

Commercialisation and scrutiny:
a practical guide for councillors

principles commercial **accountability**
scrutiny deliver **review** commerc
transparency governance **structure**
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a practical guide for councillors
knowledge responsibilities informatio
structure **understanding** commitment **max**
learning systems approach **focus**

About this guide

This guide provides practical advice to councillors on the issues arising from councils' moves to become more commercial and entrepreneurial in the way that they work. It aims to help them to use their scrutiny role to hold to account, and to support, councils' work in this area by suggesting four steps that councillors can take to explore and investigate matters relating to commercialisation, namely:

- Step 1: taking action to inform how a council is developing its overall approach to commercialisation;
- Step 2: testing your understanding of local people's needs;
- Step 3: designing governance into new systems;
- Step 4: ensuring that members have the rights to access information in a way that engages with their roles.

This guide applies principally to English councils, although we anticipate that there may be useful learning here for councillors in other UK jurisdictions.

Why should scrutiny be involved?

Commercial activity in councils is not new. Councils have, for example, been using fees and charges as a method to bring in income for many years; many councils are also large commercial landlords. What is different about these moves to commercialise – as we will go on to discuss – is that they have as much to do with changing the overall mindset of the organisation as they do about setting up new commercial ventures. A council attempting to commercialise without addressing this issue of mindset – encompassing issues around risk, oversight, the nature of decision-making and the scope of delegation, amongst other things – will find it difficult to recognise some of the major benefits.

Commercial activity can bring big opportunities for councillors and local areas, including making key services more sustainable, and more responsive to the needs of local people. It can also introduce risk. This can be around commercial imperatives and the council's wider objectives pulling the organisation in different directions, as well as potentially through the change in formal governance systems which oversee such activity.

Councils may consider that the presence of commercial structures which may be subject to company law¹ – and the presence of councillors on Boards, or other kinds of executive-side oversight – are sufficient for strong governance. However, scrutiny – depending on its design – will contribute something distinctive and unique.

Our work starts from the premise that **scrutiny can “own” the oversight of governance of commercial activity** – ensuring that systems and processes are set up and function in a way that is robust, linking together other components of the governance framework and identifying any gaps. It also rests on the idea that **culture and mindset** are central to making a success of commercial activity.

Members on the executive side are involved and engaged in governance in other ways of course – and have a key role in setting the direction on commercialisation (as well, most likely, in respect of governance of company Boards, where relevant). But there is a need for clear ownership of governance itself, and it makes sense that this ownership should sit with scrutiny rather than being the responsibility of decision-making members whose roles on the company Board, and at the council, could lead to the impression that they are conflicted when it comes to stewardship of the whole system.

We think that there are four steps that scrutiny can take to oversee, investigate and support commercial activity.

- Step 1: taking action to inform how a council is developing its overall approach to commercialisation;
- Step 2: getting a sense of local people's needs;
- Step 3: designing governance into new systems;
- Step 4: ensuring that members have the rights to access information in a way that engages with their roles.

The distinctive factors that scrutiny can bring to bear on commercial activity through engaging at each of these four steps is:

- Challenge about the fundamental purpose of commercial activity – ensuring that expectations have been set early and that mindset and attitude are central to the shift towards commercial approaches;

¹ Although as this paper goes on to consider, not all commercial activity is focused on the creation of structures subject to company law. More detail on company structures can be found on p 17

- Bringing to bear direct knowledge and understanding of the needs of local people – and meaningful, independent democratic oversight – because of members’ unique credibility, legitimacy and insight derived from their representative role;
- Helping to design systems for commercial activity which are accountable, transparent and which intelligently involve local people (as well as involving scrutiny itself);
- Ensuring that day-to-day information access and transparency arrangements are robust – working against the temptation to rely on “commercial confidentiality” to exclude information;
- Bringing to bear effective scrutiny of the governance system, and services substantively, on an ongoing basis.

Part of this guide is about introducing decision-makers and others with executive responsibility to these key justifications for scrutiny’s involvement with a view to changing minds, and fostering a more open approach to such involvement.

Scrutiny around these arrangements has tended to focus on the question, “how do we hold these structures or organisations to account?”. This is what we call institutional accountability – focusing on the governance, priorities and work of a particular organisation. This is problematic in two ways:

- Such attempts at scrutiny may duplicate existing governance processes – in the case of companies, they may replicate what happens in Board meetings and work undertaken by company non-executive directors;
- Activity which councillors may wish to scrutinise may be restricted for reasons of “commercial confidentiality”.

It is likely to be more productive to focus on outcomes for local people; outcomes to which these bodies and organisations contribute. For scrutineers, this requires knowing and understanding the networks within which the council operates with these bodies². The power of scrutiny may lie less in traditional accountability, and more in its convening power.

For these reasons, standalone scrutiny reviews “of commercialisation” may be useful only in narrow sets of circumstances – for example, where scrutiny is assisting in the design of a new operating model. At other times scrutiny is likely to want to keep a watching brief and to exercise a risk-based approach to how it intervenes – in line with scrutiny of other issues. Substantive matters relating to outcomes for local people will occasionally need to be escalated to committee – when those matters are discussed, commercialisation will be part of the context for the discussion but is only likely to be “front and centre” in as much as it is influencing the delivery of outcomes for local people. We discuss these factors in more detail in step 3 of this guide.

