National Audit Office

The creation of Ofcom: Wider lessons for public sector mergers of regulatory agencies

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 1175 Session 2005-2006 | 5 July 2006

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29 June 2006

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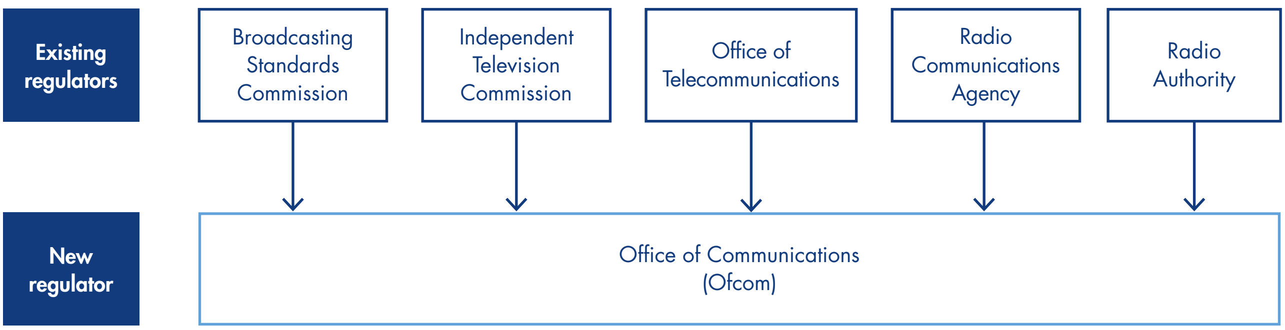
EXECUTIVE SUMMARY

1 This report reviews the costs and challenges of organisational change in the merger of five regulatory bodies to create the Office of Communications (Ofcom). The rationale for this public sector merger was the growing convergence of communications, such as broadcasting, telecommunications and Internet. In this environment, it is important that the regulatory framework does not create unnecessary barriers to innovation and growth, whilst protecting the interests of citizens and consumers.

2 Ofcom was established by the Office of Communications Act 2002 and formally took over its powers under the Communications Act 2003 on 29 December 2003. It consolidated the functions of five previous regulators covering the telecommunications, broadcasting, radio and spectrum industries, as well as taking on new powers **(Figure 1)**.

3 Part one of the report looks at the decision-making process behind the creation of Ofcom. Although the rationale and high level objectives for the merger were clearly outlined in the Government's White Paper and Regulatory Impact Assessment, the decision was not supported by sufficient detail about the costs of carrying out the merger, nor the exact benefits to be achieved. As a result, it is difficult to evaluate the value for money of this merger. The creation of Ofcom was funded by a loan from the Department of Trade and Industry amounting to £56.8 million,[1] but the National Audit Office has calculated the full cost of the merger to be at least £80 million. Policy makers who propose mergers should give serious consideration to these costs in assessing whether a merger will represent value for money.

1 The creation of Ofcom



Source: National Audit Office

1 The total loan of £56.8 million was made up of the loan principal of £52.3 million and £4.5 million of interest.

4 Part two of the report reviews how the Ofcom merger was carried out, both before and after Ofcom's Chairman and Chief Executive were appointed. The creation of Ofcom was a significant achievement given the complexities involved in merging five different bodies. This required decisive leadership, as well as rigorous management of the physical integration of the organisations and maintaining normal business. By approaching this merger as the creation of a new entity, rather than just the fusion of the five previous bodies, Ofcom has responded to the Government's ambition to create an entirely new style of regulator.[2]

5 Part three of the report undertakes a preliminary review of whether the creation of Ofcom has achieved its high-level objectives. In the absence of a measurement framework for public sector mergers, the National Audit Office developed an approach to review success. A preliminary assessment indicates that the creation of Ofcom is delivering benefits for markets and increased business satisfaction. There are also early signs that some regulatory decisions are beginning to yield benefits for consumers. In addition, our analysis shows that Ofcom is costing less per annum than the sum of its predecessors. Based on positive results for these and a series of other measures, the report concludes that many of the merger's objectives are being met. Some of the benefits, however, such as the results of joined-up communciations policy, cannot easily be quantified or may only be borne out in the longer term.

6 The good practice guide sets out lessons learned from the creation of Ofcom for other mergers in the public sector, particularly of regulatory agencies. In March 2005, the Hampton Review[3] recommended the consolidation of some 31 regulators into seven thematic bodies in the areas of nature and land management, environment, animal health, agriculture, health and safety, food health and consumer protection. At the same time, the Chancellor also announced the consolidation of 11 public sector inspectorates into four bodies covering children and learners, health and adult social care, justice and community safety, and local services.[4] More mergers of other organisations are also being planned across the public sector, in the areas of policing, health and human rights (Appendix Three).

7 Many of these mergers of public bodies will differ from the creation of Ofcom in terms of objectives, scale and type of merger. These differences may affect the extent to which lessons from this case study of Ofcom are transferable. Issues such as leadership succession, for example, will be less relevant where a larger body absorbs a much smaller body and the Chief Executive remains in post. There are, however, common dimensions to many mergers. These lessons, outlined in the good practice guide, have been validated by a panel of leaders that have delivered a range of different public sector mergers.

2 "If Ofcom becomes little more than an agglomeration of the existing regulators…then the process of establishing Ofcom will have failed", *Report of the Joint Committee on the Draft Communications Bill*, House of Lords (HL 169-I) and House of Commons (HC 876-I), 31 July 2002 (p.99).

3 *Reducing administrative burdens: effective inspection and enforcement*, Philip Hampton, March 2005.

4 *Budget report*, HM Treasury, March 2005.

RECOMMENDATIONS

For Ofcom:

1 Ofcom currently measures and reports a variety of key performance indicators covering its outputs and service delivery. It also publishes reports on the market sectors that it regulates and has a wide range of both qualitative and quantitative evaluation processes in place. As part of its overall contribution to regulatory accountability, Ofcom should also identify and measure longer-term outcomes and benefits, using an approach like the NAO's measurement framework. This could include analysis and explanation of the benefits delivered for consumers, such as price, choice, innovation and satisfaction, as well as benefits to markets.

2 The Government (the Department of Trade and Industry and the Department for Culture, Media and Sport) did not set targets for achieving cost efficiencies from the Ofcom merger at the outset, although Ofcom has since chosen to set targets and deliver efficiency savings. Ofcom should continue to deliver efficiencies as the organisation consolidates and ensure that these savings are clearly communicated to stakeholders. Ofcom could also consider benchmarking its cost of regulation to other overseas communications or UK regulators.

For future public sector mergers:

3 These recommendations are aimed at the decision makers and leaders of future mergers, and provide a framework for how Parliament may hold future mergers to account.

Decision-makers should:

4 Base the decision to merge on a balanced judgement of whether the projected benefits justify the costs of carrying out the merger.

5 Clearly identify and account for the costs of carrying out the merger, including setting a separate budget.

6 Carry out targeted due diligence as early as possible by gathering important financial, legal, operational and staffing information about the bodies to be merged. This will assist in identifying issues or risks for integration.

7 When the decision to merge is taken, establish a set of relevant measurable benefits to be achieved, and collect baseline data before the merger commences. Measure and monitor progress against these objectives.

8 Ensure regular communication with staff and stakeholders (such as businesses or consumer groups), reinforcing the merger rationale, identifying those accountable at each stage, and providing regular updates. This should include setting out what has and has not been decided.

9 Avoid a decision-making vacuum by clearly defining those accountable for each phase.

10 Appoint senior managers early, especially the Board, Chief Executive, Finance and Human Resources Directors.

Leaders carrying out the merger should:

11 Identify a realistic start date once leaders are in place. Use specialist programme management support to meet this target if necessary.

12 Use targeted consultancy support to assist in filling specific skills gaps, rather than to give overall direction to the merger planning in a leadership vacuum.

13 Develop a risk mitigation strategy for the integration of finance and IT, as problems in these areas are inherent in almost all mergers.

14 Ensure there is a plan to mitigate the risks of disruption to business as usual and the interests of stakeholders, including a dedicated planning team.

15 Ensure early focus on a remuneration strategy, particularly in regards to pensions, which should be clearly communicated to all relevant parties.

16 Establish an explicit programme to overcome the challenge of integrating the cultures of the previous bodies, and monitor progress through surveys. This programme may include the decision to house staff in a new single location.

17 Review progress regularly. The merger process continues after the formation of the new organisation and phased integration is necessary. Reviews should include processes, structure and management style.

PART ONE

The decision to create Ofcom

1.1 The decision to create Ofcom was announced in December 2000. Ofcom's start date was three years later on 29 December 2003, although consolidation continued for some time after this **(Figure 2 overleaf)**.[5] Part one of the report reviews three aspects of the decision-making process and the accompanying Regulatory Impact Assessment behind the creation of Ofcom:

- the overall rationale for the merger;
- aims and objectives for the new regulator; and
- the full cost of carrying out the merger.

Decision-makers:
Government, or relevant department, responsible for the decision to merge and setting out the high-level rationale for the merger.

The overall rationale for the merger

1.2 In December 2000 the Government proposed revisions to the UK's communications legislation in its White Paper, *A New Future for Communications*.[6] One of the most significant proposals was to consolidate the functions of five existing bodies **(Figure 3 overleaf)** to create a single, merged regulator for the telecommunications, broadcasting, radio and spectrum industries. At the time of the decision, the communications sector generated revenues of some £35.5 billion.[7]

1.3 There were three major drivers outlined in the White Paper for creating a single regulator:

- **to respond to a rapidly changing marketplace** – broadcasting and telecommunications platforms were converging (e.g. television viewed on mobile phones), and a converged regulator would be necessary to address ongoing technological development;
- **to remove overlap of existing regulation** – there were concerns about the effectiveness of co-operation between some of the previous regulators. This created a burden on some businesses (e.g. conditional access on pay television) and had the potential to hamper the effective switch over to digital television by 2009; and
- **to incorporate EU obligations** – the Government was obliged to introduce the European Commission's five telecommunications directives into UK law by 25 July 2003, which provided the basic time-scale for creating Ofcom.

1.4 The Government undertook an extensive period of consultation and then published its response in November 2001. Although there was some debate about exactly what should be merged, and the balance of the new regulator's roles and responsibilities, the overall decision to merge was not highly contentious.[8] The Department of Trade and Industry and the Department for Culture, Media and Sport shared responsibility for taking forward the merger and legislative process.

5 There is no definitive end date for the merger as it is difficult to be precise as to when integration is complete and normal business resumes.
6 Communications White Paper – *A New Future for Communications* (Cm 5010) – published on 12 December 2000.
7 Communications Bill Regulatory Impact Assessment (http://www.communicationsact.gov.uk/pdf/overarching_assessment_update.pdf).
8 *A case study on public sector mergers and regulatory structures*, Ofcom, May 2006 (p.10).

2 Milestones in creating Ofcom

Date		Milestone	
2000	December	White Paper published: A New Future for Communications	
2001	September	Ofcom Scoping Report presented to ministers	Cost of merger to be calculated across this entire period
2002	March	Ofcom Act receives Royal Assent	
	May	Draft Communications Bill published	
	July	David Currie appointed Ofcom Chairman	
	September	Main Board non-executives appointed	
	November	Management consultant consortium delivers its final report: Creating Ofcom	
2003	January	Stephen Carter appointed Chief Executive	
	January	Riverside House announced as Ofcom's London headquarters	
	July	Communications Act receives Royal Assent	
	September	Statutory commencement of transfer of property, rights and liabilities of the previous regulators to Ofcom	
	December	Ofcom vesting day: 29 December 2003	
2004	March	Designed staff performance review process (first reviews in September 2004)	
	September	First set of financial accounts laid before Parliament	
2005	February	Colleague Survey work of all Ofcom staff undertaken	
	July	Board approval for Project Unify (IT transformation programme)	
	September	Work begins on Project Progress, looking at organisational effectiveness	

Source: Ofcom (see Appendix 3 for a more detailed timeline)

3 The five previous regulators merged to create Ofcom

	Broadcasting Standards Commission	Independent Television Commission	Radio Authority	Oftel	Radio Communications Agency
Type of body	Non-Departmental Public Body	Statutory Corporation	Statutory Corporation	Non-Ministerial Government Department	Executive Agency of the Department of Trade & Industry
Budget[1]	£3.9 million	£20.1 million	£4.8 million	£18.0 million	£71.5 million
Staff numbers[1]	21	180	47	234	580
Governing legislation	Broadcasting Acts 1990 & 1996	Broadcasting Acts 1990 & 1996	Broadcasting Acts 1990 & 1996	Tele-communications Act 1984 & Competition Act 1998	Wireless Telegraphy Act 1949
Principal activities	Maintaining standards and fairness in TV and radio broadcasting	Licensing and regulation of all commercial TV services	Licensing and regulation of all commercial radio services	Regulation of the telecommunications industry	Management of the non-military radio spectrum in the UK

Source: National Audit Office and Ofcom

NOTE

1 Final year operating costs and staff numbers as stated in 2002-03 published accounts.

Aims and objectives for the new regulator

1.5 Regulatory Impact Assessments (RIAs) are produced alongside policy proposals, enabling policy makers to assess the need for, and impact of, new government proposals.[9] Assessments are meant to explain the intended effects of the policy proposal, including the risks of not going ahead, and to clearly define the objectives. They should also contain analysis and quantification, where possible, of the costs and benefits with some form of measurement or post-implementation review.[10]

1.6 The Government produced an initial RIA alongside its White Paper and then a more detailed RIA for creating Ofcom as part of an overall assessment for the Communications Bill.[11] This RIA set out a range of aims for the new regulator, which fall into three groups: reducing burdens on business, improving regulatory outcomes, and achieving efficiency savings **(Figure 4)**.

