

SSRO

Single Source
Regulations Office

BPR Activities Review: proposed changes to the benchmark activities

Consultation July 2024

Contents

| | | |
|-----------|---|-----------|
| 1. | Introduction | 3 |
| 2. | Details of proposed changes for consultation | 6 |
| 3. | Implementation | 11 |
| 4. | Consultation timetable and how to respond | 12 |
| | Appendix - 1 Activity type development process | 14 |
| | Appendix 2 – Alteration to NACE codes and text search terms for Proposal 1 – Removal of rental and leasing from the benchmark activity types | 20 |
| | Appendix 3 – Activity characterisation for Proposal 2 – Replacing separate D&M and P&M activity types with a single combined group | 21 |
| | Appendix 4 – Alteration to NACE codes and text search terms for Proposal 3 – Expanding the BPR comparable activities to include technical support services | 24 |
| | Appendix 5 – Alteration to NACE codes and text search terms for Proposal 4 – Expanding the Ancillary Services activity type to include labour outsourcing | 26 |
| | Appendix 6: Activity characterisation for Proposal 4 – Expanding the Ancillary Services activity type to include labour outsourcing | 27 |

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) and capital servicing rates used to determine the contract profit rate for pricing qualifying defence contracts (QDCs) and qualifying sub-contracts (QSCs). This assessment assists the Secretary of State to determine the rates which will be applied each financial year. The rates we provide to the Secretary of State each year are underpinned by the SSRO's established methodology ('the methodology'), which provides a predictable and stable basis for the Ministry of Defence (MOD) and its suppliers to agree profit rates for single source defence contracts¹. The SSRO keeps this methodology under review, updating it where appropriate, to ensure it remains a suitable basis for our annual assessment. The success of baseline profit rate assessment is a key element to delivering our strategic objective to maintain a pricing system that supports value for money and fair prices.²
- 1.2 The methodology was established in 2016. It uses an activities-based approach, ensuring only the profitability of companies (whether for the defence industry or not) that conduct comparable activities to those that contribute to the delivery of QDCs and QSCs are considered in the assessment of the BPR. Setting the BPR with reference to the actual profit rates, of companies undertaking activities comparable to those that enable the performance of qualifying contracts, helps deliver a contract profit rate that supports the SSRO's statutory aims of good value for money and fair prices. 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 in delivery of defence contracts were captured in activity types that the SSRO named Develop and Make (D&M) (e.g. designing and/or manufacturing activities) and Provide and Maintain (P&M) (e.g. asset provision and/or associated maintenance activities), and therefore used these as the activity types on which to base the BPR assessment.
- 1.3 There is now a significant body of QDCs and QSCs which did not exist when the original activity types used in our methodology were first developed. Revalidating our benchmark activities and refining them where necessary will mean we can continue to rely on our methodology to produce a BPR which is an appropriate starting point for the application of the contract profit rate steps.
- 1.4 The SSRO has undertaken a review of the activities in current QDCs and QSCs and analysed how the single source contracts the MOD is entering into align with the existing activity types used to select comparator companies ('the activities review'). Phase 1 comprised an in-depth review of the DefCARS³ contract portfolio in addition to engagement with, and considering representations from, stakeholders. The consultation containing the review's phase 1 findings and the associated consultation response can be found on the SSRO's website⁴.

1 <https://www.gov.uk/government/publications/2024-contract-profit-rate-assessment>

2 Part of the SSRO's regulatory objectives as set out in its corporate plan <https://www.gov.uk/government/publications/ssro-corporate-plan-2023-2026>

3 The Defence Contract Analysis and Reporting System (DefCARS) allows contractors to meet the statutory reporting requirements for contract and supplier reports to the SSRO and MOD.

4 <https://www.gov.uk/government/consultations/baseline-profit-rate-activities-review>

- 1.5 This consultation sets out how the SSRO proposes to implement the findings of phase 1 and seeks feedback on those proposals. The proposed changes aim to ensure that our BPR methodology continues to reflect the actual activities undertaken in existing qualifying contracts and as such adheres to the comparability principles that underpin our BPR assessment methodology. Our proposal to replace the existing BPR comparator group with a new combined group helps address underlying volatility and practical difficulties in company selection that have emerged from seeking to maintain a segregation between support activities and manufacturing activities we benchmark.

Key terms and definitions

| | |
|----------------------------------|---|
| Activity characterisation | A written description of the group of economic activities and the relevant boundaries which define an activity type. |
| Activity type | A group of economic activities, defined by the SSRO, which correspond to types of activity that contribute to the delivery of QDCs and QSCs. For example 'Develop and Make', 'Provide and Maintain', 'Ancillary Services', 'Construction' or 'IT Services'. |
| Comparable company | A company whose economic activities are included, in whole or in part, within an activity type. |
| Comparator group | A group of comparable companies undertaking one or more of the economic activities which make up an activity type. |

Summary of proposed changes to the methodology

- 1.6 The baseline profit rate methodology identifies companies undertaking activities comparable to those that contribute to the delivery of single source contracts. The financial data for those companies are combined to calculate an underlying profit rate for that group of companies (a "comparator group"). This process is used currently to calculate underlying profit rates for the following "activity types":
- Develop and Make (D&M);
 - Provide and Maintain (P&M);
 - Ancillary Services;
 - Construction; and
 - IT Services.
- 1.7 A detailed explanation of the SSRO's approach for developing an activity type is presented in Appendix 1 and has been followed to develop the basis of the proposed changes to the current methodology set out in this consultation.
- 1.8 The BPR is currently calculated by averaging the D&M and P&M underlying rates into a single "composite rate". Together, these activity types have been considered to represent the vast majority of single-source procurement. The SSRO publishes three additional activity types, Ancillary Services, Construction and Information Technology Services, which are not used in the calculation of the BPR as they represent only a small minority of single sourced contracts placed by the MOD. The data on all five activity types is published by the SSRO, to set in context the profitability of the BPR comparator group "composite rate" against those other sectors that the MOD may contract with more frequently outside of the regime on a competitive basis.⁵

