

# Sourcing Toolkit

## Market Health and Capability Assessments



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## Foreword

It has been acknowledged there are a number of strategic drivers requiring a transformation in public procurement practice and procedure. This requires a shift in focus away from procedural instruction to a more commercial approach to help deliver the Programme for Government commitments through public procurement.

In recognition of this, the Procurement Board agreed to apply the themes contained within the [Sourcing Playbook](#), published by Cabinet Office, to procurements in Northern Ireland with the aim of improving commercial focus.

As a result of this work, the Sourcing Toolkit was developed to incorporate the best practice guidance from the Cabinet Office's Playbook, along with guidance developed for public procurement here.

The Toolkit is a living document which will be updated to include any relevant topics added to the Cabinet Office Playbook.

The Toolkit is not mandated. It is a compilation of helpful guides and templates which public bodies may wish to use, as appropriate.

A proportionate approach should be taken to achieve a balance between the value of the contract and the transactional cost of applying the guidance outlined in the Toolkit.

The information set out in this document is neither legal advice nor statutory guidance and is not intended to be exhaustive. If there is any conflict between the Toolkit and [Procurement Policy Notes](#) (PPNs), the PPNs will take precedence.

Training on the different sections within the toolkit is provided through the [Government Commercial College](#).

# SECTION 1 - MARKET HEALTH AND CAPABILITY ASSESSMENTS

Assessing the health and capability of the market at an early stage will enable procurement teams to identify potential limitations in the market and consider whether action is needed to increase competition and improve market health (e.g. using lots).

## 1.1 Market Management

Market management is about understanding the markets that we source from, recognising our influence on these markets, and designing commercial strategies and contracts that promote healthy markets over the short, medium and long term.

The key principle of market management is to:

***“assess the health of the market you will be dealing with and consider how your commercial strategy and contract design can be adapted to address potential limitations”.***

Market management is already a key feature of NI Public Procurement Policy (NIPPP). For example:

- PPN 01/21<sup>1</sup> Scoring Social Value requires the use of pre-market engagement to identify the most feasible and beneficial way to promote social value;
- PPN 02/21<sup>2</sup> Procurement of Social and Other Specific Services requires the use of pre-market engagement to determine if procurement is the most appropriate sourcing route and, if a procurement is required, to help tailor the procedures, award criteria and financial model to reflect the nature of the services they are procuring;
- PPN 03/21<sup>3</sup> (Supply Chain Resilience) highlights the benefits of pre-market engagement to help understand the capability and capacity of both existing and new supply chains; and
- PPN 05/21<sup>4</sup> Human Rights in Public Procurement requires that departments must, when entering into any commercial contract, assess the level of risk involved in each contract and

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<sup>1</sup> [PPN 01 21 Scoring Social Value](#)

<sup>2</sup> [PPN 02 21 Procurement of Social and Other Specific Services](#)

<sup>3</sup> [PPN 03 21 Supply Chain Resilience](#)

<sup>4</sup> [PPN 05 21 Human Rights in Public Procurement](#)

produce a procurement/sourcing strategy that identifies potential human rights breaches and put measures in place to mitigate them.

Healthy, competitive markets matter because they support our ability to achieve value for money for taxpayers and drive innovation in delivering public services. Better market management should lead to more competitive resilient markets, fewer situations where we are over reliant on one or two suppliers and the achievement of best value for money<sup>5</sup>.

First generation outsourcing decisions can have a profound effect on market development. For example, those winning early contracts may acquire first mover incumbency advantages, accepting that they also take on increased risk. We should adopt models that promote competition and contestability over time, so that those that win the initial contracts know that they must deliver best value for money and perform to the standards required for the delivery of the service or risk government taking its business elsewhere in future.

An assessment of the market early on during the tender preparation and planning stage is particularly important for complex or strategic procurement projects.

## 1.2 Human Rights

The protection of Human Rights in public procurement is a priority for both the UK Government and NI Executive. Decisions made in public procurement processes can have consequences on the human rights of people employed to deliver goods and services through government contracts. This could arise in situations where:

- service users' human rights and dignity may not be respected by private or third-sector providers of essential public services delivered on behalf of central or local public authorities; for example, health and social care, housing, educational services, or services with people at risk of offending. In such circumstances, the provider may be acting as a public authority and be bound by the human rights obligations contained within the Human Rights Act 1998;
- some service contracts such as cleaning, catering and security guarding may involve the hiring of a higher volume of migrant workers/foreign nationals. These types of contracts are

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<sup>5</sup> [Definition of best value for money | Department of Finance \(finance-ni.gov.uk\)](#)

at risk of breaching the human rights of the workers. The Modern Slavery Act 2015 provides for legislation against offences of slavery, servitude and forced or compulsory labour, and human trafficking. It is the responsibility of the Department to show due diligence when awarding contracts to ensure that the human rights of the workers are protected;

- goods or services purchased by public authorities may be produced by first tier suppliers or further down the supply chain under conditions where the human rights of workers or members of local communities are violated or abused; for example, due to forced labour, illegal child labour, human trafficking, excessive working hours, health and safety breaches, forced relocations or environmental pollution.

