

# **Consultation on Economic Regulation and the Fee-capping Process**



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## **1. Foreword**

- 1.1 The Office of Qualifications and Examinations Regulation (Ofqual) has a statutory objective to secure efficiency and value for money in the provision of regulated qualifications. This objective complements our other objectives in relation to qualifications and assessment standards, public confidence and awareness. Regulation of the qualifications sector is required because there is a risk that the behaviours of producers and consumers will not secure an efficient market in which standards of qualifications are maintained.
- 1.2 Our efficiency objective set out in the Apprenticeships, Skills, Children and Learning Act 2009 (the Act) gives us a clear role at an opportune time. Expenditure on examinations and assessments has been increasing very significantly over recent years. The impact of the modularisation of examinations, the greater variety and volume of qualifications being taken and the pressures on awarding organisations' costs have all impacted on the amount being spent on examinations and assessments.
- 1.3 Expenditure on qualifications should provide value for money. The pressure on schools' and colleges' budgets presents a real risk around the affordability of current levels of expenditure and this in itself may be a catalyst for change. Employers and the individuals who are investing directly in training and skills are seeking ever higher returns on this investment. Learners and other users of qualifications have a right to expect that qualifications, and the way they are assessed, are fit for purpose and provide value for money.
- 1.4 In making choices, the purchasers of qualifications need to be able to compare different qualifications. This means that they must be able to clearly understand the content of qualifications, decide whether they meet their needs and have independent assurance of the progression routes supported by each qualification.
- 1.5 An efficient qualifications system that meets the needs of the learner, centres, employers and further and higher education will only be achieved where the incentives across participants in the system are aligned and not distorted. The Government is currently reviewing the impact on qualification choices of current funding and accountability systems. Public policy and regulatory burden could also be among key factors driving costs, product choice and innovation in qualification provision.
- 1.6 We cannot undertake our approach to securing efficiency in isolation of our other regulatory functions and we must balance appropriately any different or conflicting priorities that flow from them. The regulator must provide confidence that there are effective safeguards against competition driving

down standards. The maintenance of standards, public confidence and awareness is therefore at the heart of securing the efficient provision of qualifications. A system in which standards or public confidence are not maintained cannot be truly efficient.

1.7 It is in this complex and changing environment that we set out our proposals for our approach to securing efficiency and value for money. These proposals include:

- the introduction of recognition conditions with which awarding organisations will have to comply on an ongoing basis to provide indicators that they are operating efficiently
- an extension to our established system of monitoring awarding organisation activities to inform our knowledge of the efficiency with which particular qualifications are provided
- a process for arriving at proportionate interventions including fee-capping where inefficiency is identified
- a role in undertaking ‘temperature checks’ on the key drivers of efficiency; for example innovation
- a role for Ofqual in informing policy and minimising regulatory burden.

1.8 We look forward to receiving your views. Please see Annex D, which sets out how to respond to this consultation.

## **2. Executive summary**

### **2.1 Introduction**

2.1.1 The Act requires Ofqual to secure that regulated qualifications are provided efficiently and that they represent value for money. Efficiency is achieved when desired outcomes are achieved at the lowest possible cost, without wasted resources, effort, time or money. This brings our other objectives on standards, public confidence and awareness to the heart of securing the efficient provision of qualifications. A system in which standards or public confidence are not maintained cannot be truly efficient.

2.1.2 The approach set out in this paper is underpinned by the importance of education and training to the UK economy, and the need to ensure appropriate incentives for efficiency and maintenance of standards in the qualifications sector. Expenditure on examinations and assessments has increased very significantly over recent years. A significant proportion of spending on qualifications is publicly funded. The public has a right to expect

that this expenditure provides value for money. Similarly those individuals and employers investing directly in training and skills are looking for a more effective, customer-focused and responsive education and training system. Learners and other users of qualifications have a right to expect that qualifications, and the way they are assessed, are fit for purpose and provide value for money.

## **2.2 Efficient awarding organisations**

2.2.1 Our approach focuses on how we intend to secure the efficient provision of qualifications through our core recognition, monitoring and enforcement functions. The proposals include:

- a number of recognition conditions with which the awarding organisations will have to demonstrate ongoing compliance to provide indicators that they are operating efficiently
- an extension to our established system of monitoring awarding organisation activities to inform our knowledge of the risk that particular qualifications are being provided inefficiently
- a process for arriving at proportionate interventions including fee-capping if inefficiency is confirmed.

2.2.2 The Act gives us the power to limit the amount that awarding organisations can charge for providing their qualifications to end users if this course of action is necessary to secure efficiency and value for money. We set out in the paper the proposed process for using these fee-capping powers. We also explain that if, in the course of our monitoring activity, we conclude that particular qualifications are not being provided efficiently, we can work with other regulators to propose proportionate interventions. In particular we will work closely with the Office of Fair Trading (OFT), if, following our initial investigation, it appears be better placed to implement proportionate remedies to inefficiency. We intend to develop a Memorandum of Understanding with the OFT on how we will work together in practice.

2.2.3 We believe that our fee-capping power should create incentives for the awarding organisations to deliver their services efficiently.

## **2.3 Incentives for efficiency**

2.3.1 An efficient qualifications system will be achieved where the incentives across participants in the system are aligned and not distorted. As part of our monitoring and horizon scanning activity we will undertake research to provide an understanding of how competition, institutional and accountability structures may be influencing choices and behaviours within the sector. We

think this is necessary to inform a balanced and justifiable view on the need for regulatory intervention.

- 2.3.2 Where competition is necessary and sufficient to create incentives for efficiency and value for money we will determine whether barriers to effective competition exist and whether intervention is necessary to remedy these. In some cases factors other than the degree of competition may be driving behaviour and limiting the ability of the market to secure efficiency. In these cases our role may extend beyond the promotion of competition. Effective competition requires accessible, trusted information on choices, supply-side flexibility and effective purchasers who are able to judge the quality of the products and services they are buying. Accountability structures should be designed to avoid wherever possible distorting consumer choices.