1.7 Beyond these high-level aspirations, however, the RIA did not provide detailed objectives for Ofcom or a framework for measuring and monitoring the costs and benefits of the merger. Without the definition of objectives or a measurement framework in place, there are no clear means of comparing the merged regulator with the aggregate of its predecessors. For example, Ofcom is delivering annual efficiency savings (see paragraphs 3.10 – 3.14), and tracks stakeholder views of its effectiveness. This data explains trends since Ofcom began operating in 2003-04. But it does not enable the Government to demonstrate whether the high level objectives in the RIA have been achieved, or how far those benefits justify the costs of carrying out the merger.

4 Benefits to be achieved by the creation of Ofcom

Aim	Details from the RIA
Reducing burdens on business	■ The communications industry will have to deal with only one organisation instead of up to five bodies ■ The new regulatory regime will encourage self-regulation where possible. Businesses and consumers can therefore expect added flexibility
Improving regulatory outcomes	■ A comprehensive, coherent and joined-up approach to regulation ■ The new framework will help to promote greater clarity and certainty as compared with the existing piecemeal system ■ It will be light-touch and flexible, but robust and responsive
Achieving efficiency savings	■ Day-to-day costs are expected to be lower than under the current regime ■ Ofcom should be a lean and efficient organisation

Source: Communications Bill Regulatory Impact Assessment

9 The National Audit Office carries out annual reviews of the quality of Regulatory Impact Assessments (RIAs). The latest report, *Evaluation of Regulatory Impact Assessments, 2005-06*, was published in June 2006.
10 Cabinet Office Regulatory Impact Assessment Guidance (www.cabinetoffice.gov.uk/regulation/ria/riaindex.asp).
11 Communications Bill Regulatory Impact Assessment (www.communicationsact.gov.uk/pdf/OFCOM_assessment.pdf).

The full extent of the merger costs

1.8 The RIA acknowledged that there would be set-up costs involved in the merger.[12] It noted that some costs would "be met from taxation (before Ofcom comes into being)". Most costs, however, were covered by "loans from the Secretary of State" to Ofcom, which would "ultimately be carried by licensees…in the form of increases to fees". The RIA estimated preparatory costs, such as planning and design work, at £5 million. Additional implementation costs were identified but not quantified, such as accommodation, recruitment and IT system design. Expenditure on pension transfer costs, severance, early retirement and payments for forfeiture of existing leases was also expected. The RIA noted, however, that an estimate of total costs had not been made as this "will depend on what is needed to discharge the functions that Parliament gives Ofcom".

1.9 Licensees told the National Audit Office that the process for estimating set-up costs was not transparent and that they were not informed about the costs in a timely manner. The final loan from the Secretary of State for the Department of Trade and Industry amounted to £56.8 million, including the loan principal of £52.3 million and £4.5 million of interest. This loan is repayable between 2004-05 and 2007-08 and is funded by additional payments by Ofcom licensees, which are calculated on top of their normal licence fees.

1.10 The principal of £52.3 million does not, however, reflect the full cost of carrying out the merger. The previous regulators absorbed a proportion of costs in their final two years of operation, as did the government Departments involved. The National Audit Office has reviewed the accounts of Ofcom and the previous regulators, and identified an additional £22.5 million of merger costs, such as vacant property charges and severance costs **(Figure 5)**. There was little clarity, however, as to the point in time from which all costs would be tracked in setting up Ofcom and winding down the previous regulators. The total cost is potentially much higher than the £79.3 million calculated by the National Audit Office, as many elements, such as the opportunity cost of diverting staff from operational work to winding down activities, were not recorded at the time or are virtually impossible to quantify in retrospect.

5 Breakdown of the lifetime cost of creating Ofcom

Loan from the Department of Trade & Industry	**Amount (£m)**
■ staff costs	5.1
■ other staff costs (secondees, temporary staff and recruitment)	3.2
■ professional fees (includes set up and regulatory costs pre 29 December 2003)	12.6
■ office and administrative costs	2.6
■ premises	1.3
■ communications and other costs	0.9
■ capital expenditure	15.5
■ previous regulators' liabilities for redundancy	9.7
■ other previous regulators' liabilities	1.4
Interest on loan	4.5
Subtotal	**56.8**
Other merger costs (not included in DTI loan)	
Independent Television Commission (severance and other costs of closure)	2.8
Radcomm (early retirement and severance costs)	0.6
Radio Authority (staff retention bonuses)	0.6
Ofcom annual accounts[1] (vacant property charges[2])	18.5
Subtotal	**22.5**
Total identifiable cost	**79.3**

Source: National Audit Office, Ofcom and Annual Reports of the five previous regulators

NOTES

1 Ofcom's Annual Report and Accounts 2004-05 include restructuring costs of £5.3 million, including a provision for early retirement and redundancy costs of £1.4 million in 2004-05. Ofcom considers these are not wholly merger-related as they relate to post-merger streamlining of operations. Ofcom has funded these costs and the annual expenditure on vacant properties within its annual cash budget.

2 We have included vacant property charges relating to leasehold premises vacated by Ofcom's predecessor and not used by Ofcom. Such charges are often an inevitable part of the full lifetime cost of a merger. The figure of £18.5 million assumes no further rental income.

12 Communications Bill Regulatory Impact Assessment, paragraph 10 & Annex A – Creating Ofcom, paragraph 30.

PART TWO

Success factors and challenges in creating Ofcom

2.1 Part two of the report examines the complex process of carrying out the merger. Initial responsibility was shared between Government and the previous regulators. Lord Currie was appointed as Ofcom's Chairperson in July 2002. The Chief Executive position was advertised in October 2002, and Stephen Carter was appointed by the Board in January 2003.

2.2 This section identifies key success factors and challenges in creating Ofcom, spanning across the planning and implementation stages **(Figure 6)**. We reviewed a wide array of merger literature and Ofcom's published report of the merger. We also carried out interviews with a panel of public sector leaders who have carried out mergers, as well as merger experts (Appendix 1). This part highlights the importance in mergers of the interplay between quantifiable issues, such as programme management and finance, and more qualitative people-oriented issues such as leadership and culture.

6 Critical success factors and challenges

- Shared accountability prior to the appointment of Ofcom's leaders;
- Leadership by Ofcom's newly appointed leaders;
- Programme management;
- Focus on human resources issues;
- Finance (and related information systems); and
- Culture and communciations.

Source: National Audit Office

Shared accountability prior to the appointment of Ofcom's leaders

2.3 In many instances, the future leaders of a merged public sector organisation will not have been appointed, or be in post, during part of the planning process. The absence of those future leaders risks creating a vacuum of leadership that is largely unavoidable and early planning teams have to recognise and work around this challenge.

2.4 This was the case in creating Ofcom, and as a result, responsibility for decision-making and early planning was shared by a number of groups: a cross-departmental Bill Team, a Steering Group from the previous regulators and a dedicated Central Project Team, with advice from consultancy firms **(Figure 7 overleaf)**.

Leaders:
The Chief Executive and Chairman, or Heads of the newly merged entity.

Bill Team:
Departmental team that manages the entire drafting process for the new legislation.

7 Roles of the planning teams

Group	Members	Contribution
Bill Team	Staff from Departments of Trade & Industry, and Culture, Media & Sport, and the previous regulators	■ Managed the legislative process ■ Coordinated 70 policy officials ■ Led on initial set up of Ofcom (e.g. appointments) ■ Single interface between government and regulators
Steering Group	Heads of the five previous regulators	■ Provided experience to planning and advised Bill Team ■ Central forum to input concerns and harmonise messages for staff at each of previous regulators
Central Project Team	Staff seconded from the previous regulators, supported by external experts	■ Dedicated to planning the integration ■ Worked for Steering Group and Bill Team

Source: National Audit Office

2.5 In these circumstances, there are difficult decisions to make about the appropriate governance of merger planning, such as the roles and interaction of the planning teams and the level of detail sought in planning before the appointment of the new leaders. The role of decision-making and interaction with external stakeholders also becomes uncertain. The shared, and sometimes unclear, accountability for creating Ofcom throughout 2001 and the first half of 2002, before Ofcom's leaders were in post, affected several important issues:

- **Overall coordination** – a change in leadership of the Bill Team and lack of a single leader of the Steering Group[13] meant that there was no single, independent point of contact or accountability on issues such as funding or winding down of the previous regulators. For example, the relevant Accounting Officers of the previous regulators had already left before the final accounts were signed. The Central Project Team and Bill Team experienced difficulties in securing funds and discussions with Treasury were not held early enough;

Due diligence:
Focused information gathering process that takes place before a merger to identify issues or risks, and to assist decision-making.

- **Targeting of planning** – there was insufficient due diligence undertaken on the previous regulators in early planning to underpin a basic estimate of set-up and wind down costs, as well as planning and risk management (Appendix 5). Some aspects of due diligence received attention through a consultancy project, but Ofcom's leaders told the National Audit Office that the information gathered was variable in quality and depth. For example, there should have been far greater focus on the requirements of Ofcom's public corporation status,[14] the finances of the previous regulators and changes required to integrate and establish a financial framework for a larger organisation. In addition, Ofcom was not content with staffing details that had been previously produced; and
- **Use of consultancy** – two major consultancy tenders were awarded and carried out before Ofcom's leaders were appointed. The first, from June to October 2001, was a scoping project costing £90,000 carried out by Towers Perrin. The second, from December 2001 to November 2002, was a much larger and more detailed contract costing around £4.5 million carried out by a consortium led by Towers Perrin (included Ernst & Young and Differentis). The first project had a targeted focus, short time-frame, was low cost and provided a useful baseline for starting the planning. The current view of Ofcom, however, is that the

13 The chief executives of the existing bodies shared the role of the chair on a rotational basis.
14 Ofcom was set up as a statutory corporation, which means it has substantial independence from Government and largely recovers its costs from fees charged to customers (HM Treasury, *Public Expenditure Statistical Analyses 2006*, p.81).

level of planning in the second, much more costly consultancy project set out too much detail, such as organisational design and job specifications. Once appointed, Ofcom's Chief Executive had his own vision for the new organisation and decided to re-visit much of this work.

- **Appointment of Ofcom's leaders** – the expected start date for Ofcom was originally July 2003. By the time the Chairperson, Board and Chief Executive were in post, this target provided insufficient time to plan the integration. The Chief Executive employed specialist programme management support to identify a more realistic target date of 29 December 2003. Earlier appointment of the Chairperson, who then selected a Chief Executive (to allow about a year for detailed planning), could also have avoided effort being expended unnecessarily prior to their appointment.

2.6 Those involved in the early planning have noted that in the absence of appointed leaders, the combination of the three early planning groups (Figure 7) was necessary to create some momentum surrounding the merger, limit uncertainty for staff by showing progress, and start building acceptance of future change.

2.7 One of the most significant achievements of the early planning phase was the early creation of a shadow organisation. To achieve the Government's policy commitment to have Ofcom operational by the end of 2003, the draft Communications Bill was planned for the 2001-02 Parliamentary session. Early delays to the legislative process looked set to undermine the Ofcom timetable, and the Office of Communications Bill was introduced as an interim measure. The Office of Communications Act received Royal Assent in March 2002.

2.8 This type of Bill, called paving legislation, established Ofcom as a legal entity and allowed it to start incurring expenditure and appoint a leadership team. Establishing Ofcom as a shadow organisation early in the process meant that planning for the new organisation could run in parallel to Parliamentary debate on the substance of its new powers and responsibilities.

Leadership by Ofcom's newly appointed leaders

2.9 Ofcom's leaders took control of the merger implementation after August 2002. The joint sponsor Departments (Trade and Industry; and Culture, Media and Sport) had requested that "that Ofcom needs to be a completely new organisation, with a culture to match, and that a much more radical change is needed".[15]

2.10 With this mandate, Ofcom's Chairman and Chief Executive were bold in planning the shape of Ofcom and approached the merger as if starting a new organisation, rather than merging the structures and approaches of the five previous regulators. They built on some of the early planning by the Bill Team, Steering Group and Transition team, and revisited decisions in other areas. The National Audit Office has identified three of the most influential of these decisions in **Figure 8 overleaf**.

Programme management

2.11 Mergers are highly complex change management projects that require robust programme management to ensure that they are delivered within the specified timetable, that normal business or policy work is not neglected during the merger, and that each aspect of integration is approached at a suitable time.

15 "There is very wide recognition that Ofcom needs to be a completely new organisation, with a culture to match, and that a much more radical change is needed", *Government's Response to the Report of the Joint Committee on Draft Communications Bill*, Department of Trade and Industry & Department of Culture, Media and Sport, 2002 (p.13).

8 Key decisions made by Ofcom's leaders

Decision	Benefit
Matrix organisational structure A large senior management team coordinating project-based work	This was designed to make Ofcom more responsive to the dynamic nature of the communications market, but was also a conscious effort to break down potential barriers between the five incoming groups of staff (see paragraphs 2.23 and 2.24 on building a common culture)
More attractive remunerations[1] Conscious decision to attract staff from industry and consultancy	Ofcom decided to pursue a more policy-orientated mix of staff which has meant fewer, better-paid staff. Ofcom's leaders considered more attractive remuneration as necessary to recruit and retain high quality staff in a competitive market-place (see paragraph 3.14 and Figure 15 for the impact on costs)
A new single site for headquarters Consensus from Ofcom's leaders and staff[2] of the beneficial effects on the new organisation	Co-location of staff facilitates integration and ease of management. The new building also helped to break down potential barriers between the five incoming groups of staff, symbolised the new culture and assisted with recruitment and retention. The new accommodation was also able to be fitted out to meet the business needs of the new organisation (see paragraph 3.15 on accommodation costs)

Source: National Audit Office

NOTES

1 Underpinned by the Government's expectation that "effective regulation does not come cheap", *Report of the Joint Committee on the Draft Communications Bill*, July 2002, paragraph 77.

