Hybrid organisations: the ambiguous boundary between public and private activity

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Introduction

What do Channel 4, Companies House, the Post Office, the Royal Bank of Scotland, the Royal Mint and URENCO (a nuclear fuel company), have in common? All of them have their financial relationships with the British government managed by an agency, UK Government Investments (UKGI). All of these organisations finance their activities through charges made to various categories of user; all of them are subject to strong state engagement because all are perceived as serving a wider public purpose.

This diverse list of organisations may be described as hybrids – neither branches of government, nor commercial organisations, but with some of the characteristics of each. The term ‘UK Government Investments’ is misleading because the government financial involvement in these activities is not substantially based on an investment motive and any change to that involvement would rightly be the subject of public interest and scrutiny.

There are also many hybrid organisations outside the remit of UKGI: the BBC; museums and galleries; the Royal Parks; NHS hospital trusts; Heathrow Airport; the Bank of England; universities; the Corporation of London; privatised water and rail companies; newly created academies in secondary education; etc. That is before noting the many private businesses which derive much of their revenue from public sector activities: care home providers; companies with extensive outsourcing businesses; defence contractors. Then there is a wide range of public buildings and infrastructure assets are owned through special purpose vehicles; for example, the iconic Treasury building is leased to and from a private company which undertook and financed an extensive refurbishment.

For each hybrid, a related group of issues arises. What is the governance structure, and how does it reflect the wider public interest in these businesses? What is the capital structure, and in particular how is the equity obtained? What is the administrative procedure which takes control of these organisations if they fail, either financially or in terms of their wider societal objectives? It is evident simply from posing these questions that there are no common answers to them. Indeed in several cases it is not at all clear what the answers to these questions are. Even within UKGI, there appears to be little read across on these matters between organisations - no systematic analysis of what works well and what does not. This paper is a preliminary attempt to raise these issues. Such hybrids account for at least one quarter of all economic activity in the UK, and, given the structure of the Welsh economy, it is likely that this proportion is even higher in Wales.

Why hybrids?

A century ago, Max Weber famously identified the defining characteristic of the state as the monopoly of
legitimate coercion within a territory (Weber (2015) pp. 135-6). In the 19th century, the principal functions of the state were essentially coercive. Although the modern state continues to exercise these functions, it is primarily engaged in the delivery of services. We look to it to provide health and education, and these are the principal items in the budgets of most such states. Government provides transport infrastructure, and collects the rubbish; it ensures that taps flow with water and that electricity sockets are live. There is even an expectation that the state, or its agencies, provide entertainment on television and ensure fast internet connections.

The principal criterion for assessing performance in coercive activity is the legitimacy of the process. Judges and police officers are expected to adhere to the dictates of the law: if someone goes to prison it should be because they have committed a specified offence, not because they are thought to be a bad person. Likewise tax inspectors and benefit clerks are expected to collect and disburse according to the rules, not by reference to what they think is fair. However when the state delivers services, the principal concern is with the quality of the services. For example, we are not interested in how rubbish is collected: we just want it taken away. A good school is one which provides a good education for our children. We want comfortable and reliable trains, and the question of who provides the train is relevant only to the extent that it bears on these outcomes.

If the service can be provided in a competitive market, exit is generally a more effective mechanism of control than voice. If we do not like what a supermarket provides, we patronise another supermarket next time. This exercise of choice is generally a more powerful spur to innovation and improvement than complaint. Eastern European supermarkets were glum places, and Britain’s once proud cooperative grocery stores went into decline under the supervision of people whose primary concerns were ideological rather than in ensuring that the shelves were stocked with the things its customers wanted to buy (Myners, 2014). Nationalised industries suffered, and schools and hospitals still do, from the infiltration of producer interest groups into the supposed mechanisms of democratic control.

