ANNEX A
to Business Case

Options Appraisal

Option 1 – "Maintain"

Summary:

Refine and implement the new operating model for EK Services, exploit the existing digital ambitions as far as possible and seek further funding from councils or, alternatively, reduce costs through staff reduction

Strengths	Weaknesses
Currently very competitive costs	Risk to service, collection levels, error bonus
Mature, stable service offering	Realistic limitation on savings
Nationally recognised, award winning service with a high reputation across the sector	Costs of exit via redundancy
Track record of achieving more for less	Impact on local employment
Good relationship with the 3 councils with a high level of trust	Universal Credit looming so greater redundancies or redeployments ahead. Reducing Admin Grants likely to add further budget pressure
Highly responsive to council requirements	Large increase in charges to Councils if they desire to maintain the current levels of staffing and service quality. This would probably be to the detriment of other council services

Analysis:

As detailed above, the participating Councils have hitherto required EKS to operate within its own fixed budget and therefore inflationary pressure (including pay and contract inflation) means that year-on-year savings between £300K and £500K have historically been needed to maintain the status quo. This will remain and, with a potentially deteriorating fiscal climate, increasing inflationary pressure may add further budget pressure.

If the councils wished to maintain EKS in "steady state" with no further fundamental changes, and based on the assumptions for growth shown below), additional funding of c. £400,000 per year (leading to in an increased expenditure of £2.0m per annum by year 7) would be required, assuming

- employee related inflation of 2% per annum
- other operating cost inflation of 4%[1] per annum

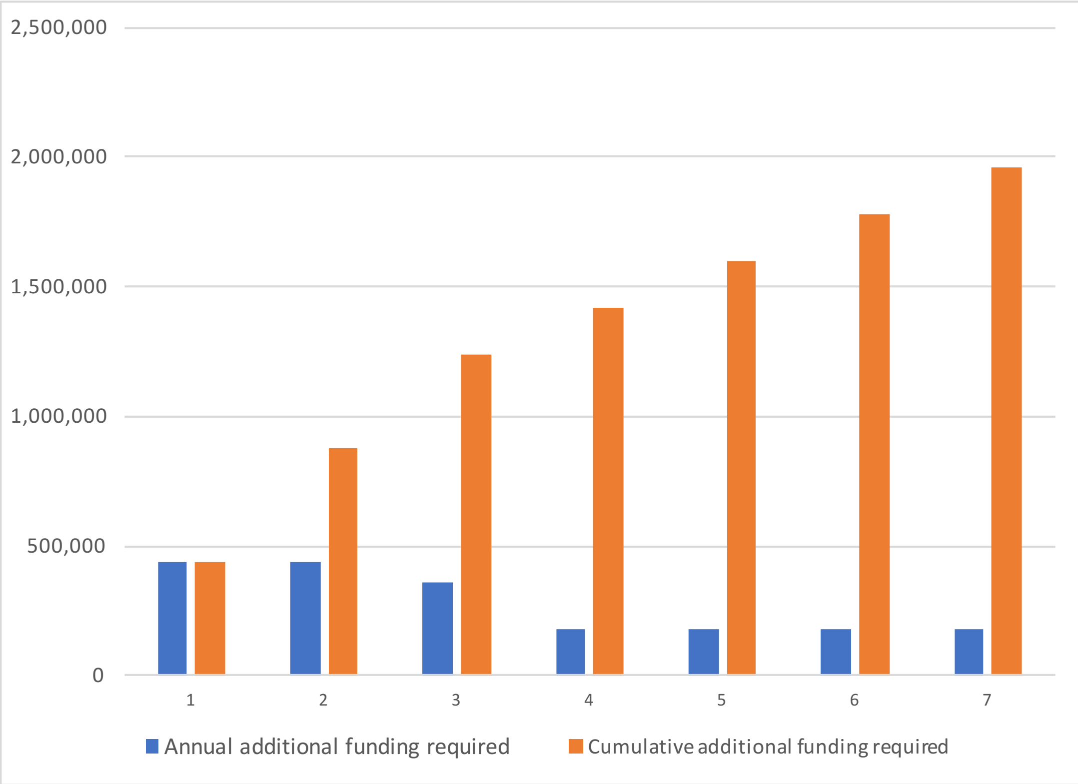

Figure 1 - Additional Council funding requirements to maintain status quo[2]

