ANNEXE A: OUTSOURCED IT

Introduction

A1 This annexe sets out the OFT's assessment of competition in the supply of outsourced IT to the public sector.[1] First, we describe the background to public sector outsourced IT, patterns of public sector expenditure, and how procurement processes and supply chains work. Second, we assess the level and effectiveness of competition in the sector, looking specifically at competitive constraints, market power, and buyer and supplier conduct that impacts on competition.

A2 We have used a number of sources of information to analyse outsourced IT contracts. These include the Kable outsourced IT database, the Kable procurement database, the OpenTED database and responses from buyers and suppliers to our questionnaires, as described in Chapter 2. We have also made use of a number of third party studies, two of which are of particular importance to our analysis:[2] a 2011 study of OJEU procurement processes in Europe between 2006 and 2010 by PwC, London Economics and Ecorys (the 'PwC, London Economics and Ecorys report');[3] and a 2012 study of public sector ICT procurement across the EU, including a survey of over 400 public sector buyers and suppliers, by Europe Economics (the 'Europe Economics report').[4]

Overview

A3 IT services can be deployed on an in-house or outsourced basis. In-house deployment occurs where a public body retains its own IT team in order to identify, procure and integrate the various hardware and software it requires. Outsourced IT, on the other hand, is an arrangement whereby third party service providers supply and deploy one or more of these services, and it is therefore defined as 'the use of external service providers

[1] As noted in Chapter 3, we do not consider managed communications services to fall within the scope of 'IT services', hence we consider 'outsourced IT' rather than the potential alternative of 'outsourced ICT'.
[2] Both of which were prepared for the European Commission.
[3] 'Public procurement in Europe: Cost and effectiveness', PwC, London Economics and Ecorys, March 2011, available at http://ec.europa.eu/internal_market/publicprocurement/docs/modernising_rules/cost-effectiveness_en.pdf
[4] Guidelines for Public Procurement of ICT Goods and Services: SMART 2011/0044 D2 – Overview of Procurement Practices', Europe Economics, 2012, available at http://cordis.europa.eu/fp7/ict/ssai/docs/study-action23/d2-finalreport-29feb2012.pdf

to effectively deliver IT-enabled business process, application service and infrastructure solutions for business outcomes'.[5] These arrangements often involve assets or staff being transferred from the buyer to the supplier.

A4 In the majority of contracts we consider to be outsourced, one supplier, known as the prime contractor, has responsibility for integrating the various goods and services it produces or procures through its own supply chains, and for managing the suppliers within these supply chains.

A5 All major categories of IT services can be and are supplied on an outsourced basis. Specifically, we consider outsourced IT to comprise one or more of the following services:

- Applications development: the design and development of software applications and solutions, tailored to the specific needs of the customer.
- Outsourced applications licensing, support and maintenance: the provision of off-the-shelf software licences and add-on services such as technical support and maintenance.[6]
- Desktop outsourcing: the management of the desktop environment (including computers and other devices), including operating system software installation, maintenance and updates, security and helpdesk services.
- Data centre outsourcing: the provision, maintenance and management of data centres or data centre capacity, as well as related services such as disaster recovery, data storage and remote applications hosting.
- SIAM: the coordination of the delivery of ICT goods and services and the management of some or all of the suppliers in the supply chain for specific contracts. The SIAM role is often by default provided by the prime contractor, although increasingly under the towers delivery model specialist services integrators are winning these contracts.

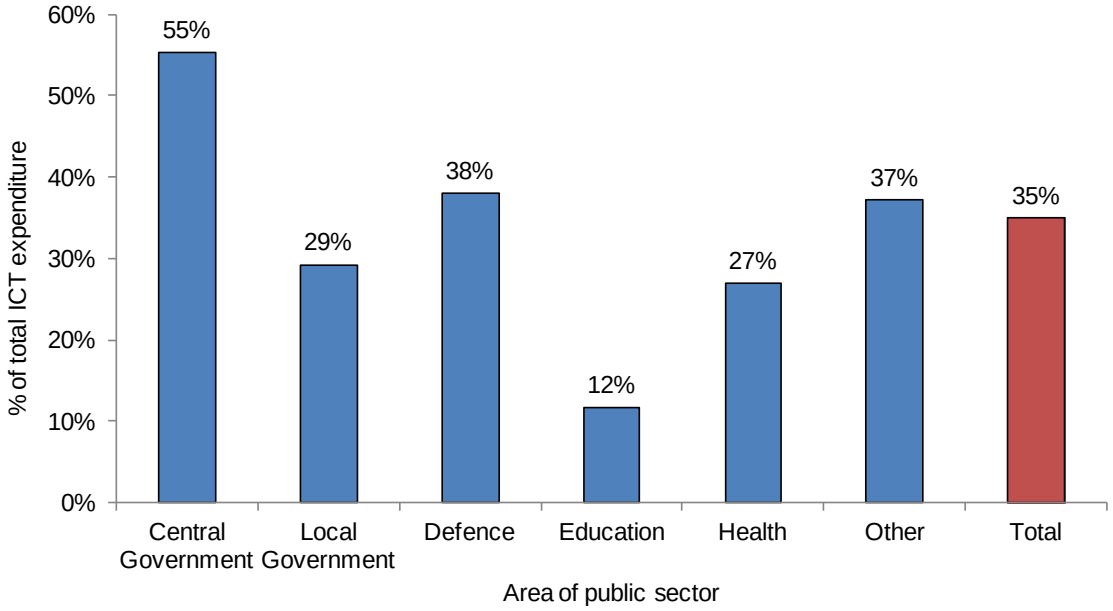
[5] See market research company Gartner's online glossary, at www.gartner.com/it-glossary/it-outsourcing/
[6] This differs from non-outsourced software licences and support and maintenance services where these are not purchased by the end-user as off-the-shelf products and services direct from the software vendor, but through a third-party outsourced provider, which may also provide applications development or hosting as value-added services.

Expenditure levels

A6 The UK is one of the world's largest consumers of all outsourced services. The UK public sector accounts for an estimated 85 per cent of all public sector outsourcing in Europe, the Middle East and Africa (EMEA), and over 50 per cent of total expenditure on outsourcing in the UK.[7]

A7 For outsourced IT specifically, the picture appears to be little different. The UK public sector spent an estimated £4.8 billion on outsourced IT in 2011/12, accounting for around 70 per cent of IT services purchased by the public sector and around 35 per cent of total ICT expenditure. This figure varies across buyers, with outsourcing accounting for 55 per cent of all IT services expenditure in central government and only 12 per cent of all IT services expenditure in education, as shown in Figure A.1 below.

Figure A.1: Public sector expenditure on outsourced IT as a proportion of all IT services, by buyer type, 2011/12



Source: Kable expenditure estimates

A8 Spend on different types of outsourced IT varies according to buyer characteristics. For example, central government is the largest customer of

[7] See www.publictechnology.net/news/uk-public-sector-now-largest-outsourcing-market-outside-us/37659. Since the source relies only on contracts worth more than £4 million per annum, the total size of outsourced services in the public sector is not easily measurable from this source, nor is the exact share of the UK across EMEA. However for these larger contracts, the UK public sector is estimated to account for around 85 per cent of the total.

outsourced (tailored) applications development and data centre services, whereas local government and health spend greater proportions on licensing, maintenance and support for COTS software applications.[8] This may be explained by the fact that there are a larger number of more similar buyers in these parts of the public sector than in central government, enabling off-the-shelf software markets to emerge.

Procurement approach and procedures

Historical context

A9 The UK public sector has displayed a preference for outsourcing the provision of IT services in recent years. Historically, these outsourced IT contracts have often been long and high-valued,[9] been highly customised for individual organisations, and involved large-scale transfers of risk.[10] As such, large prime contractors have often been the only suppliers capable of delivering these contracts.

A10 This preference has been particularly strong in the UK public sector, and less so in other countries. It is estimated that the proportion of all public sector IT services that are outsourced in each of France, Germany and Spain is roughly half that of the UK.[11]

A11 However, the landscape appears to be changing. There is an increasing focus on using open systems designed from common and easily adaptable COTS products and services, based on open source or open standards.[12] Large contracts are increasingly being broken up into multiple, smaller 'towers' with the aim of encouraging a wider supplier base and to reduce reliance on large prime contractors, as well as to aid benchmarking. Also,

[8] Source: Kable expenditure estimates.
[9] As noted in a response from one supplier: 'outsourcing mega-deals…dominated public sector IT services procurement in the 1990s and 2000s…This saw the award of contracts that were worth hundreds of millions of pounds, even billions, often lasting for a decade or more'.
[10] Such as liquidated damages associated with specific contractual breaches, or larger liability clauses.
[11] It is estimated that France, Germany and Spain outsource 29 per cent, 33 per cent and 34 per cent of their public sector IT services respectively, compared to 64 per cent in the UK. Source: Pierre Audoin Consultants analysis, provided to the OFT by T-Systems.
[12] See, for example, the ' Government ICT Strategy - Strategic Implementation Plan', paragraph 10: 'A suite of mandatory open standards will underpin the standardisation of ICT solutions. This will move government away from procuring expensive bespoke systems to greater re-use and sharing of less expensive off-the-shelf solutions. Standardisation will also enable a shift to a commodity approach to procuring ICT services, through which government will have greater flexibility to consume services based on demand'. (Available at www.gov.uk/government/uploads/system/uploads/attachment_data/file/266169/govt-ict-sip.pdf)

commercial and technical capability within the public sector, which has been lost through outsourcing to suppliers, is being increased with the aim of improving buyers' ability to define outsourced IT requirements, design procurement processes, evaluate and challenge suppliers on performance and price, and draw up suitable contracts.[13]

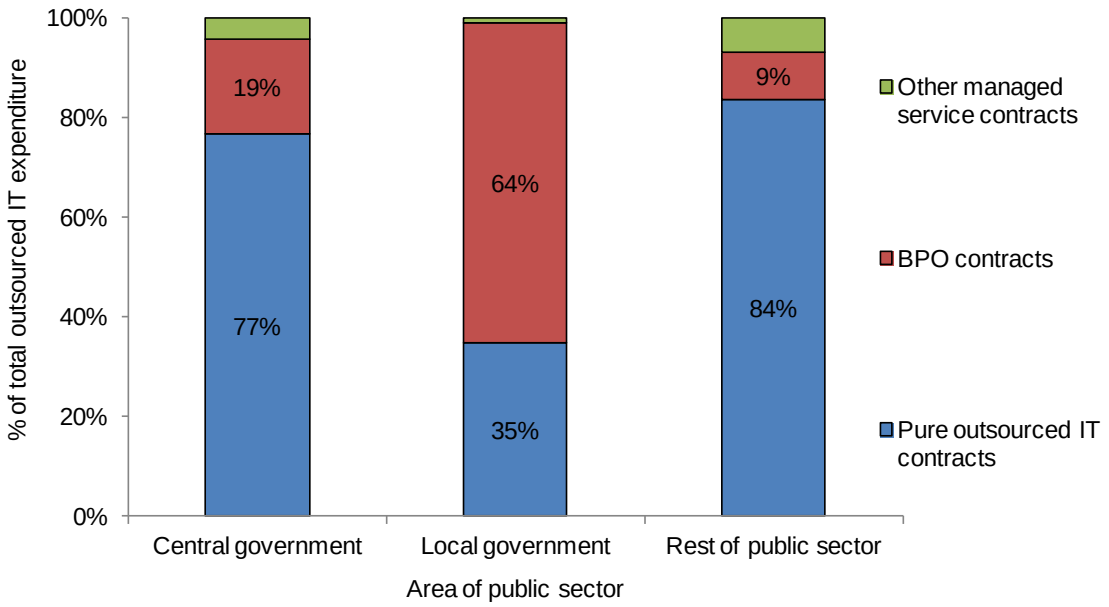
Business Process Outsourcing

A12 As well as being procured as individual service 'towers' such as data centre outsourcing, or on an aggregated basis, outsourced IT services are often procured alongside non-IT services. A common example is the outsourcing of whole business processes, which is typically referred to as business process outsourcing (BPO).

A13 BPO is particularly common in local government for business processes such as customer services, tax collection and benefits payments, and finance and human relations, and it is estimated that local authorities procure around two-thirds of their outsourced IT services through BPO contracts.[14] Only 19 per cent of outsourced IT in central government is estimated to be procured in this way, and the proportion is even lower across other parts of the public sector. This is shown in Figure A.2 below.

[13] For example the establishment of the CCS, which is open to the wider public sector to draw on the advice and expertise it can provide.
[14] Source: Kable outsourced IT database. The OFT has identified over 30 local authorities who have signed contracts including outsourced IT services with total contract values of over £100m, with several worth over £1 billion. For example, Essex County Council signed an outsourcing contract with IBM for over £5 billion in 2009. See www.telegraph.co.uk/news/politics/6865823/IBM-signs-deal-with-Essex-County-Council-Tories.html

Figure A.2: Proportion of expenditure on outsourced IT procured through BPO contracts, by buyer type, as at January 2014



Source: Kable outsourced IT database

Procurement processes[15]

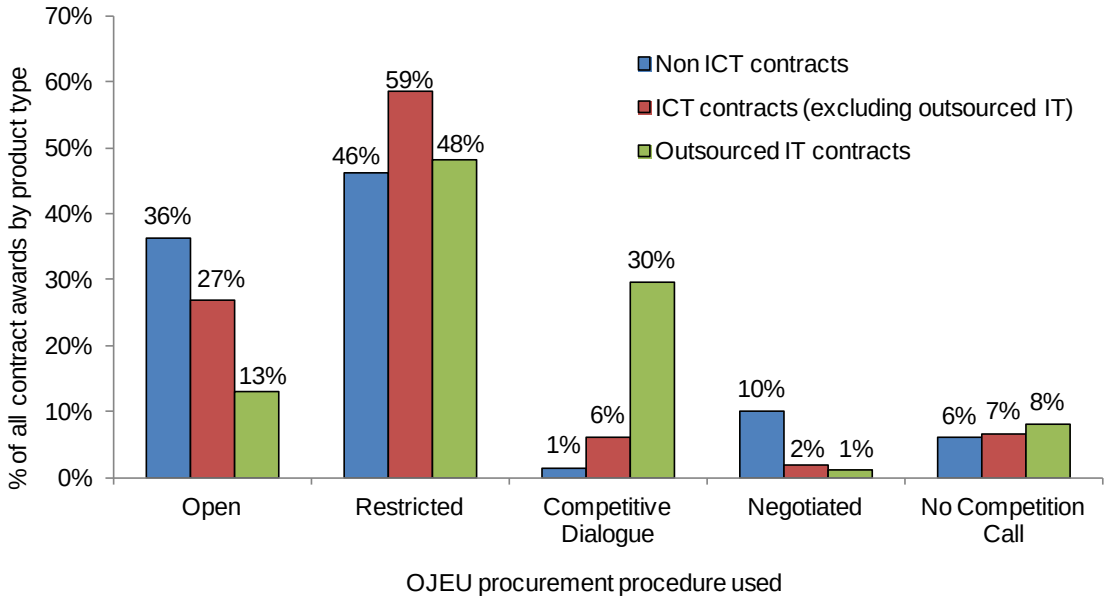
A14 Our analysis indicates that public sector organisations mostly procure outsourced IT services individually and directly, on a non-framework basis. Around 40 per cent of outsourced IT contracts by (expected) value between March 2010 and April 2013 related to framework awards.[16]

A15 The choice of procurement processes and bid assessment criteria suggests that outsourced IT contracts are particularly complex. There is a much higher use of the competitive dialogue procedure for procurement of outsourced IT services, with 30 per cent of tenders using this procedure, as shown in Figure A.3 below. Furthermore, only six (four per cent) of the 149 outsourced IT procurements from March 2010 to April 2013 were

[15] See Annexe C for further details on procurement processes
[16] Source: OFT calculations using data from the OpenTED database. It is not possible to conclude from this finding whether in any given year more expenditure goes through frameworks or direct processes because (i) reported contract values relate to expected, rather than actual, expenditure through frameworks and (ii) contract durations differ and are not always reported. For example a large total contract value may relate to a multi-year framework, meaning that year's expenditure is considerably lower. However it seems likely that more expenditure goes through direct, non-framework purchases

assessed solely by reference to the lowest bid price, compared with eight per cent of all tenders.[17]

Figure A.3: Use of different OJEU procurement procedures by type of product between March 2010 and April 2013



Source: OpenTED database; Kable procurement database

Supply chains

A16 As noted above, in the majority of outsourced IT contracts there is one prime contractor which takes responsibility for deploying and integrating the various goods and services it produces or procures through its own supply chains, and for managing sub-contractors. Prime contractors may purchase IT hardware and off-the-shelf software licences directly from producers or their channel partners,[18] and they commonly also provide a range of additional value-added services.

A17 Prime contractors often subcontract distinct outsourced services to third parties.[19] Suppliers provided us with many reasons why they would wish to

[17] Source: OpenTED database; Kable procurement database
[18] See Chapter 4 for an explanation of the role of channel partners
[19] For example, Capgemini, as the prime contractor under the Aspire contract (which delivers a range of IT services to HM Revenue and Customs including IT hardware and public services such as online VAT filing), has used around 360 subcontractors, which have cumulatively earned a reported 65 per cent of the contract value. - See http://bit.ly/1boloYd and www.computing.co.uk/ctg/news/2286959/hmrc-reveals-over-gbp37bn-spend-with-capgemini

subcontract work, including: a requirement for specialist expertise that is not held in-house by the prime contractor; a requirement for particular software and software-related services to be provided; the ability to provide a certain service at a lower cost than the prime contractor otherwise could; and the ability to meet customer preference, for example that services and solutions are 'best-of-breed' and/or that SMEs form part of the supply chain.

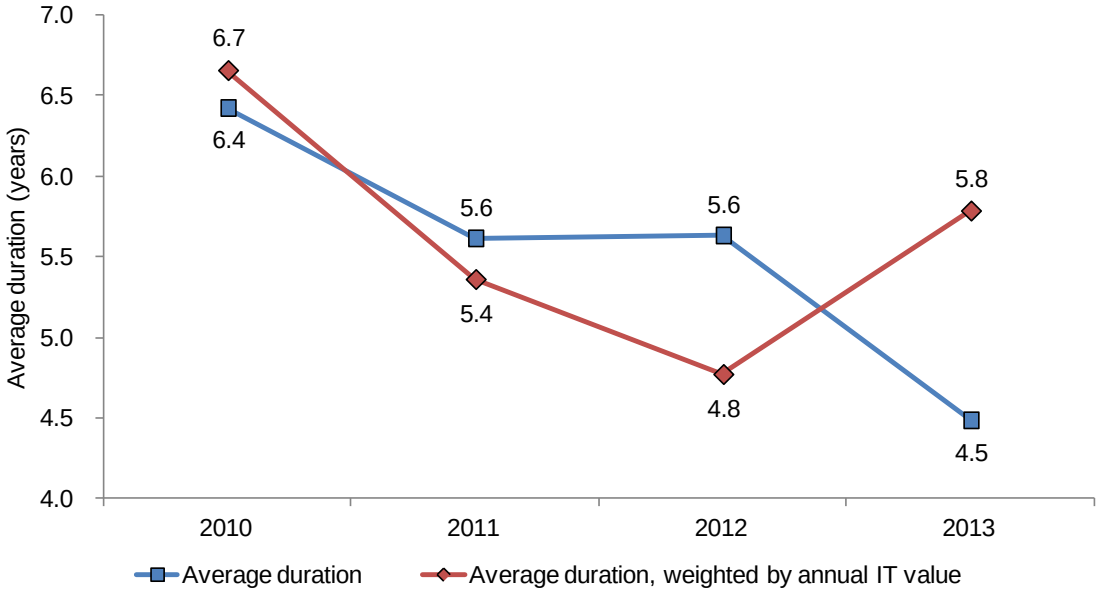
Findings on contract terms

A18 We have analysed the sources of information described in paragraph A2 to understand the characteristics of outsourced IT contracts in the public sector. Below, unless otherwise stated, we report results from the Kable outsourced IT database, which are broadly consistent with findings from each of the other sources.

A19 The (value-weighted) average duration of current contracts is over nine years.[20] UK Public sector outsourced IT contracts appear to be considerably longer than those outside the UK public sector: in 2008 the average length of global outsourced IT contracts was estimated by Gartner to be around five years long, compared with over 10 years in the UK public sector.[21] However, there is some suggestion that durations of new contracts in the public sector are shorter than for existing contracts, and are falling over time, as shown in Figure A.4 below.[22]

[20] Source: Kable outsourced IT database. Contracts with higher per-annum values also tend to have longer durations: the largest 10 outsourced IT contracts, for example, have an average length of almost 11 years. This is broadly consistent with data submitted by large suppliers which indicates that most contracts are between seven and nine years long (but which excludes some of the longest contracts).
[21] Gartner's estimates cover 12 different industries, over 400 suppliers and multiple global regions. It also estimates that the very largest contracts last on average six years and nine months. See http://bit.ly/1ihpiCy
[22]The average durations shown in Figure A.4 represent a lower bound of expected actual durations, since contracts often allow for one or more potential future extensions. The figure plots prior expectations of durations, with no subsequent re-statement as a result of extension.

Figure A.4: Average duration of new outsourced IT contracts, 2010 - 2013



Source: Kable outsourced IT database

A20 Values of outsourced IT contracts are highly variable and highly skewed, with a small number of contracts accounting for the majority of total values. Around 40 per cent of contracts have an annual IT value of under £1m, particularly in sectors where buyers are smaller such as local government and education.[23] However, the largest five per cent of contracts, mostly in central government and defence, are each worth £35m per year or more,[24] and the largest 10 contracts account for around 40 per cent of all current public sector outsourced IT expenditure. Average annual contract values fell from around £12 million in 2008 to around £8.5 million in 2013.

A21 Contract scopes are also highly variable. Around half of all outsourced IT contracts between March 2010 and April 2013 included a single product category as defined by the European Union.25 However around five per cent of contracts included more than 10 categories.

[23] The median IT-related contract values for local government and education buyers in the Kable database are £0.9 million and £1.4 million respectively. For central government the median is £3.0 million.
[24] This is consistent with public procurement as a whole: the PwC, London Economics and Ecorys report notes that for all OJEU processes in Europe between 2006 and 2010, '…contract values are heavily concentrated at the low end… almost nine tenths of all contracts [are] below the mean and add up to under 15 percent of total procurement values. This is an extraordinarily skewed distribution'. (p5)
[25] So-called 'Common Procurement Vocabulary (CPV) codes', at the two-digit level. The most common categories listed for outsourced IT contracts are 'IT services', 'software packages and information systems' and 'business services'

Competition in outsourced IT

A22 In this section we consider competition for the supply of outsourced IT to the public sector. In particular, we consider:

- competitive constraints
- market power: actual competition, potential competition, switching costs, tacit coordination and buyer power
- buyer conduct: ways in which buyers act that impact on the level and effectiveness of competition
- supplier conduct: ways in which suppliers act that impact on the level and effectiveness of competition.

Competitive constraints

A23 Below we consider the competitive constraints on outsourced IT in the public sector arising both from the demand and supply side, and from the existence of primary and secondary markets. We have not, however, conducted a market definition exercise, nor have we sought to conclude on market definition.

A24 Several references in this section are made to a 2007 report on markets with bidding processes, prepared for the OFT by DotEcon Ltd (the 'DotEcon report').[26]

Demand side constraints

A25 Since outsourced IT services are usually procured through auction processes, there is likely little or no scope for customers to substitute away from the set of services that satisfy the requirements set out in the contract notice.[27] It is therefore sensible to take as a starting point the range of different outsourced IT services that can meet the requirements stipulated by buyers within each procurement process. Demand side

[26] 'Markets with bidding processes', prepared by DotEcon Ltd for the OFT, May 2007, available at www.oft.gov.uk/shared_oft/economic_research/oft923.pdf

[27] This is noted in the DotEcon report: 'If different specifications of the product or services to be supplied were considered to be substitutes, a buyer would normally be expected to run a single integrated bidding process, giving itself the opportunity to trade off different specifications, or purchase more of one product and less of another'

constraints on the prices of these services arise from the potential for these services to be provided by an in-house IT team or to be purchased from third-party suppliers on a non-outsourced basis, as well as the potential for buyers to opt-out of deploying the services altogether.

A26 Although the option to forego deploying the services altogether is clearly available, this is unlikely to significantly constrain the price of outsourced IT services once the decision has been made to procure them.[28] We therefore do not further consider the potential for opting-out altogether. As a result, we consider two possible sources of demand side constraints - where in-house provision is possible, and where non-outsourced goods or services are potential substitutes. We consider these in the context of whether requirements are truly 'bespoke' or not.

Bespoke ICT solutions and in-house supply

A27 Evidence suggests that public sector outsourced IT services are often tailored to individual buyers, creating a solution that is to a degree 'bespoke'. For example, in a recent survey conducted for the European Commission nearly 70 per cent of respondents reported that 'the ICT they procure consists of either purely bespoke products or services…or a combination of off-the-shelf products and bespoke solutions'.[29]

A28 Where buyers require bespoke solutions, the lack of potential substitutes to outsourced IT means the only viable alternative may be in-house provision. The cost of providing in-house IT services, including recruiting suitably qualified in-house ICT and finance teams, purchasing the necessary infrastructure and providing these services will therefore act as a constraint on the cost of outsourcing this provision. This may itself depend on whether the organisation currently has an in-house ICT team. If so, they will incur fewer sunk costs associated with the recruitment and training of staff and the purchase of the necessary infrastructure. Buyers in local government and education, for example, may on average be in a better bargaining position than central government buyers, since the latter

[28] Indeed stakeholders suggested to the OFT that the majority of the largest requirements are business-critical or essential public services that could not simply go undelivered.
[29] Europe Economics report, paragraph 5.4. This is also reflected in both the above-average use of the competitive dialogue procedure and submissions from stakeholders during the market study, many of whom expressed the view that public sector buyers are often unwilling to consider solutions available on an off-the-shelf basis.

currently outsource IT services to a greater extent. [30]

A29 We have heard examples of several local authorities bringing outsourced IT services back in-house, but there is very little evidence of this occurring in the other major outsourcing customer groups of central government, defence and healthcare.[31] We cannot, however, reach a definitive conclusion on this given the evidence available to us.

Non-bespoke ICT solutions and alternative non-outsourced solutions

A30 If buyers' requirements are not truly bespoke, there may be alternative goods and services that are viable substitutes. For example, if an organisation tenders for a set of software applications, alternatives to outsourcing the development of bespoke applications may be purchasing COTS software licences,[32] or renting SaaS via the cloud.[33] The price of these alternatives may constrain the price of outsourced applications development in some cases.[34]

A31 Cloud services in particular are increasingly emerging as credible substitutes to data centre outsourcing due to the Government's recent 'Cloud First' policy and G-Cloud frameworks. [35] However we have heard little evidence that other outsourced services, such as large-scale applications development or SIAM, face similar competitive constraints.

Bundles of services

A32 A further consideration is to what extent bundles of different services within individual contracts could be disaggregated and purchased separately. Whether individual constituent services impose a competitive constraint on the bundle depends on the level of savings buyers are able to

[30] See for example, Figure A.1. 21 of the 24 ministerial departments and at least 13 of the 22 non-ministerial departments currently have outsourced IT contracts in place, compared with fewer than half of local authorities and very few education providers. Source: Kable outsourced IT database.
[31] There are several notable exceptions to this, however. For example, DWP has recently announced an intention to in-source SIAM at a future date. See http://central-government.governmentcomputing.com/news/dwp-builds-on-plans-to-in-source-its-siam for further details.
[32] This could potentially include some customisation or support and maintenance services from the original vendors or VARs; these are not typically considered outsourced IT services.
[33] See Chapter 3 for a discussion of cloud computing and the G-Cloud frameworks.
[34] Indeed the OFT has seen some evidence of suppliers challenging suppliers on the basis of the price of off-the-shelf alternatives.
[35] As shown in Chapter 3, the G-Cloud frameworks have been little used to date, accounting for around one per cent of total expenditure on software and IT services in 2013, however their usage has steadily increased month-on-month.

achieve over the life of the contract by purchasing the bundle as opposed to the constituent services individually.[36] These savings may arise due to economies of scope achieved by the supplier or due to the buyer proceeding with fewer costly procurement processes and managing fewer suppliers. We understand that procurement processes can be costly for both buyers and suppliers,[37] and on that basis, even small economies of scope may imply little competition from individual outsourced IT services on bundles of services.

A33 However, recent government initiatives aimed at breaking up large, long-term contracts[38] have resulted in buyers increasingly looking to disaggregate their requirements and becoming increasingly price sensitive when considering purchasing large-scale, aggregated outsourced IT contracts. If there are economies of scope available to suppliers or substantial procurement costs, buyers may end up paying more for individual services, although this may be partly or completely offset by an increased intensity of competition if such policies remove or reduce barriers to entry, expansion or switching.

Conclusions on demand-side competitive constraints

A34 Our analysis of demand-side constraints suggests that:

- Where services must be bespoke, there are likely to be fewer demand side constraints on prices and quality due to the limited scope for substitution to other services. The only viable substitute is likely to be in-house supply.
- Where services need not be bespoke, there may be other viable substitutes, including cloud services or COTS software licences. This implies that competitive constraints will be more significant in this case.
- Where buyers' requirements can only be met with multiple outsourced IT services, the cost of multiple procurements and potential for economies

[36] Note that this observation assumes there is sufficient competition among suppliers. If one or more suppliers were deemed to have market power over a particular buyer, they may instead be able to bundle peripheral services alongside the services being tendered for. We have heard of a few instances where suppliers have offered substantially larger bundles of services than specified in tenders, although in most cases the buyer was able to select a different bid.
[37] See paragraph A69 and the PwC, London Economics and Ecorys report (p88), which finds that UK public sector procurement processes are the third most expensive in the EU, considering costs to both buyers and suppliers.
[38] Such as the presumption that no contract will have a whole-life cost more than £100 million.

of scale or scope mean that prices of individual services would ordinarily be unlikely to constrain the prices of bundles of services. However recent government-led initiatives may make large-scale bundling unattractive or practically impossible, meaning individual services may provide more of a constraint. This does not mean buyers will necessarily achieve a better outcome as they may forego potential savings associated with bundled procurement.

A35 As discussed in paragraph A27, evidence suggests that in many cases outsourced IT services are procured on a bespoke basis. Our analysis of demand side constraints therefore suggests that there may often be little scope for demand side substitution.[39]

Supply side constraints

A36 Consideration of competitive constraints on the supply side is particularly important where, as is the case with outsourced IT, services are procured via auction processes, due to a lack of demand side substitutes.[40] Below we consider potential constraints from both current suppliers of ICT goods and services and potential supply side substitutes.

Supply side constraints may be limited in some cases

A37 Some suppliers of outsourced IT services specialise in the type of outsourced services they supply. Two notable examples are the supply of specialist defence services (usually to the Ministry of Defence), and the supply of BPO to local government. In both cases there are clear differences between the services required by these buyers and by other public sector buyers:[41]

- Four of the largest 25 suppliers of outsourced IT to the public sector derive 100 per cent of their revenues from defence, and cumulatively

[39] This is consistent with the approach suggested in the DotEcon report: 'Given differences in the specification of requirements, the goods and services procured through two different tenders are unlikely to be demand-side substitutes' (paragraph 4.12).
[40] As noted in the DotEcon report: '…different tenders for purchase of related, but differentiated, services do not necessarily constitute individual markets in their own right, even though the goods or services being bought may not be substitutable for the buyer. Supply substitutability has a much more important role in determining the boundary of the market' (paragraph 4.14).
[41] BPO requirements are discussed in Paragraphs A12 and A13. Defence contracts are usually large and as noted usually undertaken by specialist defence suppliers. Where we discuss barriers to entry and expansion, we also note that security requirements may restrict the ability of suppliers to win these contracts.

account for around more than 80 per cent of all defence spending. Moreover these four suppliers were very rarely listed as competitors by other large suppliers in response to a specific question we put to outsourced IT suppliers.[42] This suggests that defence-related IT contracts may not sufficiently constrain prices of other types of outsourced IT.[43]

- Specialism at the local government level is slightly less clear-cut since none of the largest 25 suppliers of outsourced IT to the public sector derive all of their revenues from this buyer category. However, several derive substantial proportions of their total revenues from local government,[44] and responses to our questionnaire revealed a fairly clear competitive split between these suppliers and most of the remaining 25 who mostly provide pure ICT outsourcing services to central government.

