All Party Parliamentary Group
on Employee Ownership

Sharing Ownership

The Role of Employee Ownership in Public Service Delivery

Short Inquiry

June 2011

Contents

Published by the All Party Parliamentary Group on Employee Ownership

c/o Harriet Crossthwaite, Luther Pendragon, Priory Court, Pilgrim St, London EC4V 6DR 020 7618 9100

Introduction
Jesse Norman MP

As Chair of the All Party Parliamentary Group on Employee Ownership, I am pleased to present this report on the role of employee ownership in the provision of public services.

During 2010-11, we have seen a significant increase in interest from all quarters in employee-led organisations as alternative models for the delivery of public services. As a result, public sector organisations seeking to explore employee ownership are faced with a very different landscape to that even of a year ago, and one that continues to evolve rapidly.

The last report of this All Party Parliamentary Group, *Share Value*, focused on private sector businesses owned by their employees. In light of that report, and in response to Government initiatives in this area, the Group decided to launch an inquiry looking at how the implementation of employee ownership structures could impact on the delivery of public services. Though mutuals and employee-owned organisations have important structural differences, we believe there is a great overlap of ethos and functioning, and so we have considered both together in this report, under the broad heading of employee-led ownership.

We were interested in how public sector organisations were reacting to the mutualisation initiative, and how central and local government policy was influencing, and could influence, outcomes. We wanted to know the obstacles, what help was available, and how employees and stakeholders engaged in the process. As the Postal Services Bill passed through Parliament, we wanted to look at the plans for both Royal Mail Group and Post Office Ltd, and how employee ownership could be most effectively used in both organisations.

We were particularly interested to hear from organisations which had successfully moved into employee-led ownership, and from those currently in transition. We were impressed by how the individuals dealt with the challenges they encountered, and we were enthused by the passion with which they undertook the journey. It was notable that every organisation who had completed the transfer process reported that they had no regrets at their decision, and that they would not want to return to the old structures. It was a great privilege to hear of their experiences, and on behalf of the Group I would like to thank them and wish them well.

I am very grateful to Ministers, Francis Maude and Edward Davey, who allowed us to question them in detail about their initiatives to date and plans for the future, and who were frank about potential obstacles to the continued spread of employee-led ownership and mutualisation.

We also heard from other stakeholders involved in the process. Union representatives, policy makers, academics and sector experts gave us their perspectives. Again, I would like to thank them all for being so generous with their time and their knowledge.

I and my colleagues all recognise the excellent work carried out by the Employee Ownership Association in this area, and I would like to add an additional thanks to Graeme Nuttall, partner at Field Fisher Waterhouse LLP, who provided valuable assistance on clarifying technical issues regarding tax and pensions.

Finally, I would like to thank the members of this All Party Parliamentary Group themselves. We have come to a number of findings that we hope will inform future policy. Employee ownership offers a hugely exciting long-term opportunity to transform the way in which our public services are provided. This transformation could make a massive impact on public service employees, users and customers, and on our wider communities and society. Employee ownership is everywhere to be encouraged, and in the coming months we will pursue our recommendations with Government and with other influential bodies.

Jesse Norman

1. Overview

The previous report from the All Party employee ownership group (APPG), *Share Value*,[1] examined the impact of employee ownership on private sector business performance, and its contribution to the economy. The conclusion of the Group was that the co-owned model offers **enormous potential for the UK economy**, finding that **co-owned firms appeared adept at managing innovation and change**, were underpinned by **high levels of productive employee engagement** and delivered an excellent track record in delivering **broader social, environmental and community benefit**.

Importantly, the report also found that co-ownership offered potential as a **model for public service provision**, offering ***"the tantalizing possibility of combining a public realm ethos with co-ownership delivery values".***

There have been several well-established precedents for employee owned business models in delivering public services. Council leisure services, refuse services, care and health services have been outsourced to co-owned companies or ownership transfers. The recognised success of these organisations combined with an increasing focus on the need for innovation in public service delivery and improvement has led to a heightened interest in alternative business models. The APPG identified this shift and following the 2010 General Election and the commitments from the Coalition Government to introduce more opportunities for employee ownership in the public sector, we felt the time was right to launch an inquiry into this area.

Jesse Norman (the Group's Chair) explained our rationale for launching the inquiry in June 2010 as follows:

"The Coalition Government has made strong commitments to introducing more opportunities for employee ownership in the public sector. If delivered, this will be an important opportunity for frontline workers to take greater control over how they deliver services – but there are practical barriers that policy-makers will have to overcome."

(Source: APPG press notice, July 2010)

Our decision to launch the inquiry into this important policy area has proven timely with announcements from Government on 'Rights to Provide' and the active encouragement of what are being termed employee-led mutuals. This new approach sees an onus put on employers to accept suitable proposals from front-line staff who want to take over and run their services with alternative delivery models. The Cabinet Office believes that giving staff a significant stake in shaping services improves productivity and efficiency. Our inquiry looks in part at this and the role employees can play in improving public sector efficiency.

As a result of the 'Right to Provide' approach, every Government Department is putting in place a far reaching right for public sector workers to take over the running of their services (although, services in areas such as defence and security may be exempt). To drive this reform forward, the government has launched a number of mutual 'pathfinders', with mentors including John Lewis and has backed an information helpline to support public sector mutuals. In 2011, the Government announced the creation of a mutuals Taskforce led by Julian Le Grand, Richard Titmuss Professor of Social Policy at the London School of Economics, and an enterprise incubator and the appointment of Stephen Kelly to head the creation of employee mutuals within central Government. In April the first central government mutual joint venture, MyCSP, was announced.

The All Party Parliamentary Group on Employee Ownership (APPG) was established in 2007 and issued its first report in 2008. Its aim is to raise awareness of employee ownership and the benefits it can offer both to the business community and the economy.

All Party Parliamentary Groups are made up of backbench MPs and Peers from all political parties in Parliament. They provide an opportunity for cross-party discussion and co-operation on particular issues.

The Officers of the Group are:

- Jesse Norman MP, Chair, (Hereford and South Herefordshire)
- Martin Horwood MP, Vice Chair, (Cheltenham)
- Lindsay Roy MP, Vice Chair, (Glenrothes)
- Lord Best, Treasurer
- Lord Brooke, Secretary

The Group's Officers were elected at its Annual General Meeting in July 2010 and subsequent election in February 2011. The Group is on the Approved List of All-Party Groups held by the Office of the Parliamentary Commissioner for Standards.

The Group is supported by the Employee Ownership Association, which funds the executive and administrative assistance the Group receives.

2. Findings

1. The Government's public service mutuals programme is an important step forward in creating new options for public service delivery.
2. The public service mutuals programme is not yet very well understood within government. It would benefit from more explanation, exhortation and guidance from Ministers to the relevant authorities in health, local and central government.
3. The mutuals programme must be viewed as a means to drive positive change and better public services in our communities. Although many employee-led mutuals report significant efficiencies, cost cutting alone should not be the prime motivator for seeking out mutual ownership models.
4. More work is needed to create safeguards against the possibility that mutualised public assets could be sold off before they have had a chance to show their value, undermining employee ownership and the admirable intentions behind the Government's objectives.
5. Ministers should seek to continue their dialogue with the TUC and public sector trade unions to communicate better the objective of giving public service employees more control over their work and enterprises. There should be early and effective consultation with unions over their continuing relevance in services which acquire employee ownership.
6. The Mutuals Taskforce should continue to work closely with the Cabinet Office to ensure that viable, planned mutuals are not suppressed by senior officials for reasons unconnected with the objectives of the mutuals programme.
7. Building on the work of the pathfinders, the Cabinet Office should build an evidence base to underpin the mutuals programme, so that it can track the progress and outcomes involved in the transfer of public to mutual assets, and assess the results against its stated goals.
8. Continued vigorous coordination by the Cabinet Office, and the continued visible support of the Prime Minister, will be needed to ensure that all Departments actively seek to fulfil the intentions of the employee mutuals initiative in the public sector.
9. Despite the obstacle represented by EU procurement rules, the evidence from the hearings was that with the right guidance, encouragement and direction, new employee mutuals can compete fairly and successfully with conventional and larger companies. But it remains important to make sure that new mutual public service providers are allowed to grow, and are not immediately squeezed out by larger companies.
10. The Group identified irrecoverable VAT as an additional cost in some mutualisations. The Government should consider whether existing VAT recovery arrangements for government and other public sector bodies, including Academy Schools, can be extended to services for the public benefit, delivered by mutual delivery models funded by the public sector.
11. The Cabinet Office should initiate a study on the funding and other conditions required for employee mutuals to achieve significant growth and scale over time. It will be an important milestone for this initiative when a new generation of genuinely sizeable employee mutuals emerges, which have the strength to acquire or support more vulnerable mutuals.
12. The Cabinet Office rightly recognises the importance of building up resources, directly or indirectly, of official guidance on the key challenges and obstacles that employee mutuals face. This will ensure that much needed and genuinely reliable advice is accessible to new enterprises which will likely not be cash-rich. Such guidance should be constantly evolving as this market develops so that changes affecting matters such as pensions, VAT, procurement and joint ventures can be reported on.
13. We support the intention of the Postal Services Bill to introduce employee ownership to Royal Mail, but we urge the Secretary of State to consider a future option for a larger than 10% employee stake, and we are persuaded that the Government's objectives for employee ownership in the company could be better achieved through the mechanism of an employee trust.
14. We support the case for a significant measure of employee ownership in a mutualised Post Office Limited.

