



**Department for Culture, Media and Sport**  
**Review of the Structure of Government Support for**  
**the Historic Environment in England**

**May 2004**

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# 1 Management Summary

## Terms of Reference

- 1.1 The purpose of this review is to establish options for a possible change in relationship between English Heritage (EH) and Heritage Lottery Fund (HLF), and whether implementation of any of these options might yield cost savings, whether the options are viable in operational terms and what the potential cost of implementation may be.

## Scope and Scale of EH and HLF

### *English Heritage*

- 1.2 EH's key objectives cover three key areas:
- Improving understanding of the past by research and study;
  - Promoting the historic environment by opening up their properties and increasing access through education; and
  - Protection of historic places and ensuring change is managed sensitively.

### *Heritage Lottery Fund*

- 1.3 The core aims of HLF are:
- To encourage more people to be involved in and make decisions about their heritage;
  - To ensure that everyone can learn about, have access to, and enjoy their heritage; and
  - To conserve and enhance the UK's diverse heritage.

### *Source and Use of Funds*

- 1.4 EH has total income of £161m and HLF has total income of £255m. EH is 77% Grant-in-Aid funded (which forms part of the DCMS Department Expenditure Limit) whereas HLF is 100% funded by the National Lottery (and NLDF), which while being "public" money does not form part of the DCMS "Vote" and cannot be diverted to other services.

1.5 It is important to note that although HLF has £255m of income, only £23m is spent on operating costs the remainder is distributed as heritage lottery grants. EH spends £124 million on operating costs, the remainder being spent on commissions and being distributed as grants. EH's operating cost include expenditure on a range of functions including property management, provision of statutory advice, education and outreach and policy and communications. The use of funds table in Section 4, highlights the actual level of costs that can be considered as part of a cost saving review.

1.6 Of the combined income of £416m only **£147m** is actually in scope in terms of potential cost savings.

### **Functions Considered for Potential Cost Savings**

1.7 In considering the potential for cost savings we have focused on functions:

- Where the scale of the costs incurred are material;
- Where the function can benefit from economies of scale;
- Where the function performs activities that could be performed once if the organisations shared the functions; and
- Where there may be potential for the functions to share overheads.

1.8 We therefore considered the following functions as having potential for cost savings.

- Chief Executive and Corporate functions;
- Support Functions (Finance, Information Technology, Human Resources, Accommodation, and Legal Services);
- Policy and Communications functions; and
- Operations functions.

## Potential for Savings

1.9 We believe that there is potential for material savings to be achieved through the following approaches:

- **Targeted Cost Savings:** It may be possible to drive cost savings from the individual functions within EH and HLF without changing the structure of the organisations. In discussions with HLF and EH, both recognised that there was scope for targeted cost savings across their organisations.
- **Closer Working:** It may be possible to drive cost savings through EH and HLF working closer together, for example joint promotions and sharing best practice. Policy and Communications, Grant awards and Outreach are the areas where the potential for closer working exists between EH and HLF.
- **Merger of Functions (with Potential Transfer to Third Party):** This approach is more fundamental and would see EH and HLF sharing a function (e.g. HR, Finance, IT etc). Given the scale of expenditure on support functions it should be possible to reduce that expenditure through merger. The savings could be more significant if the merger of support functions was expanded to include more than just the support functions of EH and HLF (for example a Heritage or DCMS wide support function).
- **Total Merger of Organisations (Including Potential Transfer to Third Party):** The full merger would yield all of the savings detailed above, plus further savings from the reduction of senior management. However, we believe that pursuit of this course of action would increase the risks significantly (Section 8).

1.10 The table below sets out an estimate of the likely annual savings that each of the options may deliver (NB – This table is cumulative and assumes that options are pursued in succession. For example, if the first three options are pursued, the total saving will be £6.9m, merger of organisations will yield an additional, potential, £1.2m. For detail see Section 6).

	<i>Targeted Cost Savings £M</i>	<i>Closer Working £M</i>	<i>Merger of Functions £M</i>	<i>Total Merger of Organisations £M</i>
Cumulative Total	3.2	4.9	6.9	8.1

- 1.11 We anticipate the one off investment necessary to deliver the savings to be in line with a single year's savings (for detail see Section 7).
- 1.12 This means over a three year period, assuming all costs are incurred in year one, and savings accrue in years one, two and three the net total potential savings for the period would be £16.11m (savings of £24.3m and costs of £8.19m).
- 1.13 However, these estimates of costs savings and investment necessary to deliver the savings represent a high level estimate in line with the high level scope of the review. They would need to be validated before any final conclusions could be reached.

## Risks and Issues

- 1.14 In Section 8, we outline in detail the risks and issues to be considered with each course of action. The significant risks are associated with the full merger of EH and HLF whereas the risks associated with the other courses of action (targeted savings, closer working and merger of functions) are considerably less.

## Recommendation

- 1.15 If the risk analysis, from Section 8 is combined with the savings and cost analysis from Section 7, then it is clear that:
- Full merger adds limited marginal cost savings and carries the most significant risks;
  - Merger of functions (with potential outsourcing) is significant from a cost saving view point of view and does have some implementation risks (however avoids the political risks);

- Closer working and target cost savings are significantly less risky but do not deliver as high a level of cost savings.

1.16 We would recommend not approaching full merger at present, but considering targeted efficiency gains and closer working in the short term, followed by a move to merged functions, possibly as part of a fuller review of allocation of service responsibility across the Heritage and DCMS sector.

### **Next Steps**

1.17 We would recommend that a detailed validation, feasibility and implementation plan is worked up (with the above options in mind) with EH and HLF, and that measures are put in place to monitor the delivery of the savings.

## 2 Terms of Reference

### Introduction

- 2.1 The most recent Quinquennial Reviews (QQR) of both English Heritage (EH) and the National Heritage Memorial Fund (which administers Lottery funding under the trading name HLF) were undertaken in 2002. The outcomes were far-reaching for both organisations, resulting in a Programme of Modernisation for EH and a need for a new Strategic Framework for the Memorial Fund HLF.
- 2.2 The organisations have worked hard to respond to the findings of their respective QQRs and in the meantime, the Efficiency Review announced by the Chancellor of the Exchequer in his 2003 budget speech, led by Sir Peter Gershon, means that DCMS is now also examining whether scope might exist for further efficiencies across the whole of the historic environment sector.
- 2.3 This will clearly put further pressure on both EH and HLF, although both are deemed in better shape since the QQRs to accommodate further examination. In the light of the relative proximity to the QRR reviews, PKF were appointed to validate the actual potential for real further efficiency gains, against the likely costs, and the likely organisational and other implications of any proposed change.

### Requirements

- 2.4 In particular, the study was required to:
- Consider the relationship between EH and HLF and make proposals as to how that relationship might change (options might range from closer working to full merger);
  - Estimate administrative savings from those proposals;
  - Estimate any costs, both one-off and continuing, arising from those proposals;
  - Identify the issues arising from each proposal, including (but not limited to):
    - devolution issues;
    - lottery distribution streams;

- cross-sectoral support;
- conflicts of interest;
  
- Consider the role of other bodies in the historic environment sector in relation to these proposals and make recommendations for efficiency (or other) savings; and
  
- Consider the potential for moving any resulting body out of London, and the impact on the English regional structures of both EH and HLF.

2.5 Notwithstanding the recent QQRs of EH and HLF, Ministers wish to have an independent view on whether there is a valuable prize to be had in considering the fundamental relationship between these two organisations and whether the actual, financial and perceived benefits arising from any change will outweigh the inevitable financial, operational, political and other costs.

### **Scope of Review and Assumptions**

2.6 The purpose of the review was to establish options for the relationship between EH and HLF, whether implementation of these options might yield cost savings, understand the viability of the options in operational terms and assess the cost of implementation of the options.