A38 Other features potentially limiting supply side competitive constraints are the level of bundling of outsourced services and the size of contracts. Many smaller suppliers specialise only in certain services that may form part of larger bundled outsourced IT contracts. In such cases they are unlikely to impose a competitive constraint on bundled outsourced IT contracts. Additionally they may lack the financial capacity to take on larger contracts. However, suppliers of bundled and/or large contracts may represent competitive constraints on these smaller or more specialist suppliers. This implies that the larger or more bundled contracts are, the weaker the constraints are from other suppliers.

A39 Supply side constraints may also be limited where suppliers face barriers to winning certain contracts or public bodies face barriers to switching between suppliers.[45] One important barrier in this context relates to supplier lock-in, which has been identified as a particularly prevalent feature of ICT markets.[46] In many markets, partially or fully locked-in

[42] Question 7 of the OFT's questionnaire to outsourced IT suppliers.
[43] For example, the supplier of the largest defence ICT contract (the Atlas Consortium) is a consortium of four suppliers, three of which derive substantial revenues of their own from outside the defence sector. When the contract was awarded, the Atlas Consortium reportedly faced competition from consortia of other non-defence specialists. See www.bapcojournal.com/news/archivestory.php/aid/69/MOD_DII_F__The_final_countdown.html for further details.
[44] Specifically, seven of the 25 earn over 40 per cent of their outsourced IT revenues from local government supply
[45] We discuss entry, expansion and switching between paragraphs A64 and A87.
[46] See for example the Europe Economics report: 'at least 40 per cent of [survey] respondents consider themselves 'locked-in' to their existing ICT solutions and suppliers' (p60).

consumers may be protected from harm if a large enough proportion of consumers in the same market are not locked-in.[47] However where demand side substitution is limited to individual procurements, incumbent suppliers may be able to price discriminate and lock-in may confer market power on the incumbent supplier. This means there may be limited scope for this protection where customers are locked-in.

Supply side constraints may be significant in some cases

A40 During the market study, many large outsourced IT suppliers provided evidence to suggest that there are significant competitive constraints on the supply side of public sector outsourced IT. Specific factors that suppliers drew to the OFT's attention include the TUPE Regulations, supply chains and subcontracting relationships, and supplier diversification:

- TUPE Regulations ensure that when a whole business function is outsourced to a private sector supplier (directly or through the establishment of a joint venture), employees' contracts automatically transfer so that they become employees of the new provider under the same terms and conditions. Suppliers told us that TUPE Regulations enable new entrants to gain skills, knowledge and expertise without having to incur the costs of recruiting and training new staff.[48]
- A number of suppliers who act as prime contractors told the OFT that there is usually a large pool of potential subcontractors from which they can draw when supplying outsourced IT.[49] This increases their ability to supply new customers which require specialist services.
- Suppliers also highlighted the ability of suppliers to grow and diversify either organically either by recruiting staff (which some contended is relatively easy in ICT) or through mergers and acquisitions.[50] Evidence

[47] Locked-in customers are sometimes referred to as 'infra-marginal'. If enough non-locked in customers are 'marginal', meaning that they are willing to switch away from their current supplier in the face of a price rise, that price rise will not be profitable for the current suppliers, and so the locked-in customers will be protected.
[48] We did however hear an example of where staff who were originally transferred to a joint venture under TUPE regulations subsequently left to become permanent employees of the outsourced provider. This can clearly represent a barrier to either switching to a new provider or bringing the outsourced service back in-house in the future.
[49] Many of the largest suppliers have their own initiatives to work and share expertise and skills with SME suppliers, for example HP's 'SMEngage' and CGI's 'SME Accelerate'.
[50] According to TechMarketView, the level of mergers and acquisition activity reportedly recently reached a seven year high. See www.techmarketview.com/news/archive/2013/10/15/uk-sits-ma-hits-7-year-peak

suggests that many large outsourced IT suppliers are indeed highly diversified.[51]

A41 Many suppliers put to us that supply side constraints apply across both the public and private sectors, especially for larger contracts. Several large suppliers noted, for example, that the products and services they supply do not differ materially by buyer type, and that they routinely supply both sectors. A recent report by TechMarketView[52] estimates that the top 20 suppliers of software and IT services to the public sector, of which outsourced IT represents a large proportion, earn on average less than half of their UK revenues from the public sector.[53]

A42 We also considered whether competitive constraints on the supply side are limited to the UK or are wider in scope. Some suppliers told us that there is a global market for many of the services they provide. Our analysis of the Kable outsourced IT database furthermore reveals that only three of the largest 10 suppliers are headquartered in the UK, with two based in France, one in Japan and four in North America. Smaller suppliers however tend to be UK-headquartered. This suggests that higher-valued contracts may face supply side constraints from across the globe.[54]

Conclusion on supply side constraints

A43 Our analysis of supply side competitive constraints suggests that:

- In many cases there are likely to be significant competitive constraints arising from the ability of a number of different suppliers to bid for different contracts.
- In some cases, particularly for larger contracts, these constraints may arise from suppliers of similar services to the private sector and outside the UK.

[51] Most large outsourced IT suppliers appear to provide each of the different types of outsourced services outlined in paragraph A5, either in the public or private sectors. For example, each of the top 10 suppliers to the public sector in 2011 ran at least one data centre on behalf of a government department. Source: 'Whitehall's data centre market', Kable, December 2011.
[52] 'UK Public Sector SITS Supplier Landscape 2013-14', TechMarketView, January 2014.
[53] The majority of the top 20 suppliers to the UK as a whole also feature in the top 20 suppliers to the public sector
[54] This does not apply to all potential markets. For example, requirements on both staff nationality and data centre location may mean that the provision of IT services in more sensitive areas such as defence are only national in scope.

- Constraints may not always be so strong. In particular, suppliers of defence services appear to be less likely to constrain suppliers to other parts of the public sector, and the same may apply to suppliers of BPO contracts to local government.
- In some cases where there are particularly high barriers to entry or switching suppliers, there may be few or no competitive constraints on incumbent suppliers. Such barriers may arise, for example, as a result of supplier lock-in. Where this is the case, and especially where demand side constraints are limited, suppliers of these contracts may have a degree of market power.

Primary and secondary markets

A44 As noted in Chapter 6, whether buyers are harmed as a result of barriers to switching suppliers depends on the completeness of the 'waterbed effect'. The waterbed effect arises from the possibility that as a result of the ability of suppliers to charge higher prices to customers who stand to face such barriers in the future, there is a greater incentive to compete more intensely for contracts at a time when they face no or fewer barriers.

A45 Many buyers of outsourced IT told us that they are often locked-in to suppliers both during contracts and at the time of re-tendering, and that there is limited or no competitive pressure on suppliers in these secondary markets.[55] We were also informed of a number of situations where buyers felt that they were being charged high prices for services within the lifetime of outsourced IT contracts.

A46 In Chapter 6 we note that certain market features make it more likely that waterbed effects are incomplete. We consider that many of these features appear to exist in outsourced IT markets. For example, customer requirements are often differentiated,[56] and we identify a number of information asymmetries later in this annexe. Furthermore, as discussed in paragraph A39, the ability of suppliers to price discriminate will be much easier in OJEU procurement processes with limited scope for demand side

[55] Barriers to switching are considered from paragraph A79.
[56] See, for example, paragraph A89.

substitution. However in the absence of sufficient data, we do not conclude on the completeness of the waterbed effect in outsourced IT.

Market power

A47 We consider market power to be the ability for suppliers to sustain prices above competitive levels or restrict quality below competitive levels. Market power can exist in a variety of contexts. In some markets, a single undertaking may possess market power whereas, in others, a group of undertakings may collectively possess market power where they have agreed explicitly or tacitly not to compete with each other. In our assessment we consider:

- Actual competition: the number and size of current suppliers to the sector and the existence of suppliers that could begin supplying outsourced IT.
- Potential competition: whether there are barriers to switching suppliers or to new suppliers entering and contesting the market, and whether these impede competition between current suppliers.
- Buyer power: the extent to which this exists and could mitigate adverse consequences of supplier market power.

Actual competition

A48 Actual competition depends on the extent to which incumbent suppliers of a product or service face competition from existing competitors in the market. In this section we consider the level of actual competition by looking at shares of supply, and the extent to which the competitive fringe is able to exert a constraint on larger suppliers.

Shares of supply of current contracts

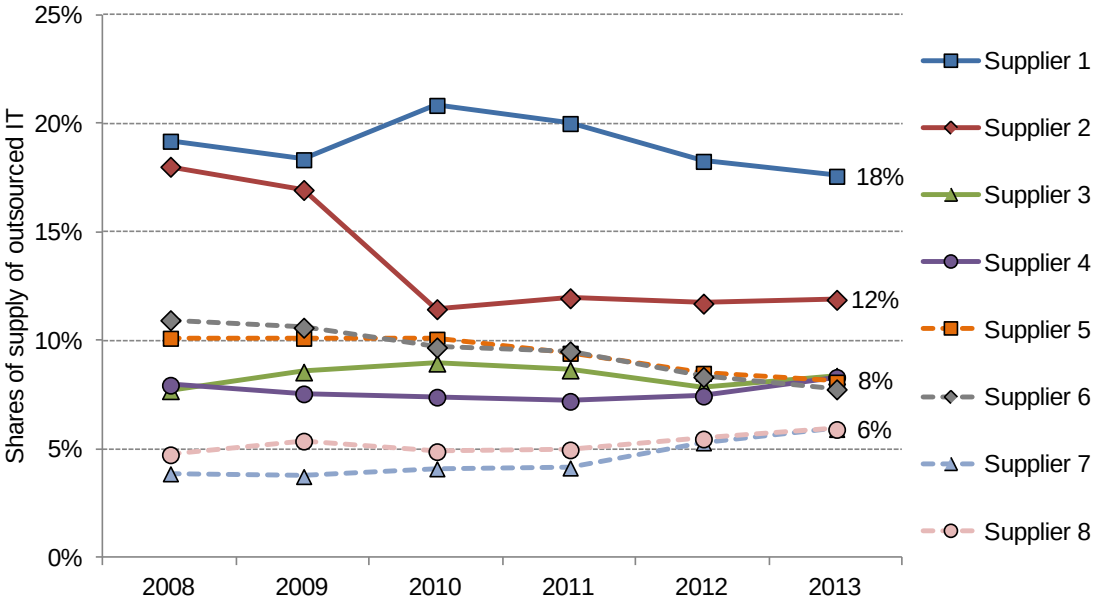
A49 In this section, unless otherwise stated, we define a supplier's share of supply as the total value of contracts it holds (evaluated as values per year rather than total contract values) as a proportion of the total value of contracts held by all suppliers. As per the conclusions drawn in paragraph A43, we consider that suppliers of outsourced IT to the defence sector are unlikely to impose a significant competitive constraint on suppliers of other

outsourced IT services.[57] For this reason, and to assess shares of supply in a meaningful way, we consider shares of supply of outsourced IT services to the UK public sector, excluding defence.[58]

A50 Outsourced IT in the public sector (excluding defence) does not appear to be highly concentrated, with the largest supplier having an 18 per cent share of supply, and the largest five suppliers having around half of all contracts (by value). However shares of supply of the top providers have been very stable over time, with the eight largest suppliers in 2008 also the eight largest suppliers in 2013. This is partly because a relatively small amount of new contracts (by value), relative to the stock of existing contracts, is tendered each year.[59] The movement of shares of supply of the largest eight providers since 2008 is shown in Figure A.5 below.

[57] Our analysis suggested that suppliers specialising in local government BPO contracts may also be subject to different competitive constraints from other buyers, but since the evidence is less conclusive we have included local government in our analysis.
[58] These do not necessarily relate to market shares as we have not defined outsourced IT to the public sector (excluding defence) as a relevant market. Even if it were, there may be further markets therein, such as individual contracts where customers are locked-in to their incumbent supplier, such that analysis of shares of supply may not be able to identify potentially high levels of concentration in these smaller markets. If, on the other hand, the relevant product market is wider, due consideration may not be given to competitor products and services, and so market shares might be overstated by shares of supply
[59] In each year from 2009 to 2013, new business accounted for between 10 and 15 per cent of all existing contract values. Source: Kable outsourced IT database.

Figure A.5: Shares of supply of the eight largest suppliers of outsourced IT to the public sector, 2008 - 2013



Source: Kable outsourced IT database. Note these figures exclude defence contracts

A51 As noted in paragraph A43, conditions of supply and demand appear to differ to some extent between outsourced IT in local government, which is supplied mostly through BPO contracts that may include substantial non-ICT services, and the rest of the public sector. If local government were treated as a separate market, it would appear to be more concentrated than the public sector as a whole,[60] using the Herfindahl-Hirschman Index (HHI) and concentration ratios as benchmark measures of concentration.[61]

[60] However this analysis may misrepresent the true intensity of competition as it does not consider the possibility that in-house supply forms part of the same market.

[61] These are both commonly used measures of concentration. The HHI is calculated by summing all of the shares of supply in a market, and the concentration ratio measures the combined shares of supply of the largest firms in a market. For example, the three firm concentration ration (often abbreviated CR3) measures the combined shares of supply of the three largest suppliers. See www.competition-commission.org.uk/assets/competitioncommission/docs/2013/publications/cc3_revised_.pdf for further details.

Table A.1: Indicative measures of concentration in local government versus the whole public sector (excluding defence), 2013

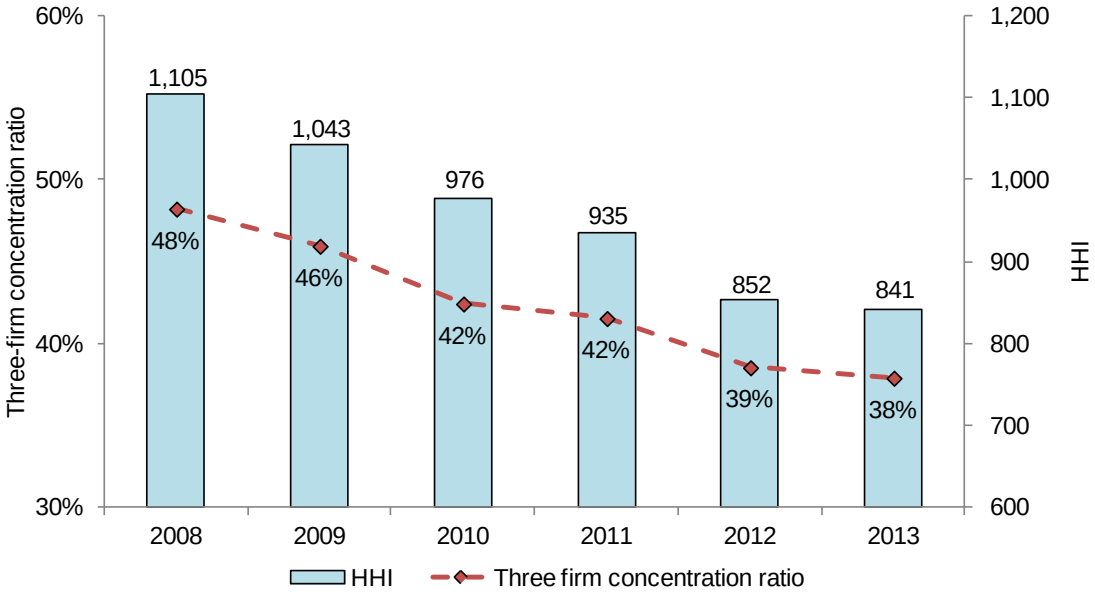
Measure	Local government	Public sector (excluding defence)
Number of contracts	203	599
HHI	1,085	841
CR3*	47%	38%
CR5*	60%	54%
CR10*	82%	81%

Source: Kable outsourced IT database.

* CR3, CR5 and CR10 measure the combined shares of supply of the three, five and 10 largest suppliers.

A52 Over the past few years, outsourced IT in the UK public sector (excluding defence) appears to have become less concentrated, with the HHI falling from 1,105 in 2008 to 841 in 2013, and the three firm concentration ratio (CR3) falling from 48 per cent to 38 per cent over the same period.

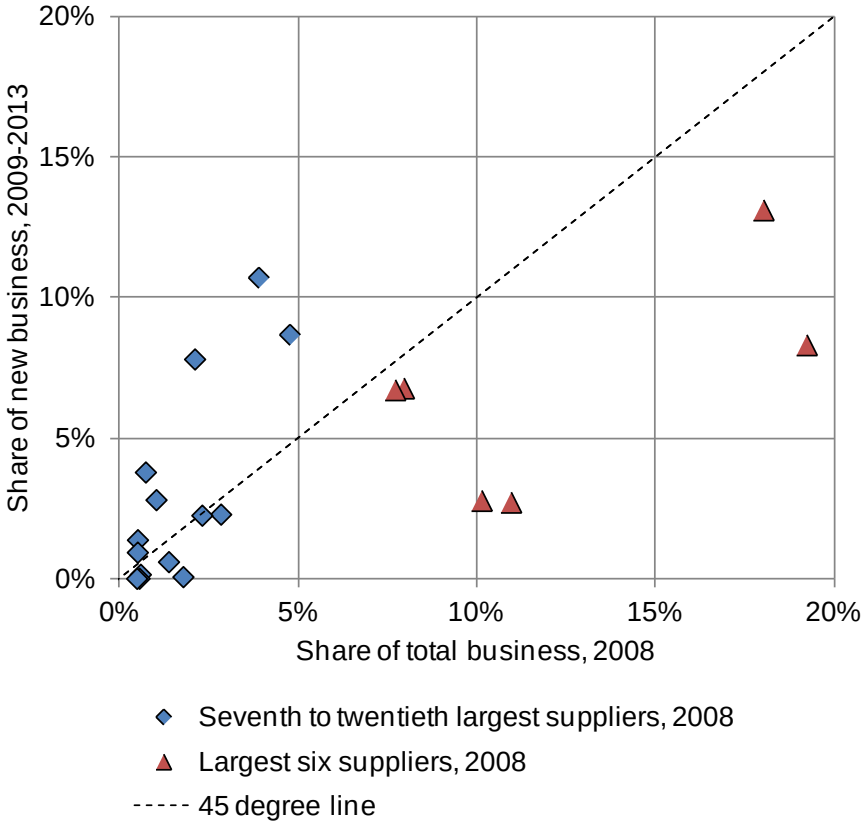
Figure A.6: Indicators of concentration of public sector outsourced IT, 2008 - 2013



Source: Kable outsourced IT database.

A53 Such a fall in both the HHI and CR3 suggests an improvement in the competitive landscape for new contracts versus existing ones. Indeed for new contracts signed between 2009 and 2013, the HHI and CR3 were lower than for the overall stock of contracts, at just 668 and 32 per cent respectively. As Figure A.7 below shows, each of the top six suppliers in 2008 won a smaller proportion of new business between 2009 and 2013 than their stock of existing business in 2008.

Figure A.7: Share of new business versus share of existing business for the largest outsourced IT suppliers, 2008 - 2013



Source: Kable outsourced IT database. Defence contracts are excluded. Suppliers below the 45 degree line earned a lower share of new contracts from 2009 to 2013 than their share of total contracts in 2008. Suppliers further to the right had a larger share of total contracts in 2008.

A54 Analysis of the data also reveals a potentially large competitive fringe in outsourced IT. While the largest 10 suppliers held over 80 per cent of all public sector outsourced IT contracts (excluding defence) in 2013, around

110 different suppliers held the remaining 20 per cent.[62] Many of these appear to be new entrants to public sector outsourced IT.

A55 There appear to be fewer suppliers with larger shares of supply in the UK public sector, compared with the private sector. Analysis of outsourced IT contracts by market intelligence providers Pierre Audoin Consultants indicates that the largest 10 suppliers to the public sector held almost two thirds of public sector outsourced IT contracts (by value) in 2013, whereas the largest 10 suppliers to the private sector held less than half of private sector contracts.[63]

Probabilities of winning contracts

A56 Since outsourced IT is usually procured through fixed term contracts, shares of supply may provide limited information about both the intensity of competition for that contract award and the likelihood of the winning supplier retaining the contract when it is re-tendered. Suppliers with high shares of supply may have faced intense competition from other bidders during the procurement process for their contracts, and may do so again when the contract is next re-tendered. Likewise, suppliers with low shares of supply may have faced little or no competition when bidding for some of their current contracts, and their customers may be locked-in when these contracts are due to be re-procured.64

A57 Probabilities of winning contracts, evaluated before contract awards are made, may be better indicators of competitive constraints than current shares of supply. This is because competition in competitive tender processes occurs prior to the contract award, and so market power would be reflected in a higher probability of winning processes, potentially enabling suppliers to bid above cost without substantially impeding its chances of winning.[65] We have not been able to evaluate winning probabilities because data on the identity of bidders and the scope and value of their bids are not collected centrally or consistently across the

[62] Source: Kable outsourced IT database.
[63] Source: Pierre Audoin Consultants analysis, provided to the OFT by T-Systems
[64] As discussed at [WATERBED], whether or not this leads to harm to buyers depends on the completeness of the waterbed effect.
[65] As noted in the DotEcon report: 'Competition in a bidding process happens prior to the result being determined…In a sealed bid procurement auction, the higher a bid, the less likely the supplier is to win…thus, market power would be reflected in a high winning probability (all other things being equal), and the different winning probabilities most closely resemble the structural indicator provided by market shares in a conventional market' (paragraph 5.34)

public sector, and we have faced considerable difficulty in obtaining this information from individual public bodies. We have however made use of the OpenTED database and the Kable procurement database which together have enabled us to identify, for a large proportion of outsourced IT contracts, the number of final offers received by public sector buyers.[66]

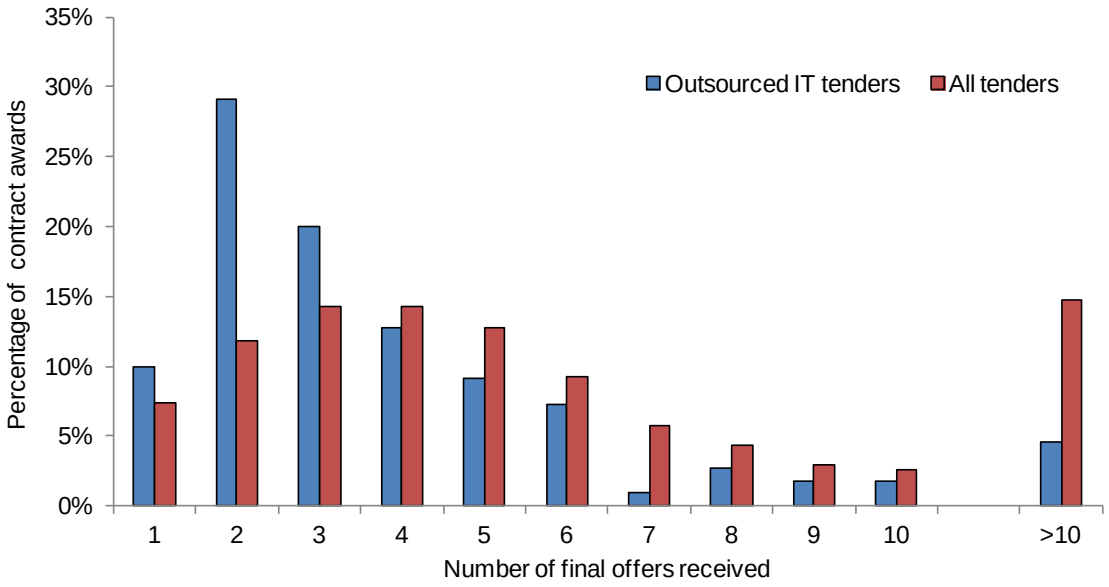
A58 The number of final offers may not reflect the intensity of competition for a given contract, as the multi-stage approach of most OJEU processes means a larger number of suppliers may have been willing and able to bid in the final round than were eligible to do so. This is especially the case where competitive dialogue procedures are used as buyers will usually deliberately restrict the number of suppliers eligible to bid for these contracts.[67] Indeed we were told of several examples of buyers receiving one or two final round offers, but nevertheless perceiving that they had secured a competitive price. However our view remains that more bidders usually make for more intense competition,[68] and so the number of final offers may provide an indication of the intensity of competition for individual contracts. This data cannot however be used to reflect on concentration or market power more widely, since the identities of individual bidders are unknown (with the exception of the winner).

A59 Public buyers receive relatively few bids in outsourced IT tenders. Of the 110 outsourced IT contracts between March 2010 and April 2013 in our database where the number of final offers was recorded, around 60 per cent (65) had three or fewer final bids, and around 40 per cent (43) had two or fewer bids. These figures compare particularly unfavourably to all OJEU processes in the UK over the same period,[69] of which 33 per cent had three or fewer bids, and around 20 per cent per cent had two or fewer bids.

[66] The number of offers received is a metric reported in OJEU contract award notices, and is considered as a measure of competitive intensity in the PwC, London Economics and Ecorys report. We merged the two databases, using the Kable procurement database to identify outsourced IT contracts and the OpenTED database to identify the number of bidders and other parameters, such as the procurement procedure used. See Annexe C for further details on OJEU notices and other parameters of procurement processes.
[67] See Annexe C for further information on procurement processes. This also includes suppliers that were disqualified at the pre-qualification stage.
[68] As noted in a 2004 OFT study: 'In most circumstances adding bidders increases the level of competition'. See 'Assessing the impact of public sector procurement on competition', OFT, 2004, available at www.oft.gov.uk/shared_oft/reports/comp_policy/oft742a.pdf (paragraph 1.20). Note that the marginal impact of new bidders may fall as more suppliers enter the auction.
[69] We assessed over 30,000 contract awards for which the number of bidders was recorded.

A60 Figure A.8 below plots the distribution of bids across both outsourced IT tenders and all tenders, for the UK public sector.[70]

Figure A.8: Distribution of number of bids across 111 outsourced IT tenders and over 30,000 tenders for all product types between March 2010 and April 2013



Source: OpenTED database; Kable procurement database.[71]

A61 Our calculations reveal two other notable observations:

- Higher valued contracts see fewer bidders than smaller contracts. Outsourced IT tenders worth over £5 million receive on average fewer than half the number of bids of those worth under £5 million.[72]
- More restrictive procurement procedures result in fewer final bids. Although this is expected,[73] the scale of the difference is large:

[70] As can be seen, the number of offers is heavily skewed, with a small number of contracts receiving a large number of offers. The mean average number of bids is greater than four, although around three quarters of tenders had fewer bids than this. This is consistent with the PwC, London Economics and Ecorys report, which finds that for OJEU processes across Europe and in all product categories: 'The distribution of bids is highly skewed…99 percent of the requests receive less than 39 bids. The remaining 1 percent however receives 15 percent of all proposals' (p93).
[71] This analysis does not consider multi-supplier frameworks or contracts with multiple lots, due to the ambiguity of the bidding data recorded for these contracts. As above, defence contracts are excluded from the analysis.
[72] This also holds when looking at median averages: contracts worth over £5 million have a median average of 2 bids, whereas contracts worth under £5 million have a median average of 5 bids.
[73] As noted in Annexe C, in competitive dialogue procedures, buyers often deliberately limit the number of bidders.

processes using competitive dialogue have an average of around 2.5 bids, compared with around 7 bids for those using the open procedure.

Conclusions on actual competition

A62 Analysis of actual competition presents a mixed view of the competitive landscape for outsourced IT:

- Shares of supply of current contracts suggest that outsourced IT in the public sector (excluding defence) is not heavily concentrated.[74] The largest three suppliers have less than 40 per cent of all contracts by value, and the HHI is below 1,000. Furthermore, shares of recent contract awards suggest the landscape has become more competitive in recent years. Measures of concentration have consistently fallen over the past six years.
- However shares of supply of existing contracts have been very stable over the past five years, as a result of high-valued contracts having long average durations. Only one third of contracted expenditure in 2009 had been subject to re-tendering or expired by the end of 2013. It remains to be seen whether some of the largest and longest current outsourced IT contracts will attract sufficient competition when they are next tendered.
- The UK public sector appears to be supplied by fewer large suppliers than the UK private sector. The share of public sector outsourced IT contract values held by the 10 largest suppliers to the public sector is 17 percentage points higher than the share private sector outsourced IT contract values held by the 10 largest suppliers to the private sector.
- There may also be markets within outsourced IT that are more heavily concentrated. As well as the potential for contracts where customers are locked-in to form their own economic markets, local government BPO contracts, for example, are provided by fewer suppliers with larger shares of supply.[75] However since we have not attempted to formally

[74] Note that this is only indicative since we have not attempted to formally define markets
[75] It may be that the same is true of defence contracts, although there are too few large defence contracts for shares of supply to provide a meaningful indication of the true extent of competition.

identify economic markets, we have not concluded on whether narrower, more highly concentrated markets exist.[76]

- Analysis of the number of final offers received shows that outsourced IT contracts attract significantly less bids than the average across all UK goods and services. While buyers of the latter receive a median average of five bids per tender, in outsourced IT there are just three, and around 40 per cent of buyers receive only one or two bids. Low numbers of bids are particularly apparent for high-value contracts procured using competitive dialogue procedures. While conclusions on market power are premature as buyers often narrow the range of eligible bidders before the final stage of the process, this suggests that in some cases there may be little competition to supply large outsourced IT contracts.

A63 Our conclusions on actual competition are broadly consistent with responses from stakeholders, many of whom informed us that public sector outsourced IT is competitive, with a large number of active suppliers. Several suppliers additionally told us that bidding processes, including for the largest contracts, are highly competitive. Our analysis has not been able to corroborate this assertion although it suggests that this may not always be the case.

Potential competition

A64 Potential competition depends on the extent to which competitors could enter the market and compete with current incumbents and the costs involved in switching to alternative suppliers. In this section, we consider:

- Entry and expansion: levels of entry and expansion in recent years and the existence of natural and artificial barriers
- Switching: levels of switching among buyers of outsourced IT and barriers that prevent or restrict them from doing so

[76] On the contrary, the actual market could be wider, incorporating private sector and/or non-UK buyers.

Entry and expansion

A65 There is evidence of recent entry and expansion for public sector outsourced IT contracts. However, a range of concerns about potential barriers to entry and expansion were also brought to our attention. In this section we consider the levels of entry and expansion by suppliers of public sector outsourced IT, and evidence of potential barriers to entry and expansion.

A66 There has been relatively little entry for high value contracts for outsourced IT services during the past few years. As shown in Figure A.5 above, the largest eight suppliers of outsourced IT to the UK public sector in 2008 retained these positions through to 2013. However, some market participants drew our attention to a number of new entrants and expansions for lower-value contracts. In particular, we were told about recent entry and expansion of a number of India-based suppliers of outsourced applications services with established footprints in the private sector, for example TCS, Wipro, Infosys and HCL. Moreover, we note that significant numbers of suppliers are finding new opportunities arising from the relatively new 'towers' model, such as those which specialise in SIAM or hosting.[77]

A67 However, some suppliers felt locked out, either of the whole public sector, particular parts of it or from individual contracts. Some of these suppliers had experience of supplying ICT on a large scale in other countries and to the UK private sector but found it difficult to access UK public sector contracts.

