

Date: 11 March 2015

Item 9: **Benchmarking and Financial Planning at TfL**

This paper will be considered in public

1 Purpose

- 1.1 This paper follows the overview of how benchmarking is informing financial projections that was presented to the Committee on 14 October 2014. This paper responds to the Committee's request for:
- (a) an overview of the current efficiencies and saving initiatives (and the benchmarking activities that contributed to these) to be delivered over the current Business Plan; and
 - (b) consideration of whether there is scope to support a stretch target to increase the level of savings to be achieved through identifying additional benchmarking efficiencies.

2 Recommendation

- 2.1 **The Committee is asked to note the paper and in particular that:**
- (a) **TfL's benchmarking activities have contributed to approximately £1.7bn (or 11 per cent of the total efficiency savings) of £16bn (net of implementation costs) over the Business Plan period from 2009/10 to 2020/21. This amount has already been applied in full as budget reductions in the Business Plan;**
 - (b) **benchmarking has been a more relevant contributory factor to savings and efficiencies targets within Rail and Underground (R&U). 15 per cent of efficiencies have been informed by benchmarking compared to 13 per cent in Surface Transport (ST), due in part to ST performing more effectively than the peer group in its largest area of operating expenditure (Buses). With the significant investment programme underway in Surface Transport and Specialist Services, initiatives are already in place to understand the lessons from R&U in the use of benchmarking capital investment;**
 - (c) **preliminary analysis indicates that there is a mixed range of potential outcomes from the application of benchmarking outputs as a stretch target methodology. As well as indicating some potential areas of improvement, in some cases it indicates that targets may already be at the outer limit of what can be achieved in the expected timescales;**
 - (d) **it is TfL's view that benchmarking only provides one input to the financial planning process and it is not considered a reliable tool in isolation for the setting of targets. Benchmarking should however be**

used as part of a wider set of tools and methods, to help evaluate potential opportunities for greater efficiencies and for senior management to challenge the status quo; and

- (e) with the prospect of future spending reviews, TfL is continuing to explore further uses of benchmarking as part of the Business Planning process.**

3 Background

Benchmarking definition

- 3.1 The purpose of this paper is to summarise the benchmarking activity that TfL undertakes in identifying efficiencies and setting stretch targets. TfL has a dedicated Finance Benchmarking and Value Team within Rail and Underground (R&U). The best practices and processes used by this team are being rolled out into Surface Transport (ST) and Specialist Services.
- 3.2 Benchmarking can undertake a variety of different tools and methodologies, below details those that TfL uses:
 - (a) the data management and systems TfL uses to generate **comparable unit cost data** and analyse **trends** and how these have been used to better inform stakeholders about TfL's overall improvement programme; and
 - (b) the **results of international best practice benchmarking studies** with other transport providers, for example the Community of Metros (CoMET) or the International Bus Benchmarking Group (IBBG) and how these have been used to evaluate cost drivers and get better understanding of **different organisations**, providing practical ideas that have informed the development of improvement initiatives.
- 3.3 Results from any benchmarking study should never be viewed in isolation. Instead the results of the study should be viewed in the context of the measure and the peer group that is being selected. For example, station cleaning costs may be more expensive than a peer group of similar transport organisations. Reasons may include higher wages in London compared to Europe but may also include a business decision that the stations needed to be cleaned more frequently to ensure a better experience for the customer. Appendix 3 provides an overview of how some reference organisations approach target setting.

Business Planning and Efficiency Identification Process

- 3.4 Benchmarking has therefore actively informed each stage of the development of efficiency savings plans. However, it is not the only source of savings targets or ideas. For example:
 - (a) increased Board and management challenge of discretionary spend has resulted in fundamental changes in attitude towards budget setting for overheads (from printing to consultancy spend), resulting in significant budget reductions;
 - (b) the introduction of whole life decision-making for asset renewal ensures that the right volume of work is scheduled at the right time to meet the needs of

assets (as opposed to pre-set renewal cycles), so improving allocation of capital expenditure;

- (c) challenge to risk and contingency levels in capital projects and changes to the allocation of risk budget ownership has improved incentives to reduce overall investment budgets;
- (d) regular reviews by senior directors in operations and maintenance have directly led to the identification of efficiency savings opportunities, sometimes in excess of the Continuous Savings targets already set. For example, the introduction of the R&U Maintenance Capability programme will deliver a reduction in annual spend on maintenance of £95m (total savings £747m); and
- (e) there has also been greater focus on the active programme management of efficiency initiatives, to increase assurance of delivery.

4 Efficiency Savings and the Contribution from Benchmarking

- 4.1 In the paper submitted to the Committee on 14 October 2014, TfL showed that it is forecast to deliver efficiency savings of £16bn to the 2020/21 period. Of this forecast £12bn of this target has been secured with a further £4.0bn of initiatives requiring further management actions.
- 4.2 An analysis of the total efficiency programme database, see Appendices 1 and 2, has identified that benchmarking has been used for the primary basis of £1.7bn (or 11 per cent of the efficiency target over the 2009/10-20/21 Business Plan).

Benchmark activity	R&U Efficiency Savings	Surface Efficiency Savings	Total – Including Specialist Services
Unit Cost Comparison	£492m	£71m	£563m
Best Practice Studies	£751m	£414m	£1,165m
Total	£1,243m	£485m	£1,728m
Savings & Efficiencies Target	£8,105m	£3,790m	£15,561m
Benchmark activity as a percentage of target	15%	13%	11%

- 4.3 R&U benchmarking activity has directly contributed to 15 per cent of its savings target to 2020/21. This is in part due to the Benchmarking and Value Team in R&U which has been well established for the past four years. A list of R&U efficiencies savings can be found in Appendix 1.
- 4.4 With the increase in investment forecast over the upcoming Business Plan period to 2023/24, ST has started to invest more in the use of benchmarking and is working closely with the Benchmarking and Value Team to share best practices and knowledge. Currently, ST has been focused on best practice studies, for

example the savings achieved through the London Highway Agency Contract (LoHAC) used the best practice established for consultancy work in the Midlands Highway Alliance. Using this information TfL worked with borough partners to compare rates for consultancy services and work and then formed an alliance to obtain better value for both activities. A list of ST efficiencies can be found in Appendix 2.

4.5 TfL Specialist Services functions have used benchmarking studies, notably the Strategic Sourcing Review following Horizon; however the results from the study did not demonstrate significant benefits. For example, in Commercial the review looked at whether it was possible to outsource some activity. The benchmark study identified that TfL had very complex contract arrangements and it showed that nearly all of the comparator organisations had not outsourced these processes. Potentially, activity around simpler contracts could have been outsourced however it was decided that this would work against TfL and a decision was made not to pursue this further.

4.6 Other benchmarking of Specialist Services functions has been undertaken, most notably the Chartered Institute of Public Finance and Accountancy (CIPFA) Value for Money Benchmark club. TfL contributed information for the 2011/12 (pre-Horizon) report and 2013/14 report. The findings from these benchmark studies were used in part to inform the Ensuring Efficient and Effective Support Services (Post-implementation review of Project Horizon). While some of the metrics were useful, it was felt that the peer group did share enough characteristics with TfL to provide meaningful targets. The graph below shows that TfL's organisation running cost is by far the largest of the peer group.

Economies of Scale

The chart investigates the relationship between cost and size of the organisation. There is some indication that very small organisation tend to use a higher proportion of their resources on the Finance Function.

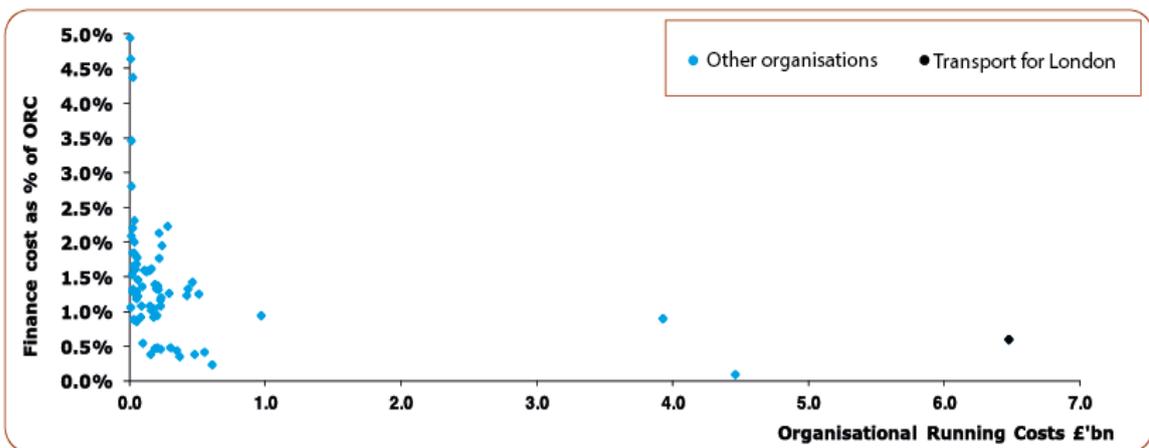


Figure 1: CIPFA peer group – Finance benchmark results

4.7 This reduces the impact of the metrics as the results will be skewed by simpler business demands at other organisations. Results from the CIPFA 2012/13 Finance benchmarking study can be found in Appendix 4.

5 Rail and Underground Efficiency Savings and the Contribution from Benchmarking

- 5.1 As discussed in the paper submitted to the Committee on 14 October 2014, R&U spends approximately £2.9bn per annum operating the railway (including Specialist Services overheads). These operating costs will increase to £3.2bn in 2020/21, including Crossrail services.
- 5.2 R&U is on target to deliver total cost reductions of £8.1bn (between 2009/10 and 2020/21, after deducting implementation costs). This is split between operating cost reductions (£5.8bn) and capital projects savings (£2.2bn).
- 5.3 Targets are disaggregated to individual directorates and progress against them is monitored periodically through scorecards and management reports.
- 5.4 An analysis of the efficiency programme, see Appendix 1, shows that benchmarking has been used as the primary basis for the creation of £1.2bn (or 15 per cent of the efficiency target over the 2009/10-2020/21 Business Plan). These efficiencies are spread across Chief Operating Office (COO) and Capital Programme Development (CPD), with £0.7bn already secured.

Benchmarking activity	Total
Unit cost comparisons	£492m
Best practice studies	£751m
Total	£1,243m

- 5.5 The connection between benchmarking and a line in the efficiency programme can be identified, for example where unit rates from external organisations have been gathered, analysed, and considered in the setting of targets. Of the £1.2bn, £492m have this direct link.

6 Surface Transport Efficiency Savings and the contribution from Benchmarking

- 6.1 As discussed in the paper submitted to the Committee on 14 October 2014, about 75 per cent of ST operating expenditure relates to Buses, where, on a unit cost basis, TfL is in the best quartile. The October paper also provided references to the fact that the vast majority of ST activity is commercially procured, giving assurance that prices have been regularly market tested. Initial analysis has identified that the £0.5bn of savings have been identified from a target of £3.8bn to 2020/21.

Benchmarking activity	Total
Unit cost comparisons	£71m
Best practice studies	£414m
Total	£485m

- 6.2 The strong performance in the largest area of ST's expenditure makes Bus benchmarking less useful a tool to explore saving ranges. Instead ST has primarily used other means to set savings targets and ideas. For example, seeing a range of costs across boroughs, LoHAC used combined purchasing power to deliver rates that are demonstrably lower than previous rates.
- 6.3 LoHAC is one of many examples where ST has secured savings where benchmarking has informed TfL's saving, but was not the original driver behind seeking a saving. Similarly, savings such as call centres for Cycle Hire, Energy Efficient Lighting and Traffic Control Maintenance and Related Services 2 (TCMS2) were informed by comparisons across existing operating areas or with technology that other cities were using, but the process of tendering and contractor engagement allowed us to deliver these savings.
- 6.4 It was recognised in the 14 October 2014 Committee paper, that with the greater Surface Investment Programme, ST is working closely with R&U to spread the best practices from R&U's capital benchmarking work, especially around repeatable work items (RWI) and broadening the range of capital expenditure that can be benchmarked.
- 6.5 ST is building on the strong practice in Buses, Asset Management Directorate (AMD) and in R&U to develop benchmarking work plans for each directorate to further improve our use of benchmarking as a tool to inform management decisions. Where appropriate this will inform further savings targets.

7 Specialist Services Efficiency Savings and the Contribution from Benchmarking

- 7.1 The Specialist Services functions have regularly participated in CIFPA's Value for Money benchmarking clubs. The results from these surveys have been used in conjunction with a Post-Implementation Review of Project Horizon and have helped to identify new opportunities for further efficiencies. Examples of recommendations include broadening the use of Financial Services Centre (FSC).
- 7.2 Several Specialist Services Functions, for example Commercial and HR, have decided to use specialist benchmarking organisations, for example The Hackett Group, to provide specific benchmark measures. These reports will typically use a broader peer group than CIFPA and are tailored more specifically to look at

driving more efficiencies and greater effectiveness. These benchmark studies are due to start in 2015.

8 Specific Examples of Benchmarking to Set Efficiencies and Challenge the Business

Signalling Asset Maintenance

- 8.1 Benchmarking of signalling maintenance costs has been carried out in depth during the past four years. There have been three phases of work:
- (a) comparison of maintenance regimes on different London Underground lines;
 - (b) a review of incident response organisation and costs; and
 - (c) a study of maintenance regimes for modern signalling systems in world-wide metros.
- 8.2 The objective of this phase was to identify best practice within London Underground and to identify achievable opportunities to improve performance and cost of asset maintenance.
- 8.3 London Underground has four different signalling systems in use. All maintenance work is carried out by TfL's direct labour organisation and the annual maintenance budget for signalling is around £0.4bn.
- 8.4 All signalling assets are subject to the same fundamental asset management standards. These allow for variation to meet the needs of each line or system type. Similarly, all lines are subject to the same performance regime, although actual performance varies by line.
- 8.5 A multi-disciplinary working group from the benchmarking, asset management and asset performance teams reviewed the maintenance plans and unit costs of signalling maintenance for each line. This review revealed a number of variations in the maintenance organisations on each line, the intervals between scheduled maintenance activities as well as unit costs. In 2010/11, the time of the study, unit costs varied between £60k and £130k per track kilometre, around an average of £80k per track kilometre.
- 8.6 Phase 1 prompted debate between asset managers and maintainers around the reasons for variations between lines. This enabled internal best practice to be shared more effectively and a greater degree of understanding has been achieved as a result. There is now a greater consistency of planned maintenance regimes across the lines and. The Phase 1 study findings initiated a number of changes:
- (a) routine change of relays: standard concessions were applied for signalling assets that were to be replaced as part of the capital upgrades programme on the sub-surface lines. This transferred good practice already in place on the Jubilee line, where the decision had been made to closely monitor non-compliant assets rather than replace them;

- (b) planned maintenance intervals: noting the lower planned maintenance frequencies on the Jubilee and Northern lines, applications were made for standard concessions to extend maintenance cycles on other lines;
- (c) the wide variation in line-based maintenance organisations prompted a second phase of analysis; and
- (d) also, in the spirit of continuous improvement and in response to the introduction of new technology, a third phase of work was commissioned to look at maintenance activities, organisations and costs in metros using the most modern technologies.

