

**SSRO**

Single Source  
Regulations Office

# Baseline Profit Rate Activities Review Consultation

June 2023

# Contents

<b>1.</b>	<b>Introduction</b>	<b>3</b>
<b>2.</b>	<b>Phase 1: DefCARS portfolio review</b>	<b>7</b>
<b>3.</b>	<b>Development of an activity group</b>	<b>18</b>
<b>4.</b>	<b>Consultation questions</b>	<b>20</b>
	<b>Appendix A</b>	<b>22</b>
	<b>Appendix B</b>	<b>30</b>
	<b>Appendix C</b>	<b>32</b>
<b>5.</b>	<b>Phase 2: Activity groups updates</b>	<b>32</b>

# 1. Introduction

## Background

- 1.1 Section 19 of the Defence Reform Act 2014 requires the SSRO to provide the Secretary of State with its assessment of the appropriate baseline profit rate (BPR), capital servicing rates and SSRO funding adjustment used to determine the contract profit rate for pricing qualifying defence contracts (QDCs) and qualifying sub-contracts (QSCs).
- 1.2 This assessment assists the Secretary of State to determine the rates which will be applied each financial year. As part of Objective 1: *Maintain a pricing system that supports value for money and fair prices* as set out in the SSRO's 2023-2026 Corporate Plan, this year we are considering how the MOD's purchasing decisions are evolving by reviewing the DefCARS contract portfolio and representations from stakeholders and considering whether this signals the need to further develop the activity types that underpin our baseline profit rate (BPR) methodology.
- 1.3 The SSRO's current BPR methodology was established in 2016. The methodology uses an activities-based approach to setting the BPR, ensuring that only the profitability of companies conducting comparable activities, whether for the defence industry or not, are used in the calculation of the BPR recommendation. This replaced the Yellow Book methodology, with a robust, reliable and replicable process based on actual reported profit data from relevant companies' statutory accounts.
- 1.4 This methodology identifies companies undertaking activities comparable to those that contribute to the delivery of single source contracts through reviewing the characteristics, risks and assets of Qualifying Defence Contracts (QDCs) and Qualifying Sub-contracts (QSCs) (hereafter collectively referred to as qualifying contracts) and analysing company accounts, business descriptions and public information. This results in a methodology that, unlike the previous regime, no longer uses companies that bear no relevance to those activities undertaken in the defence industry, such as supermarket retailers, pharmaceutical and tobacco companies.
- 1.5 The current set of activities which underpin the BPR assessment were established early in the regime. Examining single source contracts at the time, the SSRO identified that the majority of activities involved were captured in activity types named Develop and Make (D&M) or Provide and Maintain (P&M) and used these as the activity types on which to base the BPR assessment.
- 1.6 The SSRO is conducting a review of activities used in the BPR assessment in two phases. We are seeking stakeholder input on our findings to phase 1 and proposed follow-on work in phase 2 as part of the SSRO's commitment to ongoing continuous improvement of the BPR methodology.

## The approach to the baseline profit rate

- 1.7 The SSRO applies its [Single Source Baseline Profit Rate, Capital Servicing Rates and Funding Adjustment Methodology](#) (“the methodology”)<sup>1</sup> to make its assessment of the rates.
- 1.8 The methodology identifies companies whose economic activities are included in whole or in part in the activity types that contribute to the delivery of qualifying contracts. These comparable companies form the comparator groups for each activity type.
- 1.9 The financial data of the comparable companies that form the comparator groups are combined with capital servicing rates derived from relevant bond yields or interest rates to calculate a single underlying profit rate for each activity type. This process is used to calculate the underlying profit rates for the following activity types:
- Develop and make (D&M);
  - Provide and maintain (P&M);
  - Ancillary services;
  - Construction; and
  - IT Services.
- 1.10 Detailed descriptions of each activity type are included in Appendix A of this document.
- 1.11 The BPR is a composite rate derived from two activity types: Develop and Make (D&M) and Provide and Maintain (P&M). Together, these types of work represent the vast majority of single-source procurement.
- 1.12 Given that Ancillary Services, Construction and Information Technology Services account for a small proportion of single-source contract spend, they are not included in the BPR composite rate as doing so would not be consistent with the principle of comparability.
- 1.13 The methodology adopts a comparable company search process that follows transfer pricing principles to identify comparable companies. Transfer pricing is employed extensively by multinational enterprises and tax authorities globally to ensure that companies operating in a number of territories receive appropriate income and profit in each.
- 1.14 The UK’s transfer pricing legislation details how transactions between connected parties are handled and, in common with many other countries, is based on the OECD’s internationally recognised ‘arm’s length principle’, whereby the profit mark-up on transactions between connected entities are benchmarked against comparable transactions between independent entities to ensure that profits are transferred to, and so are taxed in, the appropriate jurisdiction. The [OECD Guidelines on Transfer Pricing for Multinational Enterprises and Tax Administrations](#)<sup>1</sup> (“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.

<sup>1</sup> <https://www.gov.uk/government/publications/2021-contract-profit-rate>

- 1.15 The application of the arm's length principle in international taxation is analogous to the SSRO's requirement to recommend a baseline profit rate, which simulates the outcome of a market process (for example a competitive tender). The principle of the BPR is to ensure that qualifying contracts' contractors receive a fair level of profit on contracts, consistent with their functions performed. While this approach is distinct from tax matters, the goal is similar to that of certain transfer pricing methods, which seek to identify an arm's length profit mark-up by benchmarking returns achieved by comparable companies.
- 1.16 The project aims to ensure that our BPR methodology continues to reflect the activities undertaken in existing qualifying contracts and as such adheres to the comparability principles that underpin our approach to the BPR assessment.

### **Consultation structure**

- 1.17 The consultation document is structured as follows:
- Section 2 presents the findings of Phase 1: DefCARS portfolio review.
  - Section 3 presents a brief overview of how an activity group is constructed.
  - Section 4 presents the consultation questions.
  - Section 5 contains appendices.
- 1.18 The SSRO invites all interested parties to respond to the consultation by 10 August 2023, in accordance with section 4 of this document.

### **Proposed timetable**

- 1.19 The review will be conducted in two phases:
- Phase 1 (Spring/Summer 2023) involved a detailed review of the DefCARS portfolio analysing how the contracts the MOD has entered into align with the SSRO's current activity groups. Our findings are presented in Section 2.
  - Phase 2 (Autumn/winter 2023/24) will consider stakeholder feedback and, alongside recommendations made in the consultation, examine any required refinement to the activities characterisations to improve the comparator company activity groups.
- 1.20 Phase 2 will also focus on the revalidation of our benchmark activities and refinement of the methodology as necessary should we discover:
- activities currently included which do not, or are unlikely to, substantially feature in qualifying contracts;
  - activities not currently included which do, or are likely to, substantially feature in qualifying contracts;
  - a division used in our activity groups which is not substantially reflected in the division of qualifying contracts activities (e.g. is developing and manufacturing (D&M) identifiable as a separable activity to maintaining and asset provision (P&M) activities as it is currently reflected in our approach); and/or

- analysis indicates any of the three elements used to identify comparable activities (activity characterisation, text search terms and NACE codes) are incomplete or contain redundancies that are ineffective in identifying valid comparator companies.
- 1.21 The annual BPR assessment will take place concurrent to phase 2 of the review. During this period, we will publish a response to the consultation and propose any recommended updates to the activity groups and their characteristics.
- 1.22 Dependent on the outcome of the review and input from stakeholders we will seek the SSRO Board's approval to update the activity groups and their characterisations as part of the annual BPR methodology approval cycle, implementing any recommended changes in the following BPR assessment in 2024/25. This is subject to change as the review progresses through phases 1 and 2.
- 1.23 The proposed timetable for this consultation is summarised in Table 1.

**Table 1: Proposed timetable**

Date	Activity	Review phase
22 June 2023	Consultation publication	Phase 1
10 August 2023	End of consultation	
October 2023	Publish the consultation response	
Autumn/Winter 2023	Activity characterisations review informed by phase 1 findings	Phase 2
Spring/Summer 2024	Report on review's findings and any recommended refinement to benchmark activities.	Implementation <sup>2</sup>
September 2024	Present any recommended refinements to the SSRO Board as part of the annual BPR methodology approval cycle	Approval Per paragraph 1.24 this is envisaged as the end of the review, however this is subject to change based on the outcome of the review.
Autumn 2024/Winter 2024/25	Assessment of rates based on revalidated benchmark activities	Assessment
January 2025	Recommendation of rates to the Secretary of State inclusive of revalidated benchmark activities	Recommendation

<sup>2</sup> Dependent on the outcome of phase 2 and any recommendations made, we may issue a second public consultation after the conclusion of phase 2 to request input from stakeholders.

