venture as an opportunity, tapping into experiences of large, private sector organisation.
- Corresponds to local governmental strategy to adopt commissioning models.
- Access to experienced mobilisation and management teams.

Weaknesses

- Cost of OJEU – plus at least 18 month timescale.
- Loss of control of sales destiny
- Handing over efficiencies to partner.
- Difficulty of negotiating terms mid-contract.
- Lengthy tenure of contract – usually tied-in for 5-10 years.
- Pension deficit remains with local authority.
- Current negative perception of JV's, e.g. South West One, Cornwall Strategic Partnership.

Opportunities

- Attract additional business more easily.
- Sales and marketing methods & disciplines including:
  - Proposition development
  - Sales
  - Bid management
  - Contract management
- Potential to increase employment in local economy (depending on deal structure).
- Downsizing local authority staff numbers.

Threats

- Revenue growth will not be on the JV partner's agenda.
- JV partner will be more focussed on scope change agenda to increase profits/dividends
- Loss of control via novation.
- Need to invest in strong retained vendor management – possibly have to 'buy in' in the short/medium term.
- Danger that profit generation culture supplants public representation/service.
- Contractual difficulty of 'stepping in' should the authority not be content – need clear exit strategy.
- Political sensitivities if deal involved job losses in local economy.
- Stakeholder buy-in is critical – staff/unions.

3.6.5 High Level Risks

- Term of the contract – a JV is likely to have a longer tenure due to the levels of transformation & change

- Exit arrangements are extremely costly & disruptive.

- Overhead expense is likely to higher than an outsource arrangement as there is more of a requirement to have joint projects & management boards

- The councils will experience loss of control of the change agenda.

3.6.6 Summary Overview

This is not a recommended option for the same reasons as noted in the Option Appraisal for Outsourcing - section 3.5.7.

3.7 Separate Legal Entity

This model is appropriate where there is a desire to trade commercially for a profit with other public and private sector organisations. It involves establishing a separate legal entity (SLE) – i.e. a company - which will deliver services back to the contracting authorities. There are a number of different forms a company can take such as

- company limited by shares or guarantee (either of which may be charitable);
- community interest company;
- industrial and provident society.

The most suitable structure will depend on the key aims and objectives of the SLE. A company limited by shares will tend to be appropriate where the SLE is commercial in nature. A company limited by guarantee is the traditional model for a non-profit distributing company where the intention is to reinvest profits into the business. A CIC is designed for social enterprise which operates as a business. An IPS is a form of employee mutual.

The most suitable structure for Cheshire Shared Services is a company that is limited by shares and is Teckal compliant [2]

3.7.1 What this means for the councils

Creating a Teckal compliant SLE limited by share requires:

- adoption of a commercial business model which will exact commercial behaviours (a proposed business model is explored further in Section 4.3). The SLE will need to be successful at "realising capacity or releasing capacity". The model needs to be aligned with a Business Plan so as to constant flex to levels of growth, reinvestment opportunities through efficiency realisation and management of risk.

- investment in the current management structure which fully implements the current Target Operating Model, to build a solid culture for the business to move forward. (the current target operating model is presented in Section 4.4)

- focus on Strategic Marketing activity, to develop & monetise the company offering & propositions (a proposed approach is included in Section 4.5)

3.7.1.1 Background to the Teckal exemption

If the SLE is to be established to operate under the Teckal exemption the Councils will be able to contract with it without a procurement exercise. The Teckal exemption was established by the ECJ in the case of Teckal SSRL v Commune de Viano and Azienda Gas Acqua Concorzial (AGAC) di Reggio Emilia and is sometimes referred to as the in-house exemption. For Teckal to apply, two conditions must be satisfied;

(1) The contracting authority must exercise over the service provider **control** which is similar to that which it exercises over its own departments; and
(2) The service provider carries out the essential part of its **activities** with the contracting authority.

[2] A more detailed briefing document which explains the different SLE structures and Teckal exemption can be produced upon request

Control test

In respect of the control test it is not enough to simply own the SLE. The Councils must retain the same degree of control as it has over its internal departments such that it has “a power of decisive influence over both strategic objectives and significant decisions” of the SLE. There can be no private ownership of the SLE as this would mean the control test is not satisfied. The Councils will therefore own 100% the shares in the SLE between them. Whilst the fact of ownership tends to indicate sufficient control, it is not decisive and additional provisions will be included within the company articles which reserve certain decisions to the Councils as shareholders. The control test may be satisfied by the reservation to the Councils (as shareholder) of the decisions listed below;

- Appointment and removal of directors
- changing the articles
- varying the share capital
- creating a charge
- issuing debentures
- creating or selling subsidiaries
- selling parts of the business
- entering into a contract which is not in the normal course of business
- changing the name or the registered office
- adopting or amending the business plan
- changing the nature of the business.

Governance & shareholder considerations are further explored in Section 4.7

Activities test

To meet the second test to the Teckal exemption, the SLE must carry out the essential part of its activities for the Councils and other activities must be of only marginal significance. The rationale is that EU public procurement law remains applicable to an entity which is active in the market and therefore likely to be in competition with other undertakings.

There is little case law on what is meant by marginal significance but it was considered in the case of Tragsa, in which the ECJ concluded that a company which carried out 90% of its activities for the public sector owners and 10% of work for third parties satisfied the Teckal exemption, as the 90% constituted the essential part of its activities.

In terms of the geographic area of operation of the SLE, activities carried on outside of the Councils administrative areas would not amount to activities on behalf of the Councils. It is likely that such activities would be viewed as commercial activities within the 10% of marginal activity. It is proposed that the articles reflect this geographic limitation.

3.7.1.2 Advantage & Disadvantages of Teckal

The “teckal exemption” allows an authority to award contracts to a company without a procurement exercise on the basis that the company

- effectively operates as a department of the council and
- carries out the essential part of it activities for the council.

Control can be exercised by more than one local authority although it is not clear how many "partners" there can be before control is diluted to such an extent that teckal no longer applies.

As a teckal exempt company, this model has scope for more than one local authorities to participate in the company such that they can also procure services from it without going through a tender exercise. The key drawback is the limited ability to carry out activities for any organisation other than the partner authorities beyond those which are of "marginal significance" to the main activities of the company. The case law in this area is limited but it is generally thought that non-essential activities should be kept within 10% of overall activity. To trade more extensively could lead to the SLE losing the benefit of the Teckal exemption and potential procurement challenges. Trading with third parties could, however, be undertaken by way of a separate trading company (as opposed to a subsidiary). Consideration would be required as to how such a trading company would be resourced and managed.

It is possible to operate a teckal exempt SLE and have a separate trading SLE with commonality of management but the two must not cross subsidise each other. This "trading arm" could be used to provide services to the private sector or to other public bodies who do not wish to participate in the teckal exempt company.

It is not the case that "once teckal, always teckal" – the SLE can move to operate outside of authority control as a longer term objective which frees it up to trade in a commercial way. This could be the case upon the expiry of the initial contract between the Authorities and the SLE.

The teckal exemption gives the Authorities and the SLE the financial certainty of a contract for services while it beds in and develops as a separate legal entity so that upon the expiry of the initial contract it could be in a position to bid for contracts without the teckal exemption on a commercial basis.

The nature of the relationship between the Authorities and the SLE would allow the Authorities a significant degree of control over the company to ensure it meets the strategic direction set by the Council.

Any services procured by a teckal exempt company would be subject to EU procurement directives and the Regulations since the Company would be regarded as an extension of the Council for procurement purposes.

If the SLE is not reliant on the teckal exemption then it would be free to carry out more general trading activities.

3.7.2 Assumed Drivers for this Option

- Desire to trade commercially for a profit with other public and private sector organisations
- To create future value for the authorities that requires modest investment which is low financial risk.
- Exploiting the Teckal exemption allows the shared services company to be more agile in partnering with other local authorities.