⁵ The SSRO published detailed factsheets about each of its activity type profit benchmarks (<https://www.gov.uk/government/publications/2024-contract-profit-rate-assessment>)

- 1.9 The scope of each activity type is set out in an activity characterisation, which is the fundamental basis upon which comparator companies are selected.⁶ The methodology applies a tailored search criteria, linked to each activity characterisation, to a database⁷ of company information to identify a range of potential comparator companies that meet a broad set of comparability criteria. By adjusting the activity characterisation and search criteria to reflect different activity types the group of companies selected change. The two relevant parts of the search criteria are the “NACE codes”⁸ that are assigned to companies in the database and the text search terms used in conjunction with the NACE codes to identify comparable companies within the database.
- 1.10 The table below summarises the proposed changes to the activity types used to inform company selection. Making these changes is expected to exclude certain companies’ financial data within the BPR assessment that would otherwise have been included, and also add new companies, and their financial data, into the analysis. By helping to ensure the economic activities used in the assessment continue to reflect those we know to contribute to the delivery of QDCs and QSCs, the changes will mean we can continue to rely on our methodology to produce a BPR assessment which supports the SSRO’s statutory aims of value for money and fair and reasonable prices and maintaining a pricing system that supports these aims.

| Proposed change | Description |
|---|--|
| 1. Removal of rental and leasing from the benchmark activity types in the BPR comparable activities | Specific NACE codes and text search terms would be removed from the methodology. This would result in rental and leasing companies captured by them being excluded from the comparator group used in the BPR assessment going forward. |
| 2. Replacing separate D&M and P&M activity types with a single combined group | A new activity type “Develop, Make and Support” (DM&S) would be created by combining the previous D&M and P&M into a single group alongside the implementation of proposals 1 and 3. |
| 3. Expanding the BPR comparable activities to include technical support services | Additional NACE codes and text search terms would be added to those used in the BPR rates assessment to capture technical support services companies in the comparator group. |
| 4. Expanding the Ancillary Services activity type to include labour outsourcing | Additional NACE codes and text search terms would be added to those used in the Ancillary Services activity type to capture labour outsourcing companies in the comparator group. |

- 1.11 The SSRO invites all interested parties to respond to the consultation by 5.00pm 16 August 2024. Details of how to respond to the consultation is explained in section 4 of this document.

⁶ Activity characterisation are set out in Appendices 3 and 6.

⁷ Orbis, supplied by Bureau van Dijk, a Moody’s Analytics company. Full details of its purpose and use can be found in the SSRO’s methodology: <https://www.gov.uk/government/publications/2024-contract-profit-rate-assessment>

⁸ NACE is a system of classifying economic activities for the purpose of statistical and other analysis.

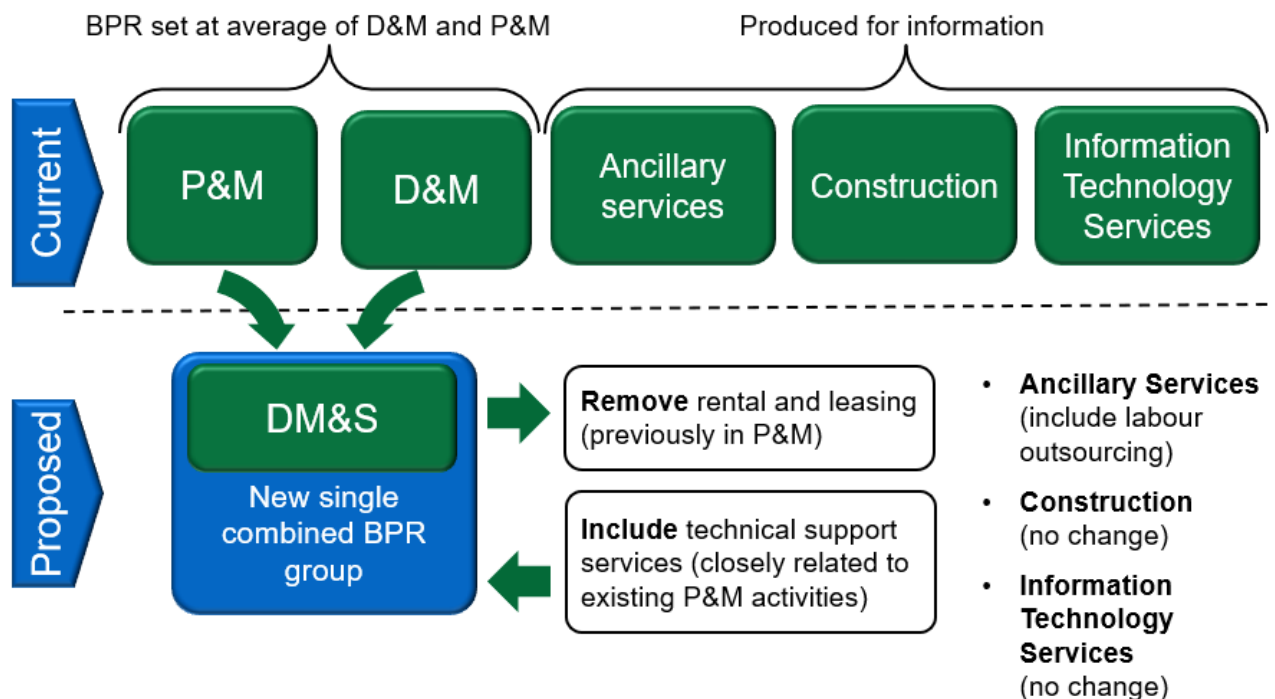
2. Details of proposed changes for consultation

