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LOCALIS

The Commercial Edge

Renewing the case for the local
investment state

Executive Summary

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About Localis

Localis is an independent think-tank dedicated to issues related to politics, public service reform and localism. We carry out innovative research, hold events and facilitate an ever growing network of members to stimulate and challenge the current orthodoxy of the governance of the UK.

www.localis.org.uk

About Human Engine

Human Engine is a Financial Times top-ranked management consultancy with specialisms in strategy, people and performance.

It was founded by a group of former local government officers who think the public sector deserves better than it gets from traditional consulting firms – more human, more personal and more knowledgeable of the reality of delivering modern public services.

We have worked with dozens of public sector organisations to help transform their strategies, operations and cultures to be more agile, commercial and entrepreneurial in order to achieve financial sustainability and improved outcomes for local people and communities.

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Executive Summary

Local authorities have engaged in commercial activity as far back as the twelfth century, when King John and the City of London raised revenue from commercial land charges to build London Bridge, through to the heyday of Joseph Chamberlain's Birmingham. Today's councils, however, are operating in a commercial environment that is unique to the here and now. In addition to austere budget cuts, social care pressures and a global pandemic, local authorities are subject to a commercial environment that is made especially difficult by a challenging media narrative, bought into by central organisations, that upholds the idea of council commercialism as inherently risky and morally suspect – continuously looking to make an example of any single local authority that gets it wrong as being applicable to the entire sector.

According to the Institute for Fiscal Studies, the coronavirus pandemic created a “perfect storm for councils, simultaneously increasing spending and reducing revenue-raising capacity”¹. Local authorities have developed their 2021-22 budgets in the context of great uncertainty about how much to expect from central government and where other means of income generation are going to lie going forward. Moreover, the government has so far been adamant that money lost due to commercial investments by local authorities will not be covered by their income compensation scheme². This presents an increasing need for commercial activity to be pursued strategically with caution, meticulousness, accountability and risk management embedded into respective agendas.

At the same time, we have reached a low watermark for political support for councils investing resources in assets or activities that deliver revenue streams to fund vital local public services. By latching onto ‘bad apple’ examples, this media-fuelled narrative depicts council commercial activity as something inherently risky and to be avoided. This is short-sighted and wrong. Undertaken with diligence, professionalism and conviction, commercialism can unlock latent place potential and deliver conspicuous and inconspicuous benefits to councils and the communities they serve. Strong, place-based answers to these questions are becoming increasingly necessary against a backdrop of an unhelpful national narrative and central government moving away from a commitment to the general power of competence.

1. Institute for Fiscal Studies (2020) – COVID-19 and English council funding: how are budgets being hit in 2020-21?

2. Ibid.

Contexts and Drivers

In this pressure cooker environment of increased spending pressures and decreased funding, commercialism has become increasingly prevalent as a means of sustaining income under duress, leading to a combination of demonstrative strategic local state resilience and, on other occasions, risky short-term and short-sighted decisions. These examples are few and far between when considered broadly but have nonetheless been latched onto in the construction of a wider 'bad commercialism' narrative, indicative of a shift in attitude from central government. Evaluations of commercialism *under duress* should not be conflated with evaluations of council commercialism overall – especially when good, resilient commercial practices undertaken by the local state have a very strong historical precedent with a wide range of excellent examples still found to this day.

This change in approach from the centre was typified in early 2021 in the revision of lending terms for the Public Works Loan Board (PWLB). The PWLB review followed on from a pre-pandemic report into local authority investment in commercial property from government spending watchdogs the National Audit Office, which revealed spend on commercial property acquisitions by local authorities in the three years to 2019 had increased by 14.4 times when compared with the preceding three years, with 49 out of 352 English councils accounting for 80 percent of commercial property spending during this time. Under the revised lending terms, council finance directors must in certify that that there is no intention to buy investment assets primarily for yield at any point in the next three years.

These recent shifts in attitude from central government outlined above, including changes in PWLB lending terms, are seen by the sector as a regressive step away from the presumption of a general power of competence introduced in 2011. At that time, amidst the beginnings of a decade of austere budget cuts, local government was told that it needed to be less 'risk averse' and embrace commercialism as means of being more creative and innovative with how they generate income and balance their books. However, with changes to PWLB rules and threats of direct action from MHCLG, it would appear as though central government are beginning to backtrack on this promising principle of decentralisation. This gap in understanding and interpretation of the role of commercialism in public service delivery needs to be closed, with a coordinated effort to build a case for local authorities to have the right to engage in commercial activity.

