

MUNICIPAL YEAR 2016/17 – REPORT NO. 174

MEETING TITLE AND DATE:

Cabinet: 18th January 2017

Report of:

Director of Finance, Resources
and Customer Services

Contact:

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Agenda: Part 1 Item: 7

Subject:

Taking forward Enfield Council's IT offer

Wards: All

Key Decision Number: 4378

Cabinet Members Consulted:

Cllr. A. Georgiou

Cllr. D. Lemonides

1 EXECUTIVE SUMMARY

1.1 On 10th February 2016, Cabinet agreed to register a limited company, owned by the Council, to leverage the IT investment made in the Enfield 2017 programme, helping mitigate future cost pressures on the Council by generating income.

1.2 This paper seeks Cabinet approval for the business case and governance arrangements, as noted in section 2.1.5 of the Cabinet report 32, key decision 4314 of 7th July 2016.

1.3 There is considerable market interest in the Enfield digital platform, in terms of the technology which underpins the Council's transformation, and, with the scale and ambition of the transformation, the experience gained. This technology includes the Digital Platform, and other solutions being developed in parallel, including Artificial Intelligence, Data Analytics and Systems Thinking.

1.4 Put together – the technology, solutions and know-how – makes the Enfield experience and the solutions we built sought after by others in the public sector.

1.5 In choosing how to proceed, three options were considered, two of which use the general power of competence from section 1 of the Localism Act 2011, and with this being for a commercial purpose, require the formation of a limited company.

1.6 **OPTION 1 - Do nothing:** avoids any commercial risk; does not mitigate any future cost pressures on the Council; loses any income generation opportunity.

1.7 **OPTION 2 - Establish an IT company to design, build, maintain, market and support technology products and services:** takes on the full commercial risk, potentially mitigates future cost pressures on the Council; takes full advantage of any income generation opportunity; increases setup and operational costs.

1.8 **OPTION 3 (Recommended) - Establish an IT company that negotiates income generating agreements with commercial organisations and provides specialist services to other public bodies:** minimises commercial risk; potentially mitigates future cost pressures on the Council; takes advantage of income generation opportunities; avoids most of the setup costs incurred in option 2 above.

2. RECOMMENDATIONS

2.1 Cabinet is invited to:

2.1.1 Approve option three, summarised at 1.8 and detailed at 4.3, to establish an IT company, limited by shares and owned by the Council, that negotiates income generating agreements with commercial organisations as well as providing IT specialist services, delegating the finalisation and signature of all start-up arrangements to the relevant Cabinet Member together with the Director of Finance, Resources and Customer Services.

2.1.2 Approve the governance arrangements detailed in sections 3.18 to 3.25 inclusive.

3. BACKGROUND

3.1 Since Cabinet's decision in October 2014 to initiate the Enfield 2017 transformation programme, there has been considerable progress. Completion of the programme is in hand. At the heart of Enfield 2017 are clear design principles, based on an overall vision for the Council, which have followed through into the organisational design, cultural change and technological development that has occurred over the last 18 months.

3.2 Because of this programme of change, there has been interest in opportunity areas from other councils and public sector bodies. Those areas include:

3.2.1 The technology solutions that support the customer pathway through the organisation. Typically, a customer's journey through the organisation entails moving amongst a series of separate IT systems, supported by a Customer Relationship Management (CRM) solution. Enfield's solution is different, and provides a unified customer journey, based on an initial triage of customer needs. The Enfield solution streamlines and automates whole aspects of the customer journey, and allows a

personalised experience.

3.2.2 The experience of implementing these complex systems as part of a much wider transformation programme, working with a range of providers across the private and public sectors. This means that Enfield has the potential to create new relationships, monetising the Council's digital transformation experience and, in turn, raise the Council's profile.

Progress to Date

3.3 Since February 2016, discussions have taken place between the Council, interested third parties and local authorities regarding our approach to digital transformation. This dialogue shows there is market interest in the idea of a digital platform for local government. We have financial propositions on the table that, if developed, could realise one or more income streams for the Council. Advice sought suggests that this approach is consistent with legislation, but must be arranged through a company separate to the Council as it uses the general power of competence specific to the Localism Act 2011.