2.1 Phase 1 concluded and committed to develop and test the specific technical changes required to implement the following proposals:

- to expand the P&M activity type characterisations, text search terms and NACE codes to include technical support.
- to reflect the division between rental and leasing companies and those that conduct activities comparable with providing availability or capability with an aim to removing activities from the benchmark activity types that do not reflect those contracted for under the regime.
- to expand the Ancillary Services activity type characterisations, text search terms, and NACE codes to include labour outsourcing.

The SSRO committed to explore the merits for moving from a BPR as a composite of two distinct activity types (D&M and P&M) to a single activity type reflecting a revised scope.

Diagram 1 – Overview of proposed changes



Proposal 1 - Removal of rental and leasing from the benchmark activity types

- 2.2 It was envisaged when the SSRO's BPR methodology was first developed that capacity provision⁹ would be an activity that may be relevant to the fulfilment of a qualifying contract. However, the phase 1 review was inconclusive in this respect, and industry stakeholders made representations to the SSRO that companies undertaking rental & leasing activities should not form part of the comparator group. Some feedback suggested this aspect of the methodology should remain as it is, noting the higher profits of rental & leasing companies as a "beneficial inclusion for industry".
- 2.3 SSRO analysis concludes removal of rental and leasing activities from the baseline profit rate assessment will help ensure that our benchmark activities only include those where we have positive evidence they contribute substantially to the delivery of qualifying contracts and, given this aligns with our established methodology, support its removal. The SSRO proposes to strengthen this further with proposal 3 – expanding the BPR comparable activities to include technical support.
- 2.4 Excluding rental and leasing from the P&M comparator group, by removing from the company search criteria those NACE codes and text search terms associated with rental and leasing would have excluded 43 percent of companies, from the current P&M comparator group (as used in 2024/25 assessment). The list of NACE codes and text search terms excluded are shown in Appendix 2.

Question 1: Do you support the removal of rental and leasing activities from the types of activity included in the baseline profit rate assessment?

Proposal 2 – Replacing separate D&M and P&M activity types with a single combined group

- 2.5 Our phase 1 review examined if developing and manufacturing (i.e. D&M) was clearly identifiable as a separable activity to asset provision and the maintaining activities (i.e. P&M), as it is currently reflected in our approach. We did not identify any compelling reason to combine these groups, given they appeared separable to us, but highlighted some potential benefits and issues of doing so.¹⁰
- 2.6 Were rental and leasing removed from P&M (see proposal 1), we believe the case to keep these two groups separate is much diminished, as maintenance and repair work may be regarded as less distinct (as an economic activity) from manufacturing than the renting and leasing of assets. Furthermore, it is likely that there would be too few companies in the P&M group to maintain a viable standalone comparator group as the primary focus would be repair and maintenance only.
- 2.7 We therefore propose that, alongside the removal of rental and leasing from P&M, to combine D&M and P&M into a single new activity, which is provisionally labelled Develop, Make and Support (DM&S). This new group, defined by a single set of economic activities, we think better reflects the application of our comparability principle. In doing so will address the aforementioned practical challenges of maintaining two distinct groups feeding into the BPR and improve the stability and reliability of the baseline profit rate methodology given the increased sensitivity to the volatility of the reduced P&M comparator group.

⁹ The provision and/or operation of economic assets to a third party.

¹⁰ https://assets.publishing.service.gov.uk/media/651ad1b36dfda600d8e3997/BPR_Activities_Review_consultation_response_October_2023.pdf

- 2.8 This new single activity type, would be constructed as follows:
- The activity characterisation, NACE codes and text search terms of the D&M activity type remain unchanged.
 - The activity characterisation, NACE codes and text search terms relating to rental and leasing are removed from P&M (proposal 1).
 - Any further changes to the NACE codes and text search terms arising from this consultation are made (see proposal 3 'Expanding comparable activities to include technical support services').
 - Each of the above elements is combined into a single activity type.
- 2.9 This proposal is conditional on the removal of rental and leasing from the P&M, as we do not consider those activities to be sufficiently akin to the other activities in D&M to form part of a combined group.
- 2.10 Appendix 3 contains the proposed activity characterisation for the new DM&S activity type.

Question 2: Do you support replacing the current distinct activity types of D&M and P&M with a new single 'Develop, Make and Support' (DM&S) activity type, if rental and leasing were removed from P&M?

Proposal 3 – Expanding the BPR comparable activities to include technical support services

- 2.11 Phase 1 of the review found that contracts undertaking technical support services comprise six percent by volume and 10 percent by total contract price of the overall portfolio of contracts¹¹. We consider this evidence to be sufficiently significant that, the SSRO is now proposing to include these services in the P&M activity type or DM&S activity type should proposal 2 be implemented.
- 2.12 To develop a technical support services characterisation, we applied the approach set out in Appendix 1 and, informed by the DefCARS portfolio review, identified potential comparable companies to develop the technical support services element of the characterisation set out in Appendix 4.
- 2.13 The activities mainly undertaken under this activity type relate to, but are not limited to, the provision of technical support on safety, engineering, training and information services. They would also include the provision of specialised data analysis services and subject matter expertise. Examples of possible comparator companies under technical support services are shown in table 1.

