

SSRO

Single Source
Regulations Office

Developing an information technology services activity group

Detailed consultation response 13 April 2022

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1. Introduction and summary

- 1.1 This paper sets out the SSRO's detailed response to our consultation (SSRO 04-1221). We would like to thank all respondents for their feedback, in light of which we have made some changes to our proposed IT services comparator group.
- 1.2 We have widened the economic activities we are seeking to capture within the comparator group. The post-consultation activity characterisation is to include companies which are engaged in the following: *the development, or operation and maintenance, of bespoke and complex IT systems; or the integration of off-the-shelf components or software to deliver a bespoke IT system/service.*
- 1.3 Some stakeholders expressed an interest in including telecommunication and satellite companies within the activity group. For reasons set out in detail within this response, we are not persuaded to do so and that is reflected in the above activity characterisation.
- 1.4 We are grateful for suggestions we received for other search terms and NACE codes to include in our company search criteria. In response we have modified our search strategy, and our final set of text search terms can be found at Table 3, and the final set of NACE codes can be found at Table 4.

Background

- 1.5 The SSRO applies its [Single Source Baseline Profit Rate, Capital Servicing Rates and Funding Adjustment Methodology](#) ("profit rate methodology")¹ to benchmark profit rates for four activity groups.
 - a. develop and make (D&M);
 - b. provide and maintain (P&M);
 - c. ancillary services; and
 - d. construction.
- 1.6 We have recommended a single baseline profit rate each year to 2021, based on the D&M and P&M benchmarks. We continue to produce the ancillary services and construction benchmarks because those activities are sometimes included in qualifying contracts and the rates may inform whether government obtains value for money on qualifying contracts and contractors are paid fair and reasonable prices.
- 1.7 The SSRO is considering an additional benchmark profit rate for an IT services activity group. We did not identify sufficient requirement for such a group when we developed the profit rate methodology in 2016 but we have reviewed that position based on the following:
 - stakeholder representations that the IT sector is insufficiently represented in the existing four activity groups; and
 - the Defence and Security Industry Strategy (DSIS), which set out proposals indicating a shift in the make-up of what the MOD procures without competition.
- 1.8 Developing a distinct IT services activity group is an effective approach to analysing and understanding the activity in relation to qualifying contracts.

¹ <https://www.gov.uk/government/publications/2022-contract-profit-rate-recommendation>

- 1.9 We consulted from 08/10/2021 to 05/12/2021 on the IT services activities that may contribute to the delivery of Qualifying Defence Contracts (QDCs) and Qualifying Subcontracts (QSCs). We described the activities which we would use to identify benchmark companies and sought input so that we can further develop the approach.
- 1.10 During the consultation period, the SSRO:
- held discussions with techUK; and
 - received three detailed written responses and one letter (see Table 1).

Table 1: Breakdown of respondents

	Government	Industry	Trade association	Industry consultant
Number of responses	1	2	1	0

- 1.11 Respondents welcomed the opportunity to engage with the SSRO on developing the IT services activity group. We thank those who responded to the consultation for sharing their views. Two respondents gave permission for their responses to be published on the [SSRO's website](#).²
- 1.12 We published an initial high-level response to the consultation on our website on 20/12/2021. We indicated that we would carry out additional investigation based on the feedback received. This has included analysis of our search strategy, refinement of activity characterisation, consideration of which sectors are in scope, further feedback from the MOD and a review of our approach by transfer pricing experts. We have considered that additional work in preparing this response.

Next steps

- 1.13 We will consider in September 2022 whether to include an IT services group in the SSRO's profit methodology. If the group is included, then an IT services activity benchmark will form part of the supporting information for next year's BPR assessment.

Consultation response structure

- 1.14 The following sections of this paper summarise the views provided by the consultation respondents, evidence from post-consultation investigations undertaken by the SSRO together with the SSRO's commentary on how the feedback has informed the final decision in the areas on which we consulted. The consultation response document is structured as follows:
- Section 2 sets out the background to the consultation, including an outline of our comparator group development process and original consultation questions
 - Section 3 presents the SSRO's post-consultation investigations.
 - Section 4 contains the collated consultation responses and the SSRO's decisions.
 - Section 5 contains appendices.

² <https://www.gov.uk/government/consultations/developing-an-information-technology-services-activity-group>