Developing the Commercial Offer

3.4 To take forward the opportunities mentioned in 3.2 above, the Council is negotiating referral based income streams for future sales of solutions developed for the Council through third-parties. Alongside these agreements, by consolidating the know-how being generated through the Enfield 2017 programme, the Council can develop a specialist IT offering for other local authorities seeking to deliver their own digital transformation programmes.

3.5 The "referral" model recognises Enfield Council a financial benefit (commission) for the use, from time to time, of officer time as a reference site for the products developed by third-parties. Effectively, the Council reputation has an economic value which we can monetise.

3.6 Each agreement between the Council and third parties allows Enfield to maintain full control over its use as a reference site as well as mitigating liability toward other parties.

3.7 Should the Council choose not to act as a reference then future sales realised by the third-party with that customer would result in no referral commission being paid to Enfield Council. In all other circumstances, regardless of whether the third-party asks the Council to act as a reference site or not, any customer purchasing one of the agreed IT solutions from the third-party, or any of their subsidiary, related organisations, or licensees, will result in the agreement being enforceable, and an on-going annual commission be payable to the Council.

3.8 Given that agreements stipulated with third parties are revenue generating, they will be predicated on the Council having autonomy of choice over whether to act as a reference. Additionally, no service will be provided to the Council by the third parties as part of this agreement, nor will the Council make any payments to those third parties in relation to these agreements. As such EU procurement rules do not apply.

3.9 Since the referral commission is independent of any other organisation there are no other dependencies that could affect their payment. Measures will also be taken to avoid liability to either the Council or the IT company for sales made by those third parties.

3.10 Enfield will, through the IT company, manage any intellectual property rights to council-specific business processes developed by IT specialists working for the Council. Any such processes will be separate to the aforementioned agreements and subject to copyright registration on a case by case basis. For the avoidance of doubt, as the existing digital

platform and underlying IT software is dependent on third party products, it is not the intellectual property of the Council.

3.11 As the income stream from commercial agreements builds, other elements of the Council's IT service could be moved into the company, so that all IT commercial activity sits in one place. This would include IT subject matter experts providing specialist services and solutions to councils and other organisations.

3.12 Initially, staff may be seconded for a limited time into the company. There is no intention that these staff would ever become permanent employees of the company and well drafted secondment agreements would be in place supporting this arrangement between the company and the London borough of Enfield that documents the secondment. As such, TUPE should not apply to these arrangements.

Delivery

3.13 It is proposed that the IT Company be developed in three phases:

3.13.1 Phase 1 – Start up (Q1/Q2 2017)

- Finance is arranged
- Establish the company, board appointed
- Board approve the business plan
- Sign referral agreements with third-party providers for commission streams

3.13.2 Phase 2 – IT Company operational (2017 – 2021). Company commences operation with details of existing and potential referral agreements and development of the specialist skills and solutions to deliver IT services to customers through to 2021.

3.13.3 Phase 3 – Exit strategy considered (2022) – as further development of the business could become privately financed, the local authority (and any partners that may be on board at the time) will be able to consider the full range of exit strategies linked to return on investment and delivery of strategic objectives at that time. Care will be taken when selecting partners to ensure that Public Contracts Regulations are respected.

3.14 Other shareholders may be able to join the IT company, with terms to be carefully decided on a case by case basis. This will allow, for example, other local authorities to become actively involved in developing a broader digital offering to market.

Benefits

3.15 There are many examples of successful Local Authority Trading Companies (LATCs) such as the Essex Care, KCC Commercial Services, and Kingstown Works Limited. Managed effectively, they can provide significant opportunities for councils to provide better services and drive efficiencies. Other benefits include:

- The ability to trade in the wider market
- Economies of scale and greater efficiency
- Returning revenue to the Council through profitability
- A more commercial culture
- Knowledge retention within the Council, through the company
- A blend of commercial awareness and public sector ethos
- Safeguarding jobs through diverse working and contracts

3.16 The strategic fit of the company with the Council priorities is clearest in the benefits afforded to “Growth and Sustainability”, whereby the Council’s association with the digital platform solution puts in place the foundations for it becoming recognised across the local government sector, giving Enfield a stronger employment and helping to attract inward investment more indirectly by raising the borough’s profile and standing.