For many services, such as water supply or commuter trains, there is no competitive market, or plausible likelihood of one. For other public services, such as the Land Registry and universities, the public interest in, and value of, their activities extends well beyond the revenues they earn. In addition there are businesses, such as Royal Bank of Scotland and Carillion, which did provide services in a competitive market, but whose failure to do so successfully raised issues of public interest which government could not ignore. That is why we have, and will continue to have, many hybrids, and why the attempt to draw clear boundaries between public and private sector will necessarily fail.

**Forms of commercial organisation**

Any trading organisation - one which has multiple sources of revenue and expenditure, requires access to reserves, to allow medium to long-term planning of its activities, which will inevitably imply uneven cash flows, and to provide for the unexpected, both losses and opportunities. The general answer to this problem in the private sector has been shareholder-provided equity. Payments to equity investors can be varied from year to year, depending on the profitability and cash flow requirements of the business, and by virtue of their contribution shareholders hold a residual claim on the assets of the business in any voluntary or involuntary liquidation.

In return, shareholders enjoy a primary role in governance.
This is the reality in smaller companies. In larger ones, whose share ownership is inevitably dispersed, shareholder accountability is largely theoretical, although it has regained strength from the innovation of the hostile takeover and the ideological promotion of shareholder value which went with the financialisation of the British and American economies.

Throughout the 20th century, the private corporation had been the dominant mechanism of economic organisation. By the 1980s, that dominance had become so overwhelming that any other form of organisation was perceived as archaic. Many mutuals and partnerships converted to limited companies, and many state-owned functions were restructured as corporate entities, generally though not always through privatisation. It was not irrelevant that these processes enabled value to be realised immediately for the benefit of those initiating or approving such change. This was to the substantial benefit of the members of mutuals, the current leaders of partnerships, and governments which controlled state enterprises.

Today the argument in favour of the public limited company looks more nuanced. The conviction that the promotion of shareholder value was the best route to economic efficiency has waned. Issues of corporate governance, and of self-serving behaviour by executives, have caused increasing concern. Beyond the global financial crisis, some egregious individual cases have highlighted a diverse range of problems: governance and management concerns at Sports Direct; financial mismanagement at BHS; the collapse of Carillion. Accountability mechanisms in the private limited company sector are not necessarily self-regulating, and they may fail to take sufficient account of legitimate public interest concerns.

The duties of directors of a British company are defined by the 2006 Companies Act, and in particular by section 172 of that Act, which states:

Duty to promote the success of the company

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

(a) the likely consequences of any decision in the long term,
(b) the interests of the company's employees,
(c) the need to foster the company's business relationships with suppliers, customers and others,
(d) the impact of the company's operations on the community and the environment,
(e) the desirability of the company maintaining a reputation for high standards of business conduct, and
(f) the need to act fairly as between members of the company.

This formulation is intentionally ambiguous. It cannot be interpreted as ‘the purpose of the companies to maximise profits’: the duty of the board of a company is to promote the success of the company, not the interests of its shareholders. However, the statute acknowledges that since the shareholders are residual claimants on the revenues and assets of the company it is likely that promoting the success of the company will benefit the members. Thus section 172 appears to give shareholders priority, while requiring the board to have regard to the interests of the stakeholder groups – employees, suppliers, customers and the community – and to sustain the corporate reputation.

Legislation in 2004 introduced the concept of the community interest company: organisations which are not run for profit, but which are not charitable (Companies (Audit, Investigations and Community Enterprise) Act 2004, Pt 2). The essential difference between a community interest company and an ordinary limited company is the asset lock: a prohibition on distributing the assets of the company for anything but community purposes. There is a specifically established regulator of community interest companies. None of the hybrids described in this paper are registered as community interest companies, although it seems a natural description of many of them. Adoption of
this organisational form has been entirely by private sector agents such as local sports clubs.

The majority of US states have now passed legislation recognising ‘B corporations’: for-profit entities which nevertheless proclaim a commitment to public good. The B corporation movement is evangelical, and some companies in the UK and elsewhere have subscribed to it. Such a declaration is broadly consistent with the general terms of section 172, although advocates of such corporations seek explicit amendment to legislation (see, for example, bcorporation.uk).