¹¹ 535 qualifying contracts that had submitted reports in DefCARS as of 01 May 2023 when phase 1 was conducted.

Table 1: Examples of potential technical support services comparator companies

| Example comparator company | Primary NACE code | NACE description |
|----------------------------|-------------------|---|
| QinetiQ | 749 | Other professional, scientific and technical activities n.e.c*. |
| | 8020 | Security systems service activities |
| Ebeni | 7219 | Other research and experimental development on natural sciences and engineering |
| | 7112 | Engineering activities and related technical consultancy |
| AtkinsRéalis Group Inc | 7112 | Engineering activities and related technical consultancy |

*not elsewhere classified

- 2.14 Activities primarily reflecting provision of routine or basic training would not be considered comparable, due to not meeting the complexity threshold set out in the methodology. Nor would companies that primarily supply basic support (consumables or labour) that is not specific to specialised equipment (for example building maintenance or office computers IT support). It may be acceptable for comparable companies to engage in some loosely comparable activities as part of delivering their core business (for example health and safety training alongside the technical use training of specialised equipment). However these activities are not expected to extend beyond what might reasonably be required to deliver the company's principal business.

Question 3: Do you support technical support services being added in the DM&S activity type (subject to proposal 2) in the proposed manner?

- 2.15 Appendix 4 sets out the NACE codes and text search terms we would propose to add to the search criteria for P&M, and how they were arrived at.

Proposal 4 - Expanding the Ancillary Services activity type to include labour outsourcing

- 2.16 Phase 1 of the review identified seven qualifying contracts which undertake labour outsourcing activities which were closely aligned to the activities under the current Ancillary Services group. The activities undertaken by the qualifying contracts under this category mainly relate to the provision of a labour pool to undertake tasks as directed by the MOD. We are now proposing to add labour outsourcing to the Ancillary Services activity type.
- 2.17 Whilst the Ancillary Services activity type is not intended to form part of the proposed DM&S group (and thus not impact the BPR), it does represent an economically distinct activity which we have found in limited instances set out above to occur under qualifying contracts. Given this, we believe it is important to keep this activity type updated, in particular considering that the type of activity under a contract is now part of the step 2 cost risk adjustment when setting the contract profit rate.

- 2.18 To develop a labour outsourcing characterisation, we applied the approach set out in Appendix 1 and informed by the DefCARS portfolio review, identified potential comparable companies to develop the labour outsourcing element of the characterisation set out in Appendix 5.
- 2.19 The activities mainly undertaken under this activity type relate to the provision of a labour pool to undertake tasks as directed by the customer (in this case the MOD). Examples of possible comparator companies under “labour outsourcing” are shown in table 2.

Table 2: Examples of potential technical support services comparator companies

| Example comparator company | Primary NACE code | NACE description |
|----------------------------|-------------------|---|
| Serco Group Plc | 8211 | Combined office administrative service activities |
| Capita | 8110 | Combined facilities support activities |
| GGM Holdings Limited | 7830 | Other human resources provision |

- 2.20 Appendix 5 sets out the NACE codes and text search terms we would propose to add to the search criteria for Ancillary Services, and how they were arrived at.

Question 4: Do you support labour outsourcing being added in the Ancillary Services activity type in the proposed manner?

3. Implementation

- 3.1 The SSRO's assessment methodology operates on a three-year cycle. The planned lifespan of a comparator group is three years, after which a new search is performed. This means a full search for new comparator companies is undertaken only every three years. Annual reviews are undertaken to validate the existing group in the intervening years.
- 3.2 This would result in a staged introduction to the practical implementation of the above proposals such that:
- The SSRO's single source baseline profit rate and capital servicing rates methodology would be updated to reflect all proposals that we intend to implement from the 2025/26 rates assessment onwards.
 - The exclusion of rental and leasing activities (proposal 1) and the combining of D&M and P&M into a new single activity type DM&S (proposal 2) would be implemented in the 2025/26 BPR assessment.
 - In the following year, for the 2026/27 BPR assessment, a full refresh of comparator companies would be undertaken (as part of the SSRO's established three-year cycle) and new comparator companies capturing technical support services (proposal 3) in the expanded DM&S activity type would then enter the comparator group.
 - The 2026/27 BPR assessment would also see comparator companies captured by labour outsourcing (proposal 4) in the expanded Ancillary Services activity type enter that comparator group.
- 3.3 We propose to maintain the three-year rolling average approach to the methodology, and this, alongside the staged introduction of any proposals we take forward, means that any impact on the BPR will be gradual. Given the historic BPR data, we anticipate the proposals to remove rental and leasing alongside the plan to combine D&M and P&M will have a further stabilising effect on the BPR, ensuring that it remains a predictable starting point for the determination of contract profit rates under the regime.

We welcome any feedback on our proposals as to how the SSRO will implement these proposed changes to the BPR methodology.

4. Consultation timetable and how to respond

4.1 The proposals of this consultation, subject to stakeholder feedback and the approval of the SSRO Board, will be implemented for the 2025/26 BPR assessment methodology. Due to the three-year cycle used to refresh the comparator groups the expansion of activity characterisations to include technical support and labour outsourcing will result in new comparators being brought in for the 2026/27 BPR assessment.

