SUMMARY

Over the last decade, more aspects of local government activity have become subject to competitive tendering. Research has generally found a consequence to be reductions in unit costs, but the size of the reduction and the added costs of, for example, additional client-side staff have been a matter of some dispute. The changes in 1987 and 1988 to the regulations made under the Local Government, Planning and Land Act 1980, which required more highways work to be exposed to competitive tender have generated some controversy. Previously 70% of work below £50,000 could be awarded to the direct labour organisation (DLO) without competition; after April 1988 only 40% of work below £25,000 could be awarded as-of-right.

Following suggestions from the AMA, ACC and Department of Transport the Commission decided to study the impact of these changes. Detailed information was collected on the experiences of thirteen authorities over the period 1986 to 1990. The authorities include some that act as a 'control group' because they have always exposed more work to competition than required by the regulations, and which should have been relatively unaffected by the changes. The study was backed up with a questionnaire distributed to 155 authorities.

Most authorities questioned believe that the changes in the competition regulations have had a neutral or slightly beneficial effect on the client-side, and that prices charged by DLOs have either decreased in real terms or stayed the same. Contractors' prices have tended to remain unchanged in real terms. Client-side staffing has stayed the same in about half of authorities, but increased in the others. Work planning has been improved, and quality of work is no different.

The information from the authorities studied in depth corroborates the questionnaire findings. In authorities which were forced to put out to tender a significant amount of extra work, the price of work newly exposed to competition reduced on average by
14% over the period 1986-87 to 1989-90 after adjusting for cost inflation. Individual authorities experienced reductions of up to 29%. This occurred over a period when the construction industry was expanding and prices might have been expected to rise faster than costs. Indeed, the prices charged to the control group whose practices did not change have increased on average by 1% more than cost inflation (Exhibit S1).

Exhibit S1
WEIGHTED AVERAGE PRICE CHANGE OF WORK NEWLY EXPOSED TO COMPETITION

Prices have reduced by more, on average, in the non-control group of authorities which were forced to put out to tender a significant amount of extra work...

The conclusion is that it is the changes to the competition regulations which have led to the savings.

The net effect is that authorities which were forced to put much more work out to tender have saved 15% on the work newly exposed to competition compared with the control group of authorities (a saving of 4% of their total highway maintenance expenditure).

Sixty percent of authorities have not taken on extra client-side staff. In the authorities studied in-depth, additional supervisory staff have been taken on largely to redress previously existing weaknesses in contract supervision. The total cost of additional staff for tendering procedures in the non-control group of authorities is outweighed by a factor of fourteen to one by the price reductions they have received, with all but one of them showing a net financial benefit. Even if the cost of additional supervisory staff were to be taken into account a substantial net benefit would be shown.

INTRODUCTION

1 There has been much debate about the benefits and disbenefits of competition in the delivery of local authority services. A requirement to put work out to competitive tender was first introduced by the Local Government, Planning and Land Act 1980, which applied to highways, sewerage, construction and building maintenance work. More recently, the Local Government Act 1988 has required competitive tendering for an additional range of functions.

2 The original regulations of the 1980 Act stipulated that for highways work no job whose value was above £100,000 could be awarded as-of-right to the DLO. This was then amended in 1982 and 1983 to reduce the threshold to £50,000 and to allow authorities to award to the DLO as-of-right no more than 70% of the total value of work below this threshold done in the previous year by DLO or contractor. Subsequent amendments reduced the threshold further to £25,000 (from April 1987) and the maximum percentage below this that can be awarded as-of-right was decreased to 40%* (from April 1988). Exhibit 1 shows these changes. Since the introduction of the lower threshold in 1987 it has not been uplifted to account for inflation. This means that a higher proportion of work now exceeds the threshold.

* In addition, exempted jobs such as winter maintenance and emergency works can be awarded as-of-right. The total percentage of all work below the threshold awarded as-of-right can therefore exceed 40%. The regulations should be consulted for the details, or see Code of Practice for Compulsory Competition, CIPFA, 1991 (para 5.01 to 5.03)
Exhibit 1

COMPETITIVE TENDERING REGULATIONS FOR HIGHWAYS WORK

The Local Government, Planning and Land Act, 1980 allows the Secretaries of State to direct, by regulation, what work must be exposed to competition...

| Regulation: SI 1981 : No.340  
| Effective 1 April 1981  
| Set £100,000 threshold. Work below the threshold could be awarded as-of-right |
| Regulation: SI 1982 : No.225  
| Effective 1 October 1982  
| Reduced threshold to £50,000 |
| Regulation: SI 1983 : No.685  
| Effective 1 October 1983  
| Allowed a maximum of 70% of the value of work below the threshold to be awarded as-of-right |
| Regulation: SI 1987 : No.101  
| Effective 1 April 1987  
| Reduced threshold to £25,000 |
| Regulation: SI 1988 : No.160  
| Effective 1 April 1988  
| Lowered the percentage of work below the threshold which could be awarded as-of-right to 40% |

3 There was concern expressed at the time by authorities that these changes would place a heavy administrative burden on them without there being sufficient compensating benefits by way of significantly reduced prices. When the 1988 regulations were debated in Parliament, the Minister said that he would consider asking the Audit Commission to monitor their effects.

4 In 1989 the ACC, AMA and Department of Transport (DTp) wrote to the Commission requesting that a study be undertaken of the impact of the changes in the regulations. While the Commission is independent and chooses its own programme of studies, it nevertheless recognised the strength of interest in the topic, and also its relevance to the wider debate about competitive tendering. The Commission decided to undertake a fact-finding exercise to identify the impact of the changes in the thresholds before records of the situation prior to the changes were lost and recollections became blurred. The objectives were to examine the costs and savings arising from the changes to the thresholds, and to comment on other aspects such as effects on the quality of work and the ability of the direct labour organisation (DLO) to undertake emergency work and winter maintenance operations for the authority (Exhibit 2).

5 This study is one of only a handful of in-depth research exercises into the effects of competition which are based on comparisons over time and which have not relied on reporting of the financial effects by authorities themselves. Previous studies have often involved comparisons of authorities which have voluntarily contracted out services with others that have not done so. Surveys of costs before and after competition by, for example, the Local Government

Exhibit 2

THE POTENTIAL PROS AND CONS OF THE CHANGES TO THE REGULATIONS

The study was designed to evaluate the balance of the costs and benefits of changes to the highways competition regulations...
Chroniclen and Manchester City Council**, while valuable, nevertheless have relied on authorities' own assessments of costs and savings, and therefore have not necessarily achieved consistency on matters such as preparation costs and adjustments for inflation. Prior to the introduction of compulsory competition the Commission reviewed the effects of voluntary competition in a number of services, including vehicle maintenance, refuse collection and ground maintenance, using both before and after comparisons and inter-authority comparisons. The Commission also looked at competition in highways work in its 1988 report on highways maintenance, Improving the Condition of Local Authority Roads - The National Picture. A comprehensive study of compulsory competition by INLOGOV, commissioned by the DOE, has recently been published***.

6 Previous research has generally found reductions in unit costs from exposure of work to competition. In Occasional Paper No.7, Preparing for Compulsory Competition, January 1989, the Commission commented on the experience of tendering in the functions to be covered by the Local Government Act 1988. It said that this limited experience suggested that authorities could receive savings of 20% or more in contract price, irrespective of whether work had been won by the private sector or by authorities' own workforces. The evidence from surveys of the first few rounds of compulsory competitive tendering under the 1988 Act is that there have been reductions in unit prices in the range of 2.5% to 25% or more, with quite wide variations between the functions, which at least in part appear to be related to the level of interest in bidding shown by private contractors.

7 The Audit Commission's 1988 report on highways maintenance confirmed the general benefits of competition, and recommended that a substantial proportion of each main category of work (though not necessarily 100 per cent) should go out to competition. The interest in the issue of competition for highways work has been heightened by the government's abolition in October 1989 of the threshold for construction and building maintenance and exposure of all such work to competitive tender.

8 This study is based on in-depth research of the experiences over time of a sample of thirteen authorities, and has been able to make consistent adjustments for inflation and changing patterns of work. The study is a contribution to the body of evidence on the effects of competition, not just in highways, although obviously the findings have to be extrapolated to other functions with care.

9 To undertake the study the Audit Commission re-established much of the team that had undertaken the earlier highways study, including Stephen Evans, Stuart Mustow, Jez Leaper and Derek Purdy. Additional research was undertaken by David Reeson and Janet Paske. An advisory group was established consisting of representatives of the local authority associations and the DTp (Appendix 1). The group met five times during the study to discuss progress. However, responsibility for the contents of this report rests with the Commission alone.

10 This report is in four sections:

Section 1 describes the situation in highways work and the background to competitive tendering;

Section 2 describes the study methodology;

Section 3 sets out the main findings;

Section 4 considers the next steps that are appropriate.

1. HIGHWAYS WORK

11 Responsibility for motorways and trunk roads falls to the Department of Transport and the Welsh Office, while counties, London boroughs and metropolitan districts (116 authorities in total) are responsible for all other public roads in their areas. Shire districts may carry out some of the work as agents for counties. The central government departments usually appoint local highway authorities as their agents for maintenance and some new construction, so much of the expenditure is channelled through local authorities.

12 In 1986-87, expenditure in 1990-91 prices by local authorities in England and Wales on their own roads amounted to £2,368 million. In 1989-90 expenditure had risen to £2,420 million*. CIPFA figures for general highways and sewerage work suggest that the ratio of work done by DLOs

* Transport Statistics Great Britain 1979-1989

7 July 1989 and 6 July 1990

** Contractors Audit, Volume 3

*** Competitive Tendering for Local Authority Services - Initial Experiences, HMSO, 1991
to work done by contractors was 43.57 in 1989-90.

13 A survey by the Federation of Civil Engineering Contractors* shows that total work on public sector roads, including motorways and trunk roads, accounted for just over 30% of the turnover of around £4 billion of a sample of 133 of the Federation’s member firms in 1989-90.

COMPETITIVE TENDERING IN HIGHWAYS

14 On the face of it, the pre-1987 regulations might have been expected to have been sufficient to ensure that the majority of work awarded to DLOs was won in competition. In practice, it was not sufficient in many authorities, particularly for routine maintenance work and jobs such as potholing and patching.

15 Firstly, typically over a quarter of the highways maintenance budget has been regarded as not subject to the competition requirements of the Act: winter maintenance, emergency work, and certain extension jobs are specifically excluded from the competition requirements, and markings, street lighting, street sweeping, grass cutting, gully emptying and sign maintenance have commonly been regarded as outside the scope of the work covered by the Act. However, many authorities did put some of this work out to tender, and under the Local Government Act 1988 it became mandatory to go out to competitive tender for the last four of these functions. In addition, street lighting was specifically included under the 1980 Act provisions to clear up a previous ambiguity over its status.

16 Secondly, a DLO could remain viable simply by undertaking work awarded to it without competition and not bothering to bid at all for work put out to competitive tender. Until the changes in the competition regulations in 1987 and 1988, typically only a small proportion of DLO work was won in competition (Exhibit 3). Overall, in counties in 1983-4, 6.5% of highways work was won competitively by DLOs; by 1989-90 the proportion had risen to 26.2%, with a decline in DLOs’ share of the work (Exhibit 4).

* Special Survey of Civil Engineering Workload Mis. FCEC, 1991
What brought this about were the changes to the competition regulations for highways work. The threshold above which all jobs have to be put to competitive tender was reduced in April 1987 from £50,000 to £25,000, and in April 1988 the proportion of work below the threshold that can be awarded as-of-right was reduced from 70% to 40%. The impact of these changes has been mainly on highways maintenance work, because the majority of construction work has always been put out to tender. Figures from the County Surveyors' Society show that in 1985-6 (prior to the regulation changes) only 3.8% of new road and improvement work was awarded as-of-right to DLOs.

STUDY METHODOLOGY

The objective of the study was to assemble information on the costs and benefits of the changes to the highways competition regulations. This required looking back at the situation over time in a sample of authorities, to see what impact the changes had on prices of jobs, staffing levels, quality of work and other matters such as the ability of the DLO to undertake winter maintenance and emergency work.

The study had a two-pronged approach:

- detailed fieldwork was undertaken in thirteen authorities in two phases, from June to November 1990 and November 1990 to March 1991. Six other authorities were also visited (Appendix 2);
- in August 1990 a short opinion questionnaire was sent to 155 authorities except those which were visited in the first phase of the detailed fieldwork. The questionnaire was also sent to a selection of district council agents. The purpose of the questionnaire was to get information on officers' perceptions of the effects of the changes.

OPINION QUESTIONNAIRE

The questionnaire asked for perceptions of the following:

- overall benefit/detriment of the changes to the client and DLO;
- price changes (DLO and contractor);
- staffing level changes (administration, supervision, central departments);
- tendering procedures (packaging, basis of prices, allocation);
- whether there is a base workload which requires a DLO;
- the effect of the changes on quality of work done;
- the effect on work planning;
- whether there are any categories of work for which the DLO has ceased to compete.

Response rates were generally encouraging at 71% overall (Table 1). The Commission is grateful for the cooperation received from the authorities, and for the assistance of the local authority associations in encouraging a response from their members.

IN-DEPTH FIELDWORK

In addition to the questionnaire, in-depth work on prices and staffing levels was undertaken in thirteen local authorities. These were chosen to achieve a range of authority type, size and geographical distribution, and can be split into two groups: a control group of six authorities and a non-control group of seven authorities (Box 1). The reason for selecting two groups of authorities was that the changes in the regulations will have had much less effect on the control group authorities and it is therefore meaningful to compare trends between the groups. In this way it has been possible to identify the impact of the changes in the regulations (Exhibit 5).

One other authority was studied because it has never received much private sector interest in its contracts. Its prices were therefore expected to have been largely unaffected by the changes in regulations, even though the amount of work exposed to competition and the number of client staff have increased. This authority does not fit into either the control or the non-control groups, and is not shown in the tables and exhibits in this report. Two other authorities were
DEFINITIONS OF THE CONTROL GROUP AND THE NON-CONTROL GROUP

<table>
<thead>
<tr>
<th>The Control Group</th>
<th>These authorities had always exposed more work than required to competition. Although they have tended to increase the proportion of work awarded in competition, this was not because they were compelled to do so.</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Non-Control Group</td>
<td>These authorities had awarded a considerable amount of work to the DLO as-of-right, and were thus forced by the regulation changes to expose more work to competition.</td>
</tr>
</tbody>
</table>

approached but were unable to produce all the information required for the full period. Three further authorities were asked to provide information only on winter maintenance.

24 Information was requested from the study authorities for each of the years 1986-7 to 1989-90. The information covered three main topics:

- expenditure, taken from the authorities’ outturn records and the DLO returns and split by activity (i.e. general and winter maintenance and new roads, improvements and minor works), size of job and executor (i.e. DLO, contractor). Some authorities were not able to provide full information so in those cases it was necessary to rely on the more limited DLO returns. Each authority was given a degree of freedom in the range of activities covered to ensure that staffing information was compatible with workload information. In consequence the information collected for one authority cannot necessarily be compared with that for another, but trends within an authority can be observed;

ACCOUNTING FOR FACTORS INFLUENCING PRICES

25 Prices have been converted to a common base year using a job specific cost index. The cost indices were based on the Civil Engineering Indices (known as the Baxter Indices) produced monthly by the Property Services Agency, and reflect increases in the cost of labour, plant and materials experienced by contractors.

26 There may be factors in addition to cost inflation and the regulation changes which have affected prices, such as improvements in productivity and changing profit margins. However, these should be taken account of by comparing the experiences of the control group of authorities with the non-control group. Nevertheless, research was undertaken on the economic climate in the engineering industry over
the period 1985 to 1990 to see what effect this might have had on prices.

Had the increased competition brought about by the regulation changes occurred at a time when the civil engineering industry was in a lean period, one might have expected prices to reduce to some extent in comparison with costs as a consequence of the state of the industry. But when the industry came upon better times one might have expected prices to increase at above the rate of cost inflation.

Data has been obtained from the Federation of Civil Engineering Contractors which shows changes in the number of operatives on site (an indicator of the state of the industry – when there are more firms reporting an increase than are reporting a decrease in the number of operatives on site, then the industry is generally expanding). The data illustrates that the industry was in decline until 1987 and there was a period of expansion after that (Exhibit 6). Thus, over the period 1986-7 to 1989-90 prices might have been expected to increase faster than cost inflation, if anything.

Locally, other factors may have affected prices. For example, a fieldwork authority near London commented that it had become difficult for the DLO to attract labour and for the client-side to attract interest from private contractors because of the work in London's Docklands.

3. FINDINGS

29 The main effects of the changes in the competition regulations are (Exhibit 7):

— the proportion of work put out to tender has increased;
— prices adjusted for cost inflation have generally reduced;
— client-side staffing has increased in some authorities;
— the ability to respond to emergencies, including winter maintenance, has not been impaired in most authorities;
— the quality of work done, including work planning, has, if anything, improved.

In the rest of this section we review each of these areas, and then summarise the overall impact on authorities.

WORK PUT OUT TO COMPETITIVE TENDER

30 In terms of overall client-side highways expenditure only two of the authorities studied in-depth exhibited growth over the period 1986-7 to 1989-90 (Exhibit 8). Instead, many showed a substantial decline, particularly towards the end of the period. In many cases this decline has been due to reduced expenditure on new roads and improvements, but maintenance expenditure has reduced in most fieldwork authorities too. Nationally,
Exhibit 7
IMPACT OF THE REGULATION CHANGES
The benefits have more than outweighed the costs...

Exhibit 8
CHANGES IN TOTAL EXPENDITURE IN REAL TERMS IN STUDY AUTHORITIES, 1986-7 TO 1989-90
Most authorities have experienced a reduction in total expenditure...

Source: Audit Commission fieldwork

- Maintenance outturn has increased slightly in real terms over the period 1986-7 to 1989-90. Road condition, as measured by the National Road Maintenance Condition Survey* has improved in the last few years, and this is likely to be due to several causes: increased levels of spending, better value for money, and a succession of relatively mild winters.

- In almost all the authorities studied in depth the proportion of maintenance work exposed to competition has increased between 1986-7 and 1989-90 (Exhibit 9 overleaf). From this analysis, and discussions with officers, it emerges that there have been two main responses to the changes in regulations:
  - to increase levels of competition beyond the requirements. The decline in the budgets of many authorities may have encouraged them to put more work out to competitive tender in an effort to secure better value for money;
  - to implement the changes required but maintain a high level of as-of-right allocations to the DLO (case study 1 overleaf).

According to the opinion questionnaire, 83% of DLOs have continued to compete for all available types of work. Exceptions are mostly specialist treatments.

Note: Authorities are not presented in the same order in every exhibit. Expenditure figures in this exhibit have been deflated using the Standing Committee on Highway Maintenance's Highway Maintenance Price Index (SCHM:HMPi)

Exhibit 9
CHANGES IN THE PROPORTION OF MAINTENANCE EXPENDITURE EXPOSED TO COMPETITION, 1986-7 TO 1989-90
A higher proportion of maintenance expenditure is being exposed to competition in most instances...

Increase in the proportion of maintenance expenditure exposed to competition

<table>
<thead>
<tr>
<th></th>
<th>Control group</th>
<th>Non-control group</th>
</tr>
</thead>
<tbody>
<tr>
<td>60%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>40%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>20%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>-20%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Audit Commission fieldwork

CASE STUDY 1

An example of an authority with a policy to maintain a healthy DLO and to allocate to it as much work as possible without competition. The authority argues that a DLO is required to cover for winter maintenance, emergencies and certain specialist activities. The authority is currently in the process of establishing a DLO separate from the client.

The box below shows key facts for the authority over the period 1986-7 to 1989-90.

| Change in maintenance expenditure (in real terms) | -11%     |
| Change in new roads, improvements etc. expenditure (in real terms) | +128%    |
| Figures for maintenance only: | 1986-7 | 1989-90 |
| Percent done by contractors | 42%   | 48%   |
| Percent done by DLO in competition | 1%    | 21%   |
| Percent done by DLO as-of-right | 57%   | 31%   |
| Estimate of additional maintenance work exposed to competition | £0.689m |
| Additional client-side staff | tender procedures | none |
| contract supervision | | |
| Weighted average price change (compared with the control group) | -27% |
| Additional staff costs (tender procedures) | none |
| Gross savings | £0.185m |
| Net benefit | £0.185m |

The authority has received considerable financial benefit from exposing additional maintenance work to competition, particularly as the increased amount of work to be exposed to competition has been absorbed by the existing tender procedures staff.

The client-side believes that the quality of work has not changed, and sees the regulation changes as being generally beneficial. In addition, now that there is a clear split between the client and DLO, the client-side believes that it will be less inclined to award work to the DLO as-of-right.

32. The proportion of maintenance work performed by the DLO has increased in five authorities and decreased in eight. In the non-control group the proportion of the DLO's maintenance work which has been awarded in competition has increased in all but one authority (Exhibit 10). Overall, seven out of thirteen DLOs now win more than half of their maintenance work in competition.

33. Table 3 shows that for the thirteen authorities an extra £26 million of maintenance work in total has been exposed to competition between 1986-7 and 1989-90 through reducing the amount of work awarded as-of-
Exhibit 10
IMPACT OF THE CHANGES ON DLOs IN THE NON-CONTROL GROUP
DLOs are winning more of their maintenance work in competition...

![Graph showing percentage of client maintenance expenditure in DLOs and DLO as-of-right competition for non-control authorities in 1986-87 and 1989-90.]

Note: Authorities are displayed in the same order in both graphs in this exhibit.
Source: Audit Commission fieldwork.

right. Over the period, the percentage of work awarded as-of-right in the non-control authorities has decreased from 61% to 33%.

Table 3
ESTIMATED ADDITIONAL MAINTENANCE WORK EXPOSED TO COMPETITION

<table>
<thead>
<tr>
<th></th>
<th>Non-control group</th>
<th>Control group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total expenditure</td>
<td>£83.521m</td>
<td>£62.206m</td>
</tr>
<tr>
<td>1986-7*</td>
<td>£69.236m</td>
<td>£52.115m</td>
</tr>
<tr>
<td>As-of-right % awarded to DLO</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1986-7</td>
<td>61.0%</td>
<td>32.5%</td>
</tr>
<tr>
<td>1989-90</td>
<td>33.3%</td>
<td>20.2%</td>
</tr>
<tr>
<td>Additional work exposed to competition*</td>
<td>£19.106m</td>
<td>£6.514m</td>
</tr>
</tbody>
</table>

Note* in constant 1990-91 prices

Source: Audit Commission questionnaire

EFFECT ON PRICES
34 Evidence on prices comes from the fieldwork and the questionnaire. The latter shows that the majority of authorities feel that both DLO and contractor prices have either fallen or remained static. The questionnaire also shows that there seems to have been a more pronounced effect on DLO prices than contractors' (Exhibit 11).

35 The in-depth fieldwork provides more quantitative evidence of the effect of the threshold changes on prices. For each authority that was able to provide data over time, prices were obtained for up to seven typical jobs. The prices were deflated using a job specific cost index as discussed in paragraph 25, and for each authority an overall price change adjusted for cost inflation has been calculated by weighting the price change for each job by the typical proportion of expenditure by that authority on that category of work.

36 The price changes adjusted for cost inflation over the period 1986-7 to 1989-90 are shown in Exhibit 12 (overleaf). This shows a range of impacts, but the general findings are:

— in the control group of authorities, prices have increased slightly on average over and above cost inflation. In two authorities they have increased; in two others they have not changed and in two authorities...
WEIGHTED AVERAGE PRICE CHANGE, 1986-7 TO 1989-90

Prices have reduced by more, on average, in the non-control authorities...

Index of price adjusted for cost inflation (1986-7 = 100)

Source: Audit Commission fieldwork

they have reduced. These findings are in line with what might have been expected from the control group;
— all but one of the non-control group authorities have had a reduction in prices compared with cost inflation. The scale of these reductions varies from 7% to 29%.

The difference between experiences in the control group and the non-control group is statistically significant. There is some indication that the authorities experiencing the smaller price reductions in Exhibit 12 were being charged competitive prices by their DLOs and contractors before the regulation changes. For example, in one authority the DLO was awarded as-of-right work at the average of contractors' bids for similar work. Interestingly, the authority excluded from the above analysis because it claims it has not had strong private sector interest in its contracts experienced a price increase of 12% above cost inflation. This is in line with the explanation that it is competition which has stimulated the price reduction in the non-control group.

Experience in the non-control group of authorities is mixed, but overall prices have dropped by an average of 14% after taking account of cost inflation (Table 4). It is unlikely that the price reductions have all been achieved by private contractors winning more contracts: DLOs' market share has decreased in the non control group authorities, but only from 75%
to 63% (over a period when 28% more work was exposed to competition). Much of the reduction in prices is probably due to increased efficiency in the DLOs resulting in lower prices charged by them (case study 2).

Table 4

<table>
<thead>
<tr>
<th>Average Price Change After Adjusting for Cost Inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-control group (7 auths)</td>
</tr>
<tr>
<td>+1.2%</td>
</tr>
<tr>
<td>Control group (6 auths)</td>
</tr>
<tr>
<td>-14.1%</td>
</tr>
</tbody>
</table>

EFFECT ON STAFFING LEVELS

It might have been expected that most authorities would have had to increase client-side staffing levels in order to cope with the extra administrative burden of increased competitive tendering, but some authorities have been able to cope with the additional burden by taking up slack in their operations. The questionnaire findings suggest that increased staffing has occurred in only about half of authorities (Exhibit 13).

Exhibit 13
REPORTED EFFECT ON CLIENT-SIDE STAFFING ESTABLISHMENT LEVELS

About half of authorities report no increase in staffing levels...
CASE STUDY 2

An example of an authority with a policy to maintain a healthy DLO and to allocate to it as much work as possible without competition. The authority argues that a DLO is required to cover for winter maintenance, emergencies and certain specialist activities.

The box below shows key facts for the authority over the period 1986-7 to 1989-90.

| Change in maintenance expenditure (in real terms) | -14% |
| Change in new roads, improvements etc. expenditure (in real terms) | +151% |
| Figures for maintenance only: | |
| 1986-7 | 1989-90 |
| Percent done by contractors | 26% | 25% |
| Percent done by DLO in competition | 0% | 28% |
| Percent done by DLO as-of-right | 74% | 47% |
| Estimate of additional maintenance work exposed to competition | £1.699m |
| Additional client-side staff | | |
| tender procedures | +5.2 FTE |
| contract supervision | +4.0 FTE |
| Weighted average price change (compared with the control group) | -26% |
| Additional staff costs (tender procedures) | £0.104m |
| Gross savings | £0.440m |
| Net benefit | £0.336m |

The authority has received considerable financial benefit from exposing additional maintenance work to competition, even though it has taken on more additional client-side tender procedures staff than any other study authority.

The price reductions have been over a period when more work was exposed to competition, but the DLO actually increased its market share. The price reductions therefore seem to have been achieved by the DLO increasing its efficiency.

The client-side believes that the quality of work has not changed, and sees the regulation changes as being generally beneficial.

40 It is in counties that the effect seems to have been greatest: 70% of responding counties say that the number of staff administering tendering has increased, and over half of them have increased the numbers of supervisory staff (Exhibit 14).

41 The in-depth fieldwork concentrated on personnel administering tender procedures and supervising contracts. The changes in staff numbers for each authority are consistent with the questionnaire findings (Exhibit 15 overleaf). No authority has taken on or transferred large numbers of extra

Exhibit 14
REPORTED EFFECT ON STAFFING LEVELS BY AUTHORITY TYPE
Counties are more likely to have taken on additional staff...

Source: Audit Commission questionnaire.
Most authorities have not taken on or transferred additional staff... since they are in many cases redressing long-standing weaknesses in supervision. The calculation of net benefit in this report has therefore excluded the cost of additional supervisory staff, although the conclusion would not be affected if they were included.

<table>
<thead>
<tr>
<th>Tendering Procedures (FTE)</th>
<th>Cost of staff @ £204k per FTE</th>
<th>£8k per FTE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-control group</td>
<td>10.2</td>
<td>0.4</td>
</tr>
<tr>
<td>Control group</td>
<td>0.4</td>
<td>0.3</td>
</tr>
</tbody>
</table>
check for any staffing movements between the client-side and the DLO and to see how competition had affected DLO manning. No evidence was found of surplus DLO staff simply transferring to the client-side.

**EFFECT ON DLOS’ EMERGENCY RÔLE**

47 From the questionnaire, 72% of authorities believe that there is a base of work which by its nature requires a permanent DLO to do it – typically winter maintenance, emergency patching and potholing and responding to emergencies such as the gales of recent winters. Some authorities claim that their DLO is approaching the size below which it will be unable to undertake winter maintenance.

48 Five authorities in both northern and southern England which have put winter maintenance operations out to tender were studied. The authorities were risk averse and keen to ensure that the successful contractor would be capable of the task. Interested contractors included DLOs, ex-DLO management buy-outs (MBOs), local and national firms and foreign companies from France, Holland and the US.

49 In all cases there was some private sector interest, although this did not result in a bid in every case. One authority received as many as seven bids, another only one. In one case where there were only two bidders this was largely because although nine companies had been expected to. In this latter case, the authority had sent out a questionnaire to contractors to establish what type of contracts they would be interested in and had then used this information in developing their contract strategy to try to encourage as much interest as possible.

50 In the authorities studied, two contracts were let to the authority’s DLO and two to MBOs (although one of these was not the authority’s own ex-DLO). Another authority let contracts to a number of private companies, covering one to four routes per contract. Where private companies were used there had been no complaints about the service provided. Indeed, two authorities employing private contractors for some of their routes intend to increase the number of routes put out to tender next year.

51 Two authorities put some of their routes out to tender for a year and another included winter maintenance in their schedule of rates to run for five years. One packaged it with street cleansing and refuse collection. Most contracts were for labour only, one was for labour and vehicles and another was for labour, vehicles and depots. Retaining ownership of depots and plant and making them available to the successful contractor or DLO gave authorities the assurance that if the contractor were to fail the authority could reconstitute the service quickly in order to fulfil their statutory obligations.

52 The Department of Transport also has experience of letting winter maintenance contracts for its motorways and trunk roads. Local authorities are used as agents with agreements subject to annual renewal, or private consulting engineers are employed on three to five year contracts to put out and manage the work. The successful contractor is placed on a term maintenance contract which includes routine maintenance.

53 This review has shown that it is certainly possible to contract out winter maintenance, although experience of using the private sector, other than through ex-DLO management buy-outs, is limited. Further research would be required to compare the costs of in-house and contracted out winter maintenance operations.

**OTHER EFFECTS**

54 The main findings from the questionnaire are as follows:

- packaging of work has changed in 49% of authorities;
- the way of obtaining tender prices has changed in 26%;
- the way in which work is allocated has changed in 37%;
- the quality of work does not seem to have been affected: 11% of respondents stated that quality had deteriorated, whilst 15% stated it had improved. The rest said it had been unaffected;
- the majority (59%) of authorities believe that the changes have led to an improvement in work planning procedures. Only 18% believe they have had a detrimental effect.

55 Most of the authorities reviewed in depth did not remark that quality of work had been significantly affected, but some felt that the quality of service had deteriorated because, for example, the client-side now felt unable to ask contractors to do a small piece of unplanned work on their way
back from some planned work. A second aspect to quality is getting the work done at the client’s convenience. None of the study authorities stated that this was a problem with work newly exposed, although one authority did state that it had problems with getting reconstruction work done when it wanted.

OVERALL IMPACT OF THE CHANGES TO THE REGULATIONS

56 In general the responses from the questionnaire are that the changes in regulations are perceived as being generally beneficial, at least as far as the client-side is concerned (Exhibits 17 and 18). Counties are much less enthusiastic about the regulation changes from the client’s perspective than other authorities. The effect on the DLO is perceived as being much less beneficial, probably because competition has forced it to make changes, and it may well have had to shed jobs.

57 Both the opinion questionnaire and in-depth visits reveal that officers are convinced that there have been non-financial benefits from increased competition. These include clearer managerial responsibilities, better specification of work, and improved planning of work. But what of the financial evaluation? Have authorities been over-burdened by additional staff costs?

58 Table 6 shows the costs incurred in the non-control group authorities, and also shows the average price impact and the value of this change on the additional maintenance work exposed to competition. The savings achieved by the non-control group are taken to be 15.1%, on the assumption implicit

Exhibit 17
PERCEPTIONS OF THE OVERALL EFFECT OF THE CHANGES ON THE AUTHORITY
Most authorities perceive a benefit to the client, but not to the DLO...

Exhibit 18
PERCEPTIONS OF THE OVERALL EFFECT – NET RESULTS
London boroughs view the changes more favourably than other classes of authority...

Note: Net results are calculated by subtracting negative results from positive results, and dividing by all respondents. No differentiation is made between ‘very’ and ‘slightly’ responses.

Source: Audit Commission questionnaire

in the design of the study that had it not been for the increased competitive tendering prices would have risen by the 1.2% that has occurred in the control group (Table 4).

59 It is debatable whether the price changes found should be applied to just the additional work exposed to competition, or whether they should be applied to all work exposed to competition in 1989-90. The former, conservative, method has been used as the basis of calculation in this report, because the jobs selected for pricing are representative of the work likely to have been most affected by increased
tendering. If the price reductions were applicable to all maintenance work exposed to competition in 1989-90 their value for non-control authorities would be £7.3m, as opposed to £2.9m.

Table 6
CALCULATION OF NET BENEFIT IN THE NON-CONTROL GROUP

| Cost of additional tender procedures staff @ £20k | £0.204m |
| Average price change | -15.1% |
| Additional work exposed to competition | £19.106m |
| Value of price change* | £2.885m |
| **NET BENEFIT** | £2.681m |

Note*: Calculated on the increased percentage of work exposed to competition

The table shows that in the non-control authorities, the costs of additional tender procedures staff have been outweighed by the price benefits by a ratio of fourteen to one. Even if the costs of employing additional supervisory staff were to be taken into account a substantial net benefit would be shown.

For all but one of the non-control authorities there has been a financial net benefit (Exhibit 19). The reason for the exception is that prices increased by 3% compared with the control group (case study 3).

Assessing the impact on the control group is more problematic. Prices have risen by 1.2% compared with cost inflation, but it is arguable that they might have risen more had the control group authorities not increased the amount of work exposed to competition. Also, the basket of jobs was not chosen to be representative of the work newly exposed to competition by the control group, having been chosen

Exhibit 19
NET FINANCIAL BENEFIT IN THE NON-CONTROL AUTHORITIES

<table>
<thead>
<tr>
<th>Annual net benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>£1.6m</td>
</tr>
<tr>
<td>£1.4m</td>
</tr>
<tr>
<td>£1.2m</td>
</tr>
<tr>
<td>£1.0m</td>
</tr>
<tr>
<td>£0.8m</td>
</tr>
<tr>
<td>£0.6m</td>
</tr>
<tr>
<td>£0.4m</td>
</tr>
<tr>
<td>£0.2m</td>
</tr>
<tr>
<td>£0.0m</td>
</tr>
</tbody>
</table>

Non-control authorities

Source: Audit Commission fieldwork

CASE STUDY 3
An example of an authority which had protected its DLO as far as possible, but as a result of changes to the regulations and, more importantly, severely reduced budget allocations for both improvements and maintenance it has implemented a considerable increase in the proportion of work awarded in competition.

The box below shows key facts for the authority over the period 1986-7 to 1989-90.

| Change in total expenditure (in real terms) | -14% |
| Percent done by contractors | 25% | 54% |
| Percent done by DLO in competition | 12% | 24% |
| Percent done by DLO as-of-right | 63% | 22% |
| Additional client-side staff tender procedures | +1.0 FTE |
| contract supervision | none |
| Weighted average price change (compared with the control group) | +3% |

Prices have increased by 3% compared with the control group, so the authority has received a financial disbenefit despite exposing additional work to competition.

However, the fact that the DLO has not fared well in competition suggests that had the authority maintained its policy of awarding the maximum amount of work to the DLO as-of-right then prices would have risen higher. Officers from the authority commented that manual workers in the area were being attracted by the wages paid in London's Docklands, and this led to the DLO having problems recruiting.

The client-side believes that the quality of work has not changed, and sees the regulation changes as being generally beneficial.
to be representative of the non-control group.

63 It is difficult to extrapolate these findings nationally, because information on authorities' tendering patterns is not collated, except for counties by the County Surveyors' Society. If it is assumed that the picture in counties is representative of other types of authority, then analysis of the information suggests that nationally £270m of maintenance work has been newly exposed to competition, and net savings are likely to be in the region of £25m a year.

4. NEXT STEPS

64 Although this is an Information Paper, it is appropriate to consider briefly the issues that the study has raised. Two issues immediately present themselves:

— have authorities sought to get round the regulations?
— could there be benefit from further changes to the regulations?

COMPLIANCE WITH THE REGULATIONS

65 The study team has discovered no evidence that the DLO regulations have been deliberately flouted, and little evidence of a change in packaging of work to enable more work to be awarded as-of-right. There are, however, slightly differing practices in terms of the work excluded from the tendering requirements, and on what constitutes a job for the purpose of deciding what work is above or below the threshold.

66 The regulations are convoluted, and guidance on their interpretation is scattered amongst a number of different documents. There may be benefit in the DOE or DTp and Welsh Office issuing consolidated guidance with some worked examples.

67 Furthermore, the level of information presented in authorities' DLO accounts varies considerably. In none of the study authorities is it possible to tell from the accounts alone whether the authority has complied with the legislation. The form of DLO accounts could be amended to require this to be shown.

SHOULD THERE BE FURTHER CHANGES TO THE REGULATIONS?

68 In those authorities which were forced by the regulations to expose significant amounts of extra work to competition, there has been an average saving of 15% on the extra work compared with a control group of authorities which have always put more work than required out to tender.

69 The study has shown that, overall, the changes to the highways competition regulations have had a net beneficial effect financially, and that most authorities consider the non-financial effects to have been favourable, if anything. Would there be benefit from exposing more work to competitive tender? The study did not set out specifically to examine this question, but some of the relevant considerations are set out below.

70 Of functions exposed to compulsory competition only highways and sewer work have competition-free allowances in addition to emergency work. Authorities argue for the retention of the allowance because they consider that DLOs have a winter maintenance and emergency role which cannot readily be undertaken by private contractors. This study has shown that winter maintenance operations can be put out to tender, although experience of using the private sector, other than through ex-DLO management buy-outs, is limited.

71 Many local authorities are genuinely unconvinced of the ability of the private sector to provide a winter maintenance service, and are concerned how they would respond to major emergencies without a DLO. In some emergencies it might be difficult for an authority to hire-in sufficient resources quickly, although authorities employing contractors operating a day in, day out function for them should have much less difficulty because such eventualities could be catered for in the contracts.

72 The issue of an effective response to winter weather and emergencies is at the heart of any debate about the value of retaining a highways DLO. Further research would be needed on this, including a comparison of the costs of in-house and contracted out winter maintenance operations and a review of how authorities with small DLOs respond to emergencies. It may be that the issue will not be resolved until more authorities have had experience of using private firms for winter maintenance and response to emergencies.

73 Putting this issue aside there is also the question of whether there would be a financial benefit from exposing further highways work to competition. The results of this study cannot
necessarily be extrapolated to infer what might happen if more work were to be exposed to competition, but does the experience of the control group of authorities have some bearing on this?

74 The control group started from a base of already exposing a considerable amount of work to competitive tender (Table 3, page 11). They voluntarily exposed more work to competition, but as a group do not appear to have received a reduction in prices after adjusting for cost inflation. However, individual experiences vary and the basket of priced jobs was not chosen to be representative of the work newly exposed to competition by the control group authorities. It is also possible to argue that as a group they might have experienced a larger price increase had they not put more work out to competition (which is what happened to the authority which claims it has not had much private sector interest in its contracts).

75 The Commission has argued that the cost of in-house services should be tested against the market place from time to time. This is a good means of demonstrating that the authority has discharged its fiduciary duty to its chargepayers.

76 However, as the regulations stand, some DLOs are continuing to be awarded the majority of their authority’s highway maintenance work with only a small proportion won competitively (Exhibit 20). This is because the competition requirements apply to all highways work, and most authorities award the bulk of construction and improvement work below £25,000 competitively, leaving the proportion of maintenance work that can be

Exhibit 20
THE PERCENTAGE OF DLOs’ MAINTENANCE WORK AWARDED AS-OF-RIGHT, 1989-90
Some DLOs are continuing to operate with only a small proportion of the maintenance work they undertake won competitively...

![Percentage of maintenance work awarded as-of-right](chart)

Source: Audit Commission fieldwork

awarded as-of-right relatively unconstrained in those authorities with a significant volume of non-maintenance work below the threshold. Also, the incidence of non-maintenance work can be erratic, and its inclusion in the workload calculation means that the proportion of maintenance work that can be awarded as-of-right can vary from one year to another.

77 While it may prove difficult and contentious to weigh these various considerations at a national level and amend the regulations, at a local level it may be possible to identify the ways of shifting the balance to an authority’s benefit. With this in mind, the Audit Commission will be producing guidance to auditors early next year should they or their authorities wish to examine these issues and their own experience of competitive tendering.
APPENDIX 1

COMPOSITION OF THE ADVISORY GROUP

Representing the Association of Metropolitan Authorities (AMA):

Bob Bird, Under Secretary, AMA
Roy Sumner, Borough Engineer & Surveyor, Trafford Borough Council
Peter Garghan, Deputy Chief Accountant, City of Birmingham
Tony Williams, Director of Technical Services, London Borough of Barnet

Representing the Association of County Councils (ACC):

David Stazicker, Under Secretary, ACC
Keith Williams, County Surveyor, West Sussex County Council

Representing the Association of District Councils (ADC):

Bob Lelliott, Borough Engineer & Surveyor, Bournemouth Borough Council

Representing the Department of Transport (DTP):

John Gant, Network General & Maintenance Division

APPENDIX 2

AUTHORITIES PARTICIPATING IN FIELDWORK FOR THE STUDY

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Cornwall County Council
Cumbria County Council
Devon County Council
Ealing London Borough Council
Havering London Borough Council
Hove Borough Council
Ipswich Borough Council
Mid Glamorgan County Council
Newcastle upon Tyne City Council
Northamptonshire County Council
Nottinghamshire County Council
Solihull Metropolitan Borough Council
Southwark London Borough Council
Trafford Metropolitan Borough Council
Warrington Borough Council
West Sussex County Council
Wirral Metropolitan Borough Council

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