

## **NORTH LINCOLNSHIRE COUNCIL**

### **CABINET**

#### **ESTABLISHMENT OF A LOCAL AUTHORITY TRADING COMPANY**

##### **1. OBJECT AND KEY POINTS IN THIS REPORT**

1.1 To seek approval to establish a Local Authority Trading Company (LATC)

1.2 The key points in this report are:

- The council has a successful track record of delivering services commercially. Over the last three years the income generated through commercial trading has increased steadily with an actual outturn exceeding £7m in 2015/16.
- The changing landscape for local government demands innovation in service delivery in order for councils to achieve their financial plans and corporate strategy objectives.
- In October 2015 the cabinet member policy and resources considered a Commercial Strategy 2015-19. An evaluation of the opportunities offered by a local authority trading company structure was stated as a future development ambition.
- The legal framework for local government requires a rigorous process to be undertaken prior to establishing an alternative trading vehicle. The report details the outcome of a comprehensive business case and planning process.

##### **2. BACKGROUND INFORMATION**

2.1 In October 2015 the Cabinet Member Policy and Resources approved a Commercial Strategy 2015-19.

2.2 The strategy detailed our vision, aspirations and ambition for future growth, including consideration of the opportunities associated with an alternative commercial trading vehicle. It recognised the council's significant track record in trading its services commercially. In 2015/16 new business generated through commercial development exceeded £150,000 with a total turnover of £7m in year.

2.3 The changing landscape for local government demands innovation in service delivery in order for councils to achieve their financial plans and corporate strategy objectives. Funding reductions from central government alongside other developing agendas such as the academisation of schools require councils to re-think their traditional approach to service delivery and design new and innovative solutions which will meet future needs.

- 2.4 The Local Government Act 1970 as amended provides councils with a range of flexible powers to trade commercially but within defined parameters. These powers can be extended where councils undertake commercial work under a trading company but the Act requires a comprehensive business case and planning process to be undertaken prior to a establishing a company structure.
- 2.5 The Act requires councils to demonstrate that all costs are fully recovered and that there is no actual or hidden subsidy so as to avoid any potential challenge on the basis that the council is distorting the marketplace.
- 2.6 Detailed research, analysis and consultation with directorates has been undertaken to identify the opportunities and associated implications of establishing a commercial trading company for realising the council's commercial strategy aspirations and its four year financial plan targets.
- 2.7 A number of potential company structures have been evaluated as part of the options appraisal stage to assess their suitability and a company limited by shares was identified as the most suitable model for achieving the council's objectives.
- 2.8 It is proposed that the council establishes a company limited by shares with the council as the sole shareholder. The company will be registered with Companies House and will trade under a business name yet to be determined.
- 2.9 The company would operate as an administrative and legal vehicle to direct, source, secure and develop new and profitable commercial income streams on behalf of the council. Any 'profit' achieved by the company would be returned to the council in the form of a dividend payment on an agreed basis. Profits will be subject to Corporation Tax as detailed in paragraph 5.6.
- 2.10 The Company will require a Board of Directors and a Company Secretary. These Directors will not receive any remuneration but will be responsible for managing the affairs of the company and will be bound by a Shareholder's Agreement.
- 2.11 The full business case proposes that the company once established will drive new business development, aligned with the commercial strategy, over a number of distinct and incremental development phases, encompassing existing and new tradable activities spanning:
- Professional & Technical Services
  - Business Management Services
  - Education Support Services
  - Operational & Facilities Management Services

### **3. OPTIONS FOR CONSIDERATION**

- 3.1 Option 1 – Cabinet approves the establishment of a Local Authority Trading Company
- 3.2 Option 2 – Cabinet do not approve the establishment of a Local Authority Trading Company

#### **4. ANALYSIS OF OPTIONS**

- 4.1 Option 1 - The formation of a local authority trading company will enable a step change in commercial performance and culture, providing additional flexibilities and freedoms together with new capabilities for optimising expertise, skills and resources. It will provide a vehicle for enabling the council to respond to current and future agendas and support the sustainability of its core service delivery through the generation of new income streams.
- 4.2 Option 2 – Not approving the establishment of a local authority trading company would impact the council’s ability to realise the outcomes detailed in Option 1. The council would continue to trade under its current delivery mechanism.