However all these forms leave a number of governance questions unanswered, and the recent near-collapse of the British cooperative movement, growing reservations about the consequences of water privatisation and rail franchising, and the increasingly precarious financial position of NHS trusts, illustrates that dissatisfaction with governance mechanisms in the hybrid sector is rife.

**The finances of hybrids**

Some hybrids are private companies with shareholders. The Royal Bank of Scotland and URENCO have external shareholders. The Royal Mint, Ordnance Survey and Network Rail are also incorporated as limited companies but their only shareholder is the Secretary of State. All of these apply the formal structures of other private companies, with a board of directors, audit and remuneration committees and an annual report filed at Companies House.

Companies House itself, like the Land Registry and the Met Office, is a trading fund, established under the Trading Funds Act 1973. Trading funds have no shareholders but otherwise mimic the main features of corporate organisation, with a Board of Directors appointed by government, and a committee structure. Trading funds set their own charges for their services, subject to overriding political control, and are thus able to access their own limited reserves. Trading funds have no borrowing powers.

The BBC and universities operate under Royal Charter. In the case of the BBC, the charter is the subject of regular contentious renewal, with associated revision not only of the licence fee, which is the main source of the Corporation’s revenue, but also of the governance structure and the scope of the Corporation’s operations.

Universities principally derive income from student fees capped by government, with research funding partly obtained from government and partly through project-specific grants obtained from private and other public sources. Most universities have built up some reserves and some have endowments and income from alumni donations. Universities can borrow, and have recently accessed bond markets on significant scale.

Monopoly utilities, notably water and electricity supply businesses, are generally constituted as public limited companies, with shareholder-provided equity. Most of these companies attempted to diversify after privatisation, generally with unhappy results. Now only three of the supply companies created at privatisation, Pennon, Severn Trent and United Utilities, remain as autonomous quoted entities, with the others mostly owned by foreign utilities and investors. The latter are thinly capitalised, with minimal equity, but their debt is perceived as effectively securitised against the regulated asset base. Welsh Water has, since 2001, been owned by Glas Cymru, a company limited by guarantee with no shareholders (a unique structure in UK the water industry). The market position of Heathrow Airport, which became a subsidiary of the Spanish company Ferrovial when that company took over the listed BAA plc, is similarly strong, although other airports face more effective competition.

Thin capitalisation is also characteristic of the special-purpose vehicles through which private finance
initiatives have been channelled. The usual structure involves different tranches of debt, the subordinate tranches having equity characteristics - they are commonly traded over the project’s lifetime.

Twenty years ago, all UK state schools were controlled by local authorities, with virtually no fiscal autonomy. Reforms have created more autonomous local authority schools, academies, and most recently free schools. About two thirds of secondary school students, though only one quarter of primary pupils, are now in academies and current government plans would transfer all local authority schools to academy status. Academies may borrow from the national loans fund subject to an agreed repayment plan from government-funded revenue.

NHS trusts also operate on the basis of annual grants. They too can borrow with government approval. In practice, such borrowing appears mainly to have been used to relieve immediate funding pressures. Capital expenditure is subject to direct negotiation and has principally been undertaken through private finance initiative (PFI) schemes.

**Governance**

Herbert Morrison led the London County Council between the First and Second World Wars and was the founder of London Transport, the monopoly provider of public transport in London. Morrison visualised a single model of the hybrid, which was applied to the public corporations created during the Labour government of 1945 to 1951 of which Morrison was a member. The key element in governance was the board. Its members were to be, in Morrison’s resounding phrase, ‘high custodians of the public interest’ rather than capitalist profiteers (Morrison (1933) p. 157).

This idea was not new. From their foundation, national museums and galleries had recruited trustees – distinguished individuals willing to devote part of their time to a public purpose. These institutions still recruit such people. In the 19th century, a sense of public duty had persuaded privileged individuals to promote railways and water supply, and to found great civic universities in regional centres such as Birmingham, Bristol, Leeds and Manchester.