3. The Policy Context

Employee ownership has always enjoyed cross-party support. Former Liberal leader Jo Grimond authored the report *Ownership for All*[2] published in 1938 in which he promoted wider employee share ownership.

The Labour Party committed itself to create "a stakeholding society" pledging to promote more employee-owned and trust-owned enterprises.

The Conservatives have long extolled the benefits of employees owning shares in the company in which they work. However, the focus has traditionally been on private sector businesses. Until recently mutualisation activity in the public sector was peripheral. Nevertheless, there have been some clear success stories.

The best-known precedent for employee ownership in public services is the deregulation of the UK bus industry, in which there were a number of employee buyouts of London and regional bus services.

However, from the perspective of the mutual sector, the lessons are clear. No independent employee-owned bus companies exist at present because the buyouts were debt-financed; the employee ownership was based unsustainably on individual shares which required an exit route, and the deregulated market forced smaller operators to consolidate and merge to achieve essential economies of scale.

This experience is likely to have influenced current policy makers on more appropriate mechanisms for this new wave of employee mutuals. The importance of sustainability and structuring the ownership model to adapt to changing environments has been a feature of subsequent employee buy-outs.

The externalisation of local council services gave rise in the 1990s to some employee owned businesses tendering for what had previously been services delivered directly by council employees. The home care sector has seen a number of successful employee owned organisations deliver home care and diversification into assisted living, domestic services and end of life care.

Because councils divested leisure services, a majority of council leisure services are now delivered by trust owned organisations. **Greenwich Leisure Ltd**, now known as GLL, which began as a spin out of council leisure services provision, now employs several thousand staff and is on course to turn over £100m this year.

The "Right to Request" scheme instigated by the last Labour Government enabled health service workers to take control of the services they provide and Central Surrey Health became an employee owned provider in 2006. **Central Surrey Health** became a model for the Department of Health's Pathfinder programme. **City Health Care Partnership** in Hull was the first Pathfinder to achieve employee owned mutual status, which it completed in June 2010. Both organisations have achieved impressive results in terms of improving patient care and staff engagement.

All three of the UK's major political parties' General Election manifestos explicitly proposed to offer additional support post-election to some combination of mutuals, co-operatives, social enterprises, employee trusts and employee-owned businesses. The Labour Party argued that ownership should be embedded in the community, with citizens playing a key role alongside employees. The Liberal Democrats expressed enthusiasm for large scale employee ownership in the public sector, while the Conservative Party articulated the notion of "Smaller Government, Big Society" where ownership and responsibility would be devolved to the employees and social enterprises.

These variations on a shared theme suggested a degree of consensus support behind mutuals from all political quarters. Indeed, in our discussion of the Coalition Government's mutualisation policy in February 2011, Cabinet Officer Minister Francis Maude MP said there was a danger of opposing sides breaking out in "violent agreement" about mutuals and employee ownership. He told the APPG:

"There is cross party consensus on the need to get rid of the monolithic top down approach; the binary choice is outdated and we need a more mixed economy in public services."

Since the election, the Coalition Government does appear to have embraced wholeheartedly the expansion of employee owned delivery models in the public sector. The move to initiate and implement mutual ownership models within public service delivery falls under the Government's flagship policy, The Big Society.

In the Coalition's 'Programme for Government' (published in May 2010) mutuals, co-operatives, social enterprises and employee-owned organisations are cited in relation to social action and encouraging social responsibility to a) make it easier for people to come together to help one another and b) to help tackle social, economical and political challenges that the UK faces.

3. The Policy Context

The Opposition has broadly supported the move, if not the detail of the policy. Roberta Blackman-Woods MP, Shadow Minister for Civil Society, wrote in a report on the Big Society for think tank Reform that:

"The Big Society is to a certain extent continuing what Labour started in office through its broad direction of travel: by encouraging volunteering, supporting and seeking to expand the number of social enterprises and third sector organizations; looking at ways to enhance the role of mutuals and employee-owned companies; and encouraging a greater sense of community".[3]

It is worth noting that the previous Government appointed Professor Julian Le Grand to chair a working group to examine the creation of children's social work practices which advocated an employee owned social enterprise solution. The working group concluded that:

"The Group's preferred model is the professional partnership which is a form of an employee owned company; an enterprise where the majority or all, of the share capital is owned by the employees themselves."[4]

The Coalition Government has now appointed Professor Le Grand to chair the Mutuals Taskforce to inform and advise the Cabinet Office on its policy of promoting mutual ownership models in the public sector.

However, despite this growing consensus, there are differing views on the nature of alternative public sector delivery models and how these should be implemented.

Cabinet Office Minister Francis Maude told the APPG that he favours a "planting and gardening approach", saying that:

"We resisted inventing a complex policy and wanted just an enabling approach; hence the Pathfinders. We wanted to test different possibilities, see what works, and what doesn't. Most are working. Certainly my visits to them have been inspirational; you see people doing things differently".

The Labour Party have criticised Government reforms in health and education - arguing that powers have gone into the hands of professionals and the "market" rather than communities, not giving service users or the public any real influence. The result, they say, is a lack of accountability and an undermining of the important partnership role that the state and local government can play with civil society.

From the evidence we received it is clear that, unsurprisingly, the majority of trade unions broadly echo the concerns of the Labour Party. John Medway from the Public and Commercial Services Union (PCS) expressed scepticism over the initiatives, viewing the mutualisation programme as a means to achieve spending cuts in public services.

Both the Communication Workers Union (CWU) and PCS were concerned that the Government's plan to roll out alternative delivery models in the public sector is ultimately a way to privatise the services. PCS argued that "employee-led mutuals" will become in time more conventional private sector providers competing in the open market.

We explicitly raised this concern. The Group asked David Burbage, from the London Borough of Windsor and Maidenhead, if the mutualisation programme was viewed as "disguised privatisation" which could "swallow up" employee led mutuals. Mr Burbage responded that this was something that would have to be guarded against: ***"We don't want to find we're dealing with Serco in a different kind of deal"***.

The Cabinet Office has been quite open about a willingness to engage with private sector providers who they see as an important potential source of funding, knowledge and experience. Cabinet Office Minister Francis Maude told the Group:

"We want lots of formats; we're in favour of joint ventures, particularly for their access to skills and finance."

The Group believes that there is room for a variety of delivery models, but would be concerned if the bus company experience outlined earlier was repeated with new employee-led mutual organisations being taken over by larger corporations before they had the opportunity to succeed. It is important that this possibility is explicitly considered and planned against.