Key Steps to Success and Growth

3.17 The key considerations to support the success and growth of the IT company are:

- Ensuring the right leadership team is in place with the drive and ambition to succeed.
- Creating the right culture with a commercial mindset and shared sense of purpose.
- Establish reward mechanisms for attracting and retaining the right people.
- Build customer focus, delivering high quality, value for money services.
- Ensure the commitment of the Council, with on-going dialogue and aligned goals.
- Prepare for growth, diversification and innovation; each opportunity assessed on merit
- Create and promote the brand, through research, marketing and public relations
- Maintain a rigorous control of costs
- Build the appropriate risk management and governance

Governance

3.18 Effective governance is key to protecting Enfield Council and the IT company. A clear governance structure that supports its business and provides surety to Enfield Council in risk management. Key factors include:

- The Council appoints the **executive board of directors** which runs the company.
- Performance and contract management arrangements will need establishing between the Council and the company. It is proposed that the responsibility for the exercise of the Council’s shareholder role (which shall include the right to vote in meetings of the company and to exercise any rights afforded to the Council in the management agreement (if applicable), or the company’s articles of association, shall be delegated to the Director - Finance, Resources and Customer Services in consultation with the Assistant Director Legal & Governance.
- The shareholder(s) receive a bi-annual report from the executive board.
- The shareholder(s) will evaluate the effectiveness of the board and its delivery of strategic objectives on an annual basis.
- A forward plan of audits will be agreed on an annual basis.
- A register of interests and potential conflicts of interest will be maintained by the company.
- A decision on proportionate repatriation of company profits to the Council. It is proposed that the company maintains sufficient profits to cover operating costs, audits, and a marketing budget, with other profits repatriated or reinvested in the company, dependent on the shareholder(s).
- As the market proposition develops and the customer base expands, further investment in the development of the company may be considered by the shareholder(s) using, for example, loans to fund expansion.
- The Council will initially retain any assets and the company will pay a fee for their use. Once the company has achieved a full year profit, this approach may be reviewed by the executive board.

3.19 Following a positive Cabinet decision on this paper, the IT company can be established to lead delivery of commercial IT services. Only one resource will be required to be funded from the outset, for management, marketing and coordination of relationships with third parties and their potential customers, all others coming on board once the first referral agreement begins to deliver an income stream. It is estimated that the full year cost of start-up, marketing and operating costs should not exceed £250,000. A loan facility for this funding will need to be established.

3.20 The IT company will be set up conventionally as a company limited by shares so that the legal constraints on it are minimised and to sustain the confidence of funders, private sector partners, shareholders and customers. To protect the IT company's ability to evolve towards a national services provider, and simplify its contracting arrangements, it will be an arm's length local authority controlled company.

3.21 The Executive Board of Directors will include a Managing Director, Board Director, Company Secretary and one or two non-executive directors with relevant IT technical and marketing experience.

3.22 Further detailed steps that will need to be taken to ensure appropriate governance include agreeing the board chairman, board composition, operational plans, service and financial reporting, risk management processes, legal and human resources processes, audit requirements and stakeholder committee reporting.

3.23 From a contractual perspective, the Council will grant the company a licence to use intellectual property rights in its name and logo for the purpose of negotiating agreements with third parties. It will also offer the company all assistance required (in terms of access to the software and to relevant individuals at the Council) to allow the Company to enter into agreements with those third parties as a reference site and will approve a scope within which the company may make statements about the Council and its use of the System. Payment terms would need to be agreed between the company and the Council for payments of commission received by the company.

3.24 The company will enter into arrangements on its own behalf with third party software providers in which it agrees to act (or rather, agrees that the Council will act) as a reference site for that software, agrees to allow access to the software and allows the provider to promote the software by reference to the Council.

3.25 In return for the access and references provided by the Council (via the company), the company will seek an ongoing commission on all sales by the software provider to the public sector. The intention would be that such commission would be paid to the company regardless of whether or not the Council or the company have been instrumental in introducing the supplier or whether the customer has used the reference. The amount of the commission is to be negotiated with the software supplier.

4 ALTERNATIVE OPTIONS CONSIDERED

4.1 Alternative options were considered in Cabinet Report 32 on 7 July 2016. Those have since been further developed with the final three options described below.

4.2 The first option: **"Do nothing"**, avoids any risk and offers no income stream for the Council, missing the opportunity to generate income. Doing nothing does not help relieve the pressure on overall funding for Council services.