2.7 As discussed with DCMS at the review initiation meeting the scope of the review is limited to EH and HLF. However some of the options for change may be applicable more widely within the heritage sector, and we state where this is the case.

2.8 The review has been undertaken over 16 elapsed working days and analysis has therefore been undertaken at a high level. Following discussions with DCMS we have focused on the financial analysis rather than the qualitative judgements arising from the conclusions that might be drawn from them.

2.9 The financial analysis has been carried out using management accounts and future budgets, of both organisations. Where assumptions have been made, these have been stated, and the overall aim is that the analysis is materially accurate.

### 3 Overview of the Heritage Sector

#### Introduction

3.1 As is set out in the Quinquennial Review reports of EH and NHMF, “The diverse nature of the heritage sector requires a wide range of expertise to support it. Currently this expertise is organised in a wide range of bodies, each with a specialisation and a range of responsibilities and support functions.”

3.2 Within DCMS, EH and HLF sit alongside other organisations with responsibilities for different aspects of the built environment and portable culture heritage:

- Historic Royal Palaces (HRP);
- The Royal Parks Agency (RPA);
- New Opportunities Fund (NOF);
- The Commission for the Architecture and Built Environment (CABE);
- Museums, Archives and Libraries Commission (MLA);
- VisitBritain; and
- Churches Conservation Trust

3.3 A number of other organisations make up the heritage sector, but are not DCMS sponsored bodies. The largest and most influential of these are

- National Trust (NT);
- Occupied Royal Palaces (ORP);
- Historic Houses Association (HHA); and
- Church of England (CoE).

- 3.4 In 1999 the Culture Select Committee suggested that DCMS should provide a stronger strategic direction for the heritage sector. In response, the DCMS and DETR (now ODPM and DEFRA) jointly commissioned EH to co-ordinate a major review of policies for the historic environment, whose results were published in November 2000 under the title *Power of Place*.
- 3.5 *A Force for our Future*, the Government's response to the recommendations of *Power of Place*, was published in December 2001 and provided a comprehensive statement of Ministerial priorities for the historic environment.
- 3.6 EH and HLF are major players in the heritage sector. Their specific aims and objectives are outlined below.

### **Aims and Objectives of English Heritage**

- 3.7 EH champions England's Historic environment for people of today and future generations. EH's purposes and principal powers are defined by the National Heritage Act 1983. These are in turn underpinned by the 1979 Ancient Monuments Act and Archaeological Areas Act, the Historic Buildings and Ancient Monuments Act (1953 revised 1983) and other legislation relating to the statutory protection of historic buildings and sites.
- 3.8 In the broadest terms, the 1983 Act requires EH to secure the preservation and enhancement of the built heritage of England for the benefit of future generations, and to encourage its popular understanding and enjoyment.
- 3.9 EH's key objectives cover three key areas:
- Improving understanding of the past by research and study;
  - Promoting the historic environment by opening up our properties and increasing access through education; and
  - Protection of our historic places and ensuring change is managed sensitively.
- 3.10 The following is a summary of the high level objectives presented in the 2003/04 – 2005/06 funding agreement:
- To provide research and advice to national and local government, including in support of rural and urban development and the planning system;

- To make the historic environment accessible to everyone (increasing interest and access);
- To realise the potential of English Heritage properties as a learning resource (for schools and lifelong learning);
- To contribute effectively to the development of thriving, inclusive and sustainable communities;
- To provide enhanced experience of EH properties; and
- To increase the effectiveness of internal management systems and the organisation's capacity to deliver against the modernising agenda.

### **Aims and Objectives of Heritage Lottery Fund**

- 3.11 The National Heritage Memorial Fund (NHMF) was established by Parliament in 1980. In 1993, NHMF was appointed as the distributor of the share of the Lottery proceeds devoted to heritage. This is delivered through the HLF.
- 3.12 The core aims of HLF are:
- To encourage more people to be involved in and make decisions about their heritage;
  - To ensure that everyone can learn about, have access to, and enjoy their heritage; and
  - To conserve and enhance the UK's diverse heritage.
- 3.13 To help address issues of deprivation, priority is given to applications for funding from specified areas of deprivation under three programmes:
- Repair Grants for Places of Worship Scheme (co-funded with EH)
  - Public Parks Initiative; and
  - Townscape Heritage Initiative (mirrored by EH's Historic Environment Regeneration Scheme)
- 3.14 In pursuing these aims during 2004-05 the HLF corporate goals are to:

- Be easily accessible to potential applicants and to bring about a more equitable spread of grants across the UK;
- Deliver a range of grants programmes which meet local needs and to provide a timely, efficient, economical and effective service to potential applicants and grantees;
- Meet the published service delivery turnaround targets for 80% of our customers overall;
- To facilitate the achievements of the Strategic Plan aims and objectives by providing specialist support to applicants, grantees, staff and decision takers;
- To carry our research and evaluation to create an evidence base for the benefits and impact of HLF funding; to explore needs and to measure achievement of Strategic Plan aims and objectives;
- To promote the benefits and impact of HLF funding through advocacy amongst the heritage sector, opinion formers and the wider community;
- To develop policy, with relevant partners, to keep HLF in the forefront of policy and practice on heritage and wider cultural, social and economic agendas relevant to the Strategic Plan;
- To account publicly and effectively for our work to date, through increased promotion of the benefits of HLF funding to the heritage sector, opinion formers and the wider community;
- In doing so, aim to generate an appreciation of the value and importance of our heritage, and the contribution of heritage projects to communities and society more generally;
- To provide a fast, accessible information service to potential applicants and other customers, including government, and using appropriate communications techniques;
- To work with the National Lottery Promotions Unit and other sectoral partners to deliver an effective national celebration of the 10th Anniversary of the National Lottery and 10 years of HLF funding throughout the UK;
- Work within our powers and protect public money;

- Equip staff to deliver the aims set out in the Strategic Plan;
- Carry out our role in an open and transparent way, ensuring fair and consistent decision taking;
- Make payments to grantees and suppliers in line with public targets; and
- Continue to improve our grants management and other IT systems.

### **Summary**

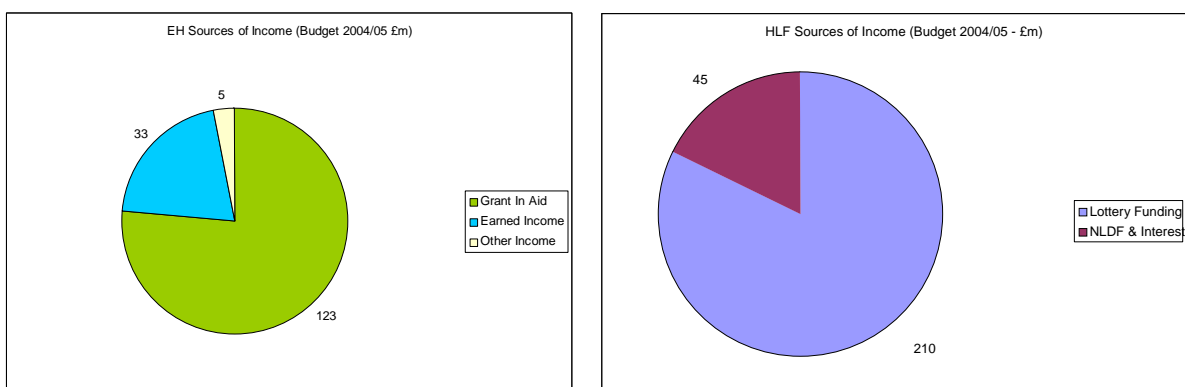
- 3.15 HLF covers all aspects of the heritage (built, natural, museums, archives, industrial, maritime, transport and intangible) across England, Wales Scotland and Northern Ireland. EH is responsible for the built heritage in England.
- 3.16 HLF is solely a grant awarding body, whereas EH fulfils a number of functions including statutory advice, regulation, grant giving, historic property management and education..
- 3.17 EH and HLF have some areas of overlapping responsibility.