3.7.3 Examples of this Delivery Model

Compass Point was created to provide shared back office services for East Lindsey and South Holland District Councils with anticipated savings of £30m. Private sector involvement in providing one off services ensured that any savings realised would be retained by the owning councils. The creation of the company cost £4.65m largely spent on redundancies, new systems, legal and change advice. Compass Point is the first company to implement Microsoft Dynamics AX system which is specifically designed for the shared service environment. The Company Board consists of eight councillors and the Chief Executives of the two councils thereby ensuring council control and a strong public ethos. Compass Point has proved successful in consolidating shared service arrangements between the two controlling councils but as yet has not attracted any new partners.

Norfolk Property Services (NPS)is a limited company wholly owned by Norfolk CC. Set in 2002 the company now delivers a comprehensive and flexible range of property services to both the pubic and private sector across the UK. NPS is an attractive prospect to partners who largely receive bespoke services. With 10 subsidiary companies around the country NPS generates a turnover of approximately £40m.

Local Authorities retain a direct influence on the strategic direction of the company through representation on the Board of Directors. This, along with, Norfolk County Council’s total ownership of the parent company, means that NPS appeals as a public-sector specialist, evidenced in that the majority of its partnerships are with other councils.

The profits of the company (including those from external clients) are shared between NPS and the partner authorities.

All of the commercial risk in establishing the joint venture company is taken by NPS who also provide the capital for investment in service improvements.

Financial independence allows the company to borrow for investment, and enables more effective cash management. A programme of continuous improvement seeks to strip out inefficiencies and unnecessary overheads and provides economies of scale.

Acivico was a company constructed by Birmingham City Council to provide and sell property management and planning services. However, on the day of its recent launch the company had to be pulled because of incomplete VAT submissions

3.7.4 SWOT Analysis

Strengths	Weaknesses
• Opportunities to trade. • Agility to optimise business model and efficiency through economies of scale in terms of partnering (insofar as the Teckal exemption requires no procurement.) • Low financial risk. • SLE model requires modest investment. • Asset retained by local authorities and future options are in local authority control. • Move to unified T's & C's – staff morale, standardisation. • Minimal disruption to existing governance. • Retains public sector ethos and control. • Remains in Cheshire economy. • Maximises and retains all cost benefits. • Quick to implement upon decision. • Represents a continuation of three year investment into Shared Services and retains intellectual capacity generated in this process.	• No immediate dividend. • Harder to sell SLE outside of Cheshire – no partner as of yet. • Needs commercial focus – particularly in terms of shaping business propositions and marketing, e.g. £6.7 million of savings thus far needs heralding.
Opportunities	**Threats**
• Attractive to other partners. • CSR may create target opportunities. • Exit strategy easier and clearer. • Does not prevent individual local authorities doing their own things – precludes very little in terms of development. • Additional income will ensure reinvestment in physical and intellectual assets. • Capacity for other factories: revenues, customer contact centre, procurement etc • Step to full outsourcing or floating possible.	• Lack of current commerciality could impair adoption of commercial ethic. • Conversely, danger that shareholder behaviours are not retained.

3.7.5 High Level Risks

Set out below are some of the key challenges and risks to externalisation of services;

- Funding – externalisation can be expensive especially if external advice is required.
- Leadership – a key objective will be to develop the business and develop new markets. Experienced commercial managers with sound leadership skills will be required to drive the business forward and may need to be recruited.
- Staff – a major success factor will be winning the support of employees and trade unions and managing the transition to the new organisation.
- Competition – the SLE may find itself unable to expand by winning new work or it may lose the initial contract with the Authorities.
- Risk of failure – as with any new business there is a risk of failure because, for example, its business case is not robust enough, it does not have sufficient resources or it develops poor relationships with clients and suppliers. The Authorities would have to consider whether they would guarantee the company financially, at least initially.
- Loss of Teckal exemption. If a significant number of the currently maintained schools converted to Academy status, the 10% limit on external trading income would be exceeded.

Any of the above may lead to service failure and the need to run an emergency procurement to put alternative arrangements in place at increased costs and reputational damage.

A more detailed Risk Assessment for the SLE option is included in Section 4.9

3.7.6 Financial Illustrations

The following figures are based on investment in the Management Structure with a fully implemented TOM; focus on proposition development; marketing and putting in place opportunities for strategic partnering and income generation.

YEAR									
1	2	3	4	5	6	7	8	9	10
£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
645	**583**	**667**	**751**	**834**	**918**	**876**	**834**	**793**	**793**

Using a discounted cashflow mechanism the 3, 5 and 10 year position is:

No of Years	£000
3	1,687
5	2,905
10	5,571

The high level business case to follow examines the financials in more detail.

3.7.7 Summary Overview

This is the **recommended option** from the Joint Officer Board, for the Authorities to take.

The following section provides a more detailed analysis of the recommended option.

4. Recommended Delivery Option

It is requested that the Shared Services Joint Committee support the Joint Officer Board recommendation to transition the shared services to a Separate Legal Entity be approved

4.1 Rationale for Recommendation

- Most of the advantages that an outsource arrangement or joint venture can bring can be achieved by the SLE, with the advantageous position that the SLE can retain all of the benefits.

- The SLE can be mobilised reasonably quickly. Before an OJEU level procurement exercise was complete the SLE can start to:

    - implement an overarching business model:
    - implement the full target operating model
    - execute the marketing plan to begin to create value, generate income, and exploit partnering opportunities.
    - It is within the authorities' gift to exploit efficiencies that adding new factories would achieve, generate additional income streams and find an additional partner within 2 years.

- CE & CWaC have been sharing services for over 3 years and have realised savings of in excess of £6.7m. It has built solid capability and intellectual capacity during that time which can be capitalised upon. There is plenty of scope to drive further efficiencies and create future value.

- The investment is modest and the financial risk is low.

4.1.1 Desired Outcomes / Objectives for the SLE

- To be the leading public sector shared company in the UK providing a high quality, customer focused services, demonstrating value for money and high levels of customer satisfaction.
- To grow the shared service business by bringing in new partners and customers to realise economies of scale and by trading key services on a fully commercial basis with other organisations.
- To meet and exceed client expectations of service delivery and quality driven by internal transformation and standardisation of processes and adoption of new technologies.

4.2 Strategic & Financial Business Case

Taking the step to an SLE is a low strategic and financial risk. The high risk is the loss of opportunity by taking a different route.

The measure of strategic success lies in the delivery of non financial benefits & outcomes during the first 24 months of the SLE.

The financial business case (shared 50:50 CE/CWaC) provides scenario based illustrations and the likely return over a 10 year period; based on essential investment in:

- Business Model
- Skilled Management Team
- Robust proposition development
- Creating the commercial culture

This business case is centred on creating future value in addition to providing a return.

4.2.1 Set-up Costs

The set up costs can be viewed on a range between best and worst case scenario. This is largely due to the approach we can take with setting up Oracle to produce a set of trading books. The best case scenario involves risks around the security of the AR/AP functions. However, whilst the SLE is wholly owned by CE & CWaC a best case scenario is acceptable with mitigation through a data sharing protocol.

External one-off set up costs	£000s
Legal advice on legal structure, shareholders agreement and contract between SLE and Councils	75
Pensions advice from fund actuary	25
Financial advice on tax	20
Chief Executive: 4 months in advance of company set up	40
Director of Corporate Services: in advance of company set up	25
External recruitment cost of Chief Exec (25% of first year salary)	30
Other costs	15
Sub-Total	230

Internal Opportunity Costs – Oracle Set up	£000s
Best Case Scenario	71
Worst Case Scenario	473

TOTAL SET UP COSTS	£000s
Best Case Scenario	**301**
Worst Case Scenario	**703**

4.2.2 Potential Grant Funding Opportunities

Worthy of mention is that Officers are looking at possible Grant Funding opportunities – there is potentially some funding (circa £100k) available from the Cabinet Office for mutual's which is thought to flexible enough to apply to this SLE.