2. Activity group development process

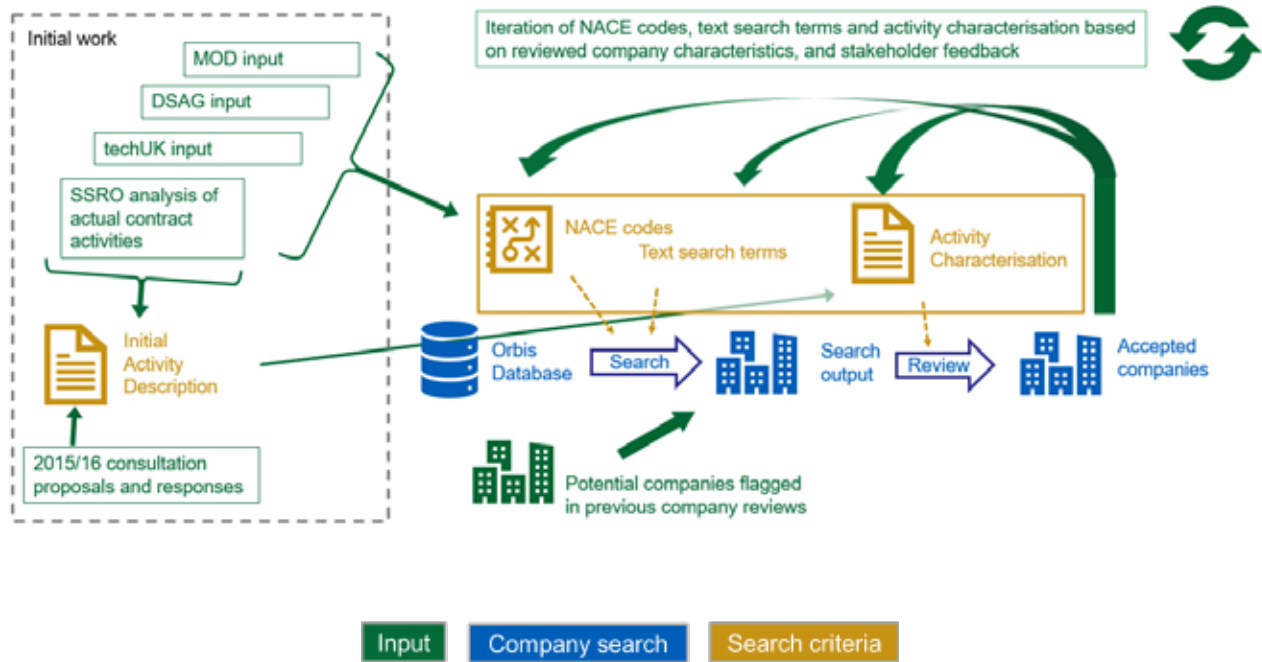
Activity group development process

- 2.1 The SSRO's activity groups are developed in accordance with transfer pricing principles, which provide an approach to pricing transactions using an arm's-length basis. The [OECD Guidelines on Transfer Pricing for Multinational Enterprises and Tax Administrations](#)³ ("the Guidelines") set out a widely accepted interpretation of the arm's-length principle together with advice on how this may be implemented and assessed.
- 2.2 The development of an activity group within the SSRO's existing BPR methodology begins with a review of internal comparables. This process finds companies which enter contracts with the MOD to provide IT services⁴. We next perform a functional analysis to understand the activities these companies are engaged in. Through finding contracts that the MOD enters for IT services, we can then find further information about the contract and company through DefCARS and the Orbis database.
- 2.3 The functional analysis and review of internal comparables are used to develop three elements, which can then be applied to identify a wider set of comparable companies through a database search:
- **activity characterisation**: captures a description of the activities a comparator company is expected to carry out;
 - **text search terms**: keywords that are used to filter the full database, depending if one or more words appear in a narrative description of that company's activities provided by the database; and
 - **NACE codes**: standardised descriptors that are used to filter the full database, depending if one or more codes are used to classify that company's activities in the database.
- 2.4 The process to develop these elements is iterative, taking account of the SSRO's knowledge of comparable activities and feedback from stakeholders. That is, after having identified comparable companies through applying the above search criteria, the list of companies is reviewed, and the parameters of the search criteria and activity characterisation is modified to produce another list of companies. This process is illustrated in Figure 1. For example, after searching with a set of parameters, we may then notice that the resultant companies tend to use a particular word in their descriptions. We may then re-run the search and include this word also in order to see if we capture more comparable companies.
- 2.5 To develop a draft methodology for an IT services comparator group prior to consultation, the SSRO considered stakeholder feedback alongside engagement with Defence Digital and internal expertise. The proposed group was aimed at providing a benchmark for contracts dominated by the provision of bespoke IT software and the integration of off the shelf components to deliver a bespoke IT solution.

3 <https://www.oecd.org/tax/transfer-pricing/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-20769717.htm>

4 We identify IT services as those assigned CPV (common procurement vocabulary) code 72

Figure 1: Development of IT services activity group characterisation, NACE code and text search terms



- 2.6 The SSRO sought stakeholder views on the proposals for the activity characterisation, text search terms and NACE codes. We invited stakeholders to respond to the following consultation questions:
1. Has the SSRO identified a suitable set of activities that should be addressed by an IT services activity group? We welcome suggestions for modification to the scope with an explanation of any benefits.
 2. Does the characterisation the SSRO has drafted accord with your expectation of the type of activities which contribute to the delivery of defence contracts for IT services? Do you have any suggestions for how it could be improved?
 3. Do you support the text search terms and NACE codes proposed? Please provide any suggested improvements/amendments where appropriate.
 4. Do you consider the companies set in Appendix 2 to undertake the type of activities which contribute to the delivery of defence contracts for IT services? Do you have suggestions of additional companies we should consider?
 5. Do you have further comments on the development of the IT services activity group?
- 2.7 Some stakeholders expressed support for our proposal, whilst others did not or proposed significant changes. We [published a response to the consultation on 20 December 2021](#)⁵, and undertook to further analyse the feedback and provide an update on our findings in spring 2022. We have since carried out further investigation and engagement to conclude our position.

⁵ [Developing an information technology services activity group - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/developing-an-information-technology-services-activity-group)

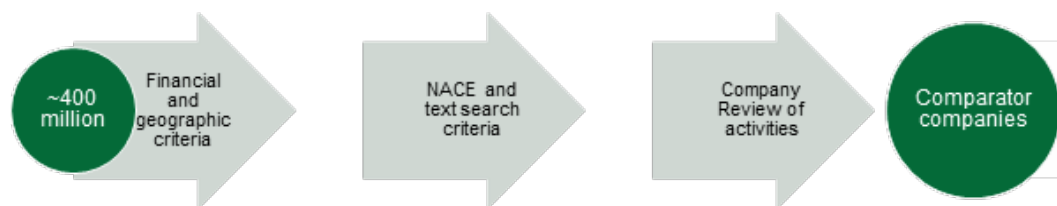
3. The SSRO's post-consultation investigations

- 3.1 The consultation feedback from stakeholders expressed support for our overall approach of developing an IT services activity type, although there were different views on how this should be specified. Both industry and BDO suggested modifications to the proposed NACE codes and text search terms, and consideration of additional internal comparables.
- 3.2 We considered this feedback and made modifications to our activity characterisation and search strategy (NACE codes, search terms, internal comparables). We examined the impact these changes had on our comparator group and used this analysis to come to our concluding position.

