Appendix B - Key Service Delivery Options Models for Insourcing

Option 1 - The Direct Labour Organisation

Table 1.1 – SWOT Analysis of Direct Labour Organisation

The Direct Labour Organisation (DLO)	
Strengths	**Weakness**
Maintains living wages and terms and conditions of employment	Does not generate profit
Maintains close control by the Authority over services to manage future changes	Does not generate community value and local economic development
Traditional methods of generating savings or economic benefits	Difficult to drive service improvement at lower cost
Certainty of delivery arrangements	Lacks flexibility and adaptability of the private sector
Reactive to customer and stakeholder needs	Can be management heavy
Tried and tested governance structures	Industrial disputes
Opportunities	**Threats**
Develop strong client role	Timeliness of third party negotiations preliminary to contract expiry (including an option for contract extension)
Performance framework can drive quality of delivery	Direct affect of pension and other costs attributable to transfer of workforce and single status
Payment mechanism can incentivise effective delivery	Fleet transfer or procurement arrangements
Develop charging arrangements for discretionary services to cover (ring fenced) costs of delivery such as trade waste collection and garden waste.	Failure to meet budget savings targets due to cost structure.
Business Considerations	

The DLO arrangement is simpler to arrange and more closely allies traditional service delivery structures.

It is more likely to meet the Council's "go live" date of December 1st 2017 although there remains a risk that third party negotiations and data provision may cause delays outside of the control of the project management team.

The business case revolves around the greater capacity to protect labour working conditions as there will be equality of status between the DLO workforce and other Council workers.
The Council also retains strong centralised control of the operation through direct management and traditional governance structures. This has the benefit for enabling the DLO to respond efficiently to changes in service delivery requirements and finance and budgets have the advantage of greater transparency.

The financial appraisal in Appendix A demonstrates that DSO / DLO would not be able to provide the savings needed in the short, medium or long term to equate to the same savings delivered through an outsourced contract and therefore might not necessarily provide 'Best Value' to the Council. This is due to considerations of the workforce and the ability the DSO has with powers to charge for discretionary services it provides although the power is limited to cost recovery only.

Option 2 - Local Authority Trading Company

Table 1.2 – SWOT Analysis of a Teckal Company

Teckal Company	
Strengths	**Weaknesses**
Economies of scale and greater efficiency	Can be loss making
Return profits to Authority	Implications of cash flow which may be negative
Creates greater commercialism	Risk Exposure
People knowledge retained in the Authority	Cannot trade or charge for core statutory services
Retains Authority control on delivery and maintains public ethos	Non - "Teckal" contracts can only be awarded on tender.
Jobs are safeguarded as work and contracts diversify	Over bureaucratic governance detracting from an appetite for commercial risk.
"Teckal"[1] arrangements simplify EU procurement rules- but only for public services	"Teckal" arrangements must satisfy the "control" and "function" tests. Only 19% of the activity can be in the open market.
Opportunities	**Threats**
Entry into "Teckal" arrangements to deliver public services on behalf of other authorities as shared services	Legal complexity especially for "Teckal" arrangements increases risk of challenge.
Wider private sector trading activities	Trading Losses / Rules on State Aid
Profit generation	Under capitalisation
Increased innovation	Taxation
Simplified procurement of supplies	Risk averse governance
	Lack of commercial knowledge
	Current review of commercial waste provision means there could be impact on likely income generation through such a venture
Business Considerations	
The business case for setting up an Local Authority Controlled Company (LACC) revolves around its scope to trade- generating profits and surpluses that can offset the costs of other Council services. As a commercial enterprise the LACC must set up in accordance with UK company law and there are a number of different structures that can be utilised. This will require expert advice. It will need to be run by a board of directors in accordance with its articles of association (its governing document) and also company law. The directors of Teckal companies often consist of Council officers, members (although this is slightly less common) and also independent directors with commercial experience from the private sector. Consideration will need to be given to the most appropriate governance structure in which decisions are made and monitored. Those who do become company directors will need to be aware of the duties imposed on them by the Companies Act 2006. The key duty in the context of a local authority-owned company is the duty to exercise independent judgment: the director must act in the best interests of the company. A "Teckal" structure will allow it to undertake Council work directly without tender and it may undertake a limited amount (20%) of private work at a profit. However if it wishes to grow beyond this then it will be required to restructure wholly as a private company obliged to seek work under tender. EU procurement and State Aid rules are sufficiently complex to require expert support as otherwise the arrangements may be open to challenge. There also considerations in relation to distortion of the local market which must be undertaken. Undertaking trading activities implies risk. These must be understood and there is a requirement to develop a robust business case under the 2003 Trading Order. The business case is a comprehensive statement needing approval before the Council can exercise its trading powers. The business case will set out the business objectives, resources required, the risks and their significance, and the financial parameters in full. In setting up the Teckal Company the Council must recover all costs associated with accommodation, goods and services, staff and anything else it provides. It must fully consider the implications of State Aid. Other important legal, commercial and financial factors will be considered such as considerations in relation to company law, cost of bidding for contracts and tax liability. It is essential that prior to setting up there is a business plan – this will be developed and delivered by the strategic client (Environment team) and the Commercial / Managing Director of the Teckal Company.	

