

Strategic Review of Swindon Commercial Services Ltd

Cabinet

Date: 26th June 2013

Author: Cabinet Member for Strategic Projects and Transformation, and
Chief Executive

Wards: All
Locality Affected: All
Parishes Affected: All

1. Purpose and Reasons

- 1.1 Swindon Commercial Services Ltd (SCS) was established as a wholly owned limited company of the Council in January 2010. As with the Council's other major partnerships, it is important to periodically review business benefits and risk against agreed objectives in order that the strategic direction can either be confirmed or amended as necessary.
- 1.2 SCS has recently identified emerging opportunities in new market areas that the company was not in a position to exploit when it was established in January 2010. This report sets out a number of considerations relating to the Company's future direction to enable Members to determine the most suitable approach that enables those opportunities to be maximised to benefit the Council.
- 1.3 The report is urgent in order to maximise the financial benefits to the Council and enable the changes to be implemented in the most economic and efficient manner, and to provide clarity to the current SCS staff about their future status.
- 1.4 The report's recommendations, if approved, will contribute towards the strategic priorities of consistently making the best use of all available resources and focus them on what matters most and right skills, right jobs in the right places.

2. Recommendations

Cabinet is asked to recommend to Council, or its Special Committee, that:

- 2.1 For the reasons set out in this report, the Council's wholly owned company Swindon Commercial Services Ltd (SCS) should be re-focused on Waste Treatment and Disposal, PV installations including large-scale arrays and activities of the DW Dunn brand, with a view to generating profitable external income in a small range of emerging opportunity areas where returns, if realised, will significantly outweigh the effort and cost of securing them and provide a financial return to the Council as shareholder.
- 2.2 The remainder of the services SCS provides to the Council including the staff and infrastructure involved ('the undertaking'), be transferred back to the Council in accordance with the high-level timetable set out in Appendix 2, enabling a

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significant reduction in the back office costs (overheads) associated with operating a large external company as detailed in table 1;

- 2.3 Agree that, following the transfer of the undertaking back to the Council;
 - 2.3.1 The current “rebate” arrangement be removed;
 - 2.3.2 The Board Director, Service Delivery carries out a detailed examination of the individual services provided currently by SCS to SBC, with a view to streamlining and integrating processes operating both within services and between client and contractor to further reduce costs;
 - 2.3.3 As part of this exercise, robust specifications be developed for all services currently provided by SCS that meet Members’ requirements, in order to enable services to be tendered in a planned way where it makes sense to do so. This allows for the possibility that Members may determine, following a detailed market comparison, that some in-house services represent value for money that includes cost, quality and social value;
 - 2.4 Authorise the Director of Law and Democratic Services and the Head of People and Development, the Board Director Resources, in consultation with the Cabinet Member for Transformation and Strategic Projects, to progress the legal, human resources and financial steps necessary, to ensure a successful transfer of SCS staff, assets and property to the Council;
 - 2.5 Authorise the Director of Law and Democratic Services, in consultation with the Cabinet Member for Transformation and Strategic Projects and the Board Director, Resources to complete any necessary legal documentation in relation to the transfer of the undertaking on such terms as he considers appropriate to protect the Council’s interests.
 - 2.6 Note that:
 - 2.6.1 in the event of the transfer of the undertaking proceeding, the tender timeline for services provided by SCS, previously agreed by Cabinet in June 2011 (Cabinet Minute 10, 2011/12 refers), will need to be reviewed and a report will be brought to Cabinet with a revised proposal later in this Municipal Year, in the context of the work described in recommendation 2.3.3, and
 - 2.6.2 work is continuing to implement the Cabinet decision from October 2011 (Cabinet Minute 53, 2011/12 refers) around Strategic Commissioning Partnership Agreements for non-housing related building construction and refurbishment works and that this is unaffected by the decisions in this report.
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3. Detail