8.7 Internal analysis of the maintenance organisations showed a significant variation, particularly in the deployment of incident response teams. The variation was measured by the density of incident response depots per track kilometre as well as the number of staff per depot. The findings are shown in Figure 2 below.

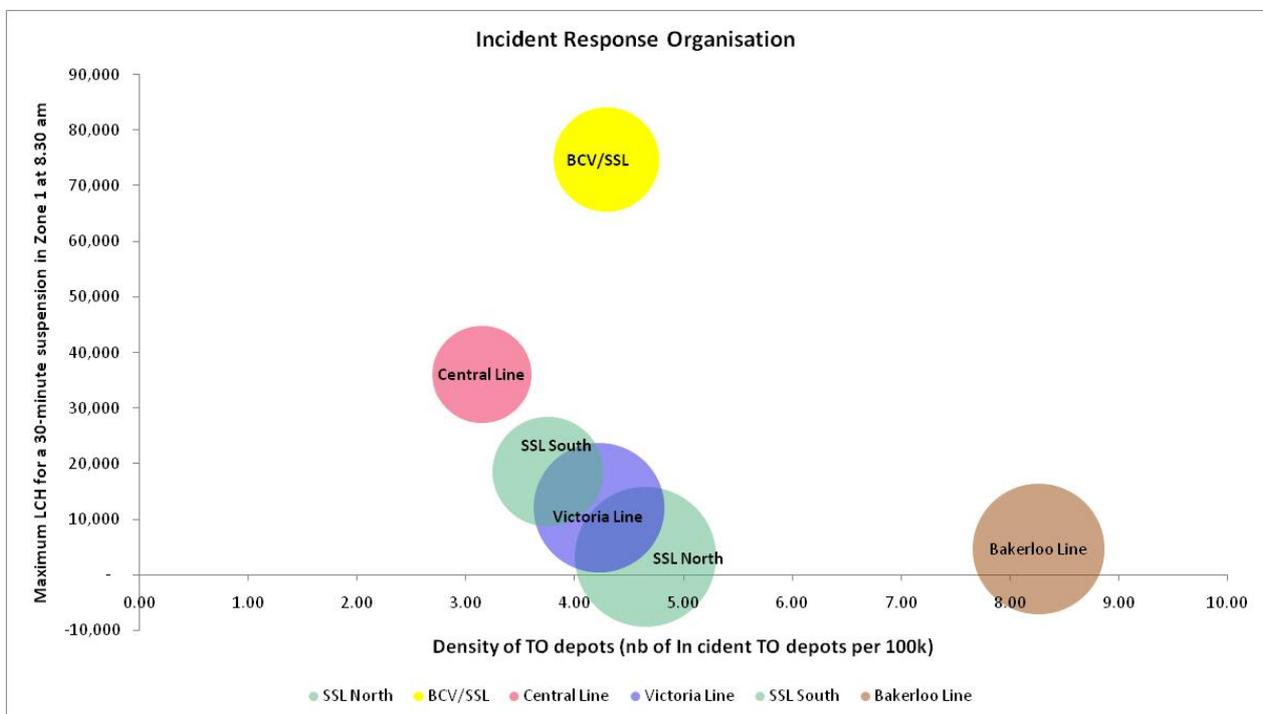


Figure 2: Comparison of maintenance organisations

- 8.8 This analysis prompted a further review of the allocation of response teams, targeting resource on most vulnerable areas and where customers would be most adversely affected.
- 8.9 London Underground expanded its benchmarking to external organisations, in particular international metros that faced similar challenges with the advent of modern Communication Based Train Control (CBTC) signalling systems.
- 8.10 Statistical analysis was not possible due to the relatively small number of participants in the study (10 metro lines). However, it was possible to identify the key cost drivers on signalling maintenance that are relevant when comparing London Underground to modern metros world-wide. Key findings from the study were:

- (a) signalling maintenance is labour intensive and wages of the host City are the most significant cost driver; average wages London-wide are up to two times higher than other metros;
- (b) metros that have built an incident response organisation to resolve signalling faults more swiftly have higher costs. London Underground's mean time to repair is, on average, eight minutes shorter than other metros studied;
- (c) lines with a higher density of lineside assets have higher maintenance costs. London Underground has developed a methodology for categorising the assets into a unit of measure called CBTC Equivalent Units (CEUs) to compare the trackside asset base of modern CBTC systems and to account for the varying complexities of different systems and lines;
- (d) the use of multi-skilled operational staff in responding to and resolving failures is a key contributing factor to reducing response times, particularly on automated lines; and
- (e) metros using predict and prevent and in particular remote condition monitoring technology have greatly reduced the number of signalling failures.

8.11 From the data collected, it was possible to derive an “international benchmark range” and to compare this to unit costs in London. The range is presented in Figure 3, below.

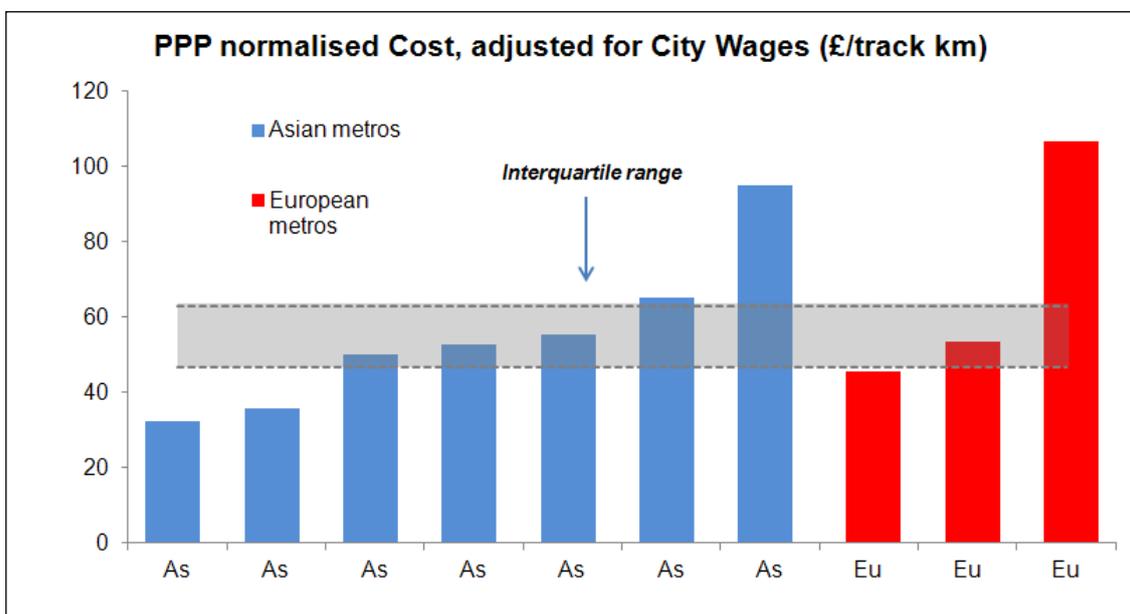


Figure 3: International benchmark range for signalling maintenance

8.12 These findings have enabled London Underground to develop a better understanding of cost drivers, informing its efficiency programme and ensuring that it delivers to levels that are comparable to the best internationally. In addition it provided real examples of best practice in areas of further opportunity such as remote condition monitoring and more generally predictive and preventative maintenance.

8.13 London Underground now has a full programme of efficiencies, including changes to maintenance regimes, revisions for legacy assets as well as the introduction of new, leaner maintenance regimes for the newly introduced technologies.

9 Scope for Using Benchmarking to Support Additional “Stretch” Targets

9.1 TfL’s own analysis shows that simple unit cost comparison does not tell the full story. Local factors such as city-wide wage levels, the age of assets, service quality commitments, electricity market prices, etc., vary between cities and these do significantly influence costs.

9.2 In 2012, TfL commissioned the Railway and Transport Strategy Centre (RTSC) at Imperial College to undertake more in-depth research to help TfL improve its understanding of the factors which impact most on London Underground’s costs. Using the rich data set gathered from over 20 metros internationally, RTSC’s research uses multivariate regression analysis to estimate the *expected costs* for the five main areas of metro operation – train and station services, rolling stock, infrastructure and station maintenance.

9.3 The preliminary findings compare London Underground’s actual costs (for 2012/13) with an “expected cost” derived from the statistical analysis. This comparison is summarised in the following graph.

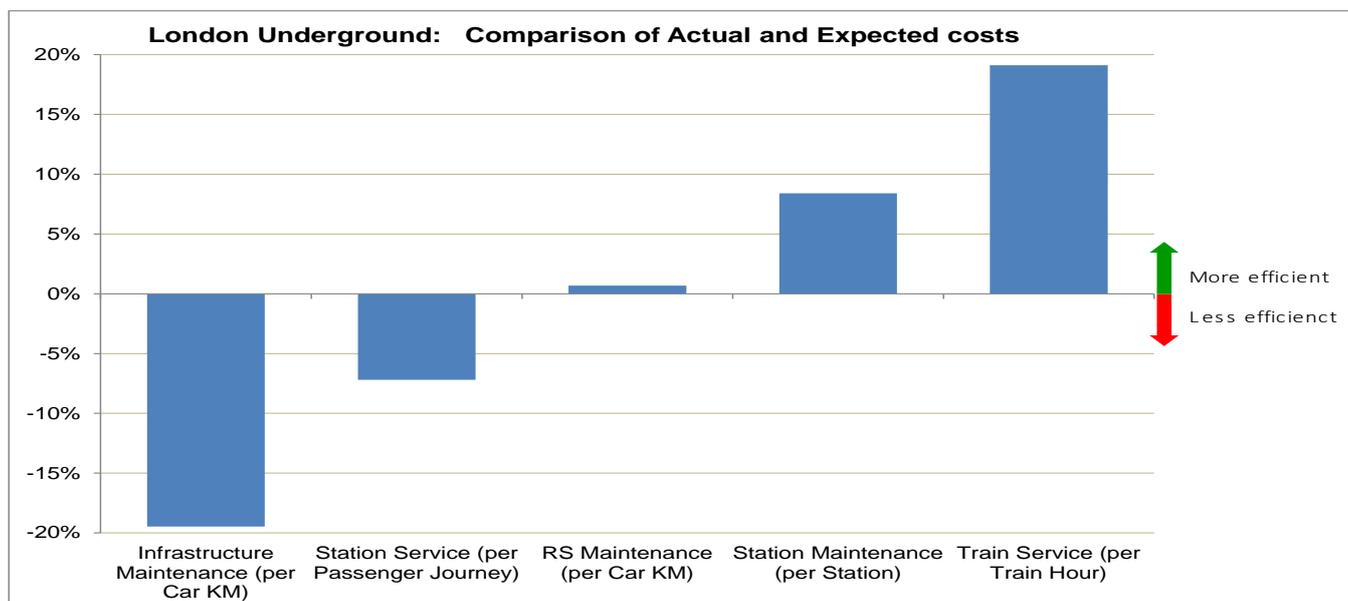


Figure 4 – Preliminary findings from RTSC cost efficiency research

9.4 If expected costs exceed actual costs, London Underground is more efficient, and vice versa. The graph above shows the relative efficiency as a percentage, where positive results indicate greater cost efficiency and negative results indicate inefficiency.

9.5 The example above provides a detailed example of the benchmarking used by the business to set efficiencies and effectively challenge the costs. Below provides TfL’s approach to benchmarking more widely.

9.6 TfL has now begun to assess whether this can be used to test future expenditure levels, following the delivery of existing efficiencies. The proposed approach is illustrated in the figure below.

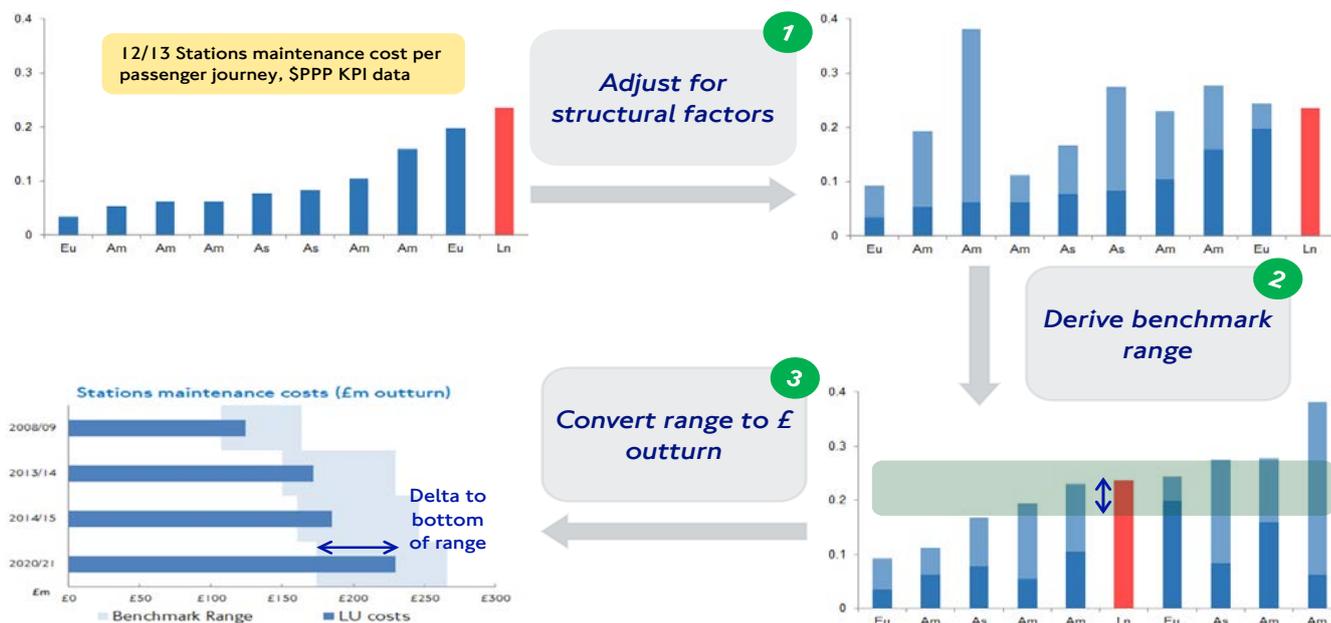


Figure 5: Proposed approach to using benchmarking

9.7 The example shown above is for stations maintenance costs. Starting with the KPI data from Imperial College, the unit costs are PPP normalised in constant 2012/13 prices. As shown from the top left graph, London Underground has the highest unit costs among this group of metros. The first step is to adjust these unit costs for London's structural factors, in this case staff wages and number of stations.