Project Management Appraisal of In-house Delivery Options

Table 1.3 below sets out the range of issues and risks implicit within the project to insource for the preferred options of “DLO” versus “Teckal Company”. The critical factor for project consideration is the outlook of each option in meeting the “go live date” of Nov 1st. The table highlights the competing complexities of each preferred option with “DLO” as less complex whereas “Teckal Company” is much more complex. “Teckal Company” is more complex because it has a range of issues needing building in as preliminary steps prior to making a final decision and this will affect the lead time.

Although “Teckal Company” is less complex there is a medium risk that third party negotiations (with Amey) could drag on the project: especially in relation to preliminaries such as a contracts review, agreement of a handover protocol, fleet issues and TUPE. Delay in these negotiations could be to the favour of the existing contractor as it may seek to profit from the delay by agreeing costly terms which may be exacerbated if the Council seeks an extension late in the day. As a result it is Officer’s view that where this is an identified risk there should be an appropriate mitigation. In this case the appropriate mitigation advised is to seek an early agreement for an Option to extend the contract in the event that there is delay.

With respect to the “Teckal Company” it is likely that the development of a robust business case and business plan will take 12- 16 weeks to draft and seek the necessary sign off and approvals. There will also be a considerable period required for drafting and approving the constitution of the Company within the project and a necessary period for training of staff and commencing development of the new commercial culture. These periods would be in addition to the potential “drag” identified in relation the development of the “DLO” and equally affecting the period of an “Teckal Company” development. There is a high risk that the development of an “Teckal Company” at the outset will not be achieved by the December 1st date and on the same grounds outlined for the “DSO” it is the officers opinion that a period of at least a 9 month extension should be considered for negotiation with Amey early and as a necessity.

If the project due to these identified factors is unable meet the December 1st “go live” date and no contingency is in place then there are two undesirable and unmitigated risks.

1. The Council is exposed to excessive demands for continuance of the service
2. The Council is exposed to critical service failure.

As a result it is considered by officers proportionate to seek either an extension of contract (as a necessity for Teckal Company) or as an option for a “DSO”

Table 1.3 - Project Delivery Risk Considerations					
Direct Labour Organisation			Teckal Company		
Issue	Risk	Mitigation	Issue	Risk	Mitigation
Project Management and resources	Insufficient commitment of resources will lead to high risk of project failure	Robust project plan and sufficient resources committed to project management and support	**Project Management and resources**	Insufficient commitment of resources will lead to high risk of project failure	Robust project plan and sufficient resources committed to project management and support
Insufficient appraisal of options	High risk that decision makers are insufficiently informed	Robust option appraisal	**Insufficient appraisal of options**	High risk that decision makers are insufficiently informed	Robust option appraisal
Charging limitations	Low risk of alignment of charges to Council policies	Within publication of fees and charges	**Failure to scope out full range of required trading activities**	Low risk that trading and charging policies are not sufficiently comprehensive and aligned to trading activities	Trading and charging policy review
SLA development	Medium risk of uncertainty and dissatisfaction over service quality and arrangements to Council "client" departments	Agreement of SLA's	**Failure to develop a robust business plan**	High risk of business failure	Develop business plan
Training and development	Medium risk of poor motivation of staff	Training and development plan	**Management and work force development plan**	Medium to high risk of business failure or compromise due to lack of commercial approach and low levels of satisfaction or motivation.	Ensure recruitment, retention and development practices are in place and fit for purpose.
Lack of stakeholder engagement	Low to medium risk of resistance	Communications plan	**Lack of stakeholder engagement**	High risk of resistance Medium to high risk of dissatisfaction	Communication plan
Service planning	Medium risk failure of engagement with client services and quality of	Service planning in conjunction with client departments	**Failure to make adequate business case**	Medium to high risk of challenge	Develop robust business case