Background and Context

- 3.1 Cabinet agreed a business case in 2009 to establish the Council's former Direct Labour Organisation, Swindon Commercial Services as a wholly owned limited company. Swindon Commercial Services Ltd started trading on 1 January 2010, with the agreed twin aims of:
- Providing best value for money (VFM) solutions for services provided to Swindon Borough Council (SBC)
 - Helping support the Council's future budget challenges through delivering increased dividends or lower prices.
- 3.2 From 2010 to 2012 there was a steady increase in the value returned from SCS to SBC, predominantly through reducing the price for SBC services in partnership with clients. This helped alleviate some of the Council's budget challenges over that period.
- 3.3 This position reversed during 2012/13 with SCS being unable to absorb cost pressures experienced during the year as they had managed in previous years. As a result, the return to SBC was significantly below the expected level, adding unexpected, late pressure to the Council's ability to deliver a balanced budget for 2012/13 and 2013/14. SCS is currently projecting a higher return in 2013/14 than was achieved in 2012/13, although it is still below the budgeted and actual level in 2011/12.
- 3.4 Although SCS has been successful in identifying emerging opportunity areas that offer promise for the future, the company has struggled since 2010 to realise significant levels of profit from contracts with organisations other than SBC. External profits since decoupling have been relatively stagnant and well below initial and subsequently recalibrated expectations.
- 3.5 In many respects this is not surprising. The strengths, weaknesses, opportunities and threats (SWOT) analysis that accompanied the original SCS business plan is attached as Appendix 1 to this report and it can be seen from this that SCS's identified strengths and opportunities were largely in public sector works. An accompanying risk identified was that public sector funding could reduce significantly in the period 2011/12 and beyond.
- 3.6 Since 2009, there has been a significant turndown in the global and national economic prospects. The fiscal responsibility programme introduced by the Coalition Government in 2010 has significantly reduced the funding available for almost all public bodies, which were primarily the target market for SCS. The
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lower level of work available has in turn increased competition and tightened available profit margins. Inevitably this has made achieving the level of predicted external turnover and profit significantly more difficult.

- 3.7 SCS has recognised this situation and sought to mitigate it by identifying alternative business opportunities, predominantly in niche markets with a green energy theme, e.g. Refuse Derived Fuel (RDF) and Photovoltaic (PV) cells, including large-scale arrays. There is undoubted potential in these markets, although the scale and timing of returns of large-scale PV installations in particular is difficult to predict accurately.
- 3.8 As sole shareholder, the Council has a key role to play in setting out clearly its future strategic objectives for the company in order that a robust business plan and appropriate management structure can be put in place to deliver them. The following sections of this report detail the options that have been considered before arriving at final conclusions and recommendations. These have been informed by inputs from both council officers and SCS.

Option Appraisal

- 3.9 Broadly three options exist for the future strategic direction of SCS, with a number of detailed scenarios within each option:
- a) Retain SCS in its current form, adopting a similar but more targeted sales strategy;
 - b) Re-focus SCS to participate in a much more targeted way on niche external markets and transfer most of the services provided to SBC back to the Council;
 - c) Wind up SCS and transfer all of the services it provides to the Council.
- 3.10 The original strategic intent behind the creation of SCS as a separate company remains both relevant and valid, as generating new and additional income streams can assist the Council's overall financial position. If it is believed that there are real opportunities to exploit external markets, the option of winding up SCS completely and transferring all of its activities to the Council would be counter intuitive and should be ruled out.

External Income Opportunities

- 3.11 It is important that any external income is truly profitable and brings a contribution that more than covers overheads. If this is not the case, the Council is effectively subsidising the external contracts and not deriving a real financial benefit. Currently, SCS's overheads represent around 6% of turnover (just over £5m, although £1m is charged directly to specific functions).

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- 3.12 SCS's initial budgeted external income and profit targets for 2013/14 showed a wide range of contribution targets totalling around £0.85m, with some lower than 6% in recognition of the market conditions. Having been asked to review these to inform the option appraisal, the company produced a revised set of sales targets across a range of activities for a mix of client markets. These figures are underpinned by a proposed new sales strategy that differentiates between proactive and responsive sales opportunities, with the latter intended to be pursued only where sufficient levels of contribution can be secured that at least cover overheads.
- 3.13 SCS is predicting external contribution levels rising from £1m in 2013/14 (included in the base rebate assumption) by around £0.5m per year. This includes predicted profit from DW Dunn Ltd, a company that SCS acquired in 2012 and which is wholly owned by the company. The most attractive contribution expectations relate to PV arrays.
- 3.14 Although the level of growth in contribution seems solid, it cannot be guaranteed as it is dependent on market conditions and SCS's ability to win work at competitive prices that include attractive contribution rates. That said, the potential scale of value that is being highlighted from PV arrays alone strongly suggests that it is worth pursuing these opportunities as a minimum. On this basis, the option of transferring all activities back to the Council and thereby foregoing any material future income (Option c) should be ruled out.