9.8 With a more comparable data set, it is possible to identify a benchmark range, excluding London Underground, for each of the areas. Outliers are also excluded to generate a reasonable benchmark range which is then converted to outturn prices and compared with the business plan for the area. In this example, current plans result in the area being in the middle of the range which may indicate a theoretical opportunity.

9.9 The preliminary analysis undertaken across operations areas indicates a mix of scenarios with some areas actually far below the range, therefore existing efficiency savings in these areas may be too aggressive, whilst in other areas there may be opportunity for greater savings.

9.10 While the ranges do inform and potentially could guide the setting of stretch targets, the relationship is not a mechanistic conversion. Internal research of the use of benchmarking in other industries and conversations with the Independent Investment Programme Advisory Group (IIPAG) confirm that benchmarking is not used in such a mechanistic way but as one input to consideration of future cost profiles.

9.11 R&U, of which London Underground covers the greatest operational spend, is therefore developing an approach to integrate this analysis into the next business

planning round, which will enable this work to be considered in the context of other performance targets and any risk of securing existing targets. Not all areas however, are suited to this approach and for these R&U is actively pursuing further benchmarks and application in alternative ways.

- 9.12 TfL is sharing these best practices with both ST and Specialist Services. ST's largest expenditure area, buses, has costs that compare favourably with peers and thus has less scope for benchmarking to drive a stretch target saving (although other savings have been embedded). Similarly LoHAC provides costs that improve on the previous costs paid by ST, hence more London boroughs joining the alliance. With this in mind, as ST expands benchmarking further, it will seek to understand the reasons behind any significant positive or negative divergence in performance or cost from peers and use comparable analysis as that performed to date on R&U costs to inform targets.
- 9.13 Specialist Services is starting to look at alternative benchmark organisations, which can provide more relevant peer groups, to identify not only cost efficiencies but also process effectiveness to set new stretch targets.

10 Conclusions

- 10.1 TfL is on target to deliver £16bn of efficiency savings by 20/21. So far £1.7bn of efficiencies, or 11 per cent, has been linked to benchmarking.
- 10.2 Top down application of benchmarking could, in theory, be used to explore the potential for stretch targets, however, benchmarking is not an exact science and cannot be used to directly extrapolate targets and the impact of structural factors unique to London must be adequately considered.
- 10.3 As stretch targets are identified, their deliverability would need to be carefully considered, in the light of the demands of the current plan and with consideration to the wider business needs and the potential risks of setting these targets. Going forward, TfL will continue to identify new efficiencies through the use of benchmarking, cost savings and improved operating processes to ensure targets are met.

List of appendices to this report:

Appendix 1: List of R&U efficiency initiatives influenced by recent benchmarking

Appendix 2: List of ST efficiency initiatives influenced by recent benchmarking

Appendix 3: A note on the use of benchmarking in setting targets – examples from other regulated infrastructure companies

Appendix 4: Results from the CIPFA benchmark for Finance

List of Background Papers:

Paper submitted to the Committee on 14 October 2014: Item 9 Benchmarking and Financial Planning at TfL

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Appendix 1

List of R&U efficiency initiatives influenced by recent benchmarking

Name of Saving	Category	Total 09/10 - 20/21
Fleet Shift Pattern Improvement Plan - already delivered	Unit Rates	4.4
Track & Signals Benchmark Improvement Plan - already delivered	Unit Rates	114.2
Track Visual Inspection Frequency to NWR (SSL)	Unit Rates	12.2
Better Collaboration / Standardisation with Network Rail	Best Practice	3.1
Maintenance unit rates	Unit Rates	142.8
Fleet Efficiency benchmarking Improvement Plan - already delivered	Unit Rates	40.1
Escalator Maintenance Strategy - savings from contracts	Unit Rates	14.3
Lift Maintenance Strategy – including savings from contracts	Best Practice	8.2
Lifts & Escalators Cleaning Strategy - Automatic Dust Tray Cleaners	Unit Rates	2.9
Escalator Maintenance Strategy - Part 2 savings from contracts	Unit Rates	19.1
Stations and Structures Maintenance suppliers	Unit Rates	101.9
Civils moving from NEC to performance based contracts	Unit Rates	14.4
Escalators Reduction of Dust Tray Cleaning Frequency	Unit Rates	3
Stations Cleaning contracts	Best Practice	2.6
Contractor improved staff utilisation	Unit Rates	1.7
Fit for the future stations	Best Practice	139.1
Unit rate improvements from supply chain	Best Practice	70.2
Savings from Future Track Contract	Best Practice	99.4
Savings from Existing Track contract	Best Practice	160.3
Pan TfL Escalator contract savings / cheaper compact escalators - Delivered Portion	Unit Rates	20.5
Pan TfL Lift contract savings - Delivered Portion	Best Practice	14.8
Possession and Lineside working	Best Practice	175.8
Track - Lower Unit rates achieved via internal teams rather than contractors	Best Practice	35.7
Station Stabilisation Programme – including contract savings	Best Practice	30
Track 20% productivity saving in future BTR works	Best Practice	7.5
Track 5% productivity saving in future deep tube renewals	Best Practice	4.4
Sub Total - Best Practice studies		751.1
Sub Total - Unit Rates		491.5
Total		1242.6

Appendix 2

List of ST efficiency initiatives influenced by recent benchmarking

Area	Description	Category	Total 09/10 - 20/21 (£m)
LoHAC	Savings from the London Highways Alliance Contract (LoHAC). Using best practice TfL pooled road renewal and maintenance activities with a growing group of London boroughs. Many activities rely on LoHAC for civil works so these savings are embedded across capital renewal, maintenance, tunnels & structures and minor civils	Best practice	266.6
Congestion Charging and Lower Emission Zone (LEZ)	The third letting of the London Road User Charging contract. A range of benchmarking including comparison of IM systems with industry best practice and contact centre appraisals through Customer Experience, Marketing & Communication (CEM&C). Savings comprised of	Best practice	<i>See below</i>
	Lower costs from latest Capita bid using benchmarking described above	Best practice	74.0
	Change to approach in second re-let using best practice asset refresh and cost assumptions	Best practice	17.4
	Use of latest industry standards in technology to reduce number of cameras required for number-plate recognition	Best practice	6.3
	Benchmarking exercise on camera data link contract	Best practice	0.3
	Other savings including lower support costs	Best practice	0.3
East Thames Buses	Disposal of East Thames Buses comparing our rates of required capital and operational income with that of commercial bus operators in London market	Unit cost	38.5
Policing	Savings from the cross-UK Winsor review of policing pay, which benchmarked pay and conditions for policing with other services	Unit cost	29.3
CCTV systems	A bottom-up review of expected CCTV maintenance costs given move to digital network in world market	Best practice	29.3
Cycle Hire	Cycle Hire Transformation programme includes a number of benchmarking activities, including call centre benchmarking (using comparison with London Rail User Charging and other CEM&C activities) and savings possible from maintenance systems available in market.	Best practice	13.0
	A/so: Additional savings from applying call centre best practice to existing contract	Best practice	4.6
Other	Electricity savings from switching to government procurement services who obtained better rates than previous TfL service	Unit cost	3.0
	Savings investing in TfL's Remedy System which provides lower costs for fault management than previous solution	Best practice	2.4
	Sub Total - Best Practice studies		414.2
	Sub Total - Unit Rates		70.8
	Total		485.0

A note on the use of benchmarking in setting targets –Examples from other regulated infrastructure companies

Benchmarking Studies

Other regulators use yardstick comparisons and benchmarking in privatised industries. The following table contains statements from a number of regulatory economists that the data is used to inform and guide the setting of targets, but the relationship is not a mechanistic conversion because that would present a risk of setting targets that are less than optimal and damage service levels.

Frontier Economics - RPI-X@20: The future role of benchmarking in regulatory reviews, Report for Ofgem, May 2010

[Frontier Economics'] view is that the greater risk to customers is in setting inappropriate targets at regulatory reviews rather than in failing to penalise inefficient performance ex post, especially when the attempt to penalise inefficiency may undermine incentives to innovate and deliver the wider set of outputs that is now required.

It would be unwise to establish a regime based on the benchmarking of plans alone. It is well understood that in a regulatory context there is an incentive to inflate plans. Benchmarking of plans alone is unlikely to mitigate that incentive. Ofgem should therefore seek to supplement its assessment of future plans with an assessment of historic cost, using the results as a way to challenge operator plans, rather than to determine allowances mechanistically.

CEPA, Background to work on assessing efficiency for the 2005 distribution price control review, Report for Ofgem, September 2003

Benchmarking is an important tool that can inform judgements about efficiency. However, it is only a tool and cannot substitute for judgements based on a wider range of evidence.

NERA Economic Consulting: Shuttleworth, Graham (2005). Benchmarking of electricity networks: Practical Problems with its use for regulation

As an interim step in an investigative procedure, benchmarking may help regulators to appraise large volumes of data on costs and outputs. However, benchmarking techniques are not robust and cannot replace detailed investigation of costs. Any attempt to rely entirely on benchmarking to set revenue allowances is bound to involve subjective and arbitrary choices. For the sake of transparency and stability in regulation, therefore, it will be necessary to regard benchmarking as an investigative technique, not an alternative method of setting revenues.

OXERA (2009). Recommendations on how to model efficiency for future price reviews. Prepared for ORR.

It is not just a simple case of combining DEA, semi-parametric regression, SFA and COLS results in a mechanistic way to arrive at final estimates of efficiency... where there are significant differences in the results, these should be investigated and

understood.

Dassler, Thoralf; Parker, David and Saal, David S. (2006). Methods and trends of performance benchmarking in UK utility regulation. Utilities Policy, 14 (3), pp. 166-174.

We find that benchmarking plays only one part and sometimes a small part in the setting of regulatory price caps in the UK. We also find that in practice benchmarking has been subject to a number of difficulties, which mean that it is never likely to be more than one tool in the regulator's armoury. The UK's experience provides lessons for regulation internationally.

Realising the Potential of GB Rail (2011) [McNulty Report], p45.

It must be emphasised that estimates of cost savings eight years out, which could result from initiatives not yet adopted, are highly uncertain. They should not be regarded as firm projections.

Public Sector Corporate Services VfM Indicators

Finance

2012/13

Transport for London

compared with

With Other Central Government Departments

*Computed and printed by:
CIPFA Business Ltd
3 Robert St, London, WC2N 6RL
Tel: 020 3117 1840*

Preface

The UK Audit Agencies (Audit Commission, NAO, Audit Wales, Audit Scotland and Northern Ireland Audit Office) combined together to develop a set of indicators to measure the value for money of support services across the public sector. KPMG, with CIPFA as a partner, was appointed to undertake the research and development work and the Audit Agencies published their report in May 2007.

The functions covered by the VfM indicators (Communications, Finance, HR, ICT, Legal, Estates Management and Procurement) have been identified by the Government as a priority area for securing efficiency improvements and releasing resources for use in delivering front-line services. Although the Audit Agencies were keen for public sector bodies to use the indicators, they decided not to offer a benchmarking service themselves. CIPFA has therefore undertaken to provide this service to the public sector.

I hope that you find the enclosed information useful, and more importantly that you use it in the spirit in which it is intended; this is a tool to help you take a view on the value for money provided by your corporate support services, and provide some pointers as to how they might improve.

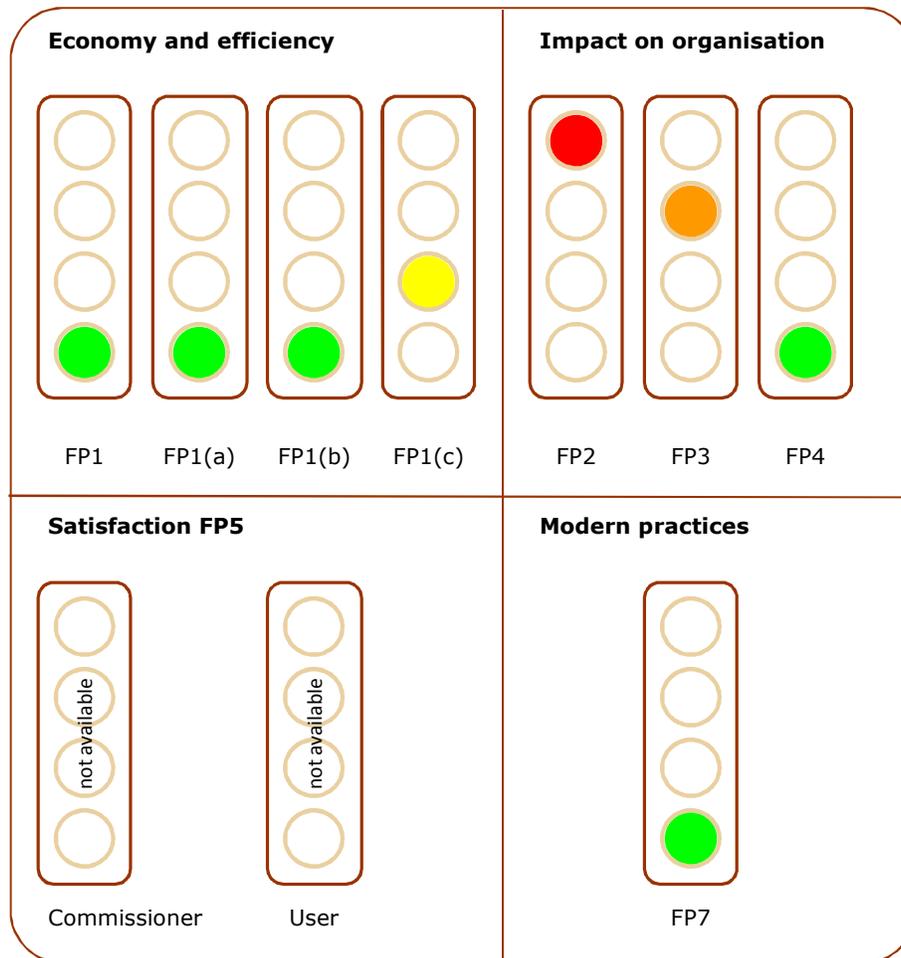
CIPFA would be more than happy to come and discuss with you potential opportunities for you to improve your services, building on the information in this report. Please do not hesitate to give John Wallace a call (0207 543 5600) if you would like to discuss this or any other matters further.