Incorporating human rights conditions in public sector contracts can help change the behaviour of companies competing for contracts. Further information can be found in [PPN 05/21 Human Rights in Public Procurement](#).

*Modern slavery* is often a hidden crime involving one person denying another person his or her freedom. It includes slavery, servitude, forced and compulsory labour and human trafficking. In addition to the Executives Procurement Policy Note (PPN05/21) the Cabinet Office Government Commercial Function has produced a guidance document:

'[Tackling Modern Slavery in Government Supply Chains](#)' which contains information that Contracting Authorities may find helpful in mitigating the risks of Modern Slavery within their supply chains.

## 1.3 Innovation

Adopting innovative solutions and emerging technologies enables the government to improve its ways of working and achieve better public service outcomes. Innovation comes in a number of forms and starts with being open to new ways of thinking and creating forums where these ideas can be considered and assessed. Projects should engage in innovative thinking from the start through early dialogue with potential suppliers and understanding new technologies. Projects should also consider research and innovation-based procedures which go beyond market engagement into inviting the market to suggest novel solutions to problems.

Social value can promote innovation in the way contracts are delivered, through encouraging inclusive employment and supply chain practices, addressing skills gaps, promoting co-design and community integration, and improving environmental sustainability. [PPN 01/21 - Scoring Social Value](#) is an Executive Policy designed to maximise social value by considering it as a key element of the award criteria. By valuing the social, economic and environmental benefits that small businesses, voluntary, community and social enterprise organisations and responsible businesses can offer, we can contribute to further diversifying public supply chains. The PPN should be used to identify social value opportunities during early engagement with supply markets and service users. It sets out the Executives social value priorities for procurement across four key themes: increasing secure employment and skills, building ethical and resilient supply chains, delivering zero carbon and promoting wellbeing. Considering these key themes in our procurements will allow us to mitigate against the risk of modern slavery in our supply chains and contribute to our 2050 net zero commitment.

## 1.4 Early Engagement

Government should not be afraid to talk to the market in advance of going out to tender. This practice is well embedded and, when carried out appropriately, there are significant benefits to both the public sector and suppliers. It can help promote forthcoming procurement opportunities and provide a forum to discuss delivery challenges and risks associated with the procurements. Through this process, we are able to understand the deliverability of our requirements, the feasibility of alternative options and whether there is appetite (within the market and government) to consider innovative solutions that could help deliver better public services.

Preliminary market engagement should actively seek out suppliers that can help to improve service delivery, including **Small and medium-sized enterprises (SMEs) and Voluntary, Community and Social Enterprises (VCSEs)** who are experts in the needs of service users and widely involved in the delivery of public services.

To enable inclusive economic growth that works for all, assessments of the market and pre-market engagement should consider opportunities for wider social, economic and environmental 'social value' benefits to staff, supply chains and communities that can be achieved through the performance of the contract.



Early market engagement should also be used to inform the procurement procedure, possible tender evaluation criteria, and overall project timetable to ensure that when going to the market, potential suppliers have sufficient time to respond to tenders.

Market engagement must observe the principles of public procurement and be handled in such a way that no supplier gains a preferential advantage. In practice, this means not setting the technical specification to suit a particular supplier or product and making sure any information shared is also available during the tender procedure. It is good practice to openly announce any market engagement exercises by publishing a Prior Information Notice (PIN) and early market engagement notice or future opportunity notice on [eTendersNI](#).

## 1.5 Market Management Activity

There is not a set form or template that market management activity must follow. Instead, a flexible, risk-based approach should be used.

The sections on ‘How to monitor market health’ and ‘How to promote healthy markets’ below provide guidance to assist those that are undertaking market management activities.

Market management activity should take place in the ‘Preparation and Planning’ phase of the procurement lifecycle and also during contract implementation.

In a repeat contracting scenario, a new market assessment will naturally be undertaken as one contracting cycle nears its end, as part of the process of developing the commercial strategy for the next contracting round.