## 2. Phase 1: DefCARS portfolio review

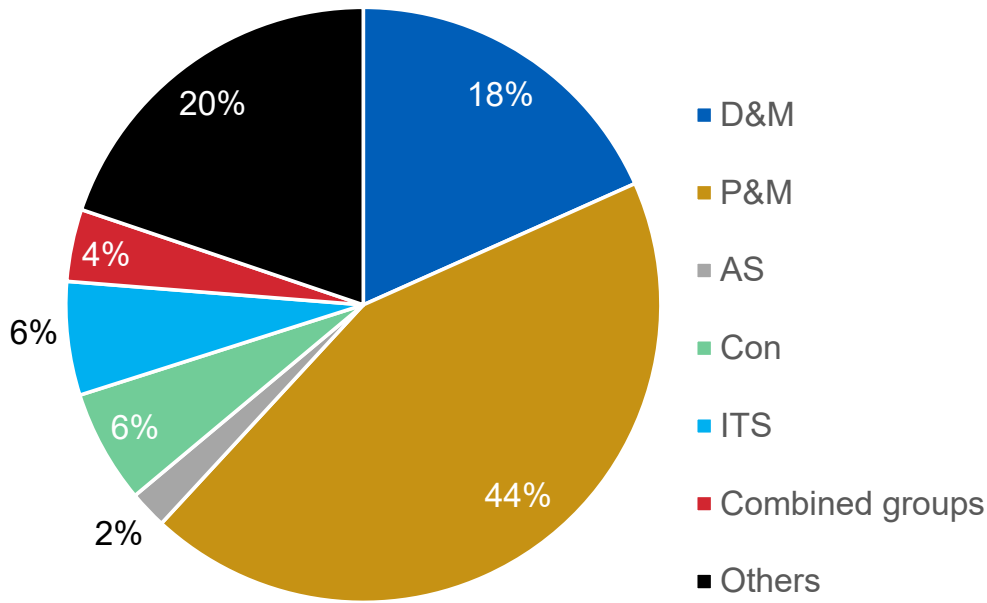
### Purpose of review

- 2.1 The current set of activities which underpin the BPR assessment were developed early in the regime. Examining single source contracts at the time, the SSRO identified the Develop and Make (D&M) and Provide and Maintain (P&M) as the dominant activities and used them as the activity types on which to base the BPR assessment when the methodology was initially developed.
- 2.2 There is now a significant body of qualifying contracts which did not exist when the original activity types used in our methodology were first developed. Data on these contracts, which is submitted in statutory reports and held in DefCARS, can inform the review of our activity types. As of 1 May 2023, there were 535 qualifying contracts that had submitted reports in DefCARS. This data can assist us to review and revalidate our benchmark activities, and refine them where necessary using information from these qualifying contracts. Ensuring our activity types are based on data reported by contractors on actual qualifying contracts provides greater assurance that the BPR is set with reference to activities that contribute to the delivery of those contracts.
- 2.3 The Phase 1 review examined the activities which the existing 535 qualifying contracts undertake and analysed how they align with the existing five activity groups.

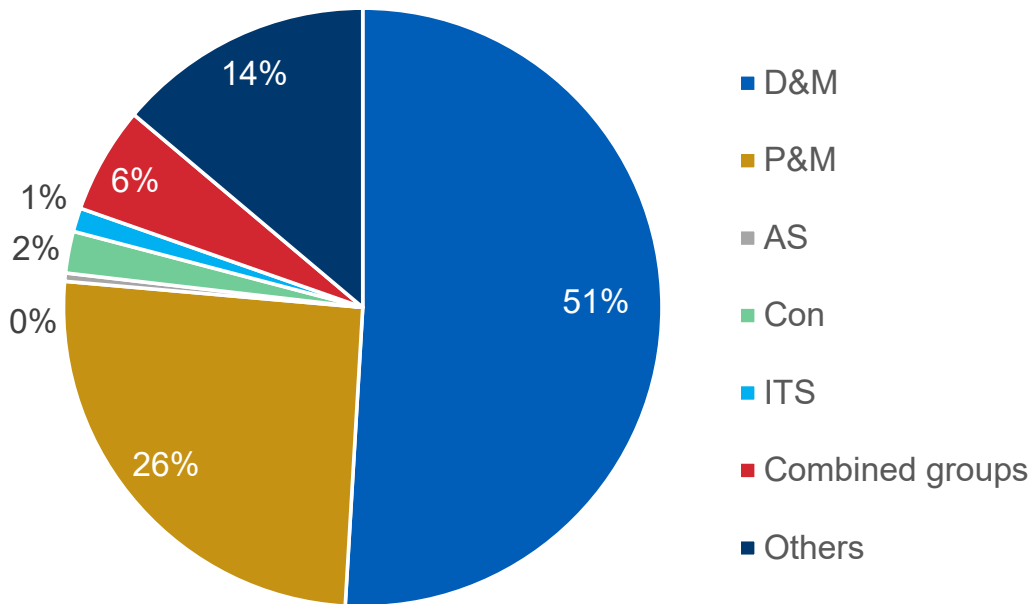
### Review findings

- 2.4 Phase 1 involved assessing if the contract activities are comparable with those set out in the relevant activity characterisation included in Appendix A. The underlying principle is that an ideal comparable contract will undertake the activities described in the relevant activity characterisation and the market characterisation. In order for a qualifying contract to be identified within an existing activity group, positive evidence is required that it undertakes comparable activities. If the qualifying contract involves a mix of activities or does not perform activities included in our existing groups, or the review is inconclusive, then it is categorised into one of the activities specified in paragraphs 2.7 - 2.9 below.
- 2.5 The DefCARS data used was the Management Information (MI) generated by the SSRO analysis team for the annual qualifying defence contracts statistics 2022/23 with additional bespoke fields to allow us to undertake the review. This was supplemented by internal subject matter experts, such as the SSRO Defence Advisor, on particular contracts and public open-source information. In combination we constructed a sufficient understanding to determine an appropriate classification for each qualifying contract.
- 2.6 We identified 76 per cent of the qualifying contracts (408 in number) that undertake activities that are comparable with those characterised in our existing five activity groups (Figure 1). These qualifying contracts account for 80 per cent (£67.2 billion) of the £83.6 billion qualifying contracts' total contract price (Figure 2). This result demonstrates that the existing five activity groups reflect significant features of the qualifying contracts the MOD has entered into within the Single Source Regime; and provides confidence in our established methodology as an appropriate starting point for the application of the six-step process to determine their contract profit rate.

**Figure 1: % of total number of qualifying contracts**



**Figure 2: % of total contract price of qualifying contracts**



*Note:* D&M – Develop and make;  
 P&M – Provide and maintain;  
 AS – Ancillary services;  
 Con – Construction; and  
 ITS – Information technology services.

Combined groups – a qualifying contract undertaking activities across two different activity groups (e.g. D&M and ITS); and  
 Others - qualifying contracts whose activities are not characterised in our existing activity groups.

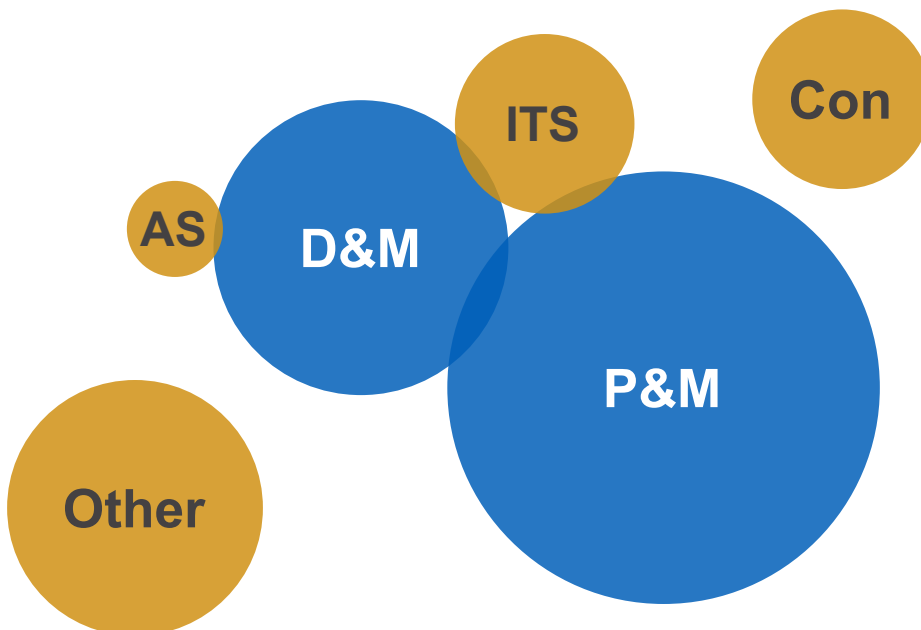
*Source:* DefCARS and SSRO



2.7 We identified some qualifying contracts that engaged in more than one activity type, which we labelled as ‘combined groups’ (e.g. P&M and ITS) to enable us to establish qualifying contracts which undertake activities that are comparable across more than one of our existing activity groups. We found only four per cent (21 qualifying contracts) which undertake activities in these combined groups. These qualifying contracts account for six per cent (£4.8 billion) of the qualifying contracts’ total contract price. A granular analysis of the combined groups is as follows:

- Nine qualifying contracts representing 1.7 per cent of the total number of qualifying contracts and accounting for 3 per cent of the qualifying contracts’ total contract price undertake combined D&M and P&M activities;
- Eight qualifying contracts representing 1.5 per cent of the total number of qualifying contracts and accounting for 2.6 per cent of the qualifying contracts’ total contract price undertake combined P&M and ancillary services activities;
- Three qualifying contracts representing 0.6 per cent of total number of qualifying contracts and accounting for less than 1 per cent of the total qualifying contracts’ total contract price value undertake combined P&M and IT services activities; and
- Only one qualifying contract undertakes combined D&M and ITS activities.
- This limited overlap of existing activity groups is illustrated in Figure 3.