## 4 High Level analysis of Funding

### Introduction

4.1 Having outlined the aims and objectives of both organisations this section describes the scale of EH and HLF and highlights their sources of income and how that income is spent.

### EH and HLF Sources of Income

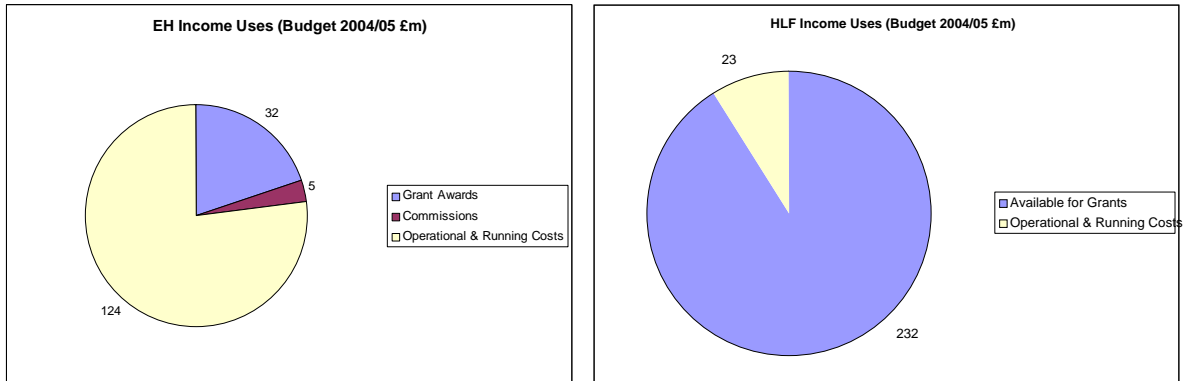


4.2 EH has total income of £161m and HLF has total income of £255m.

4.3 As can be seen from the above analysis the sources of income is fundamentally different in each organisation. EH is 77% Grant-in-Aid funded (which forms part of the DCMS Department Expenditure Limit) whereas HLF is 100% funded by the National Lottery (and NLDF), which while being “public” money does not form part of the DCMS “Vote” and cannot be diverted to other services.

4.4 This is a significant issue for DCMS to bear in mind when considering where any potential cost savings will accrue. National Lottery funding cannot be used by DCMS and therefore any savings that accrue from this income will not be passed back to DCMS and will instead fund more Heritage Lottery grants, which in itself may be regarded as a considerable prize.

### Uses of Income



- 4.5 As can be seen from the above analysis the use of income highlights the actual level of costs that could be considered as part of a cost saving review. HLF has total income of £225m but only £23m is spent on operating costs, the remainder is distributed as heritage lottery grants. EH spends £124m on operating costs, the remainder being spent on commissions and distributed as grant. EH’s operating costs, however, include functions such as property management (part of properties and outreach) and planning and development (including delivery of statutory advice).
- 4.6 This means that of the combined income of £416m only **£147m** is actually in scope in terms of potential cost savings.

### Detailed Spending

EH Costs (Budget 2004/05)			HLF Costs (Budget 2004/05)		
	£m			£m	
Operations & Cost of Sales	26.4		Depreciation	0.6	
Depreciation, C of C & Redundancy	5.6		Staff Costs	9.8	43%
Staff Costs	60.2	66%	Accommodation	2.3	10%
Accommodation	8.9	10%	Travel & Hospitality	0.6	3%
Travel & Hospitality	3.6	4%	ICT	0.8	4%
ICT	6.1	7%	Press, PR & Publications	1.6	7%
Press, PR & Publications	6.6	7%	Professional Fees	5.4	24%
Professional Fees	1.4	2%	Other	2.1	9%
Admin & Revenue Assets	4.8	5%			
<b>Total</b>	<b>91.6</b>	<b>100%</b>	<b>Total</b>	<b>22.6</b>	<b>100%</b>
	<b>124</b>			<b>23</b>	

- 4.7 The table shows the total expenditure of the two organisations. As part of our analysis we have excluded costs that cannot be categorised as routine operating costs. This is to ensure that our analysis is not biased by significant one off costs or costs that are incurred as part of Treasury guidelines or other such accounting policies. These include:

- Operations and cost of sales (EH) – the material inputs required for delivering conservation/research or generating income. These costs would be the same irrespective of any cost savings due to re-organisation and therefore have been excluded from further analysis as they do not form part of the operating cost base;
- Depreciation and cost of capital – these costs are driven by accounting policies or Treasury guidelines and do not constitute a level of expenditure that EH or HLF have control over. Inclusion in the operating cost base will artificially inflate the potential for savings; and
- Redundancy costs (EH) – these are not considered as regular running costs and have been excluded from the analysis.

4.8 This results in a combined total of **£114m** of relevant operating cost including properties and outreach (£27m) and planning and development (£22m).d.

4.9 To enable comparison and aggregation of data, the account lines used in each organisations’ budgeting process have been mapped and summarised using the categories in the table shown above.

4.10 The following table shows the expenditure of each organisation by category and function.

Summary of Costs (Budget 2004/05 £m)									
	Staff Costs	Accommodation	Travel & Hospitality	ICT	Press, PR & Publications	Professional Fees	Admin & Revenue Assets		Total
Properties & Outreach	16.2	2.4	0.6	0.3	5.6	0.6	1.0		27
Planning & Development	16.8	2.8	1.4	0.2	0.1	0.5	0.7		22
Research & Standards	14.7	2.6	1.0	0.4	0.2	0.1	0.9		20
Policy & Communications	2.1	0.2	0.2	-	0.7	-	0.5		4
Resources	5.8	0.8	0.1	5.2	-	0.2	1.9		14
Corp	4.0	0.1	0.3	-	-	-	0.2		4
Chief Executive	0.5	0.1	-	-	-	-	-		1
<b>English Heritage Total</b>	<b>60.1</b>	<b>8.9</b>	<b>3.6</b>	<b>6.1</b>	<b>6.6</b>	<b>1.4</b>	<b>4.8</b>		<b>92</b>
Operations	6.0	1.6	0.4	-	0.2	4.6	1.0		14
Policy & Communications	1.6	0.3	0.1	-	1.4	0.1	0.7		4
Resources	1.3	0.3	0.1	0.8	-	0.6	0.3		3
Senior Mgmt and Secretariat*	0.9	0.1	0.1	-	-	0.1	0.1		1
<b>Heritage Lottery Fund Total</b>	<b>9.8</b>	<b>2.3</b>	<b>0.6</b>	<b>0.8</b>	<b>1.6</b>	<b>5.4</b>	<b>2.1</b>		<b>23</b>
*Including Chief Executive (and support) cost of approx. £160,000									
<b>Combined Total</b>	<b>69.9</b>	<b>11.2</b>	<b>4.2</b>	<b>6.9</b>	<b>8.2</b>	<b>6.8</b>	<b>6.9</b>		<b>114</b>

## 5 Areas to be Considered for Change

### Introduction

- 5.1 This section sets out the areas in which EH and HLF might achieve cost savings through a change in the way that the organisations operate.
- 5.2 The key questions to address in a **financial** evaluation of the opportunities for cost savings are:
- Is the scale of the cost incurred in each function under review such that any potential savings will be material?
  - Can the function benefit from economies of scale if combined with a similar function in EH/HLF?
  - What activities are currently performed more than once that could be performed once if the organisations shared the function? and
  - Are there overheads that could be reduced or shared by merging the functions (e.g. accommodation, annual licence fees)?
- 5.3 Outlined below are the functions that we believe should be considered in order to drive out cost savings. The logic for considering these areas is also explained below.