2 In focus groups of Ofcom staff held by the NAO, four out of five staff thought the new accommodation is an improvement on their previous headquarters.

2.12 By the time Ofcom's leaders were appointed, the original target date of mid-2003 for the creation of Ofcom was unworkable. They quickly identified a more realistic target of 29 December 2003 and delivered a merged organisation within this tight time-frame. This was based on programme management of eight interrelated transition projects; a functional and fitted-out headquarters location; physical relocation of staff; fully tested and installed IS systems and infrastructure; fit-for-purpose operational business processes; agreed functional roles; an agreed reward package; and a fully functioning board and senior executive team.[16]

2.13 Ofcom took responsibility for some policy work in September 2003[17] in parallel with planning. This helped maintain a sense of 'business as usual'. Industry stakeholders told the National Audit Office that they felt reasonably well informed throughout the merger and that there was only a limited period of uncertainty as the previous regulators wound down.[18] From the outset, Ofcom signalled its strategy and approach, and delivered four significant reviews within its first year: the Review of Public Service Television Broadcasting (Phase 1 April 2004); the Strategic Review of Telecommunications (Phase 1 April 2004); the Radio Review (consultation December 2004); and the Spectrum Framework Review (consultation January 2005).

2.14 Ofcom was ready to go 'live' on its planned start date, but viewed completion of the merger and ongoing integration as a longer process **(Figure 9)**. For example at its start date, Ofcom adopted 45 of the 70 IT systems operated by the previous regulators, and have calculated costs to have reduced from over £26 million to around £20 million in 2004-05 (including renegotiating one major contract). Project Unify, Ofcom's IT change project, was started in mid-2005 to target integration of these multiple systems. Project Unify will require around £15 million investment during the period 2005-06 to 2006-07 in order to further rationalise IT infrastructure. Ofcom estimates that this will reduce IT operating costs to under half that of the previous regulators by 2008-09.

16 *A case study on public sector mergers and regulatory structures*, Ofcom, May 2006.
17 Ofcom's first decision, on the Carlton/Granada merger, was taken in October 2003.
18 As well as carrying out informal consultation with stakeholders from May 2003, Ofcom published two information booklets in mid 2003 and September 2003 with details of structures, working approach and contacts.

9 Phased integration

Action	Timing
Drawing out efficiency savings	Ofcom is seeking to reduce excess capacity over time. This reflects the gradual integration of teams and systems that will yield longer-term economies of scale.
Remuneration strategy	Early focus was on resolving pensions to ensure TUPE requirements were met.[20] Ofcom then made a conscious decision to remove differences in pay levels over time via incentives in its performance system.
IT integration	Ofcom transferred one accounting system and retained separate systems for some functions based on the ease of transfer (systems and staff) as well as reducing the risk of business interruption. The upgrading and integration of these systems is now being addressed.
Review projects	Ofcom has carried out three review projects to ascertain progress of the merger and identify the potential to improve processes and structures.

Source: National Audit Office and Ofcom

Focus on human resources issues

2.15 The Board appointed a specialist Human Resources Director, with experience of public sector mergers,[19] who joined Ofcom in February 2003. This appointment meant that Ofcom developed a remuneration strategy and made early progress on its terms and conditions framework, job matching, and communication with existing staff.

2.16 One of the most complex issues for Ofcom's leaders to address in human resources was pensions. Staff from the previous regulators were members of one of two pension schemes: the Principal Civil Service Pensions Scheme (PCSPS) for the Radiocommunications Agency, Oftel and the Broadcasting Standards Commission; and the ITC Pension Plan for the Independent Television Commission and the Radio Authority. On announcing the merger in December 2000, the Government issued a guarantee that all staff transferring to Ofcom would retain the terms of their previous pension schemes.[20] Ofcom's leaders told the National Audit Office that early discussions about pensions with the Cabinet Office were essential, to ascertain whether transferring staff could remain in the PCSPS or if Ofcom would be obliged to establish its own pension scheme.

2.17 The resulting pension arrangements largely determined Ofcom's merger remuneration strategy and defined the risk profile of future pension liabilities. Ofcom developed three options from which staff could choose: to remain on their previous terms; to move to Ofcom terms with a capped defined benefit option; or to move to Ofcom terms as offered to new recruits (with a defined contribution pension). By the end of 2004-05, 72 per cent of Ofcom staff had selected the defined contribution scheme. This type of scheme limits Ofcom's exposure to future pension liabilities.

2.18 Another challenge was staffing the new organisation in a short time frame. The previous regulators were employing 1,152 staff in 2003-04, with nearly three out of five working for the Radiocommunications Agency. In early 2003, Ofcom carried out detailed organisational design in order to identify the roles to be filled, with an estimated head count of 880 for the new regulator. These roles were largely filled by October 2003, drawing on the pool of existing staff (737 staff were transferred from previous regulators), as well as the private sector, and other parts of government.

19 The Human Resources Director held a similar post during the Financial Services Authority merger in 2000.
20 Terms and conditions of employment, notably pensions, are covered by the Transfer of Undertakings (Protection of Employment) Regulations 1981 (TUPE) and HM Treasury guidance, *A Fair Deal for Staff Pensions*, which requires "broadly comparable" pension terms.

2.19 This time-frame was, however, too short to carry out a full competency-based recruitment process for all the roles. Instead, Ofcom carried out a job-matching process at all levels outside senior management, which identified the people with the closest skills to those required by the new roles. Ofcom's leaders recognised that this process was imperfect, as it relied on the integrity of the data from the previous regulators (about staff roles, responsibilities and skills), which was often variable. In addition, there were some roles in the new organisation that would require different skills (for example, Finance, discussed in paragraphs 2.20 to 2.22 below) to those available in the previous regulators.

Finance (and related information systems)

2.20 Finance and information systems are complex in all mergers. It is important to have experienced financial leadership to develop a finance strategy for the whole merger process (including the transition period) and to ensure the establishment of a strong control environment.

2.21 In the case of Ofcom, risks facing financial integration were not identified in the early planning phase. This was because the due diligence carried out was not targeted appropriately. For instance, there were no arrangements in place for the Accounting Officer of each of the previous regulators to sign off the final accounts once the organisations had been wound down. In addition, it was not recognised that the skill sets available in the finance teams of the previous regulators were often not matched to the requirements of integration and a more complex finance function.

2.22 Ofcom appointed a Commercial Director to oversee not just Finance, but also most other back office functions such as IT and Facilities. There was, however, substantial turnover in the Finance Officer role reporting to the Commercial Director. When the complexities of financial integration emerged, Ofcom realised that a dedicated and senior level finance role was required rather than a more generic Commercial Director post. Ofcom appointed a Finance Director in August 2004, seven months after Ofcom's start date. The National Audit Office had to work very closely with Ofcom and the previous regulators over this period to ensure that accurate accounts were produced.

Culture and communications

2.23 Lack of cultural integration is often viewed as one of the primary causal factors in the failure of mergers in the private sector,[21] with low morale driving staff retention and performance. The National Audit Office explored the perceptions of Ofcom staff of the cultural aspects of the merger through a series of focus groups. Results from the focus groups indicate that Ofcom has achieved a fair degree of integration in a relatively short time-frame between groups of staff who came from the previous regulators. Ofcom's leaders, however, note that they encountered some inevitable difficulties of cultural integration in the early period as they sought to instil a new culture amongst staff.

2.24 Communication with staff throughout the merger process was crucial. The leaders of the previous regulators held Question and Answer sessions with staff early in the process. Some worked with the consultants to assist staff in coping with change. For example, the Broadcasting Standards Commission held seminars to introduce staff to the psychology of change, how they might react to the merger, and cultural differences with the other organisations. When Ofcom's leaders were appointed, they focused on providing regular progress information to staff at the previous regulators, with newsletters, an intranet site and staff conferences to report progress and make major announcements.

21 *"Achieving post-merger success: a stakeholder's guide to cultural due diligence, assessment and integration"*; Carleton & Lineberry; 2004. *"Cultural Conflict and merger failure: an experimental approach"*; Weber & Camerer: Management Science vol.49, no.9; April 2003.

PART THREE

A preliminary assessment of Ofcom

3.1 Part three of the report provides a preliminary assessment of how far the creation of Ofcom has delivered the aims and objectives set out for the merger. It introduces a measurement framework for mergers and reviews Ofcom's performance to date against this.

A measurement framework for public sector mergers

3.2 Public sector mergers cannot be judged on measures such as share price or shareholder value, as with private sector mergers. But the question of whether the expected benefits are achieved remains the same. As a proxy for value in the public sector, each merger should identify a combination of objectives that can be used to measure what constitutes success. In the absence of any standard for public sector mergers, the National Audit Office has developed a measurement framework using a balanced scorecard approach (Appendix 1), which looks at the benefits realised by mergers in five categories: strategic objectives of the merger; policy and influence; front-line services; back office services; and people.

Balanced scorecard:
An integrated performance measurement framework covering internal business processes and external outcomes.

Figure 10 overleaf shows the balanced scorecard, with measures reflecting the strategic objectives of the merger at the centre, and the four supporting categories surrounding this.

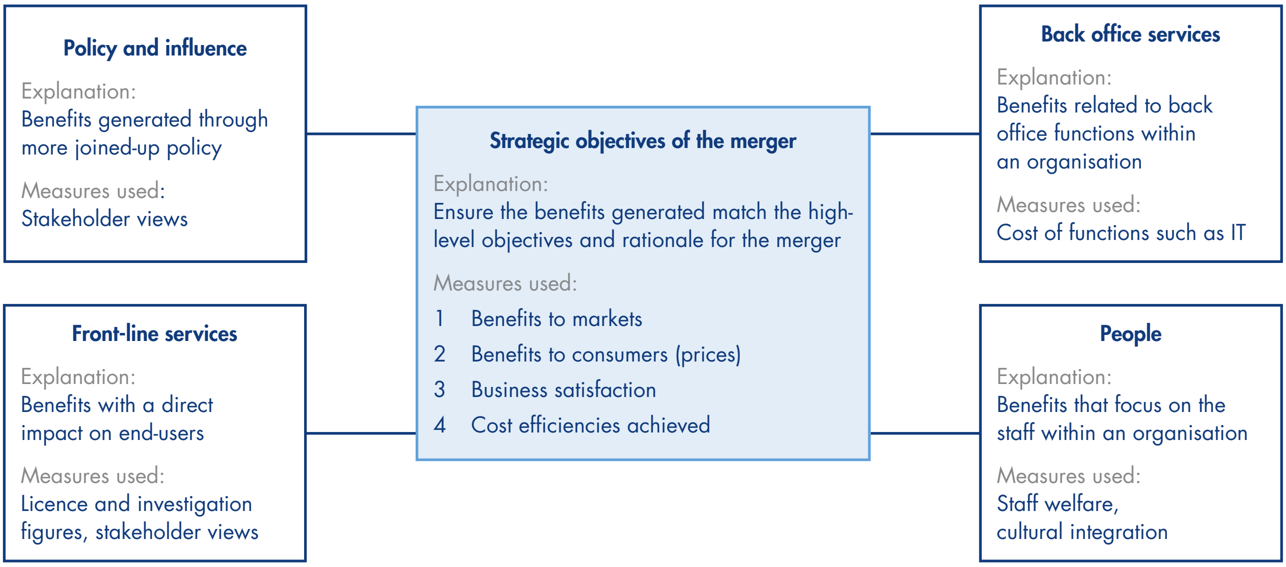
Adapting the balanced scorecard to evaluate the creation of Ofcom

3.3 The Government outlined the objectives for the creation of Ofcom in its Regulatory Impact Assessment. These objectives included reducing burdens on business, improving regulatory outcomes, and achieving efficiency savings. But it did not put in place a framework to monitor or measure whether these are achieved (paragraph 1.7). The National Audit Office has adapted its merger measurement framework, or balanced scorecard, to the creation of Ofcom in order to measure progress against the Government's objectives. By assessing the overall balance of results from the scorecard, we can evaluate whether the performance of the merger is largely positive or negative. Applying this measurement retrospectively required two modifications:

- **Identification of suitable measures** – we had to judge which currently available measures, or proxy indicators, would best reflect the Government's original aspirations for Ofcom. There are limitations as many of the outcomes cannot be judged in the short term; and
- **Obtaining relevant data** – baseline data for the previous regulators were not gathered at the outset of the merger, so we were limited to using measures where data were available, or relied on perception-based survey questions.

Baseline data:
Key performance data gathered prior to the merger, to monitor and evaluate performance during the merger.

10 A balanced scorecard approach to measure the success of Ofcom



Source: National Audit Office

3.4 Figure 10 shows the five categories that make up the balanced scorecard and the measures that we used for Ofcom. The most important part of the balanced scorecard is the central category, assessing whether the strategic objectives of a merger have been achieved. We identified four measures, or proxies, in this category for the creation of Ofcom: evaluating benefits to markets; benefits to consumers; business satisfaction; and cost efficiencies achieved.

