Public Service Mutuals
An LGiU essential guide
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Author: Mark Upton

Mark is a freelance public policy and affairs consultant (www.publicpolicystrategies.co.uk) with more than 20 years’ experience in central government in strategy development, public policy and programme management. He has worked on high profile programmes such as the Channel Tunnel Rail Link and the government’s local e-government programme. He has led policy portfolios on public service reform and on public-private partnerships as well as leading on significant projects in regeneration, housing, planning, public procurement, local government and the third sector. Mark has been a member of a number of advisory panels for the Audit Commission and for various think tank reports and was a member of the Department of Health’s Ministerial Taskforce on Third Sector Health Commissioning.

Edited by Janet Sillett, Briefings Manager, LGiU

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Introduction

This guide provides an overview for councillors and officers in local government with an interest in or considering ‘spinning out’ their internal service teams into an external mutual organisation, and for councillors scrutinising existing mutuals. It will also be of interest to partners in the community and voluntary sector.

It reviews the development of mutual and co-operative enterprises for the delivery of public services under the coalition government, focusing on developments and issues in and around local government.

The three main political parties all express support for mutual arrangements in their manifestos.

It is not a detailed ‘how to guide’ for establishing a public service mutual. The contents of this guide are correct as at 15 April 2015.

Mutuals – history and definitions

The mutualisation of public services was an important part of the coalition government’s Open Public Services agenda, coming after the 2010 Coalition Agreement promised that they would support the creation and expansion of mutuals, co-operatives, charities and social enterprises, by enabling them to have much greater involvement in the running of public services, specifically promising to give public sector workers a new right to form employee-owned co-operatives and bid to take over the services they deliver.

This reflected an existing direction of travel for Government policy with the previous Labour Government encouraging for example co-operative trust schools and employee own social enterprises in community healthcare. And of course public service mutuals, and in local government particular, most notably with leisure trusts have a longer history.

What are mutuals?

Traditionally mutuals and co-operatives are ‘owned’ by a defined group of members such as their employees, customers or others with an interest in the business. Their governance structures give members a say in how the organisation is run and they are often run for the benefit of members with profits retained within the business or distributed to its members. Specifically co-operatives operate according to well-established principles, for example of equal participation or democracy, set by the International Co-operative Alliance.

A mutual may be a social enterprise, but it is not necessarily one, as a social enterprise must reinvest their profits back into the business or the local community. Often mutuals distribute profits to their members. A mutual may be a charity or not-for-profit organisation, but not necessarily. To the extent that the organisation exists principally to distribute economic benefits to a closed group of members (e.g. employees, users and shareholders) rather than a wider community, mutuals are generally not considered part of the not-for-profit civil society or third sector.
The coalition government’s approach to promoting mutualisation in the public sector has challenged what is meant by that term. Ministers say that they do not want to dictate the precise form that mutuals should take, claiming this should be driven by what is best for service users and by employees as co-owners of the business. Consequently they see a range of options, including mutual joint venture models involving significant private sector investment and control as well as wholly employee-owned mutuals.

There have also been examples of a blended shared ownership structure involving employees, private investors and the parent state body. This can be seen in the case of the Cabinet Office’s ‘Nudge Unit’ spun-out as the Behaviour Insight Team and with the administration of civil service pensions (MyCSP). The government’s Mutuals Taskforce believes that public service mutuals may be for profit, not-for-profit or social enterprise businesses.

The Cabinet Office believes that a public service mutual is an organisation that:

- has left the public sector (i.e. they have ‘spun out’)
- but continues to deliver public services; and where,
- staff control is embedded within the running of the organisation.

Frances Maude, the Cabinet Office Minister in charge of public service reform, has refined this definition stating that to qualify as a public service mutual “there must be no less than 25 per cent employee ownership so that staff can exercise at least negative control” (‘negative control’ is a company law term taken to mean having the power to block undesired outcomes. This includes: dissolution or winding up of the company; sale or merger or a disposition of assets; and other significant decisions like changing the number of directors, paying dividends and amendments to the corporation’s charter).

In reality the degree and means of employee control may vary, with employee ownership reflected in the ownership and/or governance structure of organisations in a variety of ways, including the distribution of nominal (e.g. 1p or £1) shares, part or all equity ownership and representation on governing boards.

Peter Hunt, chief executive of the Mutuo think-tank, says:

“In my view, no organisation is mutual unless a minimum of 50 per cent + 1 is owned by the customers, employees or a mixture of the two. Consequently, a lot of government-supported ‘mutuals’ are nothing of the sort – for example, Circle Healthcare is not a mutual as it is majority investor-owned, and My Civil Service Pension is a joint venture between government, employees and an investor.”

Ed Mayo, general secretary of Co-operatives UK and a member of the government’s Mutuals Taskforce says:

“Co-operatives UK has worked with the coalition government to advise the mutuals programme. There are some excellent examples of high-quality mutual models that have emerged – such as Leading Lives in Suffolk, which is organised as a worker co-operative. We applaud the work that has been done overall.
“However, we have had a long-running disagreement with the Cabinet Office over two things. First, we argue that the term ‘mutual’ should include customer-owned and multi-stakeholder models. Second, we reject some of the loose definitions they have used, which risk turning the word ‘mutual’ into a cover for privatisation.