4.2.3 Proposed treatment of Pensions liabilities

The assumptions underpinning the employers pension contribution are set out below. The objectives underpinning these assumptions is to ensure that the SLE is in a similar position to a 3rd party outsource operation so that it can eventually compete for the Councils work on a comparable basis, while giving some time during the incubation period to allow the SLE to move from a local government to commercial operating model. To achieve these objectives the assumptions are:

- The element of the pension deficit that relates to past service will be fully funded by the two councils. This is an approach that would be used if the shared service was being outsourced.
- The increase in the future service employer contribution rates, which have been experienced in other recent outsourcings, will be phased in over a 5 year period in equal instalments- probably of around 1.5% pa, rather than having to pay the full increase immediately as would be the case with a traditional outsource. Recent outsourcings have seen the employers future service pension rate increase from around 16% to 25%.

The implication for the councils is that the deficit that relates to future service will continue to increase, but that the deficit is likely to be less than if the service had been retained in-house based on current assumptions.

4.2.4 Scenario Based Financial Illustrations

The following scenarios illustrate the incremental financial build up of the SLE from a starting point, illustrating the impact of viewing the SLE as an investment case only through to the return on investment from exploiting efficiency opportunities, achieving economies of scale through strategic partnering and maximise income generation.

Scenario A

Standalone SLE for CE & CWaC – without any partnering, additional factories or additional income.

YEAR									
1	2	3	4	5	6	7	8	9	10
£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
645	583	667	751	834	918	876	834	793	793

Not representative as the purpose of creating an SLE is to exploit further internal efficiencies partnering & income generation

Scenario B

Add additional factory - Scenario is based on merging Revenues services

YEAR									
1	2	3	4	5	6	7	8	9	10
£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
1,444	223	307	391	474	558	516	474	433	433

Scenario C

Add additional factory and generate income

YEAR									
1	2	3	4	5	6	7	8	9	10
£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
1,394	73	107	191	274	358	316	274	233	233

Scenario D

Add additional factory, generate income and add partner - Scenario is based on an authority with a similar size to that of Trafford BC

YEAR									
1	2	3	4	5	6	7	8	9	10
£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
1,394	73	107	-1,286	-1,203	-1,119	-1,161	-1,203	-1,244	-1,244

Scenario E

Add additional factory and generate income as per scenario C. This scenario uses a more aggressive income profile as shown in red below

YEAR									
1	2	3	4	5	6	7	8	9	10
£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
0	*-150*	*-300*	*-500*	*-750*	*-1,000*	*-1,200*	*-1,200*	*-1,200*	*-1,200*
1,394	-77	-193	-309	-476	-642	-884	-926	-967	-967

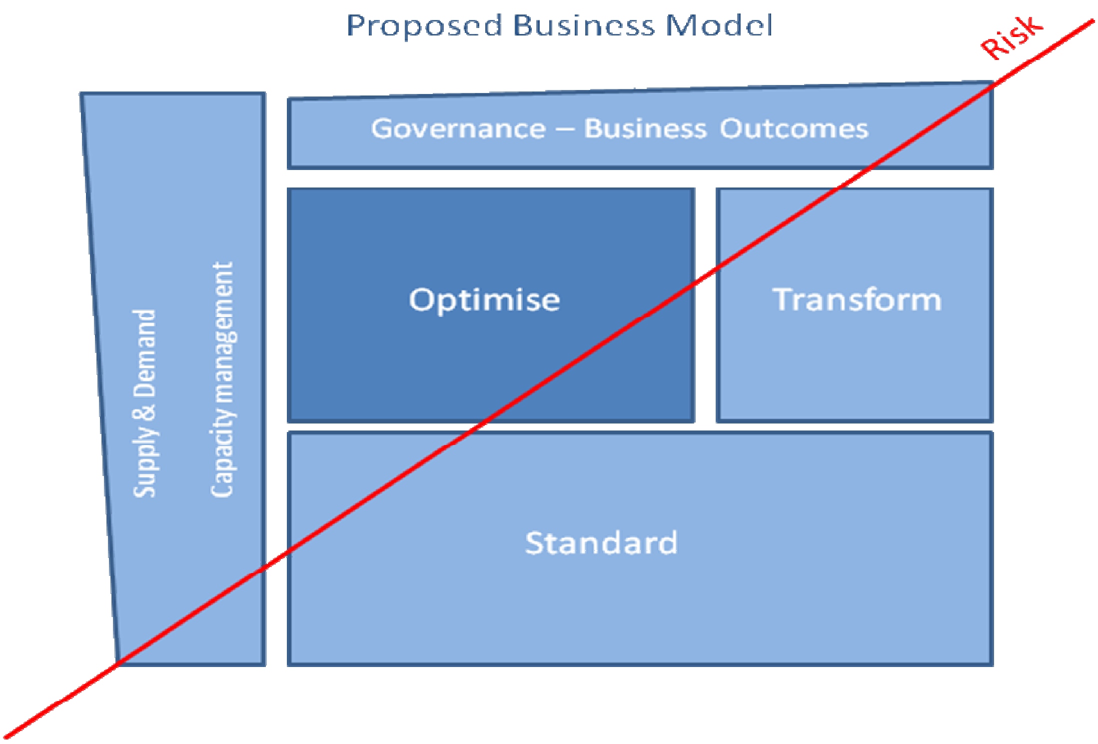
Scenario F

Add additional factory, generate income and add partner as per scenario D. This scenario uses a more aggressive income profile as shown in red below

YEAR									
1	2	3	4	5	6	7	8	9	10
£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
0	*-150*	*-300*	*-500*	*-750*	*-1,000*	*-1,200*	*-1,200*	*-1,200*	*-1,200*
1,394	-77	-193	-1,786	-1,953	-2,119	-2,361	-2,403	-2,444	-2,444

4.3 Proposed Business Model

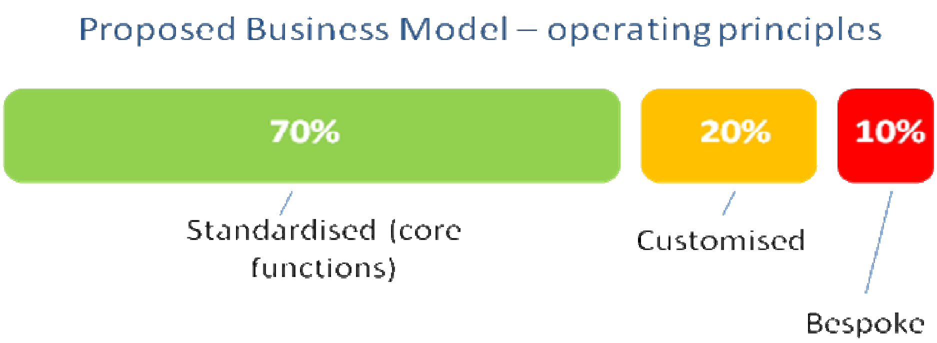
When establishing an SLE, its work (its business model) should be ideally divided into 5 disciplines and all executed at the same time.



The work it is performing aims to comply with a 70 / 20 / 10 model. Standard process and tasks should represent 70% of work done, most of which can then be easily priced and risk assessed for external sales. 20% of work will need to be optimised to fit with each business users' way of working "uniques" such as location, working practices or cost challenges. Only 10% of work undertaken should be one off "bespoke" in order to keep the cost of management for unique ways of working to a minimum. Examples of bespoke work may be language, front end (web) systems, user interface devices etc.