Procurement staff should also monitor markets and update market assessments where important developments have taken place, as part of their ongoing contract management and monitoring activity.

## 1.6 How to Monitor Market Health

Market health is about both the buyer side and the supplier side of a market. In simple terms, markets are healthy when buyers are clear about their requirements, and can select and switch to

best value for money suppliers, and when there is an adequate number of suppliers that are actively competing to offer what buyers want.

When these conditions are present, suppliers must make attractive bids in order to win contracts, and those that win contracts must work hard to deliver value for money, or risk buyers taking their business elsewhere.

## Guidance on market assessments

In the context of government outsourcing, government will often be the main buyer in a market.

The idea of the market assessment is to use a range of evidence to reach an overall view of market health and to identify any areas of potential weakness, so that appropriate action can be taken to respond to these (e.g. using lots).

The table below sets out suggested questions that can be addressed within market assessments, as well as some sub-questions and types of evidence that can assist with this exercise.

## Suggested questions for market assessments

Topic and key questions	Sub-questions	Useful evidence/tools
<i>Market overview</i>		
<ul style="list-style-type: none"> <li>• What are government's needs and what will it be buying?</li> </ul>	<ul style="list-style-type: none"> <li>• Is this the first time the service is being outsourced?</li> <li>• What is the value and complexity of these goods or services?</li> <li>• Which departments will be buying these?</li> <li>• What is government's current/intended commercial strategy?</li> </ul>	<ul style="list-style-type: none"> <li>• Liaise with other departments procuring the goods/services to identify costs/revenue figures for past/current/planned procurements</li> <li>• Commercial strategy documents</li> </ul>
<ul style="list-style-type: none"> <li>• What are the key market drivers/trends with a bearing on market health?</li> </ul>	<ul style="list-style-type: none"> <li>• How mature is the market?</li> <li>• Is government a market-maker? Does it / will it account for a large part of the demand for these goods/services?</li> <li>• What impact is technology, regulation, policy, politics etc. having on market health?</li> </ul>	<ul style="list-style-type: none"> <li>• Off-the-shelf industry reports</li> <li>• Crown Commercial Service Commercial Intelligence Market Reports</li> <li>• Revenue and contract award data from past/existing contracts</li> <li>• PESTLE analysis</li> </ul>

	<ul style="list-style-type: none"> <li>• How is this expected to evolve?</li> </ul>	
<i>Market features</i>		
<ul style="list-style-type: none"> <li>• Supply-side assessment: who are the suppliers and how do they compete?</li> </ul>	<ul style="list-style-type: none"> <li>• Which suppliers are/will be active in this market? (including public, private and others)</li> <li>• What capacity and capabilities do they have relative to government's requirements?</li> <li>• What market shares do they currently have?</li> <li>• How concentrated is the market? (see <i>market share and HHI indicators in table below</i>)</li> <li>• How closely do/will these suppliers compete?</li> <li>• What has the trend been over time?</li> <li>• Which suppliers could enter/exit the market?</li> </ul>	<ul style="list-style-type: none"> <li>• Supplier identities from government databases</li> <li>• Supplier assessments produced by Cabinet Office Markets and Suppliers team</li> <li>• SWOT analysis</li> <li>• Evaluations of past procurements</li> <li>• Revenue and contract award data from existing contracts</li> <li>• Market engagement exercises</li> <li>• Case studies of past entry/exit in this market or similar markets</li> <li>• For bid-rigging, consider Competition and Markets Authority tools and guidance<sup>6</sup></li> </ul>

<sup>6</sup> See for example: screening for cartels: tool for procurers; 60-second bid-rigging summary and e-learning module for procurers: <https://www.gov.uk/government/publications/screening-for-cartels-tool-for-procurers>

	<ul style="list-style-type: none"> <li>Is there any sign (or risk) of anti-competitive behaviour, such as bid rigging between suppliers?</li> </ul>	
<ul style="list-style-type: none"> <li>Buyer-side assessment: how easy is it to identify and switch to best value for money suppliers?</li> </ul>	<ul style="list-style-type: none"> <li>Does government have clear objectives?</li> <li>Does government have good information on suppliers? And the ability to select best value for money offers?</li> <li>Are incentives appropriate and well-aligned between buyers, suppliers and service users?</li> <li>What are the barriers/costs to government switching between suppliers? (<i>see switching cost indicator in the table below</i>)</li> </ul>	<ul style="list-style-type: none"> <li>Evaluations of past procurements</li> <li>Capability assessments produced internally by departments, or by the NAO, Executive committees etc.</li> </ul>
<ul style="list-style-type: none"> <li>Contestability: how easy is entry, expansion and exit in this market? How strong are</li> </ul>	<ul style="list-style-type: none"> <li>What are the barriers to suppliers entering and expanding? What about barriers to exit?</li> <li>How strong is incumbency advantage in this market?</li> <li>If an incumbent raised prices, reduced quality or left the market, what bargaining</li> </ul>	<ul style="list-style-type: none"> <li>Evaluations of past procurements</li> <li>Market engagement exercises</li> <li>Case studies of past entry/exit in this market or similar markets</li> <li>Porter's five forces analysis</li> </ul>