**Figure 3 – representation of mixed contract types**



2.8 We identified 106 qualifying contracts (20 per cent) whose activities are not characterised in our existing activity groups. They account for 14 per cent of the qualifying contracts’ total contract price. We also identified an activity which phase 1 review found little indication in the qualifying contracts, and hence requires further investigation. We categorised the activities into six elements, four of which are the subject of this consultation and two we deemed to require no additional input at this time (as set out in their sections below). The six elements identified were:

### Elements addressed in Phase 1 consultation

- Technical support
- Logistics
- Labour outsourcing
- Contracting for availability or capability

### Elements not addressed as part of the Phase 1 consultation

- Concept, assessment and demonstration (CAD)
- Other

### Technical support

- 2.9 The review identified 34 qualifying contracts (6 per cent) that undertake technical support services. They account for 10 per cent of the qualifying contracts' total contract price. The activities mainly undertaken by the qualifying contracts under this category relate to, but are not limited to, the provision of technical support on safety, engineering, training and information services. They also include provision of specialised data analysis services, and subject matter expertise.
- 2.10 The current P&M activity characterisations, text search terms and NACE codes make provision for services that ensure the availability of an asset either through repair and servicing to third party equipment, or through hire or lease arrangements that include associated upkeep and maintenance services. In addition to other NACE codes, the activity group uses NACE code 749 which is described as 'other professional, scientific and technical activities nec'<sup>3</sup>, which are knowledge-based activities.
- 2.11 We believe the provision of 'knowledge-based' technical support services complements the other knowledge-based activities already included in NACE code 749 and seek input on whether to add technical support services to P&M characterisations, text search terms and NACE codes.

**Consultation question 1:** Do you agree that the technical support activity complements existing knowledge-based activities and should be added to the provide and maintain activity group? Do you have any reasoning why the P&M characterisations should not be expanded to include technical support services?

### Logistics

- 2.12 The review identified 12 qualifying contracts (2 per cent) which undertake logistical supply and support services. They account for less than one per cent of the qualifying contracts' total contract price. The activities mainly undertaken by the qualifying contracts under this category relate to the management, movement and delivery of military equipment, contract support for the supply of equipment and repair and overhaul activity, and provision of logistic information and logistic support services.

<sup>3</sup> nec stands for 'not elsewhere classified'

- 2.13 The current P&M activity characterisation includes text which refers to logistics as follows: “It may be acceptable for comparable firms to engage in some loosely comparable activities as part of normal business (for example, parts procurement, warehousing, logistics, installation, or the sale of the company’s ex-hire fleet)”.
- 2.14 The review identified 12 qualifying contracts that, in their entirety, provide logistic supply and support services. It is ambiguous whether the existing P&M activity characterisation would consider this within its scope, however we believe that these activities align with the spirit of the existing P&M characterisation. We seek input on whether to add logistic services to the P&M characterisations, text search terms and NACE codes.

**Consultation question 2:** Do you agree that the logistics activity complements the business-as-usual parts procurement and logistics activities already present in the P&M characterisations such that it should be included as an additional distinct activity in the P&M group? Do you have any reasoning why the P&M characterisations should not be expanded to include logistics services?

### Labour outsourcing

- 2.15 The review identified seven qualifying contracts (one per cent) which undertake labour outsourcing activities. They account for less than one per cent of the qualifying contracts’ total contract price. The activities undertaken by the qualifying contracts under this category mainly relate to provision of a labour pool to undertake tasks as directed by the MOD.
- 2.16 The current ancillary services activity characterisation includes companies undertaking comparable activities to deliver administrative, facilities or IT support activities. The administrative support relates to outsourced business services such as payroll processing, call centres, HR, basic book-keeping, routine tax or legal advice and other clerical work.
- 2.17 We believe that labour outsourcing is closely aligned to the current group’s administrative activities and falls under the outsourced HR activities. We seek input on whether to add labour outsourcing to the ancillary services characterisations, text search terms and NACE codes.

**Consultation question 3:** Do you agree that the labour outsourcing activity aligns with existing administrative activities and should be added to the ancillary services activity group? Do you have any reasoning why the ancillary services characterisations should not be expanded to include labour outsourcing?

## Contracting for availability or capability

- 2.18 The current P&M activity group characterisations include companies undertaking comparable activities to deliver services to ensure the availability of an asset either through repair and servicing to third party equipment, or through hire or lease arrangements that include associated upkeep and maintenance services i.e. making available to a third party the use of an assets for a period in return of payment. This is intended to cover the range of contracts in this area the MOD may seek to place for traditional support, spares inclusive support, contracting for availability and contracting for capability.
- 2.19 The review of the 233 qualifying contracts identified as undertaking P&M activities evidenced a high prevalence of repair and maintenance and the associated training activities being undertaken by the qualifying contracts the MOD has entered into since the inception of the regime. The P&M group also provides for activities to be included to cover contracts for availability or capability the MOD may place (characterised as including the hire and leasing of hard assets).<sup>4</sup>
- 2.20 However, the review found little indication in the DefCARS information submitted to show availability or capability contracts under the regime and the SSRO is cognisant of industry feedback to the 2023/24 rates averaging methodology consultation that asserted that the MOD cannot single source contracts for the provision of assets through leasing, and therefore companies undertaking leasing activities should not form part of the comparator group<sup>5</sup>. It was envisaged when the SSRO's BPR methodology was first developed that capacity provision would be an activity that may be relevant to the fulfilment of a qualifying contract. There are examples where the MOD is granted the use of an asset, or the right to operate it, but does not own it. For example, the leasing of helicopters to UK armed forces overseas, and aggressor training services.
- 2.21 The MOD's Defence Industrial Strategy<sup>6</sup> continues to promote the adoption of a more integrated approach to the delivery of military capability that includes contracting for availability and contracting for capability. The Defence Logistics Organisation (DLO)<sup>7</sup> is driving end to end through-life logistic support solutions that provides opportunities and incentives for industry to align with the MOD's capability needs. Figure 4 illustrates this vision

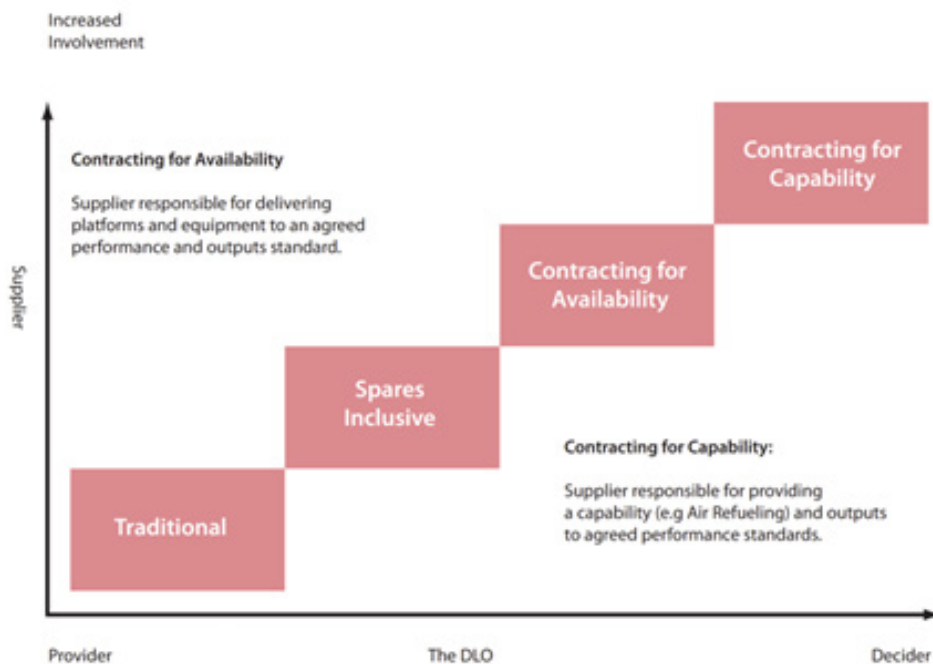
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4 To the extent that contracting for availability or capability relates to making available for use, or the operating of, an asset for the benefit of a third party is seen as akin to hiring and leasing.

5 [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1109670/BPR\\_methodology\\_consultation\\_response\\_Oct\\_2022\\_web.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1109670/BPR_methodology_consultation_response_Oct_2022_web.pdf)

6 [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/272203/6697.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/272203/6697.pdf)

7 As it was named at time of publication, now Defence Equipment and Support (DE&S)

**Figure 4: Defence Industrial Strategy excerpt**

- 2.22 As such, we have not ruled out that such an arrangement could be contracted for under the regime and think it is important to include them as they tend to generate higher rates for profit than more cost driven activities. As such our comparator group includes companies that lease aircraft, ships and other industrial hardware, such that they make those assets available for use by a third party customer, and may operate aspects of them on the customer's behalf.
- 2.23 As part of phase 2 of the review, we will undertake further investigation as to the appropriateness of continuing to reflect capacity provision in the BPR.