The risk line demonstrates the level of risk management attached to each of the disciplines.

The following diagram further articulates the principles that need to underpin the business model:



This model (as referred to in the business model commentary) applies to both the provision and improvement of services to Cheshire East and West as well as the development of external sales for the SLE.

The model focuses on the following principles;

Standardisation focuses the mind on least cost, best quality and highest degree of efficiency. The resultant model contains high degrees of certainty as to how the work is performed, what the true costs are and the most effective ways of scaling such work. It is therefore logical that Cheshire East and West will expect the SLE to achieve c 70% standardisation across their work in order to reduce budget costs as fast as possible. As sole shareholders in the SLE, it is also logical that Cheshire will support external revenues from work / capability that is highly standard as it will be very low in terms of risk.

Customised focuses the mind on change in order to gain greater efficiency, performance or pace. It is a discipline that leaves underlying cost and ways of working quite standard but applies some extra capability (like wrapping a parcel) in terms of automation, different front end presentation, different ways of gaining access to data – the options are numerous, but the principle is that the underlying process remains very standard. When looking external this is profitable work for the SLE, providing technology or work solutions that will customise someone's environment and provide them low cost, high quality base services

Bespoke focuses everyone on something new, high customised – where most underling procedures have changed. In this area design costs are high, risk of failure is high and overall benefits will be long term in the sense of being realised. Hence the low percentage of focus – the discipline of applying bespoke solutions must be mastered for the good of the Council and the good of the SLE, but volume of such work kept to a minimum in order to hold risk to a containable level.

4.4 Target Operating Model

As part of the ongoing development of the Shared Service, taking on board the learned experience of operating to date and to comply with the guiding principles for operation, a new Target Operating Model (TOM) has been developed.

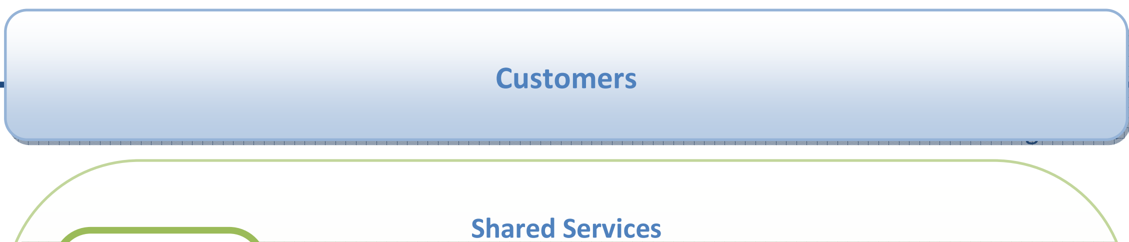
This has resulted in the TOM design work being focused on the best approach to simplify and standardise the interactions with the shared services both currently and when the shared services becomes an SLE.

The new TOM recognises that the current structural ways of working are complex and inefficient, leading to frustration in both the client and shared service functions. As such the TOM design work has focused on the best approach to simplify and standardise the interactions with the shared services both currently and when the shared services becomes an SLE. It is envisaged that the TOM will remove areas of duplication.

The new TOM also recognises the need for the shared service to be given a greater degree of operational autonomy therefore enabling it to effect changes more effectively.
The new TOM allows each shared services customer to determine the best operating model for their respective Client functions and provides an opportunity for new Client operating models to monitor all services provided by the shared service.

The new TOM also recognises the need for the shared service to be given a greater degree of operational autonomy therefore enabling it to effect changes more effectively.

The following diagram is a functional representation of the new TOM



4.4.1 Target Operating Model processes

The proposed shared services operating model is based on service delivery through four specific process functions namely **"Support"**, **"Customer"**, **"Run"** and **"Change"**. It is also designed to act as an **'acquisition engine'** to incorporate any future customers' services maximising the opportunities for standardisation of processes and avoiding duplication or replication of functions. Each of these are considered in more detail as follows:

Support

The purpose of support is to manage the operational effectiveness of TOM. Specific responsibilities include ensuring finance and resource management processes are in place and provision of oversight of all key activities in Shared Services. Finally, support will be responsible for leading and managing the risk and compliance agenda.

The business support processes will be sourced, where possible from existing East and West corporate functions including Procurement, HR and Training and Finance thus ensuring a neutral impact on headcount.

Customer
The purpose of customer is to manage the shared services customers' business relationship management, the customer's business change portfolio and associated demand funding. Key responsibilities include ensuring the shared services are investing in the right strategic area and that associated benefits are being delivered via the production of business cases and value based quality of service reporting. This function is the face of shared services to each of the main customer business areas and will have the additional role to help shape and develop new business development opportunities.

Run
The purpose of run is to deliver the customers shared service sourced business services in contract with the business expectations for all application, infrastructure and transactional service levels. Key responsibilities are to manage the service processes (aligned to service management methods) that will support multiple vendors and using where possible 'factory processes' to ensure the most effective use of resources. Run will also manage the supplier relationships involved in supporting the shared service delivery.

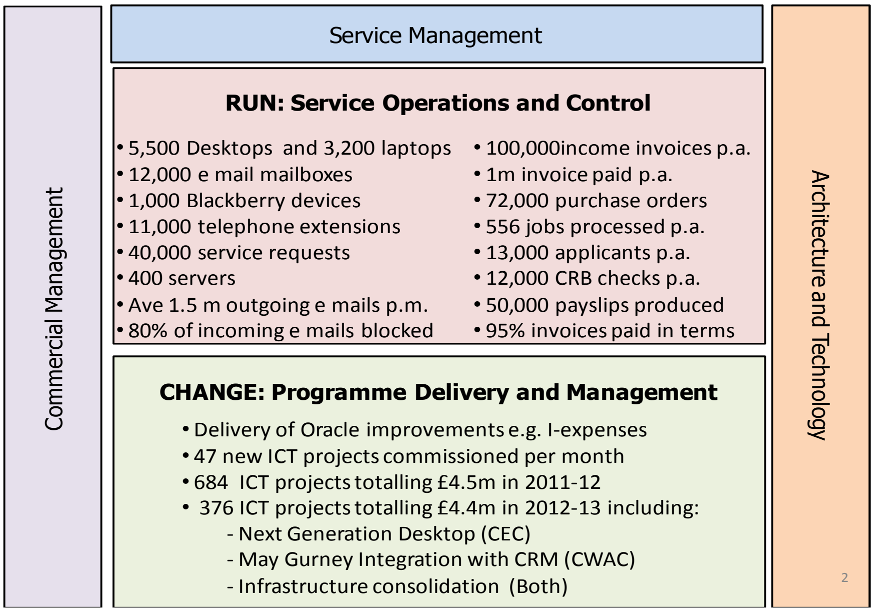
Change
The purpose of change is to manage all of the change delivery processes with, as much as possible, all resources coordinated. Key responsibilities include owning the shared services roadmaps for strategic direction as well as operating to simplified and standard project and programme management processes.

Any non-core processes will be considered for strategic sourcing in all of the TOM functional areas e.g. in the ICT service this would potentially include; desktop engineer support, network WAN and LAN and data centre management. Change would also be responsible for direction and innovation.

Target Operating Model – adding new services "factories"
New potential services e.g. revenue and benefits or customer contact centre would be added as discrete new 'Run' service factories utilising the single support, change and customer services which would only scale based on new service volumes or likely change portfolios. Any new customer wishing to utilise existing ICT or HR and Finance services would be subject to adopting the standard operating procedures of the TOM thus avoiding the risk of service factory duplications. Due diligence by both the shared service and any new customer would establish the transition approach and timelines.