3. The Policy Context

It was noticeable that not all trade unions are opposed to the Coalition Government's proposals. For example George Thomson, General Secretary of National Federation of SubPostmasters (NFSP) said in reference to the mutualisation of the Post Office Network:

"The Post Office is a living example of the Big Society, providing social meeting places and interaction between different age and social groups. Separating the Post Office out, fitted with Big Society aspirations and mutualisation, and could be a model for other Government departments to follow."

During our inquiry Edward Davey MP, Minister for Employment Relations, Consumer and Postal Affairs, welcomed the Federation's position on the mutualisation of the Post Office and emphasised:

"We're making it clear that employee ownership is playing a big part in the Big Society idea, as in other policy areas, and does assist growth."

The Group found the commitment to employee ownership, from Government witnesses as well as from individuals currently involved in actual or potential employee mutuals, to be very encouraging indeed. There was a high level of recognition for the benefits that more employee ownership could bring to public sector delivery, and palpable enthusiasm for its implementation.

It was notable that even those who voiced opposition to the thrust of policy expressed support for the general principle of increased employee ownership. It is rare that initiatives gain such widespread approval and the Group believe it is important that policy makers remain focused on addressing emerging challenges and problems and involving stakeholders in the solutions.

We hope too that policy makers will wish to use the Group's findings to inform policy making at both local and central Government level. APPG Chair Jesse Norman MP commented that the group ***"certainly see employee ownership as central to a successful economic policy."***

4. Employee Mutuals in the Public Sector - Previous Experience

Success enjoyed by the small number of public sector organisations who have achieved co-owned status has done much to blaze the trail for employee owned models within the public sector. An earlier APPG inquiry found that the co-owned business model can lay claim to some significant differentiators in terms of ethos and performance in the delivery of public services.

The Department of Health, in written evidence to the APPG, was unequivocal in its support for employee led mutuals:

"Employee ownership of front line services will improve staff engagement and drive an increase in quality. Evidence shows that the use of employee-led mutuals reduces absenteeism and increases productivity."

Central Surrey Health is one such company. The organisation delivers nursing and therapy services in the Central Surrey health area. It became co-owned on 1 October 2006 and after only one year in business, reported remarkable results:

"An example is in our physiotherapy teams where through their efforts they have been able to reduce waiting times for the musculo-skeletal service from 16 to 4 weeks. What has changed is that clinical teams are beginning to change the way in which they approach issues, often an intractable problem which has challenged us all for several years. It is no longer somebody else's problem but "our" problem!"[5]

It is this acceptance of ownership, in all senses, that appears to drive enhanced performance. Replicating this will be central to the success of mutual models in the public sector. The group's view is that it is not enough that employees become "technical" owners of the enterprise, it is of critical importance that they think and feel like owners.

The experience of co-owned companies delivering public services is that until employees genuinely have the discretion to create their own solutions, break-through in performance and delivery will be less forthcoming. As Tricia McGregor from Central Surrey Health commented:

"We combine the values and principles of the NHS with the can-do culture of a successfully run business. This means that the people who are most in touch with patients' needs, our nurses and therapists, are now in charge of providing the services. The ethos sits well with the personal beliefs of those who choose to work in public services."[6]

Employee ownership offers the opportunity of combining a public realm ethos with private sector delivery values – or perhaps more accurately – co-owned delivery values. This was a theme repeated often during evidence sessions. As Mark Sesnan, Chief Executive of GLL, commented:

"We draw down the skills that the business sector has, the freedom to act and react in the marketplace, but we bring them together with a public sector ethos on the other side and hopefully have a win-win situation in the process."[7]

The experiences of these organisations illustrate why employee ownership can work so well in public service delivery. Employees are enabled to do exactly what they went into public service to do: deliver quality services. To a large extent, organisations can choose how they run, removing frustrations and obstacles that were perceived to impede good practice rather than add value to it.

The Department of Health agreed:

"Public service reform efforts continue to place great emphasis on giving front line professionals greater freedom to personalise and improve service delivery to the public".[8]

Employee owned businesses performed well on other metrics. All of the co-owned firms reported much lower levels of labour turnover, ensuring continuity and quality of delivery. At Sunderland Home Care Associates, for example, staff turnover is between 3-5% compared with the industry average of 20%. Andrew Burnell of CHCP Healthcare reported an immediate positive effect on absence rates when CHCP transferred to an employee owned model.

Organisations were able to present remarkable performance results when they run what were previously public sector services. Circle health, 49% owned by employees, is able to give impressive comparative statistics from their experience of taking over an NHS facility. In evidence to the Group, Steve Mellon, Chief Operating Officer, said:

"The Nottingham Treatment Centre run by Circle since July 2008 is the largest in the NHS (and in Europe). In 2009, there were 20% productivity gains on pre-transfer rates, and the quality of clinical outcomes was sustained or improved (zero infection rate, one of the best 18wk cancer consultation compliance rates, a four times lower readmission rate and 99.6% patient recommendation rate).[9]

4. Employee Mutuals in the Public Sector - Previous Experience

We are aware of the argument that these successes derive not from the ownership model, but from an engaged workforce. Rachael Addicott from the King's Fund, which has been investigating employee ownership in the health sector, claimed that ***"it is engagement that is important not the final structure."***[10] However, a broader view was taken by Steve Mellon at Circle health:

"Employee engagement, which has been talked about a lot, is much harder to sustain if all that employees are given is a "sense of ownership" – it needs to be more than just rhetoric. Actual ownership is powerfully symbolic and emblematic and conveys deep integrity. To achieve this there needs to be a fundamental cultural shift. You need a strong focus on something people aspire to. Employee ownership ensures that engagement is reinforced by the accountability of managers to owners."[11]

Concern was expressed by existing employee owned organisations that quality and value of performance tend to be rated by commissioners and authorities as less important than financial and specifically cost measures.

When quality was considered as part of a procurement process, it was often secondary to issues of cost. The Group agreed that quality of service delivery should be a paramount consideration both in structuring employee-led mutuals, and in commissioning work from them.

The fact that existing employee led mutuals frequently appear better able to deliver a quality service, and to do so cost-effectively, was remarked on by the Group. This suggests that employee engagement is intrinsically linked to and stimulated by the employee ownership dimension, and not a management technique that can be bolted on to achieve the equivalent effect in non-mutuals.

APPG Vice Chair, Martin Horwood, remarked on evidence from Andrew Burnell of City Health Care Partnership:

"The real value of your organisation has been the freedom to manage in an innovative way. You have flexibility and are better able to engage employees."

There can be no doubt that these employee owned organisations have performed effectively, delivering value to their service users, the community and their employees.

However, the Group were concerned to hear the suggestion that policy and legislative changes were now making transition to employee ownership more difficult than previously. Mike Jackson from Unison reported: ***"the way the rules were written then, there was a greater chance of success. It is now not as beneficial"***. [12] This is an area the APPG seeks to address.

5. Prospects for the New Employee Mutual Spin-outs

The current wave of public sector spin outs has been driven largely by Cabinet Office initiatives. The Cabinet Office Minister, Francis Maude, told us that he is keen not to be prescriptive and adopt what has been viewed as a "laissez faire" approach. The Group noted three important initiatives designed to support the policy of public sector spin-outs.

- The **Pathfinder Programme** selected potential spin outs and matched these organisations with businesses who had some experience of co-ownership. Mentoring was carried out on a pro bono basis, and results appear to have been varied. Toff Anderson, from Care and Support Partnership in Swindon, one of the initial Pathfinders, reports that there has to be "clarity" around what the Pathfinder programme should offer. She did find their Mentor to be very valuable in advising on employee engagement, for example, and supplemented this with other sources of advice, contacting the Employee Ownership Association and OPM. [13]
- The **Mutuals Information Service** is a partnership between Local Partnerships, Co-operatives UK and the Employee Ownership Association (EOA). It was designed to be the first port of call for organisations looking to spin out of the public sector into mutual models of ownership. The service was launched in November 2010 and to date has handled in excess of 200 calls. However, the service exists only as a signposting service and is not placed to offer direct financial or resource intensive support. Advisers within the Co-operatives UK and EOA networks have been providing support on a largely pro bono basis to these enquirers, although we do not see this as a sustainable solution in the long term.
- Details have still to be announced for the **Mutuals Support Programme** which was intimated by Francis Maude in November 2010. This is to be a £10m fund which the Minister described to us as "lubricating money, to soften the barriers to entry". This cash will be available over the next three years to prospective spin outs to purchase advice. The Minister admitted to us that this is not a lot, but is hopeful that finance would be available from external providers.