### Areas to be Considered for Change

#### *Chief Executive and Corporate Functions*

- 5.4 Combining Chief Executive functions is only possible if there is a full merger of the two organisations. Therefore we have separated the Chief Executive functions from the broader support services categories in order that sub options for change can be considered. Any move to bring organisations together will give rise to potential savings in the Chief Executive functions as there will only be a need for one Chief Executive and the corresponding corporate functions (Secretariat etc). The scale of the savings will depend on the scale of the current Chief Executive function.

### ***Support Functions***

- 5.5 Support functions for the purpose of this analysis are Finance, Information Technology (IT), Human Resources (HR), Accommodation (Facilities Management or Building Services) and Legal Services.
- 5.6 The costs associated with these activities are frequently targets for cost savings. This is partly because they are often seen as soft targets (where savings can be achieved with little impact on the core organisational outputs) and partly because there is an underlying perception that economies of scale can be achieved in these functions through combination with other organisations' support functions.

### ***Policy and Communication Functions***

- 5.7 The logic for considering the Policy and Communication function is similar to the argument set out for considering support functions. In both organisations there exists a Policy and Communication functions staffed by people with similar skills. At a high level, the nature of their activity is similar and therefore this gives rise to consideration as to how they could work more closely to drive out cost savings.
- 5.8 There is an overlap in the subject and target recipients of some areas of EH and HLF policy and communications and the size of this overlap will therefore, clearly, dictate the scale of any potential savings from EH and HLF working more closely together in this area.

### ***Operations***

- 5.9 When reviewing the potential for cost savings, the core activity that is carried out by each organisation is clearly worth considering. In this instance the core activity of HLF is grant distribution whereas in EH grants is only one activity that is carried out as part of its core activities. Having examined the core activities carried out by each organisation there is potential overlap in the grant giving functions, the outreach programme and the regional office administration and structure. Further details of the opportunities in this area are provided in paragraph 6.9.
- 5.10 Again when carrying out this cost saving review it must be remembered that there are clear differences between EH and HLF in terms of responsibility and scope and this will have an impact on the extent to which their operations overlap, and in consequence the likely scale of cost savings.

## **Options to be Considered When Driving Out Cost Savings**

- 5.11 When considering cost savings, a variety of approaches to delivering the savings must be considered. Outlined below are the approaches that we believe could result in cost savings. Clearly, each approach carries a different level of risk (in terms of time to achieve saving, certainty of achieving savings and political difficulty) and reward (in terms of the level of savings when compared to the costs of implementing the change).

### ***Targeted Cost Savings Without Changes to the Organisations***

- 5.12 It should be possible to drive cost savings from the individual functions within HLF and EH respectively, without actually changing the structure of the organisations. This could be achieved for example, by re-engineering business processes or better use of technology or applying benchmarked best practice. For the purpose of this review, this activity is described as targeted cost savings, without fundamental change to the organisations.
- 5.13 This approach is often used as the start point in a cost saving exercise. Focused review by the organisations' functional teams often reveals changes to working practices that can deliver cost savings, or activity that has become redundant due to a change in the outputs required from the organisation.
- 5.14 Targeted cost saving may require minimal structural change to the organisation and therefore it can be a low risk approach to delivering cost savings. Specific examples of how these savings might be achieved, for each of the areas identified are listed in the tables in Section Six.

### ***Closer Working***

- 5.15 This approach drives cost savings through two organisations working closer together. This could involve sharing of ideas and best practice or working on joint promotions that achieve the aims and objectives of both organisations.
- 5.16 Closer working requires management commitment in terms of empowering the functions to actually invest time in understanding how each other operates. However the potential to eliminate duplicate activity where processes cut across both organisations and to share best practice means that the time investment will be well spent. The tables in section 6 outline some of the specific examples of how savings might be achieved in this manner.

- 5.17 Closer working is also a relatively low risk approach to cost savings as it does not require fundamental change to the organisations structure. However it will require clear controls to deliver the required savings.

### ***Merger of Functions (and Potential Outsourcing of Merged Functions)***

- 5.18 This approach is more fundamental and would see HLF and EH sharing a function (e.g. HR, Finance, IT etc). The service might sit within one of the organisations with the service controlled by service level agreements specified by both organisations. The aim of this would be that economies of scale would result and that it would leave one of the organisations to focus on its core activities.
- 5.19 The merger of functions also gives rise to the potential that the function could be performed by third party (e.g. joint venture or out-sourced). Services would be controlled through use of service level agreements or contracts. More focus on the function, economies of scale and shared resources would therefore result in greater cost savings. This would also give rise to the potential for a better quality service as the organisation providing the service would be doing so as it's core activity.
- 5.20 This is particularly true for support functions (HR, finance etc.) and could also work for transactional services such as processing grant applications (as opposed to evaluating those applications) and making grant payments.
- 5.21 Merging of functions will potentially give rise to a significant level of saving however due to the fundamental nature of the change it will be a riskier approach than targeted cost savings and closer working. As there is more fundamental organisational change, there is greater likelihood that distraction from core activities will occur. Implementation risks also increase due to the increased complexity of the programme (e.g. systems and personnel issues). These risks are detailed in Section Eight.

### ***Merger of EH and HLF***

- 5.22 The merger of EH and HLF is an option that can encompass all of the approaches outlined above. Indeed we would argue that a merger should not take place in isolation from the approaches outlined above and that the benefits need to be included to ensure that the fundamental change associated with a merger would be balanced against all relevant savings.
- 5.23 Clearly if EH and HLF merged, the total potential savings outlined above will be relevant. However the risks associated with a, full merger are considerable in any two organisations and

there is no reason to believe that the merger of EH and HLF would be different. In this instance, these risks relate to the probability of political difficulty and resistance within the sector. Additionally, probable conflict of interest resulting from this option would limit the savings achieved due to the need to maintain separate boards or “Chinese Walls”.

### Options for Change Alongside Potential Method of Driving Out Efficiencies

5.24 The following table shows a matrix of the **areas** for change and the **options** for driving out cost savings that could be applied:

		<i>Options</i>			
		<i>Targeted Cost Savings</i>	<i>Closer Working</i>	<i>Merger of Functions (with potential outsourcing)</i>	<i>Total Merger of Organisations</i>
<i>Areas</i>	Support Functions	o	o	o	o
	Policy and Communications	o	o	o	o
	Operations	o	o	o	o
	Chief Executive Functions	o	X	X	o

o - Indicates that it is possible to achieve savings by applying the option in this area.

X - Indicates that no possibility of savings exists.