“A mutual business is one that is independent and is owned and controlled by its members. If investors have a majority stake, rather than members, then it is not, in our view, a mutual. The term that the government uses, of a ‘mutual joint venture’, is unhelpful because it suggests that member ownership can be diluted and member control discarded. If you are owned by investors, ultimately what happens is controlled by those investors, seeking a return on their investment.

“In consultation with our many mutual members, including those working in traditional public service fields such as health and education, we have challenged some of the models promoted by the government as mutuals – including MyCSP, which offers no rights at all to the pension ‘members’ it serves, and the Nudge Unit, which offered employees a minority stake only.”

When ‘mutualisation’ of public services is actually privatisation, by Paul Gosling, Co-operative News, 26 August 2014

Rationale for promoting mutualisation

The 2011 Open Public Services White Paper saw mutual organisations as a key plank of diversifying the provision of public services, so that service users and commissioners have greater choice, alongside seeing a greater role for private and voluntary sector providers. Specifically the coalition government believes that passing ownership and control through mutualisation empowers employees to innovate and redesign services around service users and communities, driving up quality. They also have the potential to increase competition in the provision of public services.

According to the University of Northampton survey the main triggers for spinning-out have been budget cuts and decisions made by the parent public body. Secondary to this has been the existence of policy frameworks to support their development (e.g. the ‘Right to Provide’) and local political support.

Since the White Paper, Francis Maude has gone on to explain that mutuals provide an alternative to the binary choice between the public sector in-house monopoly provider or “full-blown red-blooded commercial privatisation or outsourcing” and in doing so release the “creative energy and entrepreneurialism” which exist in the public sector. While maintaining that there was still a role for “conventional outsourcing” with the private sector, these arrangements rarely deliver “the almost overnight improvement that mutualisation can stimulate”. Mr Maude also sees mutuals as providing a more palatable alternative to traditional outsourcing and privatisation which is fraught with political and employee relations risks.

The evidence on the success of mutuals so far is mixed.
The Employee Ownership Association claims that:

- employee-owned businesses are more creative and innovative
- have higher productivity levels and lower rates of turnover and absenteeism
- they care more about service quality
- they are more resilient and demonstrate a lower risk of business failure.

However this refers to employee-owned private firms in the private sector and comparing their experience with private firms which are not owned by their employees. It does not tell us what actually happens in the context of public services.

A review of existing evidence conducted by Matrix Evidence for the Employee Ownership Association casts doubt over the strength of some of this evidence. While supporting the assertion that employee-owned businesses can be just as successful as those operating through more traditional ownership models, significantly it found that the evidence which linked ownership structures and commitment, engagement, performance, productivity and resilience, was at best mixed.

The Office of Public Management (itself an employee owned business) believes that employee-owned organisations “create a sense of ‘corporate citizenship’ among their staff and positive attitudes that can extend beyond the workplace, creating greater transparency and accountability and generating social values that play a role in wider society”. However, no evidence is provided to support these statements.

Francis Maude believes that ‘spun-out’ mutuals have greater freedom to reconfigure services around the needs of users. He cites what is being achieved particularly around health and social care in drawing together different income streams from different parts of the public sector to provide integrated packages of services and interventions much quicker than multi-agency working.

However, Unison question the assumption that mutuals do indeed liberate workers to create more innovation, and allow them to provide a better service and work across boundaries; arguing that this is achievable within the public sector organisations.

The Minister’s position is supported by the All Party Parliamentary Group on Employee Ownership which concluded that employee engagement and empowerment is intrinsically linked to and stimulated by the employee ownership dimension, and is not a management technique that can be bolted on to achieve the equivalent effect in non-mutuals. The report also notes the importance of employees becoming not just technical owners but feeling like owners. However that position is not entirely supported by Matrix Evidence’s review, which found “that the primary benefits of ownership to employees flow from their influence on managerial decisions (one of the rights that typically flows from ownership)” but that “the evidence that ownership per se increases satisfaction is less convincing.”

The DCLG Select Committee concluded that the evidence for the success or otherwise of mutuals and co-operatives is limited and largely anecdotal. There are some good stories (see
box below). However these need to be set against that ‘spin outs’ by their nature are likely to be highly performing services, with management teams and employees who are already highly motivated.

The **Mutuals Taskforce’s 2012 report** detailed some early signs of success for example:

- **Central Essex Community Services** reduced staff sickness rates by approximately two days per employee since they spun out. At the same time the proportion of staff looking forward to going to work had increased from 86 per cent to 90 per cent between 2010 and 2011.

- **NAviGO** experienced reduced absenteeism and saved £80,000 as a result.

- Staff motivation and satisfaction improved at **Central Surrey Health** with 98 per cent of co-owners saying they are willing to go beyond what is normally required compared to the industry norm of 84 per cent.

- At the public sector pension provider **MyCSP** staff have raised their productivity by 15 per cent year on year.