**Consultation question 4:** To what extent does the capacity provision, for example, through contracting for availability or capability, constitute an activity which enables the performance of qualifying contracts? Does it provide support or otherwise for the inclusion of activities involving the provision and/or operation of economic assets to a third party in the P&M activity group characterisations, text search terms and NACE codes?

### Concept, assessment and demonstration (CAD)

- 2.24 Forty-five qualifying contracts (eight per cent) which undertake activities that are associated with at least one of the first three stages (concept, assessment and demonstration) of the MOD's CADMID(T)<sup>8</sup> cycle. They account for two per cent of the qualifying contracts' total contract price.
- 2.25 The CAD stages already feature in the 'Develop' element of the D&M activity group. Therefore the activities performed under these stages are already reflected in the D&M activity group. The 45 qualifying contracts couldn't be mapped on to the D&M activity group, because a company must engage in both the CAD and the manufacturing activities for it to qualify as a comparator. For this reason, we do not propose to take any further action on this category.

<sup>8</sup> Concept, Assessment, Demonstration, Manufacture (Migration), in-service, Disposal (Termination).

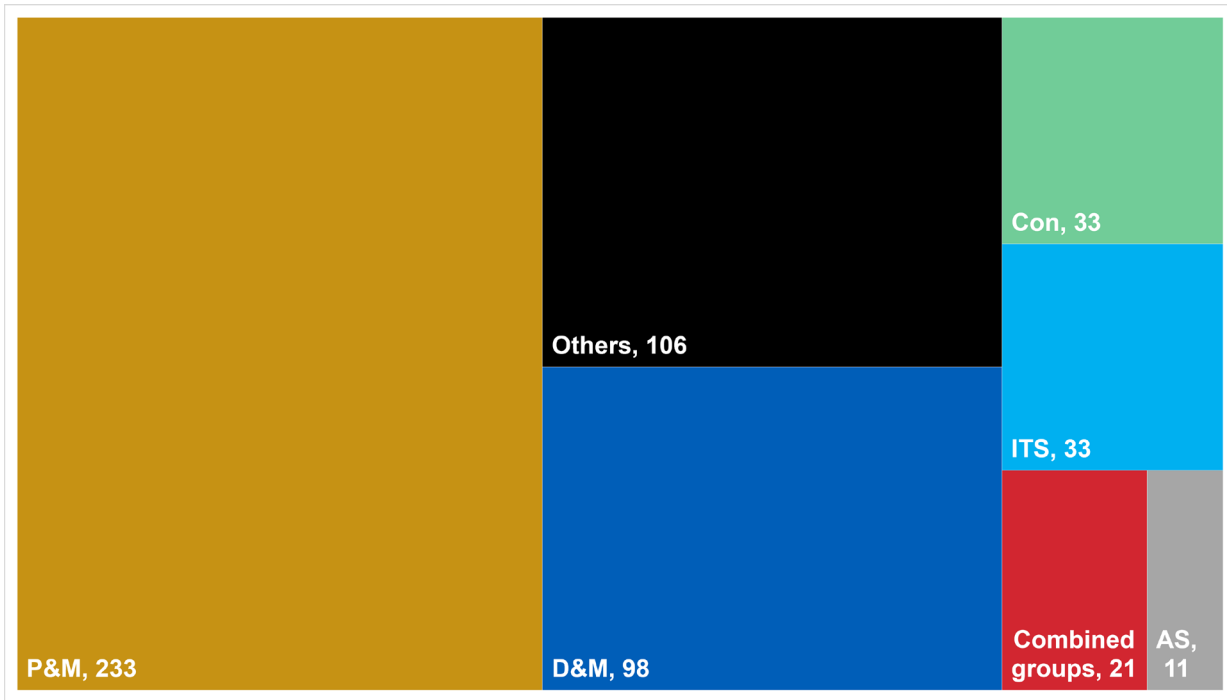
## Other

- 2.26 This group comprises a residual of the qualifying contracts which could neither be mapped to the existing activity groups or their combinations nor to the above specified categories. There are eight qualifying contracts (1.5 per cent) that engage in activities under this category. They account for less than one per cent of the qualifying contracts' total contract price. A range of activities are undertaken under this category, with each qualifying contract focusing on one or a mix of activities, including but not limited to, the provision of the following services:
- supply of medicines and vaccines;
  - procurement assessment;
  - management services; and
  - provision of storage.
- 2.27 We consider that the creation of categories to accommodate one or a few qualifying contracts does not add value to our methodology. We believe these are relatively insignificant to consider and their exclusion does not compromise the robustness of our benchmarks or the integrity of the methodology.

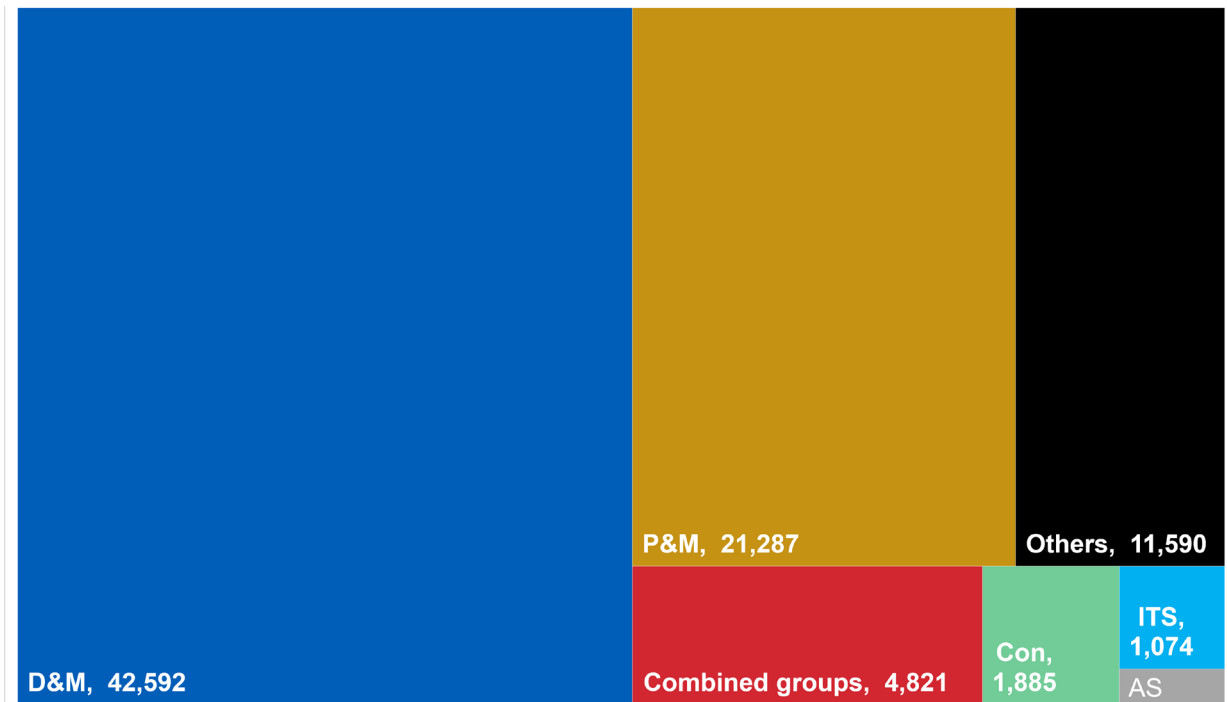
## Combined activity groups

- 2.28 We identified 80 per cent of the qualifying contracts (429 in number) which undertake activities that are comparable with those characterised in our existing five activity groups. These qualifying contracts account for 86 per cent (£72 billion) of the £83.6 billion qualifying contracts' total contract price.
- 2.29 The above percentages and numbers are split as follows:
- Seventy-six per cent (408 in number) of the qualifying contracts' activities are comparable with activity characterisations of distinct activity groups, while four per cent (21 in number) are comparable with characterisations across the four combinations of activity groups.
  - Qualifying contracts undertaking activities comparable with activity characterisations of distinct activity groups account for 80 per cent (67.2 billion) of the total contract price, while those whose activities are comparable with characterisations across the four combinations of activity groups account for six per cent (£4.8 billion).