Company search process

- 3.3 The SSRO applies the company search process illustrated in Figure 2 to identify comparable companies. Our search is based on the Orbis⁶ database, which contains information on nearly 400 million companies. It involves three key steps:
- Application of financial and geographic criteria which are common to all activity types. For example, companies in any comparator group must operate in comparable markets and have a certain level of turnover.
 - Use of NACE7 codes and text descriptions within the Orbis database to filter out companies which are unlikely to fall within the comparator group.
 - Review of company information, such as websites and financial statements, to determine if each company should be accepted into the comparator group based on our activity characterisation – this is known as **the manual review**.

Figure 2: Company search process



- 3.4 Within Orbis, each company is assigned one or more NACE codes, which can be used to easily assess its activities in a standardised manner. NACE provides a framework for collecting and presenting a large range of statistical data according to economic activity. It consists of a hierarchical structure established in Regulation (EC) No 1893/2006.⁸ Each company also has a brief text description of their primary business activity. We search for companies that have particular NACE codes, and certain key words within the business description.

⁶ Orbis is a company-specific information database, supplied by Bureau van Dijk, a Moody's Analytics company.

⁷ Statistical Classification of Economic Activities in the European Community (NACE). The current version is revision 2 and was established by Regulation (EC) No 1893/2006.

⁸ <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32006R1893>

3.5 The final stage of the company search process is to manually review the companies which have been filtered from Orbis by applying the previous two steps. For the purposes of developing the IT services activity group, this involved reviewing each company's accounts, website, and other information, to ensure that the majority of their business activity is aligned with the final activity characterisation in Appendix 1.

Scenario testing

- 3.6 We applied our company search process to three alternative scenarios:⁹
- a. **SSRO scenario:** This scenario comprised the NACE codes and text search terms proposed by the SSRO in the consultation (see Tables 3 and 4). This search captured 558 potential comparators.
 - b. **Industry scenario:** This scenario comprised the **SSRO scenario** plus the NACE codes and text search terms suggested in industry's feedback (see Tables 3 and 4). This search captured 559 potential comparators (i.e. one additional company to the **SSRO scenario**).
 - c. **BDO scenario:** This scenario comprised the **industry scenario** plus the NACE codes and text search terms suggested by transfer pricing experts at BDO (see Tables 3 and 4). This search captured 586 potential comparators (i.e. 27 additional companies to the **industry scenario**).
- 3.7 We conducted a detailed review of company information for each of the 586 potential comparators, using the activity characterisation set out in Appendix 1. We identified 57 companies whose main activity is in line with the activity characterisation (48 profit makers and 9 loss makers). A list of the accepted companies is presented in Appendix 2. The 57 companies are common to all three scenarios.
- 3.8 The most common reasons for rejecting companies at the manual review stage were that they were engaged in:
- activities where the majority of income is generated from subscription and/or licensing fees;
 - activities which predominantly target the general public as the customer base;
 - logistics, distribution or point-of sale software and services logistics, distribution or point-of sale software and services;
 - developing and selling gaming software;
 - activities related to marketing or advertising; and
 - reselling off-the-shelf IT products.
- 3.9 The scenarios suggested widened the search and found additional companies, however these were rejected at the manual review stage. The list of additional companies found are listed in Appendix 2. Despite these wider scenarios not finding new companies during this process, it is possible that will in future when new companies enter the market and our database. Our concluding position on search terms and NACE codes is set out in the below section.

⁹ The search was based on company information reported in Orbis for the year ending 2020/21. This information is for the same period used in the assessment of the 2022/23 recommended rates.

4. Consultation feedback

Sectors addressed by the IT services activity

- 4.1 The SSRO proposed in the consultation that the following activities are in scope for an IT services activity group:
- the development of bespoke IT software; and
 - integration of off-the-shelf components to deliver bespoke IT services.
- 4.2 We excluded the following from the IT services activity group:
- provision and maintenance of communication infrastructure, as this is more aligned to the SSRO's provide and maintain and the construction activity types
 - IT support services already captured by the ancillary services activity characterisation, such as data management, data processing, network hosting, IT repairs and maintenance and IT security services;
 - development of IT systems that are embedded in equipment, which are addressed by the D&M activity characterisation;
 - support and maintenance of IT systems that are embedded in equipment, which are addressed by the P&M activity characterisation; and
 - fixed point construction activities already captured by the construction activity characterisation.
- 4.3 There was support from industry respondents for the scope of the activity group, with some desire to broaden the scope. Respondents recognised that certain IT service activities are already present in defence contracts that fall under existing SSRO activity groups, such as the development of communication software embedded within hardware.
- 4.4 One respondent suggested the inclusion of the following:
- development of software for defence and civilian purposes;
 - off the shelf components to include hardware and software; and
 - consideration of cloud-based data management and security.
- 4.5 One industry respondent disagreed with the SSRO's proposal to exclude the "provision and maintenance of communication infrastructure" from the IT services activity. The respondent proposed that "the development and integration of bespoke communications systems" should be included. It was argued that this would:
- include networking;
 - recognise the increased prevalence of software driven configurable communications systems such as satellite communications control systems and software defined radio; and
 - include inter-related disciplines such as spectrum management and communications management systems inherently built into military command and control (C2) systems.