- At **City Health Care Partnership** more than 90 per cent of staff feel trusted in their jobs.

- The **Behavioural Insights Team** (often known as the Nudge Unit) has more than doubled its headcount in six months of trading as a mutual joint venture.

There have been failures as well such as Hinchingbrooke NHS trust which has been run by **Circle Partnership**, an employee co-owned partnership, not only came in the bottom 20 per cent in the last **NHS staff survey** on job satisfaction and a range of other measures, more significantly withdrew from operating the hospital under the exit terms of the contract when Care Quality Commission had recommended that the hospital trust should be placed into special measures after it was rated ‘inadequate’ on the questions of whether it was caring, safe and well led.

This follows **Peninsula Community Health**, a not-for-profit community interest company, which sought a financial rescue through a merger with Cornwall Partnership Foundation Trust. Going back in history there are examples (at Enfield and Chiltern District) of leisure trusts ‘spun out’ of local authorities financially failing and leaving very significant debts for their parent local authority to deal with. While in Hounslow concerns over the leadership and governance of the trust running leisure, libraries and culture facilities led the council taking back these services, and then outsourcing them to a private sector provider.

However these cases need to be set against the many successful trusts which have operated in local government for a number of years and that there are also examples of failure among private sector outsourcing and in-house services.

The anecdotal evidence for the two opposing positions appears not to prove anything either way. **Matrix Evidence** concluded that employee owned enterprises should not be thought of as a single business model, seeing that “the benefits that can accrue to employees and businesses alike are not a given – they depend on the specific circumstances
of employee ownership models, particularly around employee involvement and participation among others.”

Given that a number of long standing successful public service mutuals do exist suggests that rather than making general comparisons with other delivery vehicles, finding an evidential case for mutuals might be more productively built on: establishing the benefits which might accrue for different models; the critical conditions which must exist before these arrangements are entered into; and the factors which underpin their success. However, this should not be interpreted as negating the need for conducting a robust options appraisal for individual propositions.

There has been debate from the beginning about whether public service mutuals represent some kind of privatisation, and there are also some who support them in principle but who are critical of the government’s approach. The response from Francis Maude is unequivocal:

“Is mutualisation equivalent to privatisation? Technically yes. Mutuals are spinouts from the public sector into the private or social sectors so they get classified as non-public sector. It’s certainly not privatisation by the back door though. It’s as open a process as you could want.”

However what Mr Maude is perhaps referring to here is the privatisation (i.e. the transfer from the public to the private sector) of the staff and assets which deliver these services and not statutory responsibility and accountability for ensuring those services are delivered and their performance, which are not transferred but remain with the public body. This rests on the conventional wisdom that outsourcing the ‘day to day’ delivery of a public service under contract is not generally regarded as privatisation, but transferring the statutory responsibility for a public service to the private sector is.

The DCLG Select Committee in its inquiry into mutualism in local government noted that the approach being taken by the government is limited to employee-owned mutuals (and joint ventures with the private sector) when local government has a strong interest, and track record, in setting up a wider range of mutuals and co-operatives, and in particular those which involve multiple members, including from the local community. The Committee identified three generic models for mutuals and co-operatives:

- Employee-owned mutuals or co-operatives as a corporate entity owned at least 50 per cent by its employees.
- Two-way stakeholder models in which services are provided by enterprises led by frontline workers and owned by them and the communities they serve.
- Multi-way models - where a local authority is a significant stakeholder in addition to service users and employees, providing for a balance of interest in the governance.

This represents a different perspective from the government’s, whose approach has triggered a debate about whether or not the enterprises they are supporting are real and legitimate mutuals or represents a ‘watering down’ of the mutualism brand.
Mutuals: Extent and Promotion

In July 2014 the Cabinet Office announced that 91 new mutuals have ‘spun out’ from the public sector since May 2010: to be found in every region of the country (see map here); delivering nearly £1.5bn of public services; employing 35,000 people (ranging from a handful of staff to upwards of 2,000); and generating over 3,000 additional jobs in the last three years. Their number is set to increase further due to a number of projects in the pipeline; but falls well short of Francis Maude’s prediction made in 2010 that one million public sector workers could transfer to mutuals by 2015.

The Cabinet Office says that the number has increased from 9 in 2010; giving rise to the question of what defines a public service mutual. These figures do not tally with the fact that there were over 60 (local authority) leisure trusts, and 120 co-operative trust schools and a greater number of housing association and tenant management organisations which existed prior to 2010. This can be explained by the government’s focus on employee owned (or co-owned) mutual enterprises.

According to a survey conducted by the University of Northampton for think tank, Collaborate and sector organisation, the Transition Institute (“Public service spin outs 2014: Needs and wants”) - the University of Northampton survey - the majority of these recent ‘spin outs’ are in the leisure, health and social care sectors, operating at local and regional levels. Local authorities were identified as the ‘parent’ for half of the 66 spin out mutuals it surveyed, with the average age just over five years. Other examples include public libraries, children’s services (and in particular school support services), nurseries and youth services.