But the public corporations established in the wave of post-war nationalisation were not in the main successful organisations in delivering public value, either in terms of the quality of services provided to the public, or the efficiency with which these services were delivered. The organisations were dominated by engineering culture which valued technical sophistication over customer satisfaction. Squeezed between the interference of ministers and the tinkering of civil servants on one side, and insatiable demands of employees and customers on the other, potential high custodians found opportunities for public service elsewhere.

The executive management of hybrid institutions must be accountable for the financial performance and social performance. The Morrisonian answer was a single board which was responsible for both. This is not an arrangement which, as described above, is widely regarded as having proved successful. An alternative is to establish separate boards for the financial and public interest functions, a mechanism established for the BBC in 2007. Before then, the BBC operated under a Board of Governors, a resolutely Morrisonian institution. The Royal Charter implemented the separation through a BBC Trust, distinct from the BBC’s management board, although the Trust retained some oversight of finance. This arrangement was regarded as a failure, though for rather superficial reasons, mostly due to the content of some specific programmes and the salaries of presenters. Sir David Clementi’s report (Department for Digital, Culture, Media & Sport, 2016) concluded that the arrangement had indeed been a failure, and recommended that a unitary board be re-established, of
which Clementi became the first chairman. The supervision of social oversight was passed to the regulatory agency Ofcom, but financial matters remained with the board, except insofar as issues of competition were raised by the BBC’s activities. Although the BBC is particularly in the public eye, this illustrates some of the many problems of establishing an appropriate governance structure for hybrids.

Resolution
Organisations fail. Hybrid organisations may fail in either their commercial functions or their social functions, and some have. In a number of cases, the uncertainties inherent in the process of resolution are such that the government has intervened to avert the process of formal bankruptcy: for example at Royal Bank of Scotland and the Mid Staffordshire Hospital NHS trust. Both of those failures imposed substantial burdens on taxpayers, although the costs of the latter are dwarfed by the commitments required by the former. The issues raised by the insolvency of Southern Cross Care Homes in 2011, and last year both the collapse of Carillion and of Monarch Airlines, raises the question of whether existing insolvency procedures are well adapted to the failure of businesses providing important public services.

In water and railways, there are special administration procedures under the specific legislation governing these industries, which recognise the imperative need to keep taps flowing and trains running. An industry-specific resolution procedure is now in place for banks, including a complex requirement for living wills, in which the institution is required to make and file with its regulator a plan for asset disposals and financial reconstruction to avoid insolvency. The special administration procedure for the rail industry came into operation during the collapse of Railtrack, the network operator, but in other rail cases such as the Virgin East Coast collapse this year, franchises have been returned to the state or franchisees replaced.

Before the bankruptcy of Enron, the water regulator had required that its subsidiary, Wessex Water, was ringfenced, so that the creditors of the American parent had no recourse to the assets of the subsidiary, and the company was sold as a going concern without any consequence for water supply. Ringfencing of retail banks is also due to come into effect next year. There are no provisions for special administration in electricity analogous to those in rail and water; Enron also owned a power station in Teesside and it appeared likely for a time that the facility would shut down, although a management buyout restored a viable financial structure.

The vast majority of hybrids have cushions of equity inadequate to deal with financial stress, so the liability for losses, when there are any, fall largely on debt holders. The normal pattern has been that debt during a construction phase is wholly or mainly provided by contractors, and then sold on to investors when the completed project is refinanced. John Laing was responsible for building the new National Physical Laboratory under a PFI arrangement, but was also the main provider of debt to the project, and the massive cost overruns on the project crippled the parent. The outcome, ironically, was the disposal of Laing’s construction facilities business, and John Laing plc continues to exist as an investment vehicle for long-term PFI debt.

