European Services Strategy Unit
(Continuing the work of the Centre for Public Services)

UNISON Barnet: Future Shape of the Council Programme

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Briefing No. 7

The impact and performance of management buyouts, social enterprises and mutual models

Introduction

There is renewed interest in management buy-outs (MBOs), social enterprises, the 'John Lewis' model and other mutual forms of ownership as an alternative to outsourcing or 'partnerships' with private contractors.

The Briefing draws on historic and recent evidence because the current promotion of 'alternative' privatisation is not new. MBOs and cooperatives were promoted in the 1980s and more recently leisure trusts. Different economic conditions prevailed at the time, all the more reason for drawing on the performance evidence base. The Briefing examines:

- Management Buy-Outs
- Social enterprises
- Leisure Trusts
- Key issues for Development and Regulatory Services

The wider issues arising from the role of social enterprises, cooperative and MBOs in delivering public services will discussed in a later briefing.

The Director of Planning, Housing and Regeneration has indicated that a management buy-out could be part of the first stage of Future Shape consisting of Development and Regulatory Services (building control and structures, land charges, planning applications and enforcement, environmental health, crematoria/cemeteries, trading standards and licensing, street numbering).

Clarity between in-house bids and privatisation

All of the above options will transfer a service from the public to the private sector and thus will be privatisation. The form of private ownership, for example whether it is a public or private company, a cooperative, mutual, social enterprise or some other non-profit organisational model is a secondary matter. The fact of the matter is that the ownership of assets and employer responsibilities will transfer to the private or voluntary/third sector.

An in-house option should be based on proposals for the future of the service taking account of future demand for the service, innovation, service improvements, staffing requirements and workforce development. An in-house bid should contain more detailed proposals and is prepared by existing management and staff and submitted to the Council on the same basis as other bidders. It should therefore be clear that none of these models - management buy-out, mutual or social enterprise - constitute an in-house bid.

A procurement process will still be required, irrespective of an MBO or social enterprise option. However, the MBO/social enterprise option effectively means that there will be NO in-house bid.

Key issues for Development and Regulatory Services

Barnet's proposed Development and Regulatory Services project currently employs 194 staff with an annual gross expenditure of £10.8m, annual income of £7.8m leaving net expenditure of £3.0m (Barnet LBC, 2010). Salary costs are £5.4m plus pension costs of £1.7m, thus staff costs are 66% of gross expenditure.

A number of key issues are relevant:

- Staff would transfer to the MBO or social enterprise – there have no examples of secondment. A commitment to TUPE Plus and LGPS pension provision would be essential.
- Existing management transfer too – if there are questions about lack of trust and/or lack of experience and skills to manage in a new environment then these will have to be addressed by the new organisation.
- A new organisation will require substantial financial resources – a ten-year contract would be about £100m in value (gross expenditure).
- Significant financial risks – for example if the Council is unwilling and unable to meet the net expenditure of £3m per annum then the MBO or social enterprise will be forced to take radical corporate action as a stand alone organisation.
- It is important to ask what competitive edge would an MBO or social enterprise have over the large private firms operating in this sector?
- No organisation can stand still, even if it does not seek to expand or diversify, and it will need a flow of funds to re-equip, retrain staff and install new ICT systems.

None of these issues should cloud the fact that promoting an MBO or social enterprise model is advocating privatisation.

> ***"Becoming a social enterprise in any format is not a fail-safe recipe for success or even for survival. Future revenues cannot be guaranteed, nor can terms and conditions of employment be set in stone. Job security will depend on business success, on winning and retaining services in the face of diverse and increasingly effective competition. So the starting point for any in-house provider should not perhaps be concern over the merits of alternative corporate structures but rather a clear eyed analysis of how successful the organisation might be, whatever form it took"*** (Newchurch, 2006).

Management Buy-Outs

A Management Buy-out (MBO) is the purchase of a service or business by its management, usually in cooperation with a private equity provider such as a bank or other financial institution.