In reality, the programme of digital work in place within EK Services to move high volume transactional services online (for example the introduction of the IEG4 Digital Benefits product) will result in some modest staff reductions (as these form part of the business case for the adoption of IEG4) but these savings are largely used to offset the increased licensing, support and maintenance costs of the new product suite and should more accurately be viewed as a cost avoidance measure.

Should this increase in funding not be acceptable to the three Councils, EKS would be required to achieve ongoing savings of an equal amount.

[1] *This figure is based on the assumption that support contracts will be indexed against RPI or UK IT industry salary inflation. It also assumes that a percentage of support contracts are priced in USD and therefore subject to exchange rate fluctuation*

[2] *The growth requirement reduces after years 2& 3 due to an expectation of staff reductions as a result of normal efficiency activities and the anticipated changes to Universal Credit delivery*

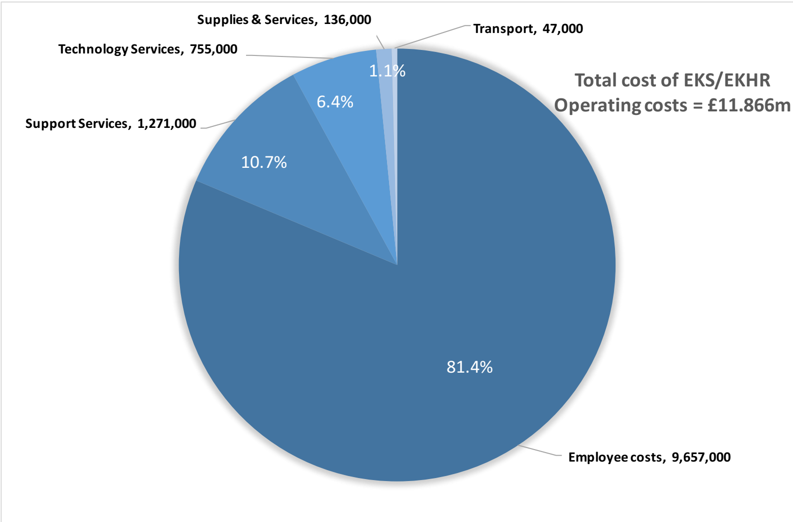

Figure 2 - EKS Operating Costs

Figure 2 outlines the current breakdown of EK Services operating costs. As would be expected, the majority of costs are staff related, with approximately £800,000 of technology and other 3rd party contract costs and £1.2m of support charges (which flow back to the councils providing those services).

On the whole, the scope for compensatory reductions in contract costs is negligible, meaning that the majority of the savings required to "stand still" need to be met from within the EKS staff budget. Assuming:

- the Councils are happy to maintain the current level of funding to EKS
- employee related inflation of 2% per annum
- overall contract inflation of 4% per annum

Savings of around 4% of budget are required year on year. Over a 7-year period, this equates to a 21% reduction in EKS staff - circa 67 posts by 2024/25 (Year 7), profiled as:

- 15 FTE in 2018/19
- A further 52 FTE posts removed over the remaining period to balance budget