- 4.6 Another respondent sought confirmation that the 'provision and maintenance of communication infrastructure' is captured by the P&M activity group.
- 4.7 Industry respondents also submitted that:
- the SSRO should review the justification for excluding regulated utilities, stating that while civil telecommunication activities are largely a regulated industry, defence telecommunications are not;
 - "off-the-shelf components" and "bespoke IT software" are not mutually exclusive activities as many IT projects are a mixture of these two and other inter-related activities;
 - "off-the-shelf components" and "bespoke IT software" activities should be broadly defined to include the use of Open Source software; and
 - "bespoke IT software" should be changed to "bespoke IT system/service" to reflect the systems integration aspect of many IT projects.
- 4.8 The SSRO sought input from the MOD regarding the types of activities that may be included in qualifying contracts. The MOD supported the activities the SSRO proposed to include. It did not consider that IT communication systems activities would fit within the type of activities that the SSRO is seeking to address with the IT services activity group. Their view supported the SSRO's assessment that:
- The types of activities undertaken to deliver communication systems contracts are more aligned to the P&M and the construction activity groups. The MOD noted that the networks component of communication systems involves engineering activities and are part of broader public utilities whose profits are regulated.
 - The product element of communication systems technology that are embedded within a piece of hardware which constitutes the product is more akin to the output of the D&M activity type.
 - There is a distinction between contracting for IT goods and services with subsidiaries of the MOD's major single source suppliers that primarily operate in the military technology market, and contracting with suppliers who operated primarily in the commercial IT sector.
- 4.9 In the MOD's experience IT services do not typically require much bespoke manufacturing. Components may be purchased off the shelf and then modified, for example ruggedised. The purchase of off the shelf components could fall under alternative pricing methods.

Response

- 4.10 We accept industry submissions to widen the activity characterisation as it accords with our understanding from discussions with the MOD:
- IT projects often involve a mixture of "off-the-shelf components" and "bespoke IT software"; and
 - IT projects may involve systems integration and this would be better captured by referring to "bespoke IT system/service" instead of "bespoke IT software".

- 4.11 To reflect these findings, we have modified the proposed activity characterisation of the IT services comparator group to include:
- the development, or operation and maintenance, of bespoke and complex IT systems, or
 - the integration of off-the-shelf components or software to deliver bespoke IT systems/services.
- 4.12 We do not propose to bring into scope any other activities or sectors proposed in feedback from stakeholders, including:
- provision and maintenance of communication infrastructure; and
 - telecommunication activities.
- 4.13 We note representations that these should be included, but we continue to consider that they are more akin to activities in our other groups and distinct to what we are seeking to capture within this IT services comparator group. The companies which tend to provide and maintain communication infrastructure are engaged in a wide range of non-comparable activities such as the construction of communication towers or laying of cables (both of which are more typically fall under our construction comparator group), or the maintenance of a network in order to provide communication services (which is akin to our provide and maintain group).
- 4.14 The SSRO's comparator groups are designed in line with OECD transfer pricing guidelines, and seek to benchmark a profit rate for a given activity type. Our understanding is that when the MOD might seek to procure IT services, they are not looking for the types of activities set out above and so we do not want to capture them within our IT services group. While firms which are engaged in "the provision and maintenance of communication infrastructure" may also engage in some "pure" IT work (such as the development of bespoke software), we are not persuaded that this is their primary business. While a company may be engaged in work across several activity characterisations, for inclusion in one of our groups we require them to be primarily involved in the activity we are seeking to benchmark.
- 4.15 If there is sufficient evidence that telecommunication activities could and should be captured within a comparator group, then the mechanism to do so would be through development of a new comparator group. We would consider where this belongs in any future review of activity types.

Activity characterisation

- 4.16 An activity characterisation is a description of the activities a comparator company is expected to carry out in order to be included in a comparator group. The SSRO proposed an IT services activity characterisation in its consultation and sought feedback on it from stakeholders.
- 4.17 One industry respondent suggests adding the following activities to the characterisation and text search terms:
- IT strategy,
 - application and system architecture,

- Enterprise Resource Planning (ERP – software to consolidate and integrate management of business processes) delivery,
- solution design,
- cloud services / activities,
- IT and information security,
- system development,
- data management and
- security encryption.

4.18 One respondent noted that there was a contradiction in the description of the activity we are seeking to characterise in our original consultation, between how it was described in the characterisation table and in the description of the sectors we are seeking to capture. This contradiction has been rectified within this response.

Response

- 4.19 We have considered the feedback and developed a revised activity characterisation (see Appendix 1). Table 2 summarises the key post consultation changes made for each of the characterisation components. We did not receive specific feedback on characterisation components where we have indicated that we have made 'no change'.
- 4.20 We agree there are important differences between the consumer and defence IT market, and so our characterisation excludes companies which are primarily consumer focused. Additionally we are not interested in capturing companies which raise a significant portion of their revenue from repeat sales (this can be considered a licencing model) and so these companies are also excluded.
- 4.21 On the point of clarification, we recognise that a company may be engaged in IT work, and also engaged in another activity group or groups, for example a firm might create bespoke software solutions and also manufacture headsets (which would be akin to D&M). For inclusion in this activity group, what matters is if the company is predominantly involved in IT services work rather than D&M, as therefore their financial characteristics will more reflect IT work rather than D&M. Table 5 contains a list of suggested companies and the reason they have been rejected, including the case where a company might undertake some relevant IT work but the bulk of their activity lies in a different comparator group.
- 4.22 The full, post-consultation, activity characterisation can be found at appendix 1. The table below highlights what has changed.

Table 2: Key changes to the characterisation proposed in the consultation document

Component	Changes made
The activity we are seeking.	<p>Updated to: <i>companies undertaking comparable activities considered as ‘IT Services’ are expected to engage in:</i></p> <ul style="list-style-type: none"> • <i>the development, or operation and maintenance, of bespoke and complex IT systems; or</i> • <i>the integration of off-the-shelf components or software to deliver a bespoke IT system/service.</i>
The type of contractual relationship observed in defence procurement we are seeking to find comparators for.	Drafting changes to clarify intent, but without substantive change.
Examples of the characteristics of the products or services provided by the company under review that would indicate comparability.	Expanded wording from detailing activities under the two heading of “IT consultancy services” and “software of application development”, to “IT management and consultancy” and “IT system, software or application development”.
Clarification on activities often observed in the companies under review where the decision may be judgemental.	No change.
How the activities being performed should generate value for the comparator.	No change.
Clarification on activities often observed in the companies under review that are acceptable if they are supporting the primary value generation.	No change.
Examples of value generation that would indicate the company under review should be rejected.	We have adjusted the wording to exclude companies engaging in rudimentary solutions or solutions having low levels of complexity. Examples of such activity has been expanded to include “standard standalone cloud services” and “IT outsourcing”.
Summary the characteristics of the end customers of the activity.	No change.
Examples of market segments that would typically indicate the company is not serving the right end customers.	No change.