## 6 Evaluation of Changes to Functions to Deliver Cost Savings

### Introduction

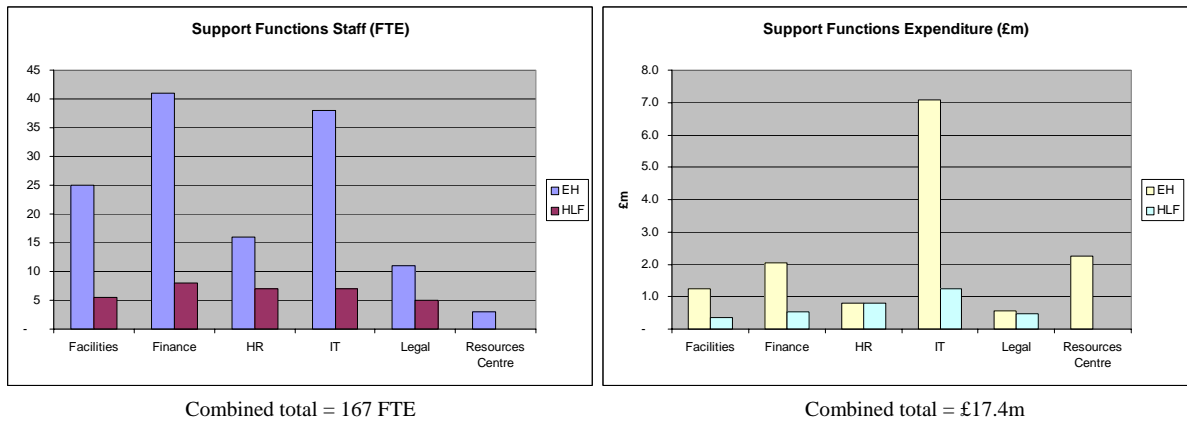
- 6.1 In Section 5 we identified the functions that could be changed and the methods that could be applied in driving out cost savings. We now consider whether in light of the cost provided by EH and HLF any of the options are worth further consideration (as set out in Section 4).
- 6.2 Suggested savings are based on constant activity levels. We do not anticipate that activity levels (e.g. the number of grant applications) will drop or increase as a result of any of the suggested changes.
- 6.3 We recognise that EH and HLF are already undergoing significant efficiency exercises. In the case of EH, the areas that we identify for potential savings are different from those under focus in the review that is underway. Potential savings identified in this report are therefore in addition to those currently targeted.
- 6.4 Outlined below is the summary of costs for EH and HLF (as set out in Section 4) in order to illustrate the costs in each functional area in the context of the total cost of EH and HLF.

	Staff Costs	Accommodation	Travel & Hospitality	ICT	Press, PR & Publications	Professional Fees	Revenue Assets	Admin &	Total
Properties & Outreach	16.2	2.4	0.6	0.3	5.6	0.6	1.0		27
Planning & Development	16.8	2.8	1.4	0.2	0.1	0.5	0.7		22
Research & Standards	14.7	2.6	1.0	0.4	0.2	0.1	0.9		20
Policy & Communications	2.1	0.2	0.2	-	0.7	-	0.5		4
Resources	5.8	0.8	0.1	5.2	-	0.2	1.9		14
Corp	4.0	0.1	0.3	-	-	-	0.2		4
Chief Executive	0.5	0.1	-	-	-	-	-		1
<b>English Heritage Total</b>	<b>60.1</b>	<b>8.9</b>	<b>3.6</b>	<b>6.1</b>	<b>6.6</b>	<b>1.4</b>	<b>4.8</b>		<b>92</b>
Operations	6.0	1.6	0.4	-	0.2	4.6	1.0		14
Policy & Communications	1.6	0.3	0.1	-	1.4	0.1	0.7		4
Resources	1.3	0.3	0.1	0.8	-	0.6	0.3		3
Senior Mgmt and Secretariat*	0.9	0.1	0.1	-	-	0.1	0.1		1
<b>Heritage Lottery Fund Total</b>	<b>9.8</b>	<b>2.3</b>	<b>0.6</b>	<b>0.8</b>	<b>1.6</b>	<b>5.4</b>	<b>2.1</b>		<b>23</b>
<b>Combined Total</b>	<b>69.9</b>	<b>11.2</b>	<b>4.2</b>	<b>6.9</b>	<b>8.2</b>	<b>6.8</b>	<b>6.9</b>		<b>114</b>

\*Including Chief Executive (and support) cost of approx. £160,000

### Support Functions

6.5 Under the current arrangements, support costs are as detailed in the tables below.



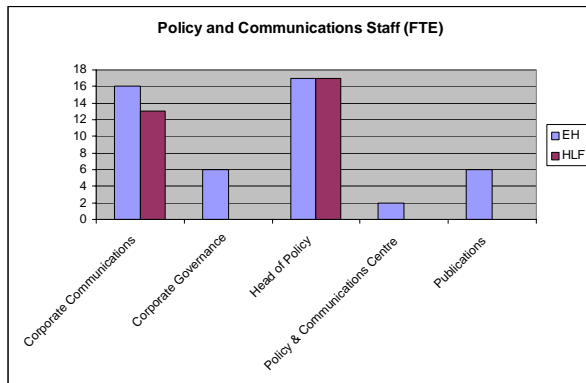
6.6 As is highlighted above, £17 million is spent in total by both organisations across the support functions (these functions are known as “Resources” in the EH and HLF management accounts). This represents 15% of the combined operating costs of the organisations.

6.7 Outlined below are the options for delivering cost savings from the support functions.

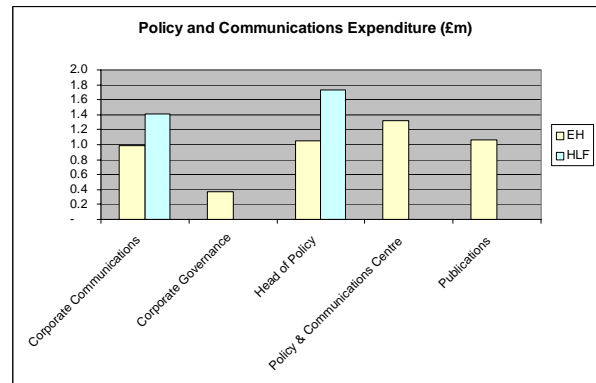
Option	Description	How savings might be achieved
1a	Targeted cost savings	Process re-design Greater utilisation of technology (e.g. for transaction processing and self-service) Consolidation of service contracts
1b	Closer working	Joint negotiation of contracts
1c	Merger of functions	Shared IT maintenance costs and potential for savings from shared support services. Reduction in head count would mean some reduction in accommodation Savings in management overhead of functions and potential elimination of some duplicate functions (e.g. cash control, management accounting) Potential additional savings from outsourcing

### Policy and Communications

6.8 The tables below indicate the resources currently dedicated to Policy and Communications functions:



Combined total = 77 FTE



Combined total = £8m

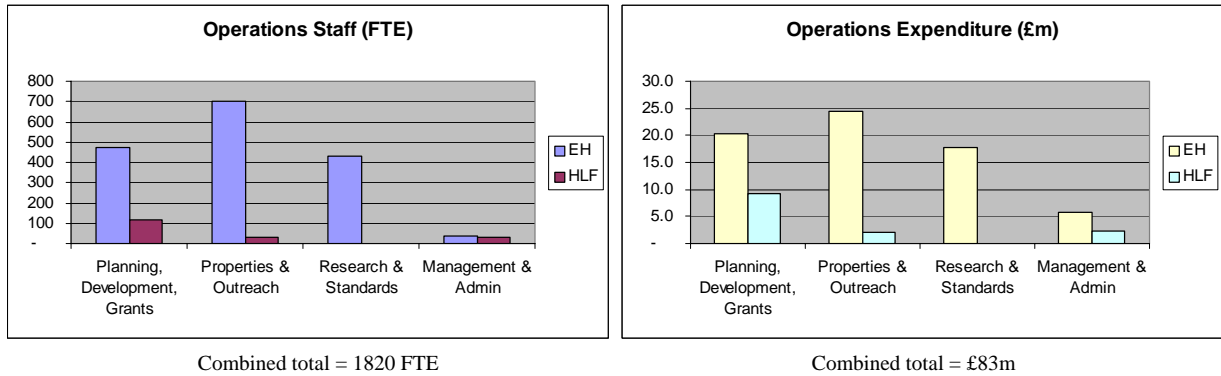
6.9 As is highlighted above £8 million is spent by both organisations across the Policy and Communications functions. This represents 7% of the combined operating costs of the organisations.