A68 Suppliers of varying sizes and some buyers pointed to public sector procurement processes as a key barrier to entry and expansion. Most public sector procurement processes place requirements on suppliers in order for them to qualify to bid for contracts, with specific requirements generally set out in pre-qualification questionnaires (PQQs).[78] The following requirements were highlighted to us as particularly problematic:

[77] Analysis of the Kable outsourced IT database also suggests that the number of companies supplying outsourced IT to the UK public sector has increased by as much as 50 per cent in the past two years.
[78] Only the open procedure (used in around one fifth of outsourced IT processes) involves no pre-qualification round. See Annexe C for more information on PQQs.

- The need to demonstrate previous experience of delivering similar IT specifically to public sector organisations; and
- Financial requirements such as minimum turnover levels or having to show a minimum accounting history

A69 Such requirements can exclude smaller suppliers and new entrants from being able to bid for public sector IT contracts. Some stakeholders suggested that problems with procurement processes do not emanate from the relevant legislation, but from the way in which public sector organisations interpret and implement it. An example can be seen in the reluctance of some buyers to carry out pre-tender engagement with suppliers. Such engagement can help them to understand available options and refine their requirements before tendering and awarding contracts. We saw some examples of public sector organisations assisting suppliers in understanding the tender process and[79] and using pre-tender engagement events to better understand available ICT solutions, but buyers tend not to engage in these activities frequently.

A70 Suppliers told us that public sector procurement processes are costly and complex and there are risks they will be delayed or cancelled at a later stage, resulting in substantial sunk costs. This is consistent with our analysis of tender data, which revealed that procurement processes can often last for more than a year.[80]

A71 Some suppliers believe that buyers place too much weight on price in final contract award decisions. This could cause sub-optimal choices, for example because the cheapest option may not be best suited to meeting buyers' requirements. It may also act as a barrier to entry for suppliers that can offer better suited solutions but at a higher cost.

A72 Further, many suppliers told us that buyers seek to impose onerous contractual terms and levels of risk on suppliers, for example unlimited liability and indemnity. This can lead to higher prices and discourage some

[79] In this context, we note that the Cabinet Office PQQ affords bidders without prior experience the opportunity to give this kind of explanation. Moreover, the accompanying Procurement Policy Note states that
'Contracting Authorities should not impose arbitrary minimum requirements which may have the unintended effect of barring new businesses from bidding.'
[80] Almost 20 per cent of the tenders in our database had a duration of more than 12 months between publication of tender notice and contract award. Source: OpenTED database.

suppliers from bidding, particularly those who are unable to assume such liabilities.

A73 Suppliers and buyers told us that the situation is changing. They pointed to initiatives aimed at ensuring buyers spend more with SMEs and the 'towers' model (see paragraph 3.26 of the main report). Larger suppliers also suggested that disaggregating contracts may be a barrier to expansion for them. There is some evidence of this in action, for example the NHS Spine 2 contract,[81] which has been disaggregated into multiple lots to allow more suppliers, including those who may not have had sufficient resource to deliver the whole of the service, to win contracts. In another case, the Ministry of Justice awarded its SIAM tower to traditional defence supplier Lockheed Martin.[82] There are also examples of public sector organisations contracting with suppliers that are relatively new to delivering outsourced IT to the UK public sector, such as TCS winning the Home Office Disclosure and Barring Service contract.[83]

A74 Frameworks were highlighted as a barrier to entry and expansion.[84] In some cases, frameworks may encourage buyers to consider options from a wider supplier base. However, many suppliers told us that there is too much overlap between different frameworks offering similar solutions, with the result that most frameworks see low levels of spending. We also heard that frameworks are not updated regularly, meaning that suppliers not on frameworks are locked out until the next update, which can be up to four years later.[85] Additionally, stakeholders told us that frameworks for products and services of higher values[86] have limited numbers of suppliers on them, resulting in less choice for buyers using them. Many stakeholders were broadly positive about the G-Cloud frameworks, noting in particular that they have created a wider supplier base for public sector organisations and that the supplier base is regularly refreshed. However, we understand that current levels of spending on G-Cloud are relatively low, with much of it being on SaaS.

[81] Spine 2 will deliver the summary care records service, which was part of the original Spine contract, Spine 2 will therefore provide the applications which enable the storage of patient clinical information.
[82] See http://news.idg.no/cw/art.cfm?id=AA48C217-F3BF-2572-91CBFC92C4362B40
[83] See www.tcs.com/news_events/press_releases/Pages/TCS_multi-million_pound_contract_UK_Home_Office.aspx
[84] See Annexe C for a discussion of frameworks
[85] This is the maximum permitted length of framework agreements, except where there are exceptional circumstances. Some centralised CCS frameworks are considerably shorter, such as the G-Cloud frameworks, which are refreshed every year, although the upcoming 'Enterprise Application Support Services' framework for specific applications maintenance and support services will last for between two and four years (on a '2+1+1' basis).
[86] For example, 'Desktop21' and 'PSN connectivity'.

A75 The process for gaining security accreditation[87] to carry out public sector IT work was highlighted as problematic by several suppliers. The process for obtaining accreditation can be lengthy and costly, potentially taking up to 12 months and costing up to £200,000.[88] This can particularly increase the burden on smaller suppliers who may be unable to take on such costs and risks with no guarantee of success or future sales.

A76 Suppliers also need to be sponsored by a government department or agency to obtain security accreditation for staff. However, this can give rise to a vicious circle where suppliers are unlikely to obtain the required sponsorship from a department or agency if they do not already have public sector IT contracts and the necessary security accreditations for their staff, but they cannot win these contracts due to not having accreditation. Further, we understand that there may be a limit on the number of suppliers and individuals that can go through the accreditation process at any one time.

A77 Suppliers told us that public sector organisations may favour suppliers with higher security accreditations than others, even if the higher level of accreditation is not required for the contract in question. This may be due to the risk averse nature of public sector organisations.

A78 Until recently, outsourced IT contracts in the public sector have generally been large in terms of their scale and value.[89] As noted above, this typically requires large prime contractors to take on the risk and costs involved, which is likely to limit the choice of suppliers available to buyers. Reducing the scale and scope of contracts should open up opportunities for other suppliers. However, many public sector outsourced IT contracts may still be large in terms of scale and value and thus the potential supplier base is likely to remain limited to larger prime contractors.

A79 Stakeholders highlighted that buyer conduct also causes barriers to entry and expansion in public sector outsourced IT. This is discussed further from paragraphs A92 to A98.

[87] See Chapter 3 for more information.
[88] Estimates provided to the OFT by some smaller suppliers during the market study.
[89] Since 2009, there have been around 70 contracts worth over £25m per year. Source: Kable outsourced IT database

Switching

A80 Buyers and suppliers provided evidence of public sector organisations switching suppliers for outsourced IT. Large suppliers told us that there are no insurmountable barriers to switching. However, other stakeholders expressed concerns about the ease with which buyers can switch between different suppliers of outsourced IT. This section sets out our analysis of barriers to switching.

A81 We saw instances of buyers switching suppliers. Notable recent examples include TCS winning the contract to provide the Disclosure and Barring Service for the Home Office from Capita in November 2012 and Computacenter winning the FCO's Firecrest desktop outsourcing contract from HP in October 2013.[90] However, analysis of contract data suggests that over the short-term, switching suppliers of outsourced IT services is the exception, rather than the norm,[91] and information we received during the market study indicates a number of potential barriers to buyers switching suppliers in outsourced IT.

A82 We found that buyers tend to be reluctant to switch suppliers, especially in the case of larger and/or customised solutions. Given the nature of the services they provide, public sector organisations are often more concerned with avoiding the risks of failure than securing the benefits of enhanced competition for ICT contracts. Disruption to vital public services would have a significant adverse impact. As a result, buyers may be more risk averse and reluctant to switch suppliers.

A83 Outsourced IT contracts typically contain contractual provisions dealing with contract termination and managing transition. Larger suppliers told us that these provisions are usually adequate and aid transition to new suppliers. In contrast, other suppliers told us that they are often poorly designed and buyers may not have adequate expertise to manage transition, resulting in incoming suppliers bearing a large proportion of transition costs. Buyers told us that even where public sector organisations have sufficient expertise to manage contract exit and transition, it is not

[90] See www.computacenter.com/news/131031_FCO_desktop.asp
[91] New business accounted for only between 10 and 15 per cent of the total stock of business in each year between 2009 and 2013, and around two thirds of expenditure in 2009 remained in place at the end of 2013. Source: Kable outsourced IT database.

always possible to determine, at the outset of a contract, what provisions will be sufficient to ensure a smooth transition to new suppliers, especially in the case of long term contracts.

A84 Some exit provisions may not require incumbent suppliers to cooperate in aiding transition to a new supplier. Concerns were raised by buyers and suppliers about some incumbents proving uncooperative or obstructive in transition processes. Examples included incumbents delaying or not providing information required to facilitate transition and overstating the risks involved in order to discourage buyers from switching. However, there are also examples of incumbent suppliers being cooperative and aiding transition to new suppliers at the end of contracts.

A85 While the evidence is mixed, there are concerns about exit provisions and levels of supplier cooperation in switching. The Crown Commercial Service (CCS) has recently published its 'Model Services Contract' for use by public sector organisations engaging in major services contracts. It contains provisions regarding exit management, for example requirements for suppliers and buyers to finalise exit plans within six months of signing contracts. Adopting the model contract may help to ease some problems with exit provisions. In addition, CCS initiatives to capture information about uncooperative behaviour by suppliers and take account of such information in awarding future contracts may deter such behaviour going forward.

A86 It is also important that exit provisions take account of any Intellectual Property Rights (IPR) and its availability during transition. Concerns were raised about public sector organisations being locked in to using certain outsourced IT solutions where they do not own relevant IPR.

A87 Certain buyer conduct was highlighted as a barrier to switching. In particular, risk aversion and not taking advantage of break points in contracts, the use of frameworks that might lock out alternative suppliers and a lack of commercial and technical capability were highlighted as likely to result in low levels of switching.

A88 We conclude that there are significant barriers to public sector organisations switching suppliers of outsourced IT. These are a combination of buyer and supplier conduct and contractual issues.

However, there is evidence that buyers are adapting their behaviour to try to encourage more switching, for example through increasing use of pre-tender engagement and initiatives to increase commercial and technical expertise. There are examples of switching resulting in more positive outcomes, suggesting that the barriers to switching we have identified are not insurmountable.

Buyer power

A89 The impact of supplier power on the parameters of competition depends to some extent on whether the public sector can leverage buyer power. In theory the UK public sector has a considerable degree of potential buyer power when purchasing outsourced IT, since it is a major customer for many of the largest suppliers.[92] There has also been considerable pressure on buyers to achieve savings on ICT expenditure. However in the context of outsourced IT, the public sector may not have countervailing buyer power where it:

- purchases in a fragmented manner, rather than leveraging economies of scale by acting as a single customer
- faces information asymmetry when agreeing solutions and associated pricing in new contracts
- does not have sufficient capability to ensure delivery of services, to control price increases and to control costs of transition following the initial signing of contracts.

A90 In terms of fragmented purchasing, many buyers frequently make procurement choices focused on their own organisations, resulting in different products, prices and suppliers for what may be common requirements across the public sector. As well as reducing the scope for joint procurement, differentiation of products restricts the ability of other buyers to effectively benchmark their own product performances and prices.

[92] The public sector accounted for around 22 per cent of all IT and BPO services (of which outsourced IT is a major component) purchased in the UK in 2012. Source: TechMarketView expenditure estimates.

A91 Where buyers do not hold sufficient data to challenge suppliers on prices and performance, or have sufficient authority or capability to negotiate collectively, this can prevent them leveraging buyer power. In this respect, we note that information asymmetries exist in this sector (see Chapters 7 and 8).

A92 Several initiatives are underway that may help the public sector to leverage its buyer power to a greater degree. Most notably:

- An increased use of shared and centrally managed frameworks that allow for multiple buyers to use the same services, and to have more control over prices.
- Cross government agreements that guarantee buyers certain prices for elements of outsourced IT, for example network usage, labour costs and software.
- The formation of the CCS to provide sources of expertise and advice for buyers to draw on, and manage more procurement that is not strategic to departments and where standard prices can be achieved.
- The establishment of the 'Crown Representative' network, which can negotiate on behalf of government as a whole and has a strategic view of certain suppliers' business that can be factored into procurement decisions.
- An increased use of joint procurement by different buyers, for example in healthcare and local government.[93]

Buyer conduct

A93 We received information pointing to various aspects of buyer conduct that impact on competition in this sector. This section considers these types of conduct.

[93] See, for example, Programme Athena, an initiative across London boroughs to create a single ICT platform (www.londoncouncils.gov.uk/capitalambition/projects/programmeathena.htm), and a 2013 healthcare framework for the delivery of electronic patient record systems procured by seven London healthcare trusts. (www.ehi.co.uk/news/EHI/8713/london-framework-winners-announced)

Risk aversion

A94 Buyers have a tendency to be risk averse and may remain with incumbent suppliers even if there may be more efficient and cheaper solutions available. Risk aversion may be driven by uncertainty about new suppliers' capacity to deliver or perceived risks around switching.

Favouring bespoke solutions

A95 Buyers may favour highly customised outsourced IT with the aim of ensuring that their requirements are fully met. This can lead to reliance on particular solutions that are no longer the cheapest or can become quickly outdated due to the pace of change in the sector, or on certain suppliers.

Contractual issues

A96 Some buyers do not anticipate and take advantage of break points in contracts, reducing the potential for switching to cheaper and more efficient solutions. They may be more inclined to extend contracts with incumbent suppliers rather than seek alternatives, especially if they are concerned about the potential risks and costs involved in switching. Some contracts, especially those for larger IT outsourcing solutions, allow suppliers to offer products and services to buyers that were not provided at the outset of the contracts. Taking these up can substantially increase contract values and prevent buyers considering alternative suppliers of these additional products and services.

A97 Some public sector organisations have entered into strategic contracts or frameworks where specific suppliers are the 'go-to' option for particular types of outsourced IT, for example application maintenance. The aim is to achieve economies of scale, and with frequent benchmarking and leveraging of buyer power it may be possible to secure competitive prices whilst minimising procurement costs. However, such arrangements inevitably block other suppliers out of the market and provide incumbents with knowledge of buyers' business processes, which may give them an advantage when contracts are re-tendered.

Insufficient commercial and technical capability

A98 Some stakeholders argued that buyers lack the ability to accurately identify their requirements, evaluate suppliers' bids, draw up adequate contracts and evaluate suppliers' performance. As a result, buyers could be making less efficient choices and raising barriers to entry, expansion and switching. Stakeholders informed the OFT that over many years outsourcing IT functions has meant public sector buyers have lost their in-house expertise, in particular technical knowledge of solutions and the ability to assess and challenge supplier performance.

Lack of information collection and benchmarking

A99 Our analysis indicates that buyers do not consistently collect or make effective use of market information, which would help them to make more efficient choices. This reinforces information asymmetries that exist and causes problems at various points in the lifetime of contracts. When awarding contracts, it may be difficult for buyers to judge which solutions are most efficient and achieve value of money. Further, suppliers may be able to take the lead in defining buyers' requirements, which may not result in buyers getting the most efficient solutions. During contracts, it may be difficult for buyers to identify and address poor performance. At the end of a contract, buyers may become over-reliant on incumbents during transition, and become locked in to particular outsourced IT solutions.[94]

Supplier conduct

A100 Several types of supplier conduct can also lead to sub-optimal outcomes for buyers. In some cases, these are linked to issues on the demand side. For example, where buyers lack market information and are less able to get the best deal, suppliers can contribute to these effects, perhaps by using unclear or complex pricing. In this section we consider how supplier conduct can adversely impact on competition in the sector.

[94] Lock-in can result from a range of factors, such as buyer risk-aversion, lack of technical expertise to scope an alternative, and an inability to level the playing field for suppliers in terms of capital costs so as to attract bids from non-incumbent suppliers.

Suppliers reinforcing information asymmetries

A101 We were told about suppliers reinforcing information asymmetries, for example through a lack of transparency or encouraging buyers to adopt solutions that may not be most efficient for their needs. For example, there is evidence of overly complex information being provided by suppliers when complying with open book accounting provisions. While the complexity of some outsourced IT contracts may inevitably result in information about them also being complex, suppliers could do more to ensure information is clearer and more meaningful for buyers. In some cases suppliers may bundle core and peripheral products and services together, potentially exacerbating problems with unclear pricing.

Suppliers imposing or increasing barriers to switching

A102 Suppliers can make it difficult for buyers to switch in a variety of ways, for example by using proprietary solutions that lock in buyers, or not fully cooperating with the transition process. Buyers suggested that some suppliers may implement proprietary rather than more open IT solutions, meaning buyers may become locked into particular solutions and less likely to switch.

A103 We were told about buyers over-emphasising the risks associated with switching in order to discourage buyers from doing so. Where buyers do not have sufficient skills and expertise they may be more likely to follow a recommendation from incumbents, regardless of whether more efficient and cheaper solutions exist. Both buyers and suppliers told us about some incumbents being obstructive, resulting in problems switching suppliers.

Suppliers exploiting lock-in

A104 Secondary markets exist in the provision of outsourced IT, which are the result of additional products and services being offered by suppliers during the lifetime of contracts. Where this happens during long term outsourced IT contracts, there are fewer competitive constraints on incumbent suppliers as buyers are less likely to go to the wider market for these additional products and services. Where information asymmetries exist and buyers lack the requisite commercial and technical capability, suppliers may be able to charge higher prices for additional products and services than if

they faced competition from other suppliers. As an example of this, one central government department told us it had observed high mark-ups for products which have emerged during the life of a contract.

Findings on the supply of outsourced IT to the public sector

A105 Our analysis shows that there are some significant barriers to entry, expansion and switching in outsourced IT. These have hindered entry and growth of new suppliers for outsourced IT and discouraged buyers from switching.

A106 However, the landscape is changing. Initiatives are in place to simplify procurement processes and improve the capability of buyers to engage with and challenge suppliers and design appropriate contracts. There are examples of buyers putting these initiatives into practice by engaging more robustly with suppliers and using market information more effectively to secure better outcomes. Existing barriers to entry, expansion and switching do not, therefore, appear insurmountable.

A107 Nevertheless, even with the changes that are underway, there is scope for further reducing the impact on competition of the issues identified above. Chapter 9 sets out our recommendations for achieving these further improvements.

ANNEXE B: COTS SOFTWARE

Introduction: Commercial off the shelf software

B1 In this market study we have focused on a subset of commercial off the shelf (COTS) software products (see Chapter 4 for further discussion about software and commercial off the shelf software).

B2 We chose to focus our attention on software products highlighted in response to our CfI and which evidence suggested are provided by a small number of suppliers with large shares of supply.

B3 The software products we selected represent a mixture of software designed for specific public sector groups (such as local authorities or schools) and software which is used across the public sector. Although other software products may share similar characteristics to those we have chosen, we expect the findings in relation to these specific products to be more widely applicable across the ICT sector.

B4 This annexe sets out the software products we have focused on:

- management Information Systems (MIS) for schools (paragraphs B5 - B142)
- social housing software (paragraphs B143 - B214)
- planning software (paragraphs B215 - B260)
- pension administration software (paragraphs B261 - B318)
- Enterprise Resource Planning (ERP) software (paragraphs B319 - B381)
- Customer Relationship Management (CRM) software (paragraphs B382 - B399)

Management Information Systems for Schools

Introduction

B5 Here we assess the competitive conditions in the supply of Management Information Systems (MIS) for schools. It will cover the following areas:

- an overview of the product
- competitive constraints
- concentration
- procurement by local authorities and by schools
- competition, switching and barriers to entry and expansion
- supplier conduct
- tendering practices.

B6 We then make some overall conclusions on whether competition is working well in the market.

Overview

B7 Management Information Systems (MIS) are used in schools to support their management and administration and to report data to the local authority (LA) and/or the Department for Education (DfE) in England or the appropriate Devolved Administration in Scotland, Wales and Northern Ireland. In its 2010 report, the British Educational Communications and Technology Agency (Becta) defined schools MIS as 'the products and services and tools that are used to support a school's management and administration, enabling the educational institution to move towards evidence based decision making and more effective teaching and learning'.[95]

[95] *School management information systems and value for money 2010: a report with recommendations addressing issues relating to legal compliance, cost reductions and bureaucratic burdens*; Becta. Becta was abolished on 1 April 2011.

B8 MIS can cover all aspects of school life, including: personal information on students and staff; timetabling; exams; monitoring attendance and behaviour; curriculum planning; collecting payments from parents; dinner money; messaging parents by text and email; workforce management; statutory returns; and financial management. The extent to which all of these functions are used depends on the type and size of the school. For example, primary schools are less likely to require functions relating to timetabling and exams. MIS can be modular or integrated. In modular systems, schools or LAs tend to purchase a core system with the essential functions and then have a choice of extra modules to add functionality as they need it. [96] In integrated systems, the MIS that is bought has all functionality included and there are no add-ons.

B9 All schools in England are required to send information to their LA or DfE at certain times of the year.[97] Schools in Scotland, Wales and Northern Ireland send information to their LAs and respective Devolved Administrations. Information collected typically includes statistics on: attendance; statements of special educational needs; test and assessment results; financial accounts; school workforce; and pupil characteristics information. Academies are required to complete all the same statutory returns as LA maintained schools alongside some different and more detailed financial returns and accounts direct to DfE, because they are funded by the DfE rather than the LA. In Scotland, information must be sent to the single exam board, the Scottish Qualifications Authority (SQA), and ScotXed.[98]

B10 DfE may make slight changes to the reporting requirements for each collection in England, as a result of policy changes or needing to measure something in a different way. Depending on the method of collection, MIS suppliers are usually given between six and 12 months notice of these changes to allow time for any necessary changes to be

[96] We use the term 'core' in this section to describe the essential functionality of an MIS, and we use the term 'non-core' to describe functionality which schools will not regard as essential to discharge their functions but may be useful to have. An MIS will have to cover core functionality, it may additionally cover non-core functionality as part of the basic product, or non-core functionality may be provided by add-on modules available from the same or different suppliers. We have not needed to define what is core and non-core for these purposes and different schools may have differing perspectives on this.
[97] A schedule of information collected can be found here: www.gov.uk/government/publications/data-collection-schedule
[98] ScotXed is part of the Scottish Government with responsibility for supporting and developing electronic data exchanges between partners in the Scottish education and wider children's services community. These include the pupil and staff censuses, attendance, absence and exclusions, school leavers, and looked after children. www.scotxed.net/Static%20Content/About%20Us.aspx

made to the MIS. This means that the MIS requires ongoing support and regular updates.

B11 Currently, DfE send a list of reporting requirements and a more technical specification to schools and MIS providers, so each knows in advance what is required by way of a central return. The MIS provider will make the necessary changes to the MIS enabling the school to generate a report automatically when needed. This report is then exported from the MIS and sent to DfE or the LA. Collecting information in this way can be time consuming and onerous, particularly with ongoing changes to requirements, and means data can quickly become outdated.

B12 Following a DfE Analytical Review,[99] DfE are exploring the feasibility of working with the sector to establish a data exchange system which will enable the movement of data between schools, DfE and other organisations based on a common data model, as well as automating the process of sending data so it does not need manual input each time. This will improve the speed and efficiency of data collection and use, and may also assist with the migration of data into different MIS.

Demand for MIS

B13 As this study relates to the supply of ICT to the public sector, we focus on the provision of MIS to state-funded schools in the UK. Where we refer to 'schools' in this report we mean state-funded schools, unless otherwise stated.

B14 In 2010, Becta estimated the total spend on schools MIS to be £122-128 million. This includes the cost of MIS software, any maintenance provided by the supplier or support provided by the LA and the cost of MIS servers in schools. Becta also noted that schools spend more on supporting MIS (£65 million in 2010) than on acquiring it (£38-44 million in 2010).[100]

B15 In 2013 there were 29,772 state schools in the UK. Figure B.1 below shows how this is divided amongst the Devolved Administrations.

[99] www.gov.uk/government/publications/department-for-education-analytical-review
[100] *School management information systems and value for money 2010: a report with recommendations addressing issues relating to legal compliance, cost reductions and bureaucratic burdens*; Becta. Pg 17-18

There are over 21,000 primary schools and over 4,000 secondary schools in the UK.

Figure B.1: Number of state schools in the UK, 2013

	England[101]	Wales[102]	Scotland[103]	Northern Ireland[104]	Total UK schools
Schools	21844	1656	5073	1199	29772

Source: Statistics from DfE and devolved administrations (see footnotes)

B16 Traditionally, all schools were managed by the LA. In Northern Ireland, Scotland and Wales, all schools are still controlled by LAs, but in England, there are different types of school with varying degrees of autonomy that fall under the term 'state school'. The main examples are academies (run by a governing body or trust and independent from the LA; they are like state-funded independent schools) and free schools (newly established schools funded by central government and independent from the LA, which can be set up by groups such as charities, parents, teachers or businesses).[105] MIS is used by virtually all of these schools.[106]

B17 Since 2010, there have been an increasing number of academies and free schools in England. In 2010 there were only 203 academies.[107] By January 2013, this had increased to 79 free schools and 2,625 academies.[108] This rise is likely to continue as Government is encouraging schools to convert to academies and for more free schools to be established.[109]

[101] *Schools, pupils and their characteristics: January 2013*; Department for Education www.gov.uk/government/publications/schools-pupils-and-their-characteristics-january-2013
[102] School Census Result 2013, SDR 109/2013 Table 1: Welsh Government www.wales.gov.uk/statistics-and-research/schools-census/?lang=en
[103] *Summary Statistics for Schools in Scotland, No.4* : 2013 Edition, Scottish Government www.scotland.gov.uk/Publications/2013/12/4199/downloads#res439969
[104] *Enrolments at grant-aided schools 2013/14: Basic statistics*; Statistical press release 10 December 2013, Department of Education www.deni.gov.uk/enrolments_at_grant-aided_primary_and_post-primary_schools_2013_14-_basic_statistics_-_final_version_105_kb.pdf
[105] See www.gov.uk/types-of-school/overview
[106] We understand there are a small number of schools that do not have a MIS currently. These schools are mainly very small free schools.
[107] *Schools, pupils and their characteristics: January 2010*; Department for Education Table 2a www.gov.uk/government/publications/schools-pupils-and-their-characteristics-january-2010
[108] *Schools, pupils and their characteristics: January 2013*; Department for Education. Table 2b www.gov.uk/government/publications/schools-pupils-and-their-characteristics-january-2013
[109] www.gov.uk/government/policies/increasing-the-number-of-academies-and-free-schools-to-create-a-better-and-more-diverse-school-system

Key suppliers

B18 There are a number of suppliers of MIS to schools in the UK. Capita is the main supplier of MIS with a share of supply to schools in the UK of approximately 75 per cent.[110] Its product is called SIMS. Other suppliers include Bromcom Computers, Scholarpack (Histon House Ltd), Follett (Aspen, through Novatia plc), Pearson Education, RM Education, Tribal, Wauton Samuel, Advanced Learning, Arbor, iSAMS, WCBS, SEEMiS, Furlong (SchoolBase), Double First and Schoolpod.

B19 Pearson Education and one other supplier have announced their intention to exit the UK MIS market.[111] Furthermore, some of the companies listed at paragraph B18 only, or predominantly, supply to independent (fee paying) schools.

B20 In Scotland, all schools are supplied their MIS via their LA, and it is paid for from the LA's budget rather than the school's. All 32 Scottish LAs now purchase from SEEMiS, which is a Limited Liability Partnership wholly owned and managed by the member LAs.[112] Previously, Pearson had supplied four Scottish LAs, but since announcing its withdrawal those LAs are transferring to SEEMiS due to a lack of alternative supplier in Scotland at present.[113]

B21 In Northern Ireland, the C2k project awarded Capita the contract to provide its SIMS product to all schools in May 2012 for five years.[114] The project is managed by the Western Education and Library Board on behalf of the other education and library boards and the Department of Education.[115]

Competitive constraints

B22 In this section we consider the competitive constraints acting on the provision of schools MIS, including demand and supply side

[110] Capita's estimate based on number of schools.
[111] See www.pearsonfronter.com/withdrawal.
[112] See www.seemis.gov.uk/site3/index.php/about-seemis
[113] Pearson's FAQ Scotland document: www.pearsonfronter.com/images/scotland_faqs.pdf
[114] This contract is part of the wider Education Network Northern Ireland (ENNI) contract, which was awarded to Northgate Managed Services to design, implement, manage and support an Education Cloud environment for schools in Northern Ireland in partnership with certain suppliers, including Capita. The total contract is worth £170 million.
[115]For more information see: www.c2kni.org.uk/corp/npartners.html and www.capita-mits.co.uk/News/Capita-to-Supply-1200-Northern-Ireland-Schools-wit

constraints, primary and secondary markets and competitive constraints arising from outside of the UK and other geographic issues. We have not conducted a market definition assessment or reached any conclusions on this. However we do assess and come to a view on the likely constraints in the provision of schools MIS on the basis of the evidence available. Our consideration here mostly reflects situations where both LAs and schools are customers (as in England; in other devolved administrations, schools may not have individual discretion over their supplier, see also paragraphs B38 and B39).

Demand side constraints

B23 As noted at paragraph B7, schools' MIS includes the products, services and tools that are used to support a school's management and administration.[116] This includes a wide variety of core functions (see paragraph B8) that any school will require, and additional functions which may be optional. In particular, some suppliers provide an optional finance component. In addition, various stand-alone modules are offered by companies which can be added on to another provider's MIS and integrate with its data, so as to provide additional functionality.

B24 We understand that nearly all schools now require an MIS for internal administration and in order to provide statutory returns.[117] No alternatives to a core MIS were suggested as providing a viable substitute for schools.

B25 However, MIS will differ in their functionality and not all customers purchase all available modules. For example, a proportion of LAs do not subscribe to the 'resources' suite of modules within SIMS and instead may use another provider's corporate financial management system.[118]

B26 There are a variety of packages that could be used by schools for financial management (and also for certain other functions such as assessment tracking) that are alternatives to those offered by the MIS suppliers. Non-MIS suppliers have established themselves and grown

[116] *School management information systems and value for money 2010: a report with recommendations addressing issues relating to legal compliance, cost reductions and bureaucratic burdens*; Becta pg 15.
[117] We understand only a very small handful of schools did not file their statutory returns using an MIS.
[118] The 'resources' suite includes modules relating to financial management and budgeting.

significant shares in the supply of financial management to academies. For primary and nursery schools with relatively simple financial management issues, it is also possible to use non-specialist financial packages or spreadsheets.

B27 Nonetheless, most MIS suppliers now offer a wide range of functionality embedded in their products. Several suppliers said that schools generally prefer to deal with a single provider, for reasons of simplicity and also to ensure the ease and reliability of data sharing between the different modules. Some of the existing MIS suppliers believed that the demand for add-ons was diminishing as suppliers copied the functionality of successful add-ons and integrated this into the core products, perhaps reflecting the customer's preference for a single supplier.

B28 Where an MIS provider offers particular functions as an optional add-on, these will constrain stand-alone add-on providers and vice versa. However, the constraint on full-specification MIS products suppliers from customers potentially switching from add-on modules seems likely to be comparatively weaker. This is because of the customers' preference for dealing with a single supplier and the degree to which most providers now bundle all modules together.

Supply-side constraints

B29 We have not identified opportunities for non-MIS product suppliers in related ICT industries to quickly and easily move into this sector. We understand that several recent entrants have developed integrated MIS products from scratch or sought to modify systems developed abroad, although typically it took a couple of years of development before the MIS was available commercially. Add-on suppliers are also likely to be constrained by the possibility for integrated-MIS suppliers to develop the equivalent functionality in their products.

Primary and secondary markets

B30 We considered whether product development and upgrades, and related support services for MIS, are part of the MIS and if they are likely to face different or similar constraints.

B31 All providers charge an annual maintenance fee (although this can be calculated and applied in different ways), and most providers will charge an initial licence fee. All providers told us that product upgrades were included as part of the ongoing maintenance contracts. We did not find evidence of a separate secondary market for product upgrades; rather it is seen as part of the MIS product provision.