4.2 The proposed timetable for this consultation is summarised in Table 3.

Table 3: Timetable

| Date | Activity |
|--------------------|---|
| 08 July 2024 | Consultation publication |
| 16 August 2024 | End of consultation |
| September 2024 | SSRO Board agrees 2025/26 BPR assessment methodology, including any changes for this year. |
| October 2024 | Consultation responses published |
| Autumn/Winter 2024 | Assessment of rates based on revalidated benchmark activities |
| January 2025 | Recommendation of rates to the Secretary of State inclusive of revalidated benchmark activities |

4.3 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 support the removal of rental and leasing activities from the types of activity included in the baseline profit rate assessment?
- Question 2: Do you support replacing the current distinct activity types of D&M and P&M with a new single 'Develop, Make and Support' (DM&S) activity type, if rental and leasing were removed from P&M?
- Question 3: Do you support technical support services being added in the DM&S activity type (subject to proposal 2) in the proposed manner?
- Question 4: Do you support labour outsourcing being added in the Ancillary Services activity type in the proposed manner?
- In addition do you have any feedback on our proposals as to how the SSRO will implement these proposed changes to the BPR methodology?

4.4 The full DM&S activity characterisation, NACE codes and text search terms that would replace the D&M and P&M activity types can be found in Appendix 3.

4.5 The updated Ancillary Services activity characterisation, NACE codes and text search terms that would replace the existing Ancillary Services activity type can be found in Appendix 6.

4.6 Consultees do not need to answer all the questions if they are only interested in some aspects of the consultation.

- 4.7 Please send responses:
- by email, including arranging an appointment to speak to the SSRO about the consultation to: consultations@ssro.gov.uk (preferred).
 - by post to: Baseline profit rate 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.
- 4.8 Responses to the consultation should be received by no later than 5.00pm on Friday 16 August 2024. Responses received after this date will not be taken into account in finalising the activities review, but may be used to inform future activity type modifications.
- 4.9 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.
- 4.10 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 their 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.
- 4.11 Stakeholders' attention is drawn to the following SSRO policy statements, available on its website, 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 Information¹²; and
 - The Single Source Regulations Office: Our Personal Information Charter¹³.

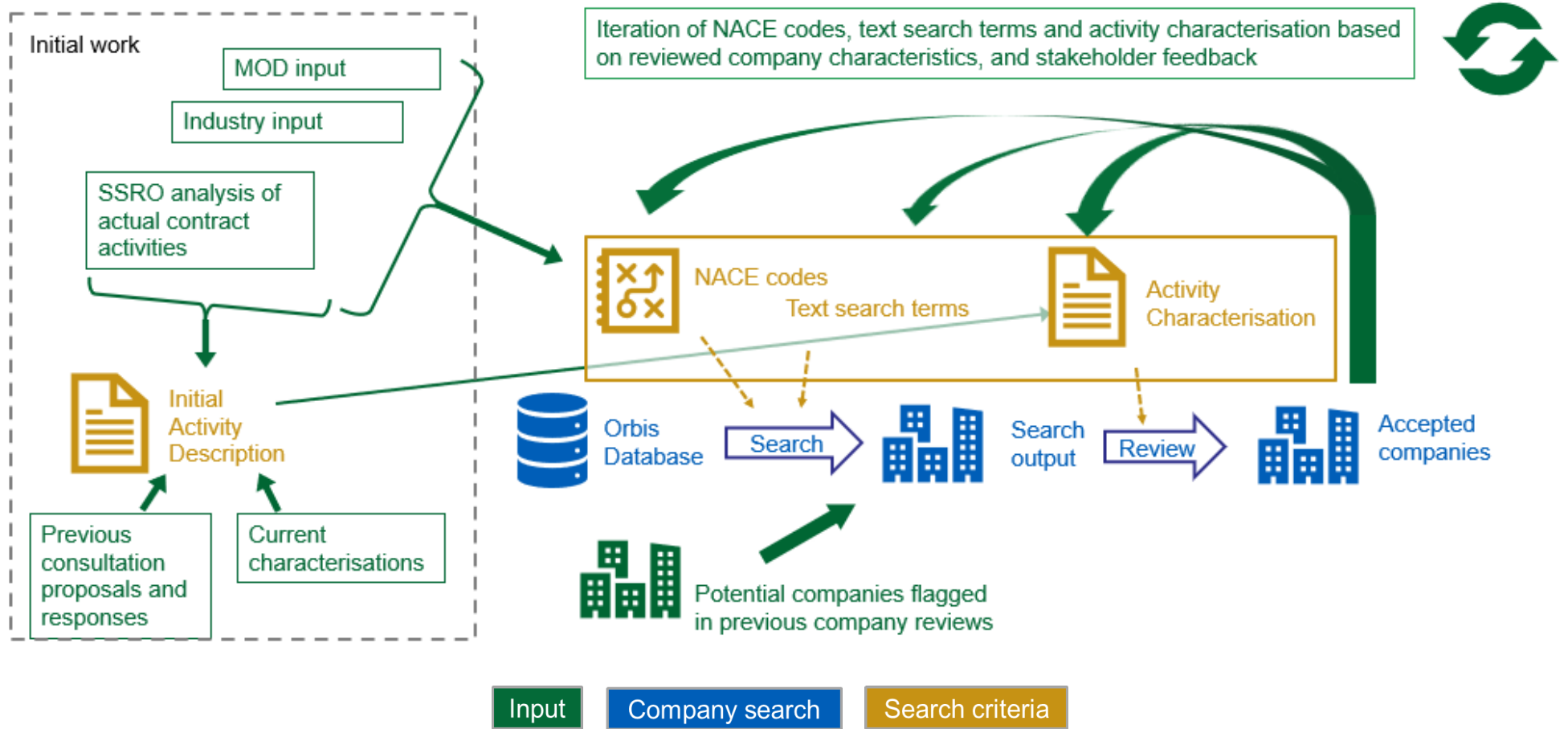
¹² <https://www.gov.uk/government/news/handling-commercially-sensitive-information>

