PREPARING FOR COMPULSORY COMPETITION

SUMMARY

The compulsory competitive tendering (CCT) provisions of the Local Government Act 1988 will produce major changes in local authorities. In future, for a range of services, authorities will not be able to use their own workforce unless the work has been won in competition with the private sector. But authorities will still fund services and retain control of policy matters, such as, the standards and quality of service.

The Audit Commission supports competition as a matter of principle. It offers the potential for both lower costs and better services; the limited experience of tendering to date suggests that authorities can receive savings of 20 per cent or more in contract price irrespective of whether work has been won by the private sector or by authorities' own workforces (Exhibit 1).

Councils must ensure that the quality of service provided does not unintentionally fall as a result. Contract specifications should accurately reflect the council's policy objectives. Contractors must be carefully selected and they or the authority's direct service organisation (DSO) must be firmly but fairly supervised. Robust monitoring systems will be required.

Most, but not all, authorities will wish to give their own workforces the chance to tender; and experience suggests that, whoever wins, authorities are likely to secure the best prices when an efficient in-house operation puts in a bid.

Authorities should set a clear strategy for their DSOs to follow. The DSO may confine itself to existing work from the parent authority or bid for other eligible customers' work; it may compete across the board or identify a niche.

Having chosen a strategy an authority will need to structure its management accordingly. This should almost certainly involve a clear separation of the 'client' and 'contractor' functions, at member and officer level.

The client role will require new skills and procedures. Work is needed on the DSO side, too. Many council workforces have made significant improvements in efficiency over the last few years; others have always performed well. Further improvements are, however, needed in many authorities if the in-house bid is to be competitive.

Exhibit 1
COST SAVINGS ACHIEVED BY VOLUNTARY COMPETITION IN REFUSE COLLECTION

The evidence suggests that competitive tendering leads to cost reduction

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Source: Audit Commission fieldwork and analysis of CIPFA statistics
INTRODUCTION

1 The Audit Commission believes that local authority services should be subjected regularly to the test of the market place. This is not to say that a local authority cannot maintain a workforce of its own. But that workforce must show that its costs are in line with best practice elsewhere.

2 The Commission's earlier paper Competitiveness and contracting out of local authorities' services argued that competition would help to realise savings and improvements worth many hundreds of millions of pounds a year. Evidence from the Commission's own analysis of costs, service by service, and early indications of the level of private sector bids, suggest that that judgement was correct. Authorities which have already, voluntarily, put work out to competition have made substantial net savings.

3 CCT will force comparisons between in-house and contractors' costs which authorities ought to have been undertaking as a matter of good management practice. In a range of services—street cleansing, ground maintenance, refuse collection, building cleaning, vehicle maintenance and catering—local authorities will only be able to use their own workforce if they win the work in open competition. Otherwise it will be carried out by contractors or in some instances by other agencies such as voluntary bodies.

4 The change is much greater than that caused by the Local Government Planning and Land Act 1980, which required compulsory competition in building works and highway maintenance. Local authority employees were still able to carry out some building and highways work as of right under this legislation. Though changes in regulations since 1980 have forced increasing volumes of building and highways work to competition, building and highways direct labour organisations (DLOs) have had several years to adjust to the new climate (Exhibit 2). As individual contracts awarded under the 1980 Act tend to be either for small portions of total workload or for short periods, loss of a single contract does not have a decisive impact on the DLO. In contrast, the new direct service organisations have had little time to adjust to the 1988 Act, under which contracts will be for long periods and may be for substantial portions or even, in the case of many refuse collection and street sweeping contracts, the total workload.

5 CCT is not privatisation. Under the 1988 Act authorities will still retain control of policy matters such as the standards, quality and frequency of work and prices charged to the public. But they will be transformed from service providers to service managers. The approach has parallels in the private sector where, as described in the CBI report The competitive advantage companies such as Rank Xerox, Midland Bank and Vauxhall Motors contract out a wide range of activities which are not part of their 'core business'.

6 The Act has wider implications. The private sector will undoubtedly win some contracts, leading to redundancies in DSOs and reductions in overall local authority manpower. Pay and terms of employment need to change to reflect the local labour market. In some places, and for some skills, the overall package will improve; in other places, and for other services, total pay will fall and fringe benefits be reduced.

Exhibit 2
THE PERCENTAGE OF COUNTIES' HIGHWAYS DLO WORK WON IN COMPETITION

In many highway authorities exposure of DLOs to competition is still small, though increasing.

Source: County Surveyors' Society questionnaire

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4 Competitiveness and contracting out of local authorities' services. HMSO 1987 ISBN 0 11 7013322
5 The Government also intends to extend competition to management of sports and recreation facilities.
6 The competitive advantage CBI October 1988 ISBN 0 85 2013538
7. Much has already been written on the effect of competition on prices and services. The Commission has already published advice on client-side aspects of services (building maintenance and highway maintenance) placed to competition under the Local Government Planning and Land Act 1980 and a report on client-side aspects of ground maintenance. It will soon publish a report on building DLOs.

8. This Occasional Paper therefore concentrates on the services defined under the 1988 Act, and offers advice on how authorities need to respond to the challenge of competition. Section 1 reviews the decisions needed on overall policy and strategy and Section 2 describes the organisational changes required. Section 3 sets out what clients need to do to manage competition successfully and Section 4 offers advice to DSOs on improving efficiency.

1. SETTING THE POLICY

9. Although compulsory competitive tendering will radically alter the way council services are managed and delivered, it does not in any way affect the responsibility of local authorities for the quality of those services. Council members and officers should not consider that their responsibility for effectiveness has been removed if a service is contracted out. The statutory duties and responsibilities of local authorities are unchanged.

10. As the Commission pointed out in its paper The competitive council the customers for council services have become increasingly concerned about the quality of service provision. Many authorities have not recognised this shift and do not yet have mechanisms for assessing the quality and effectiveness of their services.

...There is no reason why CCT should result in an unplanned lowering of the quality of services...

11. CCT will make it more important than ever for councils to bridge that gap. If services are moved from the council’s DSO to a contractor, local residents will be particularly concerned to see that the quality of service does not suffer. If it does, even though the fault may lie with a private contractor, they will inevitably see the council as being finally responsible. The focus of attention of members and senior officers (except in the DSO itself) should switch from problems of management to a concern with quality and effectiveness.

12. The first need in all areas will be to set out a clear specification of the levels of service which the council wishes to maintain. This specification should as far as possible be cast in the form of service outcomes, rather than (as has traditionally been the case) in the form of the quantity of input required. To put this simply, councils may wish to specify how short they want the grass to be, rather than how many operatives they want on the job.

13. If authorities are clear about their policy objectives, there is no reason whatsoever why CCT should result in an unplanned lowering of the quality of services. Indeed, there may be a tendency for service quality to improve if authorities take the opportunity of setting up better monitoring mechanisms for in-house and contracted-out operations. Of course it remains open for authorities to decide, as a matter of policy, to up- or down-grade service quality and to increase or reduce local taxation. These decisions are not necessarily affected one way or the other by competition.

POLICY DECISIONS

14. A key decision an authority needs to make is whether it wishes to operate within the provisions of the 1988 Act or not. The CCT provisions only apply if a council wishes to give its own or another authority’s DSO an opportunity to bid for the work. If it chooses not to do so and to award all contracts to private contractors, then it may organise the contract and tender processes without regard to the CCT provisions of the 1988 Act. In these circumstances it will be no less important to ensure that competitive bids are attracted. There are examples of authorities which are operating a 100 per cent contracting out policy but are not maximising their value for money because they use a restricted list of contractors or award contracts without competitive tendering.

15. For most authorities, however, the problem will be how to operate within CCT. The great majority are planning to allow either their own or other DSOs to bid for work.

16. Having made this decision, there are still important policy questions quite outside those concerning organisation and contract management discussed later in this paper. For example,
the authority needs to decide whether its own DSO is to be encouraged to bid for all the contracts or only for some of them. It also needs to decide whether its DSO is to concentrate only on in-house work or whether it should look for other contracts elsewhere within the terms of the Local Authorities (Goods and Services) Act 1970.

17 There will be a number of influences on these policy decisions. The council may have a view about the desirability of maintaining its position as an employer. Many authorities aim to operate as a good practice employer in their area. Indeed, considerations of this kind led to the establishment of many DSOs in the first place. Another reasonable consideration is a perceived need for some in-house expertise for emergencies and back-up work. There is no reason in principle why external contractors should not be able to provide such services but some authorities may wish to retain a modest amount of in-house capacity. Another factor must be the attitude of the DSO itself. Does it want to compete for work elsewhere? What is the attitude of DSO operatives to competition? Are they prepared to work for an operation which has to secure its future through achieving competitive prices?

18 It is not unreasonable to pursue a strategy of trying to retain as much work in-house as possible. Whether that strategy is capable of implementation will, of course, depend on the achievement of competitive prices. Otherwise keeping the work in-house will leave the authority open to charges of anti-competitive behaviour.

STRATEGIC OPTIONS

19 In general terms, there are four strategic options open to an authority which wishes to operate within CCT. The strategic game-board (Exhibit 3) shows how these different strategies may be defined. The two axes are:

- the markets within which the DSO chooses to operate; its existing markets (usually the authority itself) or new markets, in other words other authorities, housing associations, etc.

- the product or services which the DSO plans to offer. Will it be a niche player, concentrating on certain types of work at which it believes it is competitive, or try to compete across the board?

20 Obviously, there are different combinations of strategic approach which could produce an outcome straddling the boxes of the matrix. The implications of the main choices available are given below.

Option 1: Across the board, new and existing markets

21 This is the most ambitious option. It implies that the council’s DSO will aim to be competitive in all its services and will look for opportunities to expand outside its current client base. Changes in education and housing law mean that some service responsibilities will pass from local authorities to other bodies such as housing associations. So in some cases retaining current work volumes will involve selling services to new clients.

22 If the DSO is outstandingly competitive it may be a profitable route to take. But it is certainly the highest risk option a council can adopt since it may imply an increase in staff and considerable investment in preparing bids within and outside the authority. An

Exhibit 3

DSO CONTRACT STRATEGY

There are four options:

NEW AND EXISTING

CUSTOMERS

EXISTING

ACROSS THE BOARD

NICHE

SERVICES

Bid for the whole range of work from both the DSO’s own authority and other customers

Bid for the whole range of work from the DSO’s own authority only

Bid for special work from both the DSO’s own authority and other customers

Bid for specialist work from the DSO’s own authority only

OPTION 1

OPTION 2

OPTION 3

OPTION 4
authority should only consider this option where it already has sound reason to believe that its own DSO's prices are highly competitive and where it is confident that the management of the DSO, and its workforce, are competent and highly motivated to succeed. Even if success is achieved in the short term, and the authority generates surpluses, it is important to recognise that in the longer run the council remains exposed to a risk of higher redundancy payments if the additional work levels are not maintained.

Option 2: Across the board, existing markets

For most authorities this is the status quo. But they should not remain committed to it without making a positive choice. It may well be that there are areas of work in which the DSO is not competitive and where competing with little chance of success could be a costly distraction.

On the other side of the coin, if a DSO is genuinely competitive then why should it not bid for such additional work as is open to it? Authorities may have reason to believe that competition from the DSO will offer protection against price rings. They may have doubts about the long-term viability of the DSO but believe that the local market for services going to competition is weak. These assumptions can be tested empirically.

Option 3: Niche, new and existing markets

A niche business in this context would be a DSO which concluded from an examination of its own costs and those incurred by potential competitors that it was not likely to be competitive in all areas of the business. This might be for structural reasons, or because of trade union resistance, or perhaps past under-investment. On the other hand, a DSO might well identify particular parts of the business at which it has a competitive advantage. In the building area, for example, some DLOs have proved competitive in jobbing repairs where they are able to offer a schedule of rates which is attractive. Many have found, however, that large scale jobs such as re-roofing or replacing windows on a complete estate attract very tight bids from the private sector which the in-house operation cannot match, perhaps because it lacks the necessary specialist skills.

In these circumstances, it can make good sense in the long run to decide that the council will not attempt to bid for all its current work but retain an in-house capacity to undertake those parts of it which are not currently well understood or provided by the private sector. If expertise in a narrower field of business is built up, then greater economies of scale may be achieved through taking on similar work for other authorities or housing associations.

... The niche, existing markets option is likely to be the safest for most authorities...

Option 4: Niche, existing markets

Here the same arguments apply, but the council makes an explicit decision not to increase the size and therefore risk of the business by seeking external contracts. To retain all that market the DSO must again be able to market its services to the new clients created by changes in education and housing law.

This option is likely to be the safest and, in the long run, to represent the best value for money for most authorities. The factors which help DSOs to be competitive—knowledge of the business, local deposits, short travelling times—are less likely to apply outside their home territory.

LONG-TERM IMPLICATIONS

In deciding on its approach to the future under CCT an authority should also consider the long-term implications of its chosen strategy. The most important question concerns the authority's long-term intentions in relation to its DSO. Does it, for example, intend to allow the DSO to behave in a straightforward commercial manner and, therefore, eschew any attempts to use it to further social objectives (equal opportunities policies, etc.)? If this is the case then what is the value of the DSO to the authority? Might it not be preferable to consider a management buy-out or a sale? (Considering a sale or buy-out raises different considerations, beyond the scope of this paper. Authorities will need to take care that assets are not disposed of at below true value. It is almost certainly advisable to invite interested managers to make a sealed bid in competition with outside bodies).

There is no single best answer. Circumstances will vary. But there is a danger that some authorities may put themselves in a position where they are committed to the maintenance of a DSO structure which is not ideal from the DSO's point of view and, on the other hand, has no inherent attractions for the authority since the authority is not able to pursue its political or social objectives through the DSO. In those circumstances the link between the two may not be beneficial for either side.
The most damaging situation is one of continued uncertainty. If DSO managers are uncertain about the council's future intentions they will find it difficult to plan and manage for long-term success. Council policies may change with political control but it should be every authority's objective to set long-term policy guidelines within which its DSO can operate.

* * *

Having set the strategy, an authority then needs to adopt a structure which is consistent with it. The next Section examines the organisational issues which authorities need to address.

2. CHANGING THE ORGANISATION

THE CLIENT-CONTRACTOR SPLIT

A local authority should now regard itself principally as a policy maker and employer of contractors; an authority's own DSO may act as contractor but only if the work is won in competition. It is therefore vital to define clear client roles for committees and officers. The client should:

- assess consumer demand and satisfaction;
- develop new ideas on service provision and quality;
- define desired levels and quality of provision;
- plan for, and secure, adequate financial resources to support that provision;
- manage the competitive tendering process;
- and
- monitor achievement against policy.

The need for a clearly defined client role is uncontroversial; where clients should be located within the committee and departmental structure is more debatable. There is a range of options (Exhibit 4). The Audit Commission believes strongly that there should be a clear separation between client and contractor and does not favour approaches in which the two remain within the same department or report to the same committee. At member level, separation is best achieved through separate committees. A number of authorities have achieved this separation by having the DSO report to a board, constituted as a sub-committee of say, the Policy and Resources Committee, but operating in a far more commercial way. At officer level, separation can best be achieved through separate departments or alternatively through clear definition and division of responsibilities within departments.

The main reasons for advocating separation are:

- clients should be concerned with service standards and value for money. Contractors should be concerned with winning contracts and performing to standard and price; the demands of this function are quite different. 'Two-hattedness' could muddle priorities and result in officers and members compromising objectives: for example, the client's specification could be influenced by considerations directed to supporting the in-house contractor and unrelated to the council's overall objectives;
- the in-house contractor is more likely to operate competitively if separate from the client. In most authorities achieving competitiveness will require changes to basic working attitudes, methods, pay and conditions. These changes are more likely to be achieved in a free-standing DSO where the manager can manage more commercially. In a small authority, where there is no separation of client and contractor,
the post of DSO manager may be too junior to be sufficiently attractive to a high calibre manager;

- it will demonstrate that the authority is serious about giving equal treatment to all contractors—private or in-house. Leaving the in-house contractor in the same department as the client may dissuade contractors from bidding (thus reducing the prospect of improved value for money) and leave the authority open to accusations of anti-competitive-ness, whether or not there is substance to the charge;

- it will help authorities put more emphasis on general management skills rather than professional qualifications.

36 The Audit Commission's earlier work on vehicle fleet management* and highways maintenance has illustrated some of these points; client policies and budgets can be driven by DSO considerations when officers have both responsibilities. Budgets are staffing-led and service levels and priorities are not altered as needs change, leading, for example, to over frequent sweeping, gully emptying and grass cutting and to over maintenance of vehicles.

37 Such considerations easily outweigh the possible disadvantages of a full client-contractor split. Some authorities claim that adverse consequences may be:

- longer lines of communication between client and contractor;
- skill shortages—it may be difficult to split managers between departments where there is only one person at a particular level or if two work together as a good team;

- an overall increase in expenditure in small authorities resulting from two separate operational structures. The Commission has found no evidence so far that separating client and contractor increases staffing requirements substantially.

...Client-side rationalisation is an essential part of the preparation for competitive tendering...

38 It might be thought that the above arguments for not putting the client and contractor into different departments are most applicable to small authorities, whereas these are the authorities that are mainly in the vanguard of full separation. Many of the larger authorities, particularly metropolitan districts and London boroughs, are retaining mixed departments. This suggests that these arguments are not decisive.

39 Client-side rationalisation, particularly in smaller authorities which already have many chief officers and committees, is an essential part of the preparation for competitive tendering. Fears among some chief officers about loss of position and status is hindering both this process and the introduction of a clean client-contractor split. When separate DSOs have been created, authorities should ask whether they need to restructure so that they have a small number of client committees and departments. It may be possible to group functions which, from the client perspective, require similar skills.

40 A further refinement is possible. Some authorities now distinguish between policy responsibilities and day-to-day contract supervision. They are setting up specialist contract management units, with expertise in contract supervision. For example, a specialist client-side horticultural unit would prepare ground maintenance specifications and help evaluate tenders as well as dealing with work currently outside the legislation such as landscaping and planning applications. The contract management unit could handle day-to-day supervision of ground maintenance contractors as well as contractors dealing with other services.

SINGLE SERVICE OR UMBRELLA DSOs?
41 The best DSO arrangement will vary from authority to authority. Smaller authorities, particularly shire districts, will probably find that the 'umbrella' or multi-functional DSO best suits their needs. Their street sweeping, refuse collection and other defined services each employ relatively few people. The chargehand or supervisor responsible for a service may lack the experience and qualifications to reorganise and prepare a bid for work, while the small size of the operation means that a full-time manager would be an uneconomic overhead. The umbrella approach allows the sharing of overheads (e.g. for computing support, see below) and of a manager's costs. It also means that the authority has someone in post committed to the DSO who will put together a bid in the second round of competition even if the private sector wins first time round. (Separate statutory DSO accounts must be kept for each defined activity. Umbrella DSOs will need accurately to allocate shared overheads).
Recruitment of DSO managers from outside the local authority field, often on fixed-term contracts for five years or less, has been a feature of many authorities’ preparations for competition. Portsmouth City Council, for example, advertised for virtually every management post in an umbrella DSO. Pay for such managers needs to be set at a level to attract the right calibre staff. It may contain a large performance linked element and no redundancy allowances at the end of the contract. DSO managers are taking risks; failure means redundancy. They have to receive commensurate rewards and they are often provided with cars and other fringe benefits common in the private sector.

Umbrella DSOs may be less appropriate for large authorities; a county council or metropolitan district may, for example, have enough cleaning to justify a stand-alone DSO with its own manager. An umbrella organisation in these circumstances may increase overheads and bureaucracy. Managers for single service DSOs can again be recruited from outside local government.

A mixed approach under which there are a number of DSOs may be best in some authorities. Street cleansing and refuse collection might be in a cleansing DSO and ground maintenance and sport and recreation management in a leisure DSO.

The final choice of organisation structure must take account of local matters such as the size of the authority, its style, the calibre of its existing staff, the current efficiency of its workforce and so on. For these reasons the Commission does not presume to prescribe one solution common to all authorities, but it does recommend that each authority review its organisational structure (Exhibit 6).

CENTRAL AND SUPPORT SERVICES

Reorganisation and restructuring should not only affect committees, client departments and DSOs. Overheads and central charges are a cost to all. DSO overheads sometimes compare unfavourably with those in the private sector and are understandably challenged by some DSO managers. There is a need to reappraise both the level of central costs and the ways they are apportioned. CIPFA has already argued (The extension of compulsory competition: Meeting the challenge, Part IV paragraph 26) that there are some central costs which it would be illogical to apportion to DSOs:

- the cost of all central activities which would still have to be carried out, even if all possible services (even including, say, schools and rate collection) were to be delegated, contracted out or franchised out; and even if consultants were to do all the necessary supervision of contractors and franchisees. The residuum would

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*The extension of compulsory competition: Meeting the challenge
CIPFA, November 1987 ISBN 0 85 2993676
include the council chamber, elections, statutory meetings, the mayor and the mayor's car, the chief executive and all statutory officers, the offices of these key personnel, receptionists, and the civic regalia;

— the cost of quasi-services which strictly speaking are not support services at all, but are often not distinguished from it. These quasi-services include civic hospitality, twinning and public enquiries.

48 Failing to relieve DSOs of these costs may actually increase an authority's total spending; the authority still has to meet them as well as the winning contractor's price. The net effect could be an overall increase in costs (Exhibit 7 overleaf).

49 Reappraisals of central recharges should include measures to identify such costs and ensure that they are not included in DSO overheads or recharges to service committees.

50 Central recharges include the costs of computing services, solicitors, management services, reprographics, payroll and invoice processing and other services which could be, and in some cases already are, bought in. Their costs need clearly to be identified and charged out to client departments and DSOs on a quasi-contractual, trading account basis, at an agreed rate. CIPFA's recent publications Accounting for support services and Accounting for support services — A practitioner's guide* discuss support services in the light of the 1988 Act in more detail. They advocate use of service level agreements; the latter includes a simple agreement for payroll processing.

51 The approach should not be confined to DSOs only, otherwise there is scope for manipulation of recharges. Once trading accounts have been set up, direct comparisons can be made with the costs of buying in; expensive in-house support can be identified and steps taken to improve efficiency. If this cannot be done, client departments and DSOs should be given control of their support service budgets with the freedom to buy in from the private sector. Central support staff would then face the same pressures and realities as DSO employees. Some authorities have already started this process, transferring administrative support and finance staff from the centre to their DSOs, giving DSOs the freedom to alter support staff levels. The support staff's future prospects are directly linked to DSO performance, improving their commitment and the quality of service they provide. All DSOs need to control their in-house administration and support costs. These can be a major expense which is sometimes ignored.

52 Not all these changes may be feasible before the first contracts are let. Some steps can be taken quickly and some authorities have started down that road by identifying internal charges for services such as payroll processing (e.g. Bournemouth and Arun). Starting now will also mean that central services are better equipped for any extension of competition to them. (The CBI Public Expenditure Task Force argues that CCT should be extended to professional services, computing, and secretarial support among others—see The competitive advantage).

*Accounting for support services
CIPFA January 1988 ISBN 0 85299 3803

Accounting for support services — A Practitioner's guide
CIPFA September 1988 ISBN 0 85299 4695
Exhibit 7
THE TREATMENT OF CENTRAL RECHARGES

Leaving costs such as 'costs of democracy' in the DSO's overheads can actually increase an authority's expenditure.

Extra cost to authority caused by failure to remove costs of democracy from DSO price

Note: The term 'costs of democracy' is defined in The extension of compulsory competition—Meeting the challenge: CIFFA.

53 The review of central costs should be carried out in parallel with the client-side changes described in Section 3, and the restructuring of DSO operations discussed in Section 4.

Exhibit 8
ORGANISATIONAL CHANGE AND REVIEW OF OVERHEADS

The changes outlined below will help authorities implement CCT successfully.

3. MANAGING THE CLIENT ROLE

54 The onus of ensuring quality of service falls on the client who must ensure that the specification is correct, that the staffing and resources needed are in place and that contingency arrangements to deal with contractor failure have been made. There is no need for competition to lead to a deterioration in service. One of the keys to the success of many Japanese businesses has been the close relationship with thousands of independent suppliers; the same applies to Marks and Spencer and other leading multiple retailers in the United Kingdom. Marks and Spencer even install their own quality assurance procedures—and sometimes people as well— in suppliers' plants.

55 Local authorities can make similarly successful arrangements with private sector suppliers. And those committed to high quality service provision by DSOs need to recognise that, properly applied, the clear apportionment of responsibilities, definition of service levels and monitoring of performance required by CCT can lead to enhancements in service.

POLICY REVIEW

56 Those who fear that CCT will lead to a deterioration in quality of service argue that DSOs work to a high standard, that the private sector will win contracts but cut corners and

57 The changes outlined below will help authorities implement CCT successfully.
reduce the level of service the public receives. If this happens it will often be because the client has failed. It is the client's job to make clear what service levels are required; to select contractors able to provide the required quality of service; to ensure that they understand the specification and to install firm, but fair, contract management and supervision arrangements to ensure that quality is protected. The client must have clear policies on both service level and quality which can be translated into a detailed contractual specification. Previous Audit Commission studies have often found weaknesses in this area, including:

- authorities lacking policies and specifications of service and quality;
- major variations in service levels between authorities with similar policy objectives;
- a bias in policies towards higher service levels and standards than those recommended in national codes of practice (e.g. highway maintenance, Exhibit 9) or by manufacturers (e.g. vehicle maintenance);
- major differences between policies and the service levels actually provided, with both over and under provision compared with policy. Some authorities which believe that their DSOs provide a good service are therefore misinformed; they are not receiving the service they are paying for.

CCT offers an opportunity to review policies and provision to overcome these weaknesses. Under competitive tendering contracts run for three to seven years, depending on service and type of authority. Though they should include provision for variations, major changes may be difficult and require renegotiation or even retendering (particularly if the DSO has won). Any initial over-specification may lead to costly variations later. Authorities therefore need to:

- set down formally the objectives of the service including quality aspects where appropriate;
- identify the level and quality of service currently provided;
- translate the objectives into the quality and service levels they will use in contracts.

Where service levels and quality as currently delivered are lower than required by an authority's policy statement, but the service actually delivered is acceptable to members and to the public, the policy should be reappraised and modified, before the contract specification is drawn up (as the authority will otherwise pay for unnecessary work). Authorities unsure of whether to use a low or high figure can pick the lower and use schedules of rates, or other variation arrangements, to increase provision if this appears necessary later.

| Exhibit 9 |

**POLICIES ON ANNUAL FREQUENCIES OF ROUTINE HIGHWAY MAINTENANCE**

Authorities tend to undertake more frequent routine maintenance than recommended in the local Authority Associations' Code of Good Practice for Highway Maintenance.

| COUNTRIES |

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| METROPOLITAN DISTRICTS AND LONDON BOROUGHS |

<table>
<thead>
<tr>
<th>Activity</th>
<th>LAA Code</th>
<th>Inter-quartile range (i.e. the range in which half the authorities lie)</th>
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<tbody>
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<td>36 - 104</td>
<td>7</td>
<td>520</td>
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<tr>
<td>- Primary routes</td>
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<tr>
<td>Gully emptying</td>
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<td>2 - 3.5</td>
<td>1</td>
<td>12</td>
</tr>
<tr>
<td>- Primary routes</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Grass cutting</td>
<td>-</td>
<td>10 - 16</td>
<td>5</td>
<td>52</td>
</tr>
<tr>
<td>- Vision splays</td>
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</tr>
</tbody>
</table>

* Code gives the frequency for highway reasons only, excluding any amenities element, so comparisons for this item may be distorted.

Source: Audit Commission questionnaire distributed to all highway authorities, 1986
SECURING FINANCE

59 Once an authority has determined its policy objectives, it will need to provide the necessary financial resources. In the past budgets were largely based on historical levels, but in future the budget will be essentially the successful tender sum plus the cost of the client-side operation. This budget figure may also include contingency sums for any contract variations or potential changes to service provision.

60 It is important that the availability of financial resources is not dependent on the identity of the contractor. Pressures during the budget-making process to exploit contract variations to make extra payments to the DSO to help it meet its financial targets must be resisted. The Commission's auditors will take action if they discover that this is happening. Private contractors often expect to enhance their profit on variations; they must not be allowed to do so.

CONTRACT STRATEGY

61 Once the levels of service and resources have been settled, the prime task is to decide how to achieve those objectives. Decisions have to be made within the Act's prohibition on anti-competitiveness. In awarding work to DSOs authorities should not act in a manner having the effect, or intended or likely to have the effect, of restricting, distorting or preventing competition. Anti-competitiveness is not an easy concept to define. DOE Circular 19/88, and the equivalent Welsh Office publication, mention only a handful of likely anti-competitive practices (such as over-large ground maintenance contracts). In general the issue will have to be considered in the light of local circumstances; approaches and practices which are illegal in one place may not be in others.

62 Though anti-competitiveness is ultimately a matter for the Secretary of State, the Commission's auditors have responsibilities for promoting value for money and ensuring that authorities act within the law (see the appendix). Since value for money is usually best obtained by genuine competition, they will draw attention to apparently anti-competitive practices when they become aware of them. They will review the contract strategy decisions made by authorities to satisfy themselves that there is compliance with the legislation. They will also give particular consideration to matters which come to their attention or to representations made to them. But auditors are watchdogs, not bloodhounds, and should not be expected to seek out every conceivable anti-competitive practice. It is up to authorities to ensure compliance with the legislation, and the Secretary of State has powerful sanctions against a DSO if, in his opinion, an authority indulges in anti-competitive behaviour.

63 Contract strategy decisions cover issues such as:

- whether the contract will be:
  - labour only;
  - labour plus plant, materials, accommodation, etc.;
  - and whether it will include management, i.e. contractors carry out some or all of the duties normally carried out by supervising officers as well as the work itself;
- whether to specify:
  - the performance to be achieved; or
  - the detail of the work to be done.

For example, in the case of vehicle maintenance the specification can stipulate that for an annual lump sum per vehicle the fleet should be maintained in a safe and roadworthy condition (a specification of performance). Alternatively, it could set out the servicing required and the intervals between services and ask the contractor to submit a schedule of rates.

- the number of contracts for each service;
- whether, when several contracts are used, to take an area or a functional approach, e.g. in ground maintenance whether to use one contract for all work in a particular park or area or to use different contracts for grass cutting, arboricultural work, etc.;
- contract length: the regulations set minimum and maximum periods but allow authorities to choose within these ranges. In general, contractors prefer longer contract periods when they have to make capital investment.

64 Authorities also need to consider contract size. Too large a contract may be beyond the private sector's capacity and therefore be anti-competitive. Large vehicle maintenance contracts may be unacceptable; several contracts might be better; separation by vehicle type within geographical area might also increase competition, allowing small local garages to bid for cars and light vans and major freight operators to bid for heavy plant such as refuse freighters. Conversely, authority-wide refuse collection contracts have proved attractive to the private sector in the past and are unlikely to be anti-competitive.
One way of fostering competition in some services is to let a number of contracts with separate tenders for each. This is quite legitimate provided each represents a reasonably attractive workload and there are no dis-economies of scale. Although it should not be deliberately engineered, it might be fortuitous if two or three different contractors were engaged, since this would avoid the authority being prey to a monopoly supplier. Some authorities which have already voluntarily gone to contract on leisure management and ground maintenance are taking this approach.

Authorities proposing to let large contracts which would interest only large contractors, or those with a wide range of skills, should make preliminary enquiries to try and establish how many would be interested. If this suggests that fewer than three would be interested, authorities should find out whether size is deterring others.

The legislation also provides that authorities with good reasons may combine defined activities in one contract, but again this action must not be seen as an opportunity to mix radically different services to deter potential bidders. For instance, a single contract which combined authority-wide arboriculture with ground maintenance and grave digging in a single cemetery may be unattractive to the private sector. Offering a single contract for all activities defined in the Act, within one part of an authority, might well be deemed anti-competitive.

On the other hand, it may be good practice to place refuse collection and maintenance of refuse freighters together; this removes the potential for disputes about whether the refuse contractor or vehicle maintenance contractor is responsible for a service failure. It also avoids disputes about whether abuse by the refuse contractor has caused increased maintenance needs. There can also be advantages in linking refuse collection and street sweeping so that employees working on one can provide back-up for the other. In addition, split refuse can be a major contributor to rubbish on the streets; linking the contracts again prevents dispute. Authorities going voluntarily to competition have certainly found private sector operators willing to bid for and able to win and execute such linked contracts.

...Authorities should make preliminary enquiries to try and establish how many contractors would be interested...

These considerations illustrate an important point about contract strategy. The defined activities have to be considered as a whole; decisions about one affect the way others are put to competition. In particular, authorities need a clear idea of how they are to handle the interaction between leisure management and catering and cleaning in leisure centres and between vehicle maintenance and refuse collection and other services which require plant and vehicles. There can be particular problems in preparing the vehicle maintenance specification if that service goes to tender before refuse and other plant intensive services, as the future vehicle maintenance workload will be difficult to predict. Some authorities have therefore chosen to invite tenders for refuse collection, mechanical street cleaning and gully emptying ahead of the prescribed timetable so that the outcome is known before the vehicle maintenance contract needs to be let.

Labour-only contracts present another dilemma. Many refuse contractors prefer to provide plant, materials and, perhaps, depots, believing that their competitive edge lies, at least partly, in better equipment (e.g. larger, more modern freighters), in better use of that equipment (e.g. a longer working day per freighter), economies of scale (pooling spares between contracts) and increased use of their own local depots. They may find a labour-only contract unattractive. Authorities are, however, under a statutory duty to collect domestic refuse and are acutely aware of the consequences of a service failure. They may prefer to retain control of plant and depots so that they can more easily reconstitute the service if the contractor fails.

The Society of Local Authority Chief Executives and the Local Government Training Board discuss these issues in some detail in Managing competition*. Labour-only contracts are not the only answer. Contractors can be required to take over the authority's plant at the start of the contract. They can if they wish then dispose of some or all of it, and use their own equipment. The contract can allow the authority to then take over the contractor's plant at the end of the agreement at a price set out in the contract, or calculated using a formula included in the contract or at a price set by an arbitrator.

Authorities should approach contractors to ascertain the type of contracts likely to generate most interest and the size of contracts with which they are able to cope. An
alternative way of ensuring the best mix is to break work up into three or four parcels and to allow contractors to bid for one or more as they, the contractors, see fit. Each will be able to select the mix which it finds most attractive. Bids should then reflect any economies of scale while the authority will be able to select the offers which give it the lowest overall price. This approach is compatible with the CIPFA Provisional accounting code of practice which recommended that tenderers should be given the opportunity to quote the reductions they would give for being given all, or a combination of, small contracts. Authorities can similarly invite bids on labour-only and labour plus plant bases and, by combining the former with the expected costs of providing plant, again select the approach which gives the best overall cost. Contractors can similarly be allowed to put in prices for refuse collection only, street cleansing only or both.

PERFORMANCE BONDS

Performance bonds and holding company guarantees offer safeguards against contractor failure. These should not be a simple percentage of contract value; authorities should, as a matter of good practice, draw up contingency plans to cover contractor failure at the same time as they prepare their specification and use these to identify the likely extra costs of a failure (i.e. the costs above those normally incurred by the service). The performance bond or guarantee should be based on these extra costs.

Retendering will normally be needed if a contractor fails. Previous quotations are unlikely to be valid, unless the failure occurs within a few months of contract start; further competition is needed to obtain the best price. The client will incur extra costs in providing an emergency service between the failure and the start of the new contract, as well as staff costs in terminating the original contract, arranging the emergency cover and retendering the service. The emergency cover prices to use when setting bond levels may be difficult to judge until authorities have opened the original tenders. One strategy to overcome this is to take a worst case view when preparing the tender specification and to abate the bond if it later appears high.

The extra costs of emergency cover are likely to vary with local circumstances, the service involved and the strategy chosen by the authority when letting the original contract. For example, the building cleaning market is well developed and it will probably be possible to obtain cover at short notice at a price similar to that quoted for a long-term contract; in the refuse collection market emergency cover is likely to be more costly. It may also be easier to arrange emergency cover when the authority has retained ownership of plant and depots; contractors providing labour-only contracts would normally be asked for lower bonds than when the authority depends on the contractor for plant.

Some contractors might be deterred by the need to give a performance bond, and it is likely that contract prices may be higher than otherwise to cover the cost to the contractor of raising the bond. Excessive bonds would therefore, as indicated in DOE Circular 19/88, be anti-competitive. This highlights the need to demonstrate the connection between the value of the bond and the cost of contractor failure.

SPECIFICATION

The specification translates the policy and strategy decisions into job requirements. It should state clearly the overall service objectives so that any contractor knows what is expected. It should reflect in detail the type of service which the authority is seeking to provide, the work to be done, the standards for that work, the quality required and how contractor performance will be assessed. The contract should also include the action to be taken if the contractor fails to deliver.

Wherever possible the document should avoid specifying working practices and equipment; this could constrain innovation and prevent improvements in efficiency. For example, had contracts for refuse collection been drawn up in the early 1970s and specified the type of vehicle to be used then the introduction of much larger compaction vehicles might have been thwarted. There are circumstances, however, where working practices and equipment need to be specified as a proxy for the standard of service required. The only way of ensuring the standard of grass on a bowling green may be to specify that it be cut with a ten-bladed cylinder mower. In other cases describing current working practices can help clarify the specification, e.g. by mentioning, in a refuse collection specification, that access to certain streets is difficult and that the authority currently uses a narrow bodied vehicle rather than a standard freighter.

Specifications for services such as street cleaning, ground maintenance and refuse collection must be supported by accurate inventories and lists. Authorities' inventory records are often poor (Exhibit 10).
Many highway authorities, especially counties, do not possess accurate inventories of even the basic items covering over 95 per cent of scheduled maintenance expenditure. Contractors bidding on false assumptions will mean that contractors bid on a false basis and may lead to costly variation orders when errors are recognised. Depending on how variations are treated, the work may not end up being carried out by the cheapest contractor, a losing tenderer with lower variation prices might have been cheaper. Specifications should not be manipulated to favour the DSO by including unnecessary work which in-house labour does not now carry out, and would not perform if the contract were won, but which contractors will be forced to include in their price. An authority's road sweeping specification, for example, may include a requirement to sweep under parked cars even though the DSO does not currently do this, and may well not do so if it wins the contract. This is almost certainly anti-competitive. The Act requires that auditors certify DSO rate of return statements; in doing this, they will draw attention to payments made to DSOs for work which has not been performed.

SELECT LIST AND TENDER EVALUATION

82 The authority must invite tenders from at least three private contractors, unless fewer wish to tender, in which case all must be invited. DSOs from other authorities can be invited but this must be in addition to, rather than instead of, the specified number of private contractors.

83 The compilation of a short list may occasionally present problems. There is a well-established private sector in services such as building cleaning, vehicle maintenance and catering. However, the ground maintenance, refuse collection and street cleansing markets will need to expand markedly in the next few years if all authorities are to be presented with a genuine choice of contractor. Established, financially sound organisations may also try to diversify into this new market; they too may lack a relevant track record.

84 In some of the defined activities, the lack of a well-developed private sector with experience of local authority operations may oblige authorities to take on contractors which, although competent, do not have a record of local authority work. In these circumstances it may be particularly appropriate for them to seek a performance bond, based on the estimated net cost to the authority of contractor failure.
In some instances, authorities may have to invite tenders from contractors in order to comply with the legislation even though they have no confidence in their ability to do the work. This may place them in the embarrassing position of wishing later to reject a low bid even though they invited that bid in the first place.

The best way to avoid this is to ensure that the contract is attractive to both the private sector and the DSO. Once strong private sector interest is aroused, authorities should be able to vet contractors and still end up with a viable short list. If no companies bid for a contract it is no victory. It simply means that DSO performance is not sharpened by competition and that the authority’s costs are likely to be higher than they should be.

The client should develop an awareness of the market, identifying potential tenderers with proven financial status and contractual performance, assessing their methods, and details of the size and nature of contracts for which they may wish to compete and are capable of performing. Some authorities intend to finalise their contract strategy (size, mix, etc.) only after the compilation of a select list of tenderers. They can then request tenders for contracts in which there is a clearly identified interest and intention to compete.

Some authorities have developed questionnaires to help firstly to choose the competent contractors and secondly to check that the winning tender is in order. At the first stage the questionnaire requires specific details on matters such as supervision arrangements, equipment to be used, and arrangements to cover for unexpected sickness or leave.

 Authorities should meet potential contractors between sending out specifications and the contractor completing his tender, to make sure that the contractor fully understands what is required. The authority may also choose to arrange visits to contractors’ premises and current work sites, to take up references and to assure itself that quality of service will not suffer if the contractor receives the work.

If the contractor vetting procedure is good, then the authority should normally be confident that any of the invited contractors would be competent to do the work. It should then be in the position of normally accepting the lowest tender (Exhibit 11). But what should the authority do if it is not confident that the contractor can deliver the service for the price tendered?

One authority did not award its street cleansing contract to the lowest bidder because it formed the opinion that the contractor’s bid was so far out of line with the other bids that the contractor must have made an error in its calculations and therefore it risked a service failure or withdrawal by the contractor part way through the contract. It would have been content if the contractor had admitted to a loss leader, but the contractor genuinely thought it could do the work at the quoted price and make a profit.

To avoid accusations of anti-competitiveness, authorities may wish to say explicitly that they will require further justification in support of a bid substantially below the next lowest, or that they will require the contractor to put up a bond to guard against non-performance. This illustrates a general point. Authorities are likely to make better decisions, and be better

Exhibit 11
RANGE OF TENDER PRICES FOR ONE GROUND MAINTENANCE CONTRACT
There can be substantial variation in the prices offered by different tenderers

![Bar chart showing range of tender prices for one ground maintenance contract](source: Audit Commission fieldwork)
protected against allegations of anti-competitiveness, if they formally agree, but do not publish, their evaluation methods before they decide the select list or open tenders. Approaches which can be used include the financial vetting procedures described in a recent article in Public Finance and Accountancy* and the use of PAG (poor, average, good) analysis to rank potential contractors under qualitative or subjective headings (expertise, relevant previous experience, etc.).

93 When tenders quote schedules of rates and/or hourly or day works prices, they should always be evaluated by calculating the cost to the authority of the expected workload over the contract period. These calculations should make due allowance for growth and variations, for example, in refuse collection in expanding communities. Contractors who put in the lowest base prices may actually be more expensive once allowance is made for such factors. Again the work mix model to be used should be agreed before tenders are opened. The evaluations should also take full account of discounts allowed; one authority recently awarded a vehicle maintenance contract to what was in fact the second lowest bid. It made its decision on labour costs alone and did not recognise until after the contract was let that the 10 per cent parts discount offered by a losing bidder meant that it would have provided the cheaper service.

94 If an outside contractor submits the lowest bid, the authority is faced with the question of redundancy payments to its own workforce. The CIPFA report Meeting the challenge and the SOLACE/LGTB’s report Managing competition discuss how redundancy payments might be treated in tender evaluation. The Commission endorses the principle set out in DOE Circular 19/88 that full redundancy costs can be taken into account on one occasion, but one occasion only. The authority should not be entitled to take account of redundancy costs when the contract is retendered, since by that time the DSO should have improved in efficiency to match that of its competitors. The details of accounting for redundancy are under discussion in the context of further development of the CIPFA code on DSO accounts. Contractor vetting and tender evaluation options are summarised at Exhibit 12.

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**Exhibit 12**

CONTRACTOR VETTING AND TENDER EVALUATION

These procedures will help ensure that authorities award work only to competent and efficient contractors.
CONTRACT START-UP

95 The authority should have ready its plans for any handover of depots, plant, equipment and possibly employees to a successful outside contractor, and for handling redundancies. The contractor should have been granted a long enough period from the award of the contract, about three months, to get geared up for the work. The starting date should, if possible, not be at a particularly busy or inconvenient time, e.g. Christmas or Easter for refuse collection. If contracts are to start at such times then start-up and handover arrangements should be set out in the specification. Some authorities prefer to start contracts on a Monday, e.g. on July 31 1989 rather than August 1, a Tuesday.

96 Much of the bad publicity given to competition in local government services arises from difficulties at the start of the contract. This has most frequently occurred with refuse collection with, for example, whole streets where no rubbish has been collected. Some teething troubles are inevitable when a service is reorganised and similar problems have occurred with DSO operations. The client should recognise this and promote as smooth a transition as possible. There should be no temptation to penalise a contractor heavily in the early phases of a contract because of resentment at losing to the private sector. There should instead be a phasing-in period during which the default system is less penal. Only in extreme instances should there be any threat of early contract termination. The purpose should instead be to ensure that after a period of, say, one month the service is operating reasonably and in line with specification. The full default system can then be applied.

Exhibit 13

CONTRACT INSPECTION LEVELS

The inspection levels vary with type of contract

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<th>Authority</th>
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<td></td>
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<td>0.6</td>
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<td>Refuse collection and street cleansing (combined contract)</td>
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<td></td>
<td>J</td>
<td>0.8</td>
<td>0.6</td>
<td>1.3</td>
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Source: Audit Commission fieldwork

SUPERVISION AND MANAGEMENT

97 Many authorities have seen competition as demanding increased costs of contract supervision and management. This appears to be based on the belief that the work of the authority’s labour force does not need to be supervised or that the authority’s bonus scheme will manage its operatives. These are false assumptions. Earlier studies by the Commission and its auditors have revealed many instances of poor service by unsupervised DSOs; for example, bonus frauds by gully emptying crews have been an unhappy discovery during a number of recent VFM studies into routine highway maintenance. For most types of work, client supervision will certainly need to improve to meet the challenges of CCT; this should not, however, be seen as a cost of CCT but rather the belated addressing of a major management weakness.

98 The danger is not simply inadequate supervision. Some authorities may redeploy employees displaced from the DSO as contract inspectors and end up with too high a level of inspection. Exhibit 13 sets out typical inspection levels for two services which the Commission has reviewed.

99 Another danger is that inspection may be seen as an adversarial role, when it should be a collaboration with the contractor. Inspectors from the authority should regularly meet the contractor’s supervisors to discuss problems, and this should be backed up by less frequent (say, monthly) meetings between the senior manager of the authority and the contractor.

100 Some authorities have formal inspection appraisals in which the contractor’s work is assessed on a scale from good to poor, with the contractor required to make good any poor work within a specified time. Default points can also be awarded for poor quality work or failure to make good within the specified time, and deductions made if the number of default points per month exceeds a pre-determined threshold. Arun films contractors’ staff
at work from time to time to monitor the way in which the work is carried out in practice.

One option is that the contractor satisfies the client as to his own systems of ensuring performance and quality. In the full adoption of a system of quality assurance, as set out in BS5750, the contractor is accredited by an independent body as having met its standards of quality control. This reduces the client’s vetting and inspection needs, while probably increasing the contractor’s costs and hence his prices. A default by a contractor offering quality assurance should be dealt with more severely because it indicates not only a breakdown of the service but also of the contractor’s own supervision. The contractor will be motivated to avoid significant defaults because continued infringements may lead to the loss of his accreditation.

PERFORMANCE AND POLICY REVIEW

One client-side duty often neglected is performance and policy monitoring, i.e. checking not only that the contractor is meeting the specification but that the wider objectives of the service are being met. Local authority members should take on this role and seek regular reports on, for example, the level of public satisfaction about refuse collection or street cleanliness. This can be done both reactively, by monitoring complaints, and proactively, by public opinion surveys. Such information will complement reports on contractor performance (for example summaries of numbers of missed refuse collections) and help provide an overall picture of the service. The Commission’s Performance Review in local government: Action guide 4 may help authorities develop performance measures.

In some instances the contractor may be the best source of data, e.g. for usage of a leisure centre whose management has been put to contract or for details of numbers of meals served under a catering contract. The client can require details of contractors’ gully emptying and sweeping rounds, where he has not specified these in detail in the contract, to help him monitor and measure output (number of gullies emptied, number of kilometres of road swept, etc.). The authority can ensure it receives the information by including its data needs in its specification. This reduces the load on its client-side, which need only carry out occasional quality and audit checks to validate the contractor’s returns.

The points made in this Section are summarised at Exhibit 14. Section 4 discusses the changes DSOs need to make to be able to compete realistically.
4. PREPARING THE DSO FOR COMPETITION

THE NEED FOR IMPROVEMENT

104 Competition alone may not be sufficient to ensure keen prices. There may occasionally be price rings in operation, or the most efficient contractors may not bid. Contractors may pitch their bids at what the local market will bear rather than the lowest price at which they can make a reasonable profit. For example, one authority with an inefficient workshop decided to go voluntarily to contract. It approached a number of companies, each time successfully knocking down the price quoted by the last firm. The final quotation was significantly below the in-house cost and was accepted. However, when the auditors reviewed vehicle management in the authority they found that the contract price was significantly above the Commission's good practice benchmark. Similar instances have been found in street lighting maintenance when authorities have stopped using their DSO, and moved to contract, but have done so by negotiation rather than competitive tender.

105 Evidence from the Commission's studies of building and highway maintenance also suggests that authorities tend to obtain better prices, irrespective of who wins, when efficient DSOs bid against the private sector.

106 The Audit Commission therefore considers that the existence of efficient DSOs can be beneficial. Unfortunately there is considerable evidence that many local authority DSOs have been expensive and inefficient. In recent years some local authorities have made great strides in competitiveness (Exhibit 15); but there is still much scope for improvement.

107 In its early reports the Commission set benchmarks based on the levels of efficiency achieved by the best 25 per cent of authorities. It is becoming clear that the relatively few authorities which have so far contracted out their services are generally achieving prices below the Commission's previous benchmarks (Exhibit 16). DSOs need to do better than these previous benchmarks and to achieve or beat the prices now obtained by the best 10 per cent of in-house operations if they are to compete realistically under CCT. As discussed in Section 1, not all authorities are committed to maintaining an in-house capacity. A crucial choice is whether the DSO will continue to exist and bid for work and, if it will, whether to bid for everything or to target particular contracts. The choices made will be influenced by a DSO's assessment of its competitiveness in the local market. For example, many small districts will find it difficult fully to utilise mechanical street sweeping and gully emptying plant and to offer competitive prices. They can opt out of this market entirely, if their authorities let separate contracts; alternatively, if a single street cleansing contract is let, the DSO can subcontract these activities.

110 Where the DSO is to bid, major changes in management, attitudes, style, personnel arrangements, pay, vehicle and plant holdings, depot arrangements and in overhead costs will often be needed. This will cost money, perhaps in buying in new management or consultancy advice on how to reorganise, in rationalising plant and depot holdings, in carrying out training, in buying out inefficient

Exhibit 15

VEHICLE MAINTENANCE COSTS FOR SHIRE DISTRICTS WITHIN AN AUDIT DISTRICT

These districts have begun to improve their efficiency but most still do not meet the Commission's vehicle maintenance benchmark.

Maintenance cost per weighted vehicle

Current cost
Savings realised

Benchmark of competitive cost

Source: Audit Commission analysis of audit reports
The weighted vehicle concept is described in the Commission's earlier report Improving vehicle fleet management in local government, HMSO, 1984
Exhibit 16

COMPARISON OF CONTRACTOR AND DSO PRICES—REFUSE COLLECTION

Authorities using contractors tend to pay less than most, but not all, authorities using DSOs

SOUTH EASTERN DISTRICTS - SHAW FAMILY 5

Net cost per domestic hereditament

<table>
<thead>
<tr>
<th>Contractor operation</th>
<th>In-house operation</th>
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Source: 1986-87 CIPFA Waste Collection Statistics - Actual

working practices and even in meeting redundancy costs. Expenditure of this sort, if it is to be incurred, should take place now so that it does not appear in the revenue accounts required under the Act and does not affect DSO profitability. The Government has behaved somewhat similarly in investing in improvements in the efficiency of state-owned industries before it sells them off and exposes them to the rigours of the market place.

MANAGEMENT

111 Management arrangements and styles have to alter. Managers may need to be recruited from outside. A lean structure with a maximum of three or four tiers covering operatives to senior management is required. Management must also be able to make the operational and personnel decisions needed for success. The role of members, where they have up to now had a significant impact on the day-to-day running of the business, needs to change. DSOs will not survive if every operational decision has to be referred to their committees or boards or if members attempt to become involved in day-to-day management. Complaints about service levels and quality should be made to the client committee or officer, not the DSO board or DSO manager.

112 DSO board or committee members must concentrate in the future on setting policy objectives for the DSO and then on monitoring performance to ensure that objectives are met. This should be a more fulfilling role when it is properly defined and carried out. DSO boards and committees should not allow a DSO to rest on its laurels simply because it has won work and is meeting the rate of return or surplus required by the regulations. They should view the DSO as a business ‘owned’ by the authority and, as the authority’s representatives, seek the best possible return from it. Profit sharing, under which DSO managers and staff receive bonuses when the surplus exceeds the statutory minimum, can help.

113 Revisions to standing orders may also be needed to help DSO management manage. The discipline of competition and the need to satisfy the legislation on rate of return and publication of accounts may in some cases be an adequate substitute for a detailed standing order. DSO managers should make most purchase decisions without the need for prior authorisation; procedures to ensure audit trails and occasional sample checks usually suffice. The authority needs to retain sample checks to ensure the DSO is not collectively defrauding it. The type of standing order that may be considered for relaxation is one which is designed to demonstrate probity but which imposes a cost far in excess of the cost of any likely improper behaviour. Such changes should not, in fact, be confined to the DSO, though reviews of standing orders can usefully start by concentrating on those most relevant to the DSO. Many local authority procedures are over bureaucratic and need revision to meet not just CCT but other challenges—the Education Reform Act 1988 and housing reform. Such changes also help reduce overheads.

ATTITUDE AND STYLE

114 The DSO has two main objectives, to win in competition with contractors and then to complete the work for the tendered price while securing the rate of return demanded by the Secretary of State. If it fails in these, it will not be
possible to justify its continued existence even though the council may wish to pursue other objectives through its own workforce management (equal opportunities, good employment practices, etc.).

115 To compete effectively DSOs need to adopt many of the attitudes and practices of their commercial rivals. A new style and culture are needed. This can be helped by creating a separate identity for the DSO, perhaps with distinctive clothing and advertising. Customer awareness and other attitude training may be needed.

116 In medium to large DSOs, there should be a sales manager. While there are restrictions on competing for work in the private sector, the Local Authorities (Goods and Services) Act 1970 allows authorities to undertake work for each other and for other public bodies. DSOs can take advantage of this to take up slack, increase plant utilisation and spread overheads. They will need to win work from other public bodies simply to retain existing markets as education and housing reform take effect. Some DSO managers would like to go beyond this and favour a change in the law so that they can carry out work for the private sector unrestricted. Some are sailing close to the wind in extending the range of organisations they work for.

117 The Commission does not support a liberalisation of the Goods and Services Act; DSOs are not private companies and would not be taking the same risks in the market place. They would not become bankrupt if they failed; instead the ratepayer would meet the bill. In addition the special relationship that a DSO has to its parent authority would wither and die; there would be little or no value in an authority running its own DSO if the DSO was indistinguishable from a private company and the authority only one of its clients. Indeed, there is a case for arguing that a fully commercial DSO has no long-term place in the local authority structure. From the council's perspective the 'upside' potential is strictly limited, especially where the DSO may set its own terms and conditions of employment. And the 'downside' risk, in terms of redundancy payments in the event of failure, can be high. If the constraints imposed by the Goods and Services Act are such as to limit severely the viability of a DSO as a commercial operation then the authority may wish to consider the options discussed earlier. Some authorities are already moving in this direction.

...To compete effectively DSOs need to adopt many of the attitudes and practices of their commercial rivals...

118 In preparing their bids DSOs have to price the work the client is asking them to carry out and ignore any extra services they now provide. One DSO recently lost a grass cutting contract because its client had, inadvertently, omitted a caravan park containing about 1,000 dwellings from the specification. The private sector bid conformed to the specification; the DSO based its bid on the work it actually carried out and put in too high a price.

119 In preparing bids DSOs have to decide whether to take a cost plus or tender led approach to pricing. Under the former the DSO decides how it will carry out the work, the resources it needs and what they will cost. It then adds its profit margin. Under the tender led approach, the DSO first decides the price which will probably win it the work and only then considers how it will organise itself within that constraint. There are dangers to many DSOs in taking the cost plus approach for some services. The gap between many current DSO costs and contractor prices is so great that a radical reappraisal of staffing, working practices and other arrangements is often needed. The cost plus approach may constrain thinking. In many cases it is better to set a competitive price and then do whatever is needed to ensure that the DSO can deliver the service and make the necessary surplus.

120 The enterprising DSO should produce a business plan which effectively translates its aims and objectives into a statement of resources. It should identify key tasks with clearly assigned responsibilities and an implementation programme. A model business plan will be incorporated in the Commission's forthcoming report on building DLOs.

PERSONNEL AND PAY

121 A DSO's staffing levels and conditions of service are critical to its operating costs, hence the need for managerial control not only over recruitment but also staffing levels, conditions of service and dismissal.

122 Overmanning and low productivity have been major causes of poor DSO performance. Much has been done to address these problems in the last few years but much still remains to be achieved. The labour
savings which may be needed are indicated by the reductions in the refuse collection workforce which have occurred in those authorities which have voluntarily switched from DSO to private contractor—contractors typically use 35 to 45 per cent fewer employees. Employees must be used more flexibly so that full-time staffing levels are not dictated by peaks. A smaller workforce working flexible rosters, supplemented by seasonal, casual and part-time staff is more competitive; part-time workers can also reduce employers’ national insurance costs. This is particularly important in ground maintenance where the peak workload is from April to October. Some authorities have negotiated local arrangements whereby employees work a different number of hours in the week in summer than in winter but receive the same basic pay throughout the year. Some authorities are also considering whether they should prohibit holidays during the peak growing season (May to August); few private sector operators will allow a major part of their workforce to disappear when they are most needed.

Productivity needs to rise. Many authorities, for example, operate task and finish schemes for refuse collection. Their workforces start early—6.00 to 7.00 am—but also finish early—11.00 am to midday—and do four to six hours work a day. Refuse contractors also operate such schemes but aim to obtain seven to eight hours work from their men, an approach which also increases plant utilisation and decreases the number of freighters needed. Some authorities have already made these changes.

Absenteism can impose a higher overhead than central recharges.

Employees cannot feel that they have an annual sick leave quota which they can take irrespective of whether or not they are ill. Absences have to be monitored and the reasons for frequent non-attendance investigated. Some authorities have found that absenteism has fallen dramatically when they have introduced an attendance allowance. Under such schemes employees may, for example, lose all of their bonus for a week if absent (other than on annual leave) for all or part of a day.

Local authorities pride themselves on being good employers. They may be so generous that they are damaging their employees’ long-term prospects. For example, some contractors pay 5 to 10 per cent less for equivalent work, lack superannuation schemes, provide only 20 days paid leave a year, offer only the statutory minimum sick pay in the first year’s employment and are willing to accept relatively high staff turnover. These contractors’ social wage costs (costs of Earnings Related National Insurance Contributions, superannuation, sick pay, etc.) are likely to be significantly below the 35 per cent of employees’ pay for attendance time common in local authorities. All other things being equal, a contractor using the employment package above will beat the DSO.

 Authorities should encourage flexible working. For example, vehicle workshop chargehands and supervisors should carry out maintenance work whenever their other duties allow; maintenance managers can help in emergencies. Flexible working is particularly important in leisure centres, where peak demand tends to be in the evenings and at weekends. Some authorities have already moved to conditions of service under which employees receive only basic pay rates while working rostered shifts. Leisure contractors use similar conditions of service.

…Absenteism can impose a higher overhead than central recharges…”

Bonus schemes need to be reappraised. Incentive schemes should be simple and cheap to run. The traditional scheme can cost up to 40p to run for each £1 of bonus paid. Incentive schemes should either use large pieces of work (preferably in line with the activities set out in the contract and with the items used to invoice the client) or be performance related. One authority which has retained a traditional bonus scheme in its vehicle workshop now uses only 10 standard times. Other authorities have made major improvements by moving to the performance based vehicle availability bonus schemes described in earlier Commission publications* (though continued use of such schemes will depend on the type of contract offered by the client; availability bonus schemes are best used with performance based maintenance contracts which specify maximum days off the road for vehicles).

Other possible approaches include performance related pay, in which the bonus is an agreed percentage of the profit made by the DSO. This is particularly attractive for DSO managers, and many authorities which have reconstituted their DSOs in preparation for CCT have included this in the employment package.

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*Improving vehicle fleet management in local government HMSP October 1984 ISBN 0 11 7010899 Vehicle availability bonus schemes available from the Audit Commission, St Lawrence House, 29-31 Broad Street, Bristol, BS1 2EX.
Changes in pay and conditions of service will not always lead to reductions in take home pay. Much will depend on the local labour market. In parts of London and the South East, where vehicle fitters can earn £15,000 or more per annum, local authorities have problems in attracting and retaining the right calibre staff. In some cases, therefore, DSOs need to move to more attractive packages. In other cases, changes may increase take home pay but with more of that pay being performance related; one major leisure contractor claims that his staff, though receiving basic pay for rostered hours, earn more than their local authority counterparts because of the bonuses they receive.

The changes required are summarised in Exhibit 17. Most authorities will, of course, prefer to make savings and improvements voluntarily. Some have already found that their workforce will accept the need for change, and suggest ways of improving productivity and competitiveness, if they are consulted early in the process and the challenges and consequences of CCT are properly explained.

**PLANT AND DEPOTS**

DSOs (and clients, where they are providing equipment) need to guard against being over equipped. The Commission has found that local authorities have too many refuse freighters, mechanical street sweepers and gully emptiers. Much has been done to address the problem but some authorities still have far too much equipment, particularly an excessive number of spares. Authorities should review their vehicle and plant holdings against the Commission’s revised benchmarks (Exhibit 18).

DSOs whose workloads are low may not, for example, be able to justify gully emptying machines; hire may be preferable. Even then small districts may find it difficult to carry out gully emptying economically. If gully emptying is part of a comprehensive contract, the DSO can sub-contract. Sub-contracting also allows the DSO to retain lucrative un-blocking work; plant holdings can be reduced by investing in dual purpose sweepers/gully emptiers or gully emptiers equipped with jetting facilities which can also be used on sewerage agency work.

Mechanical channel sweepers may not always be needed. Depending on the specification, a street cleansing DSO may be able to hand sweep channels at the same time as footways. Some urban authorities, where car parking causes access problems, have made major savings by abandoning mechanical channel sweeping in town centres.

Some authorities are considering two shift working for refuse collection, under which one gang uses a freighter on one round in the morning and a second gang uses the same freighter on another round in the afternoon and early evening.

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**Exhibit 17**

**REVIEWING PERSONNEL AND PAY**

DSOs have to ensure that staffing costs are competitive. This involves reviewing:

- The numbers of FTEs needed
- Flexible working
- Casual staff
- Part-timers
- Seasonal staff
- Duties of chargehands and supervisors
- Overall pay needed to be competitive in the local market
- Simple, cheap to run bonus schemes providing real incentives
- Overall allowance
- Arrangements for peak periods e.g. Summer
- Sick pay
- Superannuation

**PERSONNEL COSTS**

- Staff levels
- Pay
  - Fringe benefits
  - Holidays
  - Other benefits

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Authorities should give more consideration to spot hiring as an alternative to holding large numbers of vehicles. They may be helped in this by changes in the second-hand market as CCT forces authorities to dispose of excess equipment making it easier to spot hire. A DSO should also consider the advantages of leasing. This reduces the capital holding, the rate of return needed under the regulations and therefore the price it has to put in. Leasing can also provide the flexibility to take advantage of new, more productive equipment as this becomes available.

Other plant changes may be needed. Larger refuse freighters can, for example, improve performance by reducing dead time in travelling to tips. Plant and depot reappraisals should be made in the context of the cost and profitability of the operation as a whole; higher equipment costs are fully justified if they improve overall performance.

Reappraisals of facilities are another essential part of the preparations for CCT. Changes in depot or office location and disposal of all, or part of, a site should be made where necessary. Two or three shift working is possible in vehicle workshops. Contractors used by two authorities (North Shropshire and South Shropshire) work at night. This not only reduces the contractor's costs by spreading the depot costs over more work, but gives the authority overnight turnaround and thus reduces the number of spare vehicles needed to cover downtime. Other authorities (e.g. Woking) have contract hire with maintenance arrangements with the private sector under which the contractor (Transfleet) works from the authority's premises but can use the workshop for third party work (with a formula in the contract providing the authority with increasing clawback as third party work rises). These workshops are again used 24 hours a day. Major freight handlers' interest in local authority refuse collection and vehicle maintenance may reflect a similar desire to increase their workshop utilisation. Some DSOs may need to move to smaller, more heavily utilised premises to be competitive.

OVERHEADS

Many DSOs believe that success will depend on the extent to which overheads can be controlled. It is therefore essential that, as discussed earlier, the DSO does not pay for central services it does not require. It should determine the support services it needs and then negotiate with in-house suppliers (finance, personnel, legal, etc.). In principle the DSO manager should be able to buy services from other suppliers, or decide to establish support services under its own direct control, if central in-house support is more expensive than these other approaches. The cost of administration and other support services located within the DSO also need to be monitored and controlled.

Administrative arrangements should be simple and tailor-made for the DSO. The simplification of standing orders so that decisions and work are not duplicated or checked unnecessarily has already been mentioned. Financial systems need to be speedy. Many finance departments need to improve the service they give; batch computer systems which provide statements of cost and income six weeks after the period in question are of no use to a DSO. On-line systems which include commitment accounting are required. Statutory DSOs are likely to have similar management and financial information needs irrespective of which defined activity they deal with. Section VII of CIPFA's Meeting the challenge outlines requirements and is being adopted as the basic specification by some software houses. Umbrella DSOs should be at an advantage in being able to provide timely and inexpensive information.
THE DRY RUN

Prior to competitive tendering it is valuable for a DSO to establish a contractual relationship with a client. At the same time as it is gearing up to bid for work, it should be seeking to develop the disciplines needed to work as a fully fledged contractor. With the co-operation of the client, such an exercise should be educational in that it makes apparent the change in working methods and relationships and most importantly allows the DSO to make mistakes without fatal consequences.

CONCLUSION

This Occasional Paper has outlined the actions authorities need to take to respond to the challenges of compulsory competitive tendering. A heavy implementation programme is in prospect, although several of the measures needed are no more than formalisations of practices which good authorities should follow already. In the short term the demands on scarce management skills will be severe and some authorities will encounter problems. The Commission does not underestimate the difficulty of restructuring, particularly where redundancies, and the associated human problems, are involved.

In the longer term competition ought, if handled properly, to make local authorities more efficient and more able to respond to changing demands from their customers and electors. The Commission hopes that this paper will help authorities in planning the changes needed to turn this aspiration into a reality. Its auditors will be working with authorities over the coming months to assist them with their preparations.

APPENDIX

AUDITORS' ROLE IN CCT

With one important exception, the competition provisions in the Local Government Act 1988 have not changed auditors' roles. Auditors' responsibilities for checking value for money, reviewing authorities' accounting systems, certifying accounts, and investigating fraud and corruption, remain. The innovation in the Act is the requirement for the auditor to give a written opinion on the rate of return statement prepared for each DSO.

Auditors will establish and review the arrangements made by authorities for inviting competitive tenders; they will make the necessary enquiries and undertake the relevant tests to satisfy themselves that there is compliance with the legislation; and they will give particular consideration to matters which come to their attention and to any representations made to them.

During 1989 in the run-up to the introduction of compulsory competitive tendering, auditors will review authorities' general state of preparedness for competition. Then, in the year an activity is first subject to competition, a comprehensive audit of competition will usually be undertaken. In subsequent years, auditors will examine the accounts and the rate of return statement, with a cyclical review of certain aspects of competition and a watching brief on others.

With regard to the anti-competitiveness provisions in the Act, it is the authority's duty to ensure that it does not act anti-competitively. The responsibility of the auditors is to review independently the arrangements made for inviting competition and to assess whether anti-competitiveness is likely to exist. Auditors may become involved by a variety of routes and at different stages of the audits. For example, potential anti-competitiveness could be identified through a review of tendering arrangements, particularly in the first year of competition. It could arise at the final accounts stage in reviewing whether a fair burden of central support service costs has been charged to the DSO. Alternatively, there may be complaints to the auditors or objections, which the auditors will handle in the same thorough and prompt manner as on any other issue.

To help ensure consistency of approach, the Commission has issued guidance notes to its auditors Competition — Advice to Auditors, which will also be available to authorities. The Commission has also distributed the first in a series of newsletters to its auditors dealing with the timetable for preparing for competition and setting out a guide to the prices likely to be tendered for some of the services.

The Commission intends to monitor authorities' early experiences of CCT and to provide feedback to its auditors over the coming 18 months.