**Figure 5: total number of qualifying contracts**



**Figure 6: total contract price of qualifying contracts (£ millions)**

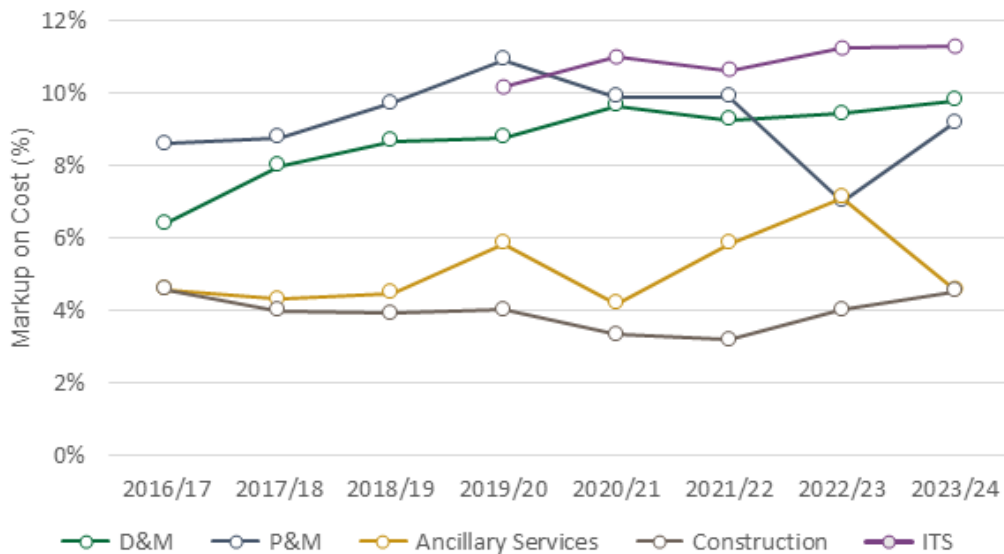


**Note:** D&M – Develop and make;  
 P&M – Provide and maintain;  
 AS – Ancillary services;  
 Con – Construction;  
 ITS – Information technology services;  
 Combined groups – a qualifying contract undertaking activities across two different activity groups (e.g. D&M and ITS); and  
 Others - qualifying contracts whose activities are not characterised in our existing activity groups.  
 Source: DefCARS and SSRO.



- 2.30 Our analysis has found that the D&M and the P&M are the two dominant activity groups for which the MOD enters into contracts (see figures 1, 2, 5 and 6). They respectively account for 18 and 44 per cent of the total number of qualifying contracts, and for 51 and 26 per cent of the total contract price of qualifying contracts.
- 2.31 Figure 7 shows the historical return on costs for the current comparator groups and is presented for information. The BPR is derived from the D&M and P&M groups only.

**Figure 7: Activity groups markup on costs unadjusted for capital servicing**



- 2.32 During the 2021 consultation on the BPR methodology, industry representatives challenged the approach to conjoining the D&M and P&M data, considering that it gives both groups equal weight in the calculation, thereby giving the P&M group, which has fewer companies, more weight than the D&M group. They questioned if the SSRO had considered that half the value of qualifying contracts are D&M and half are P&M. As an alternative, they suggested an approach whereby the data from both the P&M and D&M groups is pooled into a single data set prior to the averaging process. We responded to this point in paragraphs B60 to B63 of our response to the consultation, where we clarified that the SSRO does not rely on D&M and P&M being found in equal measure, or any other proportion, on qualifying contracts; and that we think that more granular weighting would not be meaningful.<sup>9</sup>
- 2.33 Industry asserted in its feedback to the 2022 consultation that its analysis shows that companies with qualifying contracts perform both D&M and P&M activities, hence the need to revisit this artificial divide that creates a disproportionate outcome<sup>10</sup>. Our analysis has revealed that the MOD enters into qualifying contracts which undertake predominantly separate D&M and P&M activity group activities, both in number and in contract price; while only nine qualifying contracts perform both D&M and P&M group activities.

<sup>9</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1009057/Response\\_to\\_consultation\\_on\\_the\\_baseline\\_profit\\_rate\\_and\\_its\\_adjustment\\_August\\_2021A.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1009057/Response_to_consultation_on_the_baseline_profit_rate_and_its_adjustment_August_2021A.pdf)

<sup>10</sup> See Appendix Table 1 at: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1109670/BPR\\_methodology\\_consultation\\_response\\_Oct\\_2022\\_web.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1109670/BPR_methodology_consultation_response_Oct_2022_web.pdf)

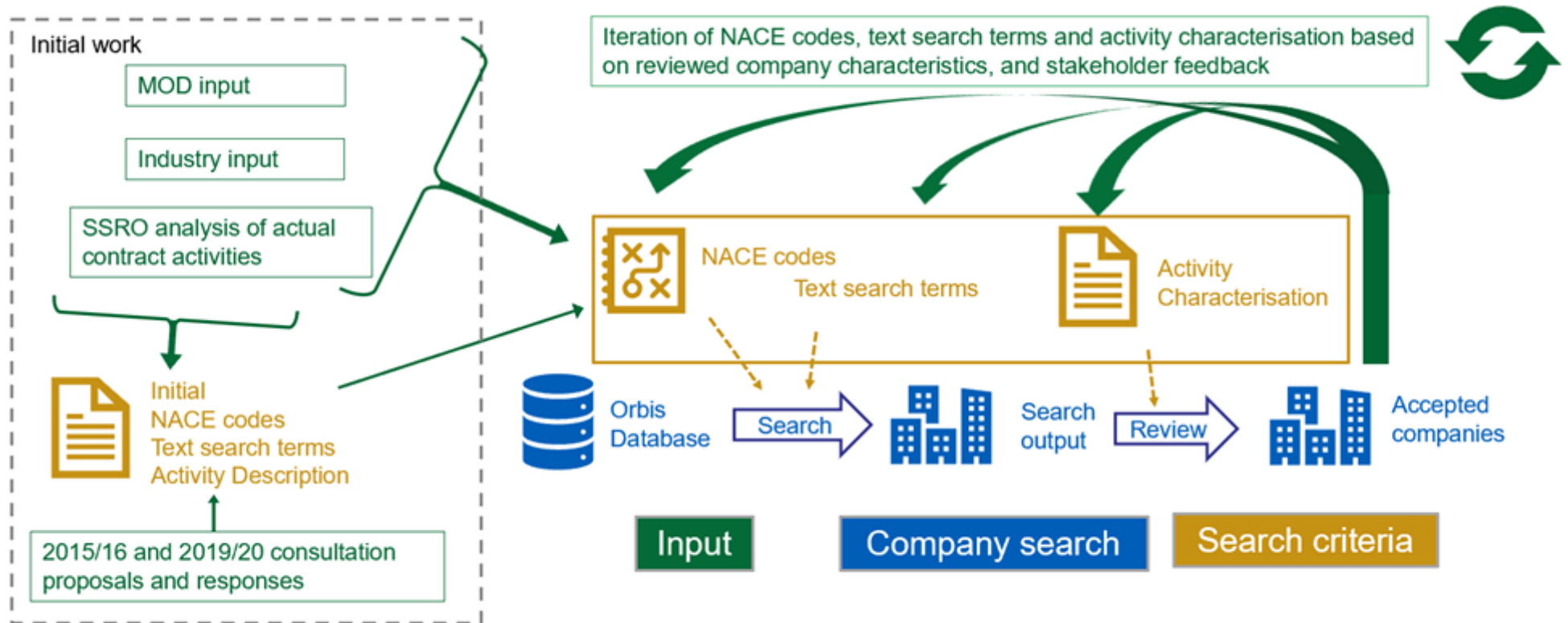


- 2.34 We are open to reconsidering the separation of D&M and P&M in Phase 2 of the review if there is new evidence presented that justifies a case for doing so.

## 3. Development of an activity group

- 3.1 As set out above, Phase 2 of the review will focus on the revalidation of our benchmark activities and refinement of the methodology as necessary. Where required, this will utilise our established approach for developing an activity group.
- 3.2 An activity group is a group of companies that carry out activities that are similar, to an appropriate extent, to the activities we are seeking to benchmark. A detailed explanation of the SSRO's approach for developing an activity group is presented in Appendix C and is summarised below.
- 3.3 The development of an activity group within the SSRO's existing BPR methodology is based on transfer pricing principles, that includes the 'arm's-length principle'. Step 3 and 4 of this principle are the functional analysis and review of internal comparables (see Box 1, Appendix C for details).
- 3.4 The functional analysis and review of internal comparables are used to develop three elements, which are used to select comparators for an activity group:
- **activity characterisation:** captures a short 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 on whether one or more words appear in a narrative description of that company's activities provided by the database;
  - **NACE codes:** standardised descriptors that are used to filter the full database, depending on whether one or more codes are used to classify that company's activities in the database.
- 3.5 The process to develop these elements is iterative, taking account of SSRO work and feedback from stakeholders, as illustrated in Figure 8.