Below is a small selection of examples of mutuals operating in and around the local government sector (web links are provided to further details on each):

| 3BM | Spun out from the London Borough of Hammersmith and Fulham, Westminster City Council and the Royal Borough of Kensington and Chelsea in autumn 2012. 3BM is a joint venture between the employees (who are the majority owners) and Prospects: the education, training and employment company. Providing education support services. |
| Achieving for Children | Launched in April 2014 and spun out of the London Boroughs of Richmond and Kingston, delivering children’s services across both boroughs. |
| Aspire Sussex Ltd | Spun-out from West Sussex County Council, Aspire is an adult education service provided in the West and East Sussex county area with a network of over 400 part-time tutors along with 60 full-time members of staff, working out of centres in major towns across the county. Funded entirely by external grants and tuition fees. |
| Be Independent | Spun out of the City of York Council in April 2014 to deliver telecare services to elderly York residents. |
| **Buckinghamshire Learning Trust** | Became operational as a charity in September 2013, BLT operates under a board of Trustees, with the majority drawn from Early Years Settings, Primary and Secondary Schools and Academies. Delivering a range of services to schools and early years’ settings, including school and early year’s improvement, specialist teaching, CPD and other key support services. |
| **Epic CIC** | Spun out of London Borough of Kensington and Chelsea providing a range of youth support services to children and young people up to the age of 19, and up to 25 where an individual has a lifelong learning difficulty and/or disability. |
| **Evolve YP** | Established in 2009 and spun out of Staffordshire County Council to deliver services for children and young people who are in care, or are leaving the care system. |
| **Explore** | The City of York Council transferred their libraries and archives and associated staff in April 2014 to a Community Benefit Society called Explore York Libraries and Archives Mutual, or Explore for short. It has a five year contract with the council to manage the City’s 14 public libraries, two reading cafés and mobile library. It is two thirds owned by the community and one third by its staff. |
| **GLL** | Formed in 1993 as a charitable social enterprise spun out of LB of Greenwich and previously known as Greenwich Leisure Ltd, GLL now employs 2,500 permanent and 4,000 casual staff and has a turnover of £133m. It runs 130 leisure and sporting facilities and has recently branched out into the management of public libraries. |
| **Inclusion Healthcare** | Spun out of Leicester City Primary Care Trust in September 2010 as a Community Interest Company, offering a range of primary care services to vulnerable groups and specialist support for people with substance misuse problems and alcohol related difficulties. |
| **Leading Lives and Accession** | Leading Lives operates as an employee owned co-operative which was spun-out from an internal county council department to become the biggest worker co-operative in the country in terms of number of employees (450 workforce). Delivering a wide range of support services in the home and in the community for 1,200 adults with learning disabilities across Suffolk. Its 12 strong board is made up of staff members elected by their peers. |
| **Oldham Community Leisure (OCL)** | Since 2002 OCL has been responsible for the management, operation and development of fifteen sports and leisure facilities across Oldham. It is a multi-member trust involving staff, Oldham Council, the voluntary, sports, health, community safety and business sectors, and service users. |
| **Pearls of Rochdale** | Spun-out of Rochdale Council the centre collects reusable materials and objects from local businesses and industry and recycles them into arts and crafts materials for education and childcare providers. |
How did the coalition government promote mutualisation?

The Right to Challenge

The ‘Right to challenge’ enacted in June 2012 – as part of the 2011 Localism Act – enables local authority employees, as well as voluntary and community groups, to express an interest in running a local authority service. It was seen as the means in local government for the government to meet its coalition agreement pledge to give public sector workers a right to form employee-owned mutuals.

The exact number of services transferred using Right to Challenge is unknown. However figures collected by DCLG (involving those who have sought central advice on the right) suggest that there have only been 50 expressions of interest (as at the end of 2014) leading to only seven proposals and three contracts being awarded. Only one of these successful ‘challenges’ is known to have involved council employees: at Buckingham and Milton Keynes Fire and Rescue Services which transferred its fire training service to two employees in August 2014. However, it is thought that the vast majority, if not all the other expressions of interest came from community-led schemes.

There has been some criticism about the effectiveness of the measure as it simply triggers an open procurement exercise where fledgling ‘spin out’ mutuals (and voluntary and community organisations) will be in competition with established private sector and large charitable and social enterprise providers who are usually better placed to win contracts through their expertise, capacity, ability to raise capital and secure economies of scale. The new EU procurement rules recently introduced which enables commissioners to reserve certain services contracts for public sector spinouts and mutuals may change this.

The recent report from the DCLG Select Committee recognised these issues and recommended that both central and local government look at ways to involve communities more routinely in the commissioning and delivery of local services, not just as a result of

<table>
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<tr>
<th>People2People</th>
<th>A Community Interest Company in Shropshire providing social work services for older people, people with physical or learning disabilities, their families and carers. People2People is owned and managed by its staff, but users have a key role in influencing how the practice develops in the future by being part of the Board and Advisory or Task Groups.</th>
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<tr>
<td>Provide</td>
<td>Delivering community health services across Essex, Cambridgeshire and Peterborough, as well as the London Boroughs of Waltham Forest and Redbridge. Involving some 1,100 staff and a turnover of £56 million</td>
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<tr>
<td>Sandwell Inspired Partnerships  Services</td>
<td>Established in January 2013 from a group of traded education support units of Sandwell Council, it provides a range of school support services including teacher and learning support, school meals, music and arts services, library services.</td>
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using the potentially confrontational route of Right to Challenge. The coalition government has said that it intends to undertake post-legislative scrutiny of the whole suite of community rights in 2015.