Ofcom's performance to date

3.5 This section outlines a preliminary assessment of Ofcom's performance to date against the strategic objectives of the merger. **Figure 11** summarises the four measures applied in this category, then below this is further detail explaining the results. A full version of how we applied the balanced scorecard is in Appendix 2. There are limitations with some of the measures used, such as benefits to markets (measure 1) and consumers (measure 2), as the results are not necessarily due solely to the creation of Ofcom. However, based on indicative results of the measures in all five categories, we conclude that to date the merger is delivering many of the benefits expected.

3.6 Ofcom pursues a wide range of benefits for consumers, including price, choice, innovation and satisfaction across a range of products. Although Ofcom is cautious in making direct links between its actions and these benefits for consumers, there are examples of regulatory decisions it has taken, such as Local Loop Unbundling (LLU), which should directly provide improved benefits to consumers. This decision, which was part of Ofcom's Strategic Review of Telecommunications, has opened up the market for telephone and broadband services to greater competition. Communications providers are now able to take control of the line that connects a home or business with the local BT exchange, without having to route through BT's main network.

3.7 In our interviews with stakeholders, many noted that Ofcom's actions on LLU are a direct result of the merger, as it would not have been possible under the previous regime. **Figure 12** shows the downward trend in prices for average monthly consumer expenditure on line rental, fixed calls, mobile calls and texts, and broadband. Total monthly expenditure on a basket of communciations products has fallen from an average of £91 in 2003 when the merger took place, to £76 in 2005. Although there are many factors influencing prices in these markets, a continued downward trend is positive, and Ofcom expects larger decreases in the medium term as the benefits of LLU accrue.

11 Scorecard category 1 – achieving the strategic objectives of the merger

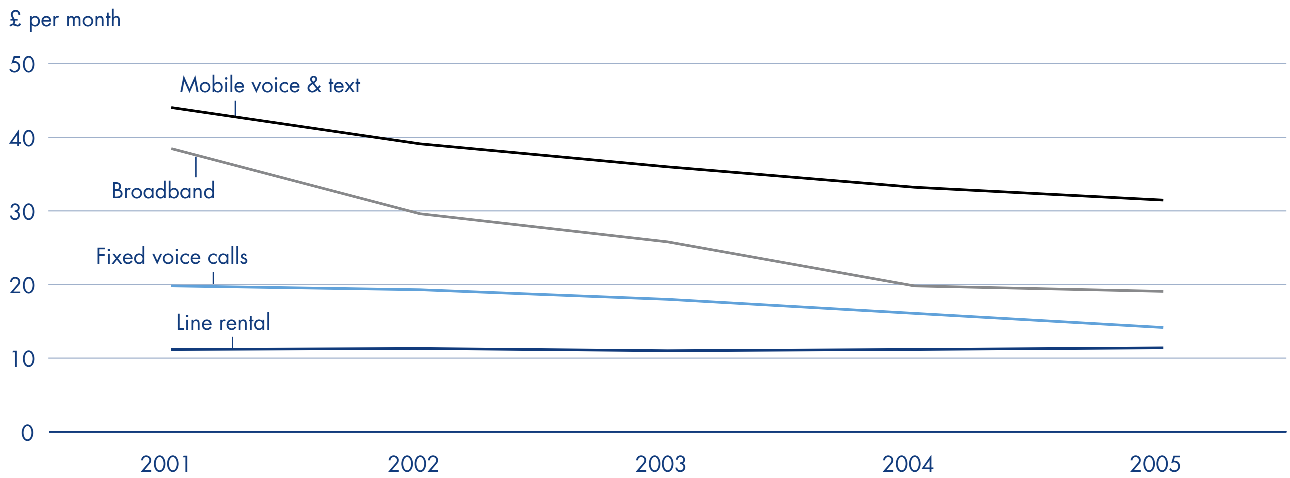
Strategic objective	Measure	Results for the creation of Ofcom
1 Benefits to markets	Comparative rating of regulation of the communications industry across Europe, based on an annual corporate survey[1]	The UK received the highest overall rating in the ECTA survey for both 2004 and 2005
2 Benefits for consumers (paragraph 3.6 – 3.7)	Scale of price reductions for key consumer communications services (broadband, mobile) compared to countries with similar markets	There are limitations in evaluating consumer benefit in the short term. The current data, however, indicates that a downward trend for UK prices has continued under Ofcom (Figure 12)
3 Business satisfaction (paragraphs 3.8 – 3.9)	National Audit Office review of business perceptions of the results of the merger	Stakeholders perceive Ofcom more positively than its predecessors on five out of eight features. Views were mixed on three other areas (Figure 13)
4 Delivering overall efficiency savings (paragraphs 3.10 – 3.15)	Overall operating costs (from annual accounts) – the data for Ofcom and the five previous regulators, however, are not strictly comparable	Ofcom has committed to delivering annual savings and its operating costs are lower than the sum of the previous regulators' adjusted costs (Figures 14 and 15)

Source: National Audit Office

NOTE

1 The annual European Communications & Technology Association (ECTA) Regulatory Scorecard is based on a survey of corporate views on how effectively each nation promotes investment and competition. It was first carried out in 2004. The survey allocates scores for a wide range of criteria covering general powers, effectiveness of dispute settlement, general market access conditions, and availability of key access products. An aggregate score is then calculated.

12 Benefits for consumers – costs of communications products



Source: Ofcom

NOTE

Stated in 2005 prices.

3.8 The National Audit Office interviewed a range of Ofcom's business stakeholders from the broadcasting, radio, telecommunications and spectrum industries to ascertain their views. Where it was not possible to talk directly to smaller businesses or stakeholders, we interviewed a representative or trade body (Appendix 1).

3.9 The purpose of the interviews was to survey perceptions of change brought about by the merger in eight areas that reflect the range of the Government's objectives for Ofcom. We asked the interviewees whether they perceived a positive, neutral or negative change on each of these eight issues, with each one carrying the same weight. **Figure 13** shows that stakeholders perceive Ofcom more positively than its predecessors on five out of eight aspects of regulation. Where Figure 13 indicates that views were mixed, responses varied between positive, neutral and negative.

3.10 Most mergers aspire to achieve some efficiency savings from consolidating both front-line services and back office functions. Although not the primary objective of this merger, Ofcom has committed to achieve annual "RPI minus X"[22] efficiency savings and has made cost savings in its first three years of operation. The National Audit Office has also analysed the overall operating costs of Ofcom against the sum of the previous regulators. It is not straightforward, however, to make this comparison, for three reasons:

- **legal status** – Ofcom is a statutory corporation, a different legal status than three of the previous regulators,[23] which has had cost implications. For example Ofcom is liable for VAT (Ofcom's conservative calculation of this liability is £8 million) on all external purchases, whereas three of its five predecessors were able to recover VAT;[24]
- **the new legislative framework** – the Communications Act 2003 expanded Ofcom's powers beyond those of the previous regulators. Ofcom has estimated the cost of carrying out these new duties and responsibilities at £3 million a year;[25] and
- **compilation of accounts** – the accounts of the previous regulators were compiled across different timeframes.[26]

3.11 These issues of comparability will, however, be an issue for many mergers. Organisations facing the challenge of mergers need to develop a meaningful comparative analysis. The National Audit Office has produced a cost profile of Ofcom compared with the previous regulators **(Figure 14)**. This shows the trend in total costs of the previous regulators after 2003-04, against Ofcom's reported costs over the same period (excluding the additional cost of repaying the set-up loan).

13 Summary of stakeholders' views

Feature of regulation	Perception of change
Joined-up approach to regulation	Very positive
Capability and capacity	Very positive
Improved service provision	Mostly positive
Increased access (services, information, problem resolution)	Mostly positive
Minimising unnecessary regulatory uncertainty	Mostly positive
Reduced number of interfaces with regulator/eliminated duplication[1]	Mixed views
Regulatory costs[1]	Mixed views
Perspective of regulatory burdens[1]	Mixed views

Source: National Audit Office stakeholder interviews

NOTE

1 Some comments from stakeholders in these areas reflected the requirements placed on Ofcom in its first years of operation. For example, the perception of increased cost of regulation in some instances reflected the fact that licensees are bearing the cost of the loan repayment. Similarly, the perception of increased burdens was a result in some cases of the necessary level of consultation in the delivery of four strategic reviews (see paragraph 2.13). Some stakeholders also noted that increased burdens may be justified by improved regulatory outcomes.

22 Under an RPI minus X regime, costs can increase by the rate of inflation, less an efficiency factor called "X". This formula, created to set prices for regulated monopolies, is designed to embed incentives to increase efficiency.

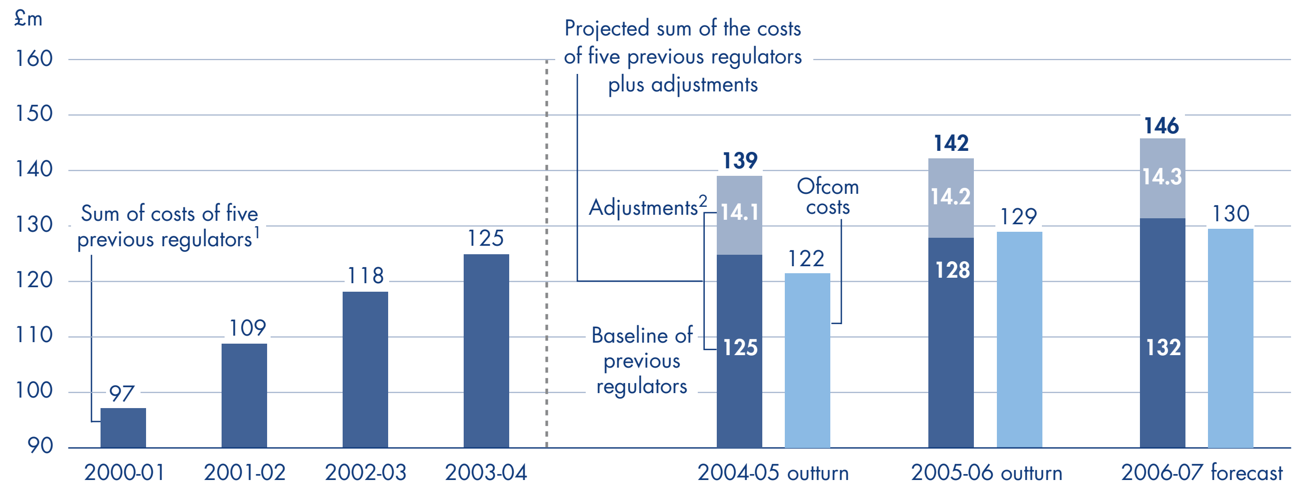
23 The Broadcasting Standards Commission (Non-Departmental Public Body), Oftel (Non-Ministerial Government Department) and Radio communications Agency (Executive Agency of the Department of Trade & Industry).

24 Independent Television Commission and the Radio Authority, like Ofcom, were liable for VAT on core expenditure. Ofcom has not, however, been able to identify the level of these VAT payments for the two previous regulators. As a result we did not subtract pre-merger VAT costs from the £8 million VAT adjustment in Figure 14.

25 The new duties included are market reviews (particularly the Public Service Broadcasting Review) and competition responsibilities relating to mergers and cross-media ownership. The £3 million provision for new duties is agreed with HM Treasury, and is not necessarily an ongoing provision in the future.

26 The previous regulators posted full or nine month accounts for 2002-03, depending on whether they were calendar or 31 March year end. Ofcom then posted three month accounts for 2003-04.

14 Ofcom operating costs against the sum of the previous regulators



Source: National Audit Office and Ofcom

NOTES

1 The 2003-04 figure of £125 million is an agreed baseline for the final costs of the previous regulators, even though Ofcom's start date was before the end of that financial year. In our analysis, this figure is then taken forward to form the baseline for the projected regulators' costs (shown here in dark blue), with a two to three per cent inflation adjustment to £128 million for 2005-06 and £132 million for 2006-07.

2 We have added £14 million of adjustments to the projected costs of the previous regulators in order to make them more comparable to Ofcom's operating costs. This figure is made up of adjustments for inflation (around £3 million), the cost of performing new duties (£3 million) and the cost of VAT liabilities (£8 million).

3 For each year post-merger, we compare the projected costs of the previous regulators to Ofcom's operating costs (Ofcom's costs are shown here in light blue). The 2004-05 and 2005-06 figures for Ofcom are outturns, and the 2006-07 figure is Ofcom's forecast.

3.12 Figure 14 shows that Ofcom has achieved efficiency savings on its adjusted costs. If Ofcom's predecessors had continued to exist, the estimated sum of their costs in 2004-05 was £139 million, including the additional costs of inflation, carrying out new duties (£3 million[25]) and VAT liabilities (£8 million[24]). The actual outturn for Ofcom was some 13 per cent lower. This reflects the opportunities for efficiency gains inherent in a large organisational consolidation.