Additional Costs of Operating an External Company

- 3.15 The potential external contribution figures do, however, need to be seen in the context of the additional overhead costs of operating SCS as a large, arms-length company.
- 3.16 Looking at a high-level analysis it is clear that some costs were added to SCS in 2009 in preparation for decoupling (e.g. new commercial management team). Significantly more costs were included in the run up to January 2010 to enable SCS to operate as a separate company (e.g. insurance £300k, finance £200k). In addition, SCS figures show that overhead costs have risen by around £1m since January 2010. On this basis, the additional costs of operating SCS as a stand-alone company look to be in the order of £1.5m - £2.0m.
- 3.17 Council officers have undertaken a significantly more detailed analysis, with information provided by the SCS Finance team. This has highlighted that there could be significant savings from bringing the majority of SCS services back in-house and leaving a much smaller and better focussed SCS operating externally. The range of financial issues that would need to be considered should the Council decide to bring a large part of the current SCS operations back in-house is summarised in Table 1 below.

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Table 1 – Net Benefit of Bringing Most Services In-House

	Savings (-) / Cost (+)
	£'000
Staffing and insurance savings (taking out extra SCS infrastructure costs)	-1,352
Further Integration of support functions	-150
Lost opportunity - SCS terms & conditions changes	+200
	-1,302
<u>Pensions</u>	
Extra costs of SCS staff transferring on to the LGPS	+400
Lower SBC Rate (18.1% less 15.4%)	-208
Avoid future rate differential due to stabilisation policy	-500
	-308
Rebate retention by SCS to ensure more sustainable cash-flows	-500
Allowance for SCS budget uncertainty, say	250
Net Savings from bringing most services back in-house	-1,860

- 3.18 These savings represent those that can only be achieved by bringing the majority of SCS's current activities in-house, leaving a much smaller core company. If any significant services provided to SBC (with the exception of Waste treatment and Disposal, which is covered by a separate 10 year contract with SCS) remain with the limited company, the scale of potential savings would be much lower. SCS themselves have recognised the need to reduce the company's overhead costs and have targeted a figure of around £1m. If this is accurate, it could be realised whether the company remains in its current form or not.

Other Material Considerations

Rebate

- 3.19 The rebate arrangement has been a source of tension between the Council and SCS for a number of years. Discussions between officers and leading Members have highlighted a wish from the Council's perspective to remove the rebate,

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which can be achieved with no financial impact of most services are brought in-house.

- 3.20 However, from the SCS perspective it is vital to keep the rebate in place to support the company's daily cashflows and to allow it to demonstrate it is a profitable business. If the rebate arrangement is fundamentally changed or removed, the SCS cashflow position would significantly deteriorate.

Tendering

- 3.21 It is acknowledged that if SCS remains as an external company the services it provides to the Council will inevitably need to be taken to market to formally test value for money. Cabinet agreed a tender timeline in June 2011 that included all services provided at that time. Work has already commenced on producing specifications for Streetsmart services, the first to be tendered, where the formal process is due to start in January 2013.
- 3.22 While the requirement to demonstrate value for money will exist regardless of the future model of service delivery, if many of the current services provided to the Council by SCS were brought in-house the absolute necessity to do this through a formal tender process would be removed. Members would have the discretion to move to tender at a time of their choosing and could determine on a service by service basis whether they wish to tender or have the Council remain as a direct service deliverer. Prior to taking any service to market, there should be an expectation that a detailed examination will be undertaken of individual services provided currently by SCS to SBC, with a view to streamlining and modernising processes operating both within services and between client and contractor to further reduce costs.
- 3.23 In this context the current tender timeline will need to be reviewed, following the appropriate consultation. Given the proposed future focus on a smaller range of market activities, there would be no impact on Cabinet's decision in October 2011 around Strategic Commissioning Partnership Agreements for non-housing related building construction and refurbishment works. The Council would continue to take such projects to market as is happening currently.
- 3.24 With the Council having signed a long-term contract with SCS for waste treatment and disposal in January 2013 as part of the new waste disposal arrangements including the Refuse Derived Fuel (RDF) facility, it would seem most appropriate for this service to remain with SCS, even if most other services are brought in house, to provide a stable platform to build from. The Council's client team believes it is feasible to retain the current position where the contract for Waste Disposal is separate from that for Waste Collection, a position mirrored in many areas across the country. However, further work is being undertaken to review the hand-offs between the waste collection, recycling and disposal

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services to determine whether an alternative solution could also be progressed. An update will be provided to the Cabinet meeting on the outcome of this work.