**Social Value**

The [Public Services (Social Value) Act 2012](https://www.opsi.gov.uk/acts/acts2012/2012act20.htm) requires commissioners to consider prior to undertaking a procurement exercise for service contracts above the EU Procurement threshold how the procurement might improve the economic, social and environmental well-being of the relevant area.

The impact or benefit for mutuals (or indeed for any organisation form) is indirect as the [Cabinet Office](https://www.gov.uk/government/organisations/cabinet-office) consistently advise that social value in the context of a procurement exercise (as framed by this legislation and the EU Procurement rules) is within the service itself and its outcomes and not the legal identity of the organisations tendering. Nonetheless it is argued that the nature of co-operatives and mutuals may make them better placed to deliver social value, but as the Cabinet Office has advised this must be tested objectively in the procurement process.

Responding to concerns from the civil society and social enterprise sectors that the legislation has not had the immediate impact that they expected of it, the government has initiated a review of the legislation led by Lord Young, the Prime Minister’s Adviser on Enterprise. The [review](https://www.gov.uk/government/publications/social-value-legislation-consultation) rejected extending the legislation to cover goods and works, as well as services and to cover procurement exercises below the EU Procurement threshold of €134,000. It did, however, prompt the government to prevent the Act’s threshold from increasing to €750,000, reflecting recent changes to the EC thresholds. This now remains at €134,000. Instead the review set out a number of recommendations to increase take up and understanding, particularly within central government and to strengthen the measurement of social value.

**Cabinet Office Capacity Support**

In 2011 the Cabinet Office established the [Mutuals Information Service](https://www.gov.uk/government/organisations/mutuals-information-service) to provide information to those interested in establishing employee-owned mutuals to deliver public services. Alongside which a [Mutual Support Programme](https://www.gov.uk/government/organisations/mutual-support-programme) provides more hands-on practical support, gathering and sharing knowledge - through which the government has been investing £10 million to support specific spin-out proposals by purchasing consultancy and professional advice on their behalf (e.g. business planning, legal issues and marketing). Practical support is also provided to newly established mutuals to enable their businesses to grow.

The Cabinet Office has also appointed 15 [mutuals ambassadors](https://www.gov.uk/government/organisations/mutuals-ambassadors) - chosen given their relevant skills and experience, including setting up a mutual or running one - to support specific projects.

In March 2014 the Cabinet Office [announced](https://www.gov.uk/government/publications/peer-review-peer-review-scheme-to-support-mutuals) plans to establish a peer review scheme to support staff and local authorities interested and involved in developing mutuals.

The Cabinet Office’s [Commissioning Academy](https://www.gov.uk/government/organisations/cabinet-office) programme also offers a model for
commissioners and decision-makers who are interested in supporting the mutual model; together with on-line guidance for commissioners.

Local Authority Mutuals Commissioning Group

The Cabinet Office have established the Local Authority Mutuals Commissioners’ Group involving 15 local authority commissioners and currently chaired by Joanne Hay, formerly Head of Business Development and Policy for Children Services at Tri-borough (now Head of Strategy at the NSPCC). Its role is to provide insight and practical solutions to support local authority commissioners currently working with a mutual spin-out project.

The key issues in expanding mutualisation

There are a number of barriers and challenges which face public bodies in establishing mutual or co-operative enterprises.

Finance

A key issue is securing start-up capital needed to establish an enterprise at a sufficient scale to compete in the market place, not only to win the first contract but also subsequent opportunities. Soft financing (i.e. non repayable) for establishing mutuals is available from the Cabinet Office’s Mutual Support Programme and the Investment and Contract Readiness Fund, Local Partnerships’ Technology ‘Spin out’ Fund and the funds managed by Social Investment Business such as Impact Readiness Fund.

However, mutuals will have a range of finance requirements over their lifetime and not just in their initial phase. Their ability to raise external finance is crucial to their success (and indeed the sector as a whole). However it is widely agreed that finance for mutuals and co-operatives is in short supply (see Boston Consulting). Funding is being provided by the Big Society Capital, and Social Finance and social finance providers such as Big Issue Invest. Mainstream commercial lenders can be reluctant to engage with mutuals if they see them as new, and therefore risky, organisations. Use of pre-spinout performance records of the mutual management is suggested to help address this. They may also be wary of complex, employee ownership structures.

The Chancellor, believing that the start-up costs of social enterprises might be eased by providing a degree of tax relief, introduced from April 2014 the Social Investment Tax Relief which allows individuals who invest in social enterprises to claim certain income tax and capital gains tax relief. This applies to investment made up to April 2019 where certain conditions are met.