² APSE, “Bringing order to chaos” (2018), <https://www.apse.org.uk/apse/index.cfm/research/current-research-programme/bringing-order-to-chaos-how-does-local-government-hold-to-account-agencies-delivering-public-services/> (Accessed 20 February 2020), p14

Step 1: taking action to inform how a council is developing its overall approach to commercialisation

Scrutiny councillors are likely to want to get involved as the council itself considers a shift in the way it carries out commercial activity. This section explains how a council might go about setting objectives for this activity – and the way in which it might consider the need for a change of culture and mindset in how it works as a consequence. Culture and mindset is a theme that runs through our approach to scrutiny and our sense to the contribution that scrutiny is able to make.

This section also explores how, practically, councils are articulating their change in approach. This change will often not be something as explicit as the council announcing that it is moving to a new model, or adopting a very different approach. Often, change may be incremental and involve an evolution in how the council works.

In summary, it is particularly important that change, whatever form it takes, recognises the need for:

- clear objectives – a vision for what commercial activity is likely to achieve for the area;
- a change in culture – recognising the constraints of prevailing culture and benefits of a mindset change;
- an appropriate understanding of risk;
- an understanding of the need to empower staff.

Making sure there are clear objectives for change

Objectives can include:

- Increasing earnings through better use of fees and charges;
- Increasing earnings through more intelligent use of council assets, including investment;
- Engaging in trading activity, by setting up a trading company which may sell services to others, or taking part in a joint venture.

Overall scrutiny will need to address questions like:

Does the council understand what it means by commercialisation?

In its plans, has the council begun to address issues around:

- Ensuring that planned activities align with the needs and expectations of local people (which we will deal with in more detail in step 2)
- Capability (which we will deal with in more detail in step 3)
- The appetite for risk (which we will deal with in more detail in step 3),
- The need for the leadership to understand and set the right behaviours
- The need for the developing and fostering of a culture more open to innovation?

These are the critical, foundational issues on which scrutiny is most needed.

The most robust and sustainable commercial approaches have been taken by councils who have alighted on these approaches as a mechanism to deliver the organisation's core objectives³. This by definition involves a shift in the council's overall operating model – a sense that change and transformation not only to the way that the council works, but the way that those in the council think, is critical in order for those objectives to be met. In these councils, commercial activity is not a bolt on, carried out in order to allow the council to continue with “business as usual”.

We believe that these changes can bring opportunities – but they also bring risk, around the fragmentation of accountability. Ownership of governance and accountability in a new system needs to be clear – there is collective responsibility but one individual or group needs to exercise leadership. For councils going down this road, we suggest that this leadership be provided by scrutiny, and that this first step – councillors reviewing and getting a sense of the framework within which the council's activities are sitting – is a critical one.

Avoiding adopting the prevailing culture - recognising and acting on the need for a shift in mindset

Councils have engaged in relationships with external providers for thirty years. This started with “contracting out”. More recently, commissioning – a more sophisticated way by which councils have sought to engage in relationships with external providers to deliver local services - has become a feature of local government practice. Many of the structural features of commercial activity are therefore not new to the sector, and this can lull us into a false sense of security when it comes to understanding what commercial activity means for the way that we work, the way councils are organised and the roles of elected members. Some of this hinges on the language that people in leadership positions use to describe commercial activity.

The primary drivers for contracting out and commissioning were the expectation that these ways of working were the primary means to deliver efficiencies, and make services better. Private providers in particular would be more adept at identifying savings opportunities – and those working across multiple councils would be able to deliver economies of scale. The competitive nature of tendering and procurement would drive down costs, and drive up quality.

Many councils – including some comparatively recently – have transformed their operating model to take account of these objectives. We considered the scrutiny implications of these changes in our 2015 publication “The change game”⁴.

These changes have led to significant shifts in mindset and attitude when it comes to governance and scrutiny – and to concerns. Briefly, these are:

- The focus of accountability becomes the relationship between contract managers working for the council, and employees of the contractor/commissioning partner. This relationship is critical, and works differently to the traditional management hierarchy in a council where members and officers both understand their mutual roles;
- Accountability becomes about transactions rather than about vision, outcome and objectives. Contract management becomes about KPIs rather than needs;
- Commercial confidentiality can cloud members' ability to engage in the work of contractors and commissioned partners;
- Providers can misunderstand and/or not engage fully with members' roles.

³ Civica/CIPFA (2019), “The commercial imperative”, <https://www.civica.com/en-gb/whitepapers-value-exchange-block-library/whitepaper-technology-public-service-report22/> (Accessed 21 February 2020); see also CfPS/APSE (2018), “Risk and commercialisation”, <https://www.cfps.org.uk/wp-content/uploads/Risk-and-Commercialisation-2019.pdf> (Accessed 21 February 2020)

⁴ CfPS (2015), “The change game”, <https://www.cfps.org.uk/wp-content/uploads/The-Change-Game.pdf> (Accessed 21 February 2020)

These are all examples of a prevailing culture – a culture that will continue into new commercial models unless active steps are taken to address it. These cultural issues have to be addressed at the very outset, at the design stage.

Sometimes, but not always, these matters can be addressed through the setting out of a clear vision and objectives.

An organisation's culture cannot just be "changed", because an organisation comprises a wide variety of cultures alongside each other – and sometimes coming into conflict. There may be some common values and principles – around accountability, responsibility, responsiveness – but culture and culture are often much more difficult to grasp than leaders imagine. Ways have to be developed to lead to an understanding of how culture change will practically lead to a change in the way that people operate day to day. We explore this in more detail in the section below on "empowering staff".

Moving away from the prevailing culture

The predominant change has to be cultural. Councils have to understand and adopt a "commercial mindset". This can be understood – and tested – by a council's scrutiny function. The following section sets out what seem to be the key components of this mindset. As part of its activity scrutiny can test whether this mindset is indeed present, and how it might need to be developed in order to deliver results.