4.3 The second option: **"Establish an IT company to build, market and support products and services"**, offers the highest potential financial return but, at the same time, the highest risk of financial loss. Guidance from the Finance department states that a company set up by

the Council would need to pay off start-up loans within a few years and from thereon in, be financially self-sustaining. Based on projections of costs and sales, the company would not be able to achieve this, as the combined start-up and running costs would exceed income for up to four years. Furthermore, the bulk of costs from year one onwards were deemed to be running costs which the Council would have to fund using revenue, not capital. In the worst-case scenario, were the company to not sell any product or service, the losses would be in the region of £1m to £2m over three years.

4.4 The third option: “**Establish an IT company that negotiates income generating agreements with commercial organisations and provides specialist services to other public bodies**”, offers a lower return than the second option but minimises the risk of any financial investment or operating loss. Guidance from the Legal department, suggests the following approach: any interested third-party would sign an agreement, with the IT company which recognises the value of the Enfield Council brand, providing the IT Company (who would in turn pay the Council) with a commission for all income related to sales of the Enfield digital platform, including related products and specialist IT services, and annual renewals in perpetuity, to new local government customers. This approach offers a faster route to market. It also potentially generates the greatest income at any point considered over the first 5 years of operation of any of the three options considered. It does not preclude development of products and solutions at any time in the future, which opens new markets and/or broadens existing ones.

5. REASONS FOR RECOMMENDATIONS

5.1 In recommending option three, at section 4.3, the two key considerations are:

5.1.1 Council has developed, as part of the Enfield 2017 programme, with the support of third parties, a reputation in local government for having a digital platform that could be easily adapted for other councils. This know-how and reputation can be leveraged to generate an income stream for the Council over the next five years. Market interest and discussions with various commercial organisations suggest that this is possible, and negotiations with some of those organisations are under way to enable this to happen.

5.1.2 The income from referrals together with specialist IT services provided directly by the company would offset some of the future financial pressures on the Council.

6. COMMENTS OF THE DIRECTOR OF FINANCE, RESOURCES AND CUSTOMER SERVICES, AND OTHER DEPARTMENTS

6.1 Financial implications

6.1.1 The recommendation in this paper sets out the opportunity for the Council to exploit its investment to generate a sustainable income source for the Council. As stated in recommendation in section 2, approval is sought to form the IT Company to enable the Council to receive income in the form of referral fees and through the provision of specialist IT services to other organisations. Start-up costs, including company formation, legal advice and contractual agreements are projected to be less than £50,000. Running costs are projected to be in the region of £200,000 for the first year. These costs will need to be covered by a working capital loan from the Council initially, with income streams offsetting these by the end of the first full financial year of operation.

6.1.2 Full details of the commercial arrangements with third parties are being finalised.

6.2 Legal Implications

6.2.1 Section 1 of the Localism Act 2011 (“2011 Act”) provides local authorities with a general power of competence (“GPOC”). Section 1(1) of the 2011 Act provides that a local authority has the power to do anything that individuals generally may do, provided it is not prohibited by legislation. The GPOC provides the Council with the necessary power given that in to utilise the GPOC the Council would have to do so through a company for a commercial purpose.

6.2.2 In accordance with the 2011 Act, the Council can set up a company under the Companies Act 2006 to do, for a commercial purpose, that which it is empowered to do under the general power of competence.

6.2.3 The proposed arrangement with the third-party company is not captured by the Council’s Contract Procedure Rules (“CPRs”) which apply to “the procurement by the Council, of Works, Supplies and Services ...” (CPR 1.1) nor is the arrangement captured by the Public Contract Regulations 2015 which apply to contracts where there is a “pecuniary interest concluded in writing between one...economic operator(s) and one...contracting authority and having as their object the execution of works, the supply of products or the provision of services” (Regulation 2(1)).

6.2.4 The Council is satisfied that the proposed arrangement with the third party, as envisaged by the Council, would appear to be a pure income-generation arrangement, with the Council paying no fees to the third party nor receiving a service from them. Instead, the Council shall receive a portion of the income generated by the third party’s sale of its own product, assisted in such sale by the allowance of the Council (as and when it deems it to be in its interests to do so) to use its site as a (sale) reference site. Considering this, the Council is satisfied that the arrangement can proceed without the need to go out to procurement.