Costs of Change

- 3.25 The Board Director, Service Delivery, in his role as Interim MD of SCS, has highlighted the need for change within the company most particularly to modernise business processes, reduce the use of on sub-contracted staff and to introduce more robust arrangements for engaging and managing sub-contractors. In addition, he has highlighted the need to re-focus the company's business strategy and withdraw from some current market areas.
- 3.26 These issues will need to be addressed regardless of the company's future status. The cost of effecting the change has not yet been quantified, although it is recognised that there is likely to be some need to secure additional skills and resources from outside organisations. It is arguable that some of the changes would be easier to effect if service delivery was transferred to the Council, as end to end processes could be re-designed in a more streamlined way. Against this, it could place additional pressure on the Council's management and change resources. Some of these would, however, be released if the requirement to prepare for the tendering of Streetsmart services in January 2014 was deferred.
- 3.27 Should Members decide to transfer the undertaking, including SCS staff, back to the Council, the transition would need to be carefully planned and managed. This would include the transfer of around 500 – 550 staff under TUPE (the Transfer of Undertakings (Protection of Employment) Regulations 2006) in accordance with the Code of Practice on workforce matters. This is a process that the Council has managed on a number of occasions in recent years with the creation of SCS and Seqol and the transfer from Health of Children Services staff and it is therefore well understood. As part of this there will need to be a consultation period with staff affected. It is not considered at this stage that it is appropriate to carry out any wider consultation in view of the need for urgency and the intention to maintain current service provision.
- 3.28 Other issues that would need to be addressed to effect the transfer include the following.
- 3.28.1 Determining where SCS would fit within the Council's management structure, in particular whether the current client / contractor arrangements would be continued;
 - 3.28.2 Revising the coding structure in the Council's financial systems to incorporate SCS's direct expenditure and income;
 - 3.28.3 Novating / transferring SCS's contracts, software licenses and insurances to SBC;

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3.28.4 Agreeing an approach to valuing and transferring assets; and

3.28.5 Merging the SCS accounts with those of SBC in-year and closing the current year's accounts for both organisations.

- 3.29 The process of establishing SCS as an arms-length company took 6 months from the point at which Members decided in principle that they wished to pursue this route. Transferring a large part of SCS back to the Council would be a simpler process and is expected to take around 4 months from the point of decision. An outline project plan is included as Appendix 2. This suggests a two stage approach be adopted, with the initial transfer taking place on 1 November 2013 and further work being undertaken following this to fully integrate services within the Council's structure by 1 April 2014. If Members decide to endorse this approach, the transition would be overseen by the Board Director, Resources, who performed this role when SCS was created.

Summary of Considerations

- 3.30 Both SCS and SBC Officers feel that there are external opportunities in the market to drive profit from niche markets (e.g. PV and RDF) and that retaining an external company to exploit these and other market opportunities as they arise is a sensible way forward. The difference in opinion is around the size of that external company.
- 3.31 The main issues for Members to consider in arriving at a decision on the future of SCS have been set out in this report and are summarised in the table below.

Table 2 – Summary of Key Considerations

	Retaining SCS broadly “as is”	Retaining a much smaller SCS and transferring most services to SBC
External income	Potential profit identified around £1m in 13/14, rising by around £0.5m - £0.6m per year in range of markets including niche “green energy” markets. Cannot be guaranteed.	Potential profit identified around £0.7m in 13/14, rising by around £0.4m - £0.5m per year only in niche “green energy” markets. Cannot be guaranteed.

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Overhead costs	SCS has identified scope to reduce by £1m (currently no clear plan to deliver).	Detailed analysis shows additional cost of operating large external company £1.5m. Could be removed by 2014/15. Could also benefit from SCS identified scope to reduce by £1m (currently no clear plan to deliver).
Pensions	Additional cost of separate LGPS fund around £0.5m per year (phased in)	Net additional cost of eligible new entrants to SBC LGPS scheme around £0.2m per year (not phased in)
Rebate	Needs to stay in place. SBC will need to allow SCS to retain around £0.5m per year of profit to aid cashflows and enable investment.	Could be removed with no net impact on the Council's budget.