## **2.4 Working with other stakeholders**

- 2.4.1 Our approach is not restricted to securing the efficiency of awarding organisations. Wherever possible we will also seek to encourage efficiency on the demand side (purchasers) and at the system level. We believe that this is desirable to come to a balanced and justifiable view on the need for regulatory intervention aimed at securing supply-side efficiency and to provide scope for us to contribute to broader policy work aimed at securing the efficient functioning of the sector. It will also allow us to highlight where the actions of a range of different participants may be contributing to inefficiency.
- 2.4.2 For there to be an efficient qualification system Government should design and implement public policy in a way that does not add unnecessarily to the aggregate costs of qualification production, delivery and procurement. The paper also sets out how we intend to work with other stakeholders such as the funding agencies to develop initiatives to drive efficiency through more effective purchasing. It sets out a role for Ofqual in informing policy and minimising regulatory burden.
- 2.4.3 We also set out a role in undertaking 'temperature checks' (stock-take studies) on the key drivers of efficiency; for example innovation. The aim of these exercises is to:
- stimulate debate
  - encourage a joined-up approach to relevant issues by participants across the sector
  - where possible, identify and share good practice.

2.4.4 We have identified innovation as an area for a stock take. The exercise will contribute to understanding the key drivers of, and barriers to, innovation in the qualifications sector.

## **2.5 Building blocks**

2.5.1 In developing our economic regulation strategy we have sought to build our framework on:

- economic concepts of efficiency and value for money
- a balanced approach to promoting efficiency and remedying inefficiency directed both at the level of the awarding organisations and at encouraging efficiency in the system of qualifications provision as a whole
- an appropriate role for competition promotion, in light of the complexities of the sector and the critical importance of maintaining standards.

2.5.2 There are many different types of efficiency:

- Productive efficiency is achieved when organisations produce output at the minimum cost.
- Allocative efficiency occurs when there is an optimal distribution of goods and services among purchasers.
- Dynamic efficiency, which is closely linked to investment and innovation, refers to improvements in efficiency over time.

2.5.3 Efficiency can also be achieved at the regulatory and policy levels by minimising regulatory burden and ensuring that policies and regulations enable the delivery of desired outcomes in the most cost-effective way. Value for money is closely related to efficiency. Our proposed approach to securing our efficiency objective seeks to secure that value for money is achieved at the individual qualification level and also that it is encouraged at the system level in aggregate.

2.5.4 For an individual qualification, or particular aspect of qualification provision, to offer value for money it must:

- be fit for purpose and be of a sufficient quality and standard to meet the needs of purchasers and end users
- be provided by awarding organisations as efficiently as possible and be purchased as efficiently as possible on the demand side, such that it reaches purchasers in the most efficient way

- have a fee level that is appropriately cost reflective.

## 2.6 Recognition conditions

2.6.1 Many aspects of efficiency are within the influence of awarding organisations. Our recognition criteria and conditions and our monitoring process will play a key role in promoting efficiency at the level of the awarding organisation. The awarding organisations must comply with the recognition conditions to provide indicators that they are operating efficiently. The conditions set out requirements in the following economic areas:

- value for money
- fee transparency
- minimising unnecessary requirements on centres and others
- packaging of products and services
- invoicing
- marketing and provision of information to purchasers
- fitness for purpose of qualifications
- data provision and notification of issues to Ofqual

2.6.2 The full set of recognition conditions that awarding organisations must comply are set out in our linked consultation *From Transition to Transformation: Strategic Regulation of Awarding Organisations and Qualifications*.

## 2.7 Monitoring and risk

2.7.1 In order to identify areas where there may be significant risk of inefficiency we will use a set of risk indicators. These will inform our decision on whether to launch an efficiency study. Our process for assessing compliance with the recognition conditions, the monitoring of awarding organisations' fees, costs revenues and volumes, and the outcome of our economic research will inform our judgement on the risk that qualifications or particular groups of qualifications are being provided inefficiently. We set out a proposed list of risk indicators and ask for views on whether these indicators are appropriate.

## 2.8 Efficiency studies

- 2.8.1 Where our indicators suggest a significant risk of inefficiency we will seek to assess the extent and impact of the potential inefficiency through an efficiency study. The outcome of an efficiency study may be:
- a *clean bill of health*
  - a *requirement for Ofqual to take further action*, which could involve a decision to progress to a remedy study, where feasible in conjunction with the OFT, to further investigate the need for targeted intervention
  - a recommendation of *further action by, or joint work with, third parties* such as Government or its agencies.
- 2.8.2 We will carry out efficiency studies only when evidence suggests a potentially significant efficiency problem that warrants further study.
- 2.8.3 We will adopt a staged approach to our efficiency studies. This will include:
- a preliminary review phase
  - a detailed study phase.
- 2.8.4 We will only progress to the detailed study phase if the results of our preliminary review suggest this is warranted. Upon completion of the efficiency study a written report will be made public, which will set out our evidence-based findings and identify next steps. Where these next steps include a remedy study, the report will also set out the scope of this study. We will consider the necessity of a fee cap as part of a remedy study, which will investigate the need and options for a targeted and proportionate intervention in the area in question.

## 2.9 Summary

- 2.9.1 Our overall approach to securing the efficient provision of regulated qualifications includes proposals aimed at:
- promoting the efficiency of individual awarding organisations through:
    - a recognition criterion that requires, before entry into the regulated sector, the awarding organisation's intention to operate efficiently and provide regulated units and qualifications that offer value for money
    - requiring awarding organisations to demonstrate compliance with recognition conditions on an ongoing basis to provide an indication that they are operating efficiently

- undertaking monitoring activities to inform our knowledge of the efficiency with which particular qualifications are provided
- incentivising efficiency within the system through:
  - conducting research to inform our understanding of the drivers of behaviour across the sector
  - undertaking stock-take exercises to stimulate debate of topical issues
  - informing policy and minimising regulatory burden
- remedying inefficiency when this occurs by:
  - using a series of indicators to determine where there may be a significant risk of inefficiency
  - undertaking efficiency studies in areas where we have identified a risk of inefficiency
  - identifying the next course of action and, where necessary, undertaking remedy studies
  - implementing remedies including fee-capping where necessary.