Search strategy

- 4.23 Text search terms are keywords and NACE codes are standardised descriptors that are used to filter down the full Orbis database if one or more of them are used to classify that company's activities in the database. A company must contain at least one relevant NACE code and one relevant search term to progress to the manual review stage. The SSRO proposed text search terms and NACE codes in the consultation and sought stakeholder feedback.

Text search terms

- 4.24 Respondents made the following suggestions in terms of the text search terms:
- A range of additional terms to place more emphasis on communications relative to IT systems (see table 3).
 - A requirement for companies to have at least one of the following three text search terms to be present: defence*, defense*, militar* ,

Response

- 4.25 We have undertaken additional analysis informed by the feedback we received and revised the set of text search terms, which are presented in Table 3. Each of the companies accepted in the IT services activity group (see Appendix 3) has at least one of the text search terms 'comput*' and 'software*' or 'technology*' in at least one of the Orbis database fields used in the company search process. The inclusion of the search for term 'satellite*' does not identify any companies in addition to those already selected. The remaining text search terms return companies already captured by terms 'comput*' and 'software*' or 'technology*' (see Table 3).
- 4.26 We do not propose to require companies to have a defence or military keyword. It is not the SSRO's intention that the comparator groups contain only companies from the defence industry – companies outside of the defence industry can provide similar services (for example bespoke IT software) and including them increases the sample size of our group and our confidence in it. Requiring these terms to be present may rule out companies that undertake comparable activities but for whom the terms are not present in their description. The terms are nevertheless included without being mandatory, to ensure companies that do reference them are identified.
- 4.27 While in this instance three search terms proposed by the SSRO would have captured all of the companies assessed as undertaking comparable activities, we consider it prudent to include a wider range of terms to avoid missing relevant companies in the search process in future. Therefore our position is to accept the proposed search terms based on expert opinion from stakeholders. However we consider the terms engineer* and architect* are most appropriate when they appear alongside "software", which is already include. "Software" alone will pick up all instances of "software architect/engineer" alongside other terms such as "software developer", without identifying companies in the broader activities engineering or architecture which are not relevant to IT services.

- 4.28 The other proposed terms we have excluded are “communication* and satellite*” (see Table 3). To include these would be confusing and contradictory to the stated activity type we are seeking to capture. As stated above in 4.21 the balance of opinions submitted to us and our judgement is that the economic activity involved in provision of communication services is not compatible with the stated aim of this IT services comparator group, and may be captured within other activity types. For example the laying of cables may be considered construction while production of communication devices may be considered D&M. The table below sets out the final search terms.

Table 3: Text search terms analysis

Text search terms proposed by the SSRO			Additional search text terms proposed by stakeholders
<i>Combination used by all accepted companies</i>	<i>Additional text search terms</i>		
comput*	militar*	network*	secur* ^
software*	defence*	portal*	mobil* ^
technology*	defense*	hardware*	encrypt* ^
	digit*	IT!	communication* ^
	information*	web*	satellite* ^
	program*		engineer* ^^
	cyber*		architect* ^^
	cloud*		install* ^^

Note: ^- additional text search terms suggested by industry

^^ - additional text search terms suggested by BDO

Red font – text search terms excluded from the final list

NACE codes

- 4.29 The consultation proposed a set of NACE codes which may be applied to search the Orbis data base for relevant comparator companies. NACE codes are a standard classification system of similar economic activities. Two respondents raised issues with the system of NACE codes:
- NACE codes are attached to many companies that are subsequently rejected as being comparable;
 - companies that should be included in the comparator group may be missed;
 - NACE codes do not cover prime contracting, which should not be viewed as restricted to the delivery of physical platforms to the Armed Forces; and
 - The NACE code system does not use the word “security” to mean cyber security and therefore does not have full coverage of activities.

4.30 Proposals were made to include the following additional NACE codes and the SSRO has analysed the effect of their inclusion (see Table 4):

- 6130 - satellite telecommunications activities;
- 6399 - other information service activities (not elsewhere classified); and
- 821 - office administrative and support activities.

4.31 Respondents also raised the following questions:

- whether the MOD has confirmed the nature of IT service contracts they are intending to single source rather than compete, to help defining the text search terms; and
- whether CPV codes are used in addition to NACE codes, and the IT services approach is an improvement to the approach applied to the existing activity groups.

Response

4.32 Our purpose in using NACE codes is to identify potentially relevant data from a database of over 400 million companies. The evidence we have from their use in the baseline profit rate assessment is that they are an effective tool in helping to identify relevant comparators. Including a NACE code which is not necessary will increase the amount of work involved in the manual review of companies, but will not bias or negatively impact the final list of comparator companies. Excluding a relevant NACE code could mean that a relevant company is excluded from the final list, therefore we err on the side of including NACE codes if they are relevant.