	delivery				
Professional Advice	N/A	N/A	**Failure to appoint required experts**	High risk that arrangements are unfit or do not function well	
Time scale impacted by speed of 3rd Party negotiations	Medium risk that TUPE and fleet transfer issues may slow pace of project.	Early contact with Amey to formalise handover protocol. Negotiation of option to extend as contingency	**Time scale impacted by speed of 3rd Party negotiations** **Complexity of legal arrangements**	Medium to high risk that TUPE, fleet transfer issues and other legal complexities may slow pace of project.	Early engagement with Amey to formalise handover protocol Early recruitment of expert, legal, financial and taxation consultants Negotiation of option to extend existing contract as a contingency
Human Resources and Organisational Development	Failure to build commercial culture, build commercial skills, develop staff, focus management and create shared values of purpose	Business development plan builds in lead time for skills acquisition and organisational cultural development.	**Failure to build commercial culture, build commercial skills, develop staff, focus management and create shared values of purpose**	Medium to high risk of business failure	Training and development plan
Pension Costs	Access arrangements to Local Government pension scheme	Adequate budgetary provision to meet shortfalls under harmonisation provisions	**Access arrangements to Local Government pension scheme**	High risk that pension costs fall to the Council Length of time admitting to scheme.	Early engagement with pension planning
Vehicle, plant and equipment strategy	Small to medium risk of failure to identify requirements in time to enable procurement and ongoing maintenance operations	AMEY inventory/ schedule of assets including fleet, plant and equipment Build in service change requirements Fleet maintenance agreement or in house	**Vehicle, plant and equipment strategy**	Small to medium risk of failure to identify requirements in time to enable procurement and ongoing maintenance operations Small to medium risk of failure to support new contract demands or	AMEY inventory/ schedule of assets including fleet, plant and equipment Build in service change requirements Fleet maintenance agreement or in house

		arrangements		downsize when required	arrangements Flexible strategy to meet changing contract demand
Financial Budgets	Small risk that budgets will become reliant on charging arrangements with limited scope for income generation	Prudent financial modelling at zero base.	**Financial Budgets**	Medium risk that company is loss making	Business case supports institution of trading company. Robust business plan. Recruitment of commercial minded senior management team Sufficient working capital
Governance Arrangements	Little risk of loss of oversight.	Ensuring subject specific committee or board arrangements are in place.	**Governance Arrangements**	Small to medium risk that governance arrangements are not fit for purpose due complexity of trading structure.	Expert advice on appropriate governance structures.
Contract Management	Medium risk that control structures are not sufficiently in place to monitor performance and quality standards	Development of client structures and performance and payment frameworks	**Contract management**	Medium risk that control structures are not sufficiently in place to monitor performance and quality standards for in house contracts Low to medium risk that performance and quality standards do not support a successful trading regime.	Development of client structures and performance and payment frameworks Governance arrangements will monitor trading activities.

Appendix B – Financial Delivery Options Appraisal for Outsourcing, Teckal Company and DSO with workforce variations