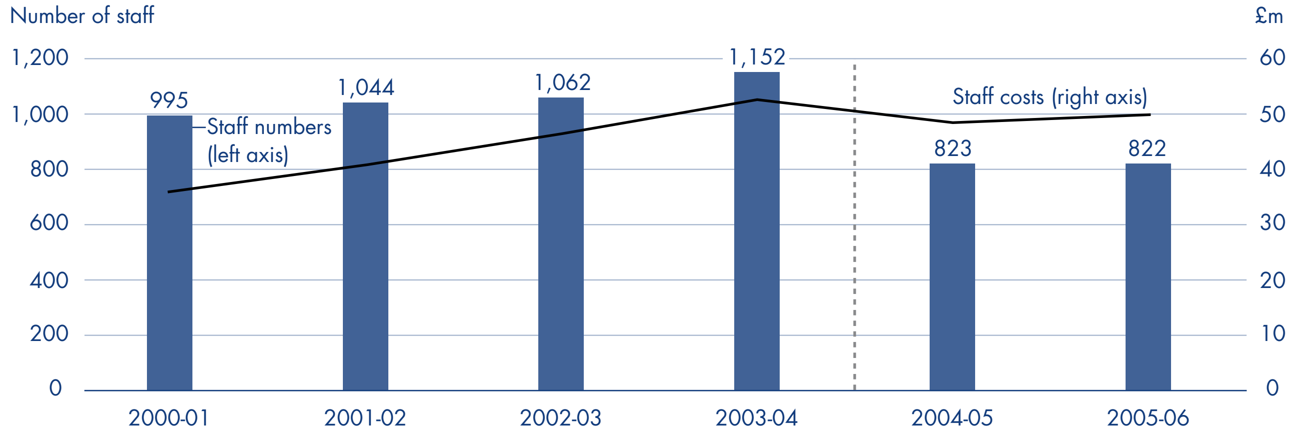
3.13 Ofcom sets itself an annual efficiency target when developing its budget estimates. In 2004-05, Ofcom budgeted for a five per cent efficiency reduction and set its budget at £140 million. Its outturn costs of £122 million were 13 per cent lower than this budget estimate. For 2005-06, Ofcom estimated they would deliver eight per cent efficiency savings from its previous year's budget estimate and set its budget at £133 million[27]. Ofcom's outturn costs for 2005-06 were £129 million, which was three per cent lower than this budget estimate.

27 The 2005-06 budget estimate is calculated after adjusting the 2004-05 budget estimate of £140 million for inflation of 3 per cent to £144.2 million, then reducing this figure by 8 per cent (efficiency saving) to £133 million. These efficiency savings are calculated from the previous year's budget estimate rather than the previous year's outturn.

3.14 We have also reviewed Ofcom's staff and accommodation costs against the previous regulators. There are limitations in this comparison as Ofcom does not have detailed breakdowns of the components of these figures in the previous regulators' accounts, such as the treatment of pension liabilities within staff costs. **Figure 15** shows a 28 per cent decrease in headcount from the high point of 1,152 in 2003-04 to 822 in 2004-05. Staff costs[28] (adjusted to exclude one-off redundancy costs) were cut by around eight per cent in 2004-05, with a small rise in 2005-06 in line with inflation. This reflects Ofcom's strategy to employ fewer, better-paid staff, focusing on policy rather than operational activity.

3.15 Mergers often create the challenge of disposing of vacant property or bearing the cost of ongoing leases.[29] Ofcom inherited a total of 45 properties from the previous regulators, and published accommodation expenditure increased from £7 million in 2003-04 to nearly £9 million in 2004-05.[30] Efficiency savings from accommodation costs will necessarily take longer to be achieved than in other expenditure areas. Ofcom has disposed of, or negotiated early lease termination, for 21 properties generating savings of over £0.5 million, disposed of the Whyteleafe property resulting in a cash receipt of £3.0 million, and sublet six other properties (including three floors of its headquarters) generating £2.1 million of rental income.

15 Staff numbers and costs



Source: National Audit Office and Ofcom

NOTE

Staff numbers are FTE annual averages, except for 2003-04 which is the 'handover' number of staff. Ofcom's numbers for 2004-05 and 2005-06 represent budgeted head count rather than staff in post.

28 Wages and salaries (excluding social security costs/National Insurance and pension costs).

29 Ofcom reports this as a vacant property cost provision (this was £22.4 million in 2003-04 and £18.5 million in 2004-05). This figure is calculated on a prudent basis and assumes no further rental incomes.

30 The published accommodation costs for Ofcom is not necessarily on the same basis as that of the previous regulators.

GOOD PRACTICE GUIDE

Wider lessons for public sector mergers of regulatory agencies

1 This guide explains the lessons derived from the Ofcom merger for future public sector mergers of regulatory agencies. It may also be helpful for public sector mergers more widely. It has four areas of focus:

a) **the transition from decision-makers to those who implement the merger;**

b) **good practice for the five phases of a merger;**

c) **communications with staff; and**

d) **a measurement framework.**

a) Transition from decision-makers to those who implement the merger

2 In public sector mergers, there is usually a clear distinction between the people that take the decision to merge, and the people that implement that decision and carry out the merger **(Figure 16)**. There is a degree of uncertainty inherent in public sector mergers resulting from this leadership vacuum, as responsibility is handed from the decision-makers to the implementers. This creates challenges in several areas that need to be identified and managed:

- clear governance of merger planning prior to the appointment of the future leaders;
- defining an appropriate level of detail to pursue during early planning and the scope for the previous bodies to make commitments that will impact the new organisation; and
- ensuring a smooth transition in normal business and dealings with external stakeholders as the merging bodies wind down and the merged body is created.

3 There is also a transition from consultation to communication with staff and stakeholders, as plans become increasingly definite. In the early stages, decision-makers need to determine what issues matter to staff and stakeholders and how concerns can be addressed. By the detailed planning and implementation stage, however, programme and change management are central to delivery. In the case of Ofcom, the early planning teams and then the Ofcom Chairman focused on extensive consultation. Implementation could not begin in earnest, however, until the Chief Executive had taken up post, at which point there was a step-change in the pace of planning.

16 Public sector mergers have some important differences from private sector mergers

Rationale

Financial considerations are unlikely to be the over-riding rationale for a public sector merger

Clearance

Public sector mergers require a Regulatory Impact Assessment, consultation, and often Parliamentary input (either legislation or debate) to proceed. Private sector mergers require regulatory clearance and shareholder agreement to proceed.

Transition in leadership

Merger decisions are usually not made autonomously by public sector bodies. There requires to be a handover from policy officials to planners and implementers. Private sector mergers are usually led throughout by a single figurehead, usually the CEO.

Timescales

The legislative process and consultation requirements increase the timescales of public sector mergers. This leads to longer periods of uncertainty for staff and stakeholders.

Confidentiality

Public sector merger decisions are published from the outset, so the impact assessment and due diligence process can be conducted with open access to all information.

Source: National Audit Office

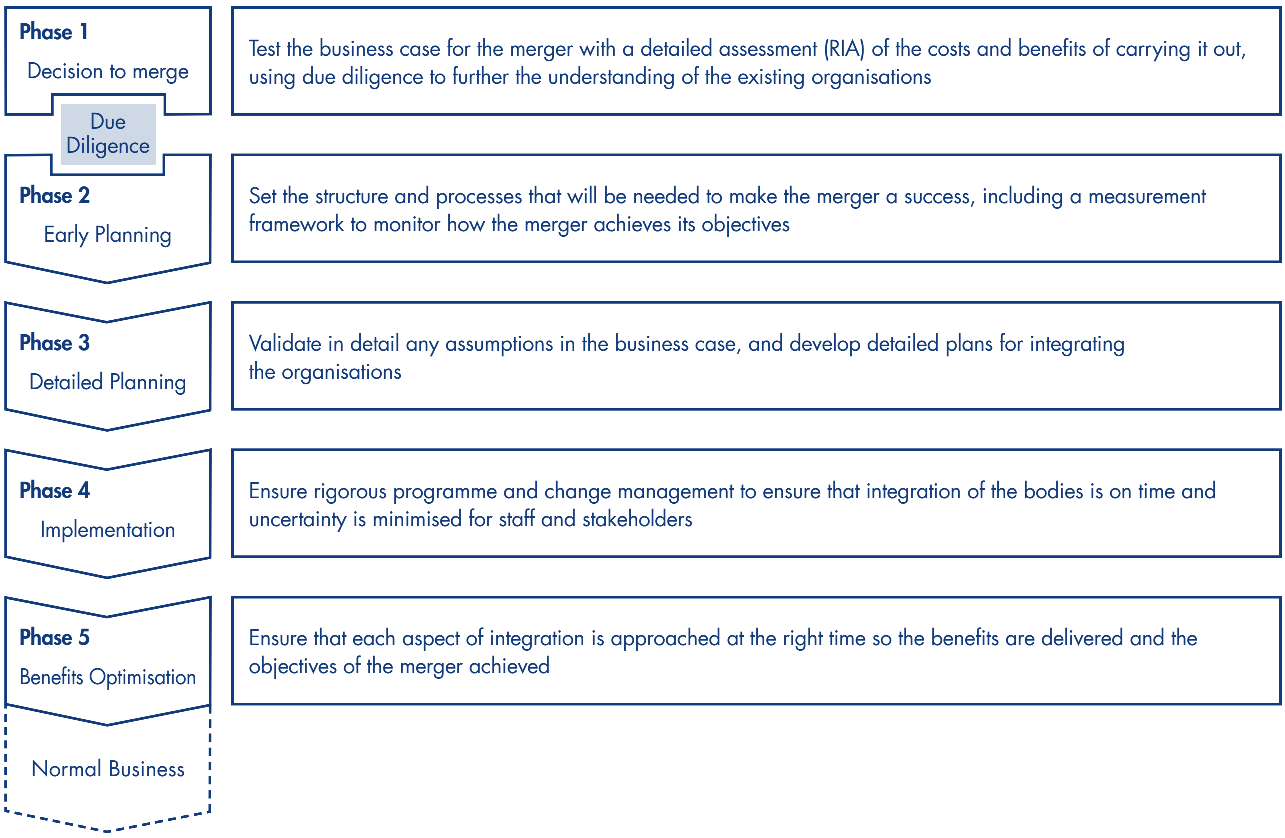
b) Good practice for the five phases of a merger

4 The challenges of a merger should not be underestimated. The majority of guidance currently available, however, focuses on private sector mergers. Information on public sector mergers is either relatively out of date or sector specific. In view of this gap, the National Audit Office distilled the success factors and lessons from the creation of Ofcom. We validated whether these factors are more widely applicable to other mergers in the public sector by seeking the views of leaders of public sector bodies who have experience of mergers in both public and private sectors, and other merger experts.

5 A merger is a continuous process but it is possible to break it down into five phases. These phases are largely generic to all types of merger combinations, whether a merger of equal organisations or the takeover of a smaller by a much larger organisation. **Figure 17** shows these as being distinct phases. However, in reality these phases often overlap, particularly when the legislative process is taking place in parallel to merger planning.

6 In this section, we have identified the following good practice points for each of the five phases that have a broader applicability to public sector mergers. This is not exhaustive but is designed to highlight key areas on which leaders need to focus. Every merger is unique, but there are common dimensions that can influence the success of a merger.

17 The five stages of a public sector merger



Source: National Audit Office

Phase 1 – Decision to merge (and developing the business case)

7 The decision to merge should be taken on the basis of a full assessment of the costs involved and the objectives to be achieved. A Regulatory Impact Assessment can be a useful tool to carry out this assessment. If the costs of carrying out the merger do not represent value for money or cannot be justified by the expected benefits, decision-makers should consider not proceeding with the merger.

8 Once the decision to merge has been taken, an important early consideration should be how to track and assess the benefits that are delivered. The costs should be clearly allocated rather than being absorbed by current budgets, and identified as merger costs when they are incurred. During this early phase it is crucial that a thorough due diligence and information gathering process is followed to identify the details of the bodies to merge and where potential problems may arise (Appendix 5). There also needs to be a focus on the governance arrangements for the early planning, particularly accountability for progress and which issues the planning teams such as the Bill Team and steering group have the authority to decide upon.

Areas to target in Phase 1:

- ✔ Central government/decision-makers to document strategic objectives of the merger and set out a clear and compelling rationale
- ✔ Costs of merger planning and transition (including external support) to be identified and budgeted from the outset (e.g. creation of the Bill Team)
- ✔ Focused due diligence of previous bodies to be carried out early (e.g. finance, IT, legal, HR, culture) to identify and assess the risks to integration
- ✔ Establish a set of targets for the merger to achieve and a baseline of data in order to track success of the merger process and benefits realised
- ✔ Accountability for each phase to be clearly defined
- ✔ CEO/leader of merged body to be identified early (in some instances, this may be an existing leader in order to provide continuity)

Phase 2 – Early planning

9 The early planning stage is carried out once the decision to merge has been taken. This will usually be the responsibility of the sponsor department in central government, as a leader for the new organisation may not yet have been selected to take the merger forward. The duration of this phase will vary. But efforts should be made to limit the length of time before the new leadership team are appointed, to avoid a decision-making vacuum. The new leadership team will need enough time to develop their vision for the new organisation, and will have to start thinking about implementation and integration (particularly cultural) as soon as possible.

Areas to target in Phase 2:

- ✔ Dedicated project team to be set up (linked to Bill Team) to lead project
- ✔ Sponsor department to focus on appointing a leadership team for the merged entity
- ✔ Key senior executives (CEO, Finance, HR and IT) to be appointed early
- ✔ Define targeted consultancy support for areas where external expertise is required
- ✔ Establish a communications and consultation plan

Phase 3 – Detailed planning

10 The detailed planning phase ideally commences once the leadership of the merged organisation is in post. The leaders will focus on how and when the integration will take place, as well as maintaining stakeholder and staff confidence. The merger presents an opportunity for change where the leaders can be bold about the type of organisation they want. There is no set timeframe for detailed planning, but a firm start date should be identified and met. Leaders should focus on basic readiness for operation by the start date, as well as reducing the impact on dealings with stakeholders and business as usual. The communication of decisions to staff (and their unions), is also important to limit uncertainty **(Figure 18)**.