Setting a vision and understanding changes to mindset

A change in culture brings with it an acceptance and understanding that effective scrutiny and oversight needs to play a part in this vision. Attitudes on these matters has to be set out from the outset.

APSE has said, in relation to arms-length bodies (thoughts that are equally applicable to commercial activity in general) that this brings with it⁵:

- the recognition by councillors that the creation of arms-length bodies does not carry with it an abdication of responsibility
- a willingness on the part of council executives to not only be held to account, but also to give account effectively and openly and be willing to respond to challenge
- the embedding of accountability within the organisation of an arms-length body and a separating of that process from the decision-making process
- easy access to information and to those working within arms-length bodies for councillors charged with ensuring accountability and a willingness to learn from complaints
- an open, communicative, positive and co-operative working relationship between the executive (or leadership) of a council and members outside of the leadership.

The challenge for the council then lies in finding ways to knit these expectations alongside critical, legal governance systems within the council into these new arrangements.

The vision may be there, but a commitment to change must also be present. This is about organisational development, putting the resources in place to make change happen and to move it

⁵ APSE/LGRU (2018), "Bringing order to chaos", <https://www.apse.org.uk/apse/assets/File/Bringing%20order%20to%20chaos.pdf> (Accessed 21 February 2020)

from ambition to reality. Elsewhere, we talk about risks to commercial activity from limited skills within the organisation.

Councils have little capacity for this kind of change now. Councillors will be grappling with a range of challenges and looking for solutions – commercial activity can look like one of these solutions, for many reasons. But it is not a panacea, and this is where matters relating to risk come in.

Questions for scrutiny to ask

Exploratory questions like these might be best asked informally, as policy is being developed. If scrutiny councillors are concerned about one particular aspect as a result of the answers to these questions, they could be dealt with by escalation to committee. Alternatively, if a proposed change is significant and enough time is available, these questions could be the basis for the scope of a task and finish review, to dig in and better understand the issue.

Setting the scene

What is the problem / are the problems we are trying to solve by moving to this new approach?

What is our objective?

Are we trying to increase revenue?

Are we trying to improve services?

Are we trying to make ourselves more responsive and accountable?

Are we trying to decrease risk?

Are we trying to make services more sustainable?

How have we arrived at these objectives?

Setting and testing our outcomes

How do we know that commercial activity, and/or a change in our operating model, will:

- **Help to make the council and its services sustainable?**
- **Help us to work better with our partners?**
- **Help us to be more responsive to local people's needs?**

What are our long term expectations for what this activity will mean for how we work, and for what the local area looks like in future?

Are new commercial investments established on the basis of business cases with a clear and demonstrable return on investment balanced against an informed view of potential risks?

Does commercial activity operate within and support council priorities and policies, such as Social Value?

Understanding how we need to change

How does commercialisation link to wider corporate plans – e.g. Corporate Plan, Corporate Strategy, Asset Management Strategy, Sustainability Strategy etc

How are we articulating these changes, within and beyond the council?

Are we being consistent in how we talk about these challenges and their possible solutions?

Is the organisation creating the mind set and the right environment for success?

Is the Leadership setting expectations about commercial behaviour, for example empowering innovation across the organisation?

Do we have the capability to succeed? Are we challenging, equipping and supporting the organisation to deliver its objectives?

Are we prioritising the best opportunities based on our objectives and delivery of our priorities?

Are our decision-making processes sufficiently agile to exploit those opportunities?

Making sure we use and manage evidence robustly

The following questions might be asked when scrutiny has a better sense of the overall direction of commercial activity, and is trying to understand what evidence underpins that overall objective. They might best be asked of a cabinet member and/or senior officers, to test and evaluate the rigour and robustness of proposed systems – a stress test of plans for governance.

How confident are we that our objectives are fit for purpose in the longer term?

How will we manage shifts in priority over time?

Are our legal, financial, performance and other management systems fit for purpose in engaging meaningfully with these changes?

Are our broader governance systems fit for purpose in this context? How can we use the Annual Governance Statement, and the review which must precede it, as a way to explore these issues further?

What strategic steps have we put in place to address organisational capability and capacity more generally?

How will we formally go about building scrutiny into these arrangements?

Do we have a coherent commercialisation strategy which articulates a common understanding of what the council is trying to achieve and how it is going about it?

Are commercial ventures being established for the right reasons? (i.e. form should follow function – decide what you're trying to achieve and then see which model fits, rather than adopting say a company model without a clear rationale for it)

Developing a keener understanding of risk

We have published research with APSE on risk and commercialisation, which covers these points in more detail⁶.

⁶ Supra, n3

For councils, getting a clear sense about appetite for risk will be crucial in the design stage. Once this is in place, more detailed systems and processes around risk at an operational level – and who oversees and owns those risks – can be set out. But none of that is possible without clear, visible political debate on the matter at the outset.

Risk is complex. People talk a lot about risk aversion in local government. “Risk aversion” may have something to do with councillors’ political sensitivities and priorities⁷ but a restrictive attitude to risk can be just as prevalent in the officer corps. Moreover, it is not necessarily risk aversion but divergence in risk appetite between organisations that presents the biggest challenge.

This happens not because of an “aversion” to risk but a poor understanding of risk – or a range of different understandings that are subjective in nature. So, becoming “more commercial” is not about being less risk averse or having a greater risk appetite, but about appreciating and understanding risk better. In particular, this is about understanding how and where councillors’ legitimate sense of where political risks may arise is fed into the way that commercial activity is designed and managed. This might involve member oversight on:

- the value that you expect to bring to the customer;
- your approach to finding work;
- scenarios relating to specific business risks;
- exit strategies, and what to do in the case of failure or poor performance.