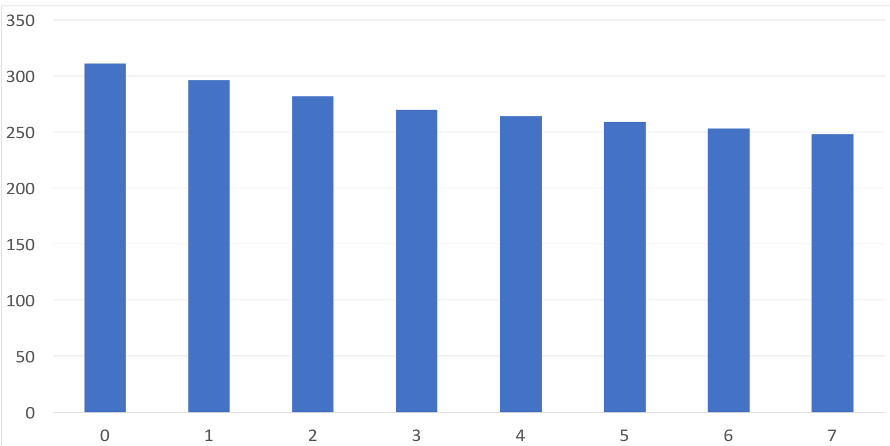

Figure 3-Headcount reduction required for "Maintain"

A reduction in staff of this scale has significant impacts, both on the organisation and the wider local economy. CIPD studies indicate the average cost of making a redundancy is £16,375 – before the cost to the treasury of paying benefits and lost tax revenues, the cost to the economy of lost spending, and the personal trauma. The impact on the residual organisation should not be underestimated – research undertaken by Bain revealed that nearly half of UK organizations have made redundancies and the move proved to be the most damaging kind of workplace change as it undermines morale, confidence, trust and comfort of staff.

Without having precise details of staff involved in any redundancy scenario, it is not possible to give totally accurate figures for the redundancy costs or actuarial strain costs to the pension scheme. However, assuming that:

- 40% of redundancies are Grade F staff, 50% Grade G and 10% Grade I
- Redundant posts are paid at the top of the grade
- The average length of service and age for each grade is:

Grade	Average age	Average length of service
F	43	10
G	46	17
I	46	17

then the costs of redundancy for 67 staff (excluding pension strain impact) could be in the region of £1,200,000.

If the Councils wish to reduce the charges (management fees) paid to operate EKS, as has been the norm over the past six years, further savings would be required above those listed above.

Assuming:

- a continued annual reduction in charges of £390,000 per year[3]
- employee related inflation of 2% per annum
- overall contract inflation of 4% per annum

a 48% reduction in headcount would be required over the same 7-year period to remain within budget (154 FTE members of staff) profiled as:

- 28 FTE in 2018/19
- 27 FTE in 2019/20
- Further 99 FTE posts removed over the remaining period to balance budget

[3] *Apportioned as: CCC: £133k DDC £102k TDC £148k, based on 2017/18 management fees*

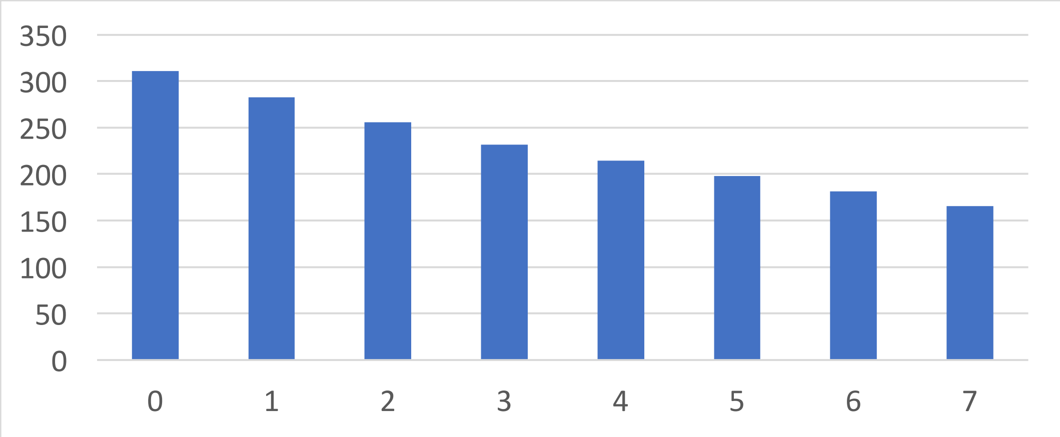

Figure 4 - EKS staff count over time including management charge reductions

With the same assumptions and caveats as per the previous scenario, the costs of redundancy on this scale could be in the region of £2,250,000.

