National Audit Office

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

Ordered by the
House of Commons
to be printed on 3 July 2006

LONDON: The Stationery Office
£9.25

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

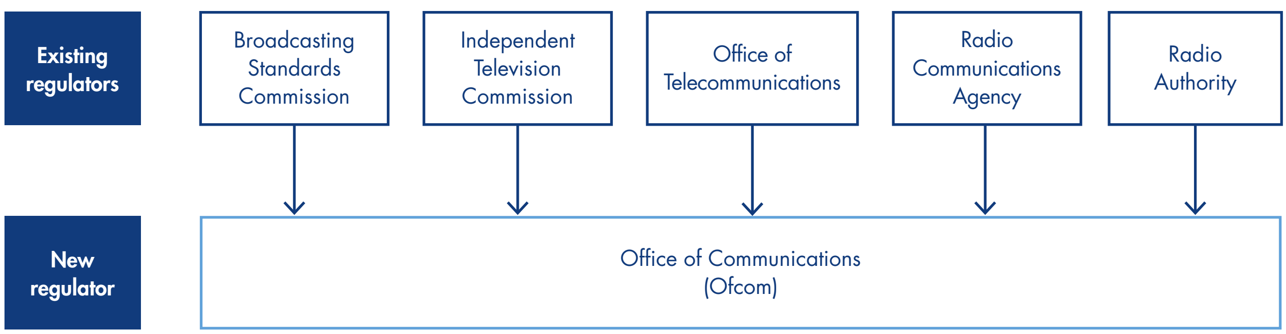
EXECUTIVE SUMMARY

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.