Areas to target in Phase 3:

- Take the hard decisions (especially people decisions) as soon as possible to limit uncertainty
- Ensure regular and honest updates with staff and stakeholders ("what we don't know yet")
- Remuneration, particularly pensions, is an important policy point and a key part of culture – a remuneration strategy should be a conscious focus of all leaders, not just HR
- Expect problems in integrating IT and Finance systems from predecessor bodies. Have resources available to tackle problems in these crucial areas of support infrastructure
- Programme management requires project management skills to deliver the merger on time, and change management skills to manage the impact of change on staff and stakeholders
- Explicit programme to assist cultural integration, including breaking down old 'silos' and if appropriate, celebrating the best of predecessor organisations
- Plan for "business as usual" to try to limit disruption for stakeholders, while making clear to the previous organisations what scope they have to make commitments at this stage

Phase 4 - Implementation

11 On the new organisation's first day as a legal entity, it should focus on basic operational readiness to assume its roles and responsibilities. Full integration can be achieved over a phased timetable. During the implementation phase, professional project and change management is central to delivery of the merger, and a less consultative, more directive approach may be more suitable at this stage. During this phase internal coordination will be difficult so particular attention should be given to protecting stakeholders and companies from internal disruption. Aim to deliver some early benefits in this phase – this will signal to staff and stakeholders that the objectives of merger can be achieved.

Areas to target in Phase 4:

- Be prepared to act fast in order to be ready on time and to minimise uncertainty
- Benefits and key performance measures to be tracked regularly (e.g. staff and stakeholder views)
- Focus on maintaining normal business
- Open internal and external communication, especially to reassert vision/merger rationale
- A new location may be necessary to facilitate change
- Maintain some IT system continuity where appropriate to avoid unnecessary burden/change

Phase 5 - Benefits optimisation

12 The final phase – benefits optimisation – reflects the fact that the benefits of the merger can take time to emerge. Integration of different aspects of the business will take place over a phased timetable, so the objectives of the merger will not all be met immediately. Extra capacity in terms of staff or budget may be required for some time. Regular reviews should be undertaken on the degree of consolidation in the new organisation. Once the merger is finalised and the organisation is in a more steady state it may also be appropriate to look to different kinds of leaders and structures to those that saw through the transition.

Areas to target in Phase 5:

- Implement the final changes, with phased integration
- Close down project team and return staff and communications to business as usual
- Comprehensive review to take stock of progress including staff and stakeholder surveys
- Define any necessary re-structuring of organisation or change to processes
- Plan for the terms and conditions to be aligned over time
- Key change management leaders may depart when nearing normal business phase
- Report on success of intended benefits and key performance measures

c) Communication with staff

13 From the outset and throughout the merger process, communications with staff are an important consideration for decision-makers and the leaders of the previous bodies and the newly-merged entity. Poor or insufficient attention to communication during the merger can be a contributory factor when a merger runs into difficulties and can create unnecessary uncertainty for staff (Figure 18). There is also a risk that staff at each of the previous organisations will receive differing information about the new organisation from their leaders.

18 Good practice in communication with staff

- The rationale for the merger should be explained in a way that is meaningful to the staff (not only at the outset but throughout the process)
- Make clear the timetable and who the decision-makers are at each stage of the merger
- Minimise unnecessary uncertainty by providing regular updates on progress including what decisions have been made, and what is still unknown (use a variety of media such as newsletters, posters, intranet, as well as face to face meetings with staff)
- Provide opportunities to consult staff where there is scope to take these views into account

Source: National Audit Office

d) Measuring the success of a merger

14 Measuring the performance of a public sector merger must focus on whether it achieves the objectives set for it by Government. As such, a combination of measures is needed which goes beyond the direct rationale for the merger and includes measures that define what 'success' will look like at the conclusion of a merger. The National Audit Office has developed a measurement framework, or balanced scorecard, for public sector mergers structured around five dimensions **(Figure 21 on page 33)**:

- strategic objectives of the merger;
- policy and influence;
- front-line services;
- back office services; and
- people.

15 It provides a tool that can be used to track benefits being delivered by the merger, with a selection of measures for each dimension that are relevant to the type of merger and type of bodies involved. These measures focus on longer term outcomes and by comparing the pre- and post-merger organisations, provide a balanced view of the benefits delivered. It is essential to collect the relevant baseline data at the outset whilst the previous bodies still have their data capture systems in place. Without establishing a clear framework or collecting this data in advance, it can be difficult to conclude whether value for money has been achieved by a merger.

APPENDIX ONE

Scope and methodology

1 This report focuses on the creation of Ofcom and the lessons learned for future public sector mergers. It examines the creation of Ofcom to identify lessons for the large number of public sector mergers that are due to take place over the next three to five years.

2 The key elements of our study methodology are outlined below:

a) Literature review

b) Drawing on primary research from Ofcom

c) Interviews with Ofcom management

d) Focus groups of Ofcom staff members

e) Structured business interviews

f) Developing a measurement framework for public sector mergers and applying this framework to the creation of Ofcom

g) Leaders' Panel

a) Literature review

3 The majority of literature available focuses on private sector mergers, and information on public sector mergers tends to be either out of date or highly sector specific. We carried out an extensive literature review covering all areas of mergers. This research informed much of our fieldwork (particularly the focus group and due diligence work streams):

- Private sector mergers
  - Performance of private sector mergers (practitioner papers and academic reports)
  - Best practice in private sector mergers (practitioner books and papers)
  - Due diligence checklists (books and articles)
  - Culture and human resources issues in mergers (practitioner papers and books)
- Public sector mergers
  - Merger best practice (US Government Accountability Office, Harvard JFK School of Government, Audit Commission, National Housing Federation)[31]
  - Guidance on developing merger business cases (Monitor, Housing Corporation)
  - Organisational change (academic reports)

b) Drawing on primary research (Ofcom case study)

4 Ofcom published its own case study of the merger process in May 2006.[32] It is a highly detailed account of the creation of Ofcom, produced in order to "aggregate the collective memories of many of those involved operationally in the project"[33] and broken down into thematic chapters, such as Finance, Legislation, Governance and Staffing. The Ofcom case study is based on documentary evidence available from the set-up process, interviews, written testimony, and contributions from those involved in the entire process, the previous regulators, and from the industries affected.

We placed reliance on this report where possible in order to minimise the burden of our study on Ofcom staff and other stakeholders. We also used the report to help frame our questions for interviews with Ofcom management and topic guides for the staff focus groups, and to provide some additional detail of technical issues in staffing such as TUPE.

31 *Making public sector mergers work: lessons learned*, Peter Frumkin, John F Kennedy School of Government, Harvard University, August 2003; *Implementation steps to assist mergers and organizational transformations*, United States Government Accountability Office, Washington, July 2003; *Less dangerous liaisons: early considerations for making mergers work*, Audit Commission, 1995; *Partnerships and practicalities: making it work*, National Housing Federation, 1999.

32 *A case study on public sector mergers and regulatory structures*, Ofcom, May 2006.

33 ibid (p. 4).

c) Interviews with Ofcom management

5 We held unstructured interviews with senior Ofcom personnel involved in the transition and implementation process. Interviews were held with the chief executive (Stephen Carter), the chief operating officer (Ed Richards), as well as key directors responsible for Operations, Finance, Human Resources and the Secretariat. We also interviewed the former director of the Ofcom transition project team who was involved in the early planning stages. The interviews focused on their views of the main drivers of success during the transition process, and issues that proved problematic and could have been handled differently in hindsight. This provided useful testimony from the leaders of the transition and implementation phases of the merger, and also helped prioritise lessons drawn out in Ofcom's much more detailed case study.

d) Focus groups of Ofcom staff members

6 The aim of the focus groups was to understand the human aspects of a merger. We developed a methodology, in collaboration with external and NAO anthropological researchers, to examine the role that culture change played during the creation of Ofcom. This followed a three stage, mixed-methods process:

- one-to-one interviews – to scope and test questions for the focus group sessions;
- questionnaire – to identify quantitative data about perceptions of culture; and
- focus group session – to gain a more detailed picture of Ofcom's culture.

We carried out five focus groups of Ofcom employees including:

- Homogeneous groups of staff who used to work for each of the pre-merger organisations; and
- A control group composed entirely of new Ofcom staff who had joined since December 2003, and therefore were not exposed to the cultures of the legacy bodies.

There were constraints in organising sufficiently large legacy regulator groups given turnover of staff since the merger and a desire to minimise burdens on Ofcom throughout the fieldwork. As a result we were unable to hold a focus group with staff from the ITC.

7 We also undertook basic cultural mapping analysis with the results of the questionnaires. This methodology, based on the Goffee and Jones' solidarity/sociability matrix,[34] is used to assess cultural compatibility in pre-merger cultural due diligence by plotting the culture of each organisation on a grid and the cultural distance between them can be estimated – the greater the distance, the longer it takes to integrate. We were unable to carry out the pre-merger assessment, but sought to apply the technique to different groups of current Ofcom staff in order to ascertain if cultural gaps still existed two and a half years after the merger.

e) Structured business interviews

8 We conducted 19 interviews with a sample of companies, trade bodies and other associations to ascertain perceptions of the success of the Ofcom merger **(Figure 19)**, focusing on:

- **how well Ofcom managed the merger process** (e.g. was it business as usual, or was there a period of instability, was there sufficient communication with stakeholders); and
- **whether benefits had been delivered by the merger** in eight areas: Improved service provision (e.g. quality of regulation); Increased capability and capacity; Reduced number of interfaces when interacting with the regulator; Joined-up policy and elimination of duplication; Reduced burden on stakeholders; Increased access (to information, problem resolution etc.); Regulatory costs incurred by stakeholders; and Minimising unnecessary regulatory uncertainty.

The responses to the questions on each of the eight aspects of regulation were structured as either positive change, negative change, or neutral and no real change.

34 Rob Goffee and Gareth Jones, *The Character of a Corporation*, 1998. A culture audit or cultural due diligence is carried out to ascertain the solidarity (the degree to which people bond or identify with their employer) and sociability (the level of warmth and friendliness among employees) of a group. Robert J Thomas, *Irreconcilable Differences*, Accenture, 2000 (p.32).

9 To ensure that this sample was sufficiently representative, we reviewed the FTSE Technology Media Telecommunications sector index as a proxy for the industries regulated by Ofcom. Those interviewed represent about 60 per cent of the total market capitalisation of this sector index. In addition, our interviews covered a number of significant unlisted organisations (e.g. BBC and Channel 5) and other significant market players that are not part of this index for various reasons (e.g. O_2 has been sold to Telefonica; Centrica recently left the industry). To ensure we obtained the views of smaller companies and consumers, we also interviewed a number of trade bodies and consumer representatives. We decided not to carry out a full census of Ofcom's stakeholders as a similar exercise had been conducted by Ofcom in 2005. We have been given access to the results, so could cross reference to the responses we received. The results broadly corroborate our own work but the benefit of the interviews was that it allowed us to explore stakeholders' views in more depth.

19 Stakeholder interviews

Type of organisation	Interviews held
Companies	**Telecoms**: BT Group, Openreach, Centrica, THUS, Cable & Wireless
	Mobile & Spectrum: Vodafone, O_2, Inmarsat, Verizon
	Broadcasting: BBC, ITV, Channel 4, Channel 5, Chrysalis
Associations	Federation of Communication Services (FCS), Commercial Radio Companies Association (CRCA), United Kingdom Competitive Telecommunications Association (UKCTA), Ofcom Consumer Panel, CBI.

Source: National Audit Office

f) Developing a measurement framework for public sector mergers

10 We awarded a competitive consultancy tender to KPMG to develop a performance measurement framework targeted specifically at public sector mergers. As requested in the tender documents, they developed a range of indicators to measure:

- the success of public sector merger processes; and
- the benefits realised by mergers.

KPMG's team included merger experts and public sector consultants, and also used a panel of KPMG sector specialists to test the work as it evolved. They produced a balanced scorecard to measure the benefits of a merger, populating the scorecard initially with a 'long list' of measures for each category. The measures for the scorecard were refined to a 'short list' based on several criteria; availability of data, implementation cost, relevance and ability to quantify. The NAO and KPMG reviewed these measures together.

11 We used the balanced scorecard developed with KPMG to measure retrospectively the benefits of creating Ofcom. Paragraphs 3.3 to 3.4 outline this process of adapting and applying the balanced scorecard to the creation of Ofcom in more detail.

g) Leaders' Panel

12 We identified a panel of public sector leaders that have carried out mergers **(Figure 20)**. The panel's role was to advise whether the key success factors in creating Ofcom are more widely applicable to other mergers. The panel was selected based on two key criteria:

- **Timeliness** – their merger experience was within the past five years approximately; and
- **Comparability** – their merger experience was in the regulatory, audit or inspection fields or of a similarly complex merger.

The panel interviews involved testing a list of success factors at each of the five main stages of a merger to validate their relevance and importance, and to identify any gaps.