Any downsizing of operations on this scale brings with it some difficult decisions – including which services to allow to degrade, which to maintain and which to cease entirely.

Inevitably, discretionary services would need to be reduced first, in order to safeguard as far as possible, the delivery of statutory services. These discretionary services (for example, welfare support, digital engagement, business rates analysis) are highly valued by EKS' clients but are exposed to the greatest risk of degradation or cessation.

Such an option is highly likely to be untenable, creating a situation which will result in a failure of service at a major scale.

Option 2 - “Exploit”

Summary:

As per the maintain option plus manage the need to contain inflation growth and deliver savings via income from new business.

Strengths	Weaknesses
Currently very competitive costs	Not structured so will require investment in areas such as business development, certification etc, starting from zero baseline
Mature, stable service offering	Need realism over quantity and speed of pipeline / delivery (4 & 5 figure sums more likely, not 6 figure)
Existing corporate layer and governance structures provide a sound foundation for expansion	Competing against other players offering solutions at scale and competitive pricing
Nationally recognised, award winning service with a high reputation across the sector	Will not prevent job losses from areas such as Benefits
Track record of achieving more for less	Lack of flexibility in the current workforce to deliver income generating services out of EK Services’ current geographical area
	To be effective would need to seek business beyond public bodies and therefore establishment of a Teckal compliant company (increasing set up costs and risk)

Analysis:

This option explores the potential for selling current services to third parties.

The opportunities this option presents are limited to the type of transactional services already provided to the partner councils by EK Services. Examples would include payroll, Revenues & Benefits resilience (offering overflow processing services), training and miscellaneous consultancy services. Informal market testing and spend analysis indicates that the profit from such activities is likely to be low, with typical profit margins of 5-10%. The development of a marketing and commercial strategy and the time required to develop a pipeline of potential opportunities means that any income is likely to be very low for the first few years and even beyond that, limited to “five figure” profits.

Councils would need to be prepared to take a commercial approach to risk and, in order to create the decision-making tempo required for a Company to operate successfully in a commercial environment, the establishment of a separate legal entity (a Teckal compliant company[4]) is likely.

This can be done but would require financial and resource investment to set up and growth in operating costs would be required.

The time required to establish such a model and the time needed to develop the commercial pipeline means that EKS would still require the initial few years of investment as outlined within Option 1 (Maintain) or reduce staffing levels by circa 40 staff. There is a risk that such staffing reduction would create service failure that in turn would impact on the ability for EKS to win any commercial contracts. A superficial survey of set-up costs for other, similar public sector based companies providing similar services suggests that initial investment of upwards of £200,000 would be required – mainly to set up a realistic business development function but also to gain the levels of professional, corporate and quality certifications that the market would reasonably expect from a supplier.

[4] *The local authority must control all of the shares in the company and must also exercise effective day-to-day control over its affairs; in other words, the same as the relationship between the council and one of its internal directorates. This can be achieved through the governance structure. The company must be "inwardly and not outwardly focused". The directive requires that at least 80% of the activity of the Teckal company – that is, over 80% of its turnover – must be for its public sector owners*

Option 3 – “Enhance”

Summary:

Look to bring other (transactional) council services into EK Services

Strengths	Weaknesses
Leverages the existing EKS corporate layer and governance	Streamline and improves value via process improvement through scale and resilience rather than deliver significant savings
Greater resilience and helps with specialist areas where recruitment / retaining is challenging	Job losses remain in areas such as Benefits through UC and Customer Services via Digital
Proven expertise in running shared services and sound governance reduces risk	Helps councils deliver savings but existing EKS staff (300+) still require inflationary pressure to be absorbed
Proven ability to both transform and deliver services	Main driver would be added resilience and not cost reduction as most clients would already have stripped out excess costs

Analysis:

Again, the services that could lend themselves to being offer by a shared service arrangement are those that are largely transactional and non-contentious. Examples could be procurement, legal services and transactional finance (with strategic finance, such as financial planning, treasury management etc.) being considered as more likely to be out of scope and maintained in house.