4.33 With respect to prime contracting and cyber security we welcome suggestion of companies engaged in these activities which are thought to be relevant comparators. We also note that:

- a. The NACE code system does not differentiate economic activities by forms of procurement, such as prime contracting. Companies whose economic activities are delivered using prime contracting are captured in the NACE code system and our searches in the development of this IT services group identify comparable prime contractors, for example DXC.¹⁰
- b. We anticipate that companies primarily engaged in cyber security would identify themselves under ones or more of the information and communication NACE codes. The hierarchy of NACE codes is not broken down to separately identify “cyber security” as a distinct economic activity, however we have selected NACE codes that we believe capture this as a subset of a wider set of IT activities. Just because the NACE code system does not specifically seek to identify cyber security companies does not mean these companies are excluded.

¹⁰ DXC has the following NACE codes, 6201 - Computer programming activities; 5829 - Other software publishing, 6209 - Other information technology and computer service activities, 6203 - Computer facilities management activities, 6311 - Data processing, hosting and related activities.

- 4.34 We have considered the suggestion of additional NACE codes and propose to add code 6399 (other information service activities nec) and 6130 (satellite telecommunications activities), although we note their inclusion did not result in additional comparable companies being identified. Additionally, while 6130 may be considered an irrelevant category given the activities we are seeking to capture, we consider it possible that in future inclusion of this NACE code may find a relevant company. We have not considered including code 821 (office administrative and support activities), as these are not activities we are seeking to benchmark and we do not consider it plausible that this NACE code will identify relevant companies in future.
- 4.35 We have considered the feedback, undertaken additional analysis and do not find evidence to support the view that we miss relevant companies if the search is limited to the NACE codes that we proposed in the consultation (see Table 4). Of the 57 accepted comparators, 51 use at least one of the SSRO scenario NACE codes in their Orbis primary NACE code fields, and the remaining six companies use them in their Orbis secondary NACE code fields.
- 4.36 We confirm that we reaffirmed the nature of the activities which the MOD were seeking to capture through this comparator group, and the current characterisation is a reflection of those activities.

Table 4: NACE codes used by accepted companies

NACE codes proposed by the SSRO		Final NACE codes
NACE code	NACE code description (economic activity)	
5829	Other software publishing	<input checked="" type="checkbox"/>
6201	Computer programming activities	<input checked="" type="checkbox"/>
6202	Computer consultancy activities	<input checked="" type="checkbox"/>
6209	Computer information technology and computer service activities	<input checked="" type="checkbox"/>
Additional NACE codes suggested by industry and BDO		
NACE code	NACE code description (economic activity)	
6130 *	Satellite telecommunications activities	<input checked="" type="checkbox"/>
6399 **	Other information service activities nec	<input checked="" type="checkbox"/>
821 **	Office administrative and support activities	<input checked="" type="checkbox"/>

Note: * - additional NACE codes suggested by industry

** - additional NACE codes suggested by BDO

Potential internal comparables

- 4.37 The SSRO used the characterisation, text search terms and NACE codes that it proposed in the consultation and undertook an analysis through which a set of potential IT services activity group comparators were identified for the original consultation. We also sought stakeholder suggestions for additional companies and respondents provided a range of suggestions that are shown in Table 5.

- 4.38 One respondent noted that there are many companies, particularly for weapons delivery systems, whose products are dominated by hardware and software delivery for their enablement. They identified three companies present in the SSRO's existing activity groups which were considered to be IT services companies. They considered this finding undermined the notion of a separate IT services comparator group.

Response

- 4.39 We have assessed each of the proposed companies against the criteria for inclusion in the comparator group. Where the criteria are met we have included them. Our investigation included searching for their detailed information and subjecting them to our company review process using the characterisations set in Appendix 1. The list of companies and our findings are presented in Table 5. We had already accepted three companies proposed by respondents (Accenture, DXC and IBM) through the standard search process.

Table 5: Results from investigation of industry's proposed internal comparables

Company	Decision	Reason for decision
DXC	Accept	Undertakes comparable activities in comparable markets
Accenture		
IBM		
Nexor	Reject	The company does not report details of its income statement and so can not be meaningfully used in the comparator group.
SecureCloud+	Reject	Its turnover is under the £10.2 m threshold and therefore fails the company size search criteria.
Deloitte	Reject	It has the wrong legal form (it is a partnership) and is therefore excluded under transfer pricing principles. Partnerships potentially have incomparable base costs to private and public companies. For example payments to partners are recorded and reported as drawings not salaries.
Amazon	Reject	Derives most of the revenue from consumer-focused activities and as such does not meet the activity characterisation.
Microsoft	Reject	Derives a significant amount of the revenue from subscription/licencing and from customer-focused activities, and as such does not meet the activity characterisation.
Leidos	Reject	It predominantly undertakes the P&M activity group activities.
L3Harris	Reject	It predominantly undertakes the D&M activity group activities.
PA consulting	Reject	These companies are subsidiaries of other companies (for example AWS is a subsidiary of Amazon), and therefore fail the independence criteria, a key function of the arm's length Transfer Pricing principle on which the BPR methodology is based. The SSRO's methodology searches for global ultimate owners which have consolidated accounts for inclusion into the comparator groups.
Roke		
BAE AI		
BMC software		
AWS		

- 4.40 We acknowledge that there is a difficulty in assigning a company purely to one activity group. This partly arises as comparator groups are used to benchmark contracts, while the relevant data for bench marking is only available at a company level. However the activity characterisation (appendix 1) is designed to be as distinct from other groups as possible. For example it excludes companies which predominantly provide IT embedded with hardware (as this would be D&M), and it excludes IT services of a low level of complexity (as this would fall under ancillary services).

Other matters

- 4.41 Three industry stakeholders provided other feedback that the SSRO did not consult on.