There will be political implications for all of the above, which councillors will need to understand, and which provides councillors with an opportunity to feed their political insights into the planning of these processes.

Understanding risk in a commercial environment also involves understanding the market(s) in which you operate, and ensuring that the risk of overexposure to one particular market is avoided – for example, by keeping a diverse portfolio of investments with a balanced risk profile.

What “risk” looks like in practice

Risk (especially political risk) may look different for different issues. So for example:

- Entering into a joint venture with a neighbouring authority on highways infrastructure may present risk around prioritisation of workload and capacity to manage responsive repairs;
- Insourcing waste and recycling may lead to risks about a failure to find economies of scale in a single-council single-service model, asset renewal for vehicle fleets and risks around transfer and direct management of significant numbers of new staff;
- Making significant capital investment in commercial property raises risks around future rent yield, future land value and potential conflicts with the authority’s own objectives relating to economic development;
- Investing in commercial property or other activity outside your own geographical area may lead to risks around a lack of local knowledge, and commercial activity not bringing about direct benefits

⁷ NLGN (2017), “Commercialisation: minimising the risks and maximising the returns”, <http://www.nlgn.org.uk/public/2017/commercialisation-minimising-the-risks-and-maximising-the-returns/> (Blogpost, accessed 21 February 2020)

for your own residents. Recent investment guidance seeks to clamp down on out of borough commercial ventures which might be seen as risky⁸.

- When considering initiatives such as introducing car parking charges in parks, councils will need to assess the level of impact on the service provision weighed against the potential financial return. Similarly, when establishing new sources of revenue such as advertising, councils need to consider political and reputational risks (for example in having clients who promote unhealthy eating)

Exposure to risk is dynamic. It changes continually, and mitigation measures need to be active, consistent and continuous. In an environment where the acquisition of buildings (including spending on commercial properties) now represents 24% of councils' total spending on fixed assets – and one where revenue profits from commercial and trading activities increased by 36.3% in real terms from 2010 to 2017⁹ – understanding how these fundamental shifts in exposure to different kinds of risk influence decision-making is crucial. And yet only 28% of councils consider that commercial activity is a major risk for them at present¹⁰. Risk is central to the CIPFA Treasury Management Code and MHCLG's Investment Guidance – councils are expected to carry out due diligence and use robust processes where financial and property investment are being used.

Recognising the different risk profile of commercial activity is not the same as saying that this activity is inherently "risky". Indeed, it may be more risky to maintain a traditional local authority operating model in the face of significant future uncertainty on demographics, funding and so on. But understanding and recognising those risks and seeking to mitigate them is critical.

In practice, these risks will be different for every council, and for every venture. But in governance terms they are likely to coalesce in a few connected areas¹¹:

- Risks around risk management itself (as we have discussed above – looseness around risk appetite and a lack of awareness of the impact and likelihood of risks some of which will be novel and outwith the authority's experience). This may also involve inexperienced attempts to transfer risk to new commercial entities, leading to a breakdown in responsibility and accountability for key outcomes¹²;
- The maintenance of transparency. We cover this in Step 3. There may be a tendency to use commercial and company arrangements to limit the visibility of certain activity in a way that is inappropriate. The true costs and value of council services has to be identified and understood as part of strong financial accounting processes to support commercial activity;
- Skills gaps. Councils not considering the change in skills and capabilities needed by a shift to commercial systems and approaches. This reflects back on what we outlined in the introduction about the need for a shift in mindset and culture. Some councils have brought in individuals from outside to head commercial units. This can help, but ultimately a more fundamental understanding of risk and benefit around commercial activity needs to be spread amongst a far wider group of leaders and managers – complemented by drawing in expert external advice. This is a challenge that councils have faced before; outsourcing and contracting led to a reduction in

⁸ CIPFA (2019), "Commercial property investment", summarised in "CIPFA clarifies rules on commercial property investment" (Accountancy Daily, 20 November 2019), <https://www.accountancydaily.co/cipfa-clarifies-rules-local-authority-property-investments> (Accessed 21 February 2020); see also HM Government (2018), "Statutory guidance on local authority investments", https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/678866/Guidance_on_local_government_investments.pdf (Accessed 21 February 2020)

⁹ NAO (2019), "C&AG Report: Local authority governance" p18, <https://www.nao.org.uk/report/local-authority-governance-2/> (Accessed 21 February 2020)

¹⁰ Ibid, p19

¹¹ Ibid, p22

¹² Institute for Government (2019), "Government outsourcing: what works and what needs reform", https://www.instituteforgovernment.org.uk/sites/default/files/publications/government-outsourcing-reform-WEB_0.pdf (Accessed 21 February 2020)

in-house skills relating to outsourced services, which in turn led to weaknesses when engaging in new procurement exercises. Local authorities should have learned lessons from these experiences;

- Greater complexity. We have noted this in the sections above – and it is an issue which we will continue to explore below. The complicating governance features for commercial arrangements themselves may lead to uncertainty. Councils may, for example, underestimate the amount of market analysis they need to carry out to support their objectives and plans, leading to overoptimism. Hence the need to design good governance into the system from the start;

Questions for scrutiny to ask

As with previous questions, these might be best asked in a formal committee context or through a task and finish group. It could form a part of wider scrutiny work on corporate risks – recognising that commercial and other risks are likely to intersect. We provide more advice on scrutiny of risk more generally in “The Good Scrutiny Guide” (2019).

How do we know that we have in place a robust process to handle and manage corporate risks?

How do we know that this process will be able to handle matters relating to commercial activity?

What is the evidence underpinning this activity?

How will information be shared between those involved in commercial activity, and others within the council and other partners, to ensure that this evidence remains accurate?