4.4.2 The current shared Services Target Operating Model (Top Level)

The following diagram put the current shared service operating model in context and provides an insight into the level of activity in each of the functions. There is currently a 320 FTE establishment across the Shared Service (ICT and HR &

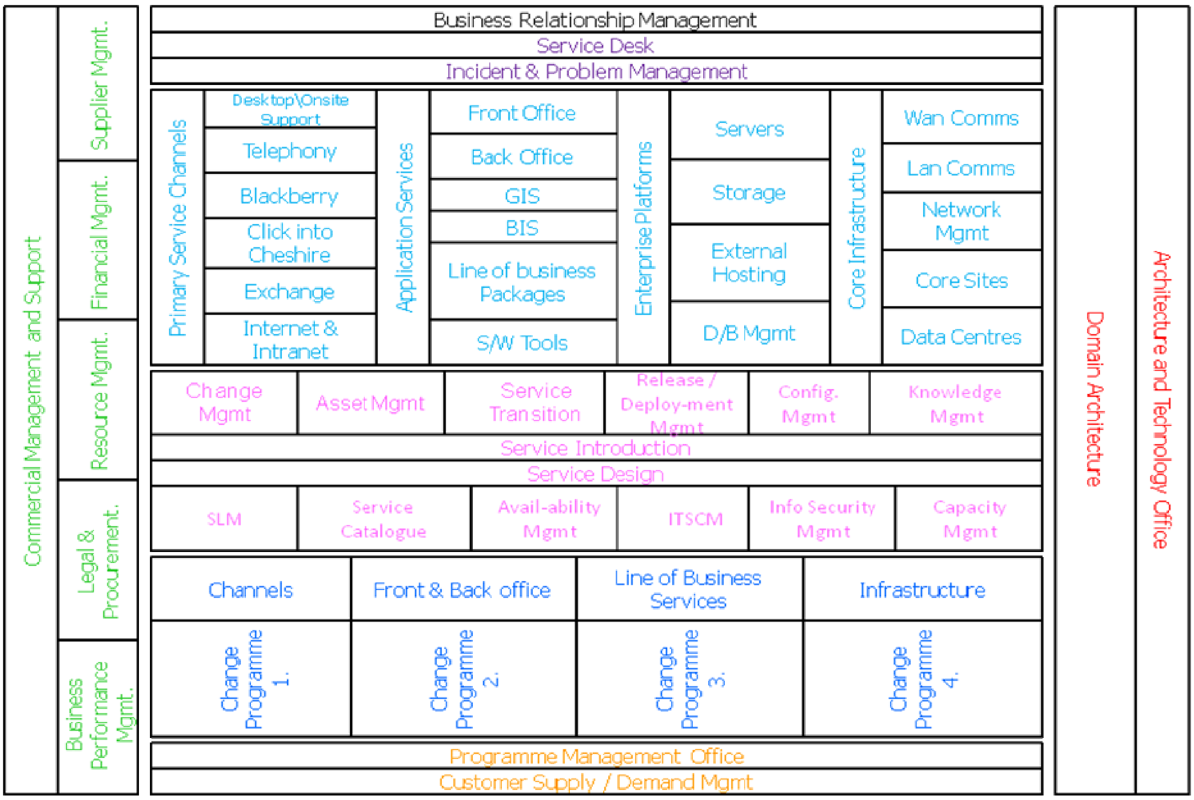


Finance).

4.4.3 Current position – moving towards full implementation

The ICT Operating model is shown in detail below.

ICTSS Operating Model (Detail)



During 2011 / 2012 a significant amount of restructuring has taken place in the ICT Shared Service resulting in savings of 76 posts.

There are key areas of the overall TOM that have yet to be implemented namely:

- Commercial Management & Support
- Business Relationship Management (new sales / market)
- A Managing Director to drive the business forward.

These posts are new and as such not included in the overall 320 FTE establishment. These new posts and are part of the business case investment requirements.

Worthy of note is that there are currently 16 vacancies across the ICT TOM, 6 vacancies of which are being held back to address current budget challenges.

4.5 Approach for Proposition Development & Strategic Marketing

The Joint Officer Board have recently commissioned a short term resource to establish a robust approach to proposition development and strategic marketing. The work is in early stages and is scheduled to be discussed at the Shared Services Joint Committee on 25th October. The output of which will further define this business case.

A brief overview of the approach is as follows:

Objectives

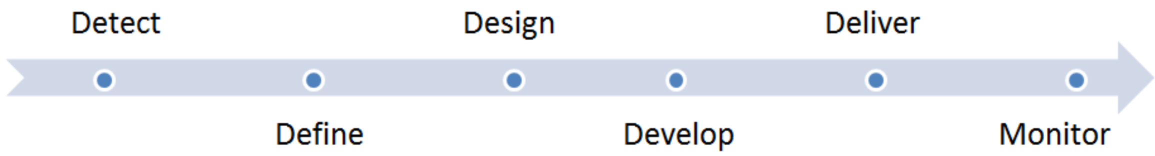
1. To maximise the opportunity to generate profitable and sustainable income from the physical and intellectual assets that have been built over the last 3 years in Shared Services.
2. To minimise the risk of wasting significant time, effort and money developing and marketing a set of offerings that no-one will buy.
3. To explore the potential for additional offerings that could be developed as a result of introducing further service lines to the Shared Services portfolio.

Deliverables

1. A clear recommendation as to which, if any, potential offerings should be taken to market.
2. For those that are recommended to 'go to market', a proposition development plan that will include:
   - Market Analysis: The market demand that we're trying to satisfy.
   - Solution Design: What will be delivered and how.
   - Commercial Model: How we will make money out of it.
   - Marketing Communications: How we will communicate, position and brand the offering.
   - Selling Approach: How we will take it to market.

Activity

Each potential market offering will be progressed through the proven offering management approach shown below.



Detect	Define	Design	Develop	Deliver	Monitor
Seek out the pain point, the unmet need…	Put some flesh on the bones. What would we offer, how would we deliver it, why would they buy?	Fully fleshed out with costed proposition development and launch plan & Business Plan	Invest in people, process, technology, infrastructure to develop the offer.	Test the market followed by full launch	Is the proposition delivering what it set out to do?

At each stage, the strength of the potential offering will be assessed by addressing a number of questions, including:

- Strategic Alignment:
- Market Attractiveness
- Competition & Differentiation
- Technical and Operational Feasibility
- Risk v Return

Only if the proposition is judged to be strong enough will it progress to the next, more detailed phase of activity.

Scope

To explore and assess the commercial potential of:

- Three existing Shared Service assets: ICT, Finance, HR
- Two potential Shared Service assets: Revenues, Customer Services

Timeline

To complete the proposition design by end March 13 – this timeline may vary depending on how strong each potential proposition is. Any significant change will be monitored through the Programme planning early reporting through current governance arrangements.

4.6 Market Analysis

A thorough review of the current shared services landscape has been undertaken and has helped inform this report. This Market Analysis accompanies this report.

It is clear that since starting our journey to establish a potential alternative model for Cheshire Shared Service the market opportunities have shifted from those originally anticipated. Analysis suggests that a good cross-section of local authorities' are already involved in sharing arrangements of one kind or another and there is no immediate prospect of a partner from this cohort.

Whilst attracting another local authority as a partner is still an option and efforts continue to do so this has not been as easy as anticipated. The key reasons for this have been the difficulty in establishing a clear proposition and our assumption that we understand the needs of that particular market place. These issues and the learning to be taken from this situation are fully explored in the accompanying document but in short the research suggests that the net will need to be cast further than the immediate geographic vicinity.

However what has become clear is that other marketing opportunities can be exploited which could benefit an SLE. This would involve a shift of focus to local SMEs with propositions being developed to stimulate and support the local economy through the provision of core back office services at a scalable and competitive rate. The development of a proposition for the SME market is considered as an essential part of the future SLE 's core business plan.