Stakeholder feedback	SSRO response
When were the SSRO activity characterisations first published, and whether they were subject to a consultation?	The SSRO first consulted on them in the SSRO's first BPR methodology consultation in September 2015 ¹¹ . The SSRO made improvements to the characterisations following consultations in July 2016 ¹² and in July 2019 ¹³ .
Some of the activity groups have blank characterisations components.	Where an activity group has a blank characterisation component it is a reflection that those attributes are not a significant feature of the corresponding activity type.
Some IT characteristics are already listed under the ancillary services activity.	The final characterisation set in Appendix 1 ensures a distinction between ancillary services and IT services activities i.e. that an activity cannot fall under both groups. Ancillary services are characterised by low levels of complexity and these are explicitly excluded from the IT services group.
The consultation document does not comment on the risks involved in the 'Develop and Make' and 'Provide and The Maintain' activity groups.	The consultation focused on identifying the economic activities that might constitute a group which reflects the activities that enable the performances of qualifying contracts. The risk involved in provision of IT services will be reflected in the profit rate of the IT services group, but is distinct from the risks of other comparator groups.

11 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/492422/Profit_Rate_Consultation_24_September_FINAL.pdf

12 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/536061/2017-18_Profit_rate_consultation_7_July_20161.pdf

13 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/813267/Consultation_on_changes_for_the_2020-21_rates_assessment_WEB.pdf

Stakeholder feedback	SSRO response
<p>The SSRO has stated that “Where a group carries out IT service activities for the MOD alongside other work, the financial data of the group may not be useful for benchmarking...”, but cited examples of companies in the D&M and P&M groups that perform no work for the MOD or have significant parts of their group who do no work for the MOD.</p>	<p>Performing work for the MOD is an indication that a company may be primarily engaged in the type of activity we are seeking to characterise, but it does not necessarily mean so. We are seeking companies whose financial data can benchmark the profit rate for an IT contract with the MOD, and it is the type of activity they are performing which is relevant for this. So we consider it is right that firms which do the right activity but do not engage with the MOD are captured in our comparator groups.</p>
<p>The SSRO should undertake a review of the actual activity groups each GUO operates in, and consider if it is possible that a number of GUOs operate in multiple activity groups, if comparability would be enhanced if some activity groups were combined.</p>	<p>In accordance with the SSRO’s 2022-25 draft corporate plan we intend to keep the methodology under review. We want to consider how the activities which occur under qualifying contracts are reflected in our baseline profit rate assessment. We have not yet programmed the activities review We will invite input from stakeholders at the time of any review.</p> <p>The SSRO has recently published a response to industry representation on a range of issues related to the selection of comparator companies. This reflects the SSRO’s most recent assessment on these matters and we will consider reviewing them further as we progress the activities set out in the corporate plan.</p>
<p>The SSRO has sought comparable parameters through consideration of existing MOD contracts, they consider this approach would benefit all activity groups. They argue that the knowledge gained from the 381+ qualifying contracts could better inform the selection criteria/parameters (e.g. minimum GUO size, and capital base); and enhance the understanding of whether D&M and P&M contracts are performed from common GUOs, and a consequent consideration to combine the two activities into one activity group</p>	
<p>Would it be better to assess the requirement for, and the cost of, a new activity category post the introduction of new pricing methodology if a new pricing formula is introduced.</p>	<p>We agree it will be important to keep this work under review in light of any changes that may be proposed to the way in which qualifying contracts are priced. We are now considering a new activity group because stakeholders have said that the IT sector is insufficiently represented in the existing four activity groups and the recent Defence and Security Industry Strategy (DSIS) set out proposals that may alter the make-up of what MOD chooses to procure without competition.</p>

5. Appendices

Appendix 1: IT services activity characterisation

Component	IT services activity characterisation
The activity we are seeking	<p>Companies undertaking comparable activities considered as 'IT Services' are expected to engage in:</p> <ul style="list-style-type: none"> • the development, or operation and maintenance, of bespoke and complex IT systems; or • the integration of off-the-shelf components or software to deliver a bespoke IT system/service.
The type of contractual relationship observed in defence procurement we are seeking to find comparators for	<p>Comparable activities would typically be of a type that can be likened to those involved in any of:</p> <ul style="list-style-type: none"> • design, • production, • manufacture, • integration, or • operation <p>of networks and computer systems or services used for military or defence purposes.</p>
Examples of the characteristics of the products or services provided by the company under review that would indicate comparability	<p>This could cover a broad range of IT management and consultancy services; and IT system, software or application development. In addition, comparable companies may also provide the hardware for IT systems or networks, or the training necessary to operate or maintain them.</p> <p>Comparable IT management and consultancy services would typically be:</p> <ul style="list-style-type: none"> • Computer management services (for example IT strategy, computer network services, systems maintenance, automation, security encryption, bespoke cloud services / activities; or IT and information security and network management); • Hardware consultancy services (for example solution design, system architecture, hardware selection, integration, acceptancy testing and recovery; disaster recovery; computer site planning and computer audit); • Software consultancy services (for example business analysis, system quality assurance and review, or system software acceptance and testing); or • Cybersecurity consultancy services (for example security architecture design or forensic analysis of breaches, penetration testing and end user security training).