## 3. Introduction

### 3.1 Purpose

- 3.1.1 Section 128 of the Act gives us objectives in relation to qualifications and assessment standards, public confidence, awareness and efficiency. These statutory objectives apply to all of our regulatory functions. This paper provides more detail and seeks views on the particular processes and powers we will adopt in our regulatory framework to secure our efficiency objective.
- 3.1.2 The efficiency objective requires us “*to secure that regulated qualifications are provided efficiently and in particular that any relevant sums payable to a body awarding or authenticating a qualification in respect of which the body is recognised under section 132 of the Act represent value for money*”.
- 3.1.3 Although our efficiency objective is a distinct objective, it overlaps with each of our other objectives. Efficiency is achieved when *desired outcomes*<sup>1</sup> are

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<sup>1</sup> Desired outcomes include those that meet the intended public policy objectives for the delivery and uptake of regulated qualifications, and for which standards are maintained, public confidence and

achieved at the lowest possible cost without wasted resources, effort, time or money. This brings the maintenance of standards, public confidence and awareness to the heart of securing the efficient provision of qualifications. A system in which standards are not maintained, and therefore in which the public do not have confidence, cannot be truly efficient.

- 3.1.4 We cannot undertake our efficiency objective and economic regulation function in isolation of our other regulatory functions. In exercising all of our regulatory functions we must ensure compatibility with, and promote, each of our objectives, balancing appropriately any different or conflicting priorities flowing from them. The full range of our functions, including recognition and monitoring as well as our fee-capping and other enforcement powers, will be relevant when securing efficiency. In securing efficiency through our functions we also require a clear understanding of the mechanics of the qualifications sector. Our research and monitoring activity, our work on standards and comparability, and our data collection exercises will be crucial in informing this understanding.

## **3.2 The importance of education and training**

- 3.2.1 Education and training are critical to the performance of the UK economy. Both the public and private sectors spend significant sums of money on them each year. The latest figures show that expenditure on secondary, post-secondary and non-tertiary education by central and local Government in the UK in 2008/09 was £33 billion, or roughly 2.5% of gross domestic product (GDP).<sup>2</sup> Including all public and private spending on education takes this figure to 6.4% of GDP.<sup>3</sup>
- 3.2.2 The problems of a low skilled workforce and the detrimental impact this can have on the growth of the economy are well documented. A responsive qualifications system can help to break this cycle, not only by increasing the productivity of the workforce but also by providing economic and social benefits to individuals and society; for example through increased employment, higher remuneration, more opportunities for social mobility, greater social cohesion and reduced criminality.

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awareness are promoted and the needs of end-users, including learners, employers and educational institutions, are met.

<sup>2</sup> [www.dcsf.gov.uk/rsgateway/DB/VOL/v000891/index.shtml](http://www.dcsf.gov.uk/rsgateway/DB/VOL/v000891/index.shtml)

<sup>3</sup> [www.parliament.uk/briefingpapers/commons/lib/research/briefings/snsg-01078.pdf](http://www.parliament.uk/briefingpapers/commons/lib/research/briefings/snsg-01078.pdf)

- 3.2.3 In recent years the direction of the qualifications sector has been influenced by many public policies. The approach taken can impact on the overall costs of the qualification system. Most recently in July 2010 the Department for Business, Innovation and Skills (BIS) launched consultations on the future direction of skills policy and skills funding.<sup>4</sup> These consultations set out proposals for a shift in focus from a centralised top-down training system towards a more responsive demand-driven system in which colleges and training organisations have greater freedom to tailor their offers to the needs of employers and learners. The skills funding consultation makes it clear that, whilst the Government remains committed to investing in the skills that the UK economy requires, in this era of financial constraint there needs to be a simplification of the system of public funding, making it more effective and focused on the areas of highest value.
- 3.2.4 This has been followed in September 2010 by an announcement by the Secretary of State for Education of a review of vocational education for 14- to 19-year-olds, to be completed by Professor Alison Wolf in early 2011. Ofqual will be responding to BIS's consultations and the Wolf Review.
- 3.2.5 There have been significant developments in the supply and demand of qualifications over recent years. On the supply side, as of September 2009, 144 recognised awarding organisations offered 9,708 regulated qualifications<sup>5</sup>, representing an increase of 170% in the number of regulated qualifications and 47% in the number of awarding organisations since 2002.<sup>6</sup> On the demand side, there were 15.1 million publicly and privately funded achievements in 2008/09. Although achievements in GCSEs and A levels have remained relatively constant in recent years, there has been considerable growth in achievements in other qualifications from 2.2 million in 2002/03 to 6.1 million in 2008/09.
- 3.2.6 As the number of achievements has increased, the value of the market has also risen. In our *2010 Annual Qualifications Market Report*<sup>7</sup> we gave an indicative figure of £933 million for the total value of the regulated qualifications sector, with £281 million spent by schools, £173 million spent by colleges and the remainder spent by independent training providers. This

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<sup>4</sup> [www.bis.gov.uk/Consultations](http://www.bis.gov.uk/Consultations)

<sup>5</sup> Including 539 A level qualifications, 691 GCSEs and 8,478 other qualifications

<sup>6</sup> [www.ofqual.gov.uk/how-we-regulate/economic-regulation/346-qualifications-market](http://www.ofqual.gov.uk/how-we-regulate/economic-regulation/346-qualifications-market)

<sup>7</sup> [www.ofqual.gov.uk/how-we-regulate/economic-regulation/346-qualifications-market](http://www.ofqual.gov.uk/how-we-regulate/economic-regulation/346-qualifications-market)

includes £219 million spent on procuring GCSEs and A levels and £614 million spent on other regulated qualifications. In addition to the large sums of money spent by individuals and employers in investing in training programmes, a significant proportion of all spending on regulated qualifications is wholly or partly funded from the public purse.