John Parsons
Benchmarking Manager

RESULTS ON ONE PAGE

Transport for London

The Audit Agencies developed an approach to considering Value for Money for Corporate Services which had four dimensions. The overall results are shown below:



Notes:

- a green light indicates performance in the best quartile; a yellow light indicates performance between the median and best quartile; an amber light indicates performance between the median and worst quartile and a red light indicates performance in the worst quartile
- for the purposes of this report, high cost and low productivity are considered poor. However, we accept this is a generalisation and that in some circumstances organisations can choose to invest more in functions because they have under invested in the past or because they want to place particular emphasis on a function
- full descriptions of the indicators are shown in the remainder of this report
- the FP7 indicator shown for modern practices was optional for organisations using the CIPFA Financial Management Model

Section 1 - ECONOMY AND EFFICIENCY

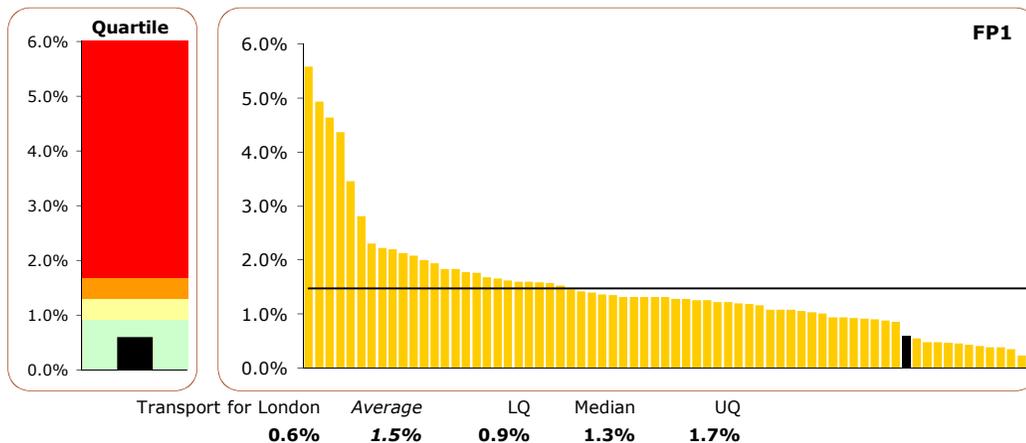
FP 1 Cost of the Finance function

Rationale and expected impact on behaviour

A standard and commonly used indicator that seeks to establish whether the costs of running the finance function are in proportion to the resources that are being managed. Measurement of the total cost of the finance function as a percentage of overall spend allows management to monitor closely the finance cost of their organisation and could be used to track trends across any given time-frame. Measurement of the cost of transaction processing and business decision support enables organisations to understand the resources devoted by finance on 'value added' activities as a proportion of finance cost.

Over time, organisations should expect to reduce expenditure on transaction processing as a percentage of the total cost of the finance function. Similarly they should expect to increase the percentage of the total cost of the finance function spent on business decision support.

FP1 Finance function cost as % of organisational running costs



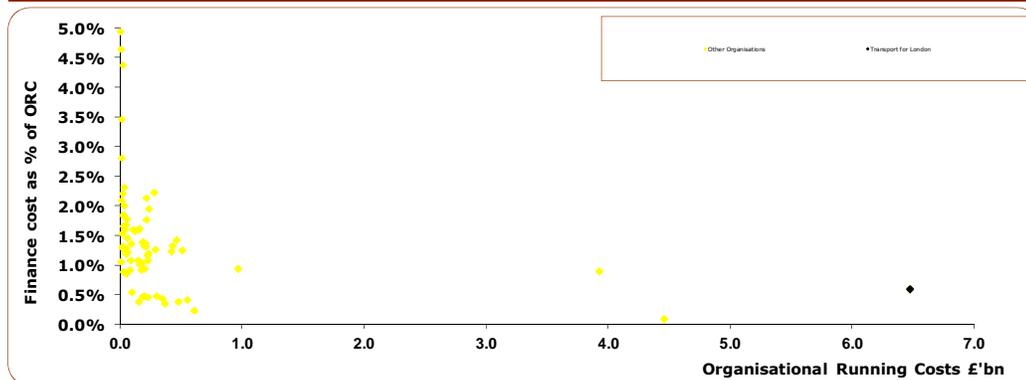
Cost of Difference

This shows the monetary value represented by the difference in percentage from the median (and lower quartile). Favourable variances are shown as negative figures.

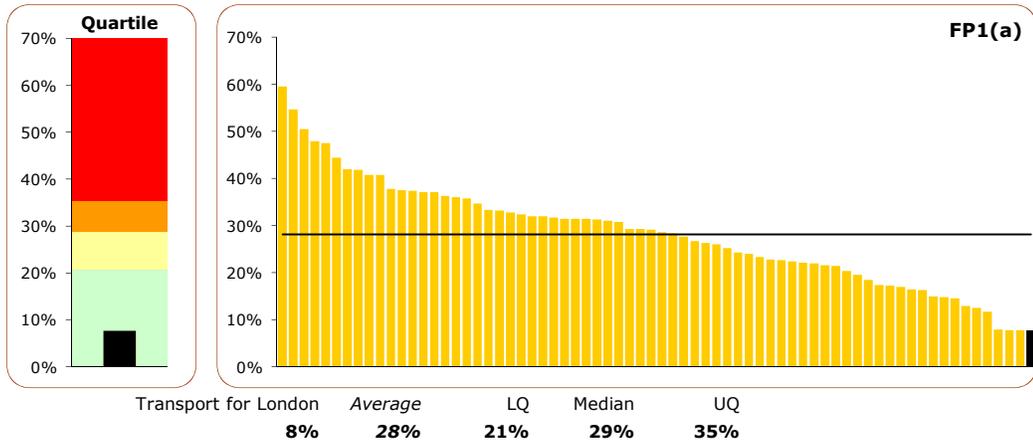
From median (£'000) **-£45,300** From lower quartile (£'000) **-£21,204**

Economies of Scale

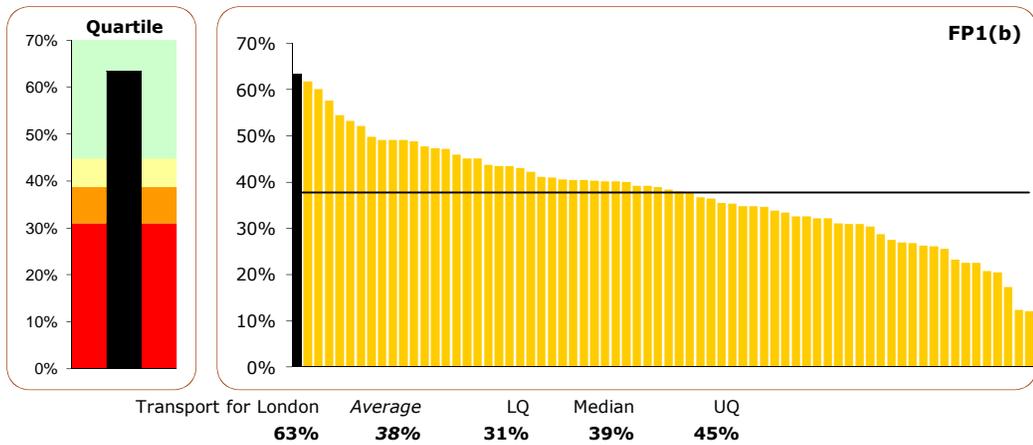
This chart investigates the relationship between cost and size of the organisation. There is some indication that very small organisations tend to use a higher proportion of their resources on the Finance function.



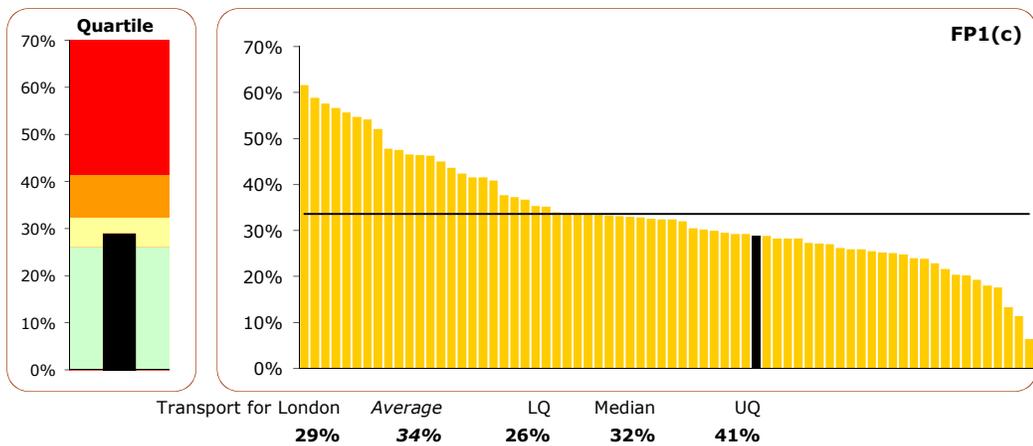
FP1(a) Transaction processing cost as a percentage of finance function costs



FP1(b) Business decision support cost as a percentage of finance function costs



FP1(c) Cost of reporting and control as a proportion of finance function costs



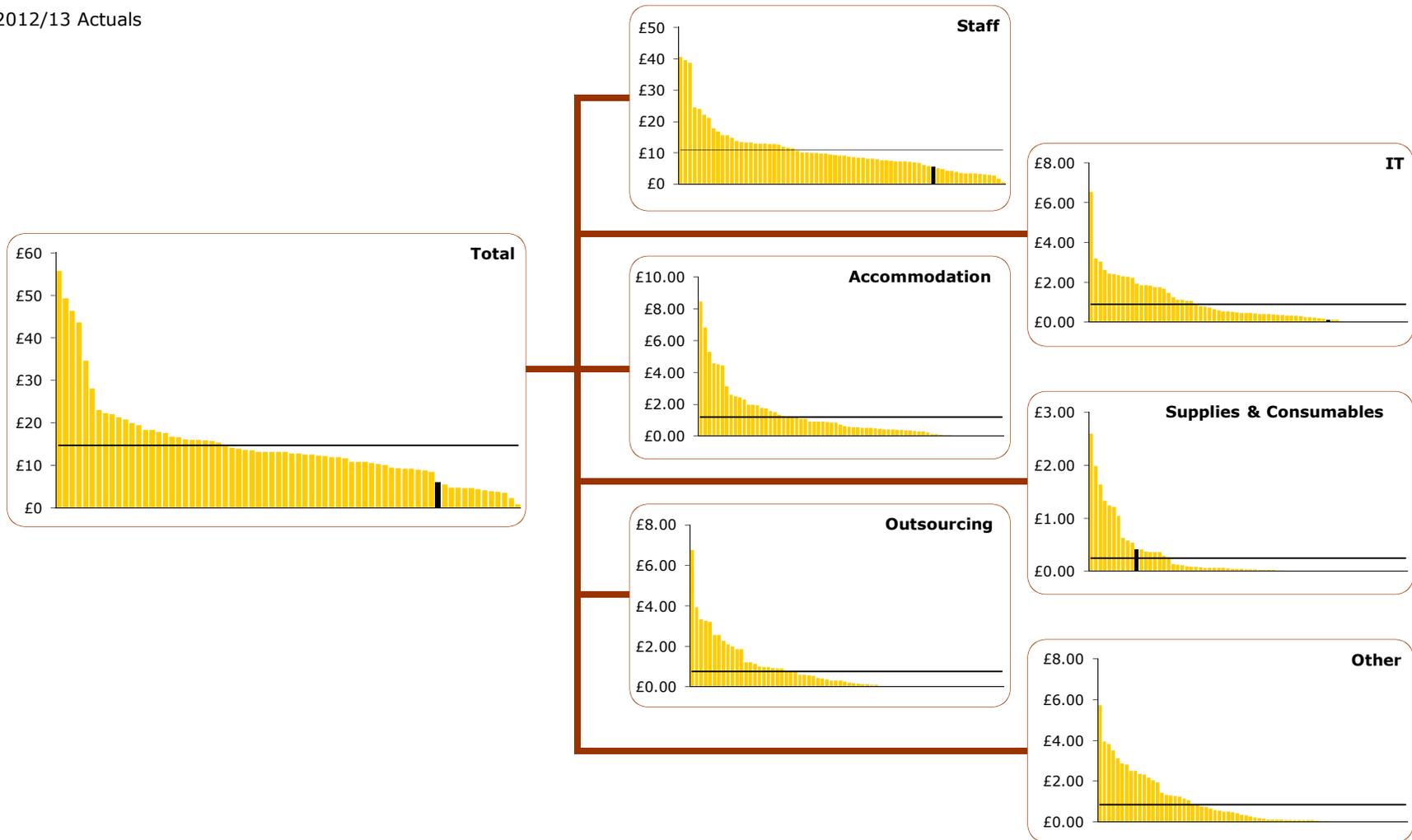
Finance cost/£'000 Organisation running costs 2012/13

For each benchmark two figures are given, the first being the organisation's cost and the second (in italics) is the group average.