In most buy-outs the management team received a disproportionately large equity share (more than 50 per cent in four-fifths of the cases), made possible by heavy reliance on debt finance (Thompson et al, 1990). Banks and financial institutions require regular reporting and scrutiny of performance. Non-managerial employees may directly purchase shares or via an employee share ownership plan (ESOP) which establishes a trust fund to buy the shares and subsequently distributes them as the enabling loan is paid off by members' savings (Ibid). Managers will also benefit most from subsequent acquisition of the company.

"To September 1994 there had been 38 buyouts from local authorities, 26 of which had been completed between 1988 and 1990. After this period the number of transactions fell because of bad publicity over problem cases and the Audit Commission report on local authority buyouts entitled `Public Interest or Private Gain'" (Frier and Birley, 1999).

The number and value of management buy-outs from government, local authority or other public sector bodies have constituted a tiny fraction of management buy-outs in the last decade. Table 1 shows that the highest percentage in the number of buy-outs was 0.4% in 2003. The privatisation deals by value between 2000-2009 were zero except for 0.1%, 0.7% and 0.3% in 2003, 2005 and 2007 respectively (CMBOR, 2009).

Table 1: **Source of Management buy-outs/buy-ins in UK – Number (%)**

Source Group	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009***
Family & private	27.1	27.6	29.0	25.2	32.2	32.6	37.2	41.2	41.7	23.3
Foreign parent	7.8	10.0	10.0	8.1	8.0	7.6	6.2	6.2	7.3	6.8
Local parent	41.6	36.6	28.7	29.6	22.1	20.8	21.4	18.7	17.8	22.2
Privatisation	**0.0**	**0.2**	**0.0**	**0.4**	**0.1**	**0.3**	**0.0**	**0.1**	**0.0**	**0.0**
Public buy-in (majority stake in publicly quoted company)	0.8	0.3	0.2	0.4	0.4	0.0	0.0	0.1	0.2	0.0
Public to private (share offer for publicly quoted company, then goes private)	6.7	5.1	3.4	5.0	2.7	2.9	3.6	3.6	2.9	4.5
Receivership (buy-outs from failed companies)	4.2	9.9	11.9	9.9	9.4	9.2	8.0	4.8	11.2	31.8
Secondary buy-out (business acquired, existing funder exits)	4.8	5.1	10.1	8.6	12.8	14.1	14.6	18.9	11.9	6.2
Unknown	6.9	5.2	6.7	12.8	12.4	12.6	9.0	6.4	6.9	5.1
Number of deals	**627**	**648**	**641**	**717**	**712**	**697**	**691**	**673**	**578**	**176**

Source: Centre for Management Buy-Out Research, University of Nottingham, 2009. * First 6 months

Two other trends are apparent. Firstly, the flow of MBO deals has slowed dramatically in 2009 primarily because of the global economic crisis and recession. Secondly, the number of buy-outs from failed companies soared from 4.2% in 2000 to 31.8% (18.8% by value) in the first half of 2009.

Local Authority MBOs in practice

"*So far there have been 11 in white collar services and 12 MBOs in manual services. Few have survived for more than a couple of years. Of these 21 MBOs, two failed very rapidly with huge debts – CSG Bath and Cambridge Information Technology Systems. Prime Contractors Ltd and Serco Northants are now in majority control of Serco, a private company actively seeking public sector contracts.*

Another takeover of MBO Circ Leisure by Citygrove, shows the vulnerability of MBOs ……Two MBOs set up by West Wiltshire District Council were taken back in-house following a highly critical auditor's report revealing a series of illegalities in the establishment of West Wiltshire Information Systems and Wilkie Maslen.

The majority of MBOs have failed to expand in spite of their move into the open market and 'liberation' from local authority control."

Competitive Tendering Strategy Handbook, GMB, NALGO, NUPE, TGWU, 1993 by Centre for Public Services.

Strict rules must be enforced to ensure that those setting up an MBO do not use Council facilities in the establishment of the organisation.

Social enterprises

Social enterprises are organisations that are run along business lines, but any profits are reinvested into the community or service developments. There are four main types:

- co-operatives and mutuals (worker cooperatives, social care cooperatives and social employment cooperatives, social firms and mutual organisations);
- trading voluntary organisations;
- intermediate labour market organisations;
- community businesses, particularly in the most severely disadvantaged areas.