6.10 Outlined below are the options for delivering cost savings from the policy and communications functions.

<i>Option</i>	<i>Description</i>	<i>How savings might be achieved</i>
2a	Targeted cost savings	Both organisations have already identified some savings in this area
2b	Closer working	Development of common policy Joint promotions Shared research into impact and benefit of heritage Joint negotiation of contracts [Possibility of extending model to rest of heritage sector]
2c	Merger of functions	Reduced managerial overhead [Possibility of further savings from extending service to rest of heritage sector]

## Operations

6.11 Total resources employed in operations are outlined below.



6.12 As outlined in Section 5, the purpose for reviewing the Operations function is to consider areas of possible overlap in the core activity of EH and HLF. Following high level review we are clear that it is unlikely that there is overlap between EH and HLF in the following areas:

- Research and Standards (EH)- HLF does not carry out research and standards work;
- Properties (EH)- HLF does not have a properties management function; and
- Planning and Development (EH)- HLF does not have responsibility for planning and development.

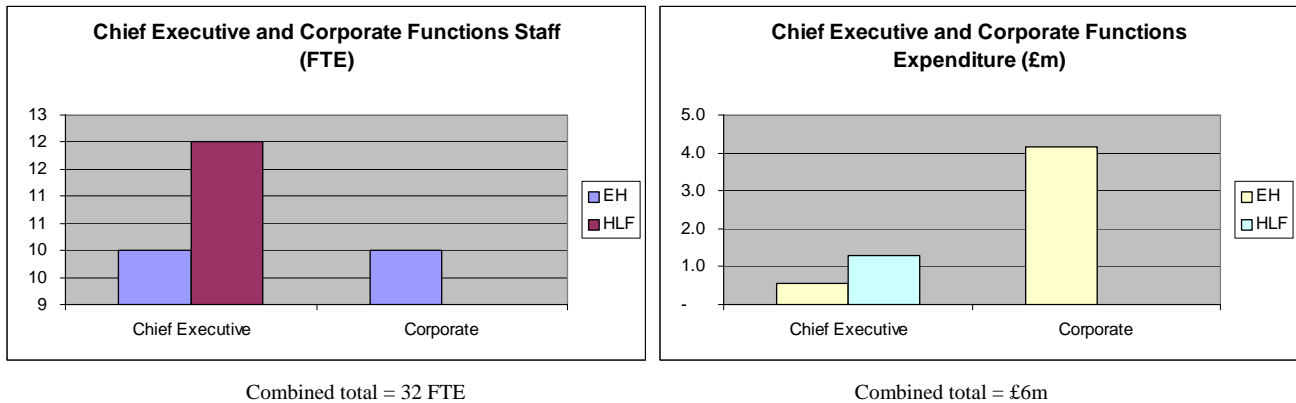
6.13 This reduces the totals of expenditure within the areas of review to around £23m and 330 FTE. This comprises the expenditure for grant operations, education and outreach and regional office administration activities for both EH and HLF.

6.14 Below, the table details the ways in which potential savings may be realised.

<i>Option</i>	<i>Description</i>	<i>How savings might be achieved</i>
3a	Targeted Cost Savings	Both organisations have already identified some savings in this area These savings do not form part of this analysis as they are focused on the areas that have been excluded above
3b	Closer working	Shared outreach and development programmes Shared regional offices and management/administration Reallocation of grant awards responsibility
3c	Merger of functions	Reduced managerial overhead

### Chief Executive and Corporate Functions

6.15 Current resources are shown below.



6.16 As is highlighted above, £6m in total is spent by both organisations across the Chief Executive and Corporate Functions. This represents 5% of the combined operating costs of the organisations.

6.17 Options for achieving savings in this area are outlined below.

Option	Description	How savings might be achieved
4a	Targeted Cost Savings	Currently, there are no savings forecast for the next three years in this area. Process review may yield some savings
4b	Full merger	Reduction in senior FTE

### Summary of Cost Saving Options

#### Targeted Cost Savings

6.18 In discussions with HLF and EH, both recognised that there was scope for targeted cost savings, with EH having begun a cost saving exercise (though not in the areas outlined above) and HLF having finished the initial investigation (expected to yield £1m).

#### Closer Working

6.19 Looking at the objectives of each organisation, there is common ground around education and enjoyment, broadening appeal and preservation:

- Policy and Communications functions could work together more closely, which would also enable EH and HLF to speak with one voice on specific issues;
- Grant awards: Savings could be achieved by developing a single process and sharing technology for use in administering grant applications and awards. Closer operational working of this type may also create the potential for additional savings in support services. For example, if HLF were to assume responsibility for distribution of EH grants, it would reduce the system maintenance overhead. Support services may also be able to work together directly, for example through a shared HR and payroll systems. From a strategic point of view, this would also produce the benefit of having a broader picture of skills availability and trends within the sector; and
- Outreach: Both organisations are trying to broaden the appeal of heritage. Whilst the constituencies represented by each are not completely consistent, there is an overlap. A review of communications with this group may provide scope for some savings.

### ***Merger of Functions (with Potential Transfer to Third Party)***

- 6.20 One of the primary areas of focus for the Gershon Report is the provision of support services. One of the areas to be addressed is whether shared services provide a means through which these services can be provided at lower cost without impairing the quality of service provided.
- 6.21 We believe that given the scale of expenditure in EH and HLF on support services, it should be possible to reduce that expenditure through a transformation programme (which would need to take into account any changes in the structure of the organisations following initiatives in other areas).
- 6.22 The merger of EH and HLF support functions would be a significant step. Whilst it would ultimately deliver savings through reduction in FTE, lower IT costs and lower overheads, these savings would not materialise in the short term.
- 6.23 The savings could be more significant if the merger of support functions was expanded to include more than just the support functions of EH and HLF (for example a Heritage-wide or DCMS-wide support function).
- 6.24 The merger of other functions (i.e. non support functions) is unlikely to have significant financial benefits over those of working more closely together (any marginal savings being from the further reduction of managerial overhead). However, this is dependent on the

organisations working and communicating as if they were one organisation, which requires clear leadership in terms of the respective roles and commitment from each of the organisations involved.

### ***Total Merger of Organisations (Including Potential Transfer to Third Party)***

6.25 We believe that the full merger of the organisations would yield all of the savings detailed above, plus further savings from the reduction of senior management FTE. However, we believe that pursuit of this course would increase the risks significantly (see Section 8).

### **Level of Savings**

6.26 In the detailed analysis in Section 6 above, we have highlighted the reasons why we believe there is potential for cost savings, and the activities that could be undertaken to exploit this potential. Due to the time constraints and the high level nature of this review we have not been able to quantify the exact savings that will accrue from carrying out the changes required.

6.27 Instead we have made broad high level calculations to quantify indicative levels of savings that could accrue:

6.28 We believe that as part of a full merger cost savings of 15% of the total relevant operating costs could be expected;

- In a merger of functions, we would expect at least 50% of the staff costs associated with the smallest function that is merged to be saved.
- In a merger of functions, combined functions will adopt the most efficient of the legacy processes, so the new function will operate as efficiently as the most efficient legacy function.

6.29 Using these methods of calculation we have generated a range of potential savings and have used the mid-point of the range to provide an indicative level of savings. The results are outlined in the table below.

6.30 Our approach assumes that there are a number of ways to achieve cost reductions, and that these should be pursued sequentially. If the sequential method were to be pursued, savings could be achieved incrementally, until the full merger is completed and maximum savings

delivered. However, a full merger would mean clarifying leadership, which would be required for a successful pursuit of savings.

6.31 As full merger will result in delivering the maximum potential savings, we have shown below the implications if the merger of functions results in delivering 85% of the maximum potential savings, closer working results in deliver of 60% of the maximum potential savings and targeted cost savings delivers 40% of the maximum potential savings.