4.7 Governance Arrangements & Shareholder Considerations

There is a Shared Services Joint Committee workshop planned for 25 October, the output of which will further inform the business case. The following is provided to provide members with some background information ahead of the workshop.

The relationship between the Councils and the SLE, for so long as it operates within the Teckal exemption, should be similar to that which operates between the Councils management teams and in-house service departments.

In practice the management of a company is divided into two parts. A board of directors manage the day to day business of the company. Shareholders are the company and have control over how it is run to protect their investment. Whilst directors are required to act in the best interests of the company, shareholders can generally act in their own best interests. The articles of association define the relationship between the board of directors and the shareholders and most commercial companies are based on a model form of articles (previously known as Table A) which generally give the directors wide powers to manage the day to day affairs. As mentioned earlier in this note, it is recommended that certain powers traditionally reserved to directors are retained by the Councils as the shareholders, to ensure that the control test necessary for Teckal to apply is satisfied.

Directors

A director is defined by the Companies Act 2006 as "any person occupying the position of director, by whatever name called" and this definition is intended to cover both directors formally appointed in accordance with the company's rules and also those who behave as directors without a formal appointment.

The liability of directors for the company's debts and liabilities is usually limited (as long as they have not acted in breach of their duties) and their duties are codified in the 2006 Act. A director is required to act in the best interests of the company, (irrespective of who appoints them) which will be important for those Council officers with dual roles in both the Councils and the SLE. Directors are not necessarily employees although a director who works full time in managing the company will usually be an employee under a service contract.

Directors are sometimes referred to as **“executive”** and **“non-executive”** directors, although these terms have no statutory meaning. An executive director usually spends all of their working time managing the company and is employed by it whereas a non-executive director will tend to devote only a small part of their time to the company and so will not be involved in day to day management. Their function tends to be to monitor the activities of the executive directors and provide an independent voice on the board. This split is more common in larger companies, especially listed public companies. Whatever their title, all directors have the same obligations and liabilities.

When looking at the structure of the board it will be important to bear in mind the following;

Size – the size of the board needs to such that there are enough people with the skills and expertise to manage the SLE without it becoming so big as to be unwieldy.

Skills –the composition of the board should be based on the skills and expertise necessary to manage the business. This could include a full time commercial manager equivalent to a head of service and may also include a Finance and an HR director. It is highly recommended that a communications expert with a background in new markets.

In addition the Councils may wish to consider appointing employee and /or a customer / service user representatives as directors. This can have advantages in that stakeholders have a sense of ownership;

- involving employees can be good for staff morale and reduce staff turnover;
- services can be better tailored to user/customer needs where there is greater opportunity to feed back directly.

Weighed against this;

- stakeholder representatives may find it difficult to reconcile the interests of those they represent with those of the SLE
- close day to day involvement in running the company may be burdensome
- stakeholders may not want to be involved – stakeholder apathy.

Input from stakeholders does not necessarily have to be a director level and there are other ways in which they may be engaged. If stakeholder director appointments are considered then the Council may wish to restrict the sort of decisions in which they may be involved and or voting rights.

For a local authority owned company non-executive directors could also include elected members and those public spirited individuals with sector specific knowledge willing to give their time to develop the SLE.

The right to appoint and remove directors would be retained by the Councils as shareholder. Without wishing to state the obvious, the skills and abilities of the management will be a key factor in its success.

Company secretary

It is no longer mandatory to have a company secretary although it will still be necessary for the role to be performed. At its most basic, the role is administrative and involves tasks such as:

- filing documents at Companies House
- maintaining internal books and registers

- Convening meetings and producing paperwork;
- Taking minutes of board and shareholder meetings.
- Company signs and stationary.

For larger companies the role tends to be more involved and may include advisory and management responsibilities including compliance with the company's constitution, legal compliance by the company and directors and corporate governance. The role can be provided by legal or accountancy firms or procured from a specialist company secretarial consultancy.

Further discussion is required as to whether a requirement for a company secretary should be included in the articles, a proper understanding of what the role entails and options as to how it may be provided.

<u>Shareholder role</u>

The Councils as shareholders will be responsible for the strategic direction and significant decisions of the SLE to ensure the control test necessary to comply with Teckal is met. The Councils will want to ensure the SLE is financially viable and accountable whilst giving it sufficient autonomy to develop innovative services. On the other hand, the SLE will be concerned that it has sufficient flexibility to drive change forward as well as clear parameters as to when and how input from its council shareholder is required.

The Council could consider using an existing management team as the client such as CMT. However, it may be preferable to set up a bespoke client side shared team which, as with the board of directors, includes a broad scope of skills and experience to guide both the Councils and the SLE. The composition and role of the client side team is very much open to discussion and shouldn't be solely driven by legal issues. This is a new area for the Council and we should start to develop ideas as to what this might look like.

<u>Shareholder agreement</u>

There is added complexity for the shared services SLE where ownership is vested in two Councils. The way in which the two Councils deal with each other will be set out in a shareholder agreement and can be used to give shareholders protection over and above that in the company's articles. Whereas company articles are public documents, the shareholder agreement is private.

The matters covered by the shareholder agreement could include

- The issue of new shares – for example, to a new partner
- What happens if one shareholder wants to sell their holding
- Management of the SLE – for example rights to appoint directors (although this will usually be covered in the articles as well)
- Appointment of external auditors and rights of access for the Councils auditors
- Financial reporting arrangements
- Future funding
- Confidentiality
- Deadlock provisions.

The shareholder decisions mentioned under the control test described in Section 3.7.1.1 (a longer list attached as Appendix 1), could be included in the shareholder agreement rather than the articles, with the advantage that the shareholder agreement is private.

4.8 Expected Benefits

The SLE will deliver a number of benefits that directly contribute to achieving the desired outcomes. The benefits are highly descriptive. Further work is required to qualify & quantify the benefits and determine the measures & metrics. The programme plan will ensure focus is on development and implementation of a robust Benefits Realisation Plan.

Strategic

- A company business model which drives savings & efficiencies:
  - Through economies of scale & lower fixed costs
  - Savings through collaboration
  - Savings through standardisation (using the 70/20/10 operating principles model)
  - Proactive utilisation of capacity – create capacity or reduce capacity
- Building a strong brand identity and vision is a catalyst for change, which will drive correct behaviours at all levels, strengthens the market-facing proposition which will in turn derive maximum value for the company.
- A vehicle to stimulate the local economy through strategic partnerships with SME's.
- Opportunity to reinvest savings in the local economy / local public sector
- The SLE will bring into being a company capable of delivering collaborative and trading services.
- Flexibility to change the shape of the company in response to technology changes and business demand
- Ability to deliver services locally, thereby supporting the localism agenda
- Operational independence and not be bound by the same restrictions to which public sector organisations are confined, thus presenting opportunities to generate profit
- The SLE will have the ability to own assets and contracts, and to flex its structure to take advantage of new technology and changes in business demand.
- Shares could be sold to either an existing partner or a third party (public sector) without undue impact on staffing/contractual arrangements
- Able to generate commercial relationships within the industry sector e.g. gold partner reseller

Operational and support

- The company will work to a new operating model, accountable to its shareholders through a robust and transparent governance structure.
- Clear separation of roles and responsibilities between the company and the Councils
- A commercial and customer focused culture
- Ownership of contracts and assets and can therefore be pro-active in driving alternative sourcing decisions
- No competitive procurement process required to deliver services to partners
- Unlock some of the barriers encountered with multi-agency working
- Adoption of Industry best practise
- A robust performance management framework to meet service delivery and quality standards agreed with its clients
- Simplified staff management as a result of single terms terms and conditions
- Transparent governance structure and processes reducing cost and complexity
- Independent business system management
- Ability to reduce costs and support business improvement

4.9 Risks

The establishment of the SLE is a major undertaking and will inevitably involve some risk. A full risk analysis has been completed and High and Medium Level risks are identified in the table below.