**Figure 8: Development of activity group characterisation, NACE codes and text search terms**



## 4. Consultation questions

- 4.1 The SSRO invites stakeholder views, together with supporting evidence where appropriate, on matters raised above and specifically on the following consultation questions:
- **Question 1:** Do you agree that the technical support activity complements existing knowledge-based activities and should be added to the provide and maintain (P&M) activity group? Do you have any reasoning why the P&M characterisations should not be expanded to include technical support services?
  - **Question 2:** Do you agree that the logistics activity complements the business-as-usual parts procurement and logistics activities already present in the P&M characterisations such that it should be included as a standalone activity in the P&M group? Do you have any reasoning why the P&M characterisations should not be expanded to include logistics services?
  - **Question 3:** Do you agree that the labour outsourcing activity aligns with existing administrative activities and should be added to the ancillary services activity group? Do you have any reasoning why the ancillary services characterisations should not be expanded to include labour outsourcing?
  - **Question 4:** To what extent does the capacity provision, for example, through contracting for availability or capability, constitute an activity which enables the performance of qualifying contracts? Does it provide support or otherwise for the inclusion of activities involving the provision and/or operation of economic assets to a third party in the P&M activity group characterisations, text search terms and NACE codes?
- 4.2 Consultees are not required to answer all the questions if they are only interested in some aspects of the consultation.
- 4.3 A consultation response form containing these questions has been published alongside this consultation document on the SSRO's website. Completed response forms should be sent:
- by email, including arranging an appointment to speak to the SSRO about the consultation to: [consultations@ssro.gov.uk](mailto:consultations@ssro.gov.uk) (preferred).
  - by post to: Baseline profit rate activities review consultation, SSRO, G51/G52 100 Parliament Street, London, SW1A 2BQ.
  - by telephone, including arranging an appointment to speak to the SSRO about the consultation: 020 3771 4767.
- 4.4 Responses to the consultation should be received by 5.00pm on Thursday 10 August 2023. Responses received after this date may not be taken into account.
- 4.5 The SSRO also welcomes the opportunity to meet with stakeholders to discuss the proposals during the consultation period. If you wish to arrange such a meeting, please contact us at the earliest opportunity using the details above.

- 4.6 In the interests of transparency for all stakeholders, the SSRO's preferred practice is to publish responses to its consultations, in full or in summary form. Respondents are asked to confirm in the response form whether they consent to their response being published and to the attribution of comments made. Where consent is not provided comments will only be published in an anonymised form.
- 4.7 Stakeholders' attention is drawn to the following SSRO policy statements, available on its website,<sup>11</sup> setting out how it handles the confidential, commercially sensitive and personal information it receives and how it meets its obligations under the Defence Reform Act 2014, the Freedom of Information Act 2000, the UK General Data Protection Regulation and the Data Protection Act 2018.
- The Single Source Regulations Office: Handling of Commercially Sensitive Information; and
  - The Single Source Regulations Office: Our Personal Information Charter.

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<sup>11</sup> <https://www.gov.uk/government/organisations/single-source-regulations-office/about/personalinformation-charter>

# Appendix A

**Table A1: Existing activity characterisations**

Component of an activity description	Develop and make	Provide and maintain	Ancillary services	Construction	Information technology services
<b>The activity we are seeking</b>	Companies undertaking comparable activities considered as 'Develop and Make' are expected to engage in manufacturing and the design and development contributing to that process	Companies undertaking comparable activities considered as 'Provide and Maintain' are expected to deliver services to ensure the availability of an asset either through repair and servicing to third party equipment, or through hire or lease arrangements that include associated upkeep and maintenance services.	Companies undertaking comparable activities considered as 'Ancillary Services' are expected to deliver either one of administrative, facilities or IT support activities.	Companies undertaking comparable activities considered as 'Construction' are expected to deliver services in relation to the construction of buildings or other structures at fixed locations.	Companies undertaking comparable activities considered as 'Information Technology Services' are expected to engage in 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
<b>Clarification on aspects of the activity where the decision may be judgemental</b>	<p>This would therefore not include manufacturing on behalf of a hiring firm that supplies the design, or those solely undertaking research or design work with no associated manufacturing.</p> <p>Where development activities do not seek to result in a novel or differentiated product the company is less likely to be considered comparable.</p>			Companies could provide such services either on a contract basis with designs and specifications received or using their own designs.	<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.</p> <p>A similar exclusion applies for an IT system that is embedded within network infrastructure (for example telecommunications or internet provision).</p>

Component of an activity description	Develop and make	Provide and maintain	Ancillary services	Construction	Information technology services
<b>Clarification on the types of risk borne by the comparator</b>			Companies undertaking these support services are not expected to bear any significant risks other than that of failing to provide the contracted outputs. This captures risk in relation to the delivery of the services, contract risk, procurement risk, staff risk and some quality control risk in respect of these activities	Comparable companies may be responsible for the management of the construction project, and are likely to bear contract risk, procurement risk, staff risk and some quality control risk in respect of these activities. They are not expected to bear any significant property price risk in respect of these activities	
<b>The type of contractual relationship observed in defence procurement we are seeking to find comparators for</b>	Comparable activities would typically be of the type that can be likened to those involved in producing equipment used for military or defence purposes	Comparable activities would typically be of the type which can be likened to those involved in the support and provision of equipment used for military or defence purposes			Comparable activities would typically be of a type that can be likened to those involved in any of design, production, manufacture, integration or operation of networks and computer systems or services used for military or defence purposes.
<b>Examples of the functions performed by the company under review that would indicate comparability</b>	This would include scientific or technical research, design, development or testing activities leading to the production of self-contained sub-systems or finished goods. To the extent that a product is being assembled or constructed then it is likely to represent comparable manufacturing.				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.

Component of an activity description	Develop and make	Provide and maintain	Ancillary services	Construction	Information technology services
<p><b>Examples of the characteristics of the goods or services provided by the company under review that would indicate comparability</b></p>	<p>This could cover a broad range of products such as structural metal goods, machinery, electronic and mechanical sub-systems, vessels, containers, general machinery, ships, aircraft, and wheeled or tracked vehicles or other means of transportation and other items of machinery of an industrial nature.</p>	<p>This could cover a broad range of products such as structural metal goods, machinery, electronic and mechanical sub-systems, vessels, containers, general machinery, ships, aircraft, and wheeled or tracked vehicles or other means of transportation and other items of machinery of an industrial nature. Comparable companies may also provide the facilities embodying or integrating the equipment and the training necessary to operate or maintain these assets.</p> <p>Repair and servicing activities include arrangements where spares and labour are charged for as they are required, or may include these costs as part of a longer term contracting arrangement.</p>	<p>Administrative support relates to outsourced business services such as payroll processing, call centres, HR, basic book-keeping, routine tax or legal advice and other clerical work. IT support services would include data management, data processing, network hosting, IT repairs and maintenance and IT security services.</p> <p>Facilities support services would include property cleaning, property repairs and maintenance, canteen services, laundry, gardening and general guarding and security services.</p>	<p>Buildings would include industrial buildings such as factories, warehouses, plants, and public, commercial or residential buildings of steel-frame or concrete construction (not individual houses) and may include the associated design services.</p> <p>Civil engineering works in the form of the erection of structures in a fixed location, for example in metal and concrete, would also be considered comparable.</p> <p>To the extent that civil engineering works relates to the assembly of a structure at a fixed location then it is more likely to be considered as 'Construction'.</p>	<p>This could cover a broad range of IT management and consultancy services and IT system, software or application development.</p> <p>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"> <li>• 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);</li> </ul>



Component of an activity description	Develop and make	Provide and maintain	Ancillary services	Construction	Information technology services
					<ul style="list-style-type: none"> <li>• Hardware consultancy services (for example solution design, system architecture, hardware selection, integration, acceptancy testing and recovery; disaster recovery; computer site planning and computer audit);</li> <li>• Software consultancy services (for example business analysis, system quality assurance and review, or system software acceptance and testing); or</li> <li>• Cybersecurity consultancy services (for example security architecture design or forensic analysis of breaches, penetration testing and end user security training).</li> </ul>

Component of an activity description	Develop and make	Provide and maintain	Ancillary services	Construction	Information technology services
					Comparable IT system, software or application development would typically include, bespoke IT system design and building, bespoke software development, or bespoke integration of tailorable third-party software or applications, and subsequent testing.
<b>Clarification on activities often observed in the companies under review where the decision may be judgemental</b>	If the product is a commoditised unit or processed raw manufacturing input, for example a generic electrical or mechanical components, sheet metal, shaped plastic, ancillary items such as basic tools, then this may not be sufficiently complex and is likely to be excluded. Electronic or mechanical assemblies or sub-systems that are complex and not of a commoditised nature are more likely to be considered the output of a comparable manufacturing process.	Diagnosis, repair and installation activities would be expected to require an in-depth knowledge of the asset being serviced. This would exclude companies whose capabilities are limited to rudimentary work, such as those involving user-serviceable parts or domestic installations (for example domestic white goods). Hire and leasing arrangements should be focused on items of an industrial or commercial nature		To the extent that companies engage in tunnelling, pipe-laying, highways maintenance or river and coastal work, these activities are not expected to extend beyond what might reasonably be required to support the delivery of a structure.  Speciality trade contractors, such as outfit contracting services (plumbing, ventilation, electrical installation and windows) must be demonstrably of an industrial nature and be active in the construction of the building.	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.