### **3.3 The rationale for regulation**

3.3.1 Regulation in the qualifications sector is required for a number of reasons, in particular given:

- the need to be confident that there are appropriate incentives for efficiency
- the need to ensure standards are maintained.

3.3.2 Employers, educational institutions and learners should be able to make informed decisions about the training and qualifications they undertake, and they should have confidence in the qualifications system. However, qualifications markets alone will not necessarily ensure that all qualifications are of an appropriate and comparable standard, and offer value for money.

#### **Incentives for efficiency**

3.3.3 For markets to deliver efficient outcomes (that is, desired outcomes at the lowest cost) participants' decisions must be underpinned by appropriate incentives. In markets with complete information about product and service characteristics, and in the absence of other market failures, efficient outcomes are driven by adjustments in price and quality in conjunction with the incentives of firms to maximise profits and the incentives of purchasers to maximise the value they achieve from their purchases. Through these incentives the market mechanism works to lower prices, ensure better quality goods and services, and provide greater choice for consumers.

3.3.4 The promotion of competition is therefore often the best tool to use to provide appropriate incentives for efficient outcomes. One important function for economic regulators if inefficiency is suspected is to determine how competitive markets are; and where competitive forces are found to be lacking, to seek to remedy this, often in conjunction with competition authorities.

3.3.5 However, whilst in many cases competition and efficiency go hand in hand, in some cases factors other than the degree of competition may be driving behaviour and limiting the ability for efficiency to be secured. In these cases

the role of economic regulation naturally extends beyond the promotion of competition.<sup>8</sup>

- 3.3.6 There are a number of salient features of the qualifications sector that make the operation of the market mechanism and the role of competition in incentivising efficient outcomes complex. The provision of awarding organisation services to schools, colleges and other training providers is part of a wider system of education and has many characteristics of public service provision. We discuss these characteristics in more detail in section 4.4. These characteristics may impact on how effectively competition between firms will secure efficiency.

### **Standards**

- 3.3.7 Misaligned incentives may also impact on product and service quality and standards. Although in some cases the market mechanism will provide awarding organisations with the incentives necessary to provide products and services of the required quality and standards, this may not occur in all cases, particularly if there is asymmetric information between awarding organisations, purchasers and end-users of qualifications. End users are not always able to judge whether a qualification is of an appropriate standard. When this is the case, and there are distortionary incentives on those who decide which qualifications learners should take, we cannot be confident that the operation of the market alone will make sure that the standards of comparable qualifications are consistent.

### **Economic regulation**

- 3.3.8 Ofqual's approach recognises the intrinsic link between our standards and efficiency objectives. We cannot promote one objective without the other, as this could lead to conflicts in regulatory approach, incompatible policies and market uncertainty, each of which could have a significant detrimental effect on public confidence in the sector. When evaluating interventions aimed at

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<sup>8</sup> As acknowledged in *Regulating in the Consumer Interest* by Consumer Focus (2010) ([www.consumerfocus.org.uk/assets/1/files/2010/03/Fresh-thinking-Regulation.pdf](http://www.consumerfocus.org.uk/assets/1/files/2010/03/Fresh-thinking-Regulation.pdf)) it is increasingly widely accepted that independent economic regulators should not restrict themselves to issues of competition and price, but should also consider wider issues in relation to economic, social and environmental well-being. According to *Economic Regulators and Sustainable Development – Promoting Good Governance* by Bartle and Vass (2006) ([www.bath.ac.uk/management/crri/pubpdf/Research\\_Reports/18\\_Bartle\\_Vass.pdf](http://www.bath.ac.uk/management/crri/pubpdf/Research_Reports/18_Bartle_Vass.pdf)), this has driven the impetus to give some economic regulators a sustainability objective to deal with concerns that they were excessively focusing on developing competition and lowering price.

increasing the degree of competition we will need to consider the impact that further competition may have on the ability to secure standards and comparability. In many cases our economic role will also be a valuable complement to the policy and regulatory roles played by other public bodies both within and outside the qualifications sector. In particular, our sector specific expertise and knowledge, our deep industry relationships, our tailored monitoring, research and policy functions and our sectoral powers will provide valuable tools to complement a number of other bodies' objectives and regulatory powers.

### 3.4 Previous consultations

3.4.1 In developing our approach to economic regulation we have drawn on feedback on our consultation *Regulating for Confidence in Standards*<sup>9</sup>, a number of economic reports that we commissioned and significant internal work to embed our economic role across our functions.

3.4.2 With regard to stakeholders' feedback, we have taken into consideration many issues, including:

- the need for us to integrate our economic regulation strategy with our objectives and duties in the Act, and our other regulatory functions
- the significant role of Government and its agencies in influencing the activities and costs of awarding organisations, through the availability of public funding and changes in public policy and regulation
- the different motivations and incentive structures of awarding organisations, in particular according to whether they are charities, operate in the public sector or are owned by shareholders.
- the need to take account of the value placed on the quality of assessment services and the social benefit of funding lower volume qualifications (we consider these issues in our discussion on cost-reflective pricing and our approach to value for money)
- the complexity of the qualifications sector and the different views of stakeholders on market definition and the role of competition
- the importance of maintaining incentives for awarding organisations to innovate and invest to improve the quality of the products and services they provide

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<sup>9</sup> <http://comment.ofqual.gov.uk/regulating-for-confidence-in-standards/>

- concerns expressed about our requirement for information on awarding organisations' costs, particularly regarding the level of disaggregation and the allocation of common costs.

### 3.5 Future consultations and publications

3.5.1 This paper sets out our overall framework for economic regulation. We will be following this with further consultations and publications over the next 12 months that will provide our stakeholders with further details on key components of our regulatory framework. These include:

- in March 2011, a further consultation on the information requirements for economic regulation, including a proposed template for data collection
- in March 2011, publication of a framework for market definition<sup>10</sup>
- in October 2011, publication of a framework for regulatory impact assessments
- in December 2011, finalisation of a set of pricing principles, covering issues such as cost reflectivity and cross-subsidisation, price discrimination, pricing structures and advance publication of fees.