**Summary**

6.32 The table below shows a summary of the estimated savings from each of the options reviewed. The figures quoted are marginal savings, which assumes that each option is pursued in succession (e.g. the closer working savings in each area are in addition to targeted cost savings and assume that the targeted cost savings have been achieved):

	<i>Targeted Cost Savings £M 40%</i>	<i>Closer Working £M 60%</i>	<i>Merger of Functions with Transfer to a Third Party £M 85%</i>	<i>Total Merger of Organisations (including potential transfer to third party) £M 100%</i>
Support Functions	1.0	1.5	2.2	2.6
Policy and Communications	0.5	0.7	1.0	1.2
Operations	1.4	2.1	2.9	3.5
Chief Executive Functions	0.4	0.5	0.8	0.9
Marginal Saving	3.2	1.6	2.0	1.2
Cumulative Total	3.2	4.9	6.9	8.1

## 7 Estimated High Level Costs of Implementation

### Introduction

7.1 The costs associated with implementing the options for change described in this report would be focused around the following areas:

- People: including job re-design, recruitment, redundancy and training;
- Technology: including specifying requirements, procuring goods and services, buy-out costs of existing contracts and overall implementation;
- Accommodation: including specification of requirement, sourcing, buy-out of existing leases and procurement; and
- Business Processes: re-design and implementation including performance management design, financial systems and procedures, HR policies etc. including implementation costs: including overall programme and project management and external support.

### Overview of Each Cost Area

#### *People*

7.2 The main cost associated with people would be potential redundancy costs. These cost would vary depending on the length of service and the grade and level of person who was being considered. Due to the average length of service of employees within EH (as discussed with EH) it is expected that redundancy costs would be a material item.

7.3 There would also be an element of training costs that would need to be factored into the costs to implement new business processes. In addition there may also be a need to budget for recruitment costs that may be necessary where the skills of the existing workforce do not match the skills necessary to deliver the new business processes.

#### *Technology*

7.4 In a merger, technology costs would be relevant in relation to the potential merging of existing systems, or the updating of both systems to sit on a new platform. The key driver to these

costs would be the functionality required by the merged organisation and the costs of the specification and procurement processes.

7.5 Both EH and HLF at present operate different financial systems and have different systems requirements. EH has specific detailed system requirements in line with its responsibilities for heritage records and statutory planning functions whereas HLF has a greater reliance on grant payment systems.

7.6 The costs associated with running these two different ICT functions would need to be further considered and would need careful implementation planning to ensure that any migration was managed to minimise the risks to the operation of the business.

### ***Accommodation***

7.7 In light of the potential for office rationalisation, the main costs associated with this area are the costs of either/or buying out existing leases and procuring combined office space. The office space would need to reflect the combined size of the regional offices and reflect the required geographical emphasis.

### ***Business Process Design and implementation costs***

7.8 The costs associated with re-designing business processes to reflect any merger could be built up in two ways. Either it is the re-allocation of internal resources to complete the task, and therefore would be an opportunity costs; or specific external support to carry out a project based assignment. These would include appointment of a programme and project manager and project office resource.

## **Summary of Potential Costs Associated with Each Option**

7.9 We have indicated above the broad areas where we believe costs will be incurred in pursuing any of the cost saving options described. As the cost savings could be achieved through a number of different changes to the businesses it is not possible to allocate costs against the detailed headings above, including support services, policy and communication etc.

7.10 However, we have assumed that for any cost saving option to be viable it would need to achieve a payback of around twelve months. In practice, this means that one-off costs should not exceed annual cost savings. Moreover, we would not necessarily assume all of the cost savings could be achieved in the first year.

7.11 Based on our experience we would strongly recommend that the costs and benefits of any prospective programme should be fully evaluated prior to initiation.

7.12 While we have not been able to detail the exact scale of the costs, by relating them to pay-back periods we have been able to identify the level of cost that we would expect to be associated with changes of this nature, if the change was to conform to accepted levels of pay-back. If the costs are more than stated below the changes would not be progressed as the pay-back may be unacceptable.

7.13 Outlined below are our high level estimates of the level of investment associated with each option for pursuing cost savings. Further analysis will be required to establish actual projected costs/investments required. These costs are shown against the potential savings in paragraph 7.16.

	<i>Targeted Cost Savings £M</i>	<i>Closer Working £M</i>	<i>Merger of Functions with Transfer to a Third Party £M</i>	<i>Total Merger of Organisations (including potential transfer to third party) £M</i>
<u>Cumulative Cost</u>	<u>3.2</u>	<u>4.9</u>	<u>6.9</u>	<u>8.19</u>

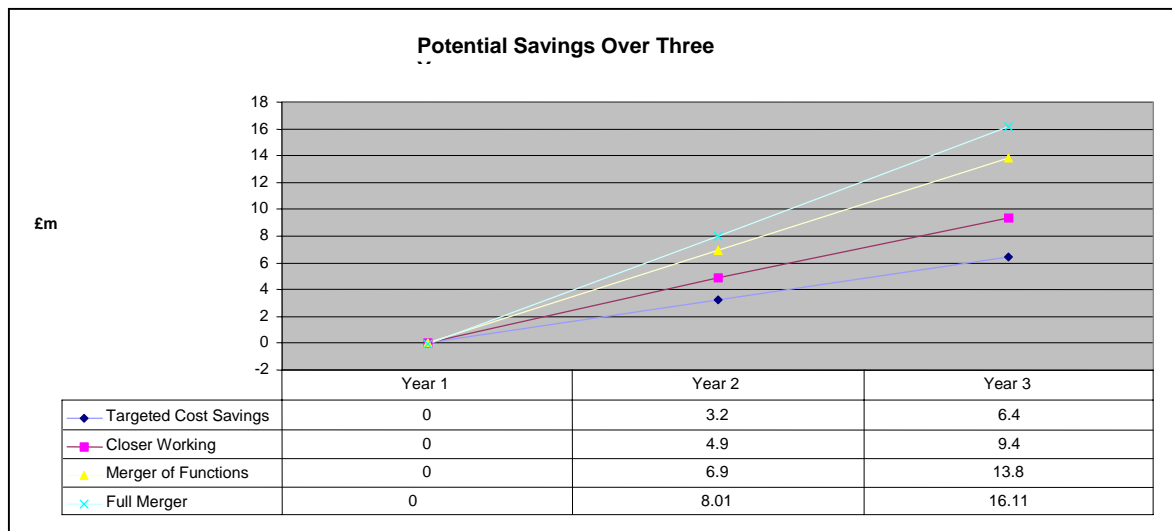
7.14 This means over a three year period, assuming all costs are incurred in year one, and savings accrue in years one, two and three the net total potential savings for the period would be £16.11m (savings of £24.3m and costs of £8.19m).

7.15 However we outline in Section 8 the risks associated with delivering the savings and the issues that will reduce the likelihood of them materialising.

### Summary of Savings and Costs

7.16 The table and chart below illustrate the estimated costs and savings of each of the options discussed. The chart, illustrates the impact of the savings over three years.

	<i>Targeted Cost Savings £M 40%</i>	<i>Closer Working £M 60%</i>	<i>Merger of Functions with Transfer to a Third Party £M 85%</i>	<i>Total Merger of Organisations (including potential transfer to third party) £M 100%</i>
<u>Cumulative Cost</u>	<u>3.2</u>	<u>4.9</u>	<u>6.9</u>	<u>8.1</u>
Cumulative Saving	3.2	4.9	6.9	8.1
Net Saving (Year 1)	0	0	0	0



## 8 Summary of Risks

### Introduction

- 8.1 As set out above, potential cost savings would certainly accrue from a number of options related to the operation of EH and HLF. However they need to be put into context against the potential risks that will be associated with delivering the savings. These risks then need to be considered before embarking on any cost saving exercise.
- 8.2 These risks have been developed at a high level and in consultation with EH and HLF.