<p>incumbency advantages?</p>	<p>power would government have? Could alternative public or private suppliers step-in in a timely fashion?</p> <ul style="list-style-type: none"> <li>• What entry trends have we observed over time?</li> </ul>	
<p><i>Market outcomes</i></p>		
<ul style="list-style-type: none"> <li>• Is the market delivering value-for- money?</li> </ul>	<ul style="list-style-type: none"> <li>• What are the levels and trends in price, quality, innovation and choice? (see <i>market outcome indicators in table below</i>)</li> <li>• What are the drivers contributing to these trends? For example, changes in government requirements, changes in the competitive environment, changes in input costs</li> <li>• Are buyers setting the right incentives for suppliers?</li> </ul>	<ul style="list-style-type: none"> <li>• Contract-level KPI data</li> <li>Employee feedback on providers within the market</li> <li>• Any Value for Money assessments produced by departments, the NAO, parliamentary committees etc.</li> <li>• Evaluations of past procurements</li> </ul>

*Conclusions and action plan*

<ul style="list-style-type: none"><li>• How healthy is the market overall?</li></ul>	<ul style="list-style-type: none"><li>• Is there effective competition between suppliers?</li><li>• Are entry, expansion and exit barriers low and are markets contestable?</li><li>• Are switching costs low?</li><li>• How strong is any incumbency advantage?</li><li>• Are there any other areas of market weakness?</li><li>• Is the market supporting good value-for-money overall?</li><li>• Overall, what are the key areas of market weakness?</li><li>• Does trend analysis suggest that market health is improving or deteriorating?</li></ul>	<ul style="list-style-type: none"><li>• Results of the assessments above</li></ul>
<ul style="list-style-type: none"><li>• How should government respond?</li></ul>	<ul style="list-style-type: none"><li>• What actions should government consider taking to address market weaknesses?</li></ul>	<p><i>See section 1.6</i></p>

	<ul style="list-style-type: none"> <li>• What further work will government do to explore these options?</li> </ul>	
		<ul style="list-style-type: none"> <li>• <a href="#">Government Commercial Operating Standards</a></li> <li>• Office of Fair Trading guidance on the links between procurement/commissioning and competition<sup>7</sup></li> </ul>

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<sup>7</sup> See for example the OFT's government in market framework and the OFT's report into public sector commissioning: <https://www.gov.uk/government/publications/government-in-markets>



## Indicators to use in a market assessment

The table below describes some indicators that can be used within a market assessment. The headline indicators are easier to generate and the additional indicators may be appropriate for more in-depth assessments.

Indicator	Guidance	Potential cause for concern if...
<i>Market features: headline indicators</i>		
Failed bidding rounds	<ul style="list-style-type: none"> <li>Identify the number of recent bidding rounds for the services where no acceptable bids were received</li> <li>Tip: include bidding rounds undertaken by other departments</li> </ul>	<ul style="list-style-type: none"> <li>One or more failed rounds identified</li> </ul>
Bids received	<ul style="list-style-type: none"> <li>Plot the trend in the number of bids received</li> <li>Tip: indicator is more informative if multiple similar bidding rounds have taken place</li> </ul>	<ul style="list-style-type: none"> <li>Very few bids received</li> <li>Declining trend in number of bids</li> </ul>
Market shares	<ul style="list-style-type: none"> <li>Plot the trend in the market shares of the main suppliers (typically the revenue earned by a supplier per annum, divided by the total</li> </ul>	<ul style="list-style-type: none"> <li>Market shares of largest suppliers are high and stable or increasing</li> <li><math>90 \leq C3 \leq 100\%</math></li> </ul>