Total Cost £5.96 £14.76	Staff £5.42 £10.80	<table border="1"> <thead> <tr> <th colspan="2">Costs 2012/13 (£'000)</th> </tr> </thead> <tbody> <tr> <td>Staff</td> <td style="text-align: right;">35,140</td> </tr> <tr> <td>IT</td> <td style="text-align: right;">738</td> </tr> <tr> <td>Accommodation</td> <td style="text-align: right;">37</td> </tr> <tr> <td>Supplies & Consumables</td> <td style="text-align: right;">2,663</td> </tr> <tr> <td>Outsourcing</td> <td style="text-align: right;">-</td> </tr> <tr> <td>Other</td> <td style="text-align: right;">36</td> </tr> <tr> <td>Total</td> <td style="text-align: right;">38,614</td> </tr> <tr> <td colspan="2" style="background-color: #f2f2f2;"> Organisational running costs </td> </tr> <tr> <td></td> <td style="text-align: right;">6,478,900</td> </tr> </tbody> </table>	Costs 2012/13 (£'000)		Staff	35,140	IT	738	Accommodation	37	Supplies & Consumables	2,663	Outsourcing	-	Other	36	Total	38,614	Organisational running costs			6,478,900
	Costs 2012/13 (£'000)																					
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Outsourcing £0.00 £0.76																						
Other £0.01 £0.86																						

Finance Cost per £'000 Organisational running costs

2012/13 Actuals



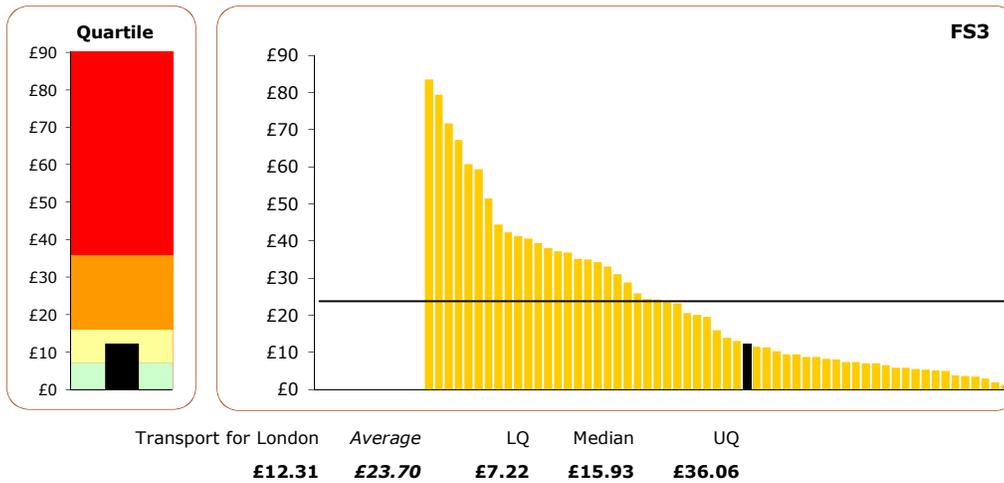
Secondary Indicators

FS3 Cost of Customer Invoicing function per customer invoice

Rationale and expected impact on behaviour

A standard and commonly used indicator that examines the efficiency of the invoicing function by identifying the cost of raising each customer invoice. Organisations should interpret achievement against this indicator alongside secondary indicators 5 (credit notes as a percentage of invoices raised) and 6 (cost of Accounts Payable per invoice processed).

In most cases organisations should aim for a period-on-period reduction in the average cost of invoice processing. This indicator could additionally suggest the minimum value for which an invoice should be raised.

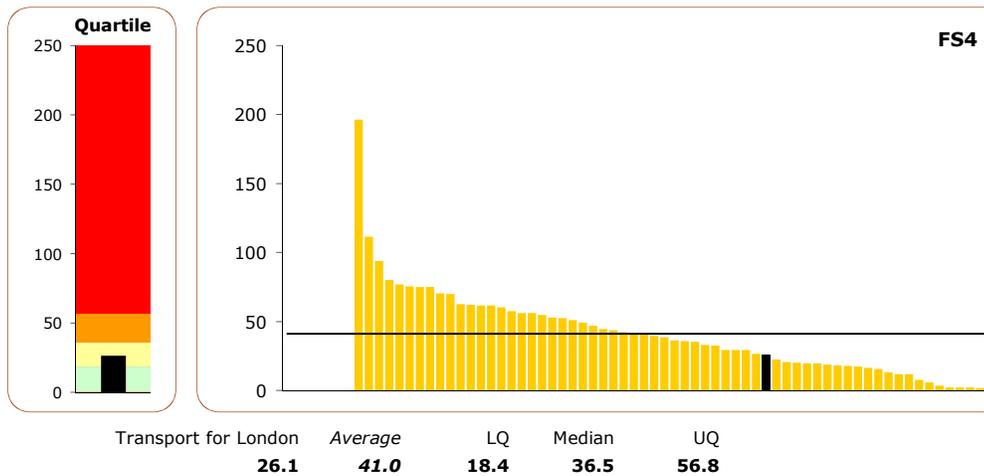


FS4 Debtor days

Rationale and expected impact on behaviour

A standard and commonly used indicator that identifies the average number of days for the organisation to receive payment for its invoices.

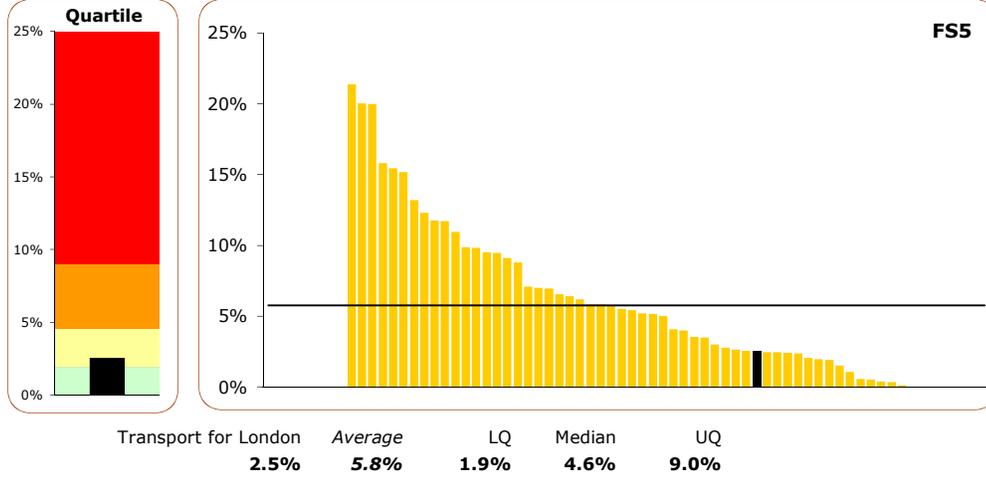
Organisations should aim to achieve a period-on-period reduction in average debtor days.



FS5 Credit notes as a % total customer invoices raised

Rationale and expected impact on behaviour

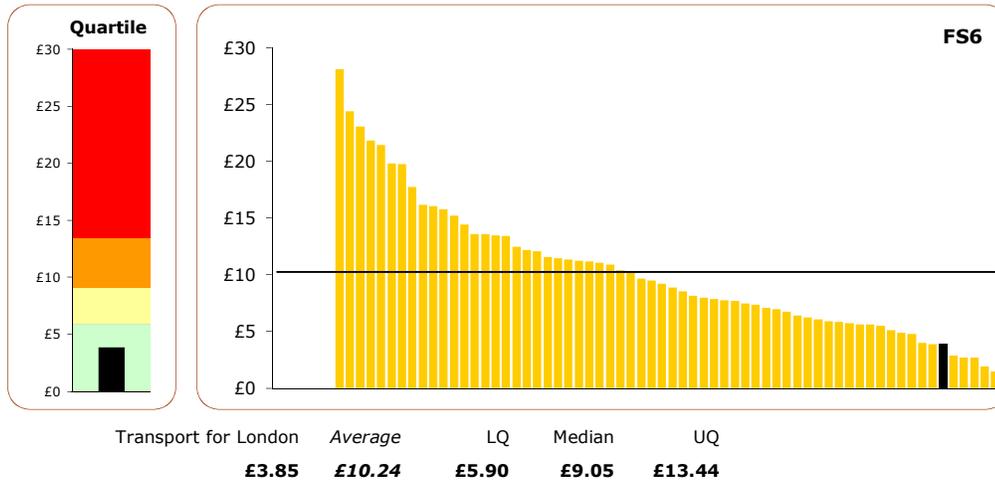
This indicator examines the accuracy of invoices raised by reviewing the number of credit notes required to make adjustments to invoices previously raised. Organisations should aim to achieve a period-on-period reduction in the percentage achieved for this indicator. Organisations should interpret achievement against this indicator alongside secondary indicators 3 (cost per customer invoice processed) and 6 (cost of Accounts Payable per invoice processed). (Note: The indicator is being used as a proxy for accuracy although it is recognised that organisations may use other mechanisms to make adjustments).



FS6 Cost of Accounts Payable per accounts payable invoice processed

Rationale and expected impact on behaviour

A standard and commonly used indicator identifying the cost of processing each supplier invoice. Organisations should aim to achieve a period-on-period reduction in the cost achieved for this indicator. Organisations should interpret achievement against this indicator alongside secondary indicators 3 (cost per invoice raised) and 5 (credit notes as a percentage of invoices raised).

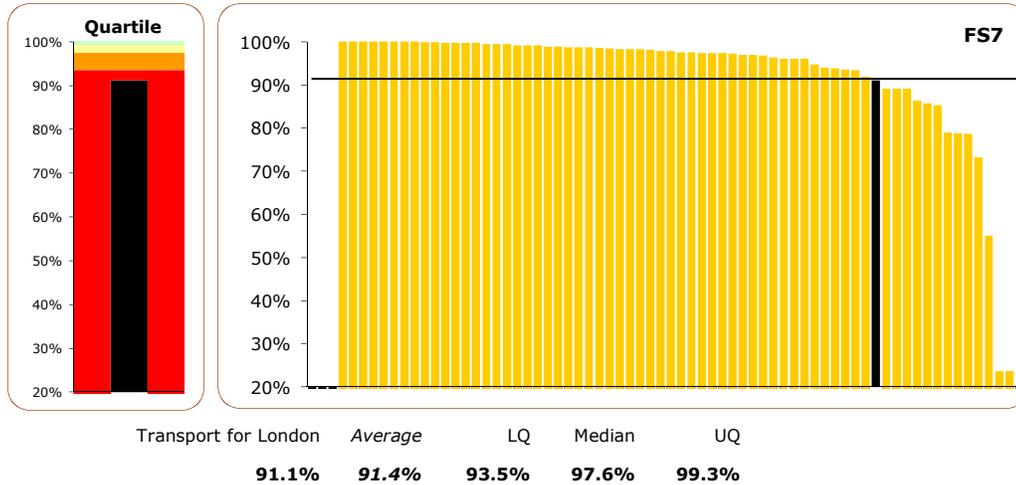


FS7 % payments made by electronic means

Rationale and expected impact on behaviour

This indicator identifies the proportion of all payments made electronically, particularly with respect to BACS and Rft1, since these methods usually offer the most effective savings of time and cost compared with manual payment systems.

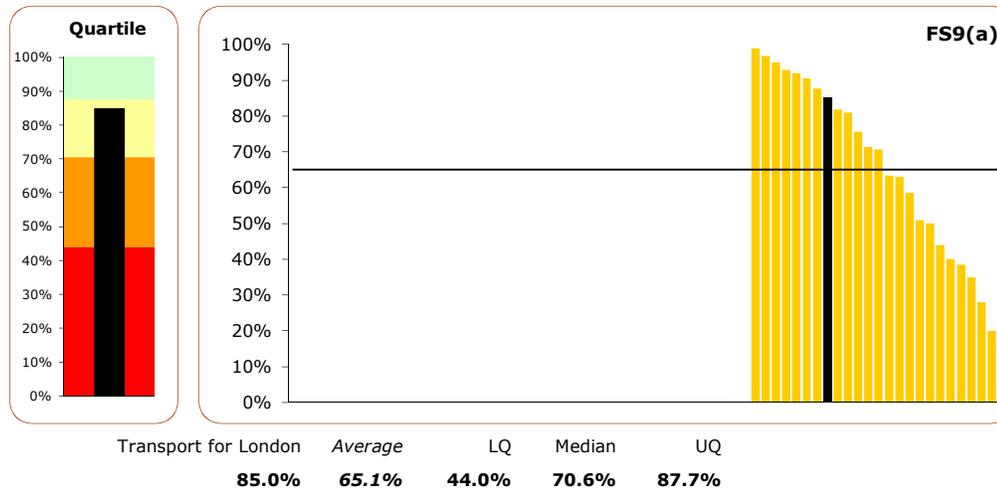
In most cases organisations would seek to achieve a period-on-period increase in the proportion of payments made electronically.



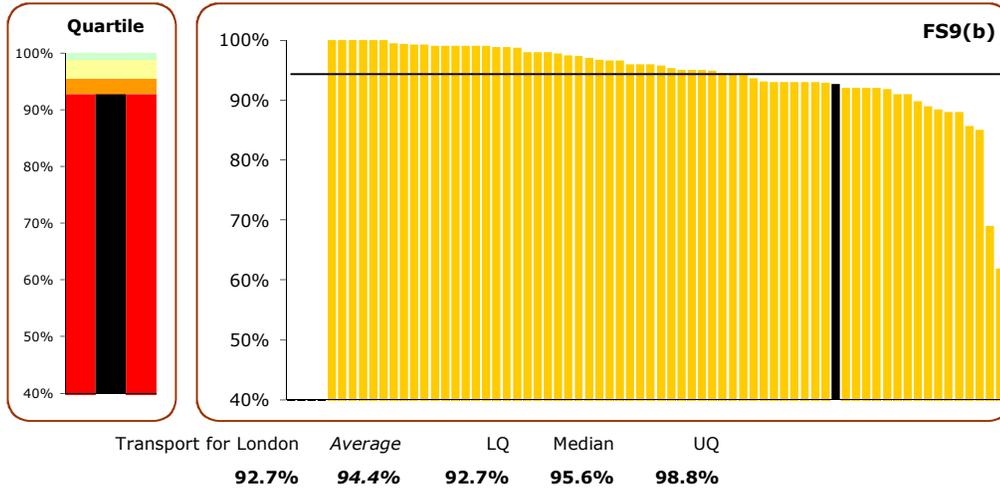
FS9(a) % invoices for commercial goods & services paid by the organisation within 10 days of receipt

Rationale and expected impact on behaviour

A standard and commonly used indicator that identifies the proportion of invoices that an organisation pays within 10 days and 30 days or within the agreed payment terms. To encourage prompt payment of invoices received. Performance should be within the appropriate prompt payment requirements.