The reasons for organisations to explore mutual models of ownership have been mixed. Some organisations are enthused by the opportunity to gain greater control over decision making, and influence the services they offer. They are welcoming the initiatives and embracing the changes. Some organisations are exploring mutual models for more negative reasons. Organisations threatened by cuts see adoption of a mutual model as a way to maintain the service, and often, their jobs.

This view is supported by Rachael Addicott of the Kings' Fund which found that in the health sector different motivations convinced organisations to seek out mutual models. She said that in some cases the desire to explore mutual forms of ownership within the health sector is:

"a response to the break up of the PCT provider arm and is a way of protecting themselves."[14]

There is an implicit concern that if job protection is the main motivator, then there is a danger the organisation may not properly assess organisational competencies and capabilities, market opportunities, and create an organisation which could adapt to future changes.

Rachael Addicott identified other motivators for public sector organisations considering spin out:

"Several social enterprises came from a more proactive reason – a way to have greater freedom from PCT or SHA so they could get things done". [15]

This restriction on freedom is something that was echoed by several organisations who gave evidence to the APPG. Paul Raynes, Policy Programme Director from the Local Government Association, told the Group:

"There's enthusiasm at member level, and from staff envisaging getting out of the managerial chain and getting autonomy."

There appeared to be no issue with commitment to the role and the team. It was implied that employees are hindered from delivering a quality service, and often employees at all levels can see better ways of working, but feel in some way impeded from putting their ideas into action. Circle's Steve Mellon reinforced the commitment of NHS employees, but reported a frustration often experienced:

"We have been hugely impressed by the vocational commitment of NHS staff but also struck by how demoralised people are by their inability to get things done." [16]

5. Prospects for the New Employee Mutual Spin-outs

This suggests that the frustrations are organisational rather than derived from engagement issues. The lack of achievement does not appear to stem from a lack of will, but from specific circumstances. People want to do a good job but generally appear to find they can't. When the business changes into an employee owned model, there is a transformational change. We were repeatedly told that when employees become owners of the service their willingness and ability to overcome these barriers is transformed as they acquire more influence and control over what they do. Interestingly, these organisations tended not to report any radical changes in how the enterprise operated and instead more of an attitudinal change. The Group believes that this dynamic is worth investigating further, in order that new mutuals are also able to capture this difference for the good of the business.

Despite these results, the APPG was concerned to hear that making the transition out of public ownership to a new model is not easy. A lack of access to appropriate and genuinely expert support and advice, and a budget to cover the cost of that advice for spin outs, was often cited as a cause for concern. Many of our witnesses reported a difficulty in sourcing advice, and in some cases, said they were given poor counsel from advisers. There was a general feeling that the process was more difficult than necessary, with some authorities constructing barriers while others removed them. In addition, those who had completed the transition reported that the management of the process was a demanding distraction to getting the day to day work done.

Hilary Thompson, Chief Executive of OPM, an employee owned business which works closely with public sector organisations and is mentoring three public sector organisations on the Pathfinder programme, told the Group:

"You need independent expert advice as you go through the process, including legal advice which need not be extensive."

This view was supported by the King's Fund's Rachael Addicott:

"The dominant message is that support is insufficient. The organisations describe wading through tricky financial and HR issues". [17]

We heard concern over the pace of the expected change, with many of the new mutuals looking to complete transitions in a matter of months. This is not a timescale borne out by the experiences heard by the group. Andrew Burnell of City Health Care Partnership told the Group their transition took three and a half years, experiencing particular issues around pensions and the relationship with unions. Swindon Care and Support Partnership's Toff Anderson estimates the entire process will take at least two years for their organisation. The Central Surrey Health transition took two years. It is important that timescales are realistic.

Despite these difficulties, every witness who had made the transition told the group that despite the difficulties, achieving employee led mutual status was worthwhile.

Francis Maude told us that the results are worth the effort and reinforce the importance of ownership and accountability:

"It is crucial that management are accountable to staff. It's striking that at all the ones I've visited they say they 'feel like owners.' Nearly all are happier than they were and say they'd never go back."

The Minister was particularly impressed by Swindon Care & Support Partnership:

"At my visit to the Swindon spin out ... we saw how they'd added cost/price stickers to equipment trays to drive home the point about the need to retain the contract, and the absence charts put up showed it had dropped by more than half."

The Group are keen that these successes are replicated across the public sector. We believe policy makers must do more to connect the would-be mutuals to experts with genuine experience of advising employee-led mutuals, and to ensure that this expertise is affordable for organisations already financially exposed and under pressure to cut costs.

The Department of Health believes employee led mutuals could fit in many aspects of their work:

"Community health services are certainly well-suited to employee ownership (as shown by the success of the Right to Request scheme), but there also examples of high-performing mutuals in mental health, primary care, and health and wellbeing services"[18]

The APPG heard a lot of support for the implementation of mutual models across public service delivery. We recognise the remarkable successes already achieved, and the benefits that employee ownership appears to deliver.

6. The Royal Mail and Post Office Ltd

The Group was keen to analyse Government plans to introduce a measure of employee ownership to Royal Mail Group (RMG) and mutual ownership to Post Office Limited (POL). The Postal Services Bill is currently making its way through Parliament. This Bill allows for an employee ownership stake of "at least 10%" within the Royal Mail Group, and proposes a mutual ownership model for the Post Office. The Bill represents a significant commitment to the concept of co-ownership although the details of the form and process of that ownership will be decided once the Bill has received Royal Assent. Royal Mail Group welcomed the Bill, saying in written evidence to the APPG:

"We very much support the Postal Services Bill, including the Government's proposals to resolve the pension deficit, provide access to external capital and enact regulatory change."

There has been some criticism of the 10% shareholding to be allocated to employees. In evidence to the Parliamentary Bill Committee, the EOA said the proposed stake was ***"disappointingly small"***[19]. Edward Davey, Minister for Employment Relations, Postal and Consumer Affairs, said that in his view: ***"a 10% employee stake is a very large percentage"***.

He told the Group that a higher stake could act as a disincentive to external investors:

"We must get private capital in. They won't be put off by a 10% stake but if it's more – which is allowed for by the bill – they could perhaps be less attracted. We've deliberately stated 10% as a minimum, so the only option is up."

In written evidence, Royal Mail Group linked the 10% stake to enhanced employee engagement:

"We welcome also the provision that at least 10% of the equity will be made available for employee share ownership. The Company has been working hard at improving employee relations and sees this as a positive step which will help to engage employees in the future of the business."

RMG went on to outline further expected benefits from employee ownership:

"We see the principal benefits to be improved employee engagement which should translate into greater participation and co-operation with changes designed to improve efficiency and reduce disruption for the public. Employee ownership should also assist the company in recruiting and retaining good quality people. All of these should result in financial benefits and a more productive and efficient company."

In a written submission to the Minister, EOA stated:

"A 10 or even 20 percent minority shareholding in RMG will not afford employees significant legal rights in this regard under the 2006 Companies Act. Nevertheless, market precedent would suggest a 10% shareholder could legitimately expect certain arrangements to be put in place ensuring a voice or veto over significant business decisions. The Association believes that the public interest nature of RMG's business would justify Ministers in insisting that the employee trust is able to exert this exceptional degree of influence". [20]

Todd Nugent, a director with merchant bankers Noble Grossart, argued that consideration must be given to the desired outcomes:

"It comes down to the relative importance of capital versus labour to the mission of the business. Royal Mail is labour-intensive. A 10% productivity improvement could be worth billions in present day value terms. The key question: how much does Royal Mail need capital and how much does it need productivity improvements? To the extent that it needs the latter, then employee ownership is the answer."