### Regulatory Impact

3.6.1 In *Regulating for Confidence in Standards*<sup>11</sup> we said we would keep the impact of our proposals under review on an ongoing basis. We consider that a well managed organisation that is acting efficiently and in a way that secures standards and protects learners should be meeting the proposed conditions already.

3.6.2 We will set out an impact assessment for our information requirements when we consult on these in March 2011. We have set out the rationale for regulation in this paper and have committed to publishing a framework for regulatory impact assessments in October 2011 and to launching a review of the regulatory burden Ofqual imposes on awarding organisations during 2011.

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<sup>10</sup> This will build on the initial work on market definition undertaken by Frontier Economics in July 2010 ([www.ofqual.gov.uk/how-we-regulate/90-articles/325-developing-a-framework-for-economic-regulation](http://www.ofqual.gov.uk/how-we-regulate/90-articles/325-developing-a-framework-for-economic-regulation)). The publication will not set out our views on specific market definitions, but will instead set out our thoughts on the issues we will need to consider and the framework for analysis that we will apply when defining markets as necessary in the future.

<sup>11</sup> <http://comment.ofqual.gov.uk/regulating-for-confidence-in-standards/>

## **4. Our economic regulation framework**

### **4.1 Efficiency**

4.1.1 The concept of efficiency is well established in economic theory and regulatory practice. Efficiency is achieved when desired outcomes are achieved at the lowest possible cost, without wasted resources, effort, time or money. As set out above this brings the maintenance of standards, public confidence and awareness to the heart of securing the efficient provision of qualifications.

4.1.2 Different types of efficiencies may be achieved by different participants across the qualifications sector:

- On the supply-side, awarding organisations may achieve efficiencies in relation to their costs and business processes (productive efficiency), pricing (part of allocative efficiency) and investment decisions (dynamic efficiency).
- On the demand-side, centres may achieve efficiencies in relation to their purchasing decisions and procurement processes (also part of allocative efficiency).
- At the system level, Government and regulatory bodies may achieve efficiencies in relation to the design and implementation of their policies and regulations (minimal regulatory burden).

### What is efficiency?

Productive efficiency is achieved when output is produced at the minimum cost.

Improvements in productive efficiency can be achieved by:

- producing the existing level of output at a lower cost
- producing a higher level of output or improving the quality of products and services at the existing cost.

Allocative efficiency occurs when there is an optimal distribution of goods and services, such that at the volume purchased the marginal value of consumption equals the marginal cost of production.

Dynamic efficiency refers to improvements in productive efficiency over time and is closely linked to investment and innovation in business processes, products and services.<sup>12</sup>

To minimise regulatory burden policies and regulations should:

- be designed to facilitate market structures necessary to ensure that products and services can be provided and purchased efficiently
- enable the system as a whole, and the organisations operating within it, to deliver intended policy objectives and desired outcomes in the most cost-effective way.

## 4.2 Value for money

4.2.1 The Act incorporates the concept of value for money both in relation to our efficiency objective and our fee-capping power. Whilst other economic regulators have regard to value for money in exercising their economic functions, the wording of the Act is unique in its application of value for money as the basis for fee-capping.

4.2.2 The Act does not define value for money. Although extensive work has been undertaken, for example by the National Audit Office, in the context of determining whether public spending represents value for money, there is no established economic framework to determine whether the *level* of prices charged for products or services represents value for money. It is therefore

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<sup>12</sup> See section 6.3 for our proposals to undertake a stock-take exercise on innovation to inform understanding of what dynamic efficiency means in practice in relation to qualification provision.

important that we clarify what we mean by value for money and explain how we propose to apply it to our regulatory functions.

- 4.2.3 The Act specifies that we must secure that any sums payable to awarding organisations in return for awarding or authenticating qualifications represent value for money. This means that we must seek to secure that the qualifications and packages of services that awarding organisations provide offer value for money.
- 4.2.4 For value for money to be achieved at the qualification level, individual qualifications and their component services must be of a sufficient quality and standard to meet the needs of purchasers and end users and be fit for purpose. In addition awarding organisations' processes for qualification development and delivery must be as efficient as possible and efficiency benefits must be shared with purchasers on the demand side. In order for purchasers to take full advantage of these efficiency benefits, efficient procurement processes on the demand side will also be required. Value for money at this level therefore combines the concepts of productive, dynamic and allocative efficiency set out in Box 1.
- 4.2.5 A key part of value for money is the idea that efficiency benefits should be shared between the supply and demand sides of the market. In determining how these benefits should be shared, economic regulators often consider the economic principles underpinning allocative efficiency. When the price that purchasers are willing to pay reflects the value of the good or service, allocative efficiency is achieved when price equals the producer's marginal cost of production. By combining this condition with productive efficiency, value for money is then considered to be achieved when price reflects the efficiently incurred costs of production. For this reason economic regulators often seek to remedy inefficiency in markets by requiring prices to be reflective of efficient costs.
- 4.2.6 Whilst in many cases this is a sensible starting point for considering how to share efficiency benefits and to secure the value for money of qualifications, we acknowledge that there are some challenges in applying the concept of cost-reflective pricing as a basis for value for money of individual qualifications *in all cases*. We summarise these challenges below.

#### **The role of cost-reflective pricing in value for money**

- 4.2.7 A necessary condition for allocative efficiency to be achieved through cost-reflective pricing is that the value of products and services is reflected in the price that purchasers are willing to pay. The connection between value and willingness to pay is complex in qualifications markets in part because there are many different sources of value for individual qualifications (see Box 2).

These different sources of value, in conjunction with the separation between the purchasers and end users of qualifications, mean that the willingness to pay for qualifications may not in all cases fully represent the value of the qualifications. This disconnection may be compounded:

- for qualifications that are funded from the public purse, as in these cases it may be necessary to distinguish between the *willingness* to pay for qualifications and the *ability* to pay
- to the extent that in some cases incentives that are not wholly reflective of the value of the purchases to end users may be driving purchasing behaviour
- where the value of some qualifications is not known to either purchasers or end users at time of purchase.