### High Level Risks and Issues

#### *Lottery Funding is not Public Expenditure*

- 8.3 HLF funding is excluded from the Public Expenditure Planning total and from the DCMS Departmental Expenditure Limit. Any savings made in administering the National Lottery cannot be released to increase the Public Expenditure Planning Total or DCMS Departmental Expenditure limit or by extension to English Heritage

#### *Difference in Statutory Powers Between Organisations*

- 8.4 HLF and EH have significantly different statutory remits. Whilst EH protect designated historic sites and monuments and promote the built heritage in England, HLF is UK wide and awards grants across the broader heritage sector. Primary legislation would be needed to merge the two organisations and harmonise their powers.

#### *Difference in Scope of Organisations*

- 8.5 28% of HLF funding has been spent on the built heritage in England, with which English Heritage is concerned. The remaining 72% has gone to other aspects of heritage throughout the UK, which are the responsibilities of other agencies such as the MLA, English Nature. If a merger was to take place this would be a significant issue.

#### *Role of the Devolved Administrations*

- 8.6 The devolved administrations would undoubtedly protest at any changes to the status quo. The re-creation of the Heritage Lottery Fund in Scotland, Wales and Northern Ireland is likely to be unacceptable. The relative share of the Lottery Heritage Fund each country would

receive would be too small to fund projects of real significance (2002/3 total commitments for each country were Northern Ireland £11.9m, Scotland £27.7m and Wales £8.6m). It is likely that the duplication of Lottery distribution activities in each country would also increase rather than reduce administrative costs.

### ***Implementation Risks Associated with the Options***

- 8.7 As with all change programmes there are significant risks surrounding the programme of activity that will be required to drive out the required cost savings. These risks can be mitigated through project management, careful planning and benefits realisation strategies with associated additional costs. However there will still remain a level of risk that will need to be considered.

### ***Options Could Distract Organisations from Delivery of Core Activities***

- 8.8 Running a significant change programme requires careful consideration and will require senior management time. This will undoubtedly dilute the senior management time of both organisations from the delivery of core services. This risk can be managed, however it is a real risk that needs to be considered as during a significant change programme there is an danger that performance will be affected.

### ***Actual Potential Estimates of Savings and Costs Could be Materially Incorrect***

- 8.9 The nature of the review has been at a high level and therefore there is a risk that the estimate of potential savings may be over-stated. Before detailed plans are progressed a more detailed validation of the potential savings and costs associated with those savings should be undertaken. This will ensure that all parties are confident that the savings and costs are materially accurate and achievable in practice.

### ***Conflict of Interest***

- 8.10 EH properties currently benefit from HLF grants. It may be that an unacceptable conflict of interest arises if an organisation is able to award itself lottery money for the maintenance of its properties. This would be the situation if EH assumed the lottery distribution function in England or if EH and HLF were merged with their existing responsibilities.

### ***Loss of Sectoral Support***

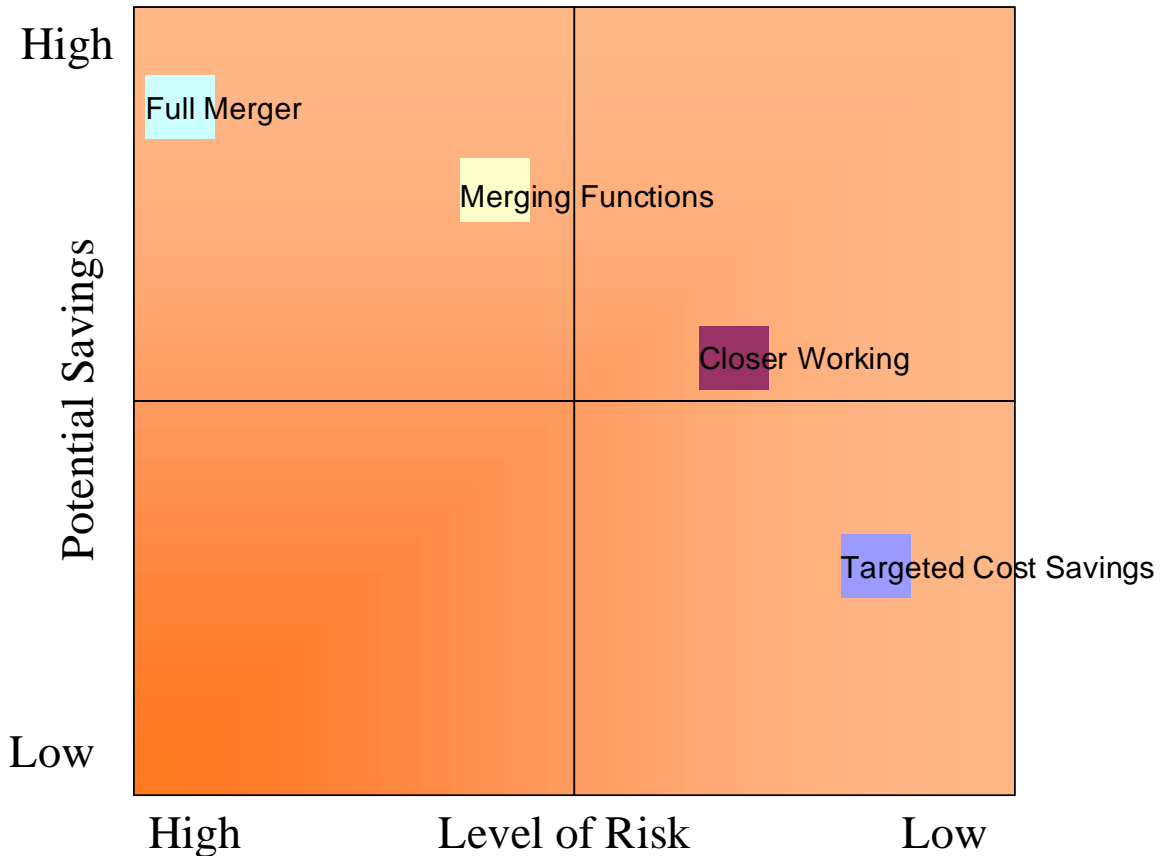
8.11 Maintaining support across the sector is crucial in implementing any changes and in securing the co-operation required to deliver a joined up service to customers. This support would be at risk if any members of the sector felt marginalised or undermined by proposals for change.

### Summary of Risks and Non-Financial Issues

8.12 The table below is a summary showing the level of perceived risk involved with each of the options. We have colour coded the risks, green to represent minimal risk, yellow more significant risk and red considerable risk to highlight the potential impact of each risk.

<i>Type of Risk</i>	<i>Targeted Cost Savings</i>	<i>Closer Working</i>	<i>Merger of Functions (including possible outsourcing)</i>	<i>Full Merger</i>
Lottery funding is not public expenditure	○	○	○	○
Powers	X	X	X	○
Wider Scope	X	X	X	○
Devolved administrations	X	X	X	○
Implementation risks	○	○	○	○
Distraction from core activities	○	○	○	○
Actual verification of savings and costs	○	○	○	○
Conflict of interest	X	X	X	○
Loss of Sectoral Support	○	○	○	○

8.13 The chart below illustrates the net cost savings associated with each option (Section 7) aligned with the risk analysis.



**Recommendation**

8.14 If the analysis above is combined with the savings and cost analysis from Section 7, then it is clear that:

- Full merger adds limited marginal cost savings and carries the most significant risks;
- Merger of functions (with potential outsourcing) is significant from a cost saving view point of view and does have some implementation risks (however avoids the political risks);
- Closer working and target cost savings are significantly less risky but do not deliver as high a level of cost savings.

8.15 We would recommend not approaching full merger at present, but considering targeted efficiency gains and closer working in the short term, followed by a move to merged

functions, possibly as part of a fuller review of allocation of service responsibility across the heritage sector.

### **Next Steps**

- 8.16 We would recommend that a detailed validation, feasibility and implementation plan is worked up (with the above options in mind) with EH and HLF, and that measures are put in place to monitor the delivery of the savings.