Risk Level	Risk Owner	Risk Description	Risk Mitigation
High	Company	Partial implementation of the TOM may have an adverse impact on skills and capacity to continue to deliver existing service to an acceptable standard.	Interim appointments are planned to address this risk. Alternative sourcing methods are being investigated to further mitigate the risk.
High	Company	The existing inefficient business processes between the two ICT client teams and the ICT shared service are not improved. Significant delays in delivering major work programmes continue.	A working group has been established identify improvements to current working practices.
High	Company	Key objectives of the SLE to develop the business and develop new markets is not realised	Recruit MD & Commercial Manager with sound leadership skills and commercial expertise
High	Company	Fail to win the hearts and minds of staff and trade unions	Implementation clear identity & vision together with a strong leadership team and robust company plan. The SLE must resolve the current differing terms and conditions issue to form a strong culture
Med	Company	The SLE may be unable to expand or compete in line with the business plan	Essential to develop out propositions, test and refine in the marketplace
Medium	Company & shareholder	Continued outsourcing by both councils reduced in-house demand for the SLE services and as a result unit costs rise due to the relatively high proportion of fixed costs.	SLE is actively seeking new partners and additional business to offset the loss of volume resulting from outsourcing.
Medium	Company & Shareholder	Risk of failure: Business model is not fully implemented; marketing plan is not realised; Insufficient resources; poor business relationships are formed	The authorities consider financial guarantees for the early years of trading. Development of a clear exit strategy and business continuity plan.
High	Shareholders	The Councils are unable to identify an additional new shareholder to join the SLE and therefore savings to offset the additional running costs of establishing the SLE are not achieved.	Discussions continue at a local level but it appears unlikely that a further full partner will be identified in the immediate future. Discussions will be broadened as the SLE develops
Medium	Shareholder	The SLE fails to transform into a commercially minded, customer focused, business operation.	The new operating model should give a clearer focus to customer needs. The Gartner (ICT) and PwC (HR/Finance) benchmarking exercises have identified areas that are not good practice and/or do not show value for money.
Medium	Shareholder	Unforeseen technical issues are	Finance & Audit teams have established

		experienced in setting up the SLE within Oracle. The current budget does not include any provision for external support to resolve any issues.	an acceptable way forward whilst the SLE is in control of the councils. The business case financials are articulated on a range between best & worst case scenarios.
Medium	Shareholder	The SLE loses a significant amount of income from either external or schools contracts (for example as schools convert to academies). These contracts make a contribution towards fixed costs (for example the network) and therefore costs cannot be reduced in line with the loss of income. Academies are not classed as within the 10% threshold of the Teckal exemption.	The Shared Services/SLE is continually exploring new commercial opportunities. Offset "lost" trading income by implementing a robust Strategic Marketing approach to developing propositions and executing the delivery plan
Medium	Shareholder	Significant numbers of staff are unable to cope with/manage the significant change in culture and working methods that will be required by the SLE.	Training/mentoring/guidance will be provided by managers to help staff adapt. In addition, workforce performance measures will be applied to ensure that all staff meet the requirements of the SLE.
Medium	Shareholder	The current "amount £ of headroom" the SLE has to trade to not breach Teckal compliance limits of 10%, is estimated at £1.2m. A separate trading company will be required to be set up at a future date with clear governance and administrative arrangements.	Detailed income generation forecasts need to be established alongside the Business Development & Marketing plan to fully understand the required timings for the need of a separate trading company
Medium	Shareholder	Schools transitioning to academies - academies are not classed as within the 10% threshold the Teckal exemption provides based on the activities and control test with the definition and application of Teckal.	Offset "lost" trading income by implementing a robust Strategic Marketing approach to developing propositions and executing the delivery plan

A robust approach to risk management is undertaken by the Joint Officer Board. It is proposed that above risks will be continually monitored through the SLE Programme.

4.10 Implementation Plan

A summary high level roadmap has been prepared. It consists of 8 key workstreams across 4 key tranches of development, namely:

- Design;
- Construct & Implement;
- Go-Live;
- Operate.

There will be gateway reviews at end of each tranche. The Programme is managed using Office of Government Commerce (OGC) Managing Successful Programmes (MSP) methodology.

The workstreams are proposed as follows:

Workstream	Scope
Blueprint	This key overarching workstream will design & implement working practices, processes & policies including: Business Model; Operational Model; Commissioning Processes; Contract Management
Governance & Legal	Governance, Shareholder agreement; Articles of Association; Contracts
HR – Structure & Staff	TUPE; Consultation; Management & Staffing structure; Recruitment; Appointments; Terms & Conditions
Finance	Options Appraisal; Business case; Oracle Build; Financial Models; Audit; Company Accounts
Strategic Marketing	Proposition Development; Company Development Plan; Analysis; routes to market; exploration of target customers/partners
Communications & Promotions	Branding; Stakeholder management; development & execution of communication plan; promotional material & event support
Change Management – including benefit realisation	Focus on design & implementation of robust change management plan (including culture change) and Benefits Realisation plan.
Business Improvement – including Performance Management Framework	Focus on design & implementation of a Business Plan (including continuous improvement planning); supporting Performance Management Framework; Staff Development Plan (to instil the correct commercial culture & behaviours)

Key tasks & milestones include the following:

- Formation of a legal company to deliver collaborative services to its founder councils and other partners and a legal company to trade services.
- Formation of a new governance structure and appointment of a management team
- Design & implement a blueprint of the new organisation, its working practices and processes.
- Implement a robust company business model
- Implementation of a commercial operating model to drive efficiency savings and to provide the flexibility to bring in new business.
- Robust approach to proposition development
- Development & execution of a commercial marketing plan
- A programme of continuous improvement and staff development to instil the culture and working practices of a commercially minded and customer focused supplier.
- Implementation of a robust performance management framework to meet service delivery and quality standards agreed with its clients.
- Transfer of assets and contracts (to be defined).
- TUPE of shared service staff to the SLE
- Create a business case & Economic, Technical or Organisational (ETO) reason that entails changes to the workforce e.g. TUPE
- A review of boundaries between clients and the SLE.
- A scope assessment of other operational units (factories) which could be transferred to the SLE i.e. Revenues and Benefits.
- Further benchmarking current ICT operations.
- A revised charging structure to demonstrate full cost recovery.
- Introduction of new partners to join the SLE.
- The exploration of new markets to trade services and generate income, thereby increasing the customer base.

5. Assumptions

Assumptions used in the financial calculations are as follows:

5.1 Discounted Cashflow

The Discounted Cash Flow (DCF) is a well established mechanism to reduce the value of future cashflows to reflect that £1 received in the future is worth less than £1 received today. The discount is based on the Councils long term cost of capital of 6%.

5.2 Internal Trading

- Minimal Oracle set up required (450 hours). Limited security over AP and AR modules.
- One additional "factory" is added to the SLE
- Business Development Manager generates £200k of additional sales pa from as yet unidentified sources using existing capacity.

5.3 Transfer Model

2 options:

HR/Finance move to CEC

- Staff physically transfer from Chester to Crewe
- 30% of staff take VR and 70% opt to move to new location
- Relocation travel costs paid for 2 years

ICT shared service move to CEC

- Staff physically transfer from Chester to Crewe
- 5% of staff take VR and 95% opt to move to new location
- Relocation travel costs paid for 2 years

5.4 Disaggregation

- All parts of the ICT/HR/Finance are disaggregated
- Full physical separation of all assets including separate data centre, networks, servers and storage
- Shared applications such as Oracle are split into two separate instances
- Development Unit in HR/Finance replicated so that each council has its own development capacity.
- The new disaggregated services are provided in the same way and to the same service standards as the former shared service
- Existing commissioning arrangements between the ICT shared service and clients are removed as an offsetting saving

5.5 Joint Venture / Outsourcing

- 2 year procurement process to source a new supply partner. Contract commences in Y3.