The unions have stated opposition to plans to privatise Royal Mail Group, and this has included opposition to an employee ownership stake. Billy Hayes, General Secretary of the Communication Workers Union, told the Group that the union were:

"...in favour of cooperatives, but this is privatisation." He went on to say: ***"We are not saying employee ownership is wrong; but you can't impose that and ignore what's happening underneath. If you impose it from above you can't expect to carry union members with you."***

The Group heard that there had been significant improvements in Royal Mail operations, a result of the unions working more closely with management and this was acknowledged by Edward Davey, Minister with responsibility for Postal Affairs. Billy Hayes reported that Chief Executive Moya Greene had described this as the biggest transformation she had seen. The union had seen the need for change and worked with the Board to achieve it.

6. The Royal Mail and Post Office Ltd

The Royal Mail Group, in their written evidence, stressed how integral the union relationship was to the ongoing success of the enterprise:

"RMG has a good track record of discussing major changes to the business with its trade unions and of consulting them on matters which are likely to affect their members and this will continue following the introduction of employee share ownership."

However, the perception of the CWU was that they had not been fully consulted, reporting that they had not been involved in any discussions regarding the proposed plans for the Royal Mail. This had led to suspicion and scepticism. Dave Ward, Assistant General Secretary, emphasised that the interests of their members were paramount and they were keen to engage in discussions:

"If we're starting from a genuine position of improving industrial relations and work then of course we're interested, but not if their agenda is imposed on us. The privatisation debate is not helping and we are extremely concerned about the changes imposed."

Despite a greatly improved working relationship, for which both management and unions must take considerable credit, there appear to be some remaining barriers to communication. The perception of the CWU was clear - they had not been consulted on any of these initiatives which will impact their members significantly. On the other hand, Royal Mail Group believed that communication was consistent. The APPG urges Royal Mail Group and CWU to build on the already significant achievements made within the organisation, and to pursue a more effective mutual communication strategy.

The RMG already has an incentive scheme in operation known as the ColleagueShare plan. This involves cash bonuses based on how the company has performed and on meeting targets. However, the CWU expressed scepticism about the perceived worth of the plan, which had not been seen to deliver value to employees. In written evidence, the Royal Mail Group said the effectiveness of the plan had still to be assessed.

As with any transition of ownership, the implementation process must be carefully considered and supported. In a written submission to the Minister, the EOA advised:

"It is critically important that a carefully considered transition plan is developed and that this plan is implemented with efficiency and sensitivity and with the active involvement of all stakeholders."[21]

The EOA perceived a danger that the transition would be seen as a technical process, and not give due importance to the cultural and organisational issues which would be instrumental in delivering the required results for employees, and for the organisation and its customers.

"EOA is extremely concerned at the possibility that the transition focus will predominantly be on matters of regulation, finance and structure; and that too little attention will be paid to the change of culture that a significant degree of employee ownership will involve in RMG. Change on this scale will require a major investment in building the skills, awareness, understanding and processes that are going to be central to the success of any transition programme. Cutting corners on this dimension to structural change in RMG will fatally undermine the chances of success."[22]

The plans for the Post Office are not as defined, with mutualism proposed as an ownership structure once the operation has managed to achieve stability.[23]

The Bill's proposals are supported by the Federation of SubPostmasters, whose general secretary, George Thomson, suggested a model for that mutual ownership. George Thomson suggested a model for that mutual ownership:

"The Federation's preference is an employee mutual with a trust ownership model based on John Lewis Partnership. Trustees could include Government, the Federation, CWU and Unite, and a consumer champion such as Citizens' Advice who would set the overall ethos of the firm with management and executive teams below that."

6. The Royal Mail and Post Office Ltd

The Postal Affairs Minister told us that he had concerns about this:

"A solely employee owned business could undermine the social nature of the Post Office; Government has been impressed with the community support for the Post Office and we want to give the public an incentive to use the network in the way they go to the co-op so they feel a sense of ownership."

He described a model with an over-arching body, which he likened to a "mother mutual" with private businesses operating below it.

The Post Office is not currently in a strong position and is facing severe challenges, a fact reiterated by both George Thomson and Edward Davey, and there are several initiatives underway to strengthen the position before mutualisation would be considered. The Department for Business, Innovation and Skills produced a paper which outlined a number of initiatives designed to drive business towards the Post Office, and ensure long term stability[24]. There is considerable optimism within BIS that these measures will succeed.

We found a strong belief that a mutual ownership model would bring considerable benefits to the organisation.

We heard from George Thomson that if a mutual model were to be pursued, then ***"the company ethos would change, staff already have 'skin in the game' as agents but there would be more buy-in if everyone has an actual ownership stake."***

Edward Davey told us that employee ownership would do much to strengthen relationships within the businesses:

"Employee ownership can improve industrial relations, especially where the trade unions are involved. You get most benefit when you have employee ownership and trade unions alongside each other; employee ownership is not hostile to unions. We want the CWU to embrace this and invest shares in the business."

The employee ownership route is perceived as the right one for Royal Mail Group by Professor Andrew Pendleton, an expert on employee ownership. He told the Group:

"Employee ownership is the most feasible way to privatise Royal Mail because it is a guarantee to workers and trade unions that if they have to offer concessions they will benefit in the medium to long term by the potential upside."

He saw employee ownership as a means to manage change within both Royal Mail and Post Office, yet cautioned:

"Probably the most threatened tier of management is middle managers who, along with trade unions, must adapt to a new style of employee involvement, participation and representation."

We have noted the high expectations about what the changes proposed by the Postal Services Bill will achieve. The APPG recommends that efforts are redoubled to engage all stakeholders as soon as possible, involving these stakeholders in shaping the future of the new organisations. Proper consideration must be paid to the cultural and governance structures of each business, ensuring that the benefits of mutual ownership are afforded the best foundations for success.

7. Challenges and Solutions

The Group has heard convincing evidence in support of employee-led mutuals, from authorities, experts and actual or potential employee mutuals. We accept the view that widespread introduction of employee-led mutuals in public services could transform many for the better – providing better services for users, and a better place to work for employee co-owners. We agree with Cabinet Office Minister Francis Maude when he described this as ***"an opportunity for transformational change"***. [25]

However, during the evidence sessions and in written submissions the Group has heard a range of concerns which must be addressed.

A. Which business and ownership model?

One of the key attributes of the employee ownership sector is its rich diversity of ownership models. There is no "one-size-fits-all" model which means that organisations can adopt a model which best suits their enterprise, its people, the service users, and its operating environment. The Department of Health said in written evidence to the APPG:

"Employee-owned organisations can be one of a variety of legal forms and there is no prescribed model for the new mutual organisations to adopt. Experience suggests that form follows function and in the right to request scheme we have seen a variety of models adopted, with sharing of best practice between organisations."

The Department of Health expressed no preference for any one model for employee led mutuals:

"Adopting a certain employee model is not considered to be of critical importance here as there are a number of different models which have proved to be successful…." [26]

Cabinet Office Minister Francis Maude has been particularly non-prescriptive when it comes to specific ownership structures professing: ***"I don't want to get hung up on models"***.[27]

However, there are also downsides to this flexibility. Terminology and semantics are not helping. Enquirers to the Mutuals Information Service variously describe their target ownership and business model as a mutual; an employee owned business; an employee mutual; employee-led; co-operative; social enterprise; or some combination of all of those. Some believe it is essential to describe themselves as 'not for profit'; some believe they must operate to a social purpose and be a social enterprise; just as many think not on both counts. Some favour an external equity partner; others assume such a move will disqualify them from the right to provide.

The point is that, with the best of motives, a clear signal about what policy makers intend has not yet been conveyed. The plethora of models, coupled with a lack of definitive advice, is a source of confusion for many of those considering a spin out, and those involved in the process.

The Group also heard that changing legislation meant that some organisations were unable to model previous spin outs, and it was therefore difficult to learn from the experience of others. Some of the organisations considering spinning out into employee led mutual status confessed to not knowing where to begin.

We have however been impressed with the efforts of the Cabinet Office Minister, Francis Maude, to clarify what the Cabinet Office intend. To the Group, and in a succession of speeches, he has stressed that he wishes to see a variety of models in operation, but expressed a preference for ***"employee ownership, or a strong element of it"***[28] - stating this was the favoured model for central Government. The view he expressed in oral evidence to the Group was that employee ownership – 'employee mutuals' or 'employee-led mutuals' - more than other mutual models was the most likely to enable staff to deliver the kind of transformation planned for public service delivery.