	Retaining SCS broadly "as is"	Retaining a much smaller SCS and transferring most services to SBC
Tendering	All services provided to SBC by SCS would need to be tendered in a planned timetable. Significant costs would be incurred by both SCS and SBC.	Members have choice on whether / when to tender services. Costs of tendering reduced / re-phased.
Costs of change	Significant changes to business operations to be managed. Some additional costs likely, not yet quantified.	Significant changes to business operations to be managed. Some additional costs likely, not yet quantified. Additional cost to transfer services back to SBC. Some additional costs likely, not yet quantified. Will be significantly lower effort and costs than to establish SCS.

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- 3.32 For the full range of issues considered, officers recommend that the most appropriate future strategy for SCS that will maximise financial benefit to the Council in the foreseeable future is to scale back the company to focus on niche “green energy” activities and to transfer most of SCS’s staff and operations back to the Council. Following this, more detailed work will be undertaken to inform Members’ decision on whether and when those services should be taken to market, having driven down costs and removed duplication of effort before doing so.
- 3.33 This would mean that in the future the services SCS would deliver as a limited company would be Waste Treatment and Disposal, PV installations including large-scale arrays and activities of the DW Dunn brand.

4. Alternative Options

- 4.1 A range of options has been considered as detailed in the report.

5. Implications, Diversity Impact Assessment and Risk Management

Financial and Procurement Implications

- 5.1 The financial and procurement implications are covered in the report. The savings identified in Table 1 by bringing most services back to the Council are predicated on a much smaller external company remaining, covering Waste treatment and Disposal, PV arrays and DW Dunn services. The savings would be greatly reduced should any further services provided by SCS to SBC be retained within the limited company.

Legal and Human Rights Implications

- 5.2 Under section 3(2) of the Local Government Act 1999, local authorities are under a general duty of Best Value to “*make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness.*” Before deciding how to fulfil that duty, authorities are under a duty to consult as appropriate. In this instance, the council is satisfying its general duty of best value for the reasons set out in the report and, in view of the urgency in this matter, considers it not appropriate to carry out a formal consultation process having regard to the fact that there will be no change in service provision resulting from the transfer back to the Council.
- 5.3 Other Legal and Human Rights implications have been taken into account in the preparation of this report and it is believed that the recommendations are compatible with convention rights.

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- 5.4 All Other Implications (including Staff, Sustainability, Health, Rural, Crime and Disorder)
- 5.5 If the recommendations of this report are accepted, there will need to be more work undertaken relating to the implications on staffing and in particular, the resource requirements that will be needed both internally and externally to ensure a seamless transition is achieved.
- 5.6 The transfer of employees to the new organisation will need to be in accordance with the TUPE (Transfer of Undertakings (Protection of Employment) Regulations 2006) and the impact of the transfer will need to be considered. A range of staff communication events will be planned to take place.
- 5.7 The proposed timeframe is challenging and will necessitate officers being released as necessary.

Diversity Impact Assessment

- 5.8 A Diversity Impact Assessment has not been completed for this report as there are no specific service changes being proposed. Any staff changes will be dealt with in accordance with the Council's Managing Change policy.

Risk Management

- 5.9 A risk register will be completed for the change programme should Members agree the recommendations. Key risks will relate to timescales and the resources required to implement the changes detailed in the report. There are felt to be manageable although the possible need to secure some additional external resources to mitigate these has been identified.

6. Consultees

- 6.1 The Board Director, Resources (Section 151 Officer) and Director of Law and Democratic Services (Monitoring Officer) are consulted in respect of all reports.

7. Background Papers

- 7.1 There are no background papers.

8. Appendices

- 8.1 Appendix 1 – SCS SWOT Analysis
- 8.2 Appendix 2 – Outline Project Plan to Transfer most SCS activities back to SBC

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9. Key Decision/Decision in Cabinet Work Programme/Forward Plan

- 9.1 This is not a Key Decision because it is a decision being referred to Council / Special Committee. It is included in the Cabinet Work Programme / Forward Plan for June 2013.