Option 1 - Teckal Company

Teckal Company	Revenue	6% Cumulative	NPV 6% Discount Rate	3.5% Cumulative	NPV 3.5% Discount Rate
Turnover	12,000,000.00	7.36	0.00	8.32	0.00
Overarching Savings	(3,200,000.00)	7.36	(23,552,000.00)	8.32	(26,627,200.00)
Pension Costs	550,000.00	7.36	4,048,000.00	8.32	4,576,550.00
Increased Local Overhead	200,000.00	7.36	1,472,000.00	8.32	1,664,200.00
Purchasing Power	100,000.00	7.36	736,000.00	8.32	832,100.00
Legislative Compliance and Employer Training	100,000.00	7.36	736,000.00	8.32	832,100.00
Control of Labour Costs	500,000.00	7.36	3,680,000.00	8.32	4,160,500.00
Client team Costs	125,000.00	7.36	920,000.00	8.32	1,040,125.00
One Off Overheads	100,000.00	0.94	94,300.00	0.97	96,700.00
Reduction Overheads Business Planning	(500,000.00)	7.36	(1,847,750.00)	8.32	(2,170,800.00)
Additional costs to generate income	100,000.00	7.36	736,000.00	8.32	832,100.00
Income Generation	(1,200,000.00)	7.36	(8,832,000.00)	8.32	(9,985,200.00)
Total NPV			**(21,809,450.00)**		**(24,748,825.00)**

Notes:

1. No adjustment for Inflation
2. Under a Teckal Structure the council may undertake work directly without tender and it may undertake a limited amount (19%) of private work as profit. Would there be any VAT implications under this structure? Would the trading company need to register as a Company in its own right?
3. Assumed Pension Costs average of £300k-£800k range
4. Assumed Income generation £1,200,000 per annum
5. Assumed additional costs to generate new income £100,000 per annum
6. Control of Labour Costs- £50k year 1, increasing £50k per annum

Option 2 - Teckal Company - Income Generation 1% Increase

Teckal Company	Revenue	6% Cumulative	NPV 6% Discount Rate	3.5% Cumulative	NPV 3.5% Discount Rate
Turnover	12,000,000.00	7.36	0.00	8.32	0.00
Overarching Savings	(3,200,000.00)	7.36	(23,552,000.00)	8.32	(26,627,200.00)
Pension Costs	550,000.00	7.36	4,048,000.00	8.32	4,576,550.00
Increased Local Overhead	200,000.00	7.36	1,472,000.00	8.32	1,664,200.00
Purchasing Power	100,000.00	7.36	736,000.00	8.32	832,100.00
Legislative Compliance and Employer Training	100,000.00	7.36	736,000.00	8.32	832,100.00
Control of Labour Costs	500,000.00	7.36	3,680,000.00	8.32	4,160,500.00
Client team Costs	125,000.00	7.36	920,000.00	8.32	1,040,125.00
One Off Overheads	100,000.00	0.94	94,300.00	0.97	96,700.00
Reduction Overheads Business Planning	(500,000.00)	7.36	(1,847,750.00)	8.32	(2,170,800.00)
Additional costs to generate income	100,000.00	7.36	736,000.00	8.32	832,100.00
Income Generation	(1,200,000.00)	7.36	(12,382,320.00)	8.32	(14,196,600.00)
Total NPV			**(25,359,770.00)**		**(28,960,225.00)**

Notes:

1. No adjustment for Inflation
2. Under a Teckal Structure the council may undertake work directly without tender and it may undertake a limited amount (20%) of private work as a profit. Would there be any VAT implications under this structure? Would the trading company need to register as a Company in its own right?
3. Assumed Pension Costs average of £300k-£800k range
4. Assumed Income generation £1,200,000 per annum
5. Assumed additional costs to generate new income £100,000 per annum
6. Control of Labour Costs- £50k year 1, increasing £50k per annum
7. Assumed Income Generation 10% of Turnover year 1, increasing by 1% per annum for ten years

Option 3 – Outsourcing

Private Company	Revenue	6% Cumulative	NPV 6% Discount Rate	3.5% Cumulative	NPV 3.5% Discount Rate
Turnover	12,000,000.00	7.36	0.00	8.32	0.00
Overarching Savings	(2,455,000.00)	7.36	(18,068,800.00)	8.32	(20,428,055.00)
Pension Costs		7.36	0.00	8.32	0.00
Increased Local Overhead		7.36	0.00	8.32	0.00
Purchasing Power		7.36	0.00	8.32	0.00
Legislative Compliance and Employer Training		7.36	0.00	8.32	0.00
Control of Labour Costs		7.36	0.00	8.32	0.00
Client team Costs		7.36	0.00	8.32	0.00
One Off Overheads		0.94	0.00	0.97	0.00
Income Generation		7.36	0.00	8.32	0.00
Profit Share	(400,000.00)	7.36	(2,944,000.00)	8.32	(3,328,400.00)
Total NPV			**(21,012,800.00)**		**(23,756,455.00)**