20 Leaders' Panel interviews

Leader	Organisation	Merger experience
Sir David Varney	Chairman, HM Revenue & Customs	HMRC, mmO_2, British Gas
Sir Callum McCarthy	Chairman, Financial Services Authority	FSA, Ofgem
Anna Walker	Chief Executive, Healthcare Commission	Healthcare Commission, DEFRA
Chris Bolt	Chief Executive, Office of Rail Regulation	ORR, National Grid-Transco
Robert Black	Auditor General for Scotland	Audit Scotland
Jeremy Colman	Auditor General for Wales	Wales Audit Office, PwC
Philip Hampton[1]	Chairman, J Sainsbury	Hampton Report, Lazard Bros
Rick Haythornthwaite[1]	Chairman, Better Regulation Commission	Blue Circle, Invensys

Source: National Audit Office

NOTE

1 These leaders were selected for their knowledge of future regulatory mergers.

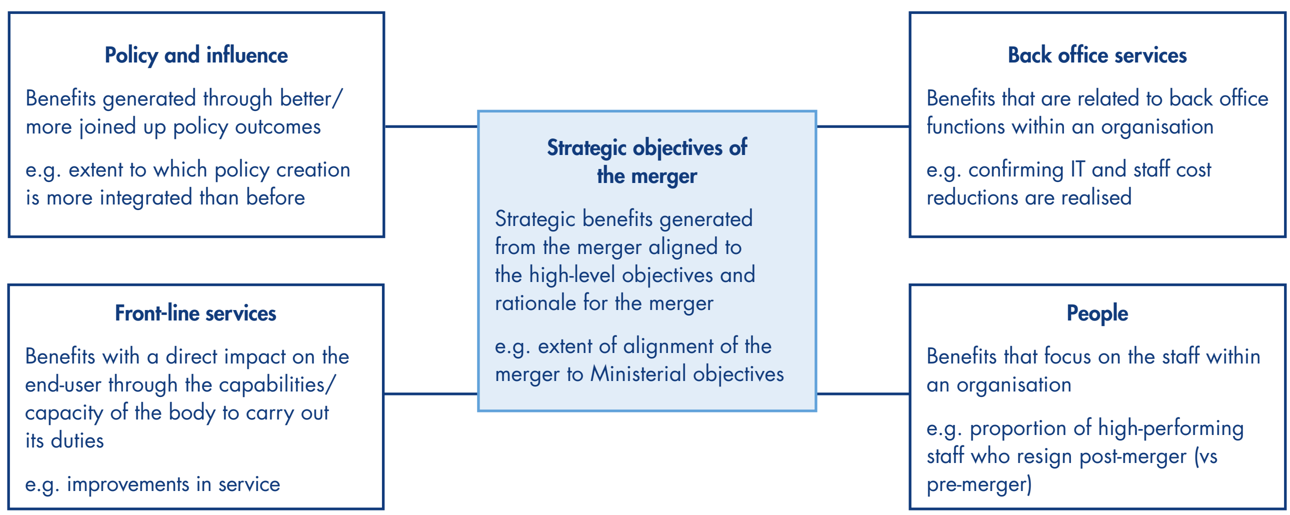
APPENDIX TWO

A balanced scorecard to review the creation of Ofcom

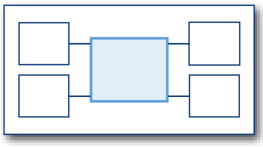
1 As introduced in Part 1, there is no single measure that can be used to determine whether a public sector merger has been successful. The National Audit Office developed a 'balanced scorecard' approach which looks at the benefits realised by mergers **(Figure 21)**. The scorecard contains one feature group of indicators (Strategic objectives of the merger) and four sub groups of indicators (Policy and influence, Front-line services, Back office operations and People). A wide array of potential indicators was gathered for each category, and rated for data availability and cost of implementation. This kind of scorecard is only as useful as the data behind it – decision makers need to establish processes to collect data at the very outset of a merger in order to track success effectively.

2 When the decision to create Ofcom was taken in December 2000, the Government did not put in place a framework to monitor the benefits of the merger against the costs and as a result, very little baseline data was gathered to assist future measurement. The National Audit Office has applied its scorecard retrospectively to the creation of Ofcom. Given the paucity of comparative data from before and after the merger, we could only use measures where data, or suitable proxies, were available. The results for Strategic objectives of the merger are contained in Part three. The results for the remaining four groups follow. In some sections, we have also identified indicators that we would have liked to measure had data been available.

21 A balanced scorecard approach to measure the success of Ofcom



Source: National Audit Office



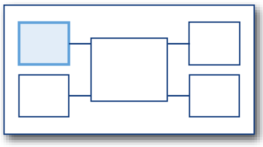
Scorecard group 1 – Strategic objectives

Under Strategic objectives of the merger, we looked at four measures:

- benefits to markets;
- benefits to consumers (prices of key communciations products);
- stakeholder views; and
- cost efficiencies achieved.

Areas that could not be measured

If the data were available, we would have measured perceptions of change from before the merger. The ECTA survey used for measuring benefits to markets, however, was only started in 2004 and 2005. The NAO survey of stakeholders was also only carried out after the merger, so relied on the perception and recollection of those surveyed.



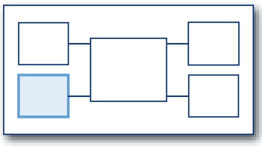
Scorecard group 2 – Policy and influence

Policy and influence is one of the hardest categories to measure. Indicators will vary greatly depending on the sector and the types of organisations being merged, require expert input and as a result it can be costly to measure. Under Policy and influence we looked at four indicators, using stakeholder views:

- a joined-up approach to regulation;
- capability, capacity and quality of policy making;
- reduced uncertainty; and
- removal of operational overlap.

Further details of results

The National Audit Office interviewed stakeholders to ascertain their views on whether certain benefits, that formed part of the merger's high level objectives, had been achieved. **Figure 22** summarises a range of views on Policy and influence.



Scorecard group 3 – Front-line services (customers/users)

This category assesses benefits that have a direct impact on the end-user. Under Front-line services we looked at six indicators:

- timely regulatory decisions (performance against investigation targets, **Figure 23**);
- licence processing (performance against customer service measures, **Figure 24 on page 36**);
- increased access to the regulator (stakeholder views, **Figure 25 on page 36**);
- improved service provision (stakeholder views);
- costs of regulation (stakeholder views); and
- regulatory burdens being placed on business (stakeholder views).

Areas that could not be measured

If the data were available, we would have measured the change in regulatory burdens placed on stakeholders. Ofcom monitors administrative burdens and has calculated the current burden as part of the Better Regulation Executive's simplification programme. The data does not exist, however, for previous years.

Further details of results

Reporting of telecommunications investigation targets has remained largely similar since Ofcom started to assume responsibility for investigations from Oftel (this includes Disputes, Communications Act and Competition Act work, as well as other investigations). We were able to review six monthly performance against delivery targets from June 2003 to September 2005 (Figure 20).

Reporting of licence processing and radio interference investigations has remained largely unchanged from the Radiocommunications Agency to Ofcom (Figure 21). The data show a slight decline in performance against standards during the integration.

22 Views of stakeholders (Policy and influence)

Aspects	Views	Quotations to illustrate rating
Joined-up approach to regulation	Very positive	*"Ofcom are doing "what it says on the tin" i.e. they are dealing with the sort of issues that under the old regulatory regime used to fall through the gaps."* *"Ofcom are more commercially-oriented and never let one side (engineers, economists) dominate, whereas in Radio Comms it was full of engineers and economic regulation was very light."*
Capability and capacity	Very positive	*"Ofcom are very talented and are thinking about the hard issues."* *"they have managed to attract an extremely high-calibre senior team (sophisticated, fair-minded, strategic ability)."* *"they have not got anything major wrong, a remarkable achievement in a highly contested market (telecoms)."* *"even the same individuals who had been at Oftel seemed to perform better once they got to Ofcom – a huge cultural change in expectations on individuals."*
Minimising unnecessary regulatory uncertainty	Mostly positive	*"the beauty of dealing with Ofcom is that their Annual Plan etcetera signals what they will do and when and then they stick to it. Where they have to delay, they signal this well in advance to stakeholders."* *"the Telecoms Strategic Review has reduced the regulatory uncertainty for future investment decisions by the industry."* *"we are still in a honeymoon period, the jury is still out on a great deal of what Ofcom have done."*
Elimination of duplication	Mixed views	*"there is now a single door in, rather than several different organisations."* *"the advantage of a combined regulator comes when we wish to escalate an issue as ultimately there is one person who decides."* *"there are some internal co-ordination problems within Ofcom; we have been asked for the same information from different teams."*

Source: National Audit Office stakeholder interviews

23 Timely investigations

	Jun-Dec 2003	Jan-Jun 2004	Jul-Dec 2004	Oct 2004[1]-Mar 2005	Apr-Sep 2005
Number of investigations	38	21	18	22	26
Completed within deadline	84%	100%	100%	82%	100%

Source: Ofcom

NOTE

1 Ofcom's published information includes this overlap with the previous reporting period.

24 Performance against customer service measures

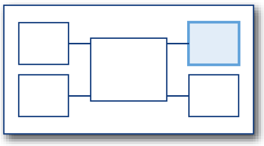
	2000-01	2001-02	2002-03	Jan-Mar 04	2004-05
Licence processing statistics (%)					
Category A licences	99	98	100	80	82
Category B licences	100	99	99	87	92
Category C licences	78	90	92	not available	95
Investigating reports of interference					
safety of life radio systems	100	100	99	98	100
commercial/professional radio systems	100	99	97	98	98
domestic broadcast reception	100	100	99	99	98

Source: Ofcom

25 Views of stakeholders (Front-line services)

Aspects rated	Overall views	Quotations to illustrate rating
Increased access (services, information, problem resolution)	Mostly positive	*"Ofcom have produced excellent reviews on the sectors they cover."* *"they are big on problem resolution which is good rather than making rulings."* *"we used to be third largest in the radio industry and had access to top of RA, but now radio is a small area in a much bigger pool and we have less ready access to the top of the organisation."* *"Ofcom website is not very accessible."*
Improved service provision	Mostly positive	*"Ofcom are much better than their predecessors at processes… they take time to consult and to explain the reasoning."* *"it's not always clear who does what."* *"I have never seen an organogram of Ofcom, and I couldn't guess what it would look like."* *"they are slower in some areas (e.g. frequency planning and radio licensing) and quicker in others; it is possible they made too many economies in some areas and are now over-stretched."*
Regulatory costs	Mixed views	*"Ofcom like to show in their Annual Plan how by excluding X,Y and Z they cost less than their predecessors, but the basic fact is that all those additional items have had to be paid for by the industry."* *"eye-brows were raised when the costs of Ofcom became known by the industry but…if they deliver on what they are promising then people accept there is a price for that."*
Perspective on regulatory burden	Mixed views	*"Ofcom is very active: everybody in the sector has had to increase the number of people dealing with regulation. The regulatory burden and costs have thus increased."* *"Ofcom are prolific in consultations, but you take them seriously. The burden has increased, but it's not necessarily a bad thing."* *"the trouble is transparency is only transparent when you have a lot of time to read the mountains of documentation… Transparency is also a function of people's disposable time." (MORI survey)* *"Ofcom do not have the visceral feel for the smaller enterprise."*

Source: National Audit Office stakeholder interviews



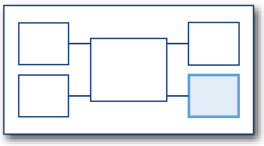
Scorecard group 4 – Back Office services

This category assesses the benefits related to back office functions within an organisation including typical economies of scale and synergies achieved in HR, Finance, Transaction processing and IT infrastructure. Under Back office services, we looked at comparative IT expenditure (paragraph 2.14).

Areas that could not be measured

Very little back office data was available from the previous regulators. We discussed data extraction options with Ofcom for these indicators which would allow us to look at trends from the start of the new organisation. In most cases, the information requests created an undue burden. If the data were readily available, we would have measured:

- Mix of staff – ratio of policy to operational staff or front office to back office staff;
- Property – space occupancy (percentage utilisation or square metres/employee); and
- Costs of various functions such as HR, finance and IT.



Scorecard group 5 – People

This category looks at benefits that focus on the staff within an organisation, particularly employee protection, association, treatment, as well as learning and development. Under the People category, we looked at:

- Staff welfare (Ofcom survey of staff perceptions[35]); and
- Degree of cultural integration of the different groups of staff (NAO focus groups).

Areas that could not be measured

Ofcom provided us with a range of data on staff turnover and absenteeism. There is, however, no data available for the previous regulators, so were not able to review changes in this category throughout the merger. If data were available, we would have sought to measure:

- Staff absenteeism;
- Unwanted turnover (proportion of key high performing staff leaving);
- External reputation as an employer (number of applications per vacancy advertised);
- Number of appeals to tribunals;
- Number of grades between CEO and front-line (hierarchy and organisation design); and
- Ratio of vacancies to staff in post, or permanent to temporary staff.

Further details of results

The results from Ofcom's survey indicate that Ofcom staff perceptions compare well overall to other organisations in transition, in particular on setting priorities and direction. Perceptions of involvement, empowerment and respect were lower than the benchmark, reflecting the decision to emphasise central control.

The NAO focus groups used cultural mapping techniques (Appendix 1). By using larger homogeneous groups of staff and baseline data from the start of the merger, this technique can be used to identify cultural divergence between staff from each of the previous regulators. Based on this limited data set, the results indicate that Ofcom has achieved a fair degree of integration between groups of staff who came from the previous regulators.

35 The survey was conducted by ISR in 2005, with responses benchmarked against other organisations in transition.

APPENDIX THREE

Public sector mergers being undertaken

1 This study has largely been prompted by the release in March 2005 of the Hampton Review, which recommended the consolidation of some 31 regulators into seven thematic bodies (denoted in **Figure 26** by dark blue dot). The Chancellor also announced in the 2005 Budget the Government's intention to reduce the number of public sector inspectorates from 11 to four (denoted in Figure 26 by light blue dot). More mergers of inspectorates and other organisations are also being planned across the public sector, including the Police and Health arenas.