B32 User support to schools is an important element of MIS. This can be delivered in three ways: support will be provided directly to the school by the MIS supplier; support will be provided directly to the school by a third party company that supports another company's MIS;[119] or LAs may operate their own support function for schools in their area if that school is using an MIS provided by a supplier with whom the authority has a contract. The MIS supplier will then train and support the LA's team.

B33 These differing sources indicate the possibility of competition between different sources of user support.

Segmentation

B34 We next considered whether constraints are different in any segments in this sector.

B35 State and private schools have different requirements for MIS because, for example, a supplier told us private schools may require specialist functionality for fees billing, scholarships and bursaries, registrations and admission, different returns, and may see a greater need for parental engagement and PR. However, we understand that the major suppliers also serve the independent schools sector, and we have seen some movement from independent school suppliers into provision to state schools.

B36 Two MIS providers aim their products mainly at primary schools.[120] We understand primary schools' requirements are often simpler than secondary schools' requirements, for example there is no need for examination modules or sophisticated curriculum and timetabling

[119] There are some companies who do not supply their own MIS but provide technical support to schools for other systems. These companies may also provide wider ICT support to schools, for example broadband, network support/management, website maintenance and design, and installing equipment.
[120] Wauton Samuel (www.wautonsamuel.co.uk/) and Scholarpack (www.scholarpack.com/).

functions. However, most primary schools are supplied with products that are designed to cover all school types. We also heard evidence from suppliers of potential for supply-side substitution between suppliers of private schools or primary schools and the rest of the sector.

B37 This suggests that all segments to face similar competitive constraints.

Geographic issues

B38 Different MIS products tend to be used in different countries. A supplier told us that in many countries, supply is concentrated in the hands of one or two providers, often reflecting those who were first to market in that country. The requirements for MIS differ between countries depending on the educational system and the reporting requirements that apply. We were told that reporting requirements in the UK tend to be much more extensive than elsewhere. While some suppliers have sought to design a product that can be customised for different countries, attempts by suppliers to establish MIS products developed abroad in the UK have not achieved significant sales.

B39 There are differences between the devolved administrations in the UK. In particular, reporting requirements and the examination system in Scotland are different to the rest of the UK, and MIS is procured by LAs rather than schools. All Scottish schools are now supplied by SEEMiS, a Limited Liability Partnership wholly owned and managed by the member councils. As noted at paragraphB20, LAs in Scotland seem unlikely to switch to the providers supplying schools elsewhere in the UK. No other suppliers currently provide a product designed for the needs of Scottish state schools, and we were told that new entry is unlikely as prospective entrants are unlikely to regard Scotland as an attractive market under the current arrangements. The process of competition in the supply of MIS to state schools in Scotland therefore appears to be different to that in the rest of the UK.

Concentration

B40 The supply of MIS is highly concentrated with Capita supplying a large proportion of the sector (excluding Scotland). For example, data from DfE shows what MIS schools used to make their census return in

2013 in England, which gives a good indication of the share of supply in England (see Figure B.2 below).

Figure B.2: Share of supply of MIS suppliers to state schools in England in 2013

Supplier	Share of supply in England %
Capita	82.96
RM	8.09
Advanced Learning	5.61
Pearson	1.38
Arbor	< 1
Aspen	< 1
Bromcom	< 1
iSAMS	< 1
Other	< 1
Scholarpack	< 1
Schoolbase	< 1
Schoolpod	< 1
Tribal	< 1
Wauton Samuel	< 1
TOTAL	100

Source: The data is based on the software supplier code supplied by schools as part of their 2013 Autumn School Census submission to DfE.[121]

B41 Becta looked at 'market shares' in England in its 2005 and 2010 reports and found Capita to have a share of supply of 81 per cent and 80 per cent respectively, with no other supplier having more than a nine per cent share.[122] Since then, there has been some change in the MIS sector, including the entry of new suppliers and exit of others. Pearson has announced its intention to withdraw from the supply of MIS in the UK by September 2014, and Serco sold its MIS product to Advanced Business Solutions in January 2013.[123] Pearson recommends RM as an alternative provider for its schools in England,

[121] See www.whatdotheyknow.com/request/which_software_schools_use_to_re_3 Based on 21, 591 schools in England. Note that individual schools may have numerous modules and/or software packages that are sourced from more than one supplier. This data refers only to the supplier of the core MIS used to submit the Autumn School Census. Therefore the number of schools differs from Figure B1 above which is based on the 2013 Spring School Census and PRU Census.
[122] *School management information systems and value for money 2010: a report with recommendations addressing issues relating to legal compliance, cost reductions and bureaucratic burdens*; Becta pg15
[123] www.progressomis.com/serco-learning-rebrands-to-advanced-learning/

although schools and LAs are free to choose another supplier if they wish.[124] In Scotland, the four LAs supplied by Pearson will transfer to SEEMiS (see paragraph B20).[125]

B42 There have also been some new entrants since 2010, such as Tribal, Arbor, Scholarpack, Follett (Aspen), Schoolpod and iSAMS. However, as shown in Figure B.2, none of these suppliers has yet made large in-roads into the market, with each having a share of supply in England of less than one per cent.

B43 As a result, whilst there have been changes in suppliers, the overall shares of supply for England have not moved substantially, though Capita has increased its share of supply by three per cent between 2010 and 2013.

B44 In Northern Ireland, Capita is the sole supplier of MIS to schools.

B45 Capita's share of supply does not appear to have changed substantially from 2005 to 2014, while SEEMiS now accounts for all state school MIS use in Scotland. This suggests the schools MIS market is stable, with any new entries or switching by schools or LAs having little impact.

Procurement

B46 The purchase of packaged software, maintenance and support services has been subject to EU procurement regulations since 1994. In its 2010 report, Becta considered the provision of MIS software and services would be subject to the full requirements of EU procurement rules, but for two possible exemptions:[126]

- Additional services exemption: relates to the provision of additional services not included in the original contract but which have become necessary, and where the services cannot be provided separately. The exemption is limited to 50 per cent of the amount of the original contract. Becta believed it is unlikely this exemption could be relied upon for purchasing MIS.

[124] See Pearson's FAQ England document: www.pearsonfronter.com/images/england_faqs1.pdf
[125] Pearson's FAQ Scotland document: www.pearsonfronter.com/images/scotland_faqs.pdf
[126] School management information systems and value for money 2010: a report with recommendations addressing issues relating to legal compliance, cost reductions and bureaucratic burdens; Becta pg19

- Only supplier exemption: this applies where 'for technical or artistic reasons, or for reasons connected with the protection of exclusive rights, the services can only be provided by a particular person'. This might include basic support for MIS or updates for reporting or regulatory changes. However, the exemption does not allow for the purchase of new software modules or additional functionality, including incremental changes to a product over time. Becta concluded that moving from a LAN-based product to a cloud-based product is unlikely to be permitted under the only supplier exemption, but instead would require the change to be competitively procured.

B47 Where an exemption does not apply, the financial threshold at which EU procurement regulations must be followed for purchases by schools and LAs is currently £172,514.[127] According to Becta, where it is for an indefinite duration, such as a perpetual MIS licence, the regulations provide that the financial value of the contract will be calculated on the original licence charge and 48 months of support.[128]

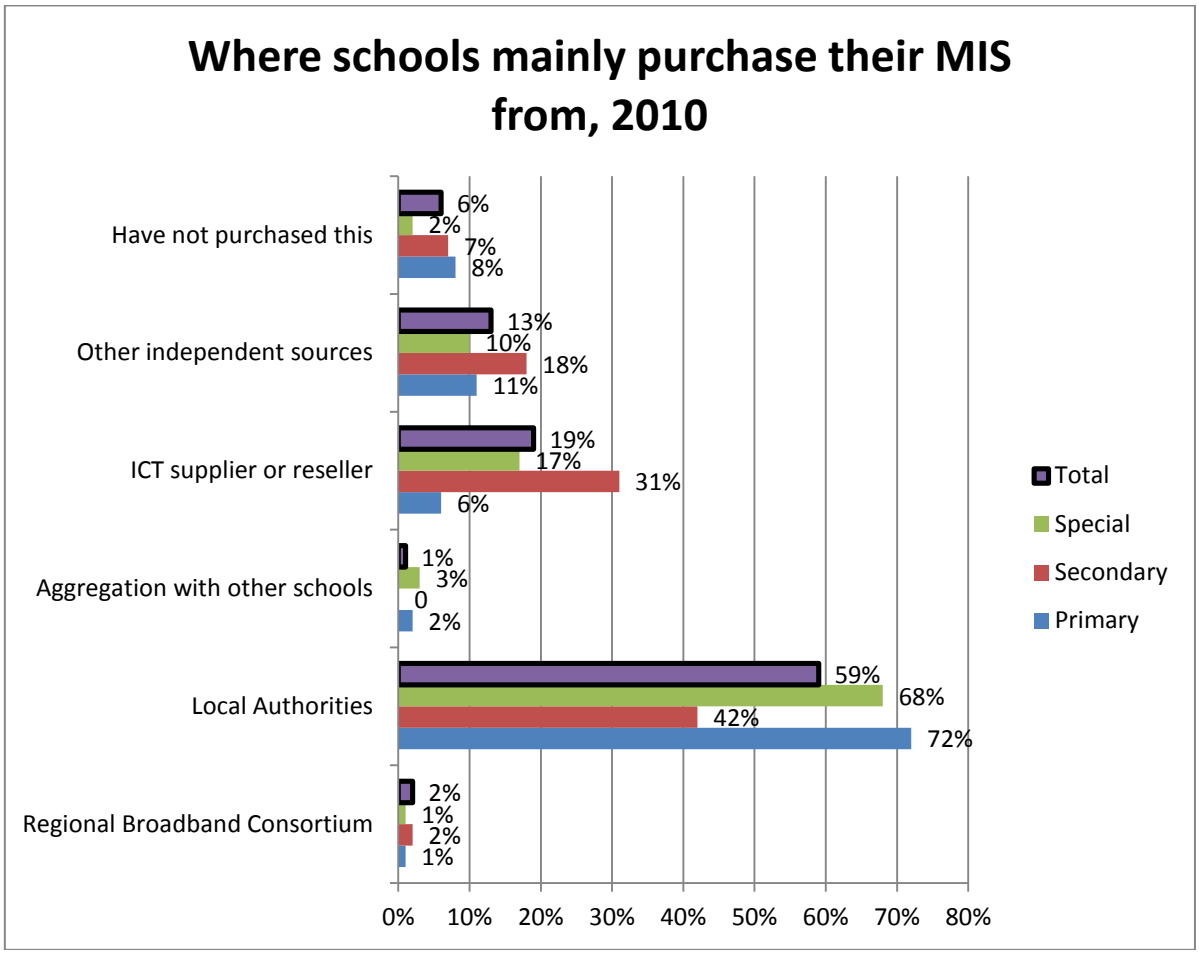
B48 Even if the value of contract is below the threshold, contracting authorities must still comply with the principles of transparency and competitive procurement, so some kind of competitive procurement is required.[129] Becta's view is that year-on-year renewals effectively comprise the award of a new contract.

Role of LAs

B49 In 2010, Becta found that LAs play a central role in the procurement of MIS, with 59 per cent of schools purchasing their MIS mainly from LAs (see Figure B.3 below). It also shows that primary schools are more likely to purchase via their LA.

[127] Procurement Policy Note - New Threshold Levels for 2014 Cabinet Office, December 2013. Schools software would be classed as a Part A service under 'others', because schools and LAs are not listed under Schedule 1 of the Public Contracts Regulations 2006: www.legislation.gov.uk/uksi/2006/5/contents/made
[128] *School management information systems and value for money 2010: a report with recommendations addressing issues relating to legal compliance, cost reductions and bureaucratic burdens*; Becta pg 20
[129] *School management information systems and value for money 2010: a report with recommendations addressing issues relating to legal compliance, cost reductions and bureaucratic burdens*; Becta pg 20

Figure B.3: Where schools mainly purchase their MIS from, 2010

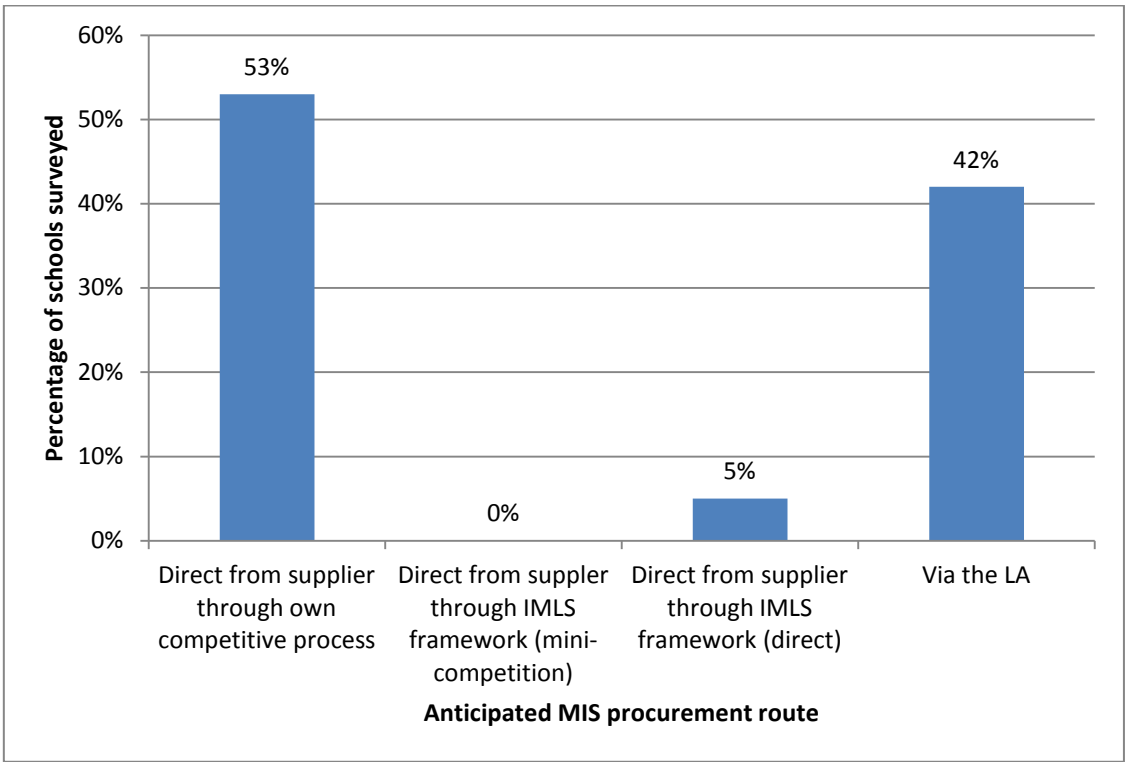


Source: Harnessing Technology Survey, Becta 2010. Schools were asked 'from where does your school mainly purchase the following ICT equipment and services: Information management systems'.

B50 LAs still play an important role in the market, but schools are increasingly purchasing direct from the supplier. Figure B.4 illustrates the route schools would choose if they were to purchase a new MIS in future.[130] We note, however, that schools and LAs often choose not to initiate a new procurement (see paragraphs B120 to B135), meaning the question of how they might procure an MIS next time could be largely hypothetical.

[130] In response to a survey conducted by Kable in 2013 of about 3000 schools throughout the UK asking 'How will [your] school procure a new MIS?'. See Pass mark for ICT: The schools ICT market forecast to 2017-18, Kable. Oct 2013 pg 28.

Figure B.4: How schools would procure a new MIS, 2013



Source: Kable[131]

B51 In most cases of LA involvement, it seems that the LA purchases an MIS and supplies it to its schools as part of a bundled service including support provided by the LA's in-house team – the schools pay the LA for this. In some cases, the bundled support comes direct from the relevant MIS supplier itself rather than the LA. We also heard of cases in which the support was provided by a third party (see paragraph B32).

B52 A range of alternatives with differing levels of LA involvement also exist. For example, we heard that in some cases a LA might negotiate terms and pricing with one or more MIS suppliers, or else suggest a recommended supplier, from which its schools can then choose to purchase directly.

Role of schools

B53 In England, there has been a recent increase in the number of schools that purchase a MIS independently (based on figures provided to us by

[131] 'Pass Mark for ICT', Kable, October 2013.

suppliers). This is due to the increasing number of academy and free schools in England, and could also be due to the individual preferences of head teachers and/or governors making use of their budgetary independence. As Figure B.3 shows, in 2010 19 per cent of schools purchased direct from the supplier or reseller (though the figure is much higher for secondary schools, at 31 per cent). Figure B.4 indicates that 58 per cent of schools would purchase direct in future. Schools (for example, via Multi Academy Trusts) can also group together to purchase an MIS and, by increasing their negotiating power, may obtain discounts from suppliers competing for their business.

Becta's findings on procurement of school MIS

B54 The procurement of MIS and related technical support has previously been examined by Becta on two separate occasions with a focus on value for money.

B55 In 2005 Becta identified a range of factors that were inhibiting the ability of LAs, schools and academies to work together with the suppliers of MIS to maximise the benefits of the public sector investment in MIS.[132] Among other things, Becta pointed to the timescale and complexity of the MIS procurement process as deterring customers from re-tendering their requirements and potentially changing suppliers. To address this, Becta recommended the establishment of an EU-compliant[133] framework agreement of approved suppliers of MIS which LAs, schools and academies should be required to use unless they were able to demonstrate that better value could be obtained elsewhere.

B56 Revisiting this recommendation in 2010, Becta noted that a framework agreement had not been implemented due to a *'lack of appetite'* among LAs.

B57 In both reports, Becta addressed in detail the legal obligations[134] surrounding the acquisition of MIS software and related services, the renewal of annual maintenance agreements, as well as the MIS

[132] Including interoperability, statutory returns and the provision of LA support
133 Full details of the EU rules on public procurement be found on the website of the European Commission at http://ec.europa.eu/internal_market/publicprocurement/index_en.htm
134 In particular, EU and UK procurement law

procurement practices of LAs, schools and academies. Becta reported that, due to a lack of understanding at LA level of the relevant legal framework, there were likely to be a significant number of MIS procurement activities that were potentially non-compliant with EU and UK procurement law. They believed that this contributed to a lack of competition for the supply of MIS to schools.

B58 Becta made clear that addressing the issues identified surrounding MIS procurement had become an 'urgent inescapable necessity' for LAs. It made recommendations on legal compliance, as well as on reducing costs and bureaucracy. In particular, Becta again urged Government to consider setting up a specific MIS procurement framework which LAs, schools and academies would have freedom (but not be compelled) to use.

Information Management and Learning Services Framework

B59 In response to the issues raised by Becta, the Government Procurement Service (GPS) (now the Crown Commercial Service (CCS)) developed, in partnership with the DfE, the Information Management and Learning Services Framework (IMLS Framework).[135]

B60 The IMLS Framework, which went live on 23 March 2012, was designed to provide LAs, schools and academies (as well as groups of these) with an efficient, EU compliant route for the purchase or renewal of MIS and related technical support.[136] It includes contractual terms agreed by suppliers awarded onto the IMLS Framework. Many of these terms and conditions are designed to address issues identified by Becta, as well as those raised in the market and the media over several years, for example preventing suppliers charging schools a relicensing fee when they change legal status.

B61 Suppliers were appointed to the IMLS Framework following an EU-compliant tender process. LAs and schools considering procuring a MIS via the IMLS Framework are required to run a mini competition

[135] An advisory group comprising representatives of LAs and other educational groups also contributed. More information about the framework can be found here: http://ccs.cabinetoffice.gov.uk/contracts/rm1500 and www.education.gov.uk/schools/adminandfinance/procurement/b0069801/buying/ict/information-management-and-learning-services-framework

136 The Framework also covers the procurement of Learning Platforms (LPs). LPs are outside the scope of our market study and will not be addressed further in this Report.

where all capable suppliers[137] are invited to submit a proposal designed specifically to meet the prospective purchaser's requirements. By using the IMLS Framework agreements LAs, schools and academies do not need to advertise and tender a contract separately (as required by procurement law). This minimises costs and shortens the procurement timeframe.

B62 DfE and GPS/CCS encourage the use of the IMLS Framework by LAs, schools and academies, either individually or jointly. This is the case even where the potential purchaser does not have to comply with European and UK procurement regulations.[138] Despite this, usage of the IMLS Framework has been low (see paragraph B122 below).

Competition between suppliers

B63 MIS suppliers compete on price but also on product features and service. In addition to price, schools and LAs will be concerned about whether the MIS has all the functions needed, data security, speed of migration to the new system, and usability for staff. We have heard that some schools or LAs would prefer to bear price increases to keep their existing MIS rather than look around for an alternative supplier, suggesting that price may not be the key consideration in the choice of supplier.

B64 Some suppliers alleged that schools and LAs may not consider the whole-life cost of an MIS when deciding whether to remain with their incumbent supplier or switch to a new one. Schools and LAs may take a short term approach to assessing price and focus on the initial costs, such as licensing, training and data migration, rather than lower annual operating costs or other savings. For example, server-based MIS generally have higher hardware costs compared to web or cloud-based systems, so may cost more in the long-run.

B65 The scope and abilities of MIS have been greatly extended since the introduction of the first systems. In many cases, MIS products now

137 The DfE website lists suppliers awarded onto the framework www.education.gov.uk/schools/adminandfinance/procurement/b0069801/buying/ict/information-management-and-learning-services-framework/supplier-listing

138 Whether a tender process is required to comply with EU and UK procurement law is dependent (among other criteria) on whether certain financial thresholds are met.

include a wide range of functionality that was either not previously available, or only available through separate add-on products.

B66 Currently, suppliers have started offering cloud-based systems where data records are stored remotely and processing done at a data centre rather than the school having to run its own servers. This facilitates easier access to the system through a variety of devices with web-access, including in-classroom and remote access, whereas traditional systems are server based and were more likely to rely on use through PCs. We heard contrasting views on the enthusiasm of schools for cloud-based systems, some feeling traditional systems performed poorly or imposed higher total costs, whereas others felt innovation and ease of use for these systems was good and they favoured sensitive data being held on the school's own servers.

B67 Most respondents highlighted a general broadening of MIS capabilities and said that the functionality of certain add-on systems had been brought into the core system (or offered as an optional module). This tended to apply to all MIS providers, all of whom adopt a policy of offering progressive upgrades to their products over time as part of the annual maintenance fee rather than charging for the release of new product versions.

B68 The static shares of supply, despite supplier entry and exit over the past few years, suggest there is only active competition between suppliers on the margins of the MIS sector. As discussed in paragraphs B76 to B85, most schools and LAs experience high real or perceived barriers to switching which makes them unlikely to look for other suppliers.

B69 In Scotland state schools are provided with MIS by their LAs, all of whom have adopted or are about to adopt SEEMiS. Despite the apparent lack of competition, we were told that SEEMiS was considered to provide good value for money when compared to systems available elsewhere. However some different views were expressed on functionality. One respondent said SEEMiS' functionality at the moment was good, while another referred to reports of some weaknesses in the product.

Switching

Levels of switching and incidence of tendering

B70 Switching can be indicative of whether competition is effective in a market, and whether customers are able to exercise choice. Interpretation of switching levels depends on the context. Where competition is effective, incentives to switch may be low. However, switching may also be low if competition is ineffective and if there are barriers to switching. Unfortunately, data on levels of switching by schools is not collected.

B71 Capita identified four examples of LAs switching their recommended supplier between 2009-10 and 2013. Individual schools are free to decide whether or not they follow their LA's recommendations. Capita said in total 321 individual schools (that is, those purchasing directly from Capita rather than being supplied through LAs) had switched to it in 2012-13 while 253 had moved away. There were 1,970 SIMS Direct customer schools in 2012, and 2,926 in 2013; the number increased significantly because of transitions to academies and free schools.

B72 There appears to be a low level of tendering activity by LAs (see paragraphs B120 to B135). From 2005 to 2010, Becta found that only 18 formal competitions for MIS products and services were launched (compared to the 152 relevant LAs it identified).[139] The Becta report also found about 50 per cent of the LAs who purchased support and maintenance from their supplier purchased the original licence over 10 years ago.[140]

B73 Some tenders have also been launched by multi-academy groups and individual schools.

B74 While not equating directly to switching activity, Becta (2010) notes that when comparing the MIS used for census returns in 2005 with those in 2010 from approximately 22,000 schools, there was virtually

[139] *School management information systems and value for money 2010: a report with recommendations addressing issues relating to legal compliance, cost reductions and bureaucratic burdens*; Becta. Pg 24
[140] *School management information systems and value for money 2010: a report with recommendations addressing issues relating to legal compliance, cost reductions and bureaucratic burdens*; Becta. Pg 35

no movement in relative market share over the period.[141] As noted at paragraphs B41 to B43, and B87, there was little change in the results for 2013 and new entrants have only picked up a small number of schools.

B75 The above suggests that levels of switching are very low. It also suggests that opportunities for suppliers to compete for new business through tenders being offered may be quite limited.

Barriers to switching

B76 LAs, or schools, might consider switching to a new MIS supplier to be a difficult, costly or risky exercise, or not worth undertaking, for a variety of reasons. Some of these barriers may be prior perceptions that are not actually realised when switching, but may nonetheless deter consideration of switching.

B77 First, users may face limited incentives to switch if their current product meets their needs and they are not motivated to seek any different functionality offered by different products, as MIS costs are a small proportion of a school's total running costs.

B78 Second, switching to a new system will require users to be trained to use the new system. We were told that schools may anticipate this to be costly and time consuming. The process may be disruptive to the running of the school and may lead to user errors while they become familiar with the new system.

B79 Third, even where a new system is cheaper over the longer-term, the short-term costs of licensing, data migration and retraining can provide a disincentive to switching (for example if LAs and schools are constrained by annual budgets).

B80 Fourth, we were told that there may be a fear that incumbent suppliers may be reluctant to cooperate with switching. We were told by the representatives of a number of schools that there is considerable confusion as to whether they would be charged for the transfer of data from one MIS to another system by the new provider and particularly whether the old supplier would require the new

[141] *School management information systems and value for money 2010: a report with recommendations addressing issues relating to legal compliance, cost reductions and bureaucratic burdens*; Becta. Pg 15-16

supplier to pay a fee for access to its system, and whether this would have to be completed within the life of the existing contract. In contrast to this, one supplier told us that switching from its MIS to another is achievable at anytime and can be facilitated by the school and its new supplier without requiring any intervention from the supplier of the old system. We have heard of instances of charges being made for data migration, but also examples where no charge was made.

B81 Fifth, the risks associated with data transfer to a new system, whether real or perceived, can be a disincentive to switching. These risks relate to the speed and reliability of the data transfer. When a school switches from one MIS to another the raw data contained within the MIS must be migrated from the old system to the new. Because the data is sensitive and vital to the operation of the school, we were told by a schools organisation that schools that they are often nervous of the risk of data loss. Additionally, we have heard of concerns over data protection issues including whether storing data on cloud-based systems will be reliable and secure, which may deter schools from considering switching to such systems.

B82 We have received conflicting accounts as to how quickly and seamlessly switching can be completed. Suppliers said that the process of switching was usually very easy. They said that data could be migrated (in some cases very quickly) without problem, and assured us that remote data hosting met all requirements for security and that there were no data protection issues. There were examples where staff retraining was accomplished rapidly and indeed new products facilitated new functionality and ways of working. Some suppliers said they would aim to migrate systems and have the new MIS up and working over a weekend or half term break.

B83 However, one supplier said that the data migration and testing process could take up to six months in total, and during that time the school would need to run two systems in parallel.

B84 Individual schools could face additional barriers to switching. For example, suppliers and a schools organisation said schools may lack the skills or resource capacity to undertake a procurement exercise and may not know what alternative products are available. Schools may also believe, incorrectly, that they are obliged to acquire their MIS

from their LA or to use a particular package to provide returns to the LA or DfE, or may be put off an alternative supplier if the LA does not provide IT support for it.

B85 We wrote to several schools that had switched their MIS supplier to ask how they had found the switching process. We had a response from four schools. Of these, two found the process 'very smooth' with the only difficulties arising from staff taking time to adapt to the different appearance of the new system. However the other two schools reported a 'stressful' switching process that was 'very problematic' due to errors in migrating data. Three of the schools each estimated the preparation and training time needed by staff to be two to three days, although the fourth school estimated that 20 days of staff productivity were lost as a result of the switching process.

B86 We consider that the lack of clarity about the actual costs and implications of switching form a barrier to switching that could act as a deterrent to effective competition going forward.

Entry and expansion

B87 There have been several examples of entry into the provision of MIS in recent years. These entrants have won between a handful and several hundred schools each, although none has won any LA contracts.[142] The schools that have adopted new suppliers' systems are often concentrated in particular areas. This was attributed by suppliers to recommendations on alternative systems passed by word of mouth between schools.

B88 In addition to full MIS suppliers, there have been entrants into the provision of financial systems or add-ons.[143]

B89 There have also been some exits from the industry. Pearson (who had a three per cent share of supply in 2010)[144] announced its exit by September 2014.[145] One other recent entrant told us it was no longer

[142] Meetings with suppliers and analysis of the software supplier code supplied by schools as part of their 2013 Autumn School Census submission to DfE.
[143] Such as PS Financials and Civica Correro.
[144] *School management information systems and value for money 2010: a report with recommendations addressing issues relating to legal compliance, cost reductions and bureaucratic burdens*; Becta pg 15
[145] www.pearsonfronter.com/withdrawal

seeking new business and its customers were being transferred to other systems.

B90 Despite these examples of entry, most suppliers[146] claimed that there were significant barriers to entry and particularly expansion to a large scale in the provision of schools MIS. They said that the barriers to switching identified above meant that schools and LAs were reluctant to switch provider, which made picking up customers difficult.

B91 Most barriers identified by suppliers focused on the procurement practices of LAs, see paragraphs B120 to B135. They said that LAs were reluctant to undertake market testing and to run open tenders. Instead, they tended to roll-over existing contracts. It was suggested to us that incumbent suppliers may selectively reduce charges to LAs contemplating re-tendering to a point where the LA may conclude that likely gains from re-tendering would not be worthwhile, although this has not been verified to us by LAs.

B92 Second, we found that where LAs do go out for tender for a new schools MIS, they tend to avoid using the IMLS Framework, see paragraph B122. We were told by some suppliers that one reason for this was that not all suppliers were willing to cooperate with the IMLS Framework (see paragraph B125), refusing to bid at all or bidding an unrealistic price.[147] They said that LAs may be reluctant to continue without the incumbent supplier as an option or as a benchmark. Consequently the tender may then be offered off-framework.

B93 In addition, new entrants cannot be approved as suppliers on the IMLS Framework list until a new approvals process is run, limiting the range of competitors available when using the framework.[148]

B94 Several suppliers claimed that LAs (and schools) may not assess systems on a whole life basis and so initial switching costs (including new licence fees, data migration and retraining) may create a substantial barrier (see paragraph B64).

[146] With the exception of two suppliers
[147] We note the framework requires that the supplier does not charge an additional licence fee when schools convert to academies, and additionally the bid information can be used for benchmarking purposes in other acquisitions.
[148] The current IMLS Framework ends in March 2016. See paragraphs B122 for discussion about the Framework and its usage.

B95 Some suppliers also said that where a LA has an in-house support team, they may be reluctant to switch because the team are trained and (in some cases) accredited in the incumbent supplier's product, and there is the perception that the procurement process might be unfairly biased towards the incumbent MIS supplier for whose MIS the LA team provides IT support. They said there may be a reluctance to make such staff redundant, and these support staff may be influential in the decision about whether to tender, the form such tendering takes and the assessment of bids. Given these staff currently support the incumbent's product they are likely to favour the incumbent supplier. We have also heard from suppliers that familiarity with a particular MIS can, where a LA's IT support team is asked to contribute, lead to inadvertent bias in favour of that system in the design of tender documentation. This might result in the tender specification describing what the incumbent MIS can do rather than what schools need from their MIS.