Component of an activity description	Develop and make	Provide and maintain	Ancillary services	Construction	Information technology services
<b>How the activities being performed should generate value for the comparator</b>	The value added, cost base or profits of the business are expected to principally derive from the manufacturing, design and development activities as described above.	The value added, cost base or profits of the business are expected to principally derive from the asset provision and maintenance activities described above.	The value added, cost base or profits of the business are expected to principally derive from the Ancillary Services activities described above.	The value added, cost base or profits of the business are expected to principally derive from the construction activities described above.	The value added, cost base or profits of the business are expected to principally derive from the services described above.
<b>Examples of value generation that would indicate the company under review is less likely to be comparable</b>	For example, comparable firms would not be expected to derive the majority of their value added through the purchase of raw materials, luxury branding, the exploitation of patents and copyrights or distribution activities.	For example, the provision of aftersales service to products that a company manufactures or sells would be insufficient to consider a company to be comparable. Companies are unlikely to be comparable if they include a significant consumer-targeted sales and marketing model or the sale of associated finance products (for example in the case of consumer automotive sales).	Companies that engage in support services loosely connected to those described above, but which are of a specialised nature would not typically be considered comparable. Such non-comparable services would include provision of security services in prisons, the design and procurement of IT infrastructure, the services of chartered professionals, or the supply of clinical staff to hospitals. Companies that do not undertake activities akin to ancillary support services (for example recruitment, construction, software development, management consultancy, engineering consultancy) are not considered comparable.	Comparable companies are not expected to hold land for long-term appreciation purposes and as such those who engage primarily in real estate development would typically be excluded.	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

Component of an activity description	Develop and make	Provide and maintain	Ancillary services	Construction	Information technology services
<p><b>Clarification on activities often observed in the companies under review that are acceptable if they are supporting the primary value generation.</b></p>	<p>It may be acceptable for comparable firms to engage in some loosely associated activities as part of delivering core comparable business (for example the procurement of inputs and the distribution and marketing of final goods). However, these activities are not expected to extend beyond what might reasonably be required to deliver the company's principal business.</p>	<p>It may be acceptable for comparable firms to engage in some loosely comparable activities as part of normal business (for example parts procurement, warehousing, logistics, installation, or the sale of the company's ex-hire fleet). However, these activities are not expected to extend beyond what might reasonably be required to deliver the company's principle business.</p>		<p>It may be acceptable for comparable companies to engage in some loosely comparable activities in the delivery of their core construction work (for example manufacturing or procurement of construction inputs, earthworks, provision of construction labour, building preservation, site clearance and recycling of reclaimed items from demolition). However, these activities should not be the focus of their business.</p>	
<p><b>Examples of value generation that would indicate the company under review should be rejected.</b></p>	<p>Significant involvement in activities that are obviously non-comparable in nature (for example provision of financial services, marketing or food processing) would be cause to reject a company.</p>	<p>Significant involvement in activities which are obviously non-comparable in nature (for example manufacturing or distribution) is grounds for rejection.</p>		<p>Significant involvement in activities which are obviously non-comparable in nature (for example toll-road operation, property investment, interior design services) is grounds for rejection.</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>

Component of an activity description	Develop and make	Provide and maintain	Ancillary services	Construction	Information technology services
<b>Summary of the end customers of the activity</b>	The end customers for the outputs generated by comparable companies are expected to be other businesses, institutions or governments.	The end customers for the services provided by comparable companies are expected to be businesses, institutions or governments.	The end customers for the services provided by comparable companies are expected to be other businesses, institutions or governments.	The end customers for the services provided by comparable companies are expected to be other businesses, institutions or governments.	The end customers for the services provided by comparable companies are expected to be other businesses, institutions or government.
<b>Examples of market segments that would typically indicate the company is not serving the right end customers</b>	Comparable companies are not expected to maintain marketing models, sales operations, large networks of product outlets or dealerships aimed at the general public.	Comparable companies are not expected to maintain significant marketing models or sales operations in relation to the goods they service, or large networks of service outlets or dealerships aimed at the general public.	Comparable companies are not expected to be entities which solely exist to provide these services to members of their own corporate group. Comparable companies are not expected to primarily serve the general public with, for example, domestic gardening or cleaning services.	Comparable companies are not expected to primarily serve the general public and as such domestic building services, roofing, flooring and general building maintenance contractors would not be considered comparable.	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

# Appendix B

**Table B1: The ‘Develop and Make’ activity type NACE Rev 2 codes and text search terms**

Sub-activity	NACE Rev 2 code	Description	Text search terms
Manufacturing	2511	Manufacture of metal structures and parts of structures	(manuf*, produc*, fabric*, build*, defense*, defence*, militar*)
	2529	Manufacture of other tanks, reservoirs and containers of metal	
	253	Manufacture of steam generators, except central heating hot water boilers	
	254	Manufacture of weapons and ammunition	
	2599	Manufacture of other fabricated metal products n.e.c.	
	2630	Manufacture of communication equipment	
	2651	Manufacture of instruments and appliances for measuring, testing and navigation	
	28	Manufacture of machinery and equipment nec	
	29	Manufacture of motor vehicles, trailers and semi-trailers	
	301	Building of ships and boats	
	302	Manufacture of railway locomotives and rolling stock	
	303	Manufacture of air and spacecraft and related machinery	
304	Manufacture of military fighting vehicles		
3099	Manufacture of other transport equipment n.e.c.		
Research and development (R&D)	749	Other professional, scientific and technical activities nec	(research*, develop*, design*)
	721	Research and experimental development on natural sciences and engineering	<b>AND</b>
	741	Specialised design activities	(test*, equip*, machin*, militar*, vehic*, defense*, defence*)
	712	Technical testing and analysis	

\* denotes a part word. For example, “develop\*” includes “develop”, “develops”, “developed”, “developing”, “developer” and “development”

**Table B2 - The ‘Provide and Maintain’ activity type NACE Rev 2 codes and text search terms**

Sub-activity	NACE Rev 2 code	Description	Text search terms
Capacity provisioning	7735	Renting and leasing of air transport equipment	(rent*, leas*, hir*) <b>AND</b> (container*, truck*, tank*, trailer*, aircr*, aviation*, industrial*, defence*, defense*, militar*)
	7739	Renting and leasing of other machinery, equipment and tangible goods nec	
	7712	Renting and leasing of trucks	
	7732	Renting and leasing of construction and civil engineering machinery and equipment	
	7734	Renting and leasing of water transport equipment	
Upkeep and maintenance	33	Repair and installation of machinery and equipment	(repair*, maint*, upkeep*, update*, training*) <b>AND</b>
	749	Other professional, scientific and technical activities nec	(equip*, vehic*, aircr*, defense*, defence*, militar*)

**Table B3: The ‘Ancillary Services’ activity type NACE Rev 2 codes and text search terms**

NACE Rev 2 code	Description	Text search terms
6311	Data processing, hosting and related activities	(outsourc*, support*, maint*) AND (clean*, maint*' facil*, industr*, upkeep*) cleric*, IT! office*, data*, admin*, defence*, defense*, militar*)
811	Combined facilities support activities	
8121	General cleaning of buildings	
8122	Other building and industrial cleaning activities	
8129	Other cleaning activities	
821	Office administrative and support activities	
8299	Other business support service activities n.e.c.	
802	Security systems service activities	

! denotes where the search is case-sensitive

**Table B4: The ‘Construction’ activity type NACE Rev 2 codes and text search terms**

NACE Rev 2 code	Description	Text search terms
41	Construction of buildings	(construct*, build*, engineer*, architect*, defense*, defence*, militar*)
42	Civil engineering	
43	Specialised construction activity	

**Table B5: The ‘information Technology Services’ activity type NACE Rev 2 codes and text search terms**

NACE Rev 2 code	Description	Text search terms
5829	Other software publishing	‘IT!, comput*, web*, network*, portal*, hardware*, software*, cyber*, program*, miltar*, defence*, defense*, digit*, cloud*, information*, technology*, secur*, mobil*, encrypt*, install*’
6130	Satellite telecommunications activities	
6201	Computer programming activities	
6202	Computer consultancy activities	
6209	Other information technology and computer service activities	
6399	Other information service activities nec	

# Appendix C

## 5. Phase 2: Activity groups updates

- 5.1 The SSRO is committed to the continuous improvement of the BPR methodology. As part of this process, in view of the findings presented under the Phase 1 section above, we will under Phase 2 of the review, revalidate the benchmark activities after additional qualifying contracts' review and considering stakeholder consultation feedback.
- 5.2 The update will use our established activity group development approach, which is based on transfer pricing principles, that include the arm's-length principle, thereby providing an approach to pricing transactions on an arm's-length basis.
- 5.3 Box 1 sets out an overview of the application of the arm's-length principle as it would apply in the context of international taxation. In common with this approach, the SSRO is seeking to establish an appropriate rate of profit for a transaction that is not carried out on an arm's length basis. In our case this is because the nature of the transaction precludes a competitive tendering process rather than because the two parties are related enterprises. Although the underlying purpose of determining an arm's length profit ultimately differs, we believe it provides a sound foundation to benchmark profit rates for different activities.
- 5.4 Assessing the appropriate rate of profit involves identifying similar transactions that are carried out on an arm's length basis. To find similar transactions, economically relevant characteristics, or comparability factors, are considered as part of the process set out in Box 1. These are broadly categorised in the transfer pricing guidelines as follows:
- The contractual terms of the transaction.
  - The functions performed by each of the parties to the transaction, taking into account assets used and risks assumed, including:
    - how those functions relate to the wider generation of value of the entity to which the contracting parties belong;
    - the circumstances surrounding the transaction; and
    - industry practice.
  - The characteristics of the property transferred or services provided.
  - The economic circumstances of the parties and of the market in which the parties operate.
  - The business strategies pursued by the parties.
- 5.5 The extent to which any one of the characteristics categorised above is economically relevant in a particular transaction depends on the extent to which it would be taken into account by independent enterprises when evaluating the terms of the same transactions were it to occur between them.