### Sources of value of qualifications

The value of a qualification has many components. This includes the value of the qualification *services* sold as part of the qualification bundle, such as:

- centre approval
- learner registration
- centre support
- examination marking and remarking
- delivery of results
- production of certificates.

It also includes the value of the qualification *content* to purchasers and end users, which comprises for example:

- the value to learners resulting from what they learn
- the value to centres in terms of meeting learners' needs
- the value to employers and education institutions in terms of the skills with which they equip their workers or students.

It also includes more intrinsic values stemming from the *reputational* value of the qualification such as:

- the value to learners as a result of the qualification's brand and capacity to signal ability
- the value to centres in being able to demonstrate a measurable indicator of their own performance
- the value to employers and education institutions as a result of enabling them to differentiate between individuals for selection purposes.

- 4.2.8 Moreover, the feasibility and desirability of cost-reflective pricing of individual qualifications *in all cases* is unclear. The implementation of cost-reflective pricing is complex when products and services share many common inputs in the development and production processes, and it is not easy to allocate costs among individual items. It is also complicated when awarding organisations need to recoup their initial costs of qualification development

over a number of years of the qualification lifecycle. In addition whilst cost-reflective pricing will be efficient from a purely economic perspective, it may lead to undesired social or political consequences.

- 4.2.9 Cross-subsidisation is prevalent in the qualifications sector, and is often proposed for social objectives, such as enabling the provision of low volume (and therefore high unit cost) socially valuable qualifications, rather than for purely economic (profit maximising) reasons. A move to cost-reflective pricing in all cases would have the effect of rationing all qualifications according to their costs of production. Just as some qualifications may fall in price, others may rise, and the extent of these rises could in some cases be such that some high unit cost qualifications would become prohibitively expensive. The social benefits of cross-subsidisation are recognised in other regulated sectors where, for example, cross-subsidisation is permitted to facilitate universal service in telecommunications or postal service provision.
- 4.2.10 We propose to set out next year a number of principles for determining when cross-subsidisation may be appropriate in the qualifications sector. This will form part of our broader publication on pricing principles (see section 3.5).
- 4.2.11 Our principles for cross-subsidisation will be informed by consideration of issues such as:
- the necessity of cross-subsidisation to protect the needs of learners; for example to permit the take up of low volume, socially valuable qualifications
  - the risk that cross-subsidisation will be detrimental to efficiency; for example by facilitating anti-competitive conduct
  - whether there are alternatives to cross-subsidisation that could achieve the same aims
  - best practice processes for implementing cross-subsidisation should this be necessary to secure desired outcomes, including, for example, principles on the transparency of the process.
- 4.2.12 These principles will then be applied on a case by case basis as necessary when undertaking our economic functions.

#### **Ofqual's proposed definition of value for money**

- 4.2.13 Our proposed definition of value for money seeks to build on the established economic concepts of efficiency discussed in section 4.1 whilst also accounting for the challenges of achieving cost-reflective pricing outlined above.

### Value for money

For an individual qualification, or particular aspect of qualification provision, to offer value for money it must:

- be fit for purpose and be of a sufficient standard and quality to meet the needs of purchasers and end users
- be provided by awarding organisations as efficiently as possible and be purchased as efficiently as possible on the demand side<sup>13</sup>, such that it reaches purchasers in the most efficient way
- have a fee *level* that is *appropriately cost reflective*.

In order for a particular *fee level* for an individual qualification or associated service, or for a package of products and services, to be appropriately cost reflective:

- awarding organisations should have the opportunity through the fees they charge to recover the efficient costs, including the opportunity cost of capital, of this provision<sup>14</sup>
- in certain cases, where it is *necessary* to secure desired regulatory outcomes, fees may exceed or be set below the efficient costs of provision for the purposes of cross-subsidisation between charges.<sup>15</sup>

4.2.14 Annex A sets out more details on how we propose to apply our definition of value for money at the individual qualification level should we undertake a fee-capping exercise in the future.

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<sup>13</sup> For example, using an appropriate procurement process or within the applicable legislative framework.

<sup>14</sup> Should we need to determine the efficient costs of provision for the purposes of a fee-capping exercise, we will develop a suitable cost model in conjunction with the awarding organisations in question.

<sup>15</sup> Our publication on pricing principles will set out in more detail our principles on cross-subsidisation, including specifying when it will be considered necessary to secure desired outcomes.

4.2.15 In seeking to secure value for money in qualifications provision, where possible we will also encourage value for money within the broader system in which qualifications are provided. To achieve value for money at the system level regulatory burden should be minimised:

- the system as a whole must deliver intended policy aims and desired outcomes in the most cost-effective way
- Government and regulatory bodies should design and implement policies and regulations that do not unnecessarily add to the aggregate costs of qualification production, delivery and procurement.

**Question**

A. Do you agree with the definition of value for money, as set out in section 4.2 and summarised in Box 3, that we are proposing to apply in undertaking our regulatory functions? Please explain why and provide any suggestions you have for how we may improve the definition.