B96 Capita told us that LAs generally provide support to schools without any involvement from them (a small number of LAs have chosen Capita to provide SIMS support directly), and it was not aware of any Capita staff being seconded to LAs. It said that it had no involvement in the role of support teams in LA tendering, and that decisions on re-tendering and the choice of supplier are often made by the LA's procurement team rather than support team. It also referred to various practices it had seen which served to ensure that support teams were aware of alternative providers.

B97 Nothing we have received through the market study gives us reason to believe that deliberate action has been taken to influence the outcome of any procurement process dishonestly.

B98 Most entrants said that they saw opportunities to sell MIS to individual schools and academies, although one supplier said that targeting individual schools was expensive and a very slow way to build market share. However suppliers alleged that many schools were unaware of the options open to them for alternative MIS and the additional functionality and uses that may be available, and said that some schools believed they were obliged to go with their LA's supported product.

B99 Some suppliers believed that Government regulation created a barrier to entry because of the burden of meeting reporting requirements. For example census requirements changed three times a year and required the products to be rewritten. The supplier needs to be able to spread the high fixed costs of making such changes across its customers which disadvantages entrants with a small customer base. However one supplier said that the burden from Government requirements and changes was reducing.

B100 Similarly, two suppliers said that product development costs related to the cost of designing the data migration process could also represent a barrier, particularly if some incumbent suppliers did not make all data available in an appropriate format. They said there is also likely to be a cost associated with the need to ensure that products would work with add-on modules supplied by third parties, where customers rely on such add-ons and they are not provided by the entrant.

B101 A final barrier identified related to the practice of including charges for product developments and upgrades in annual maintenance charges. It was claimed by a supplier that this inhibited switching because schools had paid in advance for upgrades. Moreover, schools and LAs were not re-tendering when there were significant developments in products (even though this should have triggered an obligation to do so because this meant they were effectively purchasing a substantially different product for the first time). See paragraph B46 above for discussion of school and LA's obligations under procurement regulations.

B102 In Scotland where LAs purchase all MIS for state schools, there are currently no alternative suppliers so new entry would have to occur to facilitate any switching. Unless there was very substantial switching by Scottish LAs, the size of the market may make entry unattractive, and as SEEMiS is owned and managed by member LAs, this may be less likely.

B103 Overall, we found the barriers to entry and expansion to be substantial. While entry has occurred, we note no party has managed to build a substantial share of supply.

Conduct

Pricing

B104 A variety of pricing structures are used for schools MIS reflecting differences in the modules supplied, initial licence fees, any charges for migration of existing data to a new system, charges for annual maintenance, and how support is provided. In the main, suppliers charge an initial fixed or licencing fee and thereafter an annual charge, although there are variations in how this is structured and applied.

B105 Capita's pricing reflects whether or not a LA has purchased bulk SIMS licences for its schools. SIMS licences are perpetual site licences for a one-off charge. LAs purchase licenses covering up to three suites of applications. Alternatively, schools can purchase modules or suites[149] directly from Capita, for example if they need additional modules or if their LA does not support SIMS. Schools purchasing directly from Capita will be SIMS Direct Customers. Licence charges for SIMS Direct schools are based on bands of pupil numbers, whereas those for LAs are based on number of establishments.

B106 In addition there is an annual entitlement charge covering support and/or maintenance including patches and upgrades. Capita's charges reflect the contracted service levels and performance targets. There have also been discounted charges offered on annual entitlements in return for agreeing to three or five-year contracts. LAs pay a team charge to Capita covering the cost of support to the LA's service team (such as for software, training materials, documentation, advice). The LA team will then provide SIMS support direct to the schools. The LA recovers licence, annual entitlement and team charges from the individual schools, if those schools have chosen to take SIMS via the LA.

B107 SIMS Direct customers pay an annual entitlement charge for the various modules they subscribe to, but there is no 'team charge'. Support is offered to these schools by Capita, although Capita told us many direct customers such as academies continue to receive support from their LA or contract with a third party.

[149]Suites are available at a discount compared to purchasing modules individually.

B108 Licence and annual entitlement charges are higher for SIMS Direct customers than for LA customers on a per school basis. Capita said that differences reflected support being included in the SIMS Direct pricing, and the cost of marketing to individual schools (see also paragraphs B111 to B119).

B109 Some customers said that they can find it difficult to fully understand the charges for MIS. They said charges for particular modules and support may not be clearly set out and it was unclear how annual entitlement fees were then calculated. We were also told by two suppliers that where the school receives the MIS through an LA contract, charges to schools may not be transparent, because the LA may charge a bundled fee for a variety of software provision and ICT support. Therefore a school may not know how much it is currently paying for its MIS and support, nor when contracts are up for renewal.

B110 Capita told us SIMS Direct invoices clearly listed the charges for each product and service, and that it had clarified its invoices in response to customer concerns that had been expressed in the past. Capita showed the OFT examples of recent invoices which clearly set out charges broken down by individual module and specified the dates that the annual entitlement charges covered.

Academy conversion

B111 One area of concern raised with us by schools relates to the situation when schools convert to academies. There are some differences in how such schools are run and are required to report their finances. They may also wish to use the MIS differently for their own purposes, and may need to combine data across different schools if part of an academy group. Most suppliers said that such changes were relatively minor, could be accommodated within the existing MIS product, and that no charge would be levied on the school for any necessary changes to the reporting systems or database, nor to reregister the school under its new status and identity.

B112 Where a school is a direct customer of Capita's SIMS product, (so it is not receiving SIMS as part of a LA contract), or otherwise has previously purchased SIMS licences in its own right Capita does not charge for a new licence. Where a school changes its existing support arrangements to or from Capita, a one-off fee of £200 is charged.

B113 However, where a school has previously received SIMS as part of a LA agreement, it faces significant charges in converting to an academy. Capita said that a school using SIMS under a LA agreement would need to purchase a licence in its own right directly from Capita when it becomes an academy and could not continue to be licensed via the LA.[150] Capita told us that the price charged for the direct licence is on average less than £10,000 per school. In practice the cost will depend on the modules the academy purchases and the number of pupils in the school. Capita said the licence cost was discounted where schools were previously SIMS users under an LA licence.

B114 In addition, as a direct customer, an academy will face a higher annual maintenance charge. Capita told us this was because the charge includes support, and it said such schools can be supported direct by Capita, or alternatively by a LA's support team or third party organisation.

B115 Capita said that charges to academies reflected enhancements and amendments to its software, and also other costs including the costs of sale, support, account management and ongoing research and development, required to address the specific requirements of academies which has created considerably increased numbers of customer relationships than previously existed. This includes marketing the product to individual schools to achieve sales, for example. It said the software functionality specifically developed for academies included changes to the establishment name, Companies House details, management of asset depreciation, VAT accounting and returns, specialist budget forecasting and reporting to Education Funding Agency (EFA),[151] balance sheet processing (in accordance with EFA requirements), budget variation and cash flow forecasting reports, flexible financial years and so on. It said these changes were built into the SIMS product and issued in the next available software update. Capita also indicated new databases may be required to serve academy purposes and it would prepare and build that database.[152] Capita told us the additional costs it faced were recovered from

[150] Capita website, SIMS Advice for Academies (updated December 2012) page 3.
[151] The EFA is a delivery agency of the DfE responsible for providing revenue and capital funding for education for learners between the ages of three and 19, or three and 25 for those with learning difficulties and disabilities, in England. This includes the establishment and funding of academies and free schools.
[152] Capita website, SIMS FMS Academy Financial Service Brochure page 3

academies via the new licence fee paid on conversion to academy status. However, as noted above, these licence fees are not charged where the school previously held a SIMS licence itself.

B116 Schools queried why they were required to pay for a new licence on conversion (and the level of charges made) given that a licence had already been taken out on their behalf as part of the LA procurement exercise, and given that the LA will have recouped that license fee through charges to schools. Schools told us that in practice the SIMS package was not changed or updated when they convert to academies. Therefore they believed the granting of an individual licence to an academy was seen as simply an administrative exercise and any costs were minimal. The LA retains its licence entitlement for its schools to use SIMS, and the LA's annual maintenance charge may be reduced.

B117 The relicensing costs we have seen could account for a significant proportion of the DfE's academy conversion grant of £25,000. Moreover, several schools complained that Capita could insist on an individual licence for each separate academy school within a Multi-Academy Trust, even though the Multi-Academy Trust is the legal entity rather than the schools within it. We were also told that pricing based on bands of pupil numbers could adversely impact smaller schools whose pupil numbers were substantially below the threshold (500 pupils) for the cheapest band.

B118 Schools put it to us that schools converting to academies feel they have no choice but to pay the fee because the schools do not feel they can risk an interruption in service. They perceive significant costs in switching, and may feel that there is insufficient time in the academy conversion process to test the MIS market and seek offers from alternative providers. There was also concern that migrating data could be difficult or time consuming, that this could give rise to additional charges, and that there would be a need to invest in user training with the potential for disruption while this was happening.

B119 Views differ on whether it is appropriate to charge academies a licensing fee for continuing to use a product that was already in use and where a license fee has already been charged. We note that the LA retains its original licence too. We draw no conclusions at this stage as to whether the charges leveled on academies at conversion,

or thereafter, are justified. Also, we have not assessed whether any charges are at appropriate levels (for example whether the charges reflect costs that are incurred). While switching during conversion to academy status may be difficult, we note that some cases this has taken place.

Tendering and use of procurement frameworks

B120 As noted at paragraphs B91 and B92, one of the main concerns raised by suppliers in relation to barriers to entry and exit concerned the frequency with which LAs and schools undertook procurement, the procedures followed and the use of procurement frameworks. In 2010, Becta reported on the legal obligations surrounding the purchase of MIS. It noted that there was a lack of understanding from a LA perspective as to what LAs should be doing with regards to testing the market and expressed concern about the low level of procurement that is conducted by LAs in relation to MIS products and services. We have noted in paragraph B72 that there have been a small number of tenders and this was also mentioned by some suppliers we spoke to. One supplier said there were only two or three tenders in 2013. We note that Becta's 2010 report found that 'the introduction into UK law of the Remedies Directive in December 2009 makes it much easier for suppliers to challenge contract awards and makes the implications of successful challenges more wide ranging'.[153] We were told that some suppliers felt it necessary to take or threaten legal action where suppliers felt procurement was non-compliant.[154]

B121 Tendering activity among LAs is very limited. We asked LAs why there have been so few tenders for MIS. We heard that LAs do not go out to tender for MIS because of the complexity of the EU procurement rules that have to be followed.[155]

B122 The IMLS Framework was designed to make the procurement of MIS easier and tendering by LAs more common. However, use of the IMLS Framework has been low. From the IMLS Framework's start in March 2012 to the end of 2013 less than £1.2 million of business has been

[153] *School management information systems and value for money 2010: a report with recommendations addressing issues relating to legal compliance, cost reductions and bureaucratic burdens*; Becta pg 5
[154] Meetings with a supplier and a LA.
[155] An LA purchasing on behalf of a number of schools is more likely to meet EU Procurement law thresholds than a school that procures its own MIS system. Where the thresholds are met an LA must run an EU procurement law compliant tender process. Under that process the LA is required to separately advertise and tender a contract. This increases the cost and timescale of the procurement process.

transacted under it. There were eight procurements in total; seven by LAs and one by a school.[156]

B123 One LA told us it had not known the IMLS Framework existed until we mentioned it. We were interested to understand why those LAs that were aware of the IMLS Framework had not used it.

B124 We heard that the low use of the IMLS Framework might in part be due to the abolition of Becta. It was put to us by suppliers that the momentum for change had been lost and LAs and schools no longer felt pressure to comply with procurement rules.

B125 Some LAs and suppliers made some allegations to us about supplier behaviour in relation to the use and non-use of the IMLS Framework. For example, we were told:

- In some cases when a LA had actually launched a tender the incumbent supplier approached the LA and attempted to dissuade it from doing so.
- The incumbent supplier might try to persuade the LA to use alternative framework instead of IMLS, for example those where it was the only MIS supplier or those with more favourable terms and conditions for the supplier.
- The incumbent supplier sought to avoid having to participate in tenders run using the IMLS Framework by telling LAs that there were schools within its area that wanted only their MIS product and then either threatening not to bid if the LA uses the IMLS Framework or submitting an excessively expensive bid, (we were told that this could be up to four to five times higher, although we have not received evidence providing verification of this).

B126 In support of the above allegations, we were given specific examples by suppliers of LAs that had begun tender processes through the IMLS Framework but which had allegedly abandoned them for one or more of the above reasons.

[156] Government Procurement Service figures.

B127 On the other hand, one supplier said that the incumbent would drop its price to avoid tenders (see paragraph B91), and one LA felt that the incumbent's pricing via the IMLS Framework, although more expensive, was still intended to be genuinely competitive.

B128 Capita told us that it thought that a number of aspects of the IMLS Framework did not work well. For example it said that the 'basic breakdown of prices' that suppliers were required to submit when bidding for inclusion on the IMLS Framework did not readily support like-for-like comparison of suppliers' pricing, the items included in and excluded from core requirements did not match typical school usage of MIS systems, certain technical features were mandatory but may not be required by schools, and the IMLS approach of categorising pricing by bands of user numbers did not fit with the pupil-based funding approach Capita and other suppliers adopt as a basis for pricing.

B129 Capita said the evaluation scoring model applied to IMLS placed greater emphasis on commercial and licensing issues than software functionality and technical requirements. It said potential users of the IMLS Framework found that it may not guarantee fitness for purpose of the MIS solutions that are provided by the suppliers who have been approved for the framework.

B130 It also noted that users of the IMLS Framework are not permitted to amend the terms and conditions beyond non-material minor changes.

B131 Capita told us that the requirements of the IMLS Framework meant that for the majority of its customers it believed other procurement approaches offered a better value for money alternative. It said that it had expressed these concerns to LAs. But it told us that it had not offered lower prices on condition that a customer did not go out to tender.

B132 Capita said that around 10 per cent of its LA customers have not contracted on Capita's standard terms, but instead have provided their own terms and conditions. It said most of these LAs have used variants of model contracts issued by the Office of Government Commerce (OGC)/Buying Solutions (BS)/Government Procurement Service (GPS)/Crown Commercial Service (CCS).

B133 We asked LAs why, if a LA did not go out to tender, individual schools did not do so instead. Two LAs told us that schools are not interested in switching because the cost of an MIS is around only one per cent of their overall budget, and because they are reluctant to move away from a product they are familiar or happy with. Two suppliers also mentioned this reluctance among schools but did not suggest a reason for it. One supplier had come across a school that thought it was illegal to use any system other than SIMS.

B134 As noted at paragraph B101, two suppliers stated that substantial development updates were hidden under the guise of patches and updates, but these were included within annual maintenance charges. They were concerned that this meant that retendering was not being triggered despite these substantive changes to the products.

B135 Overall, it is clear that LAs and schools are not tendering for MIS as frequently as procurement rules would suggest they should, and may not be compliant with EU procurement law. It is also clear that the IMLS Framework has not achieved its aim, partly due to LAs and schools not using it for various reasons, but also due to the reluctance of some suppliers.

Interoperability and add-ons

B136 An 'add-on' (also referred to as a 'bolt-on') is a piece of software which is designed to work with an MIS to perform a function that is not (or was not originally) part of the core functionality of the MIS in question. This might include functions to allow messaging to parents, collection of payments, managing dinner money and data analysis. For the add-on to function properly it must interoperate with the MIS (such as being able to access and share data with the core MIS).

B137 Add-ons can be developed and sold by a different supplier to that which develops and supplies the MIS. Concerns have previously been expressed about access to the necessary interface information for Capita SIMS, or the terms on which such information is available.

B138 In 2003, following such a complaint to the OFT, Capita signed Voluntary Assurances (VAs) regarding how it would make interface information available to other suppliers. During the course of this study, concern was expressed about the validity of the VAs in future,

particularly for a cloud-based version of SIMS. Capita has said the Voluntary Assurances will continue to apply to future versions of SIMS.

Findings

B139 From the discussions above we find that:

- The supply of MIS is concentrated. In Scotland there is now only one supplier to LAs, SEEMiS. In the rest of the UK, Capita accounts for a very substantial share of supply.
- SEEMiS' and Capita's shares of supply have been fairly stable for many years. Smaller rivals and new entrants have not achieved significant shares of supply.
- There are barriers to switching, whether real or perceived, that mean schools and LAs can be reluctant or find it difficult to switch to alternative providers away from the incumbent.
- Barriers to entry and expansion apply which make it difficult for new entrants to achieve a significant presence.
- There are low levels of LAs tendering for the provision of MIS, and where LAs do tender, they often do not use the ILMS Framework.
- Schools that convert to academies are likely to need to purchase new product licences even if using the same products as before conversion. These charges can be significant.

B140 These findings indicate that competition in the market for schools MIS could work better. Our findings are very reminiscent of Becta's findings in 2005 and again in 2010. Becta proposed various remedial measures to assist purchasers and yet there has been little evidence of change in market outcomes.

B141 Regarding the supply of MIS in England (where both LAs and schools have the potential to switch supplier), in order to provide effective competition in the market purchasers need to seek opportunities to test whether their current suppliers offer value for money:

- LAs need to understand their obligations to market test their MIS procurement at regular intervals or when the specification of the product changes significantly, and LAs should generally to be aware that there may be opportunity to achieve improved value for money. LAs should also use frameworks where appropriate.
- Schools should be made aware of their opportunities to switch to an alternative MIS provider, and also that they are not required to go with the LA's choice of supplier but could run their own procurement if they wish.
- To make this effective, schools and LAs would need to be properly informed about the costs and risks involved. It would be useful for schools and LAs to share experiences of switching to determine whether the perceived risks and costs of switching are realised in practice.

B142 In Scotland, LAs should assure themselves from time to time that their current arrangements deliver appropriate value for money.

Social Housing Software

Introduction

B143 Here we assess competition in social housing software. We cover the following areas:

- overview of the sector
- competitive constraints
- concentration
- entry and expansion
- switching
- buyer power
- conduct

B144 We then draw some overall conclusions on whether competition is working well within the market.

Overview

B145 Social housing software is used by Local Authorities (LAs)[157] to manage their portfolio of properties, associated tenants and leaseholders, waiting lists, allocations of properties, and to carry out their duties in relation to homeless individuals. While the focus of this section is on the supply of social housing software to LAs, the OFT understands that this software is also used by Registered Social Landlords (RSL's) which include Arm's Length Management Organisations[158] and Housing Associations across the UK.

B146 The OFT understands that around 256 of the 380 LAs in England, Wales and Scotland manage their own housing stock and would therefore be potential customers for social housing software. [159] The remaining LAs do not own housing stock, having transferred it to RSLs who would in turn be potential customers for the software. Individual councils in Northern Ireland are not responsible for housing.

B147 In 2012/13, LAs are estimated to have spent £56.5m on social housing software. [160] This includes both new contracts and renewals. The table below shows estimated shares by value of the main software suppliers based on share of expenditure by LAs.

Figure B.5 Estimates of shares by value in social housing software 2012/13

Supplier	LA share of expenditure
Northgate	[40-45%]
Capita	[20-25%]
Civica	[10-15%]
Orchard Information Systems	[10-15%]
Abritas	[0-5%]
Others	[10-15%]

Source: Kable[161]

[157] District councils, borough councils, city councils, unitary authorities, metropolitan boroughs and London boroughs.
[158] Arm's-Length Management Organisations (ALMOs) are not-for-profit companies which manage housing services on behalf of a LA.
[159] Based on data provided by Kable
[160] Kable Competition & Complexity: An overview of the local government applications market May 2013.
[161] 'Competition and complexity', Kable, May 2013.

B148 The three main suppliers of social housing software also supply different software to the public and private sectors. Others, such as Orchard Information Systems and a number of the smaller suppliers, specialise in social housing software.

B149 Social housing software is used by LAs for the management of social housing stock. The software enables users to calculate rent and service charges, generate bills, manage the repairs and maintenance of properties, allocate homes and manage tenant communications. Social housing software is normally supplied in a modular form, with individual modules making up the overall software package. In addition, customers can also purchase 'add-on' modules which are specific to the social housing software application and which offer additional functionality to the overall software package, such as mobile working. Customers can also purchase 'horizontal' modules which are not application-specific but can interact with other software applications used by LAs such as document management software.

B150 Northgate currently offers two products - one acquired as a result of a previous merger[162] and one it developed itself. Its social housing software is generally supplied as a standalone product, although it has told us that it could offer combined housing software solutions with other Northgate solutions if these were required by the client. It also said that it could offer a suite of adaptors and web services to integrate its products to other software not provided by Northgate.

B151 Capita also currently supplies two products - one of which is aimed specifically at LAs and one more geared towards Housing Associations and social landlords. We understand, however, that both of these products perform the same main functions and comprise integrated modules some of which are core while others are optional. Civica offer four products. Various suppliers are in the process of developing Cloud-based applications but these are still at an early stage of development.

B152 As set out in further detail in Chapter 3, there are three primary routes by which planning software suppliers can win business in this

[162] See the OFT's report into the anticipated acquisition by Northgate of Anite, 3 November 2008: www.oft.gov.uk/OFTwork/mergers/Mergers_Cases/2008/Northgate

market. These are via OJEU tenders, direct tenders through UK frameworks, and through new sales to existing customers.

B153 For those customers who go out to tender for a new social housing software contract, the tender will typically cover both the software licence(s) and related services such as implementation and annual maintenance and support services.[163] Customers usually sign a contract for an initial period and at the end of that period can choose either to renew the contract with the current supplier on an annual 'roll-over' basis, or can opt to go out to tender for a new contract.

B154 The OFT was told that changes in demand for social housing software are driven largely by factors such as the introduction of new legislation, technological changes within LAs and the availability of funding for renewing or updating the software. For example one supplier said that there had been a shift from viewing social housing management as being the management of 'properties and tenants' to being more 'customer' orientated. It said that this had driven some changes to the requirements of the software, and a number of recent enhancements to products such as mobile working and computer-based telephony.

Competitive Constraints

In this section we consider the competitive constraints acting on the provision of social housing software; including demand and supply side constraints, primary and secondary markets and competitive constraints arising from outside of the UK and other geographic issues. We have not conducted a market definition assessment or reached any conclusions on this (for further information on the OFT's approach see Chapter 5). However we do assess and come to a view on the likely constraints in social housing software on the basis of the evidence available.

Demand side constraints

B155 Social housing software provides both the functionality and product characteristics which meet the specific needs of housing management.

[163] Implementation services include managing the installation of the software application, including establishing interfaces with the customer's existing software and also includes initial customer training. Once the software has been implemented, customers also typically require maintenance services such as helpdesk support, training, software upgrades or revisions.

Therefore buyers are unlikely to view other software applications as a close substitute.

B156 Social housing software is generally purchased by LAs as a standalone product to address a clear functional need as opposed to part of a suite of other off-the-shelf software products. Most LAs appear to need separate software products for their various different requirements and services. One supplier said that in general its housing products were not bundled with other unrelated products because of the risks of implementing two or more complex software systems simultaneously. It did note, however, that very occasionally a customer may issue a tender for both housing and a finance system.

B157 We therefore consider that demand side constraints on suppliers of social housing software are limited. This is in line with the approach adopted by the Competition Commission in its report on Capita's acquisition of IBS OPENSystem's social housing software business.[164]

Supply side constraints

B158 At present there are three main suppliers and a number of other smaller suppliers who supply software suitable for social housing. There are a wide range of other suppliers which offer different software solutions, some of which provide a fully integrated system solution. If other software suppliers without specific social housing software solutions are easily able to modify their software products in order to supply LAs then they may be able to exert a competitive constraint on the existing suppliers. However it does not appear that different products are easily substitutable from the supply side. Whilst most software providers supply a number of different products, they tend to be stronger in particular areas. In addition we have been told that it would take a significant length of time and involve relatively significant costs for non-social housing software suppliers to develop or adjust their products for use by LAs. One supplier told us that it would take up to four years to develop a new system, although it would be less difficult for suppliers who already offer software which could be reconfigured (as was the case for one ERP supplier who was

[164] Competition Commission in its report on the completed acquisition by Capita Group Plc of IBS OPENSystems plc, June 2009, page 18. This report assessed both revenue and benefits and social housing and found that these two types of applications were not demand-side substitutes as they served different purposes and addressed specific functionality needs for customers. This was supported by the fact that these applications are procured through separate teams within the organisations, often from different suppliers: www.competition-commission.org.uk/our-work/directory-of-all-inquiries/capita-group-plc-ibs-opensystems-plc

now offering social housing software). This indicates that supply side constraints are weak.

B159 This is consistent with the conclusion reached by the Competition Commission in its review of the Capita/IBS OPENSystem acquisition. It found, for example, that because a supplier of a different software application would have to incur non-trivial investment in terms of software development costs, the conditions for supply-side substitution were unlikely to be met.[165]

B160 Although the focus of our study was on the provision of social housing software to LAs, we also considered whether software suppliers to RSLs could act as a constraint on the prices offered to LAs. It would appear that the core functionality of the software is very similar, although some suppliers offer different products to Housing Associations than those offered to LAs. We also note that both operate under the same legislative framework. It therefore seems likely that both groups of buyers (LAs and RSLs) have similar requirements. Many of the same suppliers also provide software to both LAs and RSLs. Therefore it seems likely that there are some supply side constraints from suppliers of social housing software to RSLs to those of LAs.

Primary and Secondary Markets

B161 In addition to the overall core social housing modules (the primary product), many LA customers also purchase related support, maintenance and, upgrade services (which can include helpdesk support, post-implementation training, regular updates and software revisions[166]) and other non-core modules which provide additional functionality (the secondary products). In general, these are only purchased as a result of purchasing the primary product. For example, one of the main suppliers reported that it is the only organisation able to conduct maintenance and support on its software products. Another of the main suppliers said that updates to software to maintain currency with legislative changes and other functional

[165] Competition Commission in its report on the completed acquisition by Capita Group Plc of IBS OPENSystems plc, June 2009, page 18.
[166] The exact range of products and services included as part of the annual- related services purchased by LAs depends on the particular supplier-customer agreement.

updates can only be conducted by itself, but that customers can perform some system maintenance activities.

B162 We therefore consider that once an LA has purchased the core software, it is generally committed to purchasing the supplier's services in the secondary market, particularly in relation to more significant updates. Suppliers told us that this is necessary to ensure the integrity of their products, to maintain the quality of their software releases, to prevent unintended consequences and to ensure customers are well informed about new functionality. Buyers confirmed that typically they pay an annual fee for these services based on a percentage of the annual software licence fee. One of the suppliers also said that where its customers elect to receive a managed service element, the implementation of software updates and new releases is included within the initial overall price.

Geographic issues

B163 We considered the extent to which there were constraints on the suppliers of social housing software from non-UK suppliers. We have not identified any non-UK based suppliers of social housing software active in the UK and none of the LAs indicated that they had purchased social housing software from an overseas supplier. Moreover, the differences between social housing legislation in the UK and other countries suggests that constraints from suppliers outside the UK are likely to be limited, as they would have to make significant changes to their software or develop new software.

B164 Finally, there may be regional differences in housing legislation between England, Wales and Scotland, which suggests there might be different competitive constraints. For example, procurement of housing software is undertaken centrally in Northern Ireland by the NI Housing Executive and the software has been developed to meet its specific requirements. While this might suggest limited demand-side constraints, we do not have sufficient evidence on supply-side constraints to enable us to reach a firm view.

Conclusion on competitive constraints

B165 On the basis of the evidence above there are limited demand and supply side constraints on social housing software suppliers. Social

housing software encompasses core software, non-core modules and related services. It also seems likely that there are some supply side constraints from suppliers of social housing software to RSLs to those of LAs. Geographically there are unlikely to be constraints from non-UK suppliers of software.

Concentration

B166 The supply of social housing software is concentrated, with the main two suppliers accounting for over 60 per cent of the UK share of supply to LAs.

B167 Based on the evidence assessed by us, this appears to be a relatively mature market with comparatively stable market shares over the last five years. Two of the main suppliers told us that their shares had remained fairly consistent over the last five years and there are around the same number of main competitors as there were five years ago. Therefore, opportunities for suppliers to grow business and market share rely on encouraging buyers to switch supplier.

Entry and expansion

B168 We considered the extent of entry and expansion in the market over the last five years and whether there were barriers preventing new suppliers entering or existing suppliers expanding their market shares.

Extent of entry and expansion

B169 As stated above the market for social housing software is relatively mature. There has been little change in market shares and few opportunities for new suppliers to enter the market. Opportunities for innovation in social housing software have been limited given that the main changes to software are generally driven by changes in legislation. This has resulted in little difference between the various software products. There is also a relatively small, stable customer base, making the market less attractive and accessible to new entrants.

B170 A number of LAs noted there has been a reduction in suppliers over the last decade due to mergers and acquisitions. One LA said that the number of suppliers has reduced from five or six to between two and four over the past few years. The most cited acquisition was Northgate's purchase of Anite in 2008, which was cleared by the OFT.[167] Subsequently Northgate announced its intention to withdraw support for the Anite product within two years which encouraged many LAs using that product to retender. The OFT understands that after consultation and pressure from LAs, Northgate agreed to commit to support the Anite product until 2015 at the earliest, but no decision has been made on how long support will continue beyond this date. This may trigger some tender exercises in the run up to 2015 and as a result create some entry opportunities.

B171 The other significant company to have exited the market in the last five years is IBS which was acquired by Capita, and its social housing software product has now been adopted by Capita as its main housing product.[168]

B172 The market appears to have been relatively stable over the past five years with no major new entrants. However, one supplier suggested that the market may be beginning to change with the desire among larger authorities to look for ERP software solutions which also provide social housing software (for further information see Annexe B, on ERP and CRM). It also noted that there are a number of niche companies moving into the market to supply specific, top of the range modules that would typically be part of its software solutions. For example, the OFT was told that one ERP supplier has recently entered the housing software market offering a high end product tied into its ERP capability. One LA also said that there are now more 'hosted' solutions[169] available in the market. One supplier pointed out that some consultancies are looking to develop and move into this sector. It also noted that buyers had a considerably wider choice as there had been a growth in the number of suppliers offering alternative systems, such as software and services that utilise Microsoft Dynamics or SAP frameworks, which could be considered as an alternative to housing

[167] For further information on this merger see the OFT's report into the anticipated acquisition by Northgate of Anite, 3 November 2008 www.oft.gov.uk/OFTwork/mergers/Mergers_Cases/2008/Northgate
[168] For further information on this merger see the CC's report into the completed acquisition of Capita and IBS, June 2009. www.competition-commission.org.uk/our-work/directory-of-all-inquiries/capita-group-plc-ibs-opensystems-plc
[169] Whereby users are able to access software hosted on third party infrastructure.

software. However, it is noted that such developments appear to be largely at the margins of the housing software market as at this stage they may only appeal to larger buyers and these developments are still very much in their infancy.

Barriers to entry and expansion

B173 While the developments described above might suggest that there are some entry opportunities in the market, other evidence indicates that any successful entry would still be difficult and costly to achieve. There are a number of different potential barriers that may prevent suppliers from entering or expanding.

B174 First, we considered the length of time in which a new supplier might be able to enter the market. One supplier said that the process for a new company to enter the market could take approximately four years, unless they were already in an established position and had software that they could reconfigure (as was the case with one ERP supplier), therefore it would be relatively difficult for another supplier to launch a new system. It is not clear whether the length of time to enter is a critical barrier, however it is apparent that entry cannot be achieved quickly.

B175 One supplier said that compared with the private sector, procurement processes are lengthy and bid costs are high. Such procurement costs are not recouped unless the tender is won and so tendering represents a risk to the business and acts as another barrier for new entrants.