	<p>revenues earned by suppliers in that market per annum)</p> <ul style="list-style-type: none"> <li>• Consider also plotting the trend in the C3 ratio (the sum of the market shares of the three largest suppliers)</li> <li>• Tip: these indicators are more informative in markets where government buys through multiple contracts at once</li> <li>• Tip: if total market size is unknown (data on revenues earned from non- government buyers may not be available), then shares of supply to government should be calculated</li> </ul>	
Win ratios	<ul style="list-style-type: none"> <li>• Plot the win ratios of the main suppliers over time (the number or value of contracts won by a supplier over a period of time, divided by the number or value of contracts that government has awarded for those services)</li> </ul>	<ul style="list-style-type: none"> <li>• Win ratios of largest suppliers are high and stable or increasing</li> <li>• The vast majority of contract awards go to three or fewer suppliers</li> </ul>

	<ul style="list-style-type: none"> <li>• Tip: this indicator is useful in bidding markets, where government re-tenders one or several contracts on a regular basis</li> <li>• Tip: it may also be useful to calculate switching rates to see how often a particular contract (or type of contract) changes hands</li> </ul>	
Switching costs	<ul style="list-style-type: none"> <li>• Attempt to quantify the costs that government would incur as a result of switching suppliers (either now or in future)</li> </ul>	<ul style="list-style-type: none"> <li>• Switching costs are substantial relative to contract value</li> </ul>
<i>Market features: additional indicators</i>		
Herfindahl-Hirschman Index (HHI)	<ul style="list-style-type: none"> <li>• Calculate the sum of the squared market shares of suppliers in the market (market shares will generally be based on revenues)</li> <li>• Tip: this indicator requires all market shares to be known</li> </ul>	<ul style="list-style-type: none"> <li>• HHI score from 1000-10,000</li> </ul>

It may not be possible to reach a conclusion on market health based on any one indicator alone. For example, high and increasing market shares (or win ratios) would generally indicate that competition may be weak and should be a prompt to look closely at the market and consider the reasons for these results. However, if cost and quality indicators suggest that the market is delivering good outcomes, and if the market has low barriers to entry, then (despite high market shares) there may in fact be intense competition between a small number of firms.

## 1.7 How to Promote Healthy Markets

Those designing commercial strategies and contracts can be subject to multiple competing objectives and constraints.

Considerations such as short-term affordability and limitations to departments' contract management capacity may point towards an approach of offering fewer, larger contracts in an attempt to reduce upfront costs and departmental overheads.

However, these approaches can lead to false economies and lower value for money over time. For example, these strategies may result in fewer bids, weaker competition and stronger incumbency positions for a handful of suppliers – either in the initial bidding process or in future contracting rounds.

Therefore, it is important to consider how commercial strategies and contracts can be adapted to have a positive impact on market health and best value for money.

Public procurement can promote competition and make a positive contribution towards market health where:

- it is clear about requirements and switches between suppliers in a timely and effective manner;
- the bidding processes and procedures are designed to keep entry barriers low and maintain a level playing field between suppliers;
- it minimises the risk of, anti-competitive behaviour, for example bid-rigging;
- it designs contracts that do not create excessive barriers to step-in during a contract, or creates an unassailable advantage for incumbents in future contracting rounds; and
- it plans for medium and long-term market health and does not excessively focus on the short term.

## Steps to promote market health

The table below provides further detail on the steps that can be considered. These are organised by theme, however many of these steps also have wider applicability outside of the specified theme

Theme	Questions to consider	If the answer is 'no', consider taking the following steps...
Addressing Barriers to Entry	Do bid processes and procedures ensure a level playing field between suppliers?	<ul style="list-style-type: none"> <li>• Streamline complex and burdensome procurement policies and processes.</li> <li>• Consider the ability of smaller suppliers to take part in large procurement exercises, for example those carried out under joint purchasing by multiple government departments.</li> <li>• Consider encouraging Joint Ventures between SMEs. If this is used, brokerage support could also be offered.</li> <li>• Use Market Engagement to understand and tackle barriers to entry. This could include:               <ul style="list-style-type: none"> <li>○ Providing training or guidance to SMEs on how to submit compliant bids.</li> <li>○ Talking to existing and potential suppliers to understand their capacity and capability.</li> </ul> </li> </ul>
	Does joint purchasing ensure a level playing field between suppliers?	
	Do sufficient economies of scale/scope exist to justify aggregated contracts and long contract durations?	