¹³ <https://www.gov.uk/government/organisations/single-source-regulations-office/about/personal-information-charter>

Appendix - 1 Activity type development process

- 1.1 An activity type is a group of economic activities, defined by the SSRO, which correspond to types of activity that contribute to the delivery of QDCs and QSCs. For example, Develop and Make (D&M), or Provide and Maintain (P&M). A comparator group is a group of comparable companies undertaking one or more of the economic activities which make up an activity type by carrying out those activities that are similar, to an appropriate extent, to the activities we are seeking to benchmark. This approach is also used to update an existing activity type and has been followed to produce the proposed changes in Section 2 of this consultation.
- 1.2 The development of an activity type within the SSRO's existing BPR methodology primarily focuses on carrying out a functional analysis and reviewing internal comparators (companies that are known to be carrying out those activities being searched for).
- 1.3 The functional analysis and review of internal comparators is used to develop three elements, which are subsequently used to select all comparators for an activity type:
 - **activity characterisation:** captures a short description of the activities a comparator company is expected to carry out;
 - **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; and
 - **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.
- 1.4 The process to develop these elements is iterative, taking account of SSRO work and feedback from stakeholders, as illustrated in Figure A1.

Figure A1: Development of activity type characterisation, NACE codes and text search terms



Activity characterisation

- 1.5 The SSRO's activity characterisations are written descriptions of economic activities which correspond to types of activity that contribute to the delivery of QDCs and QSCs. 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, works 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

- 1.6 To develop an activity characterisation, the SSRO considers the nature of the activities that the MOD currently contracts for. We look at information from the following sources:

- Contracts Finder, the MOD's Contracts Bulletin, and MOD contracts¹⁴ to identify and understand the type of contracts being awarded;

¹⁴ Some of these are collated by bidstats.uk which sources procurement notices from the Official Journal of the European Union, Contracts Finder and Find a Tender and stores them in one database.

- MOD input regarding the characteristics of the activities undertaken by suppliers in delivering the equipment and services it procures and how it contracts for them;
- information about QDCs and QSCs for the equipment and service, contained in statutory reports in the Defence Contract Analysis and Reporting System (DefCARS); and
- representations from industry.

1.7 This information is used to identify internal comparators. These are companies that are known to be carrying out those activities being searched for.

Identifying internal comparables

- 1.8 To identify potential internal comparables, the SSRO uses an iterative approach involving:
- identifying the companies that hold those contracts with the MOD;
 - identifying MOD contracts and the companies that deliver economic activities that relate to the activity type being developed;
 - identifying the Common Procurement Vocabulary (CPV)¹⁵ codes used in the tendering of the contracts that deliver economic activities that relate to the activity type being developed;
 - identifying other MOD contracts for similar CPV codes, considering if these contracts are delivered by undertaking similar economic activities, and considering the companies that hold those contracts for inclusion; and
 - iterating and refining the list to a set of companies most closely aligned to the economic activities for the activity type being developed.
- 1.9 Where a company has subsidiaries, the SSRO's methodology requires the use of the results of the whole corporate group.
- 1.10 The SSRO finally reviews the internal comparables' website and financial reports information to understand the economic activities they undertake. The information on the economic activities undertaken by the internal comparables is used to develop the activity characterisation.

NACE codes and text search terms

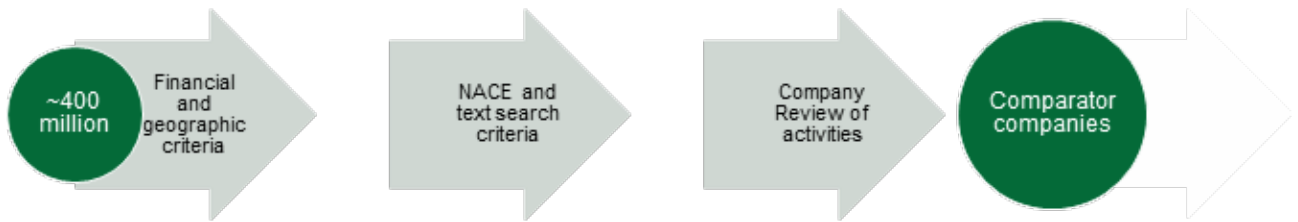
- 1.11 NACE provides a framework for collecting and presenting a large range of statistical data according to economic activity. It consists of a hierarchical structure (as established in the Regulation (EC) No 1893/2006¹⁶).

¹⁵ 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.

¹⁶ <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32006R1893>

- 1.12 The SSRO uses the Orbis¹⁷ database which contains information on more than 400 million companies, to identify comparable companies. The SSRO uses alongside other search criteria, NACE¹⁸ codes and text descriptions to screen companies within the database, 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 A2, a company search process.

Figure A2: Company search process



- 1.13 To identify NACE codes for an activity type we first:
- map the CPV codes of contracts identified from the potential internal comparables to corresponding NACE codes; and
 - considered codes suggested by industry stakeholders.
- 1.14 We then use those NACE codes, alongside the standard financial and geographic criteria that we use in our baseline profit rate assessment and identify from the Orbis database companies that satisfy the search criteria. We then review the companies against the characterisation and identify potential comparator companies.
- 1.15 To identify the final NACE codes, we select NACE codes that are common to the potential comparators. We consider these NACE codes to be the most commonly associated with the activity we seek to benchmark.
- 1.16 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

- 1.17 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.