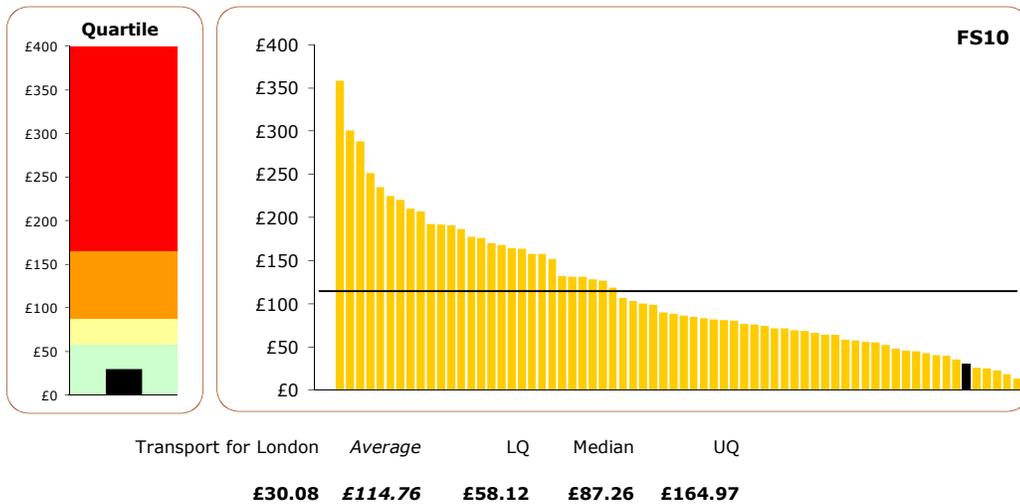


FS9(b) % invoices for commercial goods & services paid by the organisation within 30 days of receipt or within the agreed payment terms



FS10 Payroll admin cost per employee paid

Rationale and expected impact on behaviour
 A standard and commonly used indicator that seeks to establish the cost of paying one single employee as an indicator of the cost effectiveness of the payroll function.
 In most cases organisations should aim for a period-on-period reduction in the average cost.
 (Note: This function may be a responsibility of HR in some organisations. In these instances the indicator should accordingly be completed by HR)



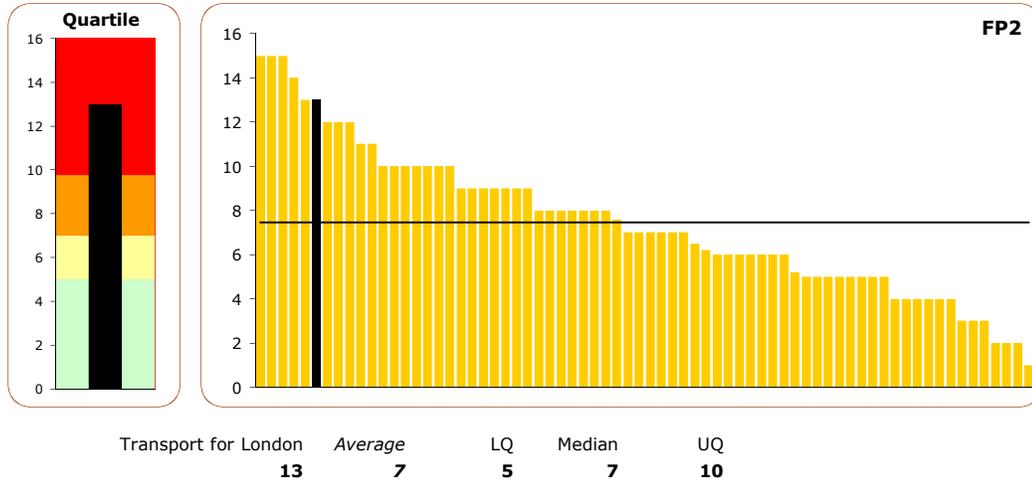
Section 2 - IMPACT

FP2 Days from period-end closure to distribution of routine financial reports to budget managers and overseeing boards and committees

Rationale and expected impact on behaviour

This indicator measures the typical number of days it takes the finance department to produce management information and so identifies the extent to which budget managers, and overseeing boards and committees, can take timely financial decisions based on up to date financial information.

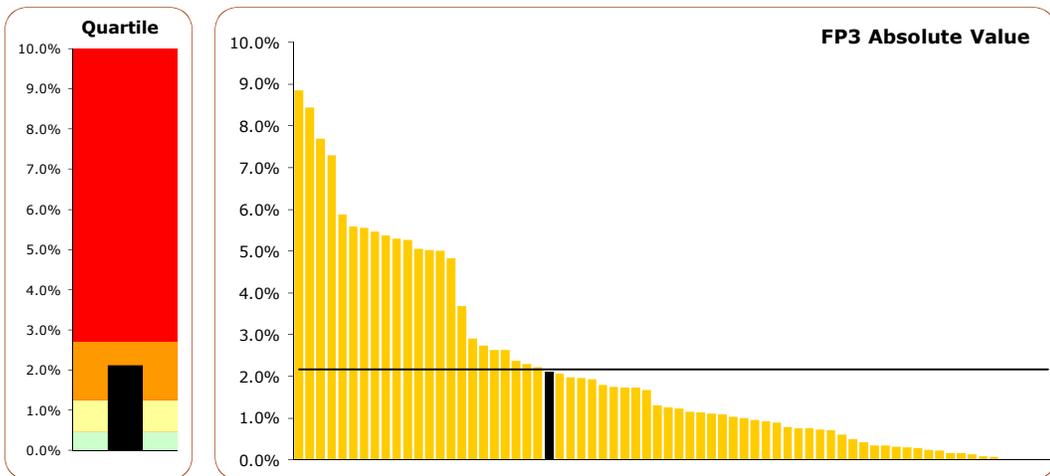
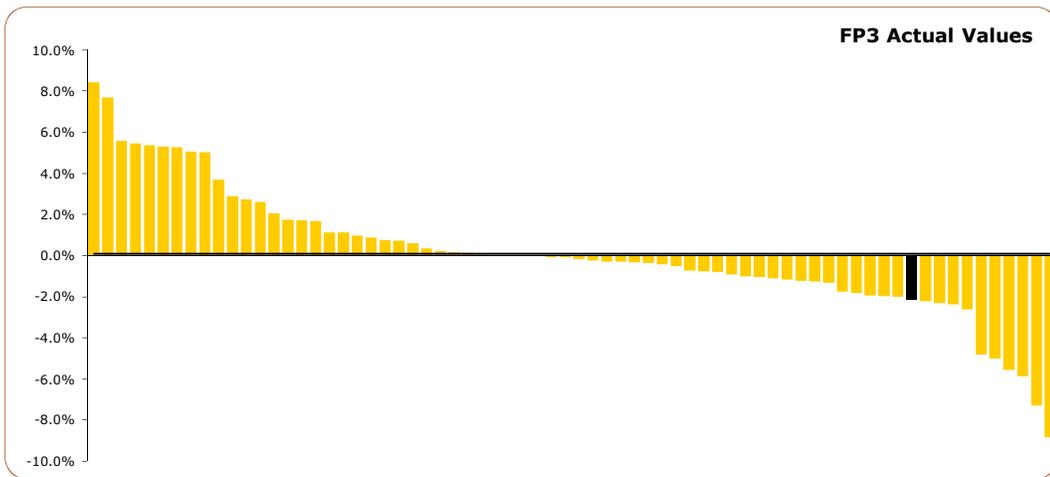
In most circumstances organisations should aim to reduce the number of working days to produce financial reports. Organisations should interpret their achievement against this indicator in conjunction with the response to the commissioner statement 'The financial information provided for financial planning and management is accurate, timely and easy to access' (contained in primary indicator 5) and secondary indicator 2(b) (which asks whether the year-end accounts were qualified by external audit).



FP3 % variation between forecast outturn at month 6 and the actual outturn at month 12

Rationale and expected impact on behaviour

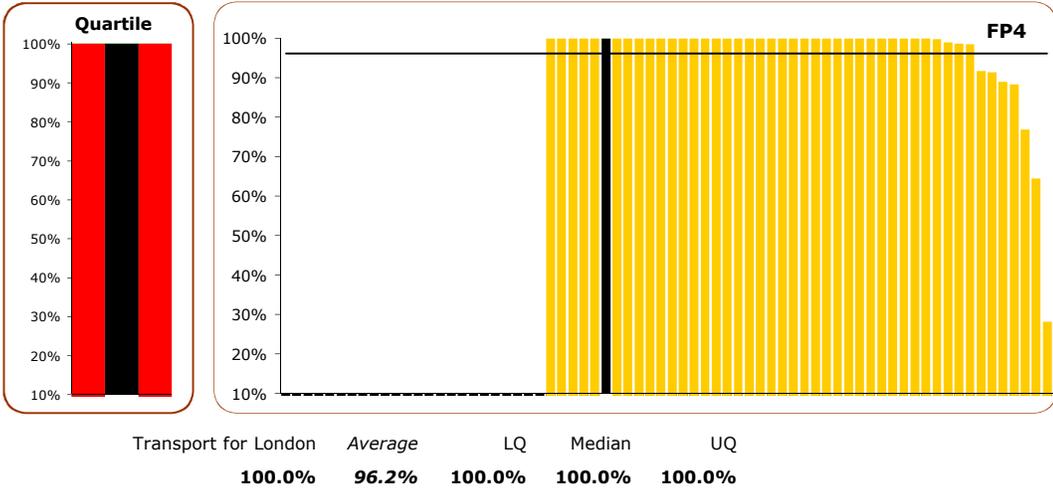
This indicator assesses the accuracy of forecasting. Organisations should aim to reduce the level of variation between their month 6 forecast and the year-end outturn by improving forecasting and budgetary control.



Transport for London	Average	LQ	Median	UQ
2.1%	2.2%	0.4%	1.2%	2.7%

FP4 % public sector organisation spend for which there are fully costed outputs which are measured by key performance metrics and for which a named individual is accountable

Rationale and expected impact on behaviour
 High performing organisations are likely to ensure that the totality of their spend is allocated against outputs, supported by key metrics which measure performance with clear lines of accountability. Over time, organisations should aim to increase the percentage of their spend that meets the criteria of this indicator.



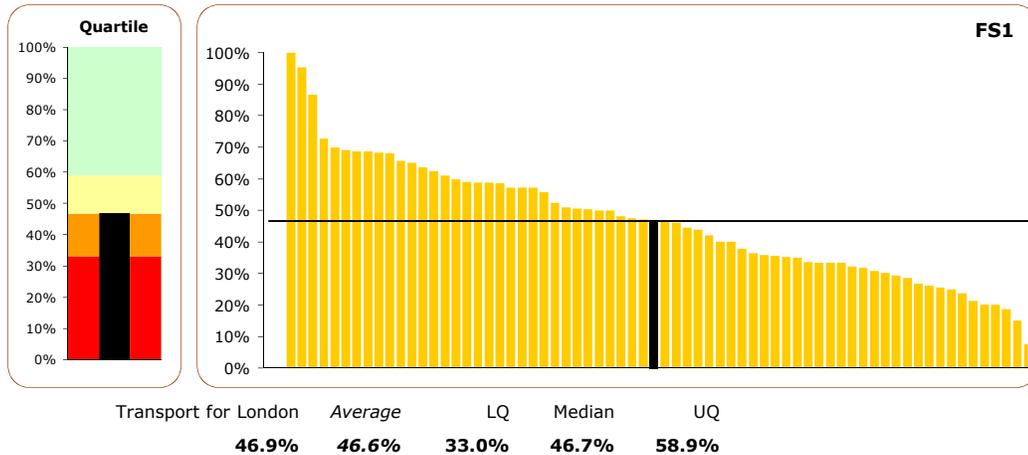
Secondary Indicators

FS1 Professionally qualified finance staff as % total finance staff (FTEs) undertaking reporting, controls and decision support processes (i.e. excludes those staff involved in transactional processes)

Rationale and expected impact on behaviour

This indicator assesses the capacity and competency of the finance department by examining the proportion of staff with a professional accountancy qualification.

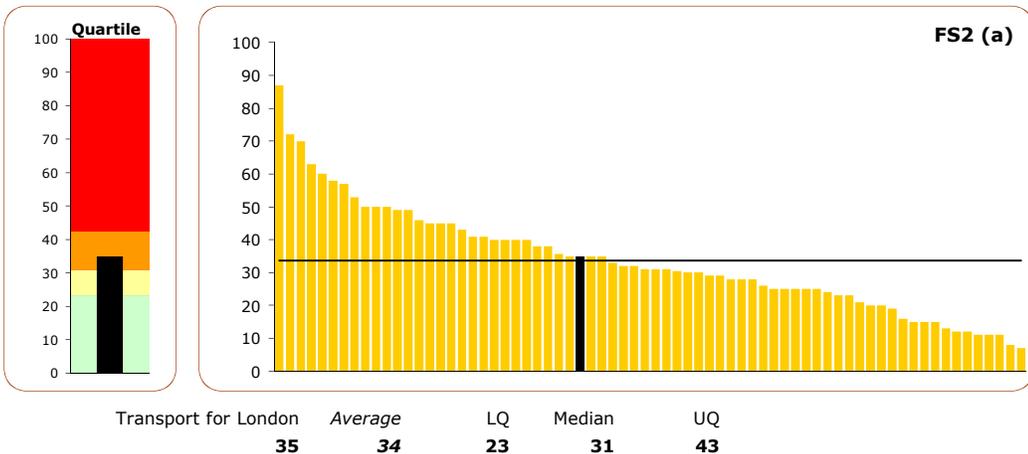
In most cases organisations would aim for a period-on-period increase in this percentage. Organisations should interpret their achievement against this indicator alongside primary indicator 5 (the commissioner and user satisfaction index) and secondary indicator 2 (the length of time necessary to produce year-end accounts and whether those accounts required qualification).