Graeme Nuttall, tax partner with Field Fisher Waterhouse LLP, who has worked in the field of employee ownership transition for many years, and has advised several of the public sector mutual spin outs, advised:

"The most appropriate type of employee ownership depends on the desired endgame. If a clear exit route (eg IPO or trade sale) is envisaged, direct individual shareholding works best. If sustainable employee ownership is the objective, a trust is usually the best structure." [29]

7. Challenges and Solutions

The APPG believe that the long term approach was the best fit for the majority of the potential mutual spin outs and were keen to explore how this sustainability could be reinforced. The APPG heard how the ownership structure could be used to strengthen the corporate governance structure and also to encourage an organisation to look to the future. Graeme Nuttall explained to the group:

"If desired, Trusts can be given special rights to appoint or remove directors or to be consulted on resolutions, however large or small the trust's holding. The fact that the Trustees have a fiduciary duty to beneficiaries - which is usually stated as "employees at any given time" - ensures that trustees take a forward-looking long term view of ownership. The fundamental problem with individualised ownership is that the turnover of employees creates ever-present demand to sell and this causes inherent instability."

Central Surrey Health (CSH) for example, which is often cited as one of the alternative delivery model success stories in the public sector, was formed under different rules to the City Health Care Partnership (CHCP). CSH is a Company limited by shares, whereas CHCP is a Community Interest Company.

Andrew Burnell claimed that rules regarding pensions and VAT had changed, and CHCP had encountered more difficulties in making the transfer to an employee owned model than CSH had four years previously.[30] This claim that it was more difficult to become employee owned was echoed by other witnesses, and the APPG are seeking further examples of this.

Hilary Thompson from OPM told us that more clarity was required on the different models, and the degree of employee influence within them. The APPG appreciated the benefits of being able to choose and adapt models to suit different organisational needs but agreed more guidance was needed to inform organisations on the definitive models, and also to advise on the factors which lead to choice of a particular model.

B. Change amid cuts: the context challenge

Several witnesses told us that the timing of the public service mutuals initiative, during a time of deep budget cuts at central and local government level, was inflicting severe damage on how the initiative was perceived and how it was being implemented.

APPG member Adrian Bailey MP challenged how much of the push was driven by financial considerations as against more employee and customer involvement. Cllr David Burbage from the Royal Borough of Windsor and Maidenhead agreed that the initiative "will add to services and value"but maintained that "it's not just a money issue". The unions in particular told of suspicions surrounding the timing of the initiative and economic drivers.

There is also a concern that the new organisations will face insupportable economic constraints, which will make success difficult.

We believe the background of expenditure cuts do present a danger that organisations may set unrealistic timescales in making the transition to new models, and could make bad decisions about selecting appropriate models and business plans for the future. Many potential spin outs were hoping to complete the business transfer process in a matter of months when the APPG heard that the change programme could take two to three years.

We believe it would help if Government's official advice to authorities, and guidance to would-be mutuals, was carefully and explicitly framed to acknowledge the context in which change is having to happen and potential obstacles.

C. The need for good commissioning

Alternative delivery models in the public sector will have to compete in the market against SMEs and large, established and frequently multinational contractors.

The default approach of many public sector commissioners is to open competitive tendering, with decisions to award contracts ultimately based on the lowest cost. However, unfortunately, this process is not conducive to alternative delivery model bids, as the established private sector is almost always able to out-bid a novice bidder on such narrow criteria given their larger economy of scale.

In order for alternative models to survive and be a success, commissioning contracts need to acknowledge that developing and strengthening the market place by increasing the number of players within it is a legitimate goal. Moreover value for the taxpayer is not simply measured by immediate cost reductions but in delivery and quality of that service.

7. Challenges and Solutions

This view was supported by Hilary Thompson from OPM, an employee owned organisation very experienced in working with public sector companies. She told the APPG:

"This issue needs to be seen as about both commissioners and providers. It's just as important that this is about good commissioning practice and development of markets; it's not just about providers. Unless you have confident commissioners, thinking long term, there is a risk of straightforward privatisation in the long term."

We have found from our inquiry that these challenges are all too real. For example, Unison state that the Department of Health Operating Framework (2010) means that Trusts will be invited to offer services below tariff, causing a step change towards price competition in the NHS. As such there will be a downward pressure on services as commissioners will be looking to get more for less[31].

The think tank Reform recently underlined this point in a ConservativeHome post: ***"For mutuals to be able to compete effectively for government business a better commissioning framework will be needed – especially in terms of commissioning that is blind to everything but value."***[32]

For these models to reach a level playing field, contracts need to have enough scope to allow for potential suppliers to innovate, reduce costs and increase profits so that their financial reserves can be maintained and reinvested back into their services and employees.

In order for this to be feasible there needs to be a period of protection for the organisation, through contract conditions - having 'realistic' contract lengths (3-5 years) is one way of doing it. Another is breaking down the commissioning arrangements into individual contracts.

For example, in healthcare, if the service provision is integrated the commissioning process is structured in a similar fashion, which can hinder the opportunity for alternative delivery model structured business to compete against more established companies. The Department of Health 'Right to Request' guidelines, which were effective as of 1 April 2011, stipulate that commissioning and provision need to be separated, which means contracts can be single tendered if a current provider "social enterprise" is involved, thus creating more of a level playing field.

OPM's Hilary Thompson described this as ***"the long term commissioning issue. Subsidising SMEs is rational if you want diversity. Long term you need a level playing field."***

Cllr David Burbage proposed that: ***"If an employee-led mutual has a strong social enterprise and/or mutual character that could 'score' more highly."*** We fully appreciate the need for competition in public service provision, but we believe it is essential to ensure that new models are given fair scope for survival and success. This means awarding recognition to the total value, not just financial value, that a provider brings to the service.

The APPG are convinced that focusing on value, rather than cost, is a lynchpin in the success of the policies. We favour competition on the basis of quality more than price; and a level playing field for smaller organisations. We have to avoid the "winner's curse" where thinly capitalised organisations have to compete where the tendering regime is all about cost. We favour longer contracts for employee led mutuals, such as five to seven years in length, and do not see any conflict if the ultimate aim is increased diversity in supply.

D. The top-down paradox – who's pushing mutuals?

The Group is concerned to hear that some spin-outs appear solely driven from very senior level, typically under the pressure of the need for immediate short term cuts, with the wider base of employees engaged only after the process had started. Mike Jackson of Unison said that he had no objections to employees wanting to spin out into independent, autonomous units, but in his experience he saw a lot of what was happening as akin to MBOs:***"Often they (the employees) are not asked. It's a top-down approach and it's the wrong way to do it."*** The Group is sympathetic to Mr Jackson's view that it is ***"...wrong to lever staff into an ownership model to which they have no commitment."***

The importance of engaging employees at the early stages was emphasised by a number of speakers giving evidence to the Group. We heard that it can take some time for employees to understand and take on board the changes, and indeed, Andrew Burnell from CHCP said that six months after the transition had completed, four years on from the start of the spin out process, the majority of employees were just beginning to understand the new organisation.

7. Challenges and Solutions

The APPG heard that it wasn't always possible or feasible to gain employee commitment right from the beginning. Hilary Thompson told the group: ***"It does take time to get employee engagement at the outset, so the pace can get ahead of where staff are. You have to have leaders who want to run a service this way."***

The APPG were convinced of the need for early engagement and the importance of avoiding any sense that new models of ownership were being imposed, either by policy or by senior leaders. Early communication was essential. Committed and responsive leadership would contribute to a smooth process.

There is another side to the top-down dimension – posing exactly the opposite problem. It is clear that another challenge for the mutualisation programme is authorities who won't let go. We are concerned at accounts of enterprising public service leaders who have been explicitly or surreptitiously blocked by their authority from initiating a spin-out despite all the conditions being met. We urge the Cabinet Office to develop mechanisms to address this problem and to offer support to would-be mutuals in this position.