Notes:

1. Overarching savings in middle of range identified
2. Assumed Profit Share 8% of turnover
3. No adjustment for Inflation
4. Assume profit share £400,000. Contractor receives first 5% of profit. SBC and Contractor receives 50% of any profit above 5%

Option 4 – DSO Single Status

DSO Single Status	Revenue	6% Cumulative	NPV 6% Discount Rate	3.5% Cumulative	NPV 3.5% Discount Rate
Turnover	12,000,000.00	7.36	0.00	8.32	0.00
Overarching Savings	(3,200,000.00)	7.36	(23,552,000.00)	8.32	(26,627,200.00)
Pension Costs	550,000.00	7.36	4,048,000.00	8.32	4,576,550.00
Increased Local Overhead	200,000.00	7.36	1,472,000.00	8.32	1,664,200.00
Purchasing Power	100,000.00	7.36	736,000.00	8.32	832,100.00
Legislative Compliance and Employer Training	100,000.00	7.36	736,000.00	8.32	832,100.00
Control of Labour Costs	500,000.00	7.36	3,680,000.00	8.32	4,160,500.00
Client team Costs	125,000.00	7.36	920,000.00	8.32	1,040,125.00
One Off Overheads	100,000.00	0.94	94,300.00	0.97	96,700.00
Reduction Overheads Business Planning	(500,000.00)	7.36	(1,847,750.00)	8.32	(2,170,800.00)
Income Generation		7.36	0.00	8.32	0.00
Profit Share		7.36	0.00	8.32	0.00
Total NPV			**(13,713,450.00)**		**(15,595,725.00)**

Notes:

1. Assumed Pension Costs average of £300k-£800k range
2. No adjustment for Inflation
3. Control of Labour Costs- £50k year 1, increasing £50k per annum

Option 5 – DSO 2 Tier Workforce

DSO 2 Tier Workforce	Revenue	6% Cumulative	NPV 6% Discount Rate	3.5% Cumulative	NPV 3.5% Discount Rate
Turnover	12,000,000.00	7.36	0.00	8.32	0.00
Overarching Savings	(3,200,000.00)	7.36	(23,552,000.00)	8.32	(26,627,200.00)
Pension Costs	481,250.00	7.36	3,542,000.00	8.32	4,004,481.25
Increased Local Overhead	200,000.00	7.36	1,472,000.00	8.32	1,664,200.00
Purchasing Power	100,000.00	7.36	736,000.00	8.32	832,100.00
Legislative Compliance and Employer Training	100,000.00	7.36	736,000.00	8.32	832,100.00
Control of Labour Costs	437,500.00	7.36	3,220,000.00	8.32	3,640,437.50
Client team Costs	125,000.00	7.36	920,000.00	8.32	1,040,125.00
One Off Overheads	100,000.00	0.94	94,300.00	0.97	96,700.00
Reduction Overheads Business Planning	(500,000.00)	7.36	(1,847,750.00)	8.32	(2,170,800.00)
Income Generation		7.36	0.00	8.32	0.00
Profit Share		7.36	0.00	8.32	0.00
Total NPV			**(14,679,450.00)**		**(16,687,856.25)**

Notes:
1. Pension Cost 12.5% lower than Single Status
2. Control of Labour Costs Contingency reduced by 12.5%
3. No adjustment for Inflation
4. Control of Labour Costs- £50k year 1, increasing £50k per annum

Ranking

Option	NPV 6%	NPV 3.5%	Rank
Trading Company	(21,809,450.00)	(24,748,825.00)	2
Trading Company with Income Generation increasing by an additional 1% per annum for 10 years	**(25,359,770.00)**	**(28,960,225.00)**	**1**
Outsourced to a new Supplier	(21,012,800.00)	(23,756,455.00)	3
DSO Singles Status	(13,713,450.00)	(15,595,725.00)	5
DSO Second Tier Workforce	(14,679,450.00)	(16,687,856.25)	4