Spin out mutuals once they transfer into the private sector will operate in a very different political and economic environment. It necessitates a greater degree of financial discipline and risk management, especially given they are often established on the basis of diminishing funding from their parental authority. They will have to develop new income streams and compete to win further contracts with other public sector commissioners in order to sustain and then growth over the longer term. While internal public service
management teams will be used to working to tight budgets, Mutuo - a think tank that advocates mutuals and cooperatives – warns that:

“They will have to become accustomed to the idea that they are no longer spending a budgeted amount of money within a state entity which ultimately bears costs whatever they are; they are in an independent entity which has income (mostly in the first instance in the form of payment from the council for services) and expenditure. The absolute requirement is to provide the service the enterprise has agreed to provide without allowing expenditure to exceed income. If this is not achieved, the result is not criticism or the threat of disciplinary action it is insolvency and the end of the enterprise.”

The 2014 University of Northampton survey said that public service mutuals are experiencing year-on-year growth, demonstrating that many are surviving their transition out of the public sector and becoming sustainable. However, caution needs to be applied to these results given the small sample size (66) and that it is likely that most of these mutuals have yet to come to the end of their first contract term with their parent public body and so have not been exposed to full competition in the market. Nonetheless the survey provides some insightful results.

Key findings around the financial sustainability of new public service mutuals taken from the University of Northampton Survey for think tank, Collaborate and sector organisation, the Transition Institute (“Public service spin outs 2014: Needs and wants”):

- Their main source of income is public sector contracts with trade with consumers (i.e. personal budgets held by social care clients, fees and charges in relation to leisure facilities) and grant funding being the second and third most important source.

- On average they have increased their annual turnover since spinning out by 43 per cent (by £5.78m) and a 53 per cent increase in profitability/surplus (by £294,117).

- Staffing levels have increased on average by 44 per cent for full time staff, and almost 45 per cent for part time staff and 75 per cent for volunteer staff.

- Staffing levels increased tenfold for those spin outs whose main income came direct from consumers compared to those whose main source of income came from public sector contracts and from grants.

- Those spin outs whose main source of income came from consumers had experienced greater average turnover growth (+£12.79m) than those for whom their main source of income was public sector contracts (+£3.89m) or indeed grants (-£0.217m), which had actually lost money.

- Conversely spins-outs whose main income came from public sector contracts had the largest increases in profitability (+£0.492m) compared with those who derived the majority of their income from consumers (+£0.053m) or grant (no increase).
Taxation

Once an organisation leaves the public sector it is subject to the same tax system that applies to any private sector business. Charities are an exception, attracting reliefs from business rates and VAT. But as a general rule corporate vehicles including mutuals are subject to corporation tax on their profits, reducing the amount of money that could be reinvested back into the organisation. A further consequence of ‘spinning out’ is that arrangements that previously had no tax consequences, because they involved one part of the organisation dealing with another, become transactions with tax consequences. For example the application of VAT on services provided back to their parent authority (and other clients) and stamp duty land tax for property leases.

Conflicts of interest

The DCLG Select Committee (inquiry on mutuals) found that local authorities face potential conflicts of interests in establishing mutuals through the need to take on a number of roles, including incubating mutuals, setting up contracts with mutuals and being the ‘regulators’ of local services. They advise that it requires expertise and skill to manage these roles and avoid - perceived or real - conflicts of interest arising.

Commercial skills

Some commentators have perceived a lack of entrepreneurial enthusiasm which holds back public sector employees from establishing their own service delivery organisations. Others point to the lack of appropriate skills as the real obstacle here. Management and the organisational cultures which promote or restrict entrepreneurial ambition are also seen as important.

In terms of skills necessary to make a commercial success of their service in the open market there are a number of key challenges for service management teams to address, such as knowing the true costs of their service and having a sufficient understanding of the market within which they will be operating. This requires a realistic idea of the value to customers of their service and who their competition might be. Significant also will be equipping the ‘spin out’ organisation with the bidding skills to compete in public procurement competitions and other commercial and marketing skills to grow and sustain the business.
Accountability

As with any public service which is delivered via a third party there are real challenges for elected members and council officers as their ability to influence decisions and manage risk is more remote. Potentially there are more risks in delivering services through a fledging organisation in terms of the long-term viability and sustainability of such organisations. However there is an opportunity for local authorities to mitigate against these risks in shaping the new organisation before it is ‘spun out’.

Whilst mutuals might appear to be more accountable questions remain as to whom they are accountable. Those that advocate their development believe that mutuals, and particularly those which involve membership drawn from the local community, offer the prospect of higher degrees of community engagement and involvement and therefore accountability, raising questions as to how this marries up with local authorities’ own democratic legitimacy to champion the rights of service users and tax payers and hold services to account. The answer appears to be around that: accountability for services ultimately lies with the local authority; responsibility for their delivery lies with the provider; and the provider organisations are held to account for delivering what has been agreed with the local authority.