### Box 1: Application of the 'arms-length principle' in the context of international taxation

**Step 1:** Determination of years to be covered.

**Step 2:** Broad-based analysis of the taxpayer's circumstances.

**Step 3:** Understanding the controlled transaction(s) under examination, based in particular on a functional analysis, in order to choose the tested party (where needed), the most appropriate transfer pricing method to the circumstances of the case, the financial indicator to be tested (in the case of a transactional profit method), and to identify the significant comparability factors to be taken into account.

**Step 4:** Review of existing internal comparables, if any.

**Step 5:** Determination of available sources of information on external comparables where such external comparables are needed taking into account their relative reliability.

**Step 6:** Selection of the most appropriate transfer pricing method and, depending on the method, determination of the relevant financial indicator (e.g. determination of the relevant net profit indicator in case of a transactional net margin method).

**Step 7:** Identification of potential comparables: determining the key characteristics to be met by any uncontrolled transaction in order to be regarded as potentially comparable, based on the relevant factors identified in Step 3 and in accordance with the comparability factors set forth at Section D.1 of Chapter 1.

**Step 8:** Determination of and making comparability adjustments where appropriate.

**Step 9:** Interpretation and use of data collected, determination of the arm's length remuneration.

*OECD Guidelines, paragraph 3.4*

- 5.6 An activity group is a group of companies that carry out activities that are similar, to an appropriate extent, to the activities we are seeking to benchmark.
- 5.7 The development of an activity group within the SSRO's existing BPR methodology primarily focuses on carrying out a functional analysis as part of step 3 and reviewing internal comparables (companies that are known to be carrying out those activities being searched for) as part of step 4. The other aspects (including geography, financial attributes, company size and status) are common across the different activity groups and are therefore not a topic of this review.

- 5.8 The functional analysis and review of internal comparables are used to develop three elements, which are used to select comparators for an activity group:
- **activity characterisation:** captures a short 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;
  - **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.
- 5.9 The process to develop these elements is iterative, taking account of SSRO work and feedback from stakeholders, as illustrated in Figure 1.

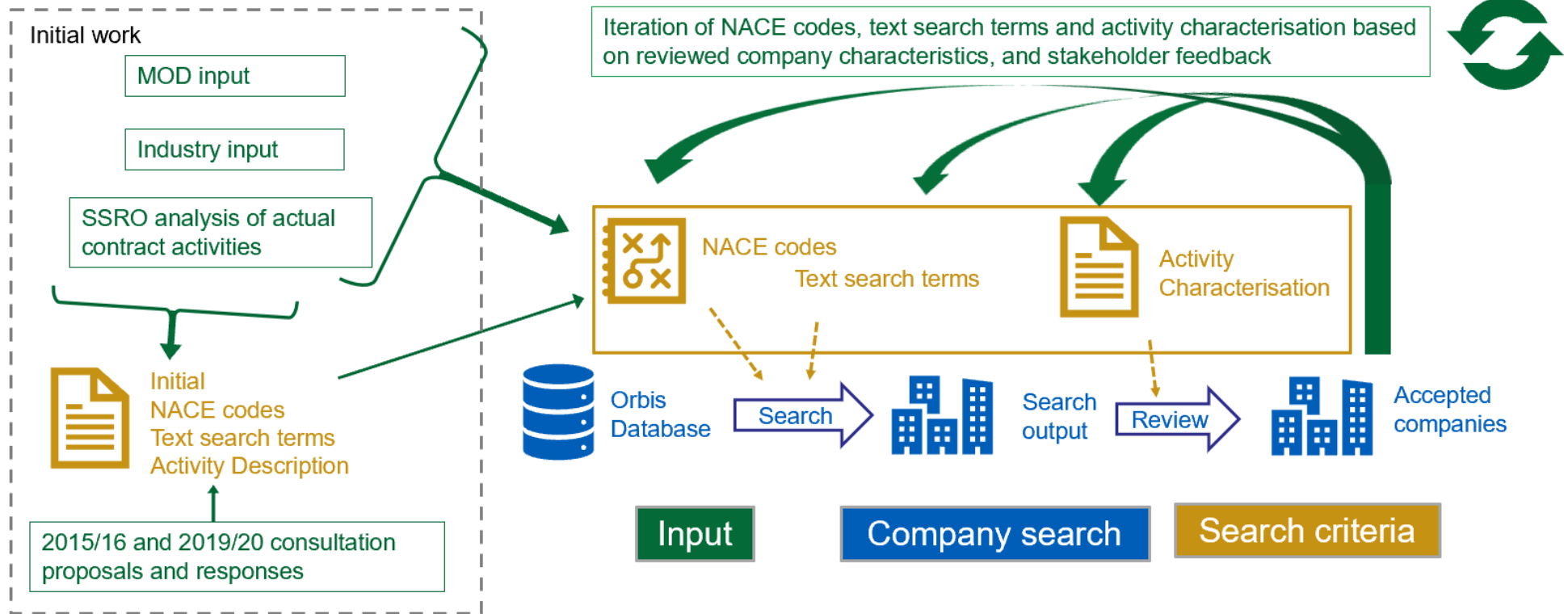
## Figure 1: Development of activity group characterisation, NACE codes and text search terms

### Activity characterisation

5.10 The SSRO's activity characterisations are written descriptions of economic activities which correspond to types of activity that contribute to the delivery of qualifying contracts. The activity descriptions for the existing five activity groups are presented in Appendix A. The typical components of an SSRO activity description include.

- Summary:
  - The activity we are seeking
  - Clarification on aspects of the activity where the decision may be judgemental
  - Clarification on the types of risk borne by the comparator
- Detailed description of activities carried out by the comparator:
  - The type of contractual relationship observed in defence procurement we are seeking to find comparators for.
  - Examples of the functions performed by the company under review that would indicate comparability
  - Examples of the characteristics of the goods or services provided by the company under review that would indicate comparability
  - Clarification on activities often observed in the companies under review where the decision may be judgemental
- Detailed description of how value is added by the comparator:
  - How the activities being performed should generate value for the comparator
  - Examples of value generation that would indicate the company under review is less likely to be comparable
  - Clarification on activities often observed in the companies under review that are acceptable if they are supporting the primary value generation.
  - Examples of value generation that would indicate the company under review should be rejected.
- End customers and the market in which the comparator operates:
  - Summary of the characteristics of the end customers of the activity
  - Examples of market segments that would typically indicate the company is not serving the right end customers

### NACE codes and text search terms



- 5.11 The SSRO uses the Orbis<sup>12</sup> database to identify comparable companies, which contains information on nearly 440 million companies. The SSRO first applies financial, geographic, size and status criteria which are common to all activity types. The SSRO then uses NACE<sup>13</sup> codes and text descriptions within the database to screen companies that are more likely to fall within a specific comparator group. SSRO staff then review the websites and, if required, financial statements of those companies and accept companies into a comparator group if they meet the relevant activity and market characterisation. The SSRO calls this process, which is illustrated in Figure 2, a company search process.

**Figure 2: Company search process**



- 5.12 The choice of NACE codes and text search terms is a balance between having a manageable number of companies to manually review and the risk of unintentionally excluding a relevant comparator.

### Selecting text search terms

- 5.13 Within Orbis, each company is provided with a brief trade description, primary business line description and full overview description which indicate their business activities. We search for keywords within these fields and if one or more words are present the company may progress to the next stage of the company search process.
- 5.14 To identify text search terms for an activity group we:
- selected words from the activity characterisation that represent the economically significant functional activities undertaken by companies for that activity group;
  - included the words “defence\*”, “defense\*” and “military\*”, which are common across all our activity groups in order to capture companies in the defence sector; and
  - considered words that are commonly used in the descriptions of the qualifying contracts identified as undertaking activities in that activity group, bearing in mind that some common words may not be specific to the activities we are seeking to benchmark.
- 5.15 The text search terms for the existing five activity groups are presented in Appendix B.

<sup>12</sup> Orbis is a company-specific information database, supplied by Bureau van Dijk, a Moody’s Analytics company.

<sup>13</sup> 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.

## Selecting NACE codes

- 5.16 NACE provides a framework for collecting and presenting a large range of statistical data according to economic activity. It consists of a hierarchical structure (as established in the Regulation (EC) No 1893/2006<sup>14</sup>). Within Orbis, each company is assigned NACE codes, which can be used to easily assess its activities in a standardised manner. We search for companies that have particular NACE codes and if one or more codes are present the company may progress to the next stage of the company search process.
- 5.17 To identify NACE codes for an activity group we first:
- map the Common Procurement Vocabulary (CPV)<sup>15</sup> codes of qualifying contracts identified for that activity, to corresponding NACE codes; and
  - consider NACE codes suggested by stakeholders.
- 5.18 The NACE codes for the existing five activity groups are presented in Appendix B.

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<sup>14</sup> <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32006R1893>

<sup>15</sup> CPV codes have been developed by the European Union as standardised codes to help the procurement process. Each CPV code has a description of a unique economic activity it represents.