26 Public sector mergers being planned

Timing	New organisation	Merger details
Apr 2005	State Veterinary Service (Animal Health Agency)	Other bodies such as Veterinary Medicines Directorate and Egg Marketing Inspectorate to be merged over time
Apr 2006	Rural Payments Agency	Merger with Horticultural Marketing Inspectorate ongoing. Other bodies to be merged 2006-2009
Apr 2006	Serious Organised Crime Agency (SOCA)	Merger of National Crime Squad, National Criminal Intelligence Service, HMRC role on drug trafficking and parts of UK Immigration Service
Apr 2006	Office of Rail Regulation	Rail inspection functions of Health & Safety Executive transferring to ORR from April 2006
Jan 2007	Natural England	Constituent bodies to operate as confederation until formal establishment of Natural England
Apr 2007	National Police Improvement Agency	Merger of PITO, Centrex and small parts of the Home Office and the police service
Apr 2007	Ofsted	A new single inspectorate for children and learners due to be operational by April 2007
Apr 2007	Inspectorate for Justice, Community Safety and Custody	Merger of five inspectorates for police, probation, courts administration, prisons and the CPS
Apr 2007	Healthcare Commission	To incorporate parts of the Commission for Social Care Inspection (CSCI)
2005 – 2008	Department of Health Arm's Length Body Review 2004	Reduction in number of bodies from 38 to 20
Oct 2007 – Oct 2009	Commission for Equality and Human Rights (CEHR)	Disability Rights Commission and Equal Opportunities Commission (October 2007) and Commission for Racial Equality (October 2009)

26 Public sector mergers being planned *continued*

Timing	New organisation	Merger details
Apr 2008	England and Wales Police Forces	Consolidation of regional police forces in England and Wales from 43 to 12
	Health and Safety Executive	Mergers of various H&S inspection authorities (detailed plans are to be in place by September 2006)
	Food Standards Agency	Wine Standards Board to be merged into FSA
	Environment Agency	Possibly including Drinking Water Inspectorate and others
	Consumer Voice	Merger of National Consumer Council and sectoral consumer bodies (e.g. energywatch & Postwatch)
	Consumer & Trading Standards Agency (CTSA) / Local Better Regulation Office (LBRO)	CTSA proposal reviewed in Pre Budget Report. This may now involve Local Better Regulation Offices within Local Authorities to deal with Trading Standard & Environmental Health work
	Local services	Benefits Fraud Inspectorate into Audit Commission
	Big Lottery Fund	Merger of three lottery bodies (two already consolidated)

Source: National Audit Office

APPENDIX FOUR

Timeline for the creation of Ofcom

1 Ofcom has documented a timeline of key milestones in creating the new organisation. It was published in full in Ofcom's case study and the National Audit Office has condensed it for this report **(Figure 27)**.

27 Ofcom merger timeline

Date	Milestone
Feb 2000	Department of Trade & Industry (DTI) and Department for Culture, Media and Sport (DCMS) issue consultation on contents of forthcoming White Paper
Dec 2000	**Communications White Paper published**
Jan 2001	Joint DTI and DCMS Communications Bill Team created (with Legacy Regulator part-time secondees)
Feb 2001	Legacy Regulators establish arrangements for Regulators Steering Group (RSG)
Apr 2001	RSG appoints Director of the Ofcom Transition Project
	Ofcom Scoping Report commissioned from Towers Perrin
Jul 2001	Ofcom (paving) Bill First Reading
Sep 2001	**Ofcom scoping report presented to ministers**
	HM Treasury agrees to lend Ofcom costs of transition (though amount not specified)
	Eight cross-organisational pathfinder groups established (required by White Paper)
Oct 2001	Ofcom Bill Second Reading (House of Lords)
	Ofcom Scoping Report published
Nov 2001	Core Bill Team begins discussions on transition funding with Treasury, DTI and DCMS
Dec 2001	Ofcom Bill Third Reading (House of Lords) & First Reading (House of Commons)
	Towers Perrin-led consortium selected for Phase 2 consultancy support
Jan 2002	Ofcom Bill Second Reading (House of Commons)
	DTI and DCMS agree to fund all pre-Board appointment transition costs
	Expansion of Central Project Team to four
Mar 2002	Ofcom Bill Third Reading (House of Commons)
	Ofcom bill receives Royal Assent
	Ministers approve Towers Perrin consortium contract
May 2002	**Draft Communications Bill published**
Jul 2002	**David Currie appointed Ofcom Chairman**
Aug 2002	DTI confirms Ofcom start-up loan to be repaid within three years
Sep 2002	Ofcom advertises for Human Resources Director

27 Ofcom merger timeline *continued*

Date	Milestone
Sep 2002	DTI meets with Towers Perrin to discuss TUPE and redundancy funding
Oct 2002	Inaugural (informal) Ofcom Board meeting
	Ofcom Board confirms with RSG its ownership of the Ofcom transition project and proposes Memorandum of Understanding. Central Project Team expands to 11
	Ofcom advertises for a CEO
Nov 2002	Communications Bill introduced into the House of Commons
	Towers Perrin Consortium delivers consultants' final report
	Ofcom discusses potential headquarters location with DTI Estates
Dec 2002	Communications Bill Second Reading (House of Commons)
	Core Bill Team Director confirmed as interim Accounting Officer
	Board determines high-level structure for Ofcom in the Nations and Regions
Jan 2003	**Stephen Carter appointed Ofcom Chief Executive**
	Riverside House announced as Ofcom's HQ in London
	MOU agreed between Ofcom and the Legacy Regulators
Feb 2003	Standing Committee scrutiny of Communications Bill ends – Communications Bill Report stage
	Ofcom Transition Team expands to 20 (including CEO and HR Director)
Mar 2003	Communications Bill Third Reading (House of Commons)
	Communications Bill Second Reading (House of Lords)
	Stephen Carter announces launch date
Apr 2003	Ofcom senior executives and transition team move to permanent HQ
	Ofcom Communications Director appointed
May 2003	Job-matching process begins and employment package finalised
Jun 2003	Communications Bill completes House of Lords Committee stage
Jul 2003	**Communications Bill receives Royal Assent**
	Stephen Carter announces number of roles required, and organisational structure with numbers by Group
	Staff notified of outcome of job matching process
	Ofcom Offer outlined at the second all-staff gathering
Aug 2003	Internal selection for multi-matched jobs beings
Sep 2003	**Statutory commencment of the transfer of property, rights and liabilities of the legacy regulators to Ofcom**
	First phase of Ofcom's detailed policy work begins
	New Ofcom Deal published
Oct 2003	Staff joining Ofcom receive working contracts
	Details of benefits and pension plans published
	Ofcom and ITC joint response on Carlton/Granada merger
Nov 2003	Ofcom staff begin physically transferring from previous regulators over three consecutive weekends
	Relocation packs and guides distributed and induction programme begins
	Ofcom formally commences review of Public Sector Broadcasting
Dec 2003	Event to mark the completion of staff transfers to Ofcom
	Ofcom Vesting Day: 29 December 2003

Source: Ofcom and National Audit Office

APPENDIX FIVE

Due diligence

1 Due diligence is an information gathering process developed in the private sector, to assess the business risks in advance of a merger or acquisition. It is based on the principle of *caveat emptor* (buyer beware), so the purchasing company understands exactly what it is buying. Over time, due diligence has become more sophisticated, and is now often used to identify and plan for integration risks, rather than simply to make or break a deal.

2 Despite its private sector origins, due diligence is just as applicable to public sector mergers. Decision makers should carry out targeted due diligence as part of the decision-making process and the regulatory impact assessment. This will encourage a detailed analysis of costs and benefits involved in the merger, as well as providing valuable information for detailed planning.

"Due diligence … is not, as many believe, a chore to be left to the accountants and lawyers. To get the best from it, due diligence has to be properly planned and managed".[36]

3 Due diligence should ideally be tailored to the particular circumstances of the merger rather than covering a long, generic checklist. This ensures that it does not become a long and expensive process, but provides in-depth information about key risk areas. Some of the traditional areas for due diligence are:

- Financial
- Legal
- Business
- Human resources
- Operations and facilities (including IT)
- Risk management

Figure 28 contains some suggested issues that could be reviewed and information gathered for a public sector merger.

28 Potential areas for due diligence in the public sector

Area	Aspects included	Public Sector equivalent
Financial		
1 Historic financial data		
■ Income statements	Distribution of revenue, cost of sales, corporate reallocations, etc.	■ Key differences in accounting policies ■ Historic surplus or deficits and performance relative to budget ■ Main sources of funding, including post-merger ■ Main expenses incurred ■ Transactions with other parts of Government
■ Cash flow statements	Sources and use of cash, working capital requirements, etc.	■ Sources and use of cash ■ Capital expenditure summaries ■ Split of expenditure between DEL and AME[1] ■ Working capital requirements

36 Peter Howson, *Due Diligence: The critical stage in mergers and acquisitions*, Gower UK 2003.

28 Due diligence check-list *continued*

Area	Aspects included	Public Sector equivalent
Financial *continued*		
■ Balance sheet	Inventory valuations, fixed asset summaries, loans and other obligations, etc.	■ Description and valuation of inventories ■ Fixed asset summary (type, location, value) ■ Adequacy of asset records and balances ■ Intra-group and Government balances ■ Investments and liabilities ■ Financial statements and management accounts
2 Financial reporting capability	Staffing, accounting controls, etc.	■ Staffing and data processing facilities ■ Financial reporting – how data is collected ■ Accounting controls ■ Current auditors (e.g. NAO or private sector)
3 Projected financial Data	Income statement assumptions, cash flow statements, etc.	■ Major assumptions, including the certainty over future funding sources ■ Working capital requirements ■ Movement in major balance sheet accounts ■ Projected financial statements, current annual budget and long-term strategic plan
Legal		
1 Legal	Ownership structure, litigation, material long-term contracts, etc.	■ Reporting mechanisms and resource boundary ■ Legal status ■ Main leases in operation, cost and term ■ Litigation pending or threatened ■ Relationship with other public sector bodies ■ Material long term contracts or commitments
Business		
1 Products/services	Description and breakdown of products/services	■ Key activities performed, and overall aims in service delivery to the public ■ Nature of activities (statutory, discretionary) ■ Main 'customers' (e.g. public, businesses) ■ Fee earning activities, and any restrictions ■ Any alternative suppliers ■ Restrictions (statutory or political) ■ New services to be offered/future change
2 Business Strategy	Industry trends, customer/competitor strategies, future acquisitions, etc.	■ Short and long terms trends affecting the body ■ Current organisational plans & strategies ■ PSA targets and other objectives ■ Political importance/profile within Parliament

28 Due diligence check-list *continued*

Area	Aspects included	Public Sector equivalent
Business *continued*		
3 Communications and marketing	Organisation of staff, promotion by channel, stakeholder relationships, etc.	■ Communication with stakeholders through major campaigns ■ Public relations and complaints history ■ Discussions with unions ■ Importance within the press and PAC ■ External reports on the bodies ■ Stakeholder surveys
Human Resources		
1 Organisation	Organisation charts, reporting, etc.	■ Organisation charts by division ■ Description of reporting relationships
2 Management	Management CVs, compensation, etc.	■ Management CVs, compensation and contracts ■ Ability of existing management to run the newly merged organisation
3 Employees	Headcount, skills base, turnover, etc.	■ Headcount by department and location ■ Description of labour skill base ■ Turnover and absenteeism ■ Current wage rates (and disparities) ■ Cultural differences between the organisations ■ Union representation
4 Compensation structures	Salaried vs hourly rate employees, retirement plans, severance plans	■ Current and future pension arrangements ■ Existence of 'reserved rights' within Civil Service Pension Schemes, and the future cost ■ Severance plans
5 Post-completion	Organisation structure, retention of key management, etc.	■ Organisation structure post-completion ■ Retention of key management/personnel ■ Transferability of existing skills ■ Ability to redeploy 'surplus' staff
Operations and Facilities		
1 Location and facilities	Location and quality of facilities	■ Description of location, tenure of occupation, quality, age and layout of facilities ■ Description of significant fixed assets ■ Strengths and weaknesses of asset base ■ Information Technology usage ■ Description of key processes ■ Reliance on skilled labour or key suppliers, and the potential impact of the merger

28 Due diligence check-list *continued*

Area	Aspects included	Public Sector equivalent
Operations and Facilities *continued*		
2 Quality Assurance	Q&A programs, technical service and support, etc.	■ Appropriate measures of 'quality' for the previous and new organisation ■ Current performance assessments of quality
3 Cost analysis	Fixed/variable costs, indirect costs, etc.	■ Cost profile (mostly fixed or variable costs) and how this will influence intended savings ■ Incentive schemes to be provided to staff
Risk Management		
1 Sustainability	Community and environmental impact	■ Relative importance of environmental factors ■ Authorisations prior to disposal of waste ■ Political impact on local communities
2 Health and Safety and Insurance	Records of injuries, current safety programmes, policies, etc.	■ Importance of health and safety issues ■ Historical records of accidents or injuries ■ Assessment of current safety procedures ■ Any current insurance policies held
3 Tax	Tax audit status, payroll taxes, etc.	■ Tax status ■ Current taxes payable, particularly VAT
4 Treasury	Cash management systems, treasury policies, etc.	■ Details of bank accounts held ■ Cash management systems and security ■ Restrictive covenants or 'ring-fenced' funds ■ Foreign exchange exposure ■ Treasury policies and procedures for drawdown of Grant-In-Aid, "Vote"

Source: National Audit Office

NOTE

1 Departmental Expenditure Limits (DEL) are multi-year spending plans for Government departments. Annually Managed Expenditure (AME) is spending that is managed on an annual basis.