<p>Does the risk allocation between public and private sector ensure that a range of suppliers are able to compete?</p>	<ul style="list-style-type: none"> <li>• In the absence of significant economies of scale and scope, consider disaggregating contracts for different services and limiting the duration of contracts, to encourage greater supplier participation and reduce switching costs.</li> <li>• When designing, specifying or encouraging new delivery models, ensure that suppliers are still incentivised to innovate and that sub-contractors can negotiate contractual terms with prime contractors on an equal footing.</li> </ul>
<p>Does the use of framework contracts allow for the entry of new suppliers if they meet the same objective criteria as existing suppliers?</p>	<ul style="list-style-type: none"> <li>• Ensure outcome-based contracts do not place excessive risk with suppliers or dissuade new/smaller suppliers from entering the market.</li> <li>• Where demand is unpredictable and can lead to a greater risk transfer, consider rewarding providers for actual volume of work they do rather than a fixed fee payment, using pay caps and minimum income guarantees.</li> <li>• Scrutinise bids and compare them against Should Cost models (further guidance on 'should cost' models can be found in Section 2 of the Sourcing Toolkit - 'Preparing to go to market'). Accepting unsustainably low bids can lead to worse Value for Money.</li> </ul>
<p>Do we understand the true cost of supply?</p>	<ul style="list-style-type: none"> <li>• Consider keeping certain assets and expertise in-house and only contracting out those aspects of service provision where there is scope for effective competition.</li> </ul>
<p>Are the capital requirements involved in supplying the market reasonable?</p>	

Addressing Barriers to Switching	Do buyers switch effectively and swiftly between rival suppliers and within appropriate timescales?	<ul style="list-style-type: none"> <li>• Take steps to promote quick and effective switching to more efficient suppliers, whilst not dissuading innovation or efficient investment by incumbent suppliers. For example: <ul style="list-style-type: none"> <li>○ Consider contractually requiring incumbents to facilitate switching at the point of contract expiry.</li> <li>○ Where services involve bespoke systems or technology, ensure that the allocation of intellectual property rights maintains our ability to switch to other suppliers in future.</li> </ul> </li> </ul>
	Do requirements to ensure continuity of supplier ensure proportionate costs across existing and potential suppliers?	<ul style="list-style-type: none"> <li>• Any requirements on potential suppliers to ensure a continuity of supply should take account of market conditions and their ability to make contingency arrangements in the event of failure or market exit.</li> <li>• When comparing public sector in-house options with other suppliers, the cost of failure by public and private sector suppliers should be accounted for.</li> </ul>
Creating appropriate and aligned incentives	Do multiple suppliers impose competitive constraints on one another?	<ul style="list-style-type: none"> <li>• Design commercial strategies and contracts in a way that incentivises suppliers to deliver value for money post contract award. For example, dividing up contracts can help maintain competitive tension during the term of contracts. Also consider using ongoing rating systems, outcome-based contracts, contracts where high performers are allocated increasing volumes over time, or greater benchmarking transparency</li> </ul>

	<p>Are buyers encouraging the right level of risk, and focus on the medium/long term as well as the short term?</p>	<ul style="list-style-type: none"><li>• Clearly articulate strategic guiding objectives and ensure these are understood by commissioners, procurers and suppliers. Check that incentives can be appropriately aligned to achieve these objectives.</li><li>• Develop better performance monitoring information.</li><li>• In markets where KPIs take a long time to crystallise, consider using interim milestones</li></ul>
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## Section 1 Appendix I – Further Guidance on Market Indicators

This appendix presents a hypothetical example scenario in which the market indicators are calculated as part of a market assessment.

It demonstrates how to calculate the indicators and how these can feed into a wider assessment of market health. It is important to remember that market indicators only form part of a market assessment; a wider range of evidence will be needed in order to reach overall conclusions about market health. The wider questions and evidence that market assessments may cover are contained in the 'Contents of a market assessment' table in the Market Management guidance.

### Background

The Department for Medicine has outsourced secure delivery services for several years. A key contract is due to expire in 12 months and so the department is reviewing its outsourcing strategy for these services and carrying out a market assessment.

The Department for Defence also procures secure delivery services, so the tendering rounds run by this department are relevant for the Department for Medicine's market assessment.

The Department for Medicine currently uses Supplier 1.

The Department for Defence currently uses a mix of Supplier 2 and Supplier 3.

Both departments retender for secure delivery services on a yearly basis.

All three suppliers offer some wider services besides secure delivery services. These wider services are not purchased by the departments and therefore data relating to these are not relevant to the market assessment.

### Calculation of market indicators for use in a market assessment

The departments agree that the Department for Defence should lead on the calculation of market indicators for use in a market assessment.

The departments both have three years of comparable bidding data. The outsourced service has not been significantly affected by technological trends in the last three years. Therefore, a time period of three years is used to generate the market indicators.