There are two principal cases of universities flirting with financial disaster. In 1987, University College, Cardiff was forced into a shotgun marriage with the University of Wales Institute of Science And Technology (UWIST). London Metropolitan University has a troubled recent history, having claimed public funds for students who were not there, and subsequently provided documentation to prospective immigrants with no intention of becoming bona fide students. Until
now, however, HEFCE and its predecessors acted as the final backstop to the higher education sector. Ostensibly, with the abolition of HEFCE there is now no government underwriting of these institutions; they are expected to raise their own revenue based on the receipt of student fees and their success in attracting research funding. If they are not successful in this, they can go bankrupt. Whether this is true in practice remains to be seen; the rate of interest at which universities have been able to access long-term funding, and the no more than marginal differences in the credit ratings attached to these institutions, suggest that bond markets are sceptical.

As at London Metropolitan University, social failure and financial failure are often associated, both groups of problem fundamentally attributable to poor executive management. The only failure to date of an NHS trust is that of Mid Staffordshire, which became notorious for its abysmal standards of patient care but also demonstrated weak levels of financial control. The same was true of Perry Barr Academies Trust, the Birmingham schools association which had benefitted from political hype considerably in excess of the more objective results of Ofsted inspections. The failure of the trust left unsettled debt to the Education Funding Agency. The National Audit Office issued a highly critical report on the costs of the reorganisation of the Mid Staffordshire Trust, which involved the transfer is of its functions and facilities to other trusts in the area.

Objectives
What are we trying to achieve with hybrid structures? They originate because it is believed, correctly, that the function such organisations perform will be better achieved by the introduction of commercial disciplines of the kind implemented in well-managed private sector organisations. Such disciplines are adopted mostly as a result of the process of operating in a competitive market which requires firms to adopt the best - in the sense of most conducive to effectiveness of output - practices of other firms.

Commercial discipline should not be confused with ‘the profit motive’: this is not an end in itself, but sometimes a means to an end. What is meant by commercial discipline involves a number of different components, relevant to all kinds of organisation but with greater or lesser importance in particular cases.

First, commercial discipline involve the planning of operations and investment over periods longer than one year. The annual accounting cycle derives from a time when agriculture was a dominant form of economic activity and is inappropriate for most businesses today. For many hybrid activities, the relevant time horizons for investment and the development of organisational capabilities is particularly long.

Second, commercial discipline involves the delegation to executive management of responsibility for day-to-day decisions and further delegation to subordinates. Along with such delegation goes responsibility for outcomes – an emphasis on ‘what has happened?’ and ‘has it worked?’ rather than ‘why did you do that?’ and certainly not ‘why are you doing that?’ It is the shift from control of process to responsibility for outcomes which distinguishes appropriately hybrid organisation from other public sector functions. That is not say that the delegation of authority and outcome is not relevant to other public sector activities - the central and difficult management skill of the police chief or army commander is to give juniors authority to act quickly within a highly disciplined framework - but the balance of emphasis is different.

Third, while both day-to-day and strategic management is the responsibility of an executive team, such development is within the context of an overarching
framework which reflects the variety of legitimate public and private interests in the activities of the organisation. For the public limited company, that overarching framework is provided by the board, and to some degree by the asset manager in major institutional investors. It is also the board which has responsibility for the appointment of executive management. That raises the question of who appoints the board. In the context of a large public limited company, the board is effectively self-perpetuating; for smaller companies with concentrated shareholdings, responsibility for board appointment lies with these shareholders.

In the case of more or less every hybrid described in this paper, the answers to the questions of accountability and responsibility are complex. This may reflect a genuine difficulty of assimilating a variety of stakeholder interests, but in many cases the answers are simply opaque and obscure.

Fourth, whatever the mechanisms of responsibility and accountability, they should be robust against interest group capture. In the private sector, the mantra of shareholder value has often recently been cover for capture by senior executives as an interest group, most evidently seen in explosion of their remuneration. Before the global financial crisis, some financial companies were plainly run more or less entirely for the benefit of senior employees.