¹⁷ Orbis is a company-specific information database, supplied by Bureau van Dijk, a Moody's Analytics company.

¹⁸ 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.

1.18 To identify text search terms for the activity type that is being developed we:

- select words from the activity characterisation that represent the economically significant functional activities undertaken by companies for the activity type being developed;
- include the words “defence*”, “defense*” and “military*”, which are common across all our activity types in order to capture companies in the defence sector; and
- consider words that are commonly used in the descriptions of the identified as potential comparator companies bearing in mind that some common words may not be specific to the activities we seek to benchmark.

Appendix 2 – Alteration to NACE codes and text search terms for Proposal 1 – Removal of rental and leasing from the benchmark activity types

Removal of rental and leasing from the SSRO's activity types would be implemented through the exclusion from our company search criteria of the following NACE codes and text search terms.

Table 4: Rental and leasing NACE codes which this change would remove

| NACE code | Description |
|-----------|---|
| 7735 | Renting and leasing of air transport equipment |
| 7739 | Renting and leasing of other machinery, equipment and tangible goods n.e.c. |
| 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 |

Table 5: Rental and leasing text search terms removed

| Text search terms | | | |
|-------------------|-----------|-------------|----------|
| rent* | leas* | hir* | |
| AND | | | |
| container* | truck* | tank* | trailer* |
| aircr* | aviation* | industrial* | defence* |
| defense* | militar* | | |

“*” denotes a part word, for example “tech*” includes “technical”, “technology”, etc

Note: We removed text search terms and those only relating to the NACE codes in Table 5. However, common terms such as defence* for other NACE codes remain in the methodology

Appendix 3 – Activity characterisation for Proposal 2 – Replacing separate D&M and P&M activity types with a single combined group

An activity characterisation is a written description of the group of economic activities and the relevant boundaries which define an activity type. The DM&S activity characterisation below incorporates proposals 1, 2 and 3.

| Component | Develop, Make & Support (DM&S) activity characterisation |
|---|--|
| The activity we are seeking | <p>Companies undertaking comparable activities considered as 'Develop, Make & Support' (DM&S) are expected to engage in:</p> <ul style="list-style-type: none"> • manufacturing and the design and development contributing to that process¹⁹ • delivery of services to ensure the availability of an asset either through technical support of supplied equipment or repair and servicing to third party equipment |
| 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 producing, or the support and provision of, equipment used for military or defence purposes. This would include:</p> <ul style="list-style-type: none"> • scientific or technical research • design, development or testing activities leading to the production of self-contained sub-systems or finished goods • assembly or construction of a product to the extent that it is likely to represent comparable manufacturing • technical support in specialised areas such as safety, engineering, training and information services • provision of specialised data analysis services and subject matter expertise • repair and servicing of specialised equipment |

¹⁹ 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. Where development activities do not seek to result in a novel or differentiated product the company is less likely to be considered comparable.

| Component | Develop, Make & Support (DM&S) activity characterisation |
|---|---|
| <p>Examples of the characteristics of the products or services provided by the company under review that would indicate comparability</p> | <p>This could cover a broad range of products such as:</p> <ul style="list-style-type: none"> • structural metal goods, • machinery, • electronic and mechanical subsystems, • vessels, • containers, • general machinery, • ships, • aircraft, • wheeled or tracked vehicles or other means of transportation • other items of machinery of an industrial nature. <p>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.</p> <p>Electronic or mechanical assemblies or subsystems that are complex and not of a commoditised nature are more likely to be considered the output of a comparable manufacturing process.</p> <p>Repair and servicing activities comparable to sustaining 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. Diagnosis, repair and installation activities, would be expected to require an in-depth knowledge of the asset being serviced.</p> <p>Technical support activities include the provision of specialist labour supplying complex safety, engineering and data analytical services. Provision of training or subject matter expertise in these areas would likely be comparable.</p> <p>This would exclude companies whose capabilities are limited to rudimentary work, such as those involving user-serviceable parts, domestic installations (for example domestic white goods) or routine/ refresher training.</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, in part or in combination, the manufacturing, design and development activities as well as the support, servicing and maintenance activities described above.</p> |

| Component | Develop, Make & Support (DM&S) activity characterisation |
|--|--|
| <p>Clarification on activities often observed in the companies under review that are acceptable if they are supporting the primary value generation.</p> | <p>For example:</p> <p>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. 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)*.</p> <p>Organisations that primarily provide routine or basic training would not be considered comparable. Nor would companies that supply basic support (consumables or labour) that is not specific to specialised equipment (for example building maintenance or office computers IT support). It may be acceptable for comparable firms to engage in some loosely comparable activities as part of delivering their core business (for example health and safety training alongside the technical use training of specialised equipment)*.</p> <p>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). 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 or installation)*.</p> <p>*However, these activities are not expected to extend beyond what might reasonably be required to deliver the company's principal business.</p> |
| <p>Examples of value generation that would indicate the company under review should be rejected.</p> | <p>Significant involvement in activities that are obviously non-comparable in nature would be cause to reject a company.</p> <p>Examples of which may include (but are not limited to):</p> <ul style="list-style-type: none"> • provision of financial services • marketing or advertising services • food processing • distribution of third-party goods • development or manufacture of pharmaceutical products • provision of transferable training • business of management consultancy |
| <p>Summary the characteristics of the end customers of the activity</p> | <p>The end customers for the outputs generated by comparable companies are expected to be other businesses, institutions or governments.</p> <p>Comparable companies are not expected to maintain marketing models, sales operations, large networks of product outlets or dealerships aimed at the general public.</p> |

Appendix 4 – Alteration to NACE codes and text search terms for Proposal 3 – Expanding the BPR comparable activities to include technical support services

Including technical support services in our activity types requires the selection of suitable NACE codes and text search terms to be added to the search criteria used to identify potential comparator companies.