Experience of shared service implementation has demonstrated that some financial savings are possible. As a benchmark, staff cost reductions in the region of 13% will typically accrue along with approximately an 8% reduction on external spend as support, maintenance and other contracts are re-negotiated.

However, it is important to note that most, if not all local authority services have already removed significant operating costs over the last few years and in most cases any significant staff reductions would need to be balanced against the acceptability of declining service quality standards. It is therefore more likely that the benefits of on-boarding additional shared services into EKS would be improved resilience and the ability to maintain current levels of performance, rather than the delivery of worthwhile, cashable savings.

Option 4 - “Expand”

Summary:

Bring additional local authorities into the existing EK Services provision

Strengths	Weaknesses
Leverages the corporate layer and governance	Level of savings not likely to be as large as one may expect, other LAs already on a journey of staff reduction so economies limited
Greater resilience and helps with specialist areas where recruitment / retaining is challenging	Universal Credit looming so greater redundancies ahead
Complements any other work within East Kent that may seek to assess opportunities for closer working	Shared Service partnerships greater than four become very challenging; usually only achievable via a contractual style relationship rather than partner approach
Should generate further savings through sharing fixed costs, subject to specific individual service business cases	Extended time frame for delivery of savings and significant effort required
Proven expertise in running shared services and sound governance reduces risk	Need for investment for infrastructure alignment and potential systems migration
Proven ability to both transform and deliver services	Could face significant cultural and/or political differences
	Lack of flexibility in the current workforce to manage services out of EK Services’ current geographical area

Analysis:

This option does offer scope for the delivery of savings and income from on-boarding services from other local authorities. The attractiveness of this option is however, diminishing over time as most councils are already undertaking aggressive programmes of cost reduction and service modernisation.

Taking as an example, the provision of Revenues & Benefits and Customer Services provision to another district council, savings are achievable (mainly through staff reduction) although significant up-front costs for systems migration are incurred. The table overleaf shows a possible indication of total costs and savings (to be split between all participating councils) for such an onboarding over four years. This includes growth for platform migration and increased running costs for EKS against the potential savings in software, ICT infrastructure and staffing:

Item	Year 1	Year 2	Year 3	Year 4
Software licencing & support		(42,300.00)	(42,300.00)	(42,300.00)
General ICT/Infrastructure costs		(10,000.00)	(10,000.00)	(10,000.00)
Staff reductions - management	(60,000.00)	(80,000.00)	(80,000.00)	(80,000.00)
Staff reductions - support staff	(30,000.00)	(60,000.00)	(60,000.00)	(60,000.00)
Staff reduction - processing staff		(60,000.00)	(90,000.00)	(90,000.00)
Additional capacity contract reduction		(30,000.00)	(30,000.00)	(30,000.00)
Platform migration costs	150,000.00	50,000.00		
Increased EKS costs estimate	30,000.00	30,000.00	30,000.00	30,000.00
Total Cost/(Saving) for four Councils combined	90,000.00	(202,300.00)	(282,300.00)	(282,300.00)

For simplicity, assuming an even distribution of savings, EKS could expect to achieve a saving in the region of £211,000 (75% of the anticipated savings) from the third year of operation.

Option 5 - “Strategic Partnership”

Summary:

Use the existing service as a basis for the development of a locally-based processing hub run by a commercial organisation but sharing growth opportunities through profit share arrangements.