Do we understand what the greatest strategic risks are to the success of commercial activity in delivering the objectives we have set out?

What is our tolerance for risk, and for failure?

How is this tolerance, and our wider appetite for risk, set? Is it reviewed at appropriate times?

Who “owns” these risks – collectively and individually? What steps are being put in place to understand these risks better, and to mitigate them?

How do we understand how risks interact with each other?

Empowering staff

For commercialism to take hold rather than consisting of marginal tinkering around the edge of council business, there will need to be activity which focuses on the need for organisational development – training staff, building skills and giving people the confidence to act on their own initiative. But this activity has to take place as part of an overall, robust governance framework. We are talking about public money, public services, and the need to have in mind our duties to local people. Scrutiny is well placed to understand these nuances and the potential to result in tension – especially where a council might think uncritically about needing to put in place a “startup culture” to inform how it works. In reality, moving away from old ways of working towards new approaches is neither easy nor quick. Traditional governance structures may be seen as inhibiting new plans and agendas, but care is needed to evolve those structures over the period of transition – above everything else it makes it easier to bring certainty to staff’s relationship with each other, and mutual expectations.

Councils may have little corporate capacity for this kind of culture change activity but it is critical to realising the ambition of commercialisation.

Questions for scrutiny to ask

These questions are likely to be more exploratory, and will tease out issues or concerns about members', and scrutiny's, place within the management of commercial activity. They might best be asked to help scrutiny to understand where scrutiny of a particular substantive issue in future will be appropriate, and how scrutiny can design its interventions to work alongside the shifts in expectations of staff.

How are overall goals set for staff?

How are staff given the space and flexibility they need in order to achieve those goals?

How much trust is placed in staff? How much oversight do they need – from senior managers and from elected members?

Who needs to be involved in decision-making? Who signs things off? Who is responsible?

How are we managing the links, in management terms, between different kinds of commercial activity, and how well do staff understand the links and hierarchies involved?

How are we learning from our experiences? How are we using that learning to influence and inform both how we develop and refine our own plans in the future, and about how we communicate both success and failure to others in our area, and further afield?

Step 2: testing your understanding of local people's needs

Part of a more commercial mindset is about understanding need, and better targeting your services and activities to meet that need. In this section we will consider the needs and demands of customers – and who your customers are. If your customers are local people (and/or if the objectives for commercial activity established at the outset are around making local people's lives better) this is something that needs to be addressed and understood.

Know your customers

What do customers need? What do customers want? These are fundamental commercial questions which have increasingly come to drive how councils do business. But these questions can hide the fact that customers, in the context of council commercialism, may not be the end users of a service.

This may be because a council is purchasing, or selling, commercial services to people who are they themselves providing the service to the public. Or the council's customers may be a subset of the local population – so rather than having the best interests of that wider population in mind, commercial considerations can lead to a focus on the needs of a particular group rather than on the wider populace.

This leads to potential problems around accountability for performance which councils have experienced before – a reduction of important public services to a transactional, customer/provider relationships which can fail to recognise the importance of democratic accountability. Scrutiny can challenge these assumptions.

Questions for scrutiny to ask

These exploratory questions are likely to be best asked informally, and could be used to identify and escalate particular areas of concern for more detailed consideration at committee.

Who will the customers of our commercial activities be?

What do we understand about those customers' characteristics?

If our customers are local people, do we know which local people we are trying to support by addressing this issue?

If your customers are other professional organisations who themselves provide services to local people, what do we understand of their own objectives?

Are there complexities in our customer base, and how we recognise and act on their needs, which might weaken our accountability to local people?

Know your customers' needs

In a commercial environment understanding the needs of your customers and prospective customers is important in being able to tailor your services to meet those needs. For a council operating commercial arrangements this is equally important. Designing those arrangements around local people's needs is a key part of ensuring that they are sustainable.

This is aligned to the points we made in the previous section about vision.

This is about forgetting for a moment your existing service model and thinking about the issue which you are helping local people to try and solve, or resolve. It is that issue – framed by need – which is the starting point for this conversation. But existing methods of service design and delivery can make it very difficult for councils to step outside of their existing assumptions about how this means they have to change.

For councils, as with any large institution, the needs of “customers” are complex. Councils owe a particular duty to these people for two reasons – firstly, some duties may be statutory but secondly, and more importantly, local people are likely not to have a choice, as they might do for more conventional commercial services. As such, being attuned and responsive to their needs is especially important.

Working out where need actually lies can be a complex endeavour, even if you know who your customers and users are. It is dangerous to assume that you benefit from users, or work with local people, who are self-aware, confident and articulate enough to be able to accurately express their needs. This can be exacerbated where councils and other providers fail to recognise the power dynamic between them – as service providers – and local people.

Moving to a more commercial approach precisely means breaking down this traditional dynamic.

Questions for scrutiny to ask

These questions by and large assume that customers are local people, and they reflect the kind of questions that might be asked of a council more generally on its understanding of local people’s needs. Some questions are ones that scrutiny might want to ask local people directly – by participating in wider council evidence gathering activity, or standalone, public-facing scrutiny activity relating to the service in question.

Understanding

How have we sought to understand people’s needs and expectations?

Have we spoken to people and do we understand their needs as expressed in their own words?

What form have those conversations taken? Have we established feedback loops to ensure regular information?

Do we understand local people’s lives enough to understand the context in which these needs sit?

How has that contextual knowledge helped us to go deeper, to get a more fundamental sense of what motivates people both as customers and as citizens?

How do local people get things done under current systems?

Deploying this understanding in decision-making

How do we demonstrate we have used local people’s insights to inform decision-making?