Challenges Facing Commercialism in Local Government

- 1. Defining commercialism.** Throughout the sector, there is often debate and deliberation around definitions and language, and this is prominent around the notion of commercialism. Establishing a clear view of commercialism can be especially difficult in local government, due to the wide variety of services councils provide. Yet it is important to have a shared understanding of what commercialism means in practice. For council commercialism to become its most effective going forward, there must be a framework for it to ground itself in, attuned to local contexts, articulating these cross-system local priorities into a desired, outcomes-based approach.
- 2. Aligning commercial activity to public value.** Commercial ventures from local authorities are unique in the sense that public value creation, rather than simply focussing on profitability, is an outcome that they should be seeking to achieve. If commercial activity can be centred around creating public value, then residents and other stakeholders can be reassured that a commercial approach is one founded upon achieving better outcomes for residents. Good commercialism should be seen as supplementary to the broader goal of public value creation which, combined with long-term growth strategies and a democratic mandate, makes the local state uniquely patient and resilient when it comes to its value proposition as a commercial partner.
- 3. Commercial governance and managing risk.** Much of being a commercially mature council is about well-practised risk management. Commercially responsible councils need relevant, proportionate governance in place to plan strategically, diversify income streams and mitigate risk. Internal scrutiny (by Elected Members and officers alike) can encourage robust business cases, sound commercial decision making and evidence-based investments. This opens the door to sector-led improvement within local government, with well-run commercial councils reaching out and positively influencing peer councils who are similarly minded, encouraging greater local entrepreneurialism.
- 4. Commercial culture.** Aside from the more procedural practices, such as embedded lines of accountability, dynamic decision-making and a clear role for scrutiny, there must be a clearly defined understanding of the different aspects of commercialism and what they mean to the organisation and locality. This understanding will move councils beyond the oversimplified version of commercialism as being a matter of profit and sales, towards one that is able to balance a genuine commitment to place-based public value creation and maximising commercial potential by building commercial acumen and a commercial culture.

Reframing the Debate

Evidently, the definitions and practices of commercialism are broad and diverse. What can be ascertained, however, are common themes of commercial maturity. These ideas are not new, but bringing together within the given context, the five themes give an understanding on approaches to local government commercialism and will support councils to apply to their place-based priorities:

1. Strategy and alignment
2. Supply
3. Demand
4. Market intelligence
5. Organisational culture

Strategy and Alignment

Commercialism should not be seen as a 'bolt-on', but as a core enabler of a council's strategic plan, alongside community engagement, leadership development, service design, digital, employee experience and its other tools for transformation. Alignment of the organisation's policies, processes and behaviours to a more commercial way of working needs to follow from this because, without the right operating context, a culture of entrepreneurship is unlikely to survive. To fundamentally link commercial strategy to place, an area's assets should be central to its strategy and brand and considered roundly: each area will have its own unique mix of natural assets, built environment, industries, skills and employment opportunities, education, human capital, tourism and partnership dynamics. This is the essence of place-based commercialism.

Supply

Councils spend up to 80% of their budgets with third parties and, despite a trend towards insourcing in some areas, most authorities still deliver most of their services via their supply chains – the value invested in this cannot be neglected. Recognising this, the post-Brexit Procurement Bill positions procurement to deliver public policy objectives including the creation of new businesses, jobs and skills; promoting supplier diversity, resilience and innovation; and tackling climate change and reducing waste. The *Transforming Public Procurement Green Paper* makes the case that councils need to prepare for the opportunities offered by the reforms, with government proposing "a new [central] unit to oversee public procurement with powers to review and, if necessary, intervene to improve the commercial capability of contracting authorities." The Local Government Association's National Procurement Strategy provides a maturity model for procurement in local government. Once the final details of the Procurement Bill are known, this should be updated and accompanied by a cross-cutting commercial skills programme for local government that matches the ambition of central government.

Demand

The concept of demand is more complicated for local government than it is for the private sector in two ways. Firstly, councils must increase demand in chargeable services. This is one of the most traditional definitions of commercialism found across the sector, in which councils generate income through fees and charges, traded services or investment of property or land. Secondly, demand can be about managing down. Not all commercial activity is associated with 'investment' or 'sales'. Dealing and managing demand on high-need high-cost services **is** acting commercially. Although there are two opposite approaches to demand, their key features are the same. Understanding costs is critical to realising the financial benefits of income generation and demand management. Both income generation initiatives and demand management initiatives are not overnight sensations. Successful initiatives require carefully considered business plans, investment and market analysis.