E. The union factor

Unions play a critical role within the public sector and are in a strong position to influence mutualisation outcomes. The APPG heard significant concerns from union representatives. There was suspicion about the ulterior motives behind the policy; concerns about the consultation process; and concerns about the ongoing role of unions in mutual ownership models.

At local level, the APPG heard the claim that unions were often not closely involved in plans to mutualise, and union representatives believed they were not engaged or consulted until late in the process. Some of the union representatives who gave evidence to the APPG were concerned that they had not been asked to give any input to the Cabinet Office or BIS in the formulation of their respective mutualisation initiatives.

On the whole, union representatives expressed respect for employee ownership and other mutual models of ownership; in other words we found no opposition per se. Margie Jaffe of Unison told the Group: ***"the principles of cooperation and employee ownership are close to union hearts"*** yet spin-outs reported at least initial opposition to mutual status from represented unions. In one case the union relationship was described as continuing to be "difficult".

The unions' concerns stemmed from suspicion that the mutualisation programme was a mask for large-scale privatisation, or a front to obscure an agenda for cuts, or both. In their written evidence to the APPG, Unison stated:

"Our overriding concern is that employee ownership is not being deployed on its merits, but rather as a mechanism to break up public services."

Union evidence to the Group can be summarised as a conviction that the mutualisation programme is not being implemented with the objective of capturing the benefits of employee ownership, but primarily in response to the need to make large savings in public service expenditure.

John Medhurst of PCS was asked by the APPG to clarify his union's attitude to new mutuals. He responded: ***"We're sceptical of their effectiveness, particularly in regard to the Francis Maude proposals and what we expect to be in the White Paper. This is mainly because of the context of spending cuts, the lack of a level playing field in terms of growing social inequality. We think the programme is designed to deliver cuts and privatisation."***

The APPG believes that genuine and concerted effort must be made to convince the unions of the drivers behind the policy, and win round their support. Evidence heard demonstrates that once unions are on board with the mutualisation process, then they can be of tremendous assistance in employee communications and in the transition process. Both Central Surrey Health and Swindon Community Care experienced this.

Swindon's Toff Anderson reported that she found it difficult to engage with the unions early on in the process, but "they didn't want to react until they were clear on the legal form we'd go for."

Research undertaken by the King's Fund suggests that existing sound relationships with unions at a local level is an important factor in gaining support for the process.

The sustainability of the new models was a concern expressed by some unions giving evidence to the Group.

7. Challenges and Solutions

John Medhurst, PCS said: ***"We think employee-led mutuals will become in time more conventional private sector providers competing in the open market."***

Unison were concerned about the risks presented by operating according to market forces, and doing this in the context of reduced expenditure. In written evidence, they stated:

"We also fear that this model transfers huge risks from the state onto individual employees, not least because they will have to compete in the market against large multinational contractors but also because the sources of funding for the services they provide are extremely limited."

The APPG believes that there is much more to be done to win union support for, or at least mitigate opposition to mutualisation in the public sector, even where latent support for mutuals exists. Unison's Margie Jaffe told the APPG:

"Employee ownership is not the only answer... the principles of cooperation and employee ownership are close to union hearts, but we don't think they sit well with the public service ethos."

Unison submitted some guidance which they believe should safeguard organisations. This has been included as Appendix 1.

The Group believes that unions and their members should be seen as key stakeholders in the public service mutualisation programme. The APPG is concerned at what appears to be frequent lack of engagement, by authorities, with unions at local and national levels.

F. Pensions and pay

Any worker transferred to an alternative delivery model would normally have their employment rights protected by TUPE regulations. However, any future changes or improvements to public sector employment terms and conditions and pay would not automatically be protected.

Currently TUPE regulations provide only limited rights relating to pensions and many scheme rules prevent public sector workers staying in their public sector pension schemes post transfer. However, transferred staff should receive a broadly comparable pension to their public pension scheme in accordance with current policy in HM Treasury – Fair Deal for Staff Pensions Guidance (1999 and 2004).

The eligibility criteria for pensions and pay are different across public sector services. For example new pension rules for NHS staff transferred to an alternative delivery model business under the 'Right to Request Scheme' are slightly different and often allow staff to stay in the NHS pension scheme. Any new staff would be employed on the terms and conditions of the new organisation which should be overall no less favourable than the terms and conditions of transferred employees, and the alternative delivery models would need to provide separate pension scheme arrangements for new staff.

Under the existing rules governing social enterprises in the NHS, if the new organisation bid for and won contracts to provide services for non-NHS funded services, going forward, any member of staff working on these contracts will not be able to retain membership of the NHS pension scheme and their service up to that point will be frozen.

However, the principles that apply to the NHS remain inconclusive – doubt has been cast over whether employees are entitled to their NHS pension if they set up a "social enterprise" scheme following the publication of the DH Guidance, *Making Quality your Business*. In an article in April 2011 in the Nursing Times[33] on the issue, the DH said the government *"will be clarifying arrangements regarding the NHS pension in due course"*.

Local Authority Pension schemes offer further variations.

Some of the new organisations are integrating what would previously have been NHS and Local Government functions and this has added further complexity to constructing pension arrangements. Andrew Burnell from CHCP Healthcare described how he had to implement three different pension schemes to cover transferring NHS and local government employees, and new employees joining the business.

To take on existing pension commitments, at a minimum, creates a huge current and future obligation for alternative business models in the competitive environment they are moving into.

The Group were made aware of the heavy pressures on new mutuals in complying with the legal requirements; assessing the options from the range of pension schemes that are available and meeting them; and fitting this fraught issue into a cogent reward strategy.

7. Challenges and Solutions

G. What if it all goes wrong?

To date, the limited record of new spin outs has been excellent in terms of sustainability and in performance. Yet it was a concern to the Group that there seemed to be no serious policy contingency for what would happen if one of these new organisations – say a large formerly central government body - were to fail. This was articulated by John Medhurst who requested: ***"..safeguards around quality of service and a contingency for if and when mutuals fail. ...Essential to know how you'll protect the service in case of failure."***

Some respondents to the APPG were concerned that large outsourcers may come in and pick up work either on failure of an employee led mutual, or by acquisition. There was also concern that these outsourcers were able to offer economies of scale which would lead to cost savings which the new employee led mutuals could not match.

Unison's Margie Jaffe said: **"But once you have a market the larger players will dominate. Trying to shift this reality is very difficult."**

It was suggested that the mutuals initiative would be deemed to have failed if many employee mutuals are quickly swallowed by large private sector companies. The Minister responded to this concern by saying he accepted that some of that will happen.

We are keen to acknowledge the valuable role that outsourcers play in public service delivery, and we strongly endorse the reality that service provision must be maintained. However, the Group believes that employee ownership will bring significant benefits to the realm of public services, and fears that these benefits would dissipate if the direct ownership element was to be lost. The APPG would like to see safeguards built in to ensure that there are disincentives to sale except in extreme circumstances.

H. Lack of money for advice

This approach has created interest, but without the attendant structure and support many of the interested organisations are struggling to make co-ownership happen. The APPG heard that early stage advice was essential, yet there was very rarely any money to finance this. Hilary Thompson stated that early options appraisal is "vital" as was business planning assistance which would enable enterprises to "be able to flourish in the market". She also advocated the need for **"a central authoritative information point"**. Many of the organisations echoed the difficulty in sourcing sound advice. Toff Anderson told the APPG about Swindon Care and Support Partnership's experience:

"We need clarity on what the mentor deal is. We've gone all over the place for help, for instance to the Employee Ownership Association and to OPM. There is a lot of conflicting information and there has to be one definitive information source on vital things like TUPE and pensions."

The Cabinet Office are attempting to address this with the Mutuals Support Fund, details of which are still to be announced. Francis Maude explained:

"We're looking at lubricating money, to soften the barriers to entry... the lubricating money we'll provide is not capital. It's to purchase advice. I agree there's not much money around for support and £10m over three years is not a lot." He suggested that there may be other sources of helpful finance: ***"It does help if outside providers can help with the financial lubricating."***

There was also concern at the amount of resource expected on a pro bono basis, which had impacted quite severely on commercial organisations who were keen to lend support, and did this at significant cost to their own organisations.