B176 The cost of accessing technically skilled and knowledgeable staff in order to develop social housing software was identified as a further potential barrier to entry. For example one supplier said that given the scale and complexity of the systems, the main obstacle to new entry or expansion would be the necessary technological investments and on-going need for research and development. On the other hand, another supplier said that these types of skills and knowledge could be resourced from the market or in collaboration, as one ERP supplier is doing. Therefore, access to staff with the right software development and implementation skills and knowledge of the regulatory and legislative framework that social housing providers operate within, would not represent a significant barrier to introducing a new product to market, although it may provide some constraint.

B177 The need for new entrants to include the cost of training and\or data migration in the bidding price also represents a further barrier to entry. One supplier noted that the incumbent would always have the advantage as staff would already be trained in the use of its product so that the bid price would be lower as it would not need to offer additional training.

B178 Reputation and prior experience of a social housing software supplier can also be an important factor in the customer's selection of supplier. For example, one supplier said that public sector procurement requires a proven track record specifically within the public sector. We also heard from suppliers that most LAs require evidence of a number of 'reference sites' which demonstrate that the supplier has a certain level of experience. In this case it is the behaviour of buyers and the requirements specified in tenders that have the effect of raising barriers to entry and limiting the degree of competition in the provision of social housing software. This is discussed further in Chapter 7.

B179 It may also be difficult for potential new suppliers to differentiate themselves and their product from the existing supplier. We were told that housing systems are all fairly similar and that there is limited scope for innovation as much of the software development is driven by legislative requirements. One of the suppliers also noted that the current suppliers in the market supply good, standard, reasonably-priced products which are generally well-received. This may mean it is difficult for new entrants to enter the market by differentiating their product from the existing suppliers. However, as referred to above, we note that one ERP supplier has recently entered offering a different type of product. The development of Cloud computing, may also create some opportunities in the future for new entrants.

B180 In relation to opportunities for expansion, one supplier noted that the main obstacle was the cost of further technological investments and an on-going requirement for high levels of research and development. A number of suppliers also pointed out that there are a limited number of opportunities to expand. This is because there are a relatively low number of tenders and as a result there is very strong competition on price to win those few customers who have tendered. In paragraph B168 we noted that both of the main suppliers' shares of supply have remained relatively constant. Below, we assess the level of tendering

in housing and conclude that these are fairly low, suggesting that opportunities for expansion are limited.

B181 Evidence on barriers to entry and expansion appears to be mixed. There has not been any significant new entry into the market over the last five years nor significant expansion by any of the existing players, although this may change as technologies develop. Equally there appear to be some barriers for new entrants such as technological expertise, length of time to enter the market, limited opportunities to enter and the level of experience which LAs typically set out in their tender requirements

Switching

Levels of switching and tendering

B182 The OFT received some data from suppliers on the estimated number of tenders over the last five years which we assessed in order to consider the frequency of tendering in social housing software. One supplier said that there have been nine formal tender opportunities over the past five years by LAs. Figures from another supplier showed that they submitted bids for 25 tenders by LAs over the last five years. Approximately 50 per cent of these tenders were for software that had previously been set up in-house by the LAs themselves. Of the tenders which had not previously been supplied in-house only three led to a change in supplier. Almost 50 per cent of the tenders were run using the OJEU process, 20 per cent using a framework and 25 per cent through direct invitation from the procuring organisation. Another of the main suppliers said that the number of tenders they had bid for fluctuated over the past five years but since 2010 it had been consistently fewer than 10 to 15 a year. Using the highest tender figures provided, this indicates that only a maximum of around 10 per cent of LAs who are potential customers for social housing software have tendered over the last five years. This evidence suggests that there are relatively limited opportunities for suppliers to win new business in this market.

B183 One of the main suppliers said that it has been trying to increase its market share but has found the market to be fairly flat in terms of tendering opportunities, although recently opportunities have increased

as some larger LAs are now looking for different wider ERP solutions. Another supplier also noted that historically there had been more tendering opportunities as housing stock transferred from LAs to RSLs and as there had been moves to modernise software, however it said that there had been fewer tendering opportunities in recent years.

B184 Responses from buyers also suggest that LA contracts are renewed fairly infrequently with one LA quoting that their contract had been held for over 15 years and another for over 10 years. One of the main suppliers suggested that in the past LAs tended to switch product every five to 10 years. However, it said that they now prefer to reinvest in existing solutions due to the complexity and cost of switching. Another main supplier said contracts did not tend to be longer than seven years so there were opportunities for switching, but it also noted that there had been a reduced number of tenders coming to market.

B185 Given the evidence above we consider that there are fairly limited opportunities for suppliers to win new business, particularly as LAs frequently roll-over their contracts, and as the evidence below illustrates, there are, or are perceived by buyers to be, a number of costs and risks in switching suppliers.

B186 Evidence from both LAs and suppliers suggests there are relatively low levels of switching. One supplier estimated that over the past five years there had been around six LAs/RSLs which have switched to other companies' products and around two per year switching to its product. Another supplier said that over the past five years 17 customers had switched to its product and five had switched away. Responses from buyers suggest that contracts may last for many years, in some cases over 15 years. A minority of respondents said that they had switched suppliers or were in the process of considering re-tendering.

Barriers to switching

Difficulties and risks in switching

B187 Many of the LAs said that they considered switching to be relatively difficult. However we have limited evidence as to the extent to which these perceived difficulties are borne out in practice.

B188 A number of LAs highlighted the potential risks arising from data migration and the time and disruption that would be required to switch provider, for example in user retraining and back-office integration. However LAs did not provide detailed evidence to support these switching risks. One LA which had recently switched commented that it was quite straightforward and that all data migration work was carried out in-house in collaboration with the new supplier. Suppliers also indicated that there were no obstacles of this kind or such risks in switching and that it was typically the responsibility of the new supplier to migrate systems and data over to the new product. One supplier said that it offered a consultancy service for migrating data or could provide standard scripts to assist the organisation in performing this task.

B189 Overall it is unclear to what extent there are significant difficulties and risks in switching providers. Nonetheless it seems that even if the difficulties of switching are not realised in practice, the perception that exists among a number of LAs that there are difficulties switching may be enough in itself to act as a significant barrier.

Switching costs

B190 A number of LAs said they were not considering switching due to the high cost. One supplier estimated the cost of switching as in the region of £400,000, depending on the size of the organisation. This included the cost of 'implementation consultancy' and potentially some other third party costs. This indicates that switching costs could be very substantial. In general this would appear to be supported by the evidence received from buyers. For example one LA said that if the review of a product indicates that it remains largely fit for purpose, the costs of switching normally dictates the decision to remain with the incumbent. Another LA said that when it reviewed its housing software there were cheaper alternatives but the cost of switching meant that it would take more than nine years before these costs could be recouped and therefore it had stayed with the incumbent supplier. The types of costs cited by LAs included licences, new hardware and software, training, data migration, and the costs of launching a retendering exercise. One supplier said that it provided training and migration at a fixed price, included as part of its tender

bid, so there would be no real additional costs. However this is nevertheless likely to increase the tender prices put forward by new suppliers in comparison with the incumbent supplier, and therefore would still represent a switching cost.

B191 Social housing software licences can be sold on a perpetual usage basis. If LAs purchase a perpetual licence this may act as a significant disincentive for buyers to switch suppliers as they would have already paid an upfront higher cost for a perpetual licence. This will create an additional cost in purchasing a new licence for different software if they were to switch suppliers.

B192 The overall evidence indicates that the costs of switching can be fairly substantial and this is likely to act as a significant barrier.

Timescales involved in switching

B193 The time taken for customers to switch suppliers might also act as a further barrier to switching. One supplier told us that customers could switch within three - four months although it could take much longer (several years) if customers retained some of the existing modules from their previous supplier. Another supplier said that switching timescales vary greatly depending on whether there is a phased delivery (up to two years to fully implement, with some elements live within four-six months), or alternatively if delivered at one time this could be achieved within a 12-18 month period. It is clear from this that the time taken to switch could be substantial and would represent a barrier to switching.

Conclusions on barriers to switching

B194 On the balance of the evidence provided, we find that there are a number of barriers to switching. Many LAs have the perception that there are significant difficulties and risks in switching, even if these may not be borne out in practice. There are also likely to be relatively substantial costs involved in switching, particularly where buyers have purchased perpetual licences, and it can be a lengthy process. This leads to reluctance on the part of LAs' to switch, resulting in relatively few tender opportunities and low levels of switching overall. Many buyers will prefer to simply roll-over contracts with an incumbent supplier.

Buyer power

B195 The OFT considered whether social housing software customers have any countervailing buyer power, in order to prevent the exercise of potential market power by the existing suppliers.

B196 Benchmarking of prices or other factors by LAs is not common place. We were told that one of the main reasons for the lack of benchmarking is that there are confidentiality clauses which prevent LAs from comparing prices. This is discussed further in Chapter 8. Furthermore, products are often customised to suit LAs individual needs which means that products, services and prices are individually negotiated and this makes it more difficult to compare prices. Some LAs were not in favour of benchmarking as it would highlight LAs who were paying more than others. This in turn could make it difficult for the LAs in question. However, we are aware of one example of benchmarking occurring which resulted in costs being significantly reduced. One LA explained that through discussion with other London Authorities and benchmarking, they had managed to negotiate a reduction in the price of their software by 40-45 per cent. It had also used its knowledge of private sector software pricing to further demonstrate that prices were excessive in comparison to those typically offered to the private sector.

B197 One supplier noted that procurements are often run by independent consultants that have a good knowledge of the market. Such services might increase the ability of LAs to exert some buyer power, particularly smaller LAs, who may have less overall experience and knowledge of the market.

B198 One of the main suppliers considered that buyers had a wide choice of suppliers and were aware of the alternative suppliers. We agree that there is some evidence that buyers consider that they have a reasonable choice of alternative suppliers. A number of LAs noted that they were aware of alternative suppliers which might meet their needs. However, a number of them also indicated that the choice of alternative suppliers had decreased as a result of merger activity (as explained in paragraphB171) and some respondents also displayed relatively little knowledge of alternative suppliers. One LA noted that

there were only a small number of suppliers which were large enough to manage its account.

B199 Overall we do not find any strong evidence indicating that most customers exercise significant levels of buyer power. They are not routinely benchmarking pricing, nor do they often purchase social housing services together as part of a wider group. In addition, customisation of software is likely to create difficulties for customers in comparing prices and some LAs have limited knowledge of alternative suppliers in the market.

Conduct

B200 The conduct of suppliers or buyers could also impact adversely on competition in the market. For example we considered whether suppliers may have greater information than the LAs about the technical obstacles to switching providers and may exaggerate those costs to discourage switching. Suppliers may also be making their pricing complex and difficult to understand, resulting in buyers making sub-optimal decisions. We also considered whether suppliers were making switching more expensive and complicated than necessary, or limiting the interoperability of their systems with others. On the other hand, the behaviour and practices of buyers also has an effect on competition in the market, for example buyers seeking greater product customisation than necessary which increases prices and limits comparability, or unnecessarily restricting the pool of potential bidders by requiring a higher level of experience and expertise than is necessary.

B201 Suppliers typically charge a licence fee and an annual charge for related services (which is a percentage of the licence fee). Licences can either be for a fixed term or on a perpetual basis. Suppliers can also provide integration or interfacing to other software solutions, for example financial management or revenues and benefits. In addition, buyers can purchase add-on modules or request certain specific upgrades during the period of a contract, in addition to those included in the price of the contract.

B202 Suppliers told us that the price of a contract is determined by a number of factors which include:

- The market price for the software application.
- The client's specific specification, based on the requirement for different modules - and whether any customisation is necessary.
- The procurement process.
- The value of the contract to the supplier at that time.
- Competitors' pricing approach.
- Other factors such as the extent of historical data to be migrated conversion processes.

B203 One supplier said that the two key areas of potential cost difference when changing suppliers are; the licence (whether it is fixed term or perpetual), and the services element (for example the development of interfaces to any other of the customer's software, training and business consultancy to ensure appropriate configuration). It stated that no two bids are the same as the amount of services purchased is driven by the client requirements. Another supplier said that typically all LAs have their software customised to some extent.

B204 We understand that social housing software products and services are often customised to the requirements of LAs. Such customisation deters or prevents LAs from comparing prices between themselves, and could be exploited by suppliers. Moreover, the greater the degree of customisation the more time consuming and costly switching becomes.

B205 In many cases LAs are actively seeking to ensure software meets their specific requirements which results in this customisation and therefore the ability of a supplier to customise its product is welcomed by LAs. Despite the fact that all the main housing software products are essentially providing similar functionality, driven by legislation, it appears that LAs business processes have evolved differently resulting in the perceived or required need for different software requirements. Therefore LAs consider that a standard product would not necessarily work or be sufficient.

B206 One supplier said that it did not promote significant customisation to its products, although it would offer this if it was required and provide

a fixed price estimate to undertake this customisation. The other main supplier also confirmed it charged a fixed cost to cover any necessary customisation. One supplier also noted that when a LA asked for such customisation, it would seek to incorporate this into its next update for all LAs. We have not found evidence to suggest that suppliers are actively promoting customisation of their products.

B207 Some aspects of the pricing of social housing software are relatively complex and it may therefore be difficult for LAs to understand pricing fully and compare bids with others. However, in many cases this complexity arises as a result of customisation and the requirements set out by the buyers in their tenders. There is no evidence to suggest that suppliers are actively complicating pricing, indeed much of the way in which products are priced results from the requirements and behaviour of buyers, although we note that suppliers have little incentive to discourage this.

B208 Some LAs were concerned that suppliers' prices are based on whatever they believe customers can afford. As noted above, one LA who questioned the price quoted and benchmarked against other neighbouring Authorities subsequently received a significant reduction in price which in part was as a result of the benchmarking (see paragraph 2.124). We also heard concerns from some LAs that interfaces with other systems can be prohibitively expensive.

B209 Both of the main suppliers told us that the fee charged for related support and maintenance services is reduced if customers commit to a multi-year contract which most therefore do. This might lead to customers opting for longer contracts than might otherwise be the case and therefore constraining the buyers' opportunity to consider switching.

B210 Overall this evidence suggests that there are some aspects of the way suppliers and buyers behave which have a negative impact on competition, in particular the ease of switching and price comparability. For example buyers are seeking to customise products which restricts the ease in which price comparisons can be made and locks-in buyers. Suppliers offering price inducements for longer term contracts can also act to restrict switching.

Findings

B211 We find that both the demand and supply side constraints on suppliers of social housing software are likely to be limited. The market is concentrated, with the main two suppliers accounting for over 60 per cent of the market. This is also a relatively mature market with market shares remaining relatively stable over the last five years.

B212 In relation to switching, there are limited opportunities for rivals to win new business as there have been relatively low levels of tendering by LAs and contracts are often rolled over. In addition, LAs do not frequently switch suppliers, even where they have tendered. We found that there are a number of barriers to switching, such as LAs' perception of the disruption and risks, the time required to switch and the costs involved. Many LAs consider switching to be difficult, costly and unnecessary if the product remains fit for purpose. They also cited procurement costs and disruption as a disincentive to switch. However some LAs have switched and one said it was relatively easily.

B213 There is mixed evidence on barriers to entry and expansion. There have been no new major entrants and there has not been any significant expansion by any of the existing players, although this may change as technologies develop. There are some barriers which make it more difficult for new suppliers to enter this market, for example the length of time to enter, difficulties in launching a new system, technological expertise, high bidding costs and the experience required by LAs. We also found that there are difficulties in existing suppliers expanding their market share, due to limited tendering opportunities and LA requirements for a wide breadth of experience.

B214 There is no strong evidence that customers are exercising any significant buyer power, but when they are able to benchmark or negotiate to put pressure on pricing it can have a significant impact. There is evidence that the conduct of both buyers and suppliers is in some ways impacting adversely on competition; particularly as many products are customised, which is being driven by buyers themselves, creating difficulties in benchmarking, switching and complicating pricing.

Planning Software

Introduction

B215 Here we assess competition in planning software. We cover the following areas:

- overview
- competitive constraints
- concentration
- entry and expansion
- switching
- conduct

B216 We then draw some general conclusions on whether competition is working well within the market.

Overview

B217 Planning software is used by Local Authorities (LAs) to process planning applications and appeals. In particular to help to verify planning applications and initiate the consultation process with neighbours and other statutory bodies. It comprises various different modules relating to different aspects such as appeals, enforcement, public access and development. Planning software is typically integrated into a LA's other existing systems as required.

B218 There are 380[170] LAs in GB who currently have responsibility for planning and who might purchase planning software.[171] LAs are estimated to have spent £13.2m on planning software in 2012/13.[172] This includes both new contracts and renewals. The table below shows estimated shares by value of the main software suppliers based on share of expenditure by LAs.

[170] We have excluded County Councils in England and LAs in Northern Ireland as they do not have responsibility for planning.
[171] Data provided by Kable. This number may decline slightly over the next few years as a result of the planned reforms to LAs in Wales which would reduce the number from 22 to approximately 11 LAs.
[172] Kable, Competition & Complexity: An overview of the local government applications market May 2013.

Table B.6 Estimated shares by value, 2012/13

Supplier	LA share of expenditure
Idox	[60-65%]
Northgate	[15-20%]
Civica	[5-10%]
Other	[15-20%]

Source: Kable[173]

B219 Idox is the main supplier accounting for an estimated [60-65] per cent. This is followed by Northgate with [15-20] per cent and Civica with [five-10] per cent. In addition, there are seven other smaller suppliers who together account for [15-20] per cent of the market. We estimate that none of these smaller suppliers supply more than three per cent of the market.[174]

B220 Idox provides a number of modules relating to all aspects of the planning process (for example appeals, enforcements, development planning). These modules form part of its two land and property software products. Each product and the individual modules within it can be implemented independently or as part of a wider suite of business functions offered by Idox. Northgate supplies one planning product which is generally offered as a standalone application.

B221 Suppliers can win business through a number of routes, including direct tenders by LAs, tenders through frameworks or direct procurement (for further information see section on procurement processes in Chapter 3). When tendering, LAs issue a specification which sets out the software and services they require. A contract typically covers both the licence terms and the support and maintenance terms (including for example, product releases/upgrades). Licences can be sold in different ways; either on a perpetual basis which is paid for upfront amount, as a capital purchase whereby the licence is for a number of years that typically covers the life of the product, or as an annual rental which the buyer can cancel at short notice. Standard support and maintenance is provided as an annual cost at a percentage of the licence fee. There are typically no separate upgrade fees, unless the LA wishes the supplier to undertake the upgrade. Planning software can be customised according to the LA's requirements, which typically incurs an additional fee. Support

[173] 'Competition and complexity', Kable, 2013.
[174] Kable data

services can also be extended and customised and one supplier said that this is priced on a case-by-case basis. Software customisation is considered further in paragraphs B257.

Competitive constraints

B222 In this section we consider the competitive constraints on the provision of planning software; including demand and supply side constraints, primary and secondary markets and constraints arising from outside the UK and other geographic issues. We have not conducted a market definition assessment or reached any conclusions on this (for further information on the OFT's approach see Chapter 5). However on the basis of the evidence available, we do assess and come to a view on the likely competitive constraints.

Demand side constraints

B223 We considered the different demand side constraints on the suppliers of planning software. Planning software is only used by LAs and it provides the specific functionality designed to meet the needs of LAs in fulfilling their roles and responsibilities in planning. Therefore LAs are unlikely to view other software applications as a close substitute. The information generally provided by the LAs and suppliers supports this. Suppliers told us that while planning software can be purchased both as a standalone product or as part of a larger package of business functions, there are no requirements for it to be linked to any other products provided.[175] We understand that planning software modules can be, and frequently are, purchased separately from other types of software. Therefore overall we consider that there are likely to be limited demand side constraints on suppliers of planning software.

Supply side constraints

B224 The evidence indicates that supply side constraints on planning software suppliers are also fairly weak. There is currently one large supplier of planning software. There are a number of much smaller suppliers and some small-scale new entry but none of these suppliers has been able to significantly expand, suggesting that supply side

[175] Although one LA said that it had been informed by its supplier that to enable full functionality of the software it was also necessary to purchase another unrelated product from that supplier.

constraints are limited. We also considered if other software suppliers could easily modify their software products to supply LAs with planning software and therefore act as a competitive constraint on existing planning software suppliers. Considerable investment in software development costs is likely to be required for a supplier without a planning software application to develop such an offer and changes are unlikely to be achieved quickly. Moreover, to date there has been no evidence of firms in adjoining software markets adapting their software to enable them to provide planning functionality over the last number of years.

Primary and Secondary Markets

B225 In addition to the core planning modules (the primary product), many LAs also purchase related support and upgrade services and other additional 'non-core' modules which provide extra functionality (the secondary products). In general, these are only purchased as a result of purchasing the primary product. For example, one of the main suppliers reported that it was the only organisation able to conduct the full scope of maintenance and support on its software products. Another supplier said that it could only provide the necessary maintenance on its software products. Therefore once a LA has purchased those suppliers' core planning software, they are on the whole committed to purchasing those suppliers' services in the secondary market. LAs typically pay an upfront annual fee for these services, which can range from 20 to 25 per cent of the annual licence fee. One supplier said that it was important for the firm providing support to its products to have knowledge of its configuration. In addition it said that its clients wanted well informed support and training about new functionality, which few, if any, other organisations are in a position to offer. However, one supplier said that although it currently provided support to its products on an exclusive basis, it would be willing to work with other organisations if they wished to provide a support service but that none so far had done so. One supplier also said that most LAs are more likely to buy a whole planning system from a single supplier because it is cheaper to do so.

Geographic issues

B226 We considered whether there were competitive constraints from outside of the UK on planning software suppliers. During the course of

discussions with suppliers and LAs, none identified any non-UK based suppliers of planning software which are significantly active in the UK and none of the LAs indicated that they had purchased software from an overseas supplier. The differences between planning legislation in the UK and other countries suggests that constraints from suppliers outside of the UK are likely to be limited as they would have to significantly adjust their product in order to supply UK buyers. LAs also give some weight to the reputation and previous experience of planning software suppliers, which would also militate against suppliers from outside the UK. The potential for supply side constraints from outside the UK is therefore likely to be limited.

B227 Finally, regional differences in planning legislation might also generate differences in the competitive constraints acting on suppliers of planning software. For example in Scotland, although each LA procures its own planning software, all planning applications are handled by a single online portal, which Idox is currently contracted to supply. This may limit the potential for other suppliers of planning software to offer products to Scottish LAs if they need to adapt significantly their applications to ensure compatibility with this online portal.[176] In Northern Ireland a single planning portal is also used. The contract for this was also won by Idox. Procurement in Northern Ireland is undertaken centrally by the Department of Environment on behalf of all LAs. There may therefore be some differences in the competitive constraints between England, Scotland and Northern Ireland, although we do not have sufficient evidence to reach a view on the extent of such differences.

Concentration

B228 The supply of planning software is highly concentrated with the largest suppliers holding over 60 per cent of supply. The extent of concentration within the market has changed little over more recent years and it may have become even more concentrated. A number of LAs and one supplier told us that the number of potential competitors has diminished over the last five years due to mergers within the sector. One LA said that the market was not as competitive as it would like. One of the main suppliers noted that although there had been significant changes in the supplier market, there were broadly the

[176] Thirty out of 32 Scottish LAs use the same supplier.

same number of suppliers and products as there were five years ago and that most consolidation had been prior to 2010.

B229 Three companies have exited the market in the last five years and approximately seven companies have entered the market. Civica widened its share in planning software when it acquired Innogistic in October 2011. Idox also purchased Plantech in 2009 and Uniform in 2007. Neither of these acquisitions reached the required thresholds to be considered by the OFT. One supplier said that there had been several new entrants into the market in the last few years, although we note that most of these are currently supplying only a very small number of customers. A number of LAs stated there has been a reduction in suppliers over the last decade due to mergers and acquisitions, although a small number also thought that the number of competitors had been relatively static. One LA said that competition had dramatically decreased as one particular supplier had bought up a number of smaller software suppliers. Another LA said that there were now a number of different suppliers which were using Cloud technology and systems like SharePoint[177] to offer newer products. However it is noted that such systems are only used at the margins of the market at the moment and that a very small amount of business is currently transacted via G-Cloud.

B230 One Scottish LA noted that there were few alternative suppliers available unless the application could be split up into individual modules. It said this was unlikely to be desirable, however, as the focus was on consolidating purchasing in order to achieve cost savings.

B231 Relatively limited evidence was obtained on the number of suppliers bidding for tenders. One LA which had gone out to tender in the last year, had received five bids of which it said four were credible. However, another LA which was currently in the process of switching, stated it had only received two valid bids for its tender.

B232 There are 11 suppliers on the Crown Commercial Service Local Government Software Application Solutions Framework (LGSAS) including the main suppliers and smaller companies. We were told that

[177] Sharepoint is a web application platform developed by Microsoft associated with intranet, content management and document management.

there are approximately two to three tenders a year using this framework.

Entry and expansion

B233 As noted in paragraph B230, a number of firms have entered the market over the last five years, although most of these are currently supplying only a very small number of LAs. We considered whether there are any barriers to entry or expansion.

B234 Suppliers told us that LAs are risk averse and more likely to choose an established player. One supplier also said that new entrants need both the resources and the experience to ensure their software is compatible with legislation. Relevant experience is also a key part of the buyer's requirements in tenders. Furthermore, we were told that the highly legislation-driven nature of the software does not lend itself to innovative solutions and this could also deter new entrants seeking a way to differentiate themselves from other suppliers in the market. Although there may be some potential barriers to entry, entry has occurred therefore it is feasible that barriers such as these can be overcome and may not be significant.

B235 We considered whether there are additional barriers for suppliers wishing to enter or expand into Scotland. One supplier said that it had found it difficult to enter Scotland because Idox ran the central planning portal. Only one supplier has adjusted its software to be compatible with this portal and that other suppliers would need to make some adjustments to their planning software in order to be considered as potential suppliers by Scottish LAs. There is limited evidence on the extent to which this is a significant cost. However it is possible that there may be a further barrier to entry in supplying planning software in Scotland.

B236 We found that there were barriers to expansion in the planning software market. One supplier said that although new companies can easily enter the marketplace, the main challenge is to establish a significant market share. This is primarily because current procurement approaches used by LAs often require businesses to have a significant and established customer base. Suppliers also said that price was an important factor for customers when considering different suppliers,

rather than product innovation or functionality, for example. One smaller supplier said that as a result it could be difficult for smaller existing players to expand their share. Another supplier noted that individual customer preferences for particular software were likely to be outweighed by the need to reduce costs. This limits the scope for existing suppliers to innovate and differentiate their products, which might also prevent smaller suppliers from significant market expansion.

B237 We considered whether any other barriers might exist for entrants or existing suppliers gaining access to the procurement opportunities offered through frameworks. The OFT understands that in order for a supplier to be accepted onto a framework it needs to have a number of references (that is, experience) and this often excludes a number of suppliers. In support of this, one supplier said that the criteria for inclusion onto frameworks are geared more towards large providers and SMEs would struggle to fulfill this. More detail on framework agreements is set out in Chapter 4.

B238 Overall, given the evidence of some new entry and changes in the suppliers competing in the market, there are likely to be relatively limited barriers for new suppliers to enter the market on a small scale. However there are barriers to expansion which mean it is difficult for suppliers to expand their market share significantly.

Switching

B239 Customer switching between planning software suppliers can be a good indicator of whether a market is competitive both in relation to the levels of tendering, and hence the opportunities for switching, and barriers to switching.

Levels of switching and tendering

B240 Most planning software is purchased through a tender. Responses from LAs demonstrate that contracts can last a relatively long time and may rarely come up for retender. For example one LA quoted their contract as having been in place since 1998, and another for more than 10 years. One supplier said that some LAs review the market every five years and others do not change for 15 to 20 years, depending on the contract with the supplier. It also said that its

contracts typically lasted either three or five years. Another major supplier said that there have been only two formally advertised tenders over the last five years, which suggests that levels of tendering may be very low.[178]

B241 On balance opportunities for switching are fairly limited as there has not been evidence of sufficient tender activity at a level where a new entrant could quickly enter and build market share.

B242 Evidence from both LAs and suppliers suggests there have been low levels of switching, although this evidence was limited. A number of LA respondents were unaware of the main competitors for the supply of planning software. According to one supplier, over the last five years three clients have switched to its product and 10 have switched away to a competitor. Another supplier said that it had made seven bids via the LGSAS framework over the last five years, of which it won five and lost two.

B243 A small number of LAs said they had switched or were in the process of considering switching suppliers. However the majority who responded had no experience of switching which suggests that the appetite amongst LAs to switch suppliers is relatively low.

Barriers to switching

B244 The majority of LAs considered that there are difficulties and costs in switching suppliers. This may be driven by a perception amongst LAs that switching is difficult, as opposed to their actual experience of switching. One LA said that it was in the process of switching suppliers and that from its experience it was relatively easy. Nonetheless the general perception amongst LAs is that switching is difficult and costly; this is likely to create a barrier to switching.

B245 The cost of migrating data and training staff was identified as a significant barrier to switching. One supplier stated that switching costs are high due to the extent of historic data that needs to be transferred. It estimated that the cost to switch would be

[178] One major supplier said that it typically responds to up to 200 tenders a year and as an example it provided tendering figures for 2012 in which it said it had tendered for more than 130. However as these do not all relate to planning products this evidence was of limited use in assessing the levels of tendering specifically related to planning.

approximately £20,000 for the licence fee, £50,000 for services and training and £15,000 for support and maintenance. It also noted that the number of professional service days required to assist with a change of supplier was significant, with each client requiring between 80-100 days of services. However, according to another supplier it normally more than covered the cost of switching to its product by guaranteeing savings over an agreed period of time.

B246 The time involved in migrating to a new system was also identified as a barrier to switching. One supplier told the OFT that the time taken to migrate systems varies significantly, from three to 24 months depending on the customer and efficiency of the supplier. However it said that the timescales for implementation of a new supplier and staff training could be mitigated by the provision of a managed and hosted solution. This supplier also noted that for its product, customers could access and migrate the data themselves should they or another third party wish to do so.

B247 LAs also highlighted the risks relating to integration between their various other systems when switching to an alternative provider. One LA said that this would create particularl difficulties given the number of interfaces and integration to other systems it had, for example as the planning software was embedded into its website and in its mobile working arrangements.

B248 Overall there are some barriers to switching given that the time and costs involved are substantial and the widely held perception among LAs that there switching is difficult.

Conduct

B249 Some aspects of the way in which suppliers or buyers in the market behave can also have the effect of restricting competition.

B250 The OFT considered whether supplier or buyer conduct had contributed towards complex or less transparent pricing or whether suppliers were price discriminating. As explained in paragraph B222, suppliers typically charge a licence fee and standard support and maintenance is a percentage of this licence fee. In general there are no separate upgrade fees, unless the LA wishes the supplier to carry out

the upgrade on their behalf. Software can be customised according to the LA's requirements, and this is typically charged at an additional fee.

B251 Suppliers said that pricing is determined by a number of different factors:

- Competition and competitors' approach to pricing - in more recent tenders a significant weight of the total score (up to 80 per cent) has been on price, whereas prior to that quality and functionality were more important.
- The type of licensing model offered - one supplier told us that it had two licensing models, a capital purchase for an agreed number of years as a one-off cost, and an annual rental.
- The client's specification.
- The market price for the software.
- The value of the contract to the company at a specified time.
- The existence of a framework - separate pricing is used for frameworks (a requirement of the tender process) with an agreed discount model and prices fixed for the duration of the framework.

B252 One LA had undertaken a county wide review and found variations in price, particularly in relation to maintenance and support services. By identifying these discrepancies it had achieved cost savings for LAs across the county. A small number of LAs expressed concern that due to the limited number of customers requiring planning software, suppliers were able to charge what they believed customers would pay. Another LA said that it was not happy with the current cost and performance of its supplier and therefore was considering switching.