Capture by a broader group of employees, mostly through the activities of trade unions, was a major problem in British nationalised industries. Indeed one of the drivers of privatisation was the Thatcher government’s attack on union power in these sectors. The refocusing of union organisation toward public sector professional workers has transferred the locus of this issue to other areas of hybrid activity such as schools and hospitals, while universities have always been employee-dominated organisations. While the interests of private-sector managers and low-skilled public-sector workers were primarily financial, these white-collar groups have broader concerns, with a particular emphasis on personal autonomy.

The emphasis above on the commonality of issues and problems in the corporate and hybrid sectors invites the question ‘what are the differences?’ The best answer to that is that corporate organisation works best when the value of corporate output is reasonably well measured by the revenue derived from customers. Hybrids are mostly found in activities where revenue is not a good measure of the value of output.

That observation prompts the question of whether better metrics could be derived for the hybrid sector. When Gavyn Davies was chairman of the BBC, he promoted the idea that the BBC should be judged by the ‘public value’ that it created (Davies 2004). As a statement of the corporation’s purpose, this must be correct. But the notion that one might derive a monetary measure of the contribution of the BBC is implausible. If the BBC is successful in its objectives, it challenges fake news, facilitates honest debate, and promotes democratic values around the world – achievements which are potentially very large, and wholly unquantifiable.

Conversely, successful private companies also create public as well as private value. Since the ‘triple bottom line’ of the corporate social responsibility movement of the 1990s the repeated demand has been that businesses should publish a range of metrics, from pay ratios to carbon footprints. The notion that only what can be counted counts gets in the way of proper analysis. The concept of public value is as relevant to a limited company as to a hybrid organisation, and until we can escape the caricature, and too common reality, that public limited companies are collections of greedy self-interested people, there is little chance of creating entities that combine the advantages of commercial discipline and public service.
Assessment

Two issues need to be dealt with at the outset. The first is that a large part of policy towards hybrids, indeed the very extent of the hybrid sector, is concerned with the structure of the government balance sheet. The capacity of global markets to absorb long-term sterling denominated debt is not materially affected by whether such paper is explicitly guaranteed by the government, backed by long-term contracts with that government or its agencies, or secured on revenues from regulated monopolies such as water and electricity. In all these cases the underlying covenant is fundamentally the same: the willingness of UK taxpayers and consumers to pay.

In reality, because UK government debt is well understood, has been reliably serviced for centuries, and is an extremely liquid market, it provides lower-cost funding than alternatives. The linkage of smaller elements of equity which are negligible in relation to the scale of such long-term debt creates opacity and illiquidity which adds to costs without compensating benefit. There are in many cases good reasons for transferring as far as possible to the contracting sector the risks associated with the project cost overruns, and also for medium – not long – term outsourcing of facilities management contracts. But these issues are separable from the choice of vehicles for government financing.

It is almost impossible to envisage a situation in which the British government planned to renege on its own mainstream debt, but could be relied on to honour long-term contracts related to assets and services located within the UK, and allow firms in regulated industries to raise charges to UK consumers of water, electricity, rail services etc. Indeed the slightest attention to current political rhetoric from leading opposition politicians demonstrates that these latter sources of revenue for debt servicing are considerably more vulnerable than the former.

The argument is sometimes made that the UK government needs substantial borrowing headroom to enable it to cope with the next financial crisis. The answer to this is not to constrain, in the meantime, the building of schools and hospitals, but to ensure that when such a crisis does occur, it does not impose significant costs on UK taxpayers. The ringfencing of domestic operations of retail banks is a welcome step in that direction.

It was easy to see the purpose of Enron’s off-balance-sheet financing. It is difficult to see who is intended to be deceived by the complex manoeuvres which enable the government to circumvent its own self-imposed financing rules – other than perhaps the government itself. James Carville’s famous comment that he wished to be reincarnated as the bond market is a classic statement of the influence that the market, or perhaps beliefs about the market, exert on political decision-making (Carville in WSJ, 25 Feb 1993). Such markets are certainly often irrational and ill-informed, but the likelihood that the British government will default on its debts in the foreseeable future is, for practical purposes, zero. As the radically different cases of the United States and Venezuela illustrate, default is more likely to arise as a result of political dysfunction than an assessment of the underlying position in terms of national assets and liabilities, the matters which are in the minds of the rating agencies.