6.2.5 The initial establishment and development of the company will be undertaken by the Council, establishing a company limited by shares for the development, ownership and operation of IT specialist services and brand commission referrals. External specialist legal advice will be sought to support this project (to consider procurement, state aid, etc. issues that might arise). An external legal firm will be appointed by LBE in accordance with the Council’s Constitution. All of which will be closely managed by the in-house Legal team.

6.2.6 The Council must be mindful of the rules with regards to State Aid. Any services, rights or property provided by the Council must be provided at a commercial rate or exemptions to the extent available will need to be utilised to avoid issues of State Aid.

6.2.7 The company will be set up in accordance with the Companies Act (2006) (as amended), including the appointment to the Board of the company. All legal documents, including any agreements that are entered because of the setting up of a company, will need to be in a form approved by the Assistant Director of Legal and Governance Services.

6.3 Property Implications

6.3.1 None arising directly from the decision in this Cabinet paper.

7. KEY RISKS

7.1 Like all issues and decisions the Council faces, there are risks and opportunities provided by this paper. The risks and opportunities will be managed using a risk register that will be reviewed at each FRCS departmental risk management meeting, with appropriate

mitigating actions and controls put in place and/or adjusted as necessary as the risk pattern changes over time.

7.2 Key risks identified for the recommendation are:

- 7.2.1 **Product lifecycle** – like all IT products, timescales for development, sales and implementation are short, and there is a limited timeframe within which sales can be generated without the need for further updates or development. The know-how developed by Enfield is no different, and, if the Council is to get a financial benefit from its earlier investment, it must move quickly to establish the Company and enable the income/royalties to be collected from partners.
- 7.2.2 **Potential market interest** – early estimates suggest that whilst there are over 400 councils in the UK, around 125 currently use the Microsoft platform upon which the digital product relies, and therefore may be interested in adopting the solution. The arrangements with potential suppliers enable a royalty from each of their customers to be returned to Enfield, and that royalty would be based on a percentage of the overall sales value of the products. In addition, through a limited company vehicle, Enfield Council would be able to provide direct specialist services to those same customers, further enhancing the income stream to the Council. The benefit of this approach being that the specialist IT aspect would come with a low investment profile for the Council, being based upon services rather than products.
- 7.2.3 **Competition** – although the products Enfield has developed are at present unique, other companies are developing similar products and, as with the product lifecycle, the Council must move quickly if it is to mitigate this risk.
- 7.2.4 **Know-how** – in developing the specialist solutions, the knowledge of marketing needed, the relationships with vendors, customers and the general reputation and technical know-how of key individuals is especially important in the first few years of operation of the company. Establishing commercial tie-ins mitigates the risk of losing that expertise and know-how.

8. IMPACT ON COUNCIL PRIORITIES

8.1 Fairness for All

By generating income for the Council through the sales of the IT platform, the need to make financial savings elsewhere in the budget to manage within the available resources reduces and, therefore, increases the possibilities for ensuring all customers within the borough are treated fairly by maintaining a wider range of services than would otherwise be possible.

8.2 Growth and Sustainability

Development of the Council's association with the digital platform solution puts in place the foundations for it becoming recognised across the local government sector, giving Enfield a stronger employment and helping to attract inward investment more indirectly by raising the borough's profile and standing.

8.3 Strong Communities

Additional income for the Council helps to maintain key services in our local communities, so helping them survive and prosper.

9. EQUALITIES IMPACT IMPLICATIONS

9.1 Formulating a third-party agreement to commercialise the digital platform does not create any equalities-related issues. However, should the IT company be formed at some point in the future, full equalities impact assessments will be undertaken. Similarly, although not the subject of this report, any restructuring of teams will be fully compliant with the Council's employment relations policies and practices, including equalities.

10. PERFORMANCE MANAGEMENT IMPLICATIONS

10.1 None arising from this report.

11. HEALTH AND SAFETY IMPLICATIONS

11.1 None arising from this report.

12. HR IMPLICATIONS

12.1 None arising from this report.

13. PUBLIC HEALTH IMPLICATIONS

13.1 None arising from this report.

14. BACKGROUND PAPERS

14.1 None