Selecting NACE codes

For each internal comparable, we identified the Common Procurement Vocabulary (CPV²⁰) codes associated with their MOD contracts and the associated economic activities. To identify NACE codes for the technical support services we first:

- mapped the CPV codes of contracts identified from the potential internal comparables analysis to corresponding NACE codes; and
- considered codes suggested by industry stakeholders.

We then used those NACE codes, alongside the standard financial and geographic criteria that we use in our baseline profit rate assessment, to search the Orbis database for potential comparable companies.²¹ We then conducted a review against the proposed technical support services element of the DM&S characterisation (Appendix 3), identifying 22 companies as potential comparator companies.²²

To identify the final proposed NACE codes for the technical support services we selected 5 NACE codes that are common to the 22 potential comparators. We consider these NACE codes to be the most commonly associated with the technical support services activities we are seeking to benchmark. Table 6 presents a list of the proposed NACE codes and their descriptions.

Table 6: Proposed technical support services NACE codes and their descriptions

| NACE code | Description |
|-----------|--|
| 712 | Technical testing and analysis |
| 749 | Other professional, scientific and technical activities n.e.c. |
| 7112 | Engineering activities and related technical consultancy |
| 3820 | Waste treatment and disposal |
| 8020 | Security systems service activities |

²⁰ 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.

²¹ The search was based on company information reported in Orbis for the year ending 2022/23. This information is for the same period used in the assessment of the 2024/25 rates.

²² This involved a moderate review of each company. Should the SSRO proceed to calculate a benchmark profit rate following the outcome of the consultation, a more detailed review would be undertaken to provide the necessary level of assurance that the selected companies are appropriate.

Selecting text search terms

Within the Orbis database, 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.

To identify text search terms for the technical support services we:

- selected words from the DM&S characterisation that represented technical support services (Appendix 3) which represent the economically significant functional activities undertaken by companies for the purposes of technical support services for contracts the MOD enters into;
- included the words “defence*”, “defense*” and “military*”, which are common across all our activity types in order to capture companies in the defence sector; and
- considered words that are commonly used in the descriptions of the companies identified as potential comparator companies (see Appendix 4), cognisant that some common words may not be specific to the activities we are seeking to benchmark.

The text search terms that we propose for technical support services are presented in Table 7.

Table 7: Proposed text search terms for technical support services

| Text search terms | | | |
|-------------------|---------------|----------|--------------|
| techn* | professional* | consult* | engineering* |
| test* | certificate* | valuat* | safety* |
| assurance* | militar* | defence* | defense* |

“*” denotes a part word, for example “techn*” includes “technical”, “technology”, etc

Appendix 5 – Alteration to NACE codes and text search terms for Proposal 4 – Expanding the Ancillary Services activity type to include labour outsourcing

Including labour outsourcing in our activity types requires the selection of suitable NACE codes and text search terms to be added to the search criteria used to identify potential comparator companies.

Selecting NACE codes

The NACE codes that are proposed for labour outsourcing services are presented in Table 8.

Table 8: Proposed technical support services NACE codes and their descriptions

| NACE code | Description |
|-----------|---|
| 781 | Activities of employment placement agencies |
| 782 | Temporary employment agency activities |
| 783 | Other human resources provision |

Selecting text search terms

The text search terms that are proposed for labour outsourcing services are presented in Table 9.

Table 9: Proposed text search terms for labour outsourcing services

| Text search terms | | | |
|-------------------|------------|----------|----------|
| placement* | personnel* | supply* | human* |
| provision* | recruit* | defence* | defense* |
| militar* | | | |

“*” denotes a part word, for example “tech*” includes “technical”, “technology”, etc

Note: Text search terms with amber font are already in the current Ancillary Services search strategy.

Appendix 6: Activity characterisation for Proposal 4 – Expanding the Ancillary Services activity type to include labour outsourcing

| Component | Ancillary Services activity characterisation |
|--|---|
| The activity we are seeking | Companies undertaking comparable activities considered as 'Ancillary Services' are expected to deliver either one of administrative, labour outsourcing, facilities, or IT support activities. |
| The type of contractual relationship observed in defence procurement we are seeking to find comparators for | 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. |
| Examples of the characteristics of the products or services provided by the company under review that would indicate comparability | 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. Labour outsourcing would include the provision of a labour pool to undertake tasks as directed by the MOD. IT support services would include data management, data processing, network hosting, IT repairs and maintenance and IT security services. Facilities support services would include property cleaning, property repairs and maintenance, canteen services, laundry, gardening and general guarding and security services. |
| How the activities being performed should generate value for the comparator | The value added, cost base or profits of the business are expected to principally derive from the Ancillary Services activities described above. |
| Examples of value generation that would indicate the company under review should be rejected. | 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. |
| Summary the characteristics of the end customers of the activity | <p>The end customers for the services provided by comparable companies are expected to be other businesses, institutions or governments. Comparable companies are not expected to be entities which solely exist to provide these services to members of their own corporate group.</p> <p>Comparable companies are not expected to primarily serve the general public with, for example, domestic gardening or cleaning services.</p> |