B253 On the other hand, many LAs expressed satisfaction with the products and the services provided by suppliers.

B254 We have limited evidence on the extent to which the conduct of suppliers or buyers creates more complex or less transparent pricing, or if suppliers are price discriminating. Although some concerns had been raised, on balance these were relatively limited and therefore we

do not consider that this is likely to be a significant problem.

B255 One LA also raised concerns that one of the suppliers is in effect forcing its clients to continually upgrade its software, as otherwise that supplier would not continue to offer support for its product, and that these upgrades might sometimes require paid consultancy effort. This supplier had informed us that most of its upgrades can be installed by customers directly if they so wished. However, there were two exceptions to this - when there are major upgrades that are complicated and a restriction by one third party technology which mandates that the supplier installs and configures the products itself. We note the concerns raised here but it has not been possible to verify whether these are valid.

B256 Customisation of products may create some difficulties for purchasers in benchmarking costs and increase switching costs. One supplier said that it does not tend to customise its planning software as it was already flexible. Another supplier, however, said that although all of its products were 'Off-the-Shelf', there was no standard system. This is because all installations are customised to reflect the individual council's requirements and that this may create difficulties in benchmarking prices and switching. No evidence has been received to suggest that suppliers are promoting such customisation, rather that this is more often than not driven by the different requirements and businesses processes of the LAs. Nevertheless, it would appear that one consequence of such customisation is to create some difficulties for LAs in benchmarking the products, services and costs between the various suppliers.

Findings

B257 We found that there are high levels of concentration, with the largest two suppliers accounting for between 75 and 80 per cent and a single supplier accounting for between 60 and 65 per cent share of LA spend. This has changed little over recent years and there is some evidence that the market may even have become more concentrated.

B258 Although there have been a number of new entrants into the market over the last few years, most of these are currently supplying only a small number of LAs and have not expanded their share. There are

some potential barriers to entry relating to the knowledge and application of the legislative requirements and limited options to offer differentiated products, although given that there has been small-scale entry these do not appear to be insurmountable. There are however more substantial barriers to expansion such as the procurement requirements of LAs which call for a significant and established customer base. This prevents smaller players in the market from winning more market share.

B259 We found that levels of tendering are low and infrequent, therefore opportunities for switching are fairly limited. There is evidence that some contracts may last for many years. There also appear to be low levels of switching. The majority of LAs perceive that switching is difficult and costly. Time taken to switch and the costs involved are also significant and create barriers to switching; it can take from three to 24 months to switch.

B260 There was no clear evidence that supplier conduct was restricting competition in the market; although there were some limited concerns in relation to pricing and upgrades. However there were concerns that LAs themselves may be limiting the opportunities and ease with which products and pricing can be benchmarked by seeking to have the products and services provided by suppliers customised.

Pensions administration software

Introduction

B261 Here we assess the level of competition in the supply of pensions administration (PA) software to UK local government. We cover the following areas:

- an overview of the market
- product characteristics
- competitive constraints
- concentration
- conditions of entry and expansion

- conditions of switching
- conduct

B262 On consideration of these areas, we seek to assess whether competition for the supply of this software is working well.

Overview

B263 There are 5.4 million retired or current local government employees in the UK enrolled on the Local Government Pensions Scheme (LGPS).[179] The scheme is split into 99 local funds,[180] the majority of which are administered by local authorities (LAs).[181] Some LAs are also responsible for the administration of their local police and fire service pension schemes of which there are 53 and 58 respectively.

B264 PA software is used by administering authorities for a variety of functions including benefit calculations, data management, electronic document management and pensioner payroll.[182] The same software will be used to administer the LGPS, police and fire service pension schemes. PA software is an essential product for in-house PA although a small number of LAs do not purchase PA software but outsource their PA to a third party.

B265 The OFT estimates that in 2012/13 the value of the market was approximately £12m.

Key suppliers

B266 The first IT solution for the administration and calculation of LGPS benefits was created in 1975 by a group of 11 LAs who formed the Consortium of Local Authority Superannuation Schemes (CLASS) Group.[183] The developed system then known as CLASS was owned and controlled by the CLASS Group but then transferred into the

[179] The Local Government Pension Scheme: Opportunity Knocks, Centre for Policy Studies, November 2013.
[180] 89 in England and Wales, 11 in Scotland and one in Northern Ireland.
[181] While there are far more than 99 LAs in the UK, there are 99 LGPS funds each of which is administered by a LA.
[182] Most PA software is modular so some functions like payroll may not be included in the core PA package.
[183] Nottinghamshire County Council Report to Pensions Committee 17/12/13

private ownership of Heywood Limited in the 1980s.[184] Heywood Limited has since become Aquilaheywood Limited (Aquilaheywood) and currently supplies 87 of the 99 LGPS administering authorities.[185] The CLASS Group is now made up of all Aquilaheywood's local government customers, and functions as an advisory body to Aquilaheywood.[186] Aquilaheywood also supplies software to the private sector.

B267 Civica Group Limited (Civica) and Equiniti Group Limited (Equiniti) are smaller players in the market, supplying four and one LAs respectively. A further seven LAs outsource their pensions administration to Capita plc (Capita). Civica, Capita and Equiniti all have a much larger presence in the private sector than Aquilaheywood. The structure of the supply of PA software to the private sector is therefore quite different from that of the supply to local government.

Product characteristics

B268 PA software is used in the public and private sectors to administer occupational pension schemes. A typical PA software package may be modular, with a basic administration system and several additional modules that can be purchased separately, for instance document imaging, workflow or payroll.[187] Some PA software comes with all of these features in built[188]. Each LA will decide separately whether to tender for these functionalities together or separately.[189]

B269 Suppliers of PA software will have to develop specific solutions to administer LGPS funds. Similarly, some LAs also administer police and fire service pension schemes and so will need administration solutions for these schemes included in their software. The specificity of PA software supplied to LAs and the barriers to developing local government solutions are considered further in the 'competitive constraints' section below.

[184] The CLASS system is no longer produced and Aquilaheywood now has two LA pieces of software used by LAs: AXISe and altair.
[185] 'A touch of class - Guide to public sector pensions 2013' supplement in Pensions Age magazine
[186] Note that the CLASS Group consists of and is run solely by LAs. Aquilaheywood are not involved in the management or running of the Group.
[187] For example Aquilaheywood's AXISe and altair software and Capita's PS Pensions software
[188] For example Capita's Pensions Office software
[189] For instance Greenwich LBC tendered separately for its PA system and its pensioner payroll system, while Edinburgh City Council tendered for a 'pension payroll system fully integrated with the pension administration system.'

Competitive constraints

B270 In this section we consider the competitive constraints acting on PA software supplied to LAs; including demand and supply side constraints, and competitive constraints arising from outside of the UK and other geographic issues. We have not conducted a market definition assessment or reached any conclusions on this. However we do assess and come to a view on the likely constraints on LA pensions administration software on the basis of the evidence available.

Supply side

B271 At present there are three firms supplying software capable of LGPS administration. Capita have also developed capable software although they only use this software as part of an outsourced PA solution. If suppliers without LGPS solutions are easily able to modify their current PA software and supply LAs then they may be able to exert a competitive constraint on the existing suppliers.

B272 We did not receive any evidence to suggest that suppliers of PA software to the private sector are currently looking to enter the market for LGPS software. One reason for this might be limited entry opportunities, although the evidence for this is conflicting. One supplier estimated that up to 20 LAs might tender for PA software in a year, based on a typical contract duration of three to five years. However, we have also been told that historically, the majority of LAs have bought directly from their supplier, without going out to tender, suggesting that the true number of tenders in any year is likely to be less than 20.

B273 Even if there are frequent entry opportunities, the OFT observes that some LA tenders in the last three years have received only a small number of bids and on some occasions bids only from Aquilaheywood.[190] This suggests that there are other supply side barriers preventing or discouraging PA software providers without a current LGPS solution from entering the market.

[190] In the last three years, PA system tenders from Aberdeen City Council, Buckinghamshire County Council, Scottish Borders Council, Dumfries and Galloway received bids only from Aquilaheywood.

B274 One such barrier to entering the market is the initial cost of developing a LA solution. One supplier told the OFT that their PA software required considerable modification and cost to administer pensions for LAs. This modification becomes increasingly costly if the software is supplied to a LA which administers both LGPS pensions and police and fire service pension schemes. This would suggest that there may be technical barriers preventing suppliers of private sector PA software from easily supplying LAs.

B275 There are also additional costs of maintaining a LGPS administration system once developed, mainly associated with regulatory and scheme changes such as those being implemented in 2014.[191] We have been told that the 2014 changes to the LGPS are unprecedented and are likely to result in significant costs to update the software. Suppliers have spent significant resources to update their software to be fully compatible with the 2014 changes to the LGPS. Aquilaheywood is currently able to spread its cost over a large customer base, an advantage that other suppliers and potential entrants would not enjoy. The costs to update functionality of PA software that has never been used to administer LGPS pensions would be considerably higher and may therefore represent a significant barrier to entry.

B276 We note, however, that Aquilaheywood, Civica and Equiniti sell the same software for use in the private sector as well as the public sector. One supplier told us that although their software has the same 'core engine', they essentially supply a different version of the product to their LGPS customers.

B277 Overall, firms currently active in the market have been able to modify their previous PA solutions to administer LGPS, police and fire service pensions. However the costs of developing these solutions and the continued costs of operating in the market will at least limit the extent to which non-LA specific PA software suppliers exert a competitive constraint on those already supplying LAs.

[191] The 2014 changes to the LGPS are wide ranging with the main change consisting of moving from a final salary scheme to a career average revalued earnings (CARE) scheme. Changes also include (but are not limited to) accrual rates, revaluation rates and employee contribution rates.

Demand side

B278 Even if suppliers without LA solutions are easily able to modify their software, buyers must be willing and able to switch to these suppliers in order for them to represent a competitive constraint. Here, we consider the products that buyers consider viable alternatives and the ease with which they could switch to these products.

B279 As mentioned above, Aquilaheywood supply the vast majority of LAs. Many of these LAs have been using the same software for more than 15 years, and in some cases 35 years or more. This demonstrates a 'stickiness' in the market suggesting that LAs have been and remain reluctant to switch or that no better alternative has been available. There are a number of reasons that may explain why switching is low: a perceived lack of viable alternatives, risk aversion and high actual or perceived switching costs. In addition switching may also be low if buyers are highly satisfied with their product.

B280 Some LAs have told us that there are no alternatives to Aquilaheywood's PA software for LGPS administrators[192] although other LAs believe that recently some alternatives have emerged. Civica, Capita and Equiniti have all been named as alternative providers of PA software to LGPS administrators by both buyers and suppliers. Aquilaheywood also identified several other PA software suppliers as competitors to their own software, although in our evidence these were not considered alternatives by the LAs.[193]

B281 One supplier also identified that outsourcing services exert a significant competitive constraint on their offering. Seven LAs have switched away from a software supplier and now outsource their PA, and one LA told the OFT that they consider there is one outsourcer with a viable alternative to their current software supplier. While this outsourced PA solution may exert a competitive constraint on PA software suppliers, other outsourcers that do not have a LGPS solution are not considered by LAs to be viable alternatives. The OFT has been told that some LAs in more rural areas have explored outsourcing as an alternative but have found it more expensive than administering in-house due to their relatively low costs of labour. Hence any constraint

[192] In addition, an OJEU contract award notice from 11/10/2013 from East Sussex County Council noted that 'altair is currently the only software that can fully address the specific needs of the County Council'
[193] There have been no mentions from LAs we have contacted of suppliers outside of Aquilaheywood, Capita, Civica and Equiniti

exerted by outsourcing services may be substantially lower for rural LAs.

B282 A significant number of LAs have told the OFT that there would be considerable risk in moving away from Aquilaheywood as a provider. One LA told the OFT, for example, that the LGPS is complex and goes through many complex changes and that Aquilaheywood is the only provider that they trust to implement scheme changes without mistakes. The fear of switching is also increased by membership of the CLASS Group as no other provider has a large group of LA users to advise them on scheme changes and minimize the risk of mistakes. LAs said that Aquilaheywood's partnership with CLASS gives them an advantage in the market. One LA said that the risks are a particular issue for LAs because they administer pensions for a large number of people and there are strong political and media pressures to ensure everything runs smoothly. It may be the case that perceptions of the risk are much higher than the reality, as the OFT has not received evidence from LAs or suppliers experiencing problems after switching. Furthermore LAs involved in designing a framework said that competing products are capable of meeting LA needs and other suppliers told the OFT that they have not had any problems with administering funds.

B283 Overall, buyers have demonstrated considerable reluctance to switch even to providers that have already developed a LGPS solution. Risk aversion drives LAs to only consider suppliers with a proven track record in administering LGPS funds.[194] In addition the only alternatives mentioned by LAs have been Civica, Capita and Equiniti, all of which are already active in the market. These buyer characteristics weaken the competitive constraint that suppliers to the private sector exert on suppliers already active in the LA market.

Geographic issues

B284 The LGPS applies to all local government employees in England, Wales and Scotland – although the Scottish LGPS is slightly different from the England & Wales scheme. Northern Ireland has its own LGPS, although it is very similar. However, the Northern Ireland LGPS is not administered through local authorities but by one central public non-

[194] For instance when the East Riding of Yorkshire Council tendered for their pensions administration system in 2012, they required the tenderer to have 'relevant experience of the LGPS'.

departmental body called the Northern Ireland Local Government Officers Superannuation Committee (NILGOSC), which is a client of Aquilaheywood.[195,196] There is no indication that NILGOSC would have access to fewer suppliers in comparison to other UK administering authorities.

B285 Since LAs are reluctant to switch to a provider with no experience in local government pensions, it seems highly unlikely that they would consider switching to a software provider without a substantial UK presence. There would also likely be large supply-side costs for modifying software that has not been used to administer any UK pensions. Again, our evidence is limited on these points so we avoid drawing firm conclusions. However, we consider that it is likely that there are limited constraints from non-UK suppliers.

Conclusion on competitive constraints

B286 The significant costs and supply-side barriers to developing a LGPS solution weaken the competitive constraints exerted by PA software suppliers and outsourcers that do not already supply LAs. Even if firms are willing and able to overcome these costs and develop solutions, buyer characteristics and switching costs further weaken the ability of these solutions to constrain existing suppliers. The available information suggests that there are also limited constraints from non-UK suppliers.

Concentration

B287 As set out in paragraph [1.6], since its entry into the LGPS market in the 1980s Aquilaheywood (or its predecessors) has been the largest supplier of PA software to LGPS administering authorities. At the end of 2013, Aquilaheywood supplies PA software to 87 of the 99 LGPS administrators in England, Wales and Scotland. Aquilaheywood also supplies the central administrator of LGPS (Northern Ireland) pensions in Northern Ireland. Three other providers: Capita, Civica, and Equiniti supply software (or outsourcing) to the remaining 12 funds.

[195] NILGOSC website www.nilgosc.org.uk
[196] Proposed scheme design for the Local Government Pension Scheme (Northern Ireland) 2014 – consultation response from Heywood.

B288 It is important to note that LGPS funds vary significantly in size, with the largest scheme having more than 25 times the members of the smallest.[197] Larger and more complex schemes are more expensive to administer and provide greater revenue to software suppliers or outsourcers. Although Civica supplies PA software to only four authorities, all are within the 12 largest schemes by membership and so we estimate their share of supply to UK LGPS administering authorities to be between four and 13 per cent. Conversely, all seven of Capita's customers are smaller funds and we estimate their share of supply to be between three and seven per cent. On the same basis, we estimate Aquilaheywood's share of supply to be between 84 and 88 per cent.

B289 Within the last 10 years, at least 12 LAs have switched from Aquilaheywood to other providers. Ten LAs recently created a framework (The Kent framework) for use by all administering authorities and tendered for the supply of PA software. The tender received five expressions of interest, although only two companies bid: Civica and Equiniti. We note that Aquilaheywood did not bid and thus if a significant number of authorities use this framework then it could lead to a significant change in market structure. The founding members of the framework alone represent 20 per cent of total LGPS members in the UK. The Kent Framework is discussed further in the 'conduct' section below.

B290 One supplier told the OFT that there are high costs of supplying local government, for example implementing the 2014 LGPS scheme changes. This supplier told us that its policy was to spread the costs fairly between its clients on a basis agreed with representatives of its client base. In addition they noted that the more LA customers a supplier has, the lower the average cost. A new entrant with fewer clients to share its costs may have to pass more costs to each client or absorb some or all of those costs. This would suggest that there may be a minimum efficient scale of entry to supply LAs and hence we would expect a degree of concentration. We note that some PA software tenders from LAs have received bids only from Aquilaheywood.

[197] In 2012-13 the Kensington and Chelsea Pension Fund recorded 9683 members while Tameside Pension Fund recorded 266,375 members. The Centre for Policy Studies estimated the average membership of English and Welsh LGPS funds to be 52,235.

B291 We have, however, also seen evidence to suggest that there are multiple firms willing and able to supply PA software or an outsourced solution to LAs, despite currently having small or nonexistent shares of supply. Greenwich London Borough Council, for example, tendered for the supply of its human resources, pensions payroll and PA systems in 2012. They received four bids to supply their PA system and five to supply their pension payroll.[198]

B292 Our assessment based on the evidence available is that the supply of PA software to UK local government appears highly concentrated, with Aquilaheywood supplying the majority of administering authorities. There is some indication that the structure is becoming less concentrated over time although this change has thus far been slow.

Entry and expansion

B293 Many LAs have been with Aquilaheywood or its predecessors for a very long time. They are therefore familiar with the software and trust that it is and will continue to be fit for purpose. This results in some LAs being wary of choosing other suppliers. Some LAs believe that there would be considerable risk in migrating to a supplier who does not have Aquilaheywood's experience and proven track record. Given this, it may be very difficult for a new entrant to encourage LAs already with Aquilaheywood to switch. This may result in a vicious circle where, unless a firm is able to obtain a reasonable market share, it will find it difficult to develop the track record of administering LGPS pensions demanded by many LA buyers and, without the track record, it cannot win customers and obtain a reasonable market share. Furthermore, suppliers will not want to bear the costs of developing a LGPS solution if they believe that they will not be able to win switchers from incumbents.

B294 There are also other costs involved in switching, which create a significant incumbency advantage, and provide a significant barrier to entry and expansion. These switching costs likely provide some explanation as to why Aquilaheywood has maintained a large share of

[198] Contract award notice 2012/S 56-090930 in the Official Journal of the European Union. Aquilaheywood were the awarded the contract for both the supply of the PA and pension payroll system.

supply over a long period of time. These costs are explored further under conditions of switching below.

B295 It has been put to the OFT that costs of operating in the public sector are considerably higher than in the private sector. Suppliers have informed the OFT that that there is additional cost involved in supplying LAs. One supplier believed that the primary reason for this difference is the costs associated with changes in the LGPS. As mentioned previously, significant resources have been spent in updating PA software to incorporate the 2014 LGPS changes.

B296 The evidence indicates that size and scale are also required for an entrant to be taken seriously as a competitor. The OFT has been told that PA software buyers in both the public and private sectors carefully consider the financial stability of suppliers during procurement due to the risks of the firm failing and the buyer being unable to pay its members' pensions. One supplier suggested that customers might feel that, for financial security, a new software supplier entrant would need somewhere around £10m turnover and a good balance sheet, although this supplier acknowledged that this may vary by LA and was indicative only and based on feedback received from customers in different markets. This indicates that any entry will likely only come from larger firms already established in supplying software, which is consistent with entry from Civica, Capita and Equiniti in recent years.

Switching

B297 Whilst there has been some switching in the past five to 10 years and the Kent Framework could encourage further switching, overall switching rates appear to have remained low over time with CLASS Group membership changing very little.[199] Our evidence suggests that there may only have been 12 LAs switching supplier in the last 10 years.[200]

[199] 2005 press release from heywood on Class Group AGM states 87 members – the same as in 2013.
[200] Nottinghamshire's note to their Pensions Committee states that there were no alternatives to Aquilaheywood until 2005. In 2013, 12 administering authorities are using alternative software suppliers or outsourcers suggesting at least 12 switched between 2005 and 2014. This figure will underestimate the number of switches if there have been any LAs switching to Aquilaheywood from other suppliers in the same period - thus this figure is a lower bound on the number of switches in the last 10 years.

B298 In addition to the perceived or actual risks associated with switching supplier, there are also direct costs involved. In order to switch supplier, data would have to be migrated to the new software. Due to differences in how the data is stored and the mechanics of how different software accesses this data to make calculations, this can be a costly exercise taking many months. Information provided by one supplier suggested that typical migration costs can be three times more than the annual subscription costs for the software. Migration times and cost can vary widely depending on the size of the pension fund and the quality of data kept by LAs. The OFT estimates, based on information provided by buyers and suppliers, that a migration could take between three and 10 months.

B299 There are also indirect costs involved in switching like training staff to use the new software, which add to the overall costs of switching. One LA estimates that a switch away from their supplier could cost as much as £500,000, more than three times their annual level of fees. This suggests that an alternative supplier would have to be considerably cheaper in order for a buyer to consider a switch, especially because the majority of savings would be made in the future.

B300 Aquilaheywood have a considerable advantage over competitors from their historical association with the CLASS Group. Aquilaheywood are able to consult directly with the majority of LGPS administrators and as such their product should be closely aligned with the specific needs of local authorities. If the LA were to switch to an alternative provider, without access to an advisory body such as CLASS, then it would forego this benefit. Therefore there is an additional opportunity cost involved in switching away from Aquilaheywood.

Conduct

B301 Some LAs told us that Aquilaheywood used its strong position in the market to charge high prices to make its software compatible with the 2014 LGPS. Aquilaheywood said that, where major enhancements are required to the software which are pension scheme specific, as has been the case with the LGPS reforms, the additional development costs required to meet the changes mandated by government are fairly apportioned across all their clients. They also state that the costs related to the 2014 LGPS changes were discussed in full, in advance

with the CLASS management group and were signed off by that body. The estimates of the cost of the upgrade that we received differed substantially across suppliers, but we have not formed a view on the reasons for this.

B302 Two LAs raised concerns about the difficulty and expense of a potential switch away from Aquilaheywood. Aquilaheywood told the OFT that this is not an issue specific to them but that switching any pensions administration platform can be complex and will incur costs for the LA undertaking the change of platform. They add that they do not put any obstacles in the way of customers switching to other suppliers and that there are clauses in most supplier's contracts, including those that it agrees, which ensure that reasonable assistance will be provided when migrating away. They said that the only costs LAs pay when switching its software are for the actual services provided on request to help with data migration. The OFT has not received complaints from other suppliers about Aquilaheywood making the switching process difficult.

The Kent Framework

B303 As mentioned previously 10 LAs led by Kent County Council recently developed a framework for the procurement of PA software for use by all UK administering authorities. The framework initially received five expressions of interest, including from Aquilaheywood, although only two companies, Civica and Equiniti, bid to supply through the framework. The framework has now gone live and all UK administering authorities are able to procure their PA software through the framework from either Civica or Equiniti. The duration of this framework is four years.

B304 We have been told that some authorities initially wanting to use the framework to tender for software have been put off from doing so because Aquilaheywood are not part of it.

Software upgrade

B305 Aquilaheywood gave notice in September 2013 on its legacy software, AXISe, which it said it could not support for technical

reasons beyond the end of 2014.[201] With up to 40 of Aquilaheywood's LA customers using this legacy product, any LA using it and thinking of switching would have to get a new system up and running by the end of 2014.

B306 Norfolk County Council pensions committee agenda notes record that, whilst they were aware that the Heywood system [AXISe] would be withdrawn at some point, they were not expecting the announcement so soon or with such a short timeframe. Their intention had been to go the market after the introduction of LGPS 2014. This they found was no longer possible.[202] Other LAs have also said that they believe the timeframe from notice to discontinuation of support was short. Some LAs have told the OFT that they reconsidered switching because of the constraint of getting a new system in place before the end of 2014.[203]

B307 Aquilaheywood commented that it had provided parallel support for AXISe alongside the new altair platform for a period of six years, during which time, 50 clients had successfully upgraded to the new altair platform. They said that the recent Government mandated change to the LGPS rules for 2014 had required Aquilaheywood to make a further significant investment in AXISe, whilst also making the same investment into altair. With further Pension Scheme changes in the pipeline (for example, the move to a CARE scheme), Aquilaheywood and CLASS were reluctant to countenance another significant duplication of costs and hence took the decision to announce the end of life date for AXISe. They said that this date was discussed and agreed with representatives of the CLASS management group, and that the intention to cease support for AXISe has been a topic of discussion at the CLASS Group meetings well in advance of the announcement of the 2014 end date, giving LA customers plenty of opportunity to decide on their strategy. They said that the end of life date was announced in September providing 16 months notice, longer than that contractually required.

[201] Aquilaheywood said that a number of third party technical components within AXISe are out of formal support at that the end of 2014.
[202] Norfolk County Council pensions committee agenda 03/12/13, page 81, www.norfolk.gov.uk/download/pensions031213agendapdf
[203] The OFT notes that some of the founding members of the Kent Framework decided not to call off against the framework after the notice was given on AXISe.

B308 Some LAs have used the software upgrade and the opening of the Kent framework as a point at which to assess the market and go to tender. Aquilaheywood says that this indicates that the notice provision on AXISe gave LAs sufficient time to switch if desired. Some LAs have indeed switched away from Aquilaheywood allowing other suppliers to increase their LA customer base. Civica, for example, has attracted some new LGPS customers primarily via the Kent framework.[204] Civica believes that with more time available for migration and conversion, several existing competitor users would have also made the switch to Civica.

Discounts

B309 Aquilaheywood has offered discounts to LAs on upgrading to altair where these LAs do not go through an invitation to tender or request for proposal process. Aquilaheywood has commented that it has passed on the savings it makes in not having to undertake the very significant work involved in a public sector tender, and that it sees this as helping its clients financially and is, therefore, in the interests of its clients. Aquilaheywood further stated that, if a tender process is undertaken, the LA will still receive competitive pricing in line with more normal discount structures.

B310 Furthermore, Aquilaheywood have offered LAs the opportunity to receive further discounts if they are able to make quick decisions. Aquilaheywood has stated that these are additional discounts that, in their view, benefit the public purse where a customer is able to make a quick decision and which thereby helps Aquilaheywood and the LA community with their planning of work for 2014. They say that a normal level of discount and competitive pricing remains in place for customers who need longer to make purchase decisions and that Aquilaheywood has tried, wherever possible, to minimise the costs incurred by its LA clients in switching to altair.

B311 While the OFT notes that there may be legitimate commercial reasons for these pricing practices, they can lead to reduced entry and expansion opportunities for suppliers and deter buyers from shopping around and switching.

[204] Civica says that its LGPS customer base will soon be more than 10 and it has a clear focus to expand its local government offering

B312 Overall, in relation to the concerns raised about PA software, it is not possible to reach any robust conclusions. It seems clear that not there has not been 'customer lock-in' in the sense that LAs were compelled to transfer to the incumbent's replacement product (some LAs switched supplier). However, it seems equally clear that at least some LAs felt that their ability to switch was constrained.

Quality

B313 All LAs that the OFT spoke to have expressed satisfaction with the functionality of Aquilaheywood's products; however some LAs have been less satisfied with the quality of service from Aquilaheywood. Aquilaheywood said that they undertake formal regular customer satisfaction surveys and that the low switching rate away from their product is because they provide a very good product and excellent service.[205]

Findings

B314 The OFT's evidence suggests that there are limited competitive constraints acting on PA software supplied to LAs.

B315 The supply of PA software to UK local government appears highly concentrated, with Aquilaheywood supplying 87 of 99 LGPS administering authorities. There is some indication that concentration is falling over time although this change has thus far been slow.

B316 Switching costs are high, especially due to data migration costs. LAs appear to be risk-averse when considering rival suppliers. They expect a proven track record of administering pensions under the LGPS and Aquilaheywood has, by far, the most experience. The existence of the CLASS Group also exacerbates this risk aversion.

B317 We found that there are considerable barriers to entry to supply LAs, including a need for size and scale. While there has been some new entry in the past 10 years and two new firms have each acquired at

[205] Aquilaheywood runs a customer satisfaction survey on a rolling monthly basis, reported in aggregate each year. They say that the survey shows consistently high scores, averaging over eight out of 10 for product quality, services and support.

least one LA supply contract, their share of supply is still low. Switching costs and risk-aversion make entry and expansion difficult.

B318 We have heard concerns that the conduct of suppliers in the market can deter buyers from shopping around and switching thus leading to reduced entry and expansion opportunities.

Software: Enterprise Resource Planning

Introduction

B319 This annex assesses the competitive conditions in the supply of Enterprise Resource Planning (ERP) software to UK local government. It will cover the following areas:

- an overview of the product
- product differentiation
- competitive constraints
- shares of supply
- entry and expansion
- switching

B320 We then base our overall findings on the effectiveness of competition in the supply of ERP on the evidence we have reviewed on these areas.

B321 The European Commission previously examined the supply of ERP software when it examined the acquisition of Peoplesoft by Oracle.[206] Although this analysis was undertaken in 2004, the comparative maturity of ERP software products means that many of its findings remain relevant. We note areas where our findings suggest the conclusions of that analysis remain broadly applicable as well as areas where some subsequent technological and other developments may have changed how competition operates.

[206] See European Commission DG Comp decision report available at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=2_M_3216

Overview of the product

B322 ERP functions underpin an organisation's main finance and management processes, including functions such as accounting, payments and invoicing, HR and payroll and other related services. ERP software has become integral to the provision of these functions.

B323 It is generally modular with the finance software package (the accounting general ledger etc.) effectively comprising the 'core' of the system and buyers having the option to purchase further functionality separately. The organisational functions supported by ERP are related and so the various modules have information flows between them. Figure B.7 below, provides a summary of the main module types and their functionality.

Figure B.7: Main categories of ERP software components

ERP Component	Functions
Core finance	General ledger, accounts receivable (debtors) and accounts payable (creditors) – core functions to provide financial reporting, financial management and associated controls.
Income management, cash receipting and e-payments	Systems to support income management, cash receipting and e-payments.
Facilities and assets	Property management and buildings services (non-housing), vehicle tracking and maintenance etc.
HR & Payroll	Systems to support time recording, workforce planning, payment of salaries and other remuneration and personnel records etc.
Organisational Intelligence and Performance Management	Business process management, information management, performance management and project management
Procurement	Contracts and supplier relationship management
Risk & Compliance	Systems to support risk management, audit and legal issue management.

B324 The major suppliers of ERP software include large suppliers who offer complete ERP software 'suites'; an organisation can choose to purchase just the 'core' finance system or a whole suite which includes additional packages such as payroll and HR. Within the suppliers of suites, a further distinction can be drawn between suppliers of 'high function' software for large organisations and suppliers of 'mid-market' suites; we understand that the products are distinguished by their capabilities relating to the number of users, number of transactions and complexity of process they can support. Oracle and SAP are examples of 'high function' suppliers, whereas Unit4's Agresso and some providers of local government-focussed products are generally considered mid-market. This distinction also existed at the time of the EC's 2004 merger assessment.

B325 Other, smaller suppliers offer software products that only provide certain specific functions (for example, payroll) and provide interfaces between their software and the major 'core' finance packages. There are many such suppliers and, although smaller than suppliers of suites, would not be considered SMEs because they have significant shares of supply of major ERP components.

B326 From a technical perspective, the software comprises: a database to store the information, middleware to access and modify the stored information and applications which provide a desktop 'front end' for users to read, add to and change the stored information. This system requires appropriate supporting hardware (servers, networks, desktop computers, mobile devices) and IT professionals to implement and maintain the system.