Component	IT services activity characterisation
	<p>Comparable IT system, software or application development would typically include:</p> <ul style="list-style-type: none"> • Bespoke IT system design and building; • Bespoke software development; or • Bespoke integration of tailorable third-party software or applications, and subsequent testing
<p>Clarification on activities often observed in the companies under review where the decision may be judgemental</p>	<p>A bespoke IT system is tailored to the specific customer operating model and requirements. This may include new development or may include the integration or customisation of underlying systems or software created by others. Companies that resell software or applications without tailoring or integrating them are less likely to be carrying out comparable activities. Companies that generate most of their revenue from subscriptions or licenses are less likely to be carrying out comparable activities.</p>
<p>How the activities being performed should generate value for the comparator</p>	<p>The value added, cost base or profits of the business are expected to principally derive from the services described above.</p>
<p>Clarification on activities often observed in the companies under review that are acceptable if they are supporting the primary value generation.</p>	<p>Where the IT system is embedded within equipment (for example a ship or a vehicle), a comparable company would not typically be expected to carry out equipment design, manufacturing or maintenance activities that extend beyond what might reasonably be required to deliver the underlying IT system. A similar exclusion applies for an IT system that is embedded within network infrastructure (for example telecommunications or internet provision).</p>
<p>Examples of value generation that would indicate the company under review should be rejected.</p>	<p>Companies that engage in the provision of rudimentary IT services would not typically be considered comparable, for example the provision of IT support services, data management, routine software maintenance, off-the-shelf solutions, standard standalone cloud services, or IT outsourcing.</p>
<p>Summary the characteristics of the end customers of the activity</p>	<p>The end customers for the services provided by comparable companies are expected to be other businesses, institutions or governments.</p>
<p>Examples of market segments that would typically indicate the company is not serving the right end customers</p>	<p>Comparable companies are not expected to primarily engage in the development of public infrastructure or serve the general public with, for example, computer hardware and software and internet services. Companies that primarily serve customer-facing industries, such as financial services, media and advertising, hospitality or retail are less likely to be carrying out comparable activities.</p>

Appendix 2: List of accepted companies

Accenture Public Limited Company	Itera ASA
Adesso AG	Kainos Group PLC
Allgeier SE	Kinaxis Inc.
American Software INC	KRATZER AUTOMATION Aktiengesellschaft *
Ansys INC	Manhattan Associates INC
Atea ASA	Materna Information & Communications SE
Atos SE	Micro Focus International PLC *
Avaya Holdings Corp. *	Mnemonic AS
Barstone Limited	Omnicell, Inc.
Beta CAE Systems S.A.	Oracle Corp
Bjss Limited	Prodware SA
Canonical Group Limited	Project Daytona Limited
Cerner Corp	PTC Inc.
CGI Inc.	Ribbon Communications, Inc.
Cognizant Technology Solutions Corp	Servicenow, Inc.
Columbus A/S	Skill AS
CS Group SA *	Societe Pour l'Informatique Industrielle SA
Cynergistek, Inc. *	Sopra Steria Group SA
Dotmatics Limited	Sorint.Lab Societa' PER Azioni
DXC Technology Company *	SSH Communications Security OYJ *
Excelredstone Services Limited	Sword Group SE
Exela Technologies, Inc. *	Synopsys INC
Fortinet INC	Ten10 Group Limited
F-Secure OYJ	THE Descartes Systems Group INC
Generix Group	TSR INC *

* indicates loss maker

Appendix 3: List of additional companies from the industry and BDO scenario searches

BVD ID	Company name	Industry scenario	BDO scenario
US752702753	Pioneer Natural Resources CO		<input checked="" type="checkbox"/>
US203717839	LPL Financial Holdings Inc.		<input checked="" type="checkbox"/>
GB02048608	Serco Group PLC		<input checked="" type="checkbox"/>
US590864469	Brown & Brown INC		<input checked="" type="checkbox"/>
US880326081	Ormat Technologies, INC		<input checked="" type="checkbox"/>
ESB46126686	Pavimentos Y Construcciones de Hormigon SL		<input checked="" type="checkbox"/>
NO977199611	Infinitum AS		<input checked="" type="checkbox"/>
IE552564	Cairn Homes PLC		<input checked="" type="checkbox"/>
US201700361	ARC Document Solutions, Inc.		<input checked="" type="checkbox"/>
DE3170118882	Regiocom SE		<input checked="" type="checkbox"/>
GB07493527	Toluna Holdings Limited		<input checked="" type="checkbox"/>
GB05635505	Nexus Infrastructure PLC		<input checked="" type="checkbox"/>
SE5566938881	Besqab AB		<input checked="" type="checkbox"/>
ESB82552118	Serrano 134 S.L.		<input checked="" type="checkbox"/>
ESB96490867	Edicom Capital Sociedad Limitada.		<input checked="" type="checkbox"/>
IT03672990284	SFC Holding S.P.A.		<input checked="" type="checkbox"/>
DE7110026848	FIZ Karlsruhe - Leibniz-Institut fuer Informationsinfrastruktur GmbH		<input checked="" type="checkbox"/>
ESA38102232	Garcia Pascual Canarias SA		<input checked="" type="checkbox"/>
GB08203105	Broadband Satellite Services Limited	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
GB08064713	CMC Holdings (SW) LTD		<input checked="" type="checkbox"/>
ESA41868126	Grupo Rusvel SA		<input checked="" type="checkbox"/>
NO983163327	Buypass AS		<input checked="" type="checkbox"/>
IT06862080154	L'Eco Della Stampa S.P.A.		<input checked="" type="checkbox"/>
PT513750150	Damap Group, S.A.		<input checked="" type="checkbox"/>
NO934603729	Onsagers AS		<input checked="" type="checkbox"/>
GBSC355700	Whittaker Group Limited		<input checked="" type="checkbox"/>
GB04623948	Howard Holdings (Anglia) Limited		<input checked="" type="checkbox"/>
ESB86045382	Teyame 360 SL.		<input checked="" type="checkbox"/>

- company captured by the search scenario in addition to those captured in the SSRO scenario search

the 1990s, the number of people in the UK who are aged 65 and over has increased from 10.5 million to 13.5 million, and the number of people aged 75 and over has increased from 4.5 million to 6.5 million (Office for National Statistics 2000).

There is a growing awareness of the need to address the needs of older people, and the need to ensure that the health care system is able to meet the needs of this population. The Department of Health (2000) has set out a strategy for the health care system to meet the needs of older people, and the Health Service Research Unit (2000) has set out a research agenda for the health care system to meet the needs of older people.

The Health Service Research Unit (2000) has identified a number of key areas for research, and the Department of Health (2000) has identified a number of key areas for research. The Health Service Research Unit (2000) has identified a number of key areas for research, and the Department of Health (2000) has identified a number of key areas for research.

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