How do we expect a new operating model / a new approach to commercialisation to improve things for local people?

How have we involved local people in challenging and refining these assumptions about improvement?

What do we know about the blockages and frustrations that people feel when trying to engage with us as customers and as citizens?

How will a more commercial approach allow us to be more responsive when we understand these blockages and frustrations?

How are we making clearer to our customers – as part of a more commercial approach – what they can expect from us, and what we might expect from them in return?

Step 3: designing governance into new systems

Good governance has to be designed into new systems in a proportionate way. This includes thinking about how changes in culture and mindset have to be built into the system. In this section we will look at how new systems to support the objectives of commercial activity are built, and how good governance can be designed in to those structures.

At this point scrutiny can start to consider the detail of new systems themselves – the structures, the processes and the relationships which tie them together.

There are a range of commercial structures that councils have established in order to bring about these changes. Some examples include:

- Establishing trading companies. Wholly owned trading companies provide a way for councils to sell their services to other councils, and to other organisations. Councils possess significant expertise on a range of issues; expertise which is likely to have value to others.
- “Insourcing”. Bringing contracted out services back in house provides opportunities to increase accountability, make services more flexible, and keep services efficient.
- Joint ventures. Councils can join with their neighbours and/or other organisations to plan, design and deliver services, or to sell services to others.
- Investment. For a long time, pension funds have invested in things like commercial property – as a solid investment likely to deliver reasonable, and predictable, yields over multiple years. Councils have more recently moved into this space – seeing such investments as a way to deliver wider benefits for the area. Owning commercial property in the area, for example, gives you more levers to pull with regard to economic development and local growth.

These examples are not mutually exclusive; many councils are experimenting with and actively using more than one of them.

Local democracy has to be seen as part of the overall governance framework applying to new delivery arrangements, just as much as it is part of traditional council systems. Otherwise member-led governance will look like a bolt on.

Be proportionate and avoid duplication

We have already talked about scrutiny’s clear role and responsibility when it comes to designing and establishing commercial arrangements. Now we come to the long-term operation of those arrangements, and how scrutiny will be involved on an ongoing basis – on oversight, on review, on improvement. This sits within the context of our overall suggestion that scrutiny exercises, and owns, oversight of the governance systems that underpin commercial activity in general, and that scrutiny focuses its work on mindset and culture.

Success rests on designing scrutiny interventions that fit within the overall governance framework of commercial activity.

A range of ways of working exist¹³. All are likely to involve integrating an understanding of this into wider scrutiny work, rather than trying to embark on separate, distinct “scrutiny of commercial activity”. These ways of working include:

- Keeping a watching brief over service delivered and issues managed through more commercial

¹³ MHCLG (2019), “Statutory guidance on overview and scrutiny”, <https://www.gov.uk/government/publications/overview-and-scrutiny-statutory-guidance-for-councils-and-combined-authorities> (Accessed 21 February 2020), CfPS (2019), “The good scrutiny guide”, <https://www.cfps.org.uk/the-good-scrutiny-guide/> (Accessed 21 February 2020)

means. Ideally, this should be transacted alongside the more general watching brief that scrutiny holds over local services more generally¹⁴.

- Escalating key issues to committee based on risk and the efficacy of existing oversight arrangements. An analysis of risk may lead to concerns from members that existing arrangements are struggling to manage a given issue. Arrangements can be made for scrutiny to pick those issues up and deal with them on a responsive basis;
- Planned, in depth work to contribute to commercial planning. It could be that scrutiny could play an active role in user research, drawing in the insights that councillors will have as representatives of local people. Large companies have non-executive directors whose task it is to bring different perspectives to bear on their Boards' activity – scrutiny can play a similar role. A specific, strategic role for scrutiny will help to anchor the rest of its role, demonstrating through in-depth work that it can make an active contribution. The annual work programming process is likely to give rise to these opportunities – they should be keyed in to commercial strategy in a clearly expressed way.

Questions for scrutiny to ask

These are questions for scrutiny to ask itself, in thinking about its approach towards commercial activity. They can act as useful prompts for conversations between scrutiny and executive about its ongoing role.

How well do we understand the wider governance framework and scrutiny's place within it?

What gaps might exist in that framework, and how might scrutiny be placed to fill those gaps?

How do we know that we are not duplicating governance and oversight systems operated by others?

How does everyone within the system recognise their role, individually and collectively?

How are different commercial activities knitted together at the corporate level, and how can scrutiny use this understanding to assist it to safeguard that framework?

How do we ensure that local democracy and local political accountability continues to sit at the centre of governance systems for commercial ventures and activity?

How do we ensure that the governance for commercial activity does not simply replicate local government systems and processes?

¹⁴ REF

Step 4: ensuring that members have the rights to access information in a way that enables them to add value

Depending on scrutiny's overall role, it will need a spectrum of information in order to effectively oversee commercial activity, as part of its broader scrutiny activity. Once scrutiny's overall role and ways of working have been agreed, it will be possible to consider what information is available, and how scrutiny can get access to use it. In this section we will talk about scrutiny's rights of access to information and about overcoming the pressure to keep certain information sources confidential for commercial reasons. We also talk about drawing in information and insights from other sources – specifically, local people. This links to what we said about understanding needs in step 2.

Part of the previous step was about articulating and agreeing the principle that transparency is important. This step is about unpicking that – on the basis of the foregoing, agreeing exactly what information is required, what members can expect to see and how it will be used.