Market Intelligence

Councils are uniquely plugged in to their local communities and local economies. This allows them to build a picture of the market that is both more granular than most national operators could hope to achieve and more strategic than most local organisations can develop alone. This positions local authorities perfectly as intelligent mid-market operators in respect of both buying and selling services. Having worked through the ethical considerations (outlined in detail in the Challenges section of this report) and identified their tolerance of risk, councils should put their data to commercial uses to drive decision-making and demand management, as well as to create systematically collected, refined and applied insights into income generation.

Organisational Culture

A council's commercial culture must be visible both internally and externally. Whilst some portrayals of council commercialism have been unfair, it is undeniably true that there is inherent potential risk associated with commercialism, especially when supported by borrowing and the use of public funds³. In order to allow for tangible local state autonomy in commercial matters, there needs to be a rebuilding of trust facilitated by stronger, more vocal commitments to a change in approach and practice. This starts with a commercial culture that is lived and breathed throughout the organisation internally. The council's commercial ethos and approach needs to be shared to all staff – and in staff inductions – to set the context from the start. This means communicating clearly, consistently and often, explaining how commercial activity is aligned with the organisation's core purpose and support the delivery of place-based public value across the locality.

3. National Audit Office (2020) – Local authority investment in commercial property

Conclusions and Recommendations

There is a tremendous role for commercially minded councils, particularly when considering how to drive, fuel and recover local economies post-COVID. Utilising the Commercial Maturity Model can enable local authorities to assess their commercial strengths, weaknesses, areas for improvements, areas for investment and, ultimately, support the development of their place-based commercial approach.

As the sector leads local recovery from the pandemic, commercial decisions by councils, be that local investment, reshaping contracts to encourage social value or trading services, will influence place-based commercialism and place-shaping.

As such, we have drawn a set of recommendations for each stakeholder group to encourage clear, practical and actionable conclusions from this research.

Recommendations for Local Government Leadership

- 1. Set out your definition and communicate widely.** Be clear how this aligns to the purpose and values of the organisation, adopt a simple statement of policy and communicate with staff, partners and customers.
- 2. Likewise, agree risk appetite and communicate this early.** There is no sense in imbuing staff with the spirits and skills of entrepreneurs then tying their hands with process and rejecting every idea that entails risk.
- 3. Invest in the skills needed to deliver this.** Give your teams the tools and techniques needed to deliver the councils commercial approach and use these skills to add value to public services. This can include softer skills like creativity, adaptability and influencing as well as more traditional commercial acumen such as market analysis, sales and finance.
- 4. Work with partners and drive greater value out of contracts.** Social Value can be a means to delivering public value. Don't underestimate the value that can be harnessed from supply chains and rigorous contract management
- 5. Undertake a self-assessment of your commercial maturity using the commercial maturity model.** Be sure to be check and challenge your own organisation and focus on how commercial activity will deliver the councils public value objectives

Recommendations for Elected Members in Scrutiny Roles

- 1. Understand the drivers, risks and legislative limitations of commercial decisions in your locality.** This includes the reasons behind commercial activity, extent of council powers to do so and how this is applicable to your given locality. This also relates to aligning commercial activity to the council's corporate objectives.
- 2. Have a clear framework for evaluating commercial decisions, including financial and social considerations.** Situations and priorities change and with them so can the impact of commercial activity. But using a consistent framework for evaluation can ensure the council maximising the social return on investment, as well as financial.

Recommendations for Central Government Partners

- 1. Recommit to the principles of the general power of competence** to enable councils the autonomy to act in the interests of their locality.
- 2. Develop a broader understanding of commercialism.** Government has made great strides in sharpening the commercial capabilities of those involved in public procurement. But, for local authorities, commercial activity is much broader than procurement and contract management. At present, there is a risk that local and central government use the same terms to describe different things. A common language will enable better understanding.
- 3. Deepen understanding of why councils are taking commercial decisions by creating a commercial network.** Councils have routinely delivered successful commercial initiatives. There is an opportunity for cross-sector learning to promote and entrench good commercial practice and join the gaps between policy and practice.
- 4. Consider what support could be offered on capability uplift.** Support local government to introduce a sector-led commercial skills programme that matches the ambition of central government training initiatives to position the sector to continue to manage its own commercial activity without the need for intervention.



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