- Supply partner is not able to deliver significant savings in parts of the business which are mainly staff-related e.g. service desk/field engineers and technical architecture.
- Savings of 15% pa can be achieved on network and server and storage costs, after initial upfront investment by the supply partner. As a result savings in this area will not be delivered until year 5 of the contract.
- Savings are shared between the councils and the supply partner 50/50.

5.6 Separate Legal Entity (SLE)

- Substantial Oracle set up required (7,500 hours -Worst Case Scenario)
- Pensions – future service contribution rate increases from the Councils stabilised rate of 16% to 25%. Increase in employers' contribution phased in over 5 years. Councils stabilised rate increases at 0.5% pa (current level of increase).
- Pensions – historic service deficit retained by Councils.
- SLE closes the LGPS to new members. New employees are provided with a stakeholder pension with an employer contribution rate of 6%. Staff turnover is assumed to be 4%
- Business Development Manager generates £200k of additional sales pa from as yet unidentified sources.
- A new, as yet unidentified partner is added to the SLE. New partner pay all integration costs. Partner keeps 66% of future savings to cover upfront investment costs. Savings start in Y5 following a 2 year period for integration, rationalisation of systems.
- Operational efficiency of the partners HR/Finance function is broadly similar to that of the Shared Service.
  Business Development Manager generates £200k of additional sales pa from as yet unidentified sources using existing capacity.

6. Appendix 1

MATTERS RESERVED FOR SHAREHOLDERS

Without the prior written consent of all of the shareholders, the Company shall not:

(Note: The following clauses 1.1 – 1.5; 1.10; 1.15; 1.17; 1.33; 1.35; 1.36 & 1.37 – are viewed as essential to the shareholder agreement)

1.1 alter its memorandum or articles of association or adopt any articles or pass any resolutions inconsistent with them;

1.2 vary its issued share or loan capital or create or grant any options or other rights to subscribe for shares or to convert into shares;

1.3 reduce its share capital or reduce any uncalled liability in respect of partly paid shares or purchase or redeem any of its shares;

1.4 issue debentures, securities convertible into shares, share warrants or options in respect of shares;

1.5 create or acquire a subsidiary or dispose of shares in a subsidiary;

1.6 appoint or dismiss a Director;

1.7 terminate the membership of a participating member; [CLG only]

1.8 unless required to do so by law, do or permit to be done anything as a result of which it may be wound up (whether voluntarily or compulsorily), [except as provided for in this agreement];

1.9 enter into a scheme of arrangement within the meaning of S.895 and Part 26 of the Companies Act 2006;

1.10 create a fixed or floating charge, lien (other than a lien arising by operation of law) or other encumbrance over all or part of its undertaking or assets, except to secure its indebtedness for sums borrowed in the normal course of the business;

1.11 borrow amounts in excess of a maximum aggregate sum outstanding at any time of [£10,000], excluding borrowings in the normal course of the business;

1.12 except where a matter is included in the budget, make a loan or advance or give credit (other than normal trade credit);

1.13 give a guarantee or indemnity to secure the liabilities or obligations of any person other than in the normal course of the business;

1.14 factor or assign any of its book debts;

1.15 sell, lease, create an interest in or otherwise dispose of the whole or a material part of its undertaking or assets, or contract to do so;

1.16 except where a matter is included in the budget, enter into a contract orarrangement involving expenditure on capital account or the realization of capital assets if the amount or the aggregate amount of the expenditure or realization by the Company would exceed [£10,000] in any year. For the purpose of this sub-clause, the aggregate amount payable under an agreement for hire, hire purchase or purchase on credit sale or conditional sale terms is deemed to be capital expenditure incurred in the year in which the agreement is entered into;

1.17 enter into a contract or arrangement which is not in the normal course of the business or makes any material change in the nature of the business;

1.18 terminate or make any material amendment to the Service Agreement (including any ancillary agreements);

1.19 enter into a contract or arrangement which is not on arm's length terms;

1.20 enter into or vary a contract or arrangement (whether legally binding or not) with a shareholder or director of the Company or with any person as nominee for any of them other than as permitted under the Service Agreement (including any ancillary agreements);

1.21 take or agree to take or dispose or agree to dispose of an interest in, or license over, land;

1.22 acquire shares or securities of a person;

1.23 enter into a partnership, profit-sharing or joint venture agreement;

1.24 adopt a pension scheme or similar arrangement;

1.25 appoint or remove the Auditors;

1.26 change its accounting or taxation policies, or operating and management procedures, other than as recommended in writing by the auditors;

1.27 commence, settle or take any material decisions relating to legal or arbitration proceedings which involves a claim (including costs) in excess of [£10,000];

1.28 settle any insurance claim which involves a claim (including costs) in excess of [£10,000];

1.29 settle any warranty claim under the Service Agreement which involves a claim (including costs) in excess of [£10,000]

1.30 permit the registration (upon subscription or transfer) of any person as a shareholder of the Company;

1.31 apply for the listing or trading of any shares or debt securities on any stock exchange or market;

1.32 pass any resolution for its winding up or presenting any petition for its administration; [duplicates 1.8]

1.33 alter the name of the Company or its registered office;

1.34 alter the Area in which the Company is to operate;

1.35 adopt or amend the business plan in respect of each Financial Year;

1.36 change the nature of the Company's business or commencing any new business by the Company which is not ancillary or incidental to the business;

1.37 form any subsidiary or acquire shares in any other company or participating in any partnership or joint venture (incorporated or not);

1.38 amalgamate or merge with any other company or business undertaking;

1.39 make any acquisition or disposal by the Company of any material asset(s);

1.40 make any loan (otherwise than by way of deposit with a bank or other institution the normal business of which includes the acceptance of deposits or in the ordinary course of business) or grant any credit (other than in the normal course of trading) or give any guarantee (other than in the normal course of trading) or indemnity;

1.41 alter any mandate given to the Company's bankers relating to any matter concerning the operation of the Company's bank accounts other than by the substitution of any person nominated as a signatory by the party entitled to make such nomination;

1.42 give notice of termination of any arrangements contracts or transactions which are material in the nature of the Company's business. For the purpose of this sub-clause, material in nature shall mean an arrangement, contract or transaction which exceeds £10,000 in value;

1.43 materially vary any arrangements, contracts or transactions. For the purpose of this sub-clause, to materially vary any such arrangements, contracts or transactions shall involve making any change to the value of the arrangement, contract or transaction of more than [£10,000], or which significantly increases the risk or liability of the Company;

1.44 grant any rights (by license or otherwise) in or over any intellectual property owned or used by the Company;

1.45 make or permit to be made any change in the accounting policies and principles adopted by the Company in the preparation of its audited and management accounts except as may be required to ensure compliance with relevant accounting standards under the Act or any other generally accepted accounting principles in the United Kingdom;

1.46 establish or amend any profit-sharing, share option, bonus or other incentive scheme of any nature for directors or employees;

1.47 agree to remunerate (by payment of fees, the provision of benefits-in-kind or otherwise) any officer of or consultant to the Company at a rate in excess of [£50,000] per annum or increasing the remuneration of any such person to a rate in excess of [£2,000] per annum;

1.48 enter into or vary any contract of employment providing for the payment of remuneration (including pension and other benefits) in excess of a rate of£70,000 per annum or increasing the remuneration of any staff (including pension and other benefits) to a rate in excess of £2,000 per annum; or

1.49 make any agreement with any revenue or tax authorities or making any claim, disclaimer, election or consent exceeding [£10,000] for tax purposes in relation to the Company or its business.

1.50 approve any applications for early retirements or ill-health retirements