Staff engagement

Critics of the kind of public service mutuals being promoted by the government believe that they are generally instituted and implemented by politicians and senior officers with little or no involvement of the workforce or those who use services; an approach that runs contrary to many of the traditional principles of mutualism.

Supporters say that mutuals and co-operatives models offer staff an opportunity to have a greater say in running the organisation, not only through ownership but also by providing a better organisational structure through which to release their entrepreneurial skills, previously hide-bound by working in a public sector organisation.

The Northampton University survey appears to support the critics’ case that ‘spin-outs’ are driven from very senior levels from within the parent body, typically under the pressure to deliver budget cuts, with the wider base of employees engaged only after the process has started. However, once the decision is made and the service is ‘spun out’ staff then become increasingly involved in decision making and governance.

Nonetheless there are challenges in engaging staff in the development of mutuals. Some will not fully grasp the concept, made more challenging with conflicting views of what constituents a mutual. Addressing this together with clarifying pension and job security and other terms and conditions of employment will be critical. While those in management positions may be reluctant to relinquish budgetary control and some may actively or passively be resistant to the change. These issues are not unique to the development of mutuals. Rather they are quite common to the number of different forms of change.

Trade Unions, and in particular UNSION, PCS and Unite, have also been concerned about the impact of transferring service delivery to bodies outside the public sector, contending that they generally reduce pay, conditions and pensions for staff. Indeed they have opposed
many mutual projects both at a national and local level. In order to find common ground on these issues Co-operatives UK and the Trade Union Congress came together in 2013 to publish best practice guidelines for the creation of public service mutuals, including conditions around: workforce engagement and consultation; governance and democratic participation; and employment standards.

**Governance**

A mutual is not a legal form. There are several legal structures that lend themselves to a mutual organisation (see table below). The majority are currently either incorporated as [Companies Limited by Guarantee](#) or [Company Limited by Shares](#). Those choosing to incorporate as a [Community Interest Company](#), introduced in 2005 to provide for a dedicated corporate structure for social enterprises, have been increasing in recent years. Another favoured legal form for mutuals are [Industrial and Provident Societies](#). Since August 2014 these are known as Co-Operative Societies and Community Benefit Societies when legislation of the same name consolidated the law to provide a single membership structure.

Choosing the right legal model has important implications for what an enterprise can deliver and its relationship with the local community on how it can raise new finance. For example, a Community Interest Company can have an ‘asset lock’ to ensure any assets can only be used for public benefit and has flexibility in raising private investment. In contrast a charity model has less investment and income flexibility but has tax advantages around VAT and business rates.

**Corporate Vehicles which can be used for mutual enterprises**

<table>
<thead>
<tr>
<th>Legal form</th>
<th>Overview</th>
<th>Ownership</th>
<th>Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company limited by guarantee</td>
<td>Usually not-for-profit or non profit distributing.</td>
<td>Typically, members can attend general meetings and vote, and in most companies they can appoint and remove the directors, and have ultimate control over the company.</td>
<td>Members have limited personal liability, usually up to £1. This is usually written into the articles of association.</td>
</tr>
<tr>
<td>Company limited by shares</td>
<td>Usually profit motivated.</td>
<td>Shareholders with voting rights ultimately control the company. Other shareholders can exist with non-voting rights.</td>
<td>Shareholders have no personal liability if the company goes into debt.</td>
</tr>
</tbody>
</table>
Asset loss

There are recognised risks associated with transferring public property and other assets to new mutuals or co-operatives. Key to reducing this risk is the use of appropriate forms of contractual ‘lock-ins’ to protect services and assets where they have become poorly managed and to prevent their sale or their transfer to the private sector in the event of failure. Such provisions are seen as essential in order to gain local community and political support for asset transfer. However, they could potentially hinder growth by preventing these assets being used to lever in capital finance.

The DCLG Select Committee concluded that on balance the financial benefits of transferring the ownership of assets in many cases outweigh the risks and there should not be a general block on such transfers. Nonetheless they believe that local authorities should take care to provide that the staff, service and assets, originally owned or delivered by the authority, could be brought back under their control in the event that a mutual fails. The Government’s response to the Select Committee report advised that:

“An asset lock is designed to ensure that the assets of the organisation (including any profits or other surpluses generated by its activities) are used to support the aims and objectives of their mission statement. The organisations that are automatically subject to an asset lock are: Trusts; Community Interest Companies; Industrial and Provident Societies and Charitable companies. Where a local authority is transferring an asset to a mutual as part of a service contract, they are able to put an asset lock on any asset they transfer. These do not prevent a body from borrowing against or selling that asset in future as long as the proceeds are used to promote the core charitable aims of that body. It is ultimately down to authorities to ensure that they put in proportionate levels of protection for such assets when they are drawing up these contracts.”
What are the latest developments?

EU procurement directives

New European-wide reforms to the EU Public Procurement rules have recently been put in place to make them simpler and more flexible. These are likely to have benefits for small and fledging contractors in particular.