### Market structure and contestability

The department starts by considering the **failed bidding rounds indicator**. Neither department have experienced any **failed bidding rounds** (i.e. tendering rounds with no bidders) so this indicator does not indicate any market health issues.

The department next considers the **bids received indicator**. Both departments have run three bidding rounds in the past three years. The number of **bids received** in each bidding round is set out in the table below.

Number of bids received:

	Department for Medicine	Department for Defence
Year 1	6	7
Year 2	6	7
Year 3	6	7

The number of bids received by each department has remained relatively stable at 6-7 bids per tender over the previous three years. Therefore the bids received indicator suggests the amount of supplier interest in the market is neither growing nor shrinking overall.

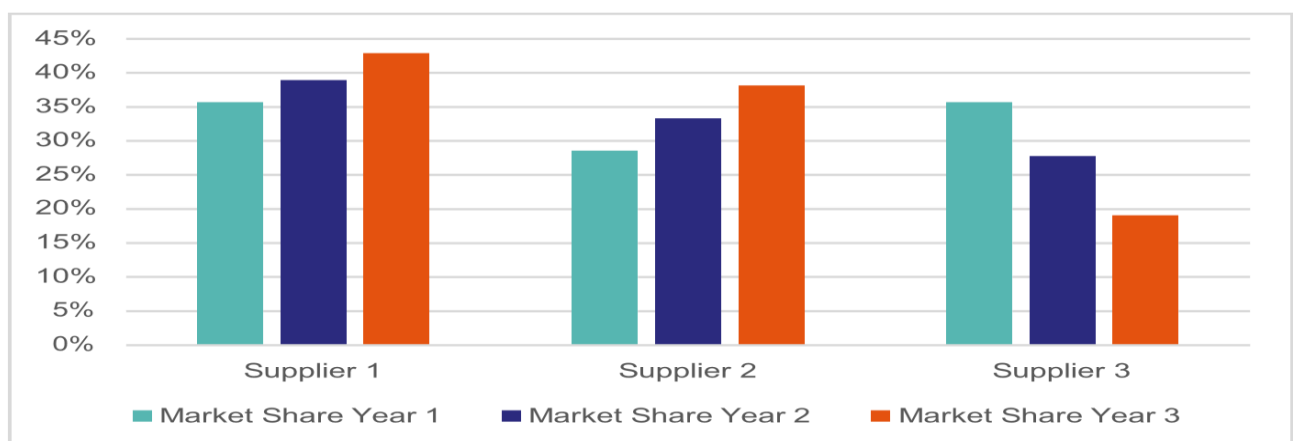
The department next considers **market share** indicators. As noted previously, government uses three suppliers in total. This is relatively low, but in itself is inconclusive. The table below shows the total spend by each department with each of the three suppliers for secure delivery services. To calculate these, the Department for Defence had to obtain information from the Department for Medicine's previous tendering exercises.

**Market shares** were calculated by dividing the total spend on secure delivery services with a supplier by the total spend by government on those services for each year. Importantly, the spend below only relates to relevant services that are in-scope of the market assessment.

Suppliers' revenues:

	Revenue Y1	Revenue Y2	Revenue Y3	Market Share Year 1	Market Share Year 2	Market Share Year 3
Supplier 1	£5m	£7m	£9m	36%	39%	43%
Supplier 2	£4m	£6m	£8m	28%	33%	38%
Supplier 3	£5m	£5m	£4m	36%	28%	19%
Total gov spend	£14m	£18m	£21m	100%	100%	100%

Market shares:



This analysis showed that the market shares of the largest suppliers (Supplier 1 and Supplier 2) are high and increasing. Supplier 3's market share has decreased.

The market shares were also used to calculate a **C3** ratio and the **HHI**.

The C3 is calculated by summing the market shares of the three largest suppliers. As there are only three suppliers in this market, the C3 was 100%.

**Tip:** The C3 indicator does not indicate the relative size of the three largest suppliers. A market where the three largest suppliers have market shares of 80%, 10% and 10% would have the same C3 as a market where the three largest suppliers all have a market share of 33%. The first case is likely to be more concerning.

HHI is calculated by squaring the market shares of all suppliers in the market and summing these together.

$$48^2+35^2+17^2=3,818$$

This is above the threshold of 1,000 which generally means that there is a level of concentration in the market which could be a cause for concern. However, the department decides to gather further evidence, including on market outcomes, before drawing any conclusions.