B327 The buyer of the software may also directly purchase these required complementary products and services or they may be supplied by a third party, although a major supplier explained to us that technological developments have begun to blur the distinction between different arrangements for the provision of software-related support and services. They stated that: 'the distinction between 'off the shelf software' and 'outsourced IT and bespoke systems and software' ... does not reflect general market trends for the CRM and ERP business. With the new paradigm of cloud computing customers choose between on premise software, software as a service (SaaS), private and public cloud, and outsourced IT solutions. CRM and ERP workloads can increasingly be shifted between the different solutions.'

Product differentiation

B328 From our review of the available evidence on the industry- we have not identified any inherent functional requirements of ERP systems that are specific to the public sector. We were told by both buyers and suppliers that many of the products purchased by the public sector are also available to private sector companies, although there are some products targeted specifically at the public sector.

B329 LAs vary considerably in size and, according to Kable, their spend on ERP software also varies substantially, from the typical District Council which spends just £175k to the average County Council which spends around £2m per annum.

B330 We observe that suppliers of both high function and mid-tier products provide software to the UK public sector. We understand, from discussions with buyers and suppliers, that smaller LA's ERP functional requirements can be met by mid tier products, while larger ones would require a high-function suite.

Competitive constraints

B331 In this section we evaluate possible sources of competitive constraint, from both the demand and supply side, on the price and other relevant parameters of ERP software supplied to the public sector. We have not conducted a market definition exercise nor have we sought to conclude on market definition.

B332 We were told by some buyers that they select ERP services in the course of reviewing how best to meet their functional need, rather than separately deciding whether or not to provide the associated functions in house. We therefore first consider this as a possible competitive constraint on ERP software suppliers, then we successively consider the choices available to buyers and the extent to which the exercise of these choices create a competitive constraint between different suppliers.

Choice between outsourcing and in-house

B333 A significant proportion of the UK public sector has outsourced the whole business processes which rely upon ERP software (that is, finance and HR functions) rather than maintaining in-house departments and purchasing ERP software to support those functions. When a whole business process is outsourced, the provider may either continue operating the LA's existing software or may migrate the functions to their own choice of software package.

B334 However, buyers told us that they would generally not re-evaluate a choice between outsourcing and in-house with the same frequency with which software provision might be reviewed. In particular, some LAs observed that the loss of qualified staff and institutional knowledge resulting from outsourcing would make bringing services back in-house very costly.

B335 This therefore corroborates conclusions reached from our consideration of outsourcing that it likely does not constitute a competitive constraint on the providers of ERP software; this is also consistent with the EC's 2004 conclusions.

Choice of managed service provider/implementation partner

B336 If a buyer decides not to outsource business processes and therefore requires ERP functions, some of the ICT administration and support services (including hosting) is still usually provided by implementation partners, such as Systems Integrators (SIs), rather than in-house by the buyer or directly by the software provider. We spoke to a number of local authority buyers which tendered a contract for ERP services to be bid for by an SI who would implement the underlying software package as well as manage any data migration, staff training and provide some level of ongoing support. The underlying software product itself is still usually supported by the software provider in most cases. Buyers told us that bids may be received from more than one SI pitching with the same underlying software package.

B337 Although bids from SIs will be based upon implementing a particular ERP software package, this does not mean they necessarily procure the software on behalf of the LA. One major SI told us: 'Many public

sector customers have arrangements in place whereby they can buy [major software] licences directly, or through government framework agreements, at lower cost than [the SI] can source them for the customer. This is enabled due to deals agreed between Local/Central Government and [the major software provider] directly.' A major software provider commented that, across its software products: 'Most public sector sales used to be indirect but that balance has over time changed to a 75/25 split between direct/sub-contracting.' However, the supplier added that a number of factors may influence the public sector to directly contract with them and that it is not necessarily so that they would always get the software cheaper by coming direct.

B338 Typically, we found that under such deals the public sector pays lower prices for an equivalent ERP product than would a similarly sized private enterprise. This price outcome therefore reflects the outcome of bilateral negotiations at a different, higher, level than between individual LAs and ERP suppliers.[207] Where this is the case, the underlying software price is effectively no longer a parameter of competition, leaving only non-price factors and the SI's own proposed fees.

Choice between integrated and 'best-of-breed'

B339 Choosing ERP software includes choosing between an integrated ERP suite from one of the large software suppliers and what are termed 'best-of-breed' solutions using different software suppliers for different ERP system components. Both solutions are common: a survey by Kable found that 'among UK local authorities 55% of decision makers stated that they would opt to procure 'best of breed' solutions when they come to replace current corporate systems.'[208]

B340 We note the EC's conclusion in its 2004 assessment of the product market that 'best-of-breed' providers are not part of the market for 'high function' ERP software. However, as we discuss below, most UK local authority buyers do not require 'high function' ERP software.

[207] See CCS summary of central agreements at: http://ccs.cabinetoffice.gov.uk/i-am-buyer/categories/ict/special-agreements. This covers major software suppliers including Oracle and SAP.
[208] Kable 'Joined-up local government: Corporate systems in local authorities' August 2013, p.13

B341 The modular nature of ERP systems has also given some LAs to whom we spoke the flexibility to initially migrate the core finance component of their system and to later migrate additional modules when the previous software used for that area becomes due for replacement.

Choice between true 'off-the-shelf' software and customised implementations

B342 Although we are considering the market for 'Commercial Off-The-Shelf' software, we understand that some degree of customisation of the software is still often undertaken so that it meets buyers' specifications more fully.

B343 Customisation can have either positive or negative implications for market outcomes. On the one hand, it may enable the buyer's functional needs to be met more fully and effectively and is therefore welfare-enhancing. On the other hand, it can also lead to higher prices if suppliers pass on the higher costs of developing customised implementations. It can also limit future flexibility to switch to an alternative provider because the new supplier will need to develop a bespoke product or service that directly replaces that of the existing supplier, or the buyer will need to reconfigure internal processes and retrain staff to enable the use of a more standardised alternative product or service. Some IT managers from LAs explained to us that previous ERP procurements have not incorporated wider reviews of business processes and therefore software has been customised to fit existing processes, rather than the other way around. .

B344 However, buyers appear to increasingly realise that customised solutions are more expensive to purchase and maintain and often limit future flexibility and so, increasingly, managers at some LAs to whom we spoke told us they are avoiding it. They emphasised that software procurements should not treat current business processes as fixed and that LAs wider activities and processes could be redesigned to better fit more standardised ICT products and services.

Separate secondary market for support

B345 The typical fee structure for these (and some other) software products comprises an initial charge for the required number and type of licences and then an annual support and maintenance charge (which may, or may not, include upgrades). We understand that the software supplier's annual fee is usually a fixed proportion of the up-front licence cost: around 20 per cent to 25 per cent is typical, which was corroborated by both evidence from suppliers and discussions with LAs. There may be different levels of support available for different levels of annual charge.

B346 We have been told that, generally, suppliers will not commit to fixed charges for the whole life of the contract. Any extra support not provided as part of the annual fee is generally provided on a time and materials (T&M) basis, although the daily rate itself may be capped.

B347 Most suppliers charge such an annual fee for supporting the software itself although other parties (that is, the SIs) may provide related services such as basic end-user training and support. There have been examples of third parties entering, or attempting to enter, the market for direct support of the software itself, raising the question of whether this constitutes a separate market. Although at least one US-based firm - Rimini Street - appears to have achieved some scale and offers support for most large ERP suppliers' products, they do not supply the UK public sector.

B348 One LA's ICT manager advocated purchasing SAP maintenance and support from Rimini Street, which they understood could provide support at half the price of SAP's own 'Gold' product. However the council decided against doing so due to the perceived risk, citing Rimini Street's involvement in a high-profile court case in the US with Oracle regarding IP infringement. This provides some evidence that the income stream from support is important to incumbent software suppliers, because they are pursuing legal cases to protect their position in this secondary market. This implies there is at least the potential that suppliers are competing away some profits to make sales in primary market with the expectation of recovering these later from support revenues.

Geographic scope

B349 In ERP, the software suppliers with the largest global market shares already have significant shares of the UK market.[209] We have not identified any inherent barriers to ERP software developed outside the UK being able to bid for UK contracts; this is consistent with the European Commission's 2004 merger clearance. However, it should be noted that not all suppliers with large UK market shares have a significant international presence; this is consistent with some comments we received from buyers and suppliers that, for implementation services of this type, UK public sector experience was sometimes a bid evaluation criterion.

Conclusion on the extent of competitive constraints

B350 As suggested in our consideration of outsourcing, at some level there is buyers may substitute between outsourced and in-house provision of ICT. However, based on our discussions with buyers, there appear to be sufficient barriers to such substitution, particularly bringing services back in house, that the cost of one would only constrain the other over the long term.[210]

B351 It is possible that specialist suppliers of particular niche components within ERP software are a competitive constraint on suppliers of whole suites for those components where they supply competing products. Small suppliers have been able to sustain and even grow market share in specific ERP components and a fairly even split in LA preferences between 'best of breed' and integrated solutions suggests that they will continue to substitute between the two. However it remains possible that large providers could leverage their scale and scope in wider markets to compete more intensely against smaller providers.

B352 It is possible that the market for the supply of ERP systems is wider than the public sector and wider than the UK. We do not, however, have sufficient evidence to determine whether the constraint exerted by private sector or overseas suppliers is sufficient to prevent price rises in the public sector.

[209] Based on TechMarketView 'UK Public Sector SITS Supplier Landscape 2013-14' January 2014, p.6 and TechMarketView ' UK Local Government Software & IT Services Supplier Landscape 2013-14' p.8
[210] This is consistent with the EC DG Comp conclusion in the evaluation of merger of Oracle and Peoplesoft.

Value of supply of ERP to the public sector

B353 We have considered the value of the supply of ERP systems to Local Authorities in England and Wales.

B354 Market analysts Kable estimate that the supply of ERP systems to Local Authorities in England and Wales is worth over £200m per annum (2012-13), of which core finance is the largest component accounting for £55.8m of the £200.4m total expenditure.[211]

Shares of supply

B355 Figure B.8 below shows Kable's estimates of shares of supply to the UK public sector. SAP has the greatest share of supply on all measurements followed by Oracle. Although Oracle seems to be stronger within the supply to LA than on the worldwide measurement.

Figure B.8: Shares of revenues of major ERP suppliers

Supplier	**UK LA Market Share - Kable (%)**
SAP	15-20
Oracle	10-15
Capita	5-10
Civica	5-10
Northgate	5-10
Unit4	0-5

Source: Kable 'Competition and complexity', May 2013

B356 Kable also provides estimates of the shares of supply for each of the main components of ERP software. From our review of their data, we identified that suppliers of complete ERP suites have significant shares of supply of the core finance, HR and payroll and procurement components. However we note that, for HR and payroll software, there are also other firms with significant shares of supply in addition to suppliers of suites. In the income management, facilities and assets and risk and compliance components, different suppliers have the largest shares

[211] Note that the revenues and benefits function often falls under the remit of the finance division but we do not consider this software here as it is generally procured separately.

Entry and expansion

Levels of entry and expansion

B357 Market analyst reports suggest that the revenue shares of the largest suppliers have been comparatively stable over time but we do not have the detailed data with which to verify this. They have also highlighted some instances of expansion by some mid-market suppliers in the local government ERP market.[212]

B358 Although some suppliers of specific components have sustained market footholds, past examples are not necessarily a guide to current conditions of entry. However we do note at least one example of a contract through G-cloud by a large overseas and private sector provider, which currently has negligible presence in the UK public sector.

Barriers to entry and expansion

Sunk costs of entry

B359 As the ERP model is built around a 'core' finance function, to which other components providing additional functions can be attached, an entrant could seek to enter either particular sections of the market, or the whole market with an integrated suite of products.

B360 Suppliers said that it would be easier to develop new rival products for individual components of ERP systems, (which then integrate/interface with 'core' products from existing suppliers) than to develop a comprehensive rival ERP suite. This is consistent with the reports of market analysts that aggregate shares of supply of major suppliers have been comparatively stable over time while some niche

[212] TechMarketView ' UK Public Sector SITS Supplier Landscape 2013-14', January 2014, p28: 'In times of Government austerity, Oracle is a tough sell due to the significant services burden associated with it. In local government this has become particularly apparent as mid-market providers, most notably UNIT4 with its Agresso ERP solution and ACS with Cedar, have started winning at authorities that had previously been wedded to Oracle solutions'
[212] Kable 'Joined-up local government: Corporate systems in local authorities' August 2013, p.15: 'However, cost remains a key consideration and councils are suppliers. Unit4 has been one of the main beneficiaries from this trend. As well as competitive price points, local authorities are also be attracted by Unit4's flexibility and its growing base of reference customers.'

suppliers still have comparatively high shares of supply of specific ERP components.

Frequency and size of competitive opportunity

B361 This is now a mature market in that all buyers will already have software that underpins their ERP functions, that is, an incumbent supplier; there are no truly 'new' customers. Many current buyers have had the same provider since they first migrated to a modern ERP software solution.

B362 In general, LAs will need to use current supported software and will upgrade to the latest supported versions or go to tender if support for their current product is terminated; a situation encountered by some LAs who responded to us. We understand this is driven by data security requirements and the importance of system reliability. If a product for which a LA holds a licence becomes obsolete, the incumbency advantage will reduce.

B363 However, while a tender process may be necessary for competition, on its own it is not sufficient to ensure there is a true opportunity for a new supplier because the incumbent could still have considerable advantage on both a cost basis and as a result of buyers' risk aversion.

B364 The larger number of councils of smaller scale and lower complexity suggests that there will be fewer opportunities for the suppliers of high function enterprise solutions and potentially more, smaller opportunities for mid-market suppliers.

B365 In future there may be fewer individual clients to target because some LAs are developing shared service centres to provide finance and management functions for themselves, other LAs and other regional public bodies. We spoke to one LA undertaking such a project and they explained that these developments are motivated both by anticipated cost savings and as an additional revenue source in response to tight budgets. Market analysts have noted this trend, which has included co-ordination between groups of London Councils using the same software packages and at least four other examples in other regions. However, in terms of outcomes, any possible reduction

in the competition that results from fewer contracts may be more than offset by the benefits of increased buyer power from aggregating demand into fewer, larger contracts.

Other barriers

B366 Some potential suppliers have asserted that local authorities' procurement criteria create artificial entry barriers through procurement criteria that require a track record of provision to the public sector. However, we have not heard about any instances of this in the underlying ERP software itself. As shown in our consideration of geographic market definition and concentration data, all major suppliers across sectors have a presence in the UK public sector.

B367 To understand how competition occurs in this market, we tried to identify how suppliers differentiate their bids and on what basis bids are successful. When evaluating bids for ERP contracts, LAs have indicated that a range of factors bear upon the award decision. One local authority referred to a bid from a major software supplier being beaten 'on all evaluation criteria' by a bid from a mid-market supplier. However we have not seen any evidence of particular evaluation criteria that are peculiar to ERP software. Chapter 6 on Buyer Conduct in the main body of the report discusses ICT procurement evaluation criteria across the UK public sector.

B368 However we note that some buyers have required that the SI/MSP has public sector credentials: one LA respondent stated that: 'The quality of the bidders varied. Most failed because they had no track record of working in local government so would struggle to deal with LG specific issues.'

Switching

Levels of switching

B369 We do not have data on switching rates in this market. However, suppliers responses suggested that changes of ERP software supplier are typically undertaken at intervals of 10 years or more. This is supported by responses we received from LAs when we asked them when their current supplier was first appointed.

Barriers to switching

B370 LA respondents unanimously told us that there would be very significant barriers to changing their whole underlying ERP suite. We find that these include both 'natural' barriers to switching and 'artificial' barriers which arise from the conduct of both buyers and suppliers.

B371 LAs who have considered switching typically estimate the cost of switching ERP suite supplier to be around three to four times the annual licensing and support fees. This is the estimated cost of a new perpetual licence and expected one-off transition fees from an SI/MSP for implementation. LAs told us that these estimates are based on numbers of licences required, buyer's scoping of the work involved in terms of man days and typical day rates in the sector. In fact, based on our conversations with LAs, we believe this is likely to be an underestimate of the true economic cost as it includes only external costs and does not take into account the opportunity cost of staff time spent on transition, including in-house procurement and IT as well as training all users.

B372 In many instances, these inherent costs that arise from the complexity of switching to a new provider are often artificially inflated by LA's choices (made many years earlier) to customise their implementations extensively. This makes change more costly as any replacement must also receive equivalent customisation or the LA must also change its business processes to fit an off-the-shelf product as part of the switch.

B373 Notwithstanding the financial costs, LAs are in any case unwilling to switch ERP supplier because the ERP system is integral to delivering their core services. Some buyers to whom we spoke expressed the view that decision makers are highly averse to the risk of disruption to the provision of these services (for example, paying out benefits) and therefore are disinclined to switch as they perceive any financial benefit to be small relative to the risk of negative 'political' outcomes. The harm from risk aversion could be partially overcome by improved information-sharing in the sector so that examples of successful transitions are shared as best-practice.

B374 Supplier behaviour has also created an artificial barrier to switching through the pricing structure that has historically been applied to ERP software (as well as many other types). We found that most ERP software requires the user to purchase a 'perpetual' licence for a lump sum upfront cost and then pay an annual subscription for maintenance and support. This means that, outside of product obsolescence (where the supplier requires the buyer to purchase a perpetual licence for a new product), there is a significant cost-saving from remaining with the incumbent provider for the lifetime of the product.

B375 Some buyers confirmed to us that the new licence formed a significant proportion of the external cost of a switch and that it had been a factor in their decision not to do so. We also note that buyers have discretion as to when, and how often, they tender (or even evaluate) their ERP service contracts and that, under a perpetual licence, there is no 'natural' trigger to review contracts.

B376 We did find some evidence, however, that changing the provider of an individual, non-core component ERP software such as HR may be less costly. One County Council noted that they had switched the provider of their HR and payroll software at a low cost and that this 'was relatively straightforward using a mix of in-house skills and supplier services'.

Findings

B377 We do not believe that outsourced IT service providers exert a competitive constraint on providers of ERP software for in-house implementations. We do not have sufficient evidence to conclude whether suppliers to the private sector and or overseas markets exert a strong competitive constraint on public sector suppliers. However, it does appear that specialist suppliers of particular ERP software components exert some competitive constraint on the providers of integrated suites, and vice versa.

B378 There appear to be some barriers to entry that are inherent to the characteristics of the product due to its complexity and usage to support all business-as-usual operations of LAs. We have also identified some important barriers to buyer switching that result in buyers being substantially 'locked-in' to their current suppliers, which

may in turn further deter entry. To some extent, these are exacerbated by practices of both buyers and suppliers.

B379 This may explain the observed very low levels of switching and some of the same market features that make switching costly - namely customised implementations - also make it harder for LAs to assess whether they are receiving value for money through benchmarking against comparators.

B380 Some innovations of which we are aware have the potential to mitigate the impact of some features which we identify could lead to poor outcomes, for example the growth of SaaS with a 'pay as you go' fee model rather than a fixed perpetual licence fee should reduce some of the incumbency advantage over time.

B381 However, such innovations are still in their infancy and there is still considerable scope for buyers to become more effective in evaluating the range of suppliers that could meet their needs and to improve their ability to assess whether they are receiving value for money.

Software: Customer Relationship Management

Introduction

B382 Here we assess the competitive conditions in the supply of Customer Relationship Management (CRM) software to UK local government. We cover the following areas:

- an overview of the product
- competitive constraints
- shares of supply
- conditions of entry, expansion and switching.

B383 We then use the evidence on these areas to conclude on the effectiveness of competition in the supply of this product.

Overview

B384 Customer relationship management functions enable LAs to manage their communications with suppliers, households and other stakeholders in order to deliver their services.

B385 We have been told that a large LA may have many more CRM 'processes' than a typical private enterprise (where CRM largely forms part of the sales function) because, for LAs, CRM is part of service delivery. One supplier told us that a typical council could have as many as 200 processes, ranging from managing the maintenance of street lighting to arranging the movement of bulky items.

B386 Like ERP, CRM functions can be provided on a wholly outsourced basis but, whether outsourced or in-house, they will rely upon an underlying CRM software package.

B387 CRM software is not modular in the same way as ERP, so there are no products that supply only a subset of specific CRM functions. However, CRM software will usually interface with other systems particularly, for example, telephony systems. There are also some complementary software products; Kable groups CRM with a few other software types such as election registration and management applications which are comparatively small by revenue.

Public sector only or wider

B388 One major supplier offers a public sector-specific product that is not available to private companies; however others explained that they offer products that are universal.

B389 At least one local authority also noted in their response that functional CRM requirements of the public sector are more similar to the private sector than for some other types of COTS.

Market size

B390 We mainly rely upon Kable's estimates of the size of the market for CRM services in UK local authorities. They identify a £117m

'information and engagement' market, of which CRM itself comprises £82m.

Geographic market

B391 For CRM, although there are differences in how the product is used by the public sector compared to the private sector, there is no inherent national boundary to the market. This is borne out by the shares of supply data discussed below. Several of the current large international suppliers, have a foothold in the UK LA market.

Concentration

B392 Concentration in the CRM market is lower than many other COTS markets for UK local authority software. Although the largest providers to LAs in the domestic market are specialists who also provide a range of other products and services focused on the UK public sector, their collective shares of supply do not suggest a particularly concentrated market.

Figure B.10: Shares of supply

Market shares of revenue	**UK Local Authorities (%)**
Civica	10-15
Northgate	10-15
Microsoft	5-10
KANA (Lagan)	5-10
SAP	0-5
Oracle	0-5
Others	50-55

Source: Kable 'Competition and complexity', May 2013

Entry, expansion and switching

B393 We have not identified any significant examples of entry into this sector from our research or evidence that we have received from

parties. Evidence from suppliers and market analysts also does not identify significant expansion by any current suppliers. This is consistent with the comparative infrequency of competitive opportunities which we have identified.

B394 CRM products are considered to be mature by buyers and suppliers and only very few tenders are held each year compared to the total number of LAs buyers of CRM. Evidence from suppliers suggests that, in recent years, there have been fewer than five competitive opportunities annually. LAs told us that the typical LA has used their current provider for a long time.

B395 Most responses from both buyers and suppliers suggest that switching costs are comparatively lower for CRM software than for ERP.

Findings

B396 From the evidence we have gathered on how CRM software is supplied to the UK public sector, we find it more likely that competition is working well in CRM software than in some other software markets.

B397 We find that the supply of CRM software is less concentrated than, for example, the supply of ERP and other software types although we have not identified recent examples of significant new entrants. In addition, the financial and time costs of switching appear to be lower for ERP systems and switching is perceived to be less risky by buyers.

B398 However, despite this, the length of CRM supplier relationships among LAs that responded to us suggests the typical LA has not switched its CRM software supplier for around 10 years despite considerable development in software markets over that period.

B399 We find that, as in other software markets, there is a lack of available means to benchmark prices and other characteristics so it buyers do not have the means to assess whether they are achieving value for money.

ANNEXE C: PROCUREMENT PROCESSES

C1 In this annexe we review the different rules and regulations that UK public bodies must abide by when procuring ICT goods and services.

OJEU processes

C2 When procuring goods or services with a contract value over a certain threshold,[213] public sector organisations must comply with the European Public Contracts Directive 2004. The resulting procurement processes, which must almost always[214] allow for suppliers to compete to supply the goods and services, are known as 'OJEU' processes.[215] The majority of ICT purchases are procured through OJEU processes.[216] Below we consider their main features.

Criteria for assessing bids

C3 Before beginning an OJEU process, buyers must select whether to judge bids against one of two types of criteria: the 'lowest price' or the 'most economically advantageous tender' (MEAT). Whereas the lowest-priced bid is automatically deemed the winner under the 'lowest price' criterion, MEAT requires buyers to specify in advance a set of criteria against which bids will be assessed, and the weighting that will be applied to each.[217]

Types of procedure

C4 There are four types of procedure that public sector buyers can use when running an OJEU process, known as 'open', 'restricted',

[213] Currently £111,676 for central government departments and their bodies and agencies, and £172,514 for other public sector bodies. These values relate to total contract values, rather than values calculated on an annual basis.
[214] In rare cases, for example where goods and services must be purchased within a very short space of time, buyers can award a contract without running a competitive procurement process. This is known as there having been 'no competition call'. The OpenTED database reveals that between March 2010 and April 2013, six per cent of ICT contracts were awarded with 'no competition call', accounting for an estimated one per cent of total contract values.
[215] This stands for the Official Journal of the European Union, where opportunities and awards are published.
[216] Note that this includes frameworks which, subject to the same value thresholds, must be set up via an OJEU process.
[217] For example, bids to gain a place on the Government Procurement Service's 2012 PSN Connectivity framework were assessed on the basis of their 'price' (with a 25 per cent weighting) and their 'quality' (with a 75 per cent weighting).

'competitive dialogue' and 'negotiated'. Below we briefly discuss each in turn.

Open procedure

C5 The open procedure is one of two (the other being the restricted procedure) that should be used where the buyer is able to identify the goods or services it requires in advance of the tender process. The buyer first publishes an 'invitation to tender' (ITT) which lists these goods and services alongside other information; interested suppliers may then submit sealed bids, which are evaluated against the specified assessment criteria.

C6 The open procedure was used for 27 per cent of ICT contracts awarded in the UK between March 2010 and April 2013, accounting for an estimated 19 per cent of total contract values.[218]

Restricted procedure

C7 The restricted procedure follows the same format as the open procedure, although under a restricted procedure, the buyer first publishes its requirements in a contract notice, inviting potential suppliers to complete a 'pre-qualification questionnaire' (PQQ).[219] Only those who meet the criteria are subsequently sent an ITT. Qualifying suppliers can then submit sealed bids, which are evaluated against the specified assessment criteria.

C8 The restricted procedure was used for 51 per cent of ICT contracts awarded in the UK between March 2010 and April 2013, accounting for an estimated 42 per cent of total contract values.[220]

Competitive dialogue procedure

C9 The competitive dialogue procedure can only be used where a buyer's requirements are particularly complex, or where a buyer is unsure of the goods or services it wishes to purchase. The procedure begins

[218] Source: OpenTED database. Around eight per cent of contracts do not indicate the procedure used and of those which do, around 40 per cent do not indicate the total value. In formulating our estimates we assume those contract awards with missing data are distributed in an identical way to the (majority of) contract awards with recorded data.
[219] For more detail on PQQs, see paragraph A16.
[220] Source: OpenTED database. See footnote 218 for some qualifications to these figures.

with a contract notice and a PQQ in the same way as the restricted procedure, although the buyer sets out its general requirements rather than the exact goods and services it wishes to procure. Rather than an ITT, qualifying suppliers are then issued with an invitation to participate in 'dialogue'.[221]

C10 The dialogue stage is intended to help the buyer to identify the goods and services that meet its requirements, through one-on-one discussions with each potential supplier. Through the process of dialogue the buyer typically narrows the field of potential suppliers by disqualifying potential bidders in line with the assessment criteria.[222] Following the dialogue stage the buyer provides the remaining potential suppliers, whose number should where possible be high enough to 'make for genuine competition',[223] with an ITT. These suppliers can then submit sealed bids, which are evaluated against the specified assessment criteria.

C11 The competitive dialogue procedure was used for nine per cent of ICT contracts awarded in the UK between March 2010 and April 2013, accounting for an estimated 33 per cent of total contract values.224

Negotiated procedure

C12 The negotiated procedure can only be used where it is impractical for bidders to specify prices in such a way that they can meaningfully be compared between different bids. Its use is therefore heavily restricted and it is uncommon in public sector ICT procurements. The procedure begins in the same way as the restricted procedure, with a contract notice, a PQQ and a subsequent ITT sent to qualifying suppliers.[225] Following the submission of tenders, certain bidders are invited to negotiate with the buyer over terms and prices, in line with the specified assessment criteria.

[221] A buyer need not invite all qualified parties to participate in dialogue. It may not limit the number of potential suppliers to below three at this stage, unless fewer than three met the PQQ criteria.
[222] Since these criteria almost always involve some weighting on price, potential suppliers may be asked to indicate maximum 'not to exceed' prices of their final offers
[223] See Article 44(4), Directive 2004/18/EC
[224] Source: OpenTED database. See footnote 218 for some qualifications to these figures.
[225] Except that as with the competitive dialogue procedure, the number of suppliers sent an ITT may be limited further than those who met the PQQ criteria.

C13 The negotiated procedure was used for seven per cent of ICT contracts awarded in the UK between March 2010 and April 2013, accounting for an estimated four per cent of total contract values.[226]

Pre-qualification criteria

C14 The open procedure is the only one in which all interested suppliers are eligible to bid for a contract. Under each of the other procedures, suppliers who express an interest in bidding contracts are first sent a PQQ. The PQQ invites these suppliers to demonstrate that they meet the buyer's various bid qualification criteria which may relate to financial capacity, technical expertise or prior delivery track records. Those who meet the criteria may be invited to proceed with the tender process.

Sub-OJEU processes

C15 Public sector purchases worth less than the OJEU thresholds ('sub-OJEU processes') must often still follow certain regulations. For example, UK central government tenders worth over £10,000 must be centrally advertised and subject to a competitive procurement process.227 Thresholds for the type of competitive process that must be run, and the different procedures used, differ across the public sector.228

Published notices

C16 For OJEU processes, buyers are required to publish certain documents ('notices') on the Tenders Electronic Daily (TED) website.[229] For both OJEU and many sub-OJEU processes, buyers must also publish these

[226] Source: OpenTED database. See footnote 218 for some qualifications to these figures.
[227] See http://bit.ly/1gUmjwq
[228] For reasons of data availability, we have been unable to comprehensively assess sub-OJEU contract awards. However we note that around 10 per cent of contracts in our database of public sector ICT OJEU contract awards have a total contract value that falls below the lower (central government) OJEU threshold in the relevant year, and more still need not have proceeded with an OJEU process if the relevant threshold was the higher value (it has not been possible to comprehensively determine which threshold applies for each process). This is consistent with a general finding in the PwC, London Economics and Ecorys report, which found that across the EU and between 2006 and 2010, around 18 per cent of all OJEU processes fell below the minimum threshold. (p19).
[229] At http://ted.europa.eu. This is the online version of the supplement to the Official Journal of the European Union where these notices must also be published.

notices elsewhere online, for example on specialist procurement 'portal' websites. Below we consider the main types of notices.

Prior Information Notices (OJEU only)

C17 Before beginning an OJEU tender process a buyer may publish a 'prior information notice' (PIN), which provides information about the nature of the proposed procurement ahead of the tender process. PINs may also inform potential suppliers of proposed pre-tender dialogue. Publication of PINs is obligatory above a certain threshold,[230] and their publication enables buyers to run shorter OJEU processes.

Contract notices

C18 Buyers must publish contract notices in advance of a tender process. For OJEU processes, this sets out the goods and services the buyer wishes to purchase, except for the competitive dialogue procedure where it sets out the buyer's overall requirements. Central government departments must publish sub-OJEU contract notices above £10,000 on the 'Contracts Finder' website,[231] with similar portal websites existing in Scotland,[232] Wales[233] and Northern Ireland.[234] LAs in England are strongly encouraged to publish online contract notices worth over £500.[235]

Contract award notices

C19 Following the award of a contract, buyers must often publish contract award notices. These usually reveal the winning bid value and supplier, and may contain additional information such as the scope of the winning bid. The regulations governing their publication where contract values fall below the relevant OJEU threshold are identical to those for contract notices.

[230] This threshold is currently £625,050.
[231] https://online.contractsfinder.businesslink.gov.uk/
[232] The Scottish government encourages Scottish authorities to publish all opportunities worth over £50,000 on the Public Contracts Scotland website at www.publiccontractsscotland.gov.uk. This may become mandatory if, and when, the Procurement Reform (Scotland) Bill gains royal assent.
[233] Sell2Wales (www.sell2wales.gov.uk), whose use is not mandatory by buyers.
[234] eSourcing NI (https://e-sourcingni.bravosolution.co.uk/web/login.shtml), whose use is not mandatory by buyers.
[235] See http://bit.ly/1nFZgyh