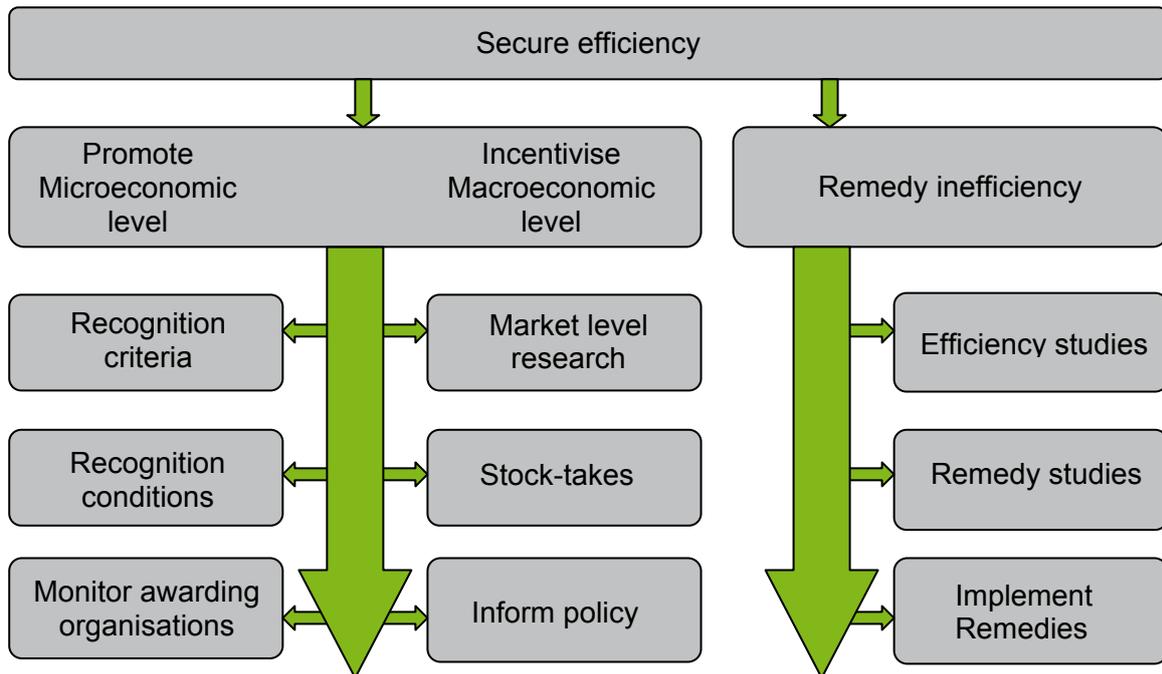
Strongly agree	Agree	Neither agree nor disagree	Disagree	Strongly disagree	Don't know

Comments .....

**4.3 Our approach to our efficiency objective**

4.3.1 In Figure 1 we summarise the building blocks of our approach to securing the efficient provision of regulated qualifications.

**Figure 1: Ofqual’s approach to securing efficiency**



4.3.2 Section 5 sets out our proposed approach to promoting efficiency at the microeconomic level, section 6 sets out proposals aimed at creating the incentives for efficiency at the macroeconomic level within the qualifications system and section 7 sets out our proposed approach to implementing proportionate remedies where inefficiency is identified.

#### **Box 4: Our approach to our efficiency objective**

Our approach to securing the efficient provision of regulated qualifications is built on:

- promoting efficiency at the *microeconomic* level within individual awarding organisations
- incentivising efficiency at the *macroeconomic* level within the system
- remedying inefficiency when this occurs.

Our efficiency objective under the Act requires us to secure the efficient *provision* of regulated qualifications. Therefore a key part of our approach to economic regulation is to promote productive, allocative and dynamic efficiency within each awarding organisation.

However, our approach is not restricted to the promotion of supply-side efficiency. We acknowledge that effective purchasing choices on the demand side are also necessary to secure value for money at the individual qualification level (see Box 3). Wherever possible we will also seek to encourage efficiency at the system level. We will also seek to remedy inefficiency where we find it exists.

4.3.3 Because many aspects of efficiency are within the influence of awarding organisations, our recognition criteria and conditions and our monitoring process will play a key role in promoting efficiency at the level of the awarding organisation (the *microeconomic* level). However, we recognise that the actions of other market participants, such as Government and regulatory bodies at the system level, will also impact on the efficiency of qualifications provision. For example public policies and regulations may affect the extent to which awarding organisations are able to reduce their costs or develop new processes and services over time and market structures will impact on incentives for efficiency. Therefore we will also seek to understand the extent to which behaviours at the system level (the *macroeconomic* level) may be driving the efficiency of awarding organisations, and wherever possible we will seek to encourage efficiency at the broader system level.

4.3.4 In addition we acknowledge that effective purchasing choices on the demand side are also necessary to secure efficiency and value for money at the individual qualification level. Our work with other stakeholders, such as the funding agencies, to create more effective purchasers will inform our work in this area.

4.3.5 There is considerable merit in taking this holistic approach to economic regulation. Not only is it necessary to come to a balanced and justifiable view on the need for regulatory intervention, but it will also provide scope for us to contribute to broader policy work aimed at securing the efficient functioning of the sector and will highlight where the actions of a range of different participants may be creating inefficiency.

**Question**

B. Do you agree with our approach to securing efficiency, as set out in section 4.3, which is built on the idea of promoting efficiency at the awarding organisation level, encouraging efficiency at the system level and remedying inefficiency where we find this occurs? If not, please explain why and provide any suggestions you have for how we could improve our approach.

Strongly agree	Agree	Neither agree nor disagree	Disagree	Strongly disagree	Don't know

Comments .....

**4.4 The role of competition in securing efficiency**

4.4.1 In seeking to encourage the efficiency of the system within which qualifications are provided we will seek to understand which types of market structure will best incentivise awarding organisations to operate efficiently, and the degree of competition that will best facilitate desired outcomes, including the maintenance of standards and public confidence.

4.4.2 In many parts of the qualifications sector, competition, when it works effectively, will create the incentives necessary for efficiency. In these cases if we identify – through, for example, an efficiency study – that barriers to effective competition exist<sup>16</sup>, our role will be to determine whether intervention is necessary to remedy these barriers. Where intervention to promote competition is found to be desirable, action by third parties such as

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<sup>16</sup> Given the variety of types of organisation operating in the qualifications sector, an important aspect of our work in this respect will be to understand the extent to which regulations and legislation may be hindering competitive neutrality between organisations. See the OFT's report *Competition in Mixed Markets: Ensuring Competitive Neutrality* ([www.of.gov.uk/shared\\_of/economic\\_research/oft1242.pdf](http://www.of.gov.uk/shared_of/economic_research/oft1242.pdf)) for more on competitive neutrality.

the OFT may be beneficial given our lack of concurrent competition powers. In these cases we will work closely together to implement a joined-up approach to remedying inefficiency. We are currently developing a Memorandum of Understanding with the OFT to assist with this.