#### **5. RESOURCE IMPLICATIONS (FINANCIAL, STAFFING, PROPERTY, IT)**

- 5.1 All activity within the scope of the company will be subject to full cost recovery. The proposal is driven by the need to develop new and substantial income streams to support the council’s budget plans and corporate strategy objectives as detailed.
- 5.2 There will be up-front costs to form the company and further costs to operate it (such as financial support and insurance); these are estimated to be approximately £13,000 per annum. There is also a need to establish business development and marketing capacity to bid for contracts and to grow the businesses, these costs are more significant and are not repaid until contracts are secured. For this reason there is likely to be an initial deficit in running the company but if the company trades successfully then it will move into profit. Administrative and business development support will be provided by the council’s existing commercial unit on a cost recharge basis.
- 5.3 Initially the company will not have resources of its own to finance its spending and is unlikely to be able to borrow money without an established trading history. In agreeing to establish the company the council will provide a loan to cover the initial trading period including set up costs. There will be a written loan agreement with agreed instalments, repayable with interest at an agreed commercial rate. This will be subject to separate a decision making process.
- 5.4 Projected turnover as set out in the Full Business Case is expected to be £422,000 over four years. These figures are based on the initial scope of activities at launch and include a number of assumptions which will be refined as more detailed work is undertaken. The envisaged budget contribution to the council over 4 years is estimated at £140,000, again based on the activities in scope at launch. Pre-tax profit over the four year period is projected to be approximately £43,000 in total. This gives a pre-tax profit margin of 12%. Profit after tax is estimated at £35,000 (10%). It is important to note that additional traded activities will be added incrementally in line with the development vision set out paragraph 2.11.
- 5.5 It is also proposed that the company will initially use council accommodation and resources in its operations and will reimburse the council for doing so. These proposals will not have any direct implications for staff. Staff may at times be working on company business, but the time and resource will be charged to the

company. Service level agreements will be completed with the council regarding use of council staff and resources.

- 5.6 There will be VAT and tax implications arising from setting up the company. These are detailed in the business case. The company will need to register with Companies House and also register for VAT if its taxable supplies exceed the VAT registration threshold. Corporation tax will be payable on any profits arising at a rate of 20% in 2016/17 reducing to 19% in 2017/18.

## **6. OUTCOME OF INTEGRATED IMPACT ASSESSMENT (IF APPLICABLE)**

- 6.1 Impacts have been considered as part of the development of the business case. In summary there are a number of legal and statutory implications related to the establishment of a local authority trading company that will need to be managed and complied with as part of the implementation process.
- 6.2 Operating a trading arm through a company vehicle such as a Limited Company will require that Directors of the company operate in accordance with UK Company law. Although the company has limited liability, the Directors of the company may individually face claims for wrongful operation of the company. It is therefore recommended that the Council indemnify the Directors through appropriate Directors Liability Insurance both whilst acting as a director and for a period of six years following cessation as a company director.

## **7. OUTCOMES OF CONSULTATION & CONFLICTS OF INTEREST**

- 7.1 Extensive council wide consultation via the Commercial Programme Board and CMT has taken place and there is full support for the proposals set out in this report.
- 7.2 Further consultation with legal and finance has taken place and the business cases have been developed with input from legal and finance staff.
- 7.3 External professional advice has been obtained and feedback received is that the business case is robust and achievable and the model proposed should provide a good catalyst for future aspirations to grow commercially.
- 7.4 A number of the initial services identified for trading through the company are part of the wider shared service programme with North East Lincolnshire Council. Consultation has taken place to ensure that the proposed formation of a company supports the existing shared services programme for professional back-office services.

## **8. RECOMMENDATIONS**

- 8.1 That cabinet approves the establishment of a Local Authority Trading Company; and
- 8.2 That subsequent decision making in respect of the company's formation and operation is delegated to the commercial enterprise cabinet member

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**Background Papers used in the preparation of this report:**

Commercial Strategy 2015-19  
EXEMPT FROM PUBLICATION: Full Business Case – Establishing a Local  
Authority Trading Company (June 2016)