Strengths	**Weaknesses**
Financial savings from contract go-live date	Contract management capacity either with a residual EK Services of the client councils would need to be strengthened
Guaranteed performance levels and quality	Potential complexity of aligning client-side functions in a 4-way contract unless this function remains with a residual EK Services
Avoidance of redundancy for transferring staff	Long term budget commitment (albeit at a reduced level) required from contracting Councils
Staff job security for the contract duration	Impact of bringing staff back into the Councils at contract end is not quantifiable at present
Staff terms and conditions (including LGPS) protected	Staff concerns around a transfer to a private sector employer
Indexation increases likely to be less than maintaining status quo	Potential for inflation-linked contract price growth
Creation of a partnership style of operation where added value from service growth is shared	Flexibility for EKS to be used to deliver further budget savings in the future is reduced
Local new job creation	
Provides flexibility for the Councils to consider parallel “maintain” or “enhance” options	
Risk of impacts from new burdens (eg introduction of apprenticeship levy, increased employee costs) is reduced	

Analysis:

Unlike a traditional outsourcing arrangement, where a third-party supplier delivers services under contract for a defined price, usually extracting costs through staff reduction and redundancy, the proposed strategic partnership model with a supplier offers more benefits over and above a simple reduction in operating costs. These typically include a mixture of: direct cost reductions, profit share from new business generation and economic development benefits from delivering jobs growth and accompanying spend into the local economy.

This is a relatively well-established business model, with several councils across the country having entered into similar arrangements over the past few years. At the same time, the market for business process outsourcing (BPO) activities in both public and private sector has increased as a result of organisations needing to deliver reductions in operating costs as well as providing some certainly around future expenditure and the “cost of doing business.”

As part of their expansion plans in the Business Process Outsourcing (BPO) market, Civica are proposing to establish a trading hub and centre of excellence (CoE) in the south east to complement their existing locations (Hull, South Worcester, Denbighshire and Gloucester). EK Services have been exploring the possibility of a commercial contract with a partnership approach, with Civica. This would seek to provide a core contract delivering existing Income, Payments and Customer Services functions to a defined level of performance and quality, along with a “Centre of Excellence” (termed “the Hub”), based within the Councils’ existing premises (and generating a rental income), providing additional capacity to Civica’s existing on-demand services that are marketed nationally and internationally as well as providing a platform to provide other transactional contracts to new business opportunities.

In practice, this means that staff would transfer (under TUPE regulation) to the chosen supplier and continue to deliver services for EKS as before, from the same locations, with no visible change to the councils or customers. As the new provider streamlines service delivery, staff can be moved from providing services to EKS under the “core contract” into a team within the Hub that provides services to third parties, reinforced with existing or newly recruited Civica staff. This results in income to the councils (as a result of a profit share arrangement for revenue generated by the Hub plus rental for any additional desk space that is required within the existing EKS locations as a result of staffing growth.)

This provides a number of expected benefits to EK Services and its partner Councils:

- Financial savings from day 1;
- Guaranteed performance levels and quality;
- Guaranteeing approx. 220 jobs for the duration of the contract (i.e. up to 7 to 10 years);
- Avoidance of imminent redundancy for up to 30 FTE;
- Staff terms and conditions (including LGPS) protected;
- Ongoing investment in the service;
- Creation of an East Kent based processing hub (“Centre of Excellence”) to be operated on a profit sharing basis plus rent per desk space generating new income to the Councils;
- Local new job creation;

The trading hub will have exclusivity for new work from new business across Kent, Sussex, Surrey, SE London and Essex. It is also used to provide resilience to the core contract if needed, which de-risks the chance of performance slide due to staff erosion as other contracts often find.

A financial analysis of the likely savings that would accrue is detailed in the confidential Annex B to this report, although it is anticipated that the formal contract negotiation process would result in additional savings being identified.

A summary of how this type of partnership has worked in parts of the country, along with an explanation of the business development activity proposed, is given in Annex D.

At contract end, the trading hub operation is expected to operate from their existing locations, providing a continued rental income to the councils. The “core contract” (delivery of the councils Revenues, Benefits and Customer Services functions) could be re-procured (aiming for the market to produce an equivalent or better commercial offer than the original contract) or alternatively choose to move this provision back in-house, whilst complying with the TUPE regulations in force at that time.