**Tip:** Even where concentration indicators (such as HHI) show that a market is concentrated, the market may not be subject to weak competition. Suppliers in a highly concentrated market could still face intense competition if barriers to entry and exit are very low, so that contracts can easily change hands. Win ratios are also calculated for each of the suppliers across the two departments tendering exercises. These can be found in the table below.

Win ratios:

	Bid	Won	Win Ratio
Supplier 1	6	3	50%
Supplier 2	6	3	50%
Supplier 3	6	3	50%

Win ratios are relatively high for each of the three suppliers.

**Tip:** Win ratios are helpful in shedding light on the strength of suppliers over time. This can be useful in bidding markets with one or more of the following characteristics:

- tenders take place infrequently,
- the value of individual contracts is significant from the perspective of the supplier, or
- there tends to be a single successful bidder (ie winner takes all),

In these situations, a snap shot of market shares based on revenue will not always provide a good indication of the strength of a supplier.

For example, if a supplier had recently won a very large contract and had a revenue- based market share of over 90%, but had a low win ratio based on the past five tenders, this would indicate that it does not have as much strength in the market as

## Market outcomes

The contracts used by the departments each contain a 95% success rate target for on-time deliveries. The department decides that this KPI can be used as a **market performance** indicator.

The suppliers' success rates for on-time delivery are set out the below. These indicate that:

Suppliers 1 and 2 performed well in Years 1 and 2, however their performance declined in Year 3 and they are no longer reaching their target. Supplier 3 has consistently failed to meet the 95% target.

The department observes that:

Work is flowing from the poorest performing provider (Supplier 3) to suppliers that are performing better.

However overall market performance is declining.

KPI performance:

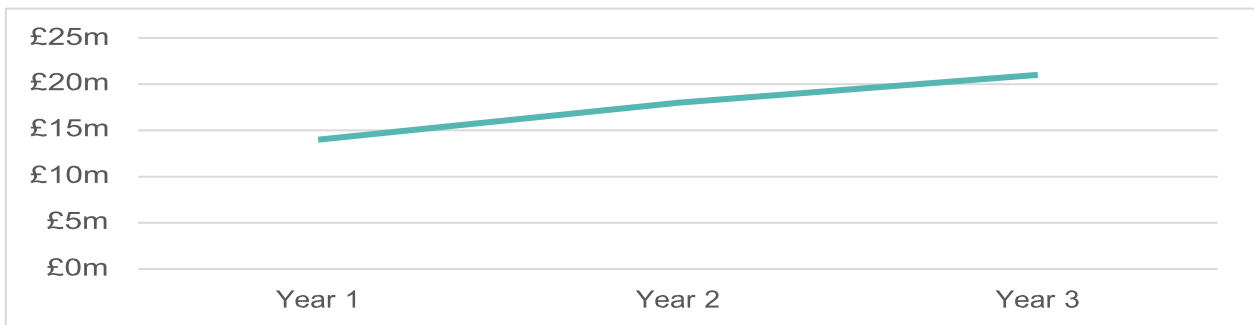
	Year 1	Year 2	Year 3
Supplier 1	96%	95%	84%
Supplier 2	95%	95%	73%
Supplier 3	94%	83%	60%

As part of its market assessment, the department plans to repeat this exercise for other KPIs set out in its contracts, and also bring in other more qualitative evidence on other aspects of performance such as levels of innovation.

Next the department assesses the overall cost of these contracts.

The total spend of both departments is displayed on the graph below, representing the cost to taxpayers

Total contract cost:



Total contract cost has increased across the three years. The department observes that:

- Based on available indicators, market performance has fallen overall, so the rising costs do not appear to be explained by higher quality.
- For both departments, demand has stayed constant, so the rising costs do not appear to be explained by increases in demand.

Profit indicators are not calculated, as the suppliers do not report profits in a way that allows these to be segmented by services.

## Recap of market indicators and next steps

The indicators on market structure and contestability suggest:

- Departments appear to be receiving a reasonable number of bids on a yearly basis.
- However, only three suppliers actually hold contracts and the market has become concentrated in favour of two of those.

The indicators on market performance show:

- The quality of service delivered by the market appears to be declining.
- Yet at the same time, costs to government are rising.

The indicators calculated so far suggest that there may be weak competition in the market.

To identify a fuller picture of competition and market health, the Department for Medicine decides to undertake some wider market assessment work, including a buyer-side analysis and some supplier-side market engagement work. Amongst other things, this will consider:

- Why other bidders have been unsuccessful.
- Whether the departments face significant barriers to switching providers.
- Whether incumbent suppliers have a strong incumbency advantage.