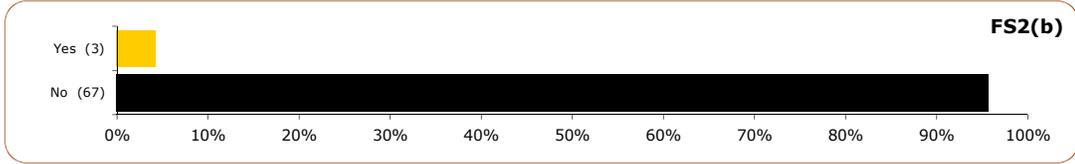
FS2 (a) Days from date of year-end to submission of annual accounts for audit

Rationale and expected impact on behaviour

This indicator examines the effectiveness of the finance function by assessing their ability to produce a timely and accurate set of annual accounts. Date of year-end to submission of annual accounts for audit varies both across organisations and sectors. It will be appropriate to compare with similar type organisations. In most circumstances organisations should aim to both reduce the number of days taken to prepare their year-end accounts and ensure that they do not require external qualification.

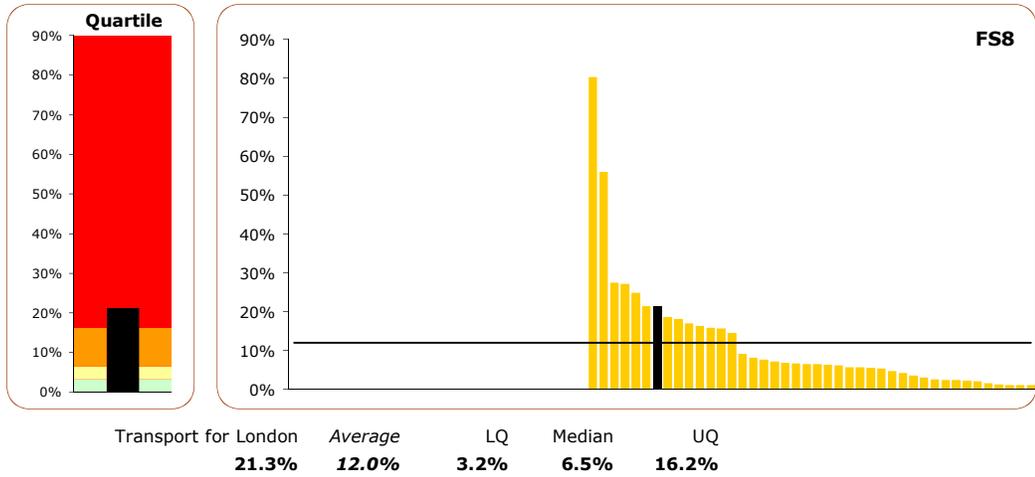


FS2(b) Was the last set of accounts qualified by external audit?



FS8 % outstanding debt that is more than 90 days old from date of invoice

Rationale and expected impact on behaviour
 This indicator examines the ability of the finance department to recover outstanding debts from customers. We have adopted the commonly used 90-day credit period as the basis for the indicator. Organisations should aim to achieve a period-on-period reduction in the proportion achieved for this indicator. This indicator should be used in tandem with Secondary Indicator 4.



Section 3 - SATISFACTION

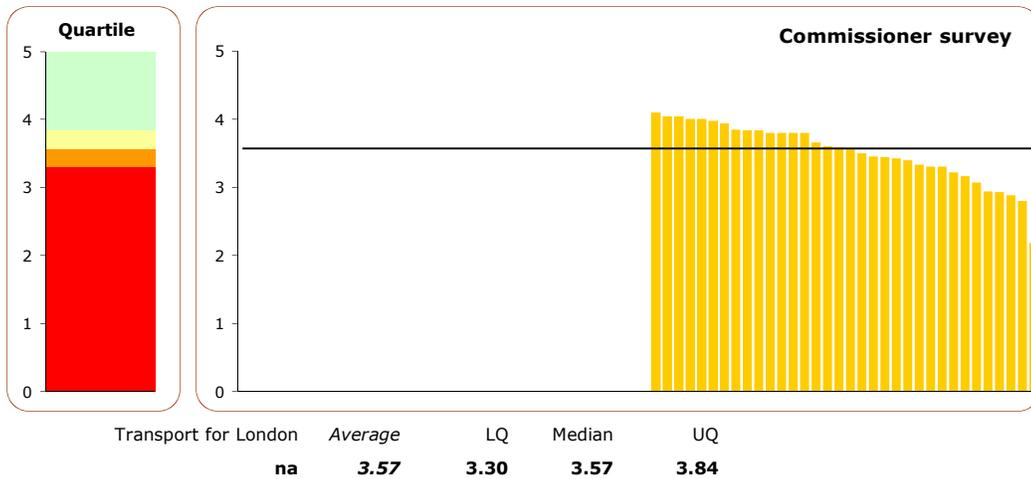
Rationale and expected impact on behaviour

This indicator examines the effectiveness of the finance function by assessing the perceptions of its commissioners and users. The indicators have been identified because they are considered to indicate whether the function communicates effectively with its commissioners and users, and is responsive to the requirements of the organisation.

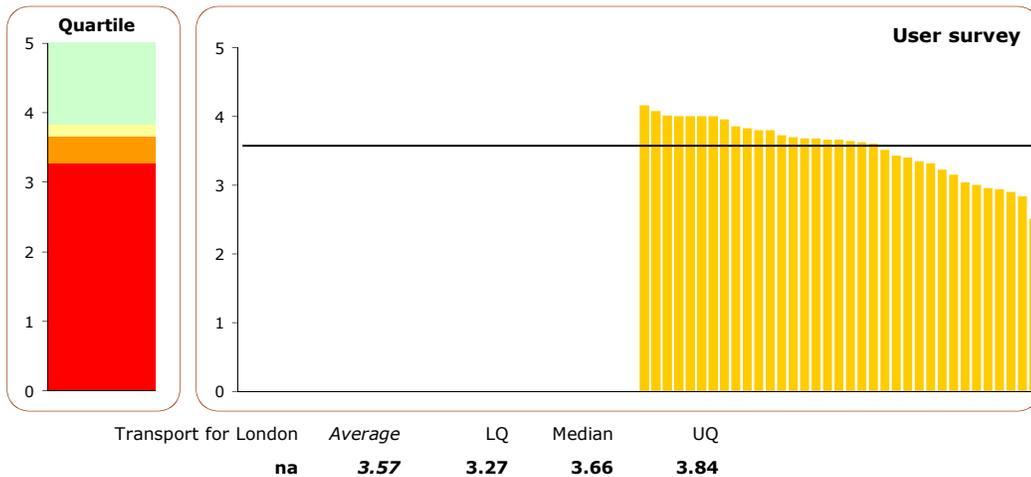
Over time, organisations should seek to increase the proportion of commissioners and users agreeing with the statements.

Please note if you are using the online surveys we will complete this section for the final reports.

FP5(a) Commissioner satisfaction average score



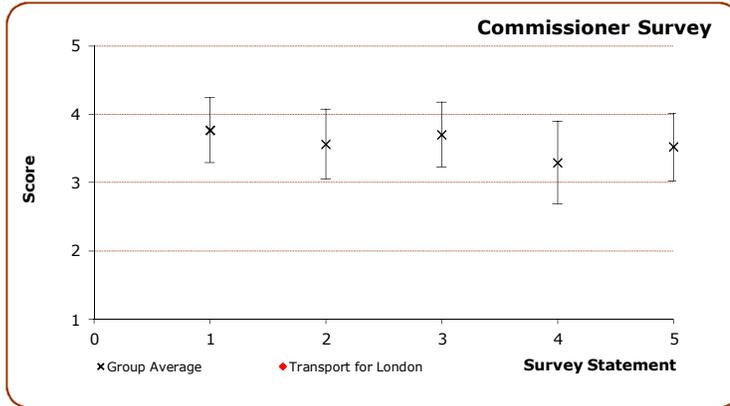
FP5(b) User satisfaction average score



Analysis of individual statement scores

These charts show the average performance scores for all participants as black x's. The black error bars show one standard deviation either side of the mean. Approximately 65 - 70% of the organisations will fall within this range. The red diamond is the average score for your organisation.

Commissioner Survey



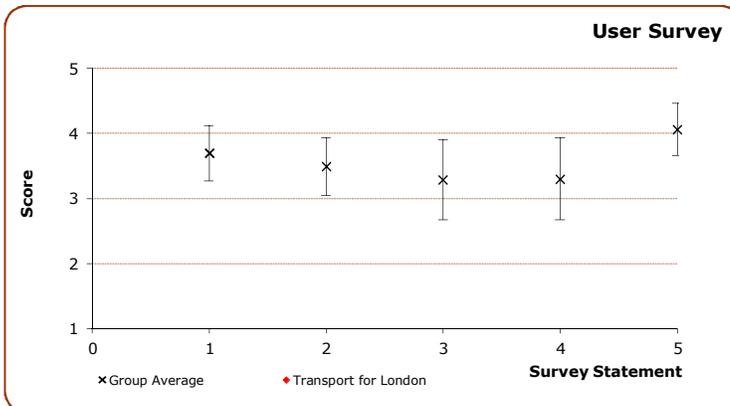
Scores

- 5 Strongly Agree
- 4 Agree
- 3 Neither
- 2 Disagree
- 1 Strongly Disagree

Survey Statements

- The Finance function supports the financial implications of the organisation's strategy, policy and delivery discussions by providing effective support and challenge.
- The financial information provided for financial planning and management is accurate, timely and easy to access.
- The organisation's financial systems are secure and efficient.
- The Finance function proactively anticipates my needs.
- The Finance function provides value for money.

User Survey



Scores

- 5 Strongly Agree
- 4 Agree
- 3 Neither
- 2 Disagree
- 1 Strongly Disagree

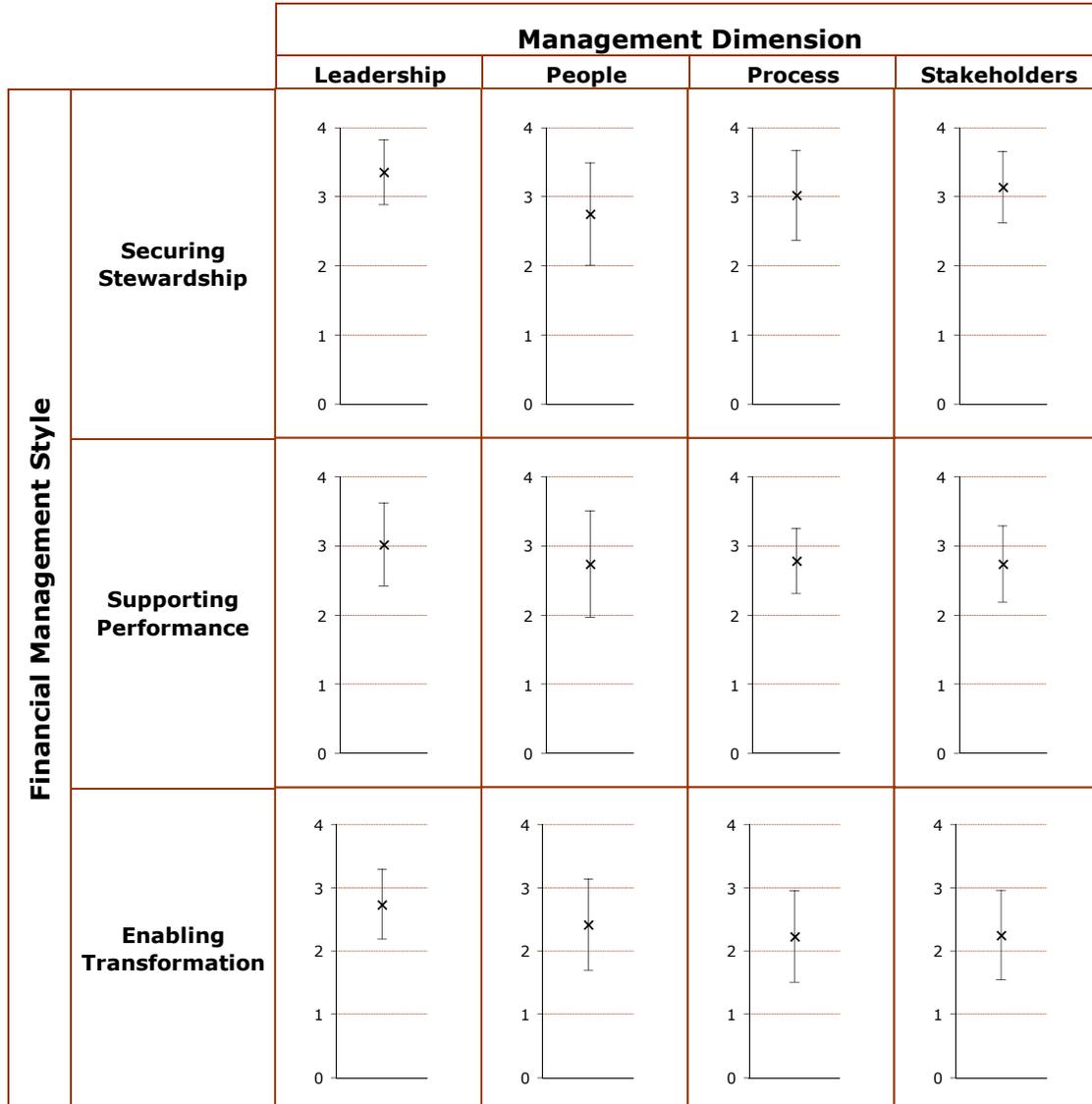
Survey Statements

- Finance regularly provides the information needed to understand the level of delivery in my area of responsibility and the related cost.
- Finance policies and procedures are clear and understandable.
- The organisation has clear and easy to use financial systems.
- Appropriate financial management training for non-finance staff is provided.
- I know who to contact if I have a query regarding finance.