Mr Maude replied: **"There won't be a shortage of capital. The Big Society bank will add to the funds for social enterprise and some of these enterprises won't need a lot of capital."**

7. Challenges and Solutions

I. Tax implications for public sector spin-outs

There are a number of tax implications that can hinder or halt the success of an alternative delivery model in the public sector.

Once a business leaves the public sector it is subject to the same tax system as applies to any private sector business. Charities are an exception, but as a general rule a corporate alternative delivery model is subject to corporation tax on its profits. This obviously reduces the amount of money that could be reinvested back into the organisation. There are payroll implications, including registering for PAYE.

One consequence of moving out of an organisation 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. This is the experience of CHCP:

- As soon as they became a CIC outside the NHS standard VAT charges apply. This is a cash flow problem for businesses that may recover all their VAT. However, supplies of health services are often exempt from VAT which stops or restricts the reclaim of VAT. Irrecoverable or "sticking" VAT has been a significant or additional cost in NHS mutualisations to date.
- There were additional tax costs to take into account in the business plan. No lease is needed if one part of a public sector body occupies a building owned by that body. New organisations have to enter into formal leases to occupy buildings. Upon the signing of a lease, an organisation then may be liable to pay stamp duty land tax (SDLT) depending of the terms of the lease. When CHCP has to re-sign its leases in three years' time, SDLT will have to be paid again.

The Group heard from others that the new business must review its VAT position with a focus on what VAT it has to charge and whether it can offset all the VAT it has to pay.

The APPG are pleased that the Mutuals Task Force is undertaking a careful examination of the tax implications for mutual spin-outs.

Appendix 1: Written Evidence Submitted by Unison

Safeguards for successful employee ownership of public services:

a) Prerequisites

- Genuine, bottom up, staff and union involvement and engagement from the outset.

  EO can only work where there is a genuine desire on the part of the staff involved, not just their managers, and where they are integral to the development of the enterprise.

- Involvement of service users and others who will be affected by the formation of the enterprise
- A staff ballot to ascertain support for EO
- Substantial support for staff in the development and running of the EO. Development will be time intensive and require funding.
- An open and transparent process
- Open and transparent financial information
- An equality impact assessment of staff; service users and on neighbouring public authorities and services
- A minimum, initial, contract length – at least 5 years – to enable the SE to get established, before it is exposed to the market
- Preferably formed as an Industrial and Provident Society
- If formed as a not for profit company then:
  - all employees should be full members, required to sell their shares back to the company should they leave
  - employees should own a majority of the shares
  - employees should elect a significant proportion of the board
- Asset lock to prevent predatory asset stripping of what are currently publicly owned assets
- Access to capital at reasonable rates – this can make or break an SME at critical points in its development
- Accountability – mechanisms for the enterprise to remain accountable to service users and the community
- As a publicly funded body it should provide access to information in the same way as Freedom of Information works for wholly public bodies

b) Employment standards

- Terms and conditions broadly comparable to transferred staff, including for new starters
- Admission to public sector pension schemes, and failing that, ongoing provision of comparable pensions
- Ongoing professional development and skills training

c) At commissioning stage

- An appraisal of the effectiveness of the EO model, including a comparison with an in-house, direct delivery model
- Level playing field for staff terms and conditions written in to any new contracts so that competition is not based on cutting terms and conditions, but rather on service delivery factors
- New starters to be on the same terms and conditions as transferred staff
- Recognition of quality in the procurement process
- Recognition of social and environmental issues
- Full cost funding – a problem yet to be resolved for the community and voluntary sector
- Build in professional development and skills training
- Public accountability supported by open and transparent financial information
- As a publicly funded body it should provide access to information in same way as Freedom of Information works for wholly public bodies

Appendix 2 : List of Contributors

- **Employee owned organisations**
  - Steve Melton, Chief Operations Officer, Circle
  - Terry Hill, Chairman, Arup Trust
  - John Swinney, Group Strategy Director, Eaga plc
  - Fred Bowden, Chairman, Tullis Russell
  - Andrew Burnell, Chief Executive, City Healthcare Partnership CIC
- **Organisations involved in the Cabinet Office Mutual Pathfinder Programme**
  - Toff Anderson, Care and Support Partnership, Swindon
- **Expert Advisers**
  - John Alexander, Investment Director, Baxi Partnership Ltd
  - Graeme Nuttall, Partner, Field Fisher Waterhouse
  - Hilary Thompson, Chief Executive, Office for Public Management
  - Todd Nugent, Director, Noble Grossart
- **Trade unions representing workers in healthcare, communications and the civil service**
  - George Thomson, National Federation of SubPostmasters
  - Billy Hayes, General Secretary, CWU
  - Dave Ward, Deputy General Secretary, CWU
  - Mike Jackson, Senior National Officer for Health, UNISON
  - Margie Jaffe, National Policy Officer, UNISON
  - John Medhurst, Policy and Research Officer, Public and Commercial Services Union
- **Academics**
  - Rachael Addicott, Senior Research Fellow at the King's Fund
  - Professor Andrew Pendleton, University of York
- **Royal Mail Group**
  - Written Submission
- **Local Government**
  - Cllr David Burbage Leader, Royal Borough of Windsor and Maidenhead (one of Government's Big Society Vanguards
  - Paul Raynes, Policy Programme Director, Local Government Association
- **Government Ministers**
  - Edward Davey MP, Minister of State for Business, Innovation and Skills
  - Paul Burstow MP, Minister of State for Health
  - Francis Maude MP, Minister for the Cabinet Office and Paymaster General

Appendix 3: References

1 ***Share Value: How employee ownership is changing the face of business***, All Party Parliamentary Group Report May 2008

2 Jo Grimond ***Ownership for All*** 1938

3 Roberta Blackman-Woods MP ***Building the Big Society*** March 2011

4 Julian Le Grand ***Consistent Care Matters: exploring the potential of social work practices*** June 2007

5 ***Share Value: How employee ownership is changing the face of business*** All Party Parliamentary Group Report May 2008

6 ***Share Value: How employee ownership is changing the face of business*** All Party Parliamentary Group Report May 2008

7 ***Share Value: How employee ownership is changing the face of business*** All Party Parliamentary Group Report May 2008

8 Department of Health Written Evidence

9 Steve Mellon, Circle Healt, Oral Evidence

10 Rachael Addicot, Kings Fund, Oral Evidence

11 Steve Mellon, Circle health, Oral Evidence

12 Mike Jackson,Unison, Oral Evidence

13 Toff Anderson, Care and Support Partnership Swindon, Oral Evidence

14 Rachael Addicot, King's Fund, Oral Evidence

15 Rachael Addicot, King's Fund, Oral Evidence

16 Steve Mellon Circle health, Oral Evidence

17 Rachael Addicot, King's Fund, Oral Evidence

18 Department of Health Written Evidence

19 Postal Services Bill Committee Evidence Session, November 2010

20 EOA submission to Department of Business Innovation and Skills on the Future of Royal Mail Group

21 EOA submission to Department of Business Innovation and Skills on the Future of Royal Mail Group

22 EOA submission to Department of Business Innovation and Skills on the Future of Royal Mail Group

23 Postal Services Bill 2011

24 ***Securing the Post Office in the Digital Age*** Department of Business Innovation and Skills November 2010

25 Francis Maude MP, Speech, House of Commons Launch of ***How to become an employee-owned mutual*** March 2011

26 Department of Health, Written Submission

27 Francis Maude MP, Oral Evidence

28 Francis Maude MP, Oral Evidence

29 Graham Nuttall, Field Fisher Waterhouse, Oral Evidence

30 Andrew Burnell, City Health Care Partnership, Oral Evidence

31 Unison Written Submission

32 Will Tanner, Reform, Conservative Home website March 2011

33 David Williams, Nursing Times April 2011

Published by the All Party Parliamentary Group on Employee Ownership

c/o Harriet Crossthwaite, Luther Pendragon, Priory Court, Pilgrim St, London EC4V 6DR 020 7618 9100

All Party Parliamentary Group
on Employee Ownership