The government has defined a social enterprise as:

> *"Social enterprise is a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners.*
>
> *Social enterprises tackle a wide range of social and environmental issues and operate in all parts of the economy. By using business solutions to achieve public good, the government believes that social enterprises have a distinct and valuable role to play in helping create a strong, sustainable and socially inclusive economy"* (UNISON, 2007).

There is a variety of legal models which include Community Interest Companies (CICs), a form of limited liability company, and other options such as industrial and provident societies UNISON, 2007).

Many social enterprises are successful but every venture takes on risks.

Ealing Community Transport was regarded as a highly successful social enterprise that had expanded its range of services. However, this changed in 2008. ECT Recycling was *"loudly heralded as a flagship venture in social enterprise, has just been through a near-death experience and has effectively been saved by the private sector"* (Macalister, 2008)

> *"ECT's diversified growth was financed through borrowing and uncontrolled losses within the rail business put a severe strain on resources within ECT. Our banking arrangements were with the RBS, so when they were under their own pressures, the bank withdrew its credit facilities in early 2008.*
>
> *In June 2008, a white knight in the form of May Gurney bought out ECT's debt and recycling & engineering businesses. The rail business was eventually disposed in September 2008 and the health provision became independent. In March 2009, ECT ceased operating its sole bus service on behalf of Transport for London"* (Ealing Community Transport, 2009).

ECT were forced to restructure and closed the recycling, engineering, bus, community rail and healthcare subsidiaries.

The government is encouraging the formation of social enterprises to takeover Primary Care community services. There are distinct differences between establishing a social enterprise to develop a new service and 'grow' a new organisation in contrast to taking over an existing service, particularly large well-established services with statutory duties and commitments.

Social enterprises are faced with a number of threats and opportunities. The promotional win-win publicity needs to be balanced with the recognition that they confront certain obstacles. As part of that re-balancing, the findings of a Newchurch briefing on social enterprises in the NHS is stated below. It simply compared the disadvantages of social enterprises with their private sector competitors and concluded:

- *"Limited access to capital, with no ability to raise equity, there is a reliance on debt, with only a restricted range of providers prepared to lend, particularly where security*

against any assets may be difficult and of course debt funding carries with it a cashflow penalty.

- *Difficulty under public sector procurement rules in meeting the often applied 'economic viability' test.*
- *Slow or confused decision making, constrained by the need to take into account non-commercial issues and to consult a widely based and diffuse ownership*
- *Limitations on their ability to change their service portfolios so that they may become condemned to continuing to provide services at uneconomic costs.*
- *Additional regulatory and governance costs.*
- *The increasing threat of litigation, deterring managers, members and directors and encouraging them to seek the protection of a limited liability structure.*
- *The difficulty in reforming labour practices in organisations where incentives and sanctions maybe restricted"* (Newchurch, 2006).

Leisure trusts

By 2006 there were about 90 leisure trusts operating either one, a group or all local authority leisure services. Most leisure trusts are companies limited by guarantee (67%) or industrial and provident societies (24%). They operate on a not-for-profit basis with most registered as charities. The local authority usually leases premises to the trust on a long-term lease, typically between 10 and 25 years, in return for a nominal rent. Staff transfer the to the trust under TUPE.

- Virtually all the savings come from rate reductions and VAT savings, which are much smaller initially because of the high set up costs.
- Direct democratic control of the service will cease - elected member representation on a trust is limited to less than 20% of the board. Company law requires that Board members must put the interests of the leisure trust before those of the local authority.
- After a year the Trust will usually cease to use council services and will be responsible its own procurement and contracting or corporate and other services.

At least four Leisure Trusts have failed:

Bristol trust collapse: Despite the fanfare surrounding the launch of the Bristol Community Sport (BCS) trust in 1997, the council's Best Value Review and the Audit Commission inspection in 2002 were a damning analysis of leisure services. Leisure was described as a 'service of two halves' – poor quality facilities (managed by the trust) and innovative sports development (provided by the council).

East Herts Leisure Trust and **Enfield Leisure Trust collapse:** Enfield Leisure Trust went into liquidation on 4 September 2006. Its subsidiary, East Herts Leisure Trust, trading as Aspire Leisure Trust, had a contract with East Hertfordshire DC that had a £500,000 deficit in the first year of a five-year contract. East Herts Council were forced to terminate the contract and transfer the service and jobs to Stevenage Leisure Trust (East Herts report – www.european-services-strategy.org.uk).

Chiltern Leisure Trust: Chiltern District Council had to write off £1.2m and terminate the trust in 2004 after it had submitted a business plan to the Council to reduce its mounting debts since its formation in 2000. However, the trust sought an increase in the management fee to £672,000, which the council rejected.

Greenwich Leisure Ltd was one of the first leisure trusts to be established in the early 1990s and is widely quoted as being a highly successful "innovative staff-led leisure trust." However, a number of important issues, particularly regarding accountability and control, were identified in UNISON's study of leisure trusts a few years later (UNISON, 1998). It is a management-led

leisure trust and has established itself as a London-wide leisure contractor bidding for contracts whenever they arise.

It has leisure contracts in Barnet, Camden, Ealing, Greenwich, Hackney, Hammersmith and Fulham, Lambeth, Merton, Newham, Sutton, Tower Hamlets and Waltham Forest.

Greenwich Leisure won some contracts previously outsourced to other private contractors. Some UNISON branches reported that Greenwich Leisure's initial approach appeared more positive, particularly with regard to pensions. However, a different picture later emerged and a different employment picture to that presented by Greenwich Leisure and advocates of the leisure trust model. London UNISON branches reported in 2007 that:

- Many of its employment practices and attitudes to trade unions mirror those of private sector mainstream leisure contractors.
- The level of trade union organisation in leisure services in local authorities where Greenwich Leisure has contracts was, with a couple of exceptions, very low.
- One contract reported that only 20% of staff transferred to Greenwich Leisure were still employed by them.

"Being taken over by GLL is just as bad as any private company. They like to portray themselves as being different as they are a "not for profit" organisation but their management style is the same as any hostile, anti-trade union, private sector employer."

"Greenwich Leisure effectively, does not recognise trade unions. They don't negotiate about anything…….This is a company which has no respect for TUPE."

UNISON, London Borough of Newham.

"At the point of transfer they appeared very good and supportive but as time has gone on they have stopped communicating with us."

UNISON, London Borough of Waltham Forest

There have been problems with reductions in staffing levels, cuts in terms and conditions and increased casualisation of the workforce in many other leisure trusts (European Services Strategy Unit).

Audit Commission research concluded that "the transfer of facilities to trusts has assisted councils to avoid the payment of non-domestic rates. This has potentially released funds for much needed local investment. However, our research has found that the re-investment of significant levels of savings in sports and recreation provision is infrequent. Where taxation savings are re-invested they have tended to support maintenance budgets rather than assist significant and often needed rationalisation and improvement of provision" Audit Commission, 2006).

An Audit Commission analysis of 84 inspection reports on local authority sports and leisure services showed that 6% of directly delivered local authority services were excellent compared to 0% of trusts; the comparable figures for good services were 37% compared to 30% of trusts; 60% of trusts were judged to be 'fair' compared with 52% of directly provided services; and 0% of the latter were considered poor compared to 10% of trusts (Audit Commission, 2002). On the basis of these samples Leisure Trusts were not performing as well as local authority in-house services.

Table x: **Audit Commission findings 84 inspection reports on local authority sports and leisure services**

Rating	Directly delivered leisure services	Leisure trusts
Excellent	6%	0%
Good	37%	30%
Fair	52%	60%
Poor	0%	10%

Source: Audit Commission, 2002.

The later Audit Commission report compared the performance of in-house managed services, trust and private contractors but used only a few criteria. There was little difference in participation rates; in-house services required higher subsidies (although the comparison did not take account of tax advantages of trusts and differences in the type of facilities); the cost per head of population was highest for in-house services and lowest for private contractors; in-house services had the lowest swimming charges in London (Audit Commission, 2006).

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