Section 4 - MANAGEMENT PRACTICE INDICATORS

FP6 CIPFA Financial Management Model

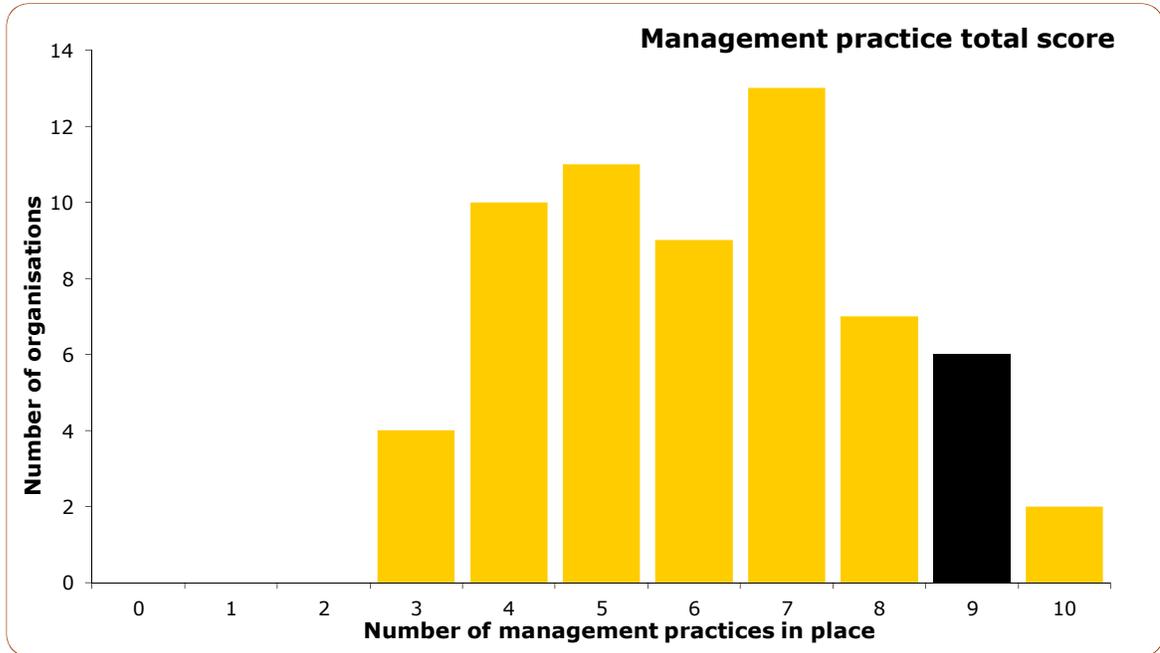
This indicator was intended primarily for Central Government Bodies



These charts show the average performance scores for all participants as black x's. The black error bars show one standard deviation either side of the mean. Approximately 65 - 70% of the organisations will fall within this range. The red diamond is the average score for your organisation.

(Care should be taken when interpreting these results as they are based on a very small sample size)

FP7 Modern Management Practices

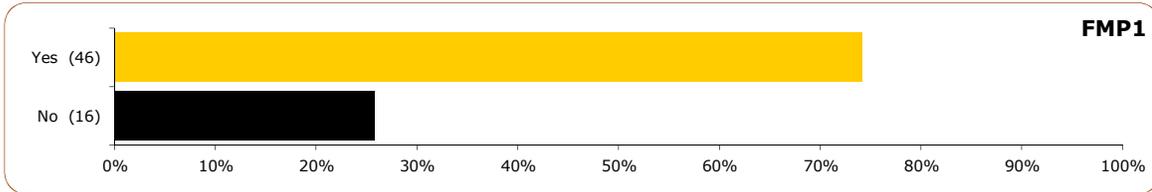


Transport for London *Average* LQ Median UQ
9 **6** **5** **6** **7**

Transport for London	Yes	No	% Yes	% No
FMP1	No	46	74.2%	25.8%
FMP2	Yes	23	37.1%	62.9%
FMP3	Yes	41	66.1%	33.9%
FMP4	Yes	55	88.7%	11.3%
FMP5	Yes	47	75.8%	24.2%
FMP6	Yes	28	45.2%	54.8%
FMP7	Yes	32	51.6%	48.4%
FMP8	Yes	53	85.5%	14.5%
FMP9	Yes	20	32.3%	67.7%
FMP10	Yes	37	59.7%	40.3%

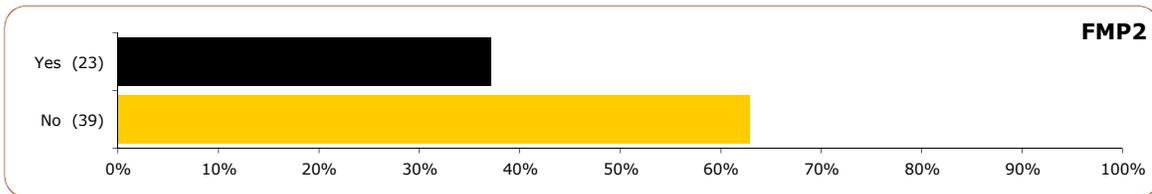
FMP1

The responsibilities of budget holders are clearly understood and embedded in performance appraisal.



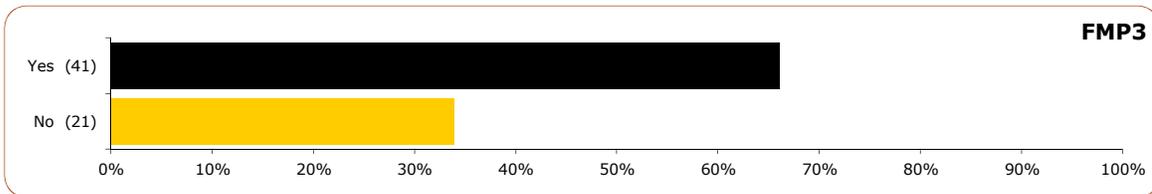
FMP2

Service levels and expectations have been set with key internal customers using a documented approach such as an SLA or Customer Charter, with regular service review meetings held.



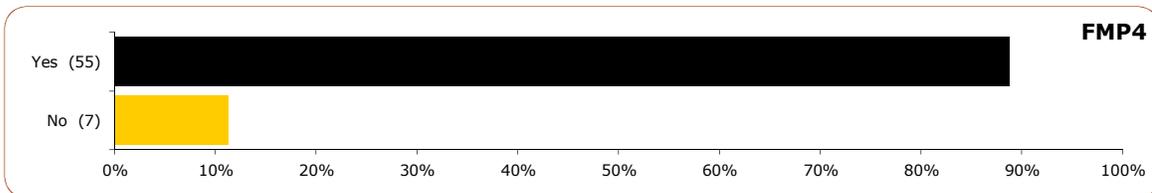
FMP3

A rolling programme of reviewing and benchmarking the organisation's costs is in place across major service areas.



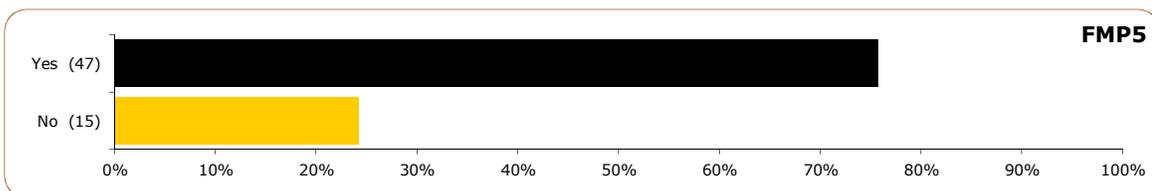
FMP4

Standardised organisation-wide integrated software is in place with centralised data processing. This should cover as a minimum purchase to payment of supplier and invoice to cash receipt from a customer.



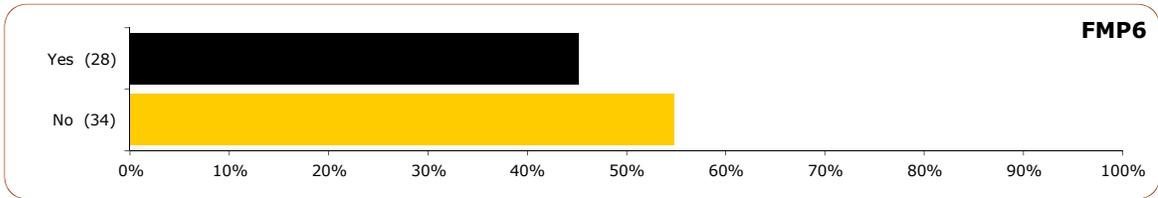
FMP5

The organisation can demonstrate that it has used at least two of the following to steam-line financial processes in the last 3 years; a) bar coding, b) invoice scanning/imaging, c) workflow, d) web technologies to build extranets with external stakeholders, e) intranet to build self service capabilities for staff to check status, run reports, f) on-line travel and expense system used by claimants that is fully integrated with the accounting system.



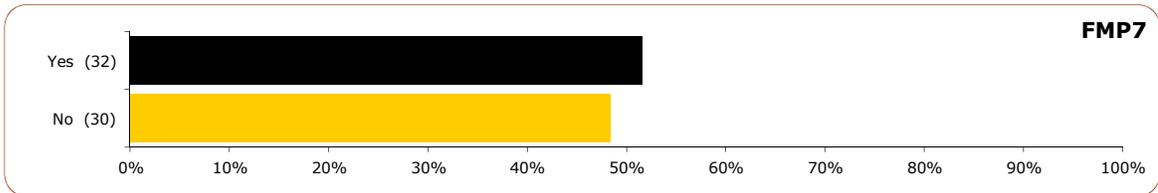
FMP6

Fully automated accruals system based on purchase order and good/services received information held within a fully integrated accounting system.



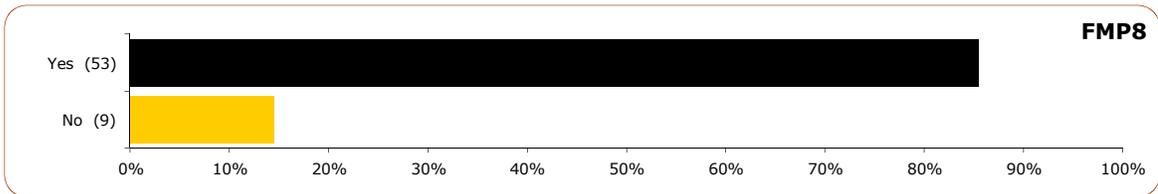
FMP7

Budget holders have on-line, real-time insight into the status of their budget and can run standard financial and manpower reports through their desk top PC.



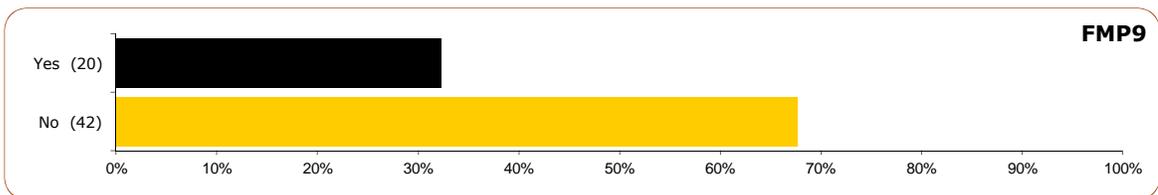
FMP8

A needs based budget based on activity levels rather than historical baselines, is prepared at least every 3 years.



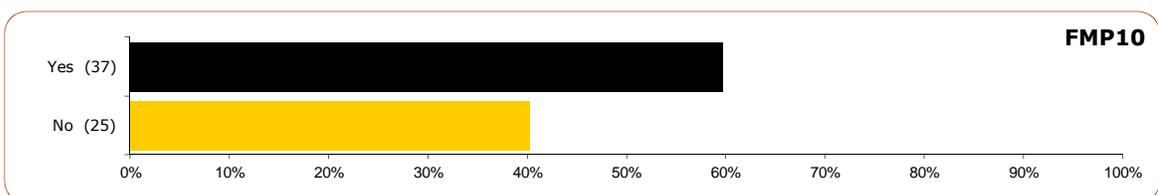
FMP9

Customer satisfaction surveys are conducted at least annually with results openly published and acted upon.



FMP10

A comprehensive professional development programme is in place for Finance staff which ensures that they receive at least 5 days of continuing professional development per annum.



Section 5 - TABULAR DATA

	Transport for London	Average	Lower Quartile	Median	Upper Quartile	
Primary Indicators						
FP1	Cost of the Finance function as a percentage of organisational running costs (expenditure)	0.6%	1.5%	0.9%	1.3%	1.7%
FP1(a)	Cost of transaction processing as a proportion of the finance function	8%	28%	21%	29%	35%
FP1(b)	Cost of business decision support as a proportion of the cost of the finance function	63%	38%	31%	39%	45%
FP1(c)	Cost of reporting and control as a proportion of the cost of the finance function	29%	34%	26%	32%	41%
FP2	Cycle time in working days from period-end closure to the distribution of routine financial reports to all budget managers and overseeing boards and committees	13	7	5	7	10
FP3	% of variation between the forecast outturn and the actual outturn at month 12 (absolute values)	2.1%	2.2%	0.4%	1.2%	2.7%
FP4	Percentage of public sector organisation spend for which there are fully costed outputs which are measured by key performance metrics and for which a named individual is accountable	100.0%	96.2%	100.0%	100.0%	100.0%
Secondary Indicators						
FS1	Professionally qualified finance staff as a percentage of total finance staff (FTEs) undertaking reporting, controls and decision support processes (i.e. excludes those staff involved in transactional processes)	46.9%	46.6%	33.0%	46.7%	58.9%
FS2(a)	Cycle time in days from date of year-end to submission of audited accounts	35	34	23	31	43
FS2(b)	Were the last set of accounts qualified by external audit?	No	3	67	4%	96%
FS3	Cost of Customer Invoicing function per customer invoice processed	£12.31	£23.70	£7.22	£15.93	£36.06
FS4	Debtors days	26.1	41.0	18.4	36.5	56.8
FS5	Credit notes as % of total customer invoices raised	2.5%	5.8%	1.9%	4.6%	9.0%
FS6	Cost of Accounts Payable per accounts payable invoice processed	£3.85	£10.24	£5.90	£9.05	£13.44
FS7	Proportion of all payments made by electronic means	91.1%	91.4%	93.5%	97.6%	99.3%
FS8	Proportion of outstanding debt that is more than 90 days old from date of invoice	21.3%	12.0%	3.2%	6.5%	16.2%
FS9(a)	% invoices for commercial goods & services paid by the organisation within 10 days of receipt	85.0%	65.1%	44.0%	70.6%	87.7%
FS9(b)	% invoices for commercial goods & services paid by the organisation within 30 days of receipt or within the agreed payment terms	92.7%	94.4%	92.7%	95.6%	98.8%
FS10	Cost of Payroll Admin per employee paid	£30.08	£114.76	£58.12	£87.26	£164.97