More significant for ‘spin-out’ mutuals will be new procedures giving contracting authorities the ability to restrict participation in the procurement of particular contracts to mutual organisations for certain health, social care, housing, education and cultural services. The reservation has time-based conditions to prevent misuse, so contracting authorities cannot reserve contracts for organisations that have been awarded contracts within the last three years, and contracts cannot be longer than three years. The European Commission’s and the UK Government’s aim in introducing this flexibility is “to shield future new public service mutuals from the full panoply of EU regulations while they establish themselves as businesses”.

Mutuals in the NHS

More recently, the pace of mutualisation in the NHS has slowed somewhat as other areas of public services have started to explore the model. However that is set to change. An independent review of staff engagement and empowerment in the NHS and conducted independently by Professor Chris Ham, Chief Executive of the King’s Fund, and commissioned by the government recommended that staff should be given a stronger role in all NHS organisations, with public-sector mutuals being cited as an effective means of achieving this in practice, advocating that that more NHS organisations, including hospital trusts, be supported to voluntarily convert to mutuality.

In response the Department of Health and the Cabinet Office have established a new pathfinder programme to support Foundation Trusts and NHS Trusts to explore the potential benefit of mutualisation for their services with a £1 million fund to support around ten Pathfinder Trusts. Up to now employee owned (and co owned) enterprises, with the notable exception of Hinchingbrooke health care NHS trust which is run by Circle Health, have been confined to community health. However the recent decision by Circle Health to withdraw from the Hinchingbrooke contract (see above), will no doubt have an impact on what might come of this, together with the outcome of the imminent General Election.

2015 General Election

The manifestos of the three main parties all express support for public service mutuals but they show different emphases:

Conservatives

The party talks about how it will “deliver better public services and more open government” through public service mutuals. It says: “We want more of them, so we will guarantee a ‘right to mutualise’ within the public sector”.

LGiU Public service mutuals
Labour

“Our charities, mutuals, co-ops and social enterprises are pioneering new models of production that enhance social value, promote financial inclusion, and give individuals and communities control.

“We will continue to support and help develop the social economy by improving access for co-operative and mutual organisations to growth finance through the new British Investment Bank”.

Liberal Democrats

The manifesto says that it has supported employee democracy and the mutuals movement. In building on this, the party says it will “spread democracy in everyday life by encouraging mutuals, co-operatives and employee participation and by increasing the opportunities for people to take democratic control over the services on which they rely”.

It will do this by encouraging employers to promote employee participation and employee ownership and will change company law to permit a German-style two-tier board structure to include employees.

And finally

Here are some very helpful and very wise words from Mutuo, a think tank established to promote mutualisation:

“Some of the rhetoric around mutuals and their potential role in public services has resulted in some quarters in a hazy belief that mutuals are a good thing in themselves and that by adopting a mutual structure an enterprise gains an immediate advantage of some kind. In the present climate, this has translated at times into a belief that a practical response to a massive cut in funding would be to become a mutual. Unfortunately, this is wrong. There is no magical funding stream to which mutuals have instant and exclusive access. There are advantages in mutual structures but they are secured in specific situations in specific ways and have no direct relationship to funding.

“In broad terms, a successful mutual harnesses the interests of its stakeholders to drive its performance. In a successful employee owned mutual, the ownership and participation which employees enjoy give them incentive, commitment and responsibility and this influences their performance and the performance of the mutual. In a successful user owned mutual, the voice which users have enables them to shape and improve the mutual’s performance and the ownership they have encourages them to think responsibly about the way they use what the mutual offers. There would be no point in establishing a mutual unless it was believed that some or all of these benefits could be achieved; a mutual structure is not an ornament or an end in itself. A mutual structure may – and indeed should – also provide an environment in which constructive and responsible dialogue can take place with staff and service users about cost savings or changes to the way services are delivered. This may have some impact on financial performance. It cannot, however, alter then reality that a new enterprise established to deliver public services is a business and has to behave like a business.”
External Links

- Francis Maude speech to the RAS - Efficiency and reform: the next chapter
- Francis Maude Oakeshott Memorial Lecture 2014
- University of Northampton, Collaborate and the Transition Institute, Public service spin outs 2014: Needs and wants
- Government response to the Communities and Local Government Select Committee’s report: mutual and co-operative approaches to delivering local services
- The DCLG Select Committee report, Mutual and co-operative approaches to delivering local services

Related LGIU Briefings

- Open Public Services – Briefing on progress
- Creative Commissioning: scope for the voluntary and community sector to respond to the new commissioning agenda
- Public Procurement – latest developments
- Communities and Local Government Select Committee Report and Government Response ‘Mutual and co-operative approaches to delivering local services’
- Public Services (Social Value) Act 2012
- Community Rights: an assessment
LGiU (Local Government Information Unit) is a think tank and membership association, with 200 local authorities and other organisations subscribing to its services. LGiU's mission is to strengthen local democracy to put citizens in control of their own lives, communities and services. LGiU is a registered charity run by its members for its members.

LGiU works with NDPBs, NGOs, and private and voluntary sector partners, as well as councils: providing briefings on emerging national and regional policy, publishing its own policy reports and recommendations, and seeking to influence decision-makers and policy teams locally, regionally and centrally.