The second preliminary issue is that parts of the hybrid sector today suffer from one of the central problems which reduced the effectiveness of British nationalised industries. Civil servants, and many of their political masters, seek to avoid responsibility for outcomes in an activity while being reluctant to relinquish control of that activity. Perhaps the most acute manifestation of this is in energy, where a laudable but perhaps unrealistic desire to create a competitive energy market conflicts with strong, and not
necessarily consistent, views about what the outcomes of that market should be. Rail franchising raises similar issues. Perhaps evolution of mechanisms of greater autonomy in schools and hospitals is still at too early a stage for this criticism to be fairly levelled, but the tension between power without responsibility and its corollary of responsibility without power is already evident.

Futures

The range of functions undertaken by hybrids is diverse and it is reasonable to conclude that there is no 'one size fits all' structure. But the degree of idiosyncrasy and diversity described confirms that there has been no attempt to draw general lessons of experience, far less developed criteria of good practice.

In the public limited company, the board has oversight of both the activities of the organisation and the effectiveness of its executive management. It is difficult to conclude that this function is universally performed well anywhere: at Royal Bank of Scotland and Carillion superficially impressive boards proved ineffectual in holding executive management to account.

Any review of the composition of hybrid boards reveals that their composition is unimpressive by the standards of boards of major public companies. Hybrid boards should not be captured by interest groups, while nevertheless the objectives of the organisation must reflect the reasonable expectations of different stakeholder groups; this outcome will generally be better achieved by honest brokers than through the conflicting assertive voices of delegates advocating the importance of the interests they represent. While there is importance to achieving diversity of gender, ethnicity, etc. it is difficult to avoid the impression the board composition of hybrids is currently constructed with greater reference to genuflecting to the needs of varied constituencies than in achieving effectiveness of supervisory function. However in the absence of an effective board, it is not possible to achieve either proper accountability for executive management or secure balance between the social and financial objectives of hybrids.

That balance is key to their performance. Just as the different needs of different stakeholders are not well resolved by representatives competing for their respective interests, the relative importance of financial and social objectives of hybrids are better matched against each other by a single body than subject to conflict between different bodies proclaiming the supremacy of either the social or the financial. Perhaps the central difficulty of managing services in health and education is to persuade practitioners to assume responsibility for using available resources to achieve the best possible health and educational outcomes, rather than simply to act as advocates the needs of patients of students and demand, insatiably and unsuccessfully, that whatever resources they believe to be necessary are made available.

One would need to have extreme, and unjustifiable, faith in the role of a board populated by high custodians of the public interest to believe that hybrids could be left free of broader regulatory oversight. Such oversight may be undertaken by a regulatory agency such as OFWAT or OFGEM or, as seems more appropriate for agencies such as Companies House and the Land Registry, directly by the responsible government department. As with the boards of hybrids, there is no merit and significant disadvantage in separating the regulation of finance from the regulation of social functions.

UKGI is staffed principally by people with experience in corporate finance and investment banking. This is plainly useful when the government’s objective is to sell shares in the hybrid. However only in a small number even of the hybrids in which UKGI is involved is
this appropriate. Shares in, for example, Companies House would simply represent a stake in future revenues from Companies House, necessarily controlled by government – effectively a convoluted form of government borrowing. While the sale of securities would facilitate the application of a Companies Act structure, principally in relation to membership of the board, that in turn raises the question of who the members of such a company would be. This question does not appear to have a satisfactory answer in the case, for example, of privatised water companies which have complex ownership structures based on elaborate financial engineering. Whatever the right answer to the question of who should be the ultimate controlling party in the provision of important public services in the UK, the answer cannot possibly be ‘a company located in a tax and regulatory haven with unknown beneficial owners’.

References