4.4.3 However, as noted in section 3.3, there are a number of features of the qualifications sector that make the role of competition in incentivising efficiency complex. For example:

- On the demand side, many purchases of qualifications are publicly funded and underpinned by public policy objectives. Therefore the extent to which desired outcomes are achieved depends in some cases not only on the interaction between firms on the supply side of the market, but also on the extent to which purchasers are able to exercise effective choices and have the appropriate incentives to make purchasing decisions that achieve desired outcomes and intended policy objectives.
- On the supply side, different awarding organisations face a variety of incentives, reflecting the diverse legal structures, governance arrangements and connected activities of organisations, and the variety of commercial and non-commercial objectives. This diversity of supply structures, in particular the presence of a number of not-for-profit organisations, complicates the link between competition and efficiency.
- At the system level, the roles of Government and regulation remain key in influencing the structure of qualifications markets. For example the sector has been subject to consolidation in some parts, and there remains a high degree of regulation across many parts of the sector, which continue to influence entry and aspects of qualification development, design and delivery.
- At the product level, the signalling value of qualifications may be a factor determining the optimal level of choice between different qualifications. The value of qualifications is not wholly derived from the services themselves. Part of the value derives from the ability of qualifications to *signal* the capability of learners. This signalling ability depends in part on how well recognised the qualifications are and how widely they are used, and therefore there will be some value for learners to hold the same types of qualification as others. This is recognised in paragraph 129(3) of the Act, which requires that there is *reasonable* choice for learners in terms of the number of different regulated qualifications and the different forms of these, but that the number of different qualifications in similar subject areas or serving similar functions should not be *excessive*.

4.4.4 In light of these features therefore we will promote further competition in those cases where we are confident that this will secure greater efficiency.<sup>17</sup> Where it is not clear that a more competitive market structure is a necessary and sufficient driver for efficiency, our approach will be broader and could include, for example, research on the role of alternative market structures in securing efficiency.

## **4.5 Our economic goals**

4.5.1 We have set a number of immediate steps we will be looking to achieve over the next year to help us secure our statutory efficiency objective. These include:

- developing a comprehensive and implementable framework for economic regulation that is supported by our stakeholders
- developing clear guidance on pricing principles and promoting its use
- improving the transparency of information around the drivers of demand for, and expenditure on, regulated qualifications
- undertaking a stock-take exercise on innovation as a first step to reducing the regulatory barriers to innovation (see section 6.3)
- identifying drivers of unnecessary costs in relation to the provision of regulated qualifications, including undertaking a review of the regulatory burden we impose on awarding organisations (see section 6.4)
- having a clear fee-capping process in place.

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<sup>17</sup> This approach is consistent with our objectives and duties as laid out in the Act.

## 5. Promoting efficiency within awarding organisations

### 5.1 Introduction

- 5.1.1 The first strand of our approach to securing efficiency is to promote the efficiency of awarding organisations by:
- implementing a recognition criterion that requires an awarding organisation to provide evidence of its intention to operate efficiently before entering the regulated sector
  - ensuring compliance with the recognition conditions on an ongoing basis
  - undertaking monitoring activities to inform our knowledge of the efficiency with which particular qualifications are provided.

### 5.2 Recognition process

- 5.2.1 Our recognition criteria and conditions aim to ensure that only awarding organisations that have the capacity, capability, resources and governance arrangements to award regulated qualifications in a way that secures standards, efficiency and public confidence will be allowed to operate in the regulated sector.
- 5.2.2 As set out in section 3.1, we cannot view the statutory objectives that underpin our recognition process in isolation, and therefore each of the criteria and conditions that flow from them are linked with our efficiency objective. Nonetheless, some of the criteria and conditions are more directly related to the economic concepts outlined in this paper. These are summarised in Table 1, and set out in full, alongside the associated guidance, in Annex B.

**Table 1: Economic recognition criteria and conditions**

<b>Criterion/condition number</b>	<b>Scope of criterion/condition</b>
Criterion 6	Intention to operate efficiently and provide regulated units and qualifications that offer value for money
Condition F1	Regulated units and qualifications represent value for money
Condition F5	Open and transparent fees, including requirements in

	<p>relation to:<sup>18</sup></p> <ul style="list-style-type: none"> <li>■ pricing structures</li> <li>■ advance publication of fees</li> <li>■ public availability of fee lists</li> </ul>
Condition H1, H2 and H4	<p>Fitness for purpose of qualifications and provision of information including:</p> <ul style="list-style-type: none"> <li>■ the rationale for their development</li> <li>■ the demonstration of support from the relevant employment or education sector</li> <li>■ confirmation of progression opportunities for learners</li> </ul>
Condition F6	Minimise unnecessary requirements on centres and other parties
Condition F2	Fair packaging of products and services
Condition F3	Fair invoicing for purchasers with relevant payment terms
Condition F4	Appropriate marketing, selling and promotion of products and services
Condition A13	Data provision to Ofqual <sup>19</sup>
Condition A9	<p>Notification of issues to Ofqual, in relation to:</p> <ul style="list-style-type: none"> <li>■ changes in governance and business models</li> <li>■ significant cost drivers</li> <li>■ connected activities</li> </ul>

<sup>18</sup> We will set out more detailed views on these issues in our guidance on pricing principles to be finalised in December 2011.

<sup>19</sup> We will consult on specific proposals for data provision in March 2011 as part of a detailed consultation on information requirements (see section 5.4).

**Question**

C. Do you agree that we should place the economic recognition criteria and conditions summarised in Table 1 and set out in full in Annex B on awarding organisations? If not, please explain why.

Strongly agree	Agree	Neither agree nor disagree	Disagree	Strongly disagree	Don't know

Comments .....

**5.3 Compