Improving strategic commissioning in the culture and sport sector

Guidance paper 2

Options appraisal, the business case and procurement

This is the second of three detailed guidance papers to support 'Understanding commissioning: a practical guide for the culture and sport sector'.

An **Options Appraisal** is described as “The process of defining objectives, examining options and weighing up the costs, benefits, risks and uncertainties of those options before a decision is made.” (Source: HM Government: Green Book).

It enables you to objectively and systematically evaluate the best way to achieve your desired outcomes / optimal solution. This is achieved by exploring the relative costs and benefits of a particular option and then compare this fairly to how other options perform against the same set of evaluation criteria which you will have developed.

A **Business Case** presents clearly information necessary to support a series of decisions. These decisions, over time, increasingly commit an organisation to the achievement of the outcomes or benefits possible as a result of investment in business change. Early decisions focus on whether the investment is justified in value for money terms assessing: benefits, strategic fit, achievability, affordability, options and commercial aspects. (Source Office of Government Commerce 2008).

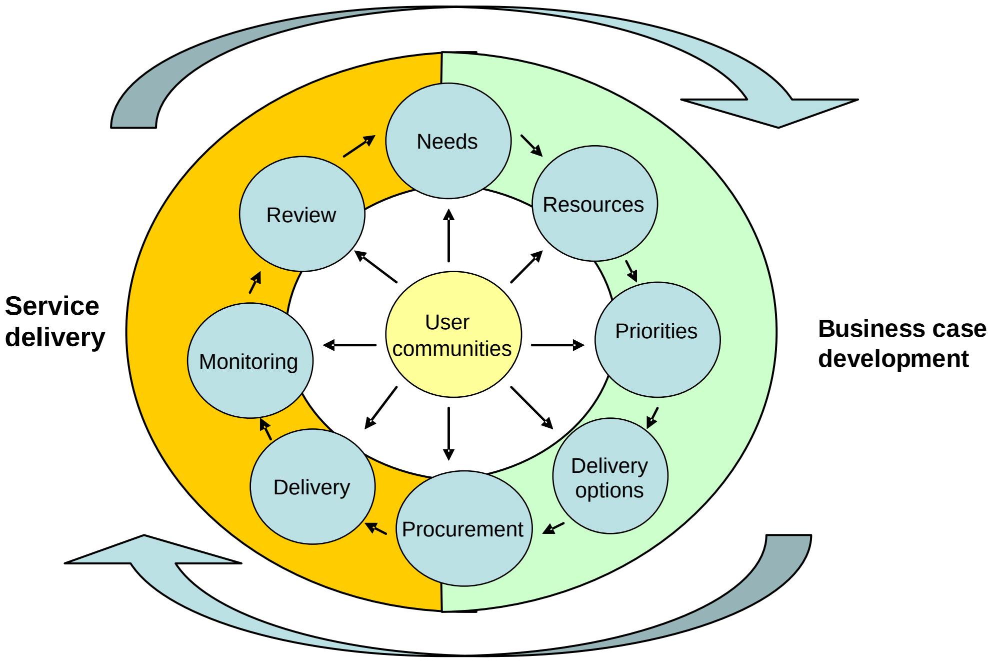
Procurement is defined as “the process of acquiring goods, works and services, covering both acquisition from third parties and from in-house providers. The process spans the **whole life-cycle** from identification of needs, through to the end of a services contract or the end of the useful life of an asset. It involves options appraisal and the critical 'make or buy' decision”. (Source National Procurement Strategy for Local Government, October 2003).

1. Appraising the options for meeting needs.

After systematically defining the needs (See needs assessment guidance paper1) and outcomes you are seeking to achieve the process of **Options Appraisal** enables you to identify and evaluate all the possible ways of delivering services taking into account the resources available to ensure decisions made subsequently through **Procurement** processes are supported by a sound **Business Case**.

The commissioning model set out in the following diagram summarises the key stages you would undertake to translate need into delivery and ultimately achieve the required outcomes. See Figure 1.

Figure 1



Typically, an **options appraisal** is used to assist Councils take the right decisions by ensuring that no policy, programme or project is adopted without first answering these key questions:

- **Are there better ways to achieve our objectives?**
- **Are there better uses for the resources available?**
- **Is this the best way to achieve our desired outcomes?**

Typical examples of how they are used are:

- Policy, programme and project development - decisions on the level and type of services to be provided, now and in the future.
- New or replacement capital projects - decisions to undertake a project, its scale and location, procurement method, timing, and the degree of private / third sector involvement.
- Use or disposal of existing assets - decisions to sell land, or other assets, replace or relocate facilities or operations.
- Procurement decisions- decisions to purchase the supply of services.

Options should not be ruled out simply because they are judged to be too ‘radical’, because appraisal will be difficult, or because they involve confronting difficult choices and vested interests. Options should be appraised on their costs and benefits, not on personal preferences of key stakeholders or individuals.

The **key benefit** of conducting an options appraisal is that it maximises the chances of achieving your desired outcome / solution.

It also enables you to ensure that:

- You achieve clarity on desired outcomes for your services.
- You have an objective, independent, transparent and open assessment that would stand up to internal and external scrutiny.
- You understand the nature and level of risk relating to the chosen option.
- You can select an optimal 'best value' solution.

The **consequences** of not using a properly conducted options appraisal can be significant and costly.

- You may not achieve value for money.
- You may face challenge as the probity of the process internally or from the District Auditor and Audit Commission.
- You will put at risk your performance in your Council's Comprehensive Area Assessment (CAA).
- You may not understand the levels of risk you are taking on board and therefore experience unforeseen financial, service and operational impacts.
- You may be acting in an anti-competitive manner and be at risk of a legal challenge by a supplier.
- You may select a sub-optimal solution and be saddled with it for a significant period of time. Exiting from any contractual arrangement could result in high termination costs.
- Critically, you decrease your chances of achieving your desired outcomes / solution.

It is important to take **whole-life costs** of a commissioning/procurement decision into consideration at all stages of designing services and evaluating potential solutions.

With some operational contracts often being let for 10 to 15 years, the whole-life costs in terms of capital and revenue are considerable. Investment strategies for portfolios of facilities under contract are an important consideration, linked to who will take responsibility for maintenance and repair of buildings and plant. Procurement costs, potential termination costs and associated exit strategies need to be considered as part of the options appraisal process.

It is important to remember that failure to assess the full costs of procurement means that both the decision may be flawed and the service and other services may be affected if additional unforeseen costs need to be found at any point in the future.

Hopefully, you're now persuaded to undertake your **options appraisal** thoroughly. The following ten key steps should be taken to ensure you're on the right track.

Ten Key Steps of an Options Appraisal

1. **Establishing the strategic need** (see needs assessment guidance paper 1). Depending on circumstances this may identify a problem to be solved such as providing new facilities or an opportunity for example, outcomes to be achieved such as improving community health as part of the sustainable community strategy.

2. **Establish the range of resources available.** Resources will always be limited either in capital terms or revenue terms. The process of options appraisal may take place within defined resources for example a fixed budget or be geared to attracting new resources through a partnership agreement with a supplier or range of suppliers. Matching options to resources will a key part of making the business case.

3. **Establishing the key outcomes and objectives you want to achieve in terms of meeting the strategic need.** This may be simply defining the change you want to achieve or involve defining 'the likely solution' such as providing a new facility, opportunity or a new service. This should not however constrain your approach to looking at the options.

4. **Establish your 'do minimum' or "baseline" position.** There may be a bottom line in terms of costs or minimum outcomes that must be achieved for the project to continue. There may also be a minimum or "do nothing "solution to consider.

5. **Establish your organisation's position on risk transfer.** Generally, if your delivery partner is taking on all or most of the risk, they may price this into the contract, so you should consider where each risk best sits.

6. **Develop your evaluation criteria for the long and short listing process**. You will need to be clear how you intend to come to a decision and what factors should and must be taken into account. This would need to ready when you start to procure.

7. **Identify the full range of options, which may be available to deliver your desired outcomes and objectives.** Develop a long list of possible options to ensure the optimal solution is included in the options from the outset.

8. **Create a short list from a high level option appraisal.** Use the evaluation criteria to select and exclude options that either fail to

meet your objectives or exceed the resources available. This would always include the ‘do minimum’ option.

9. **Evaluate fully the short-listed options against the evaluation criteria.** Use weighting and a scoring framework so it is clear how you came to your decision.

10. **Progressing the preferred option**. After the above analysis has been completed, a preferred option or options will emerge. Depending on the nature of the agreed procurement, this may be one or more providers with which you wish to negotiate. Appropriate decision making and governance arrangements will clearly need to apply throughout the process to enable elected members to take well informed and clear decisions.

2. Identifying and choosing from the full range of suppliers in the Culture and Sport sector.

The Culture and Sport sector is already a mixed economy in terms of the range of suppliers operating in the sector. Each type of supplier has their own strengths and weaknesses depending on the need to be met, outcomes to be achieved, resources available and the solution required locally by elected members. The purpose of option appraisal is to ensure you have considered all these potential suppliers.

These are broadly summarised below:

In house
Directly employed and managed by the Council and funded through the Council’s revenue budget.

Third Sector Social Enterprise (created from an in house operation)
This would be created from the previous in house team that has been transferred over into an externalised social enterprise. This would be under new governance and legal arrangements. Normally, staff pensions, benefits and previous terms and conditions are transferred over, but these may not be always applied to new staff joining the social enterprise. These organisations are often but not always called Trusts.

Third Sector Social Enterprise (already existing)
An existing social enterprise which may be already functioning in the Culture and Sport sector or in another field of public service could be contracted to operate a facility and or provide services. These may range from leisure trusts operating in other Council areas to a wide range of specialist organisations that have developed out of the community and voluntary sector. (See guidance note 3 building capacity in the third sector.)

Private Sector Operator
A private sector operator could be contracted to operate a facility and / or provide services only. In some cases a partnership of private sector suppliers could be contracted to design, build and operate new facilities as is often found in BSF (Building Schools for the Future) or PPP (Public Private Partnership) projects.

Private Sector Operator with Social Enterprise Model (Hybrid)
In a hybrid trust the Council may set up or participate in a trust company that has not-for-profit objectives. The trust company is then granted the lease for the facilities and contracts with the Council for their management. In turn it enters into a performance based management contract with a private sector operator, with the National Non Domestic Rate savings being passed back to the Council, and the private sector company managing the service as an agent of the trust company.

Mixed economy
Many Councils will use a combination of the above suppliers to deliver their services. Voluntary and community organisations which may also be social enterprises are likely to have niche specialist expertise in service delivery and it is likely that both Councils and contractors will contract /subcontract these to deliver specialist services such as arts and sport development and outreach services to vulnerable people. (See the separate guidance note on building capacity in the third sector.)

Choosing the right supplier

For to the management of Culture and Sport services the main providers currently have different degrees of representation across the sector. Commissioning is likely to lead to extended choice and variation in providers in the future.

The Culture and Sport market is evolving as a result of increased competition and providers responding to opportunities in strategic commissioning, outsourcing and externalisation of services.

As part of your options appraisal, you will need to give each type of supplier vehicle full consideration

Procuring physical improvements to Culture and Sport facilities

For the development or refurbishment of Culture and Sport buildings there are a range of capabilities within suppliers linked to construction procurement.

Many organisations have a supply chain of design and build capability through forming a consortium. This enables them to join up the development and operations, through approaches such as design and build or traditional build.

Many Local Education Partnerships (LEPs) are extending their activities into developing community facilities through the BSF programme.

There are a wide range of variants an authority can consider, and the construction procurement route needs to form part of an options appraisal. This will enable the client to identify their core requirements, be it cost certainty, risk management and / or quality.

Identify which type of supplier vehicle best meets your requirements

Each supplier vehicle has its relative advantages and disadvantages. Consideration should also be given to the fact that there can often be quite a variance in size, quality and experience in individual organisations within a type of supplier vehicle.

Health Warning: *The criteria below should only be used as a general guide and further scrutiny of the actual options and organisations is strongly recommended using these features as prompts to explore their level of relevance / accuracy to a particular Council. If in doubt – always ask the prospective provider if they can deliver or would be prepared to deliver this type of service and where they have experience of doing it elsewhere.* *Councils have a number of service requirements to consider when selecting a provider of facilities and or services. Each provider may offer different advantages and disadvantages and as we have mentioned previously, there is often a fair degree of variation in terms of service quality, cost and technical capability within a particular provider type.* *The recommended approach is not to make any assumption about a provider until you have had an opportunity to examine their experience and competencies through long list evaluation/ soft market testing or a formal procurement process.*

Identifying the potential advantages and disadvantages of different supplier vehicles

Table 1 highlights the general considerations and financial considerations you need to assess when evaluating a potential provider against alternatives.

You will also need to understand the key taxation implications of different management options and any tax advantages and how these savings may be used by your Council.

It is strongly recommended that these evaluation criteria are tested with suppliers through soft market testing and the procurement process. You may require external support from consultants and we recommend that you ensure that the evaluation of each type of supplier can be demonstrated to be robust and evidence based. Many types of supplier are now evolving their capability and previous shortcomings may have changed or will change in the future.

Typically, you should adopt a standard weighting and scoring methodology to objectively assess the options you are considering, with the criteria that are more important for your authority, being allocated a larger weighting.

Table 1 – Evaluation criteria

Finance Criteria	Guidance
Set up costs of a Social Enterprise	Explore in detail
Length of financial planning window	Explore in detail with options for break clauses if contracting out
Commercial ability to generate optimal returns from particular income streams	Explore in detail
Purchasing power – supplies / utilities etc	Explore in detail
Access to commercially competitive capital / lease revenue	Explore in detail
Level of risk transferred – e.g. • change of law • utility (tariff risk versus consumption risk) • latent defects on existing facilities • investment risk • competition risk • plant replacement risk • demand risk	Explore in detail
Capability to provide design and construction services –e.g. design and build	Relevant if facility improvements form part of the requirement
Impact on Central Services Overheads e.g. Finance, HR, legal and payroll etc	This will need to be explored internally with each of the potential options considered.
Scope for NNDR savings	This will need to be explored through the Council's finance team.
Scope for VAT savings. (Note this area is regularly under review by HM Customs and Excise.)	This will need to be explored through a Tax specialist, HMRC HM Revenue & Customs' National Advice Service on 0845 010 9000 and the Council's finance team.
General Criteria	**Guidance**
Flexibility of operation if unforeseen circumstances emerge	Explore

Finance Criteria	Guidance
Access to expert management to assist in development of service and optimal performance	Explore in detail
Alignment with achievement of social objectives	Explore in detail
If operator fails, who carries the risk?	Explore in detail
Potential for partnership working Level of direct influence the Council can have on the operation of their facilities and service. Level of influence and control on the provider's activities.	Explore in detail through soft market testing and the procurement process.

3. Making a business case to support your decisions.

In carrying out your options appraisal it is also important to develop in parallel your **business case** ahead of any procurement process.

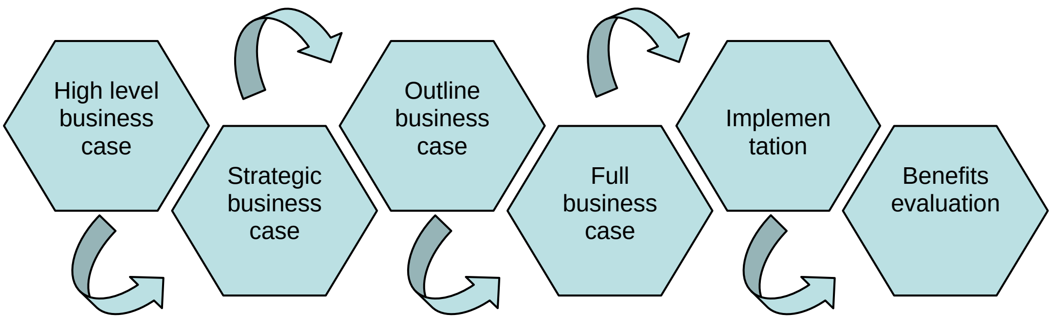
The business case should demonstrate a logical approach to business planning and shows clearly how the preferred option (i.e. the one that will be presented to the market) has been identified in the context of the resources available over the life of the project or contract.

This will be through a presentation of, amongst other things, your vision, the needs, outcomes and objectives to be met, how that vision fits with wider Council and LSP outcomes and objectives (financial, regeneration, etc), financial affordability of the scheme, the initial options appraisal and the Council's commitment to its preferred option.

Depending on the size of the project, you will need to determine the appropriate level of business case development required to support the scale of financial commitment being made by the Council and your own internal governance arrangements and processes.

The typical approach to the development of a business case is based on the stages in figure 2 and runs in parallel to the commissioning process.

Figure 2: Business case approach



The business case should contain a live risk register and keep this updated on an ongoing basis. The potential impact of each of these risks should be considered, followed by mitigation measures for each.

This will ensure that if these risks come to pass, the Council will be prepared for them and will have considered measures to reduce their impact.

As such, the business case should help provide a clear audit trail of how the preferred option has been reached and that it works best financially for the Council and for best meeting the aspirations and needs of the community.

It should be viewed as a living document that will need to be adapted as the preferred option is identified and developed.

At the point where a single option is selected, the business case should be developed in detail around the commercial elements of the option so that it evolves into a full business case to support the final decision made.

3. Procurement

In most cases a formal procurement process will follow an options appraisal, enabling the Council to select a provider to deliver a new facility, manage facilities and or deliver services. The procurement exercise should be seen as a key stage in the commissioning process:

Who should be involved in a procurement of a supplier?

It is important that Councils put together a team of senior representatives and specialists to lead, manage the process and make sure the right decision is made. This should include:

- Project Sponsor – acting as the key link to the Lead Member and Corporate Centre.
- Lead Member – acting as the key link to Members.
- Project Director / Manager responsible for day to day management of the procurement.
- Key partners / stakeholders (if relevant - this could include customer or user groups.)
- Finance (including audit) advice.
- Legal advice.
- Procurement advice.

Often, due to the specialist nature of the procurement, external advice may also be required relating to:

- Project management
- Building surveying.

- Cost management.
- Development monitoring.
- Business planning / benchmarking.
- Performance management.
- Consultancy regarding output / outcome specifications.
- Legal advice regarding management agreements and contracts.
- Other specialist advice.

Where necessary, if not available in-house you may need to seek external advisors to provide you with help to develop your requirements prior to undertaking your procurement process.

Soft Market Testing

When used correctly, soft market testing can be a powerful way for a Council to generate interest from the market and, on an ongoing basis, maintain this appetite.

However, for it to be successful, the Council must be clear on what it wants to achieve and that it is achievable (as perceived by the Council and the supplier market). If the project appears to be undeliverable, the value of a soft market testing exercise is going to be limited and it will discourage potential suppliers from bidding.

A well structured soft market testing exercise can be used to refine elements of the business case (e.g. the financial projections, the preferred delivery route, the facility / service mix and risk transfer), but it should not be used as a starting point in itself. The robust testing of operational projections can be one of the most beneficial outcomes of soft market testing.

Another consideration to be aware of is that it can enable a Council to ascertain when it would be best to approach the market formally. At any one time, there will be a range of contracts being offered to the market and it is often not possible for all potential suppliers to bid for every opportunity. Therefore, the timing of formal delivery to the market is crucial.

In terms of the third sector (and in some cases the private sector) it may be necessary to first build the capacity of the potential market to enable it to actively compete for contracts actively and in a fair and open way. (See guidance document 3 building capacity in the third sector).

Tendering and contracting with a supplier

Typically, a management contract will involve a commitment to a long-term partnership with the chosen supplier. In addition there may be a requirement for partnership investment.

In some instances the provision of new facilities will be aligned with the provision of a new supplier making the procurement process both more complex and difficult.

The findings from the needs analysis and the options appraisal will have already provided a framework for the procurement process but, ultimately, it will require a decision from Councillors on which option is in the best interests of the Council.

Your Council's standing orders will dictate if a contract of a certain value will be subject to Official Journal of the European Union (OJEU) procurement. However, options other than OJEU can be pursued if the Council takes the decision to waive the standing orders. The core options available to the Council are:

- Open procedure
- Restricted procedure
- Competitive dialogue
- Procurement through an existing Framework Agreement where suppliers have pre-qualified.

You must take specialist advice prior to selecting an appropriate procurement route.

Each of these options are summarised below:

Open procedure

This involves a single stage process with the Council publishing an Official Journal of the European Union (OJEU) notice and then issuing an Invitation to Tender (ITT) to any supplier requesting one. Suppliers (bidders) are then required to submit tenders by a specified deadline and the Council evaluates them and selects its preferred supplier.

It is the simplest of all the procurement processes and is mainly used for contracts where the scope is fixed and easily defined. This approach works well for contracts where you k now there is a limited number of potential bidders, hence there is no need for a shortlisting stage. It does not allow any negotiation with bidders and so is not suitable for complex contracts, for example, that involve facility development because it may be more difficult for the Council to achieve the value for money solution it is seeking.

Restricted procedure

This is similar to the open procedure, but involves a two-stage process where bidders are first shortlisted after submitting an expression of interest and only those on the shortlist are invited to tender. However, as with the open procedure, the tendering phase does not allow any scope for negotiation with the bidders and so is not suitable for complex contracts.

Competitive dialogue

Competitive dialogue is a relatively new option (introduced in 2005) and, as with the negotiated procedure, can only be used in certain circumstances where is would not be possible to award a contract using the open or restricted procedures, e.g. where the scope of the contract requires refinement with the bidders. In practical terms, it has now largely superseded the negotiated option.

In broad terms, it is similar to the negotiated procedure, in that it is a two-stage process with an OJEU/short-listing phase followed by negotiation, called the Dialogue phase in this instance.

The purpose of the Dialogue is to enable the Council to refine its requirements through interaction with the bidders and then provide a final specification against which they must submit a tender. The key difference between it and the negotiated route is that there is no scope for further discussion at preferred bidder stage. In effect, the preferred bidder's tender is its final offer.

In practice, this route requires significantly greater input from all bidders and the Council and therefore is a more costly process for all participants. The bidders have to undertake more work at risk than is the case in the negotiated procedure in order to be able to submit a fully compliant tender. For the Council, there is a greater time input required to evaluate bids. However, this route can produce the best results in terms of encouraging innovation from bidders through dialogue.

To achieve successful results from this option, it is important that the Council takes a pragmatic approach to the structure of the dialogue to ensure that the bidders are not incurring significant costs when there are still a high number (three or more) involved. Failure to do so may mean a lack of interest from the market at the outset or a rapid withdrawal of bidders once the process in underway.

Procurement through an existing Framework Agreement

Many services are now being accessed through framework agreements, which are usually originally procured through the Open procedure via OJEU. Often legal, procurement advice and facility development support are included in framework agreements. This approach enables Councils to reduce the time in procuring specific services through a pre-selected list of specialist suppliers. Typically, Framework Agreements do not cover the full range of specialist Culture and Sport services. We advise you to check the framework agreements your Council uses prior to commencing any procurement process.

Process and Timescales

As an example of the length of time it will take to procure via the approaches highlighted earlier, Table 5 shows a list of the main stages in procurement for

Competitive Dialogue. Indicative minimum timescales have been provided based on procurement of leisure management contracts as a guide only. Different services and sizes of contracts will result in differences in procurement timescales. The other core options highlighted (with the exception of Open procedure via OJEU) will take less time, but this will be determined by a number of factors including resources, complexity, input from specialist consultants and the capability of the Council's team.

Table 5 – Indicative Timescale for Competitive Dialogue

Stage	Estimated Duration
Develop prospectus and Pre-qualification questionnaire (PQQ)	4 weeks
Advertise - Open Tender OJEU	5 weeks
Response from contractors to PQQ	6 weeks
Develop output specification / tender documentation (concurrent with OJEU/PQQ period)	6 weeks
Short listing for Dialogue phase	1 week
Feedback to unsuccessful applicants	2 weeks
Dialogue phase	12 weeks
Review of dialogue phase submissions	4 weeks
Finalisation of tender documentation	4 weeks
Short listing for tender phase	2 weeks
Tender phase	12 weeks
Select preferred bidder	4 weeks
Negotiation with preferred supplier	4 weeks
Contract close	2 weeks
Contingency	3 months
Total	**17–20 months**

Contract Length

There are advantages and disadvantages associated with contracts of different length and circumstances will dictate the best option for Councils. In terms of major facility management contractors, the sector has over time seen the length of contract duration grow to reflect the desire to meet investment requirements, with contracts now often being awarded for ten to fifteen years. There is a risk that if the contract does not have adequate flexibility built into it for change of requirements, it can become too inflexible a service delivery vehicle.

Short -Term Contracts (0 – 5 years)

Short-term contracts (up to 5 years) offer the advantages to the Council of not being tied into a long term agreement – and these are often suitable for situations such as:

- operation of a facility prior to major refurbishment
- bringing a range of contracts in line with each other
- establishing confidence in an supplier prior to a longer-term contract being agreed.

The disadvantages relate primarily to investment from the operator and the requirement for a return in investment – a short contract often inhibits the potential for a major investment to be paid back, and surpluses generated in future years.

Similarly, a short-term contract limits the potential for the supplier to establish long- term revenue and is thus less attractive to them than a longer contract.

To compensate for this, they will build in higher margins to reflect the additional risk of a short-term contract.

Long-Term Contracts (10-15 years)

Long-term contracts between 10-15 years offer the advantages of establishing a long-term relationship and approach with the right contract and opportunities for working closely in partnership for the mutual benefit of both parties.

The most successful arrangements are based on a transparent 'open book' approach to finance, where the Council understands the key drivers for the contractor and vice versa.

The Council would have certainty over the delivery of leisure across all its centres for a longer term. It will aid strategic planning and investment while reducing financial risk.

Within a long-term contract it is sensible to build in break clauses, every five years, to enable issues such as buildings maintenance, revenue support, changes in utility costs and corporate objectives to be reviewed and integrated into the next phase of the contract.

The disadvantages of a long -term contract are based around the following risks:

- The contract documentation does not meet the Council's requirements in the future and if not properly designed, cannot be amended to reflect developing requirements.
- The partnership can erode over time.
- Issues outside of both parties control can impact on them financially and create tension around the management of risk (e.g. utility costs in facility management).

- If the Council experiences significant pressure on its budgets in the future, it may be saddled with a contract it cannot afford in the long-term, or is very expensive to terminate.

In summary, the key to a successful partnership is based on the relationship between the two parties, the contract and output specification and a clear approach to future development of the partnership.

Performance Management

It is essential that the Council considers performance management requirements as part of the overall commissioning process and as a critical part of its continuous improvement process.

The needs assessment process will enable Councils to identify the outcomes they wish to achieve over the duration of the contract. These can be used to establish specific objectives and output measures that will enable it to have confidence that longer term outcomes in terms of such things as health improvement, community cohesion or community satisfaction will be achieved.

The procurement process must be used to ensure that the performance management framework the Council proposes to work within throughout the period of the contract can be accommodated by the successful operator. The operator will be required to supply, at specified periods, appropriate information to enable the Council to ensure the outputs and outcomes are being achieved.

A balanced scorecard system should be developed with the operator that enables both parties to receive the information they both require to manage the contract and achieve the outcomes. Measuring outcomes is always difficult and collecting performance information can be costly therefore it is important to negotiate as part of the procurement process how this can be best achieved and not wait until the contract has been agreed., A balanced scorecard should include a range of performance measurements, quality standards and targets for:

- achieving the Council's objectives and outcomes including key national and local performance indicators
- measuring quality of service and community satisfaction
- financial performance.

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