Understanding what information is out there

The kind of information produced will depend on the nature of the commercial activity in which the council is engaged. Much of it will be similar to information traditionally produced by councils, such as:

- Business plans and strategies;
- Business cases and options appraisals;
- Where relevant, sales and marketing strategies, and commercial strategies;
- Investment plans;
- Operational and delivery plans;
- Risk registers and detailed project plans;
- Performance and finance monitoring scorecards and associated material.

Elsewhere in this document we have mentioned risks around transparency in commercial activity.

Demonstrate your need to access information

This cuts to the heart of the need for a change in mindset if commercial activity is going to drive a council's approach in a way that is meaningful.

The temptation to rely on commercial confidentiality to withhold information which might otherwise be public is significant. Scrutiny's work will be more difficult if it can only access high level or partial information. Below we talk about the specific information that scrutiny might need to see in order to do its work properly – before that can be addressed the central point of scrutiny's rights need to be committed to and agreed.

There are some central principles underpinning members' rights of access to information, particularly as those rights intersect with commercial activity:

- Councils should prepare information in such a way that the risk of necessary commercial confidentiality is reduced – for example, preparing reports and management information to work around this information;

- Councillors are entitled to access information held by the authority even where this information might be commercially confidential. Regulations passed in 2012 grant scrutiny councillors particular rights here¹⁵;
- As a matter of principle it is poor practice to have Part II¹⁶ discussions at formal overview and scrutiny committee¹⁷. Exempt information can be used as part of scrutiny work, but in such a way that conversation around related issues can still be supported to happen in public.

Building a positive mindset involves councils, and commercial activities and entities, challenging themselves and each other over assumptions that information should be exempt or withheld. Commercial entities whose sole shareholders and members are public bodies (and particularly local authorities) might need to recognise, and reflect in their articles of association, a commitment to greater transparency than might be the case for an “ordinary” private company – recognising the flow of public money through their accounts and their need to account for their activity and spending accordingly.

Agreeing the basic principles for transparency is a necessary prerequisite for the next step – detailed discussion of the information that scrutiny needs to access and use in order to be able to carry out its role.

Understand commercial confidentiality and practical access issues

The question is what of this material could be made available to scrutiny members. Making information available to scrutiny members is not the same as making that information public. As noted in the statutory guidance on overview and scrutiny (and elsewhere) general management information from the council and elsewhere can be used as part of an information digest, to which members have regular access, and which can be used to decide what specific issues are then escalated to a committee for more detailed discussion. The way that that discussion is framed can be informed by the commercial sensitivity of the issue in question.

Blanket refusals of scrutiny’s attempt to engage in issues because of a sense that any such engagement is likely to breach rules and agreements around commercial confidentiality are, therefore, likely to be inappropriate. Commercial entities will have to recognise that ownership by a public body means being subject to a degree of public scrutiny; those providing support to such entities will need to think carefully to understand what this means for their day to day work. Scrutiny also has a duty here, to be clear about its own aims and objectives and to think creatively about how work can be designed to reduce the risk of confidential information being made public. Usually, safeguards may involve ensuring that members can have access to certain commercially confidential sets of information – as will be their right – but designing scrutiny’s formal interventions in such a way that means that for most cases, discussion of those matters in committee is not necessary.

Questions for scrutiny to ask

What information is likely to provide members with a sufficiently good overview of commercial activity to carry out their role (that role having already been considered and agreed, as we discuss throughout this report) while not impinging upon or duplicating other elements of the governance system?

¹⁵ The Local Authorities (Executive Arrangements)(Meetings and Access to Information)(England) Regulations 2012: <http://www.legislation.gov.uk/ukSI/2012/2089/contents/made>

¹⁶ That part of council committee meetings from which members of the public can be excluded under Schedule 12A of the Local Government Act 1972.

¹⁷ CfPS (2012), “Your right to know”, <https://www.cfps.org.uk/wp-content/uploads/Your-Right-to-Know.pdf> (Accessed 21 February 2020), see also CfPS (2019), “The good scrutiny guide”

What support do scrutiny members need in order to make best use of this information?

These questions are likely to be used to work through with the executive what information scrutiny should have access to on a regular basis.

What management information is produced on a regular basis to support commercial activity (regular company reporting, for example)?

Who is involved in selecting and designing what information is produced?

How is raw data converted into a form useful to those at a senior level, and who does this?

Who is involved in “owning”, reviewing and holding to account this use of information, and how information flows between commercial entities/activities and the council?

Are there blockages in these flows – for example for reasons of commercial confidentiality – and how are these managed?

To what extent is information, generally, in the public domain?

How does the information we collect and use help us to be responsive – both to our customers and the wider community?

Does this information present us with a partial view of the commercial and community pressures under which we work?

Do these pressures produce tensions between commercial activity and democratic accountability?

How does our attitude and approach to information and its use underpin a different attitude and set of behaviours around commercial activity?

What barriers are there to scrutiny having timely access to information about commercial activity?

What safeguards might need to be built into the way that scrutiny works in order to break down some of these barriers?

These questions can be used to analyse that information once received, and to consider how it can be used to support high quality scrutiny work which makes a difference.

What does this information tell us about need and demand?

What does this information tell us about how responsive we are being to need – and to the risks in not delivering?

What does this information tell us about whether governance and oversight of commercial activity is working as it should?

What does this information tell us about whether there is an issue on which overview and scrutiny can add value?

Is there additional information (from within the council or commercial entity / activity or from outside) that could be useful in our analysis?

Getting external impressions

In step 2 we noted how understanding local needs can assist in the design of commercial approaches. The other side of this coin is about integrating more general insights from local people into the way that scrutiny happens on an ongoing basis.

This information, and these insights, can be used to reflect and improve. A more commercial approach should involve a more responsive attitude to insights emerging from local people. We have already, however, noted the challenges involved in failing to recognise that customers, users and local people may not all be the same people – understanding where insights come from and how they might challenge the commercial assumptions we make is important.

Insights like these may highlight tensions between a council's need to provide high quality services to local people and the specific commercial imperatives of particular ventures (which may be wholly or partly owned by the council). These insights may be one of the only techniques to understand how and where commercial activity, which may work for the council strategically, is having a less positive impact on the ground. Scrutiny councillors have a particular role in using this information because:

- They are often a source of this insight themselves – through ward work and door knocking;
- They have the unique credibility and legitimacy, as elected representatives, to use this information and to challenge the council and its commercial imperatives when these may not be acting in the best interests of local people.

Questions for scrutiny to ask

Again, these questions are likely to be most useful in identifying where and how matters might be escalated for more detailed, formal discussion in committee.

How might officers and commercial partners account for a discrepancy in intelligence they receive through formal routes and intelligence coming to councillors' attention on the doorstep or in surgeries?

How are local people's expectations and needs shifting and how are we responding to those changes?

How are we, in the interests of maintaining a commercial and responsive attitude, actively seeking to understand local people and their needs, and how these may change, on an ongoing basis?

Interpreting information

Once agreements have been reached on the principles underpinning transparency in a commercial environment, what information can be used, and on the availability of that information, thought can turn to the support that councillors will need in order to use that information intelligently.

Here, support is likely to look similar to the kind of support that scrutiny needs in looking at and using any kind of complex technical information. The difference lies in aligning that detailed review of data with an understanding of the commercial imperatives that provide the backdrop for commercial activity. In other words –

- What is our commercial strategy?
- What does this information tell us about that strategy?
- Does that strategy pull our behaviour in different directions, and what does that mean for our responsiveness to local people?
- And what does all this mean for governance?

Appendix: some rules covering commercial entities and activities and their governance

The operation of commercial entities, and the transaction of commercial activity, by local authorities is covered by rules.

Where councils set up trading companies (solely or jointly with others) those companies will be subject to company law arrangements. There is a danger that scrutiny – if poorly conceived or planned – may be seen duplicating or otherwise cutting across these arrangements. An awareness of the rules will help scrutiny to understand where it fits in.

Principal responsibilities are set out in:

- The Companies Act 2006 (for which detailed guidance exists, produced by Companies House);
- The Insolvency Act 1986.

For a council establishing a new company the first structural choice will lie in the decision of whether the company will be limited by guarantee or by shares. A profit-seeking entity is more likely to be limited by shares; a not-for-profit structure will lend itself more to limit by guarantee. This decision will need to be informed by the overall vision underpinning the commercial activity in prospect, as discussed on page 8.

The Companies Act 2006 lays down basic expectations on corporate governance. There is likely to be little productive to be gained in scrutiny “investigating” whether these basic standards are adhered to, because this will be a matter for professional auditors to ascertain. But an awareness of their existence provides a grounding for understanding scrutiny’s role in oversight. In a basic sense, rules include:

- Constitutional separation of powers. A company must have “articles of association” which set out basic procedures around accounts, the roles of directors and arrangements for holding meetings. The Articles will vest management responsibility in the hands of Directors;
- Reference to the roles of shareholder and “members”. Members of a company, rather than its shareholders, are generally those who hold rights in law. Often, shareholders will themselves be members. Members specific powers, and their relationship with Directors, will be set out in the Articles. In a local authority context the council may often be the only “member” and shareholder of a company but joint ventures can complicate the situation;
- Reference to the roles and duties of directors. The key duties for Directors are set out in ss 171 to 177 of the Companies Act 2006 – they are:
 - To act within their powers, ie according to the articles of association;
 - To promote the success of the company – in a way that benefits shareholders but also “success” as defined through a set of other factors. It is in this area that the drivers for a company owned by a local authority may end up diverging from the drivers for the local authority itself, as we discuss elsewhere;
 - To exercise independent judgement. Again, this is something which can be seen as fettering democratic control and oversight of a council-owned company;
 - To exercise reasonable care, skill and diligence;
 - To avoid conflicts of interest;
 - To declare an interest in a proposed transaction with the company.

Governance is subject to a number of national bodies which collectively steward and safeguard the governance system. These arrangements are different for certain companies – for example, larger companies are obliged to comply with expectations set out in the UK Corporate Governance Code, set out by the Financial Reporting Council (FRC). A council may also in the course of its business be obliged to comply with the terms of the UK Stewardship Code. Certain larger companies have greater obligations around reporting - for a council trading company or similar this will depend on the number of employees.

This reflects the position in 2019 – ongoing changes to rules around corporate governance are expected in the coming years. For example, it is expected that the Financial Reporting Council's roles and responsibilities will be transferred in due course to a new Audit, Reporting and Governance Authority (ARGA).

Councils' monitoring officers will be able to provide advice on the rule-based systems underpinning commercial activity, and should be able to work with councillors to understand how they can work within these systems effectively.

It is worth mentioning that many commercial activities will not involve the establishment of company arrangements. Where councils are integrating commercial activity into the structure of the organisation, many of the issues above will not arise – but the council will have to consider and reflect on how the commercial imperative for the service or issue in question aligns with the council's wider priorities. As we discuss in step 2, it cannot be guaranteed that there will be alignment between the two.

Councils seeking to use commercial approaches to (for example) invest in commercial property, or make other capital investments, they have to pay regard to local government rules around investment and borrowing. The CIPFA Prudential Code for Capital Finance in Local Authorities, published in early 2018, requires local authorities to bring balance to their approaches to security, liquidity and return – these are primarily issues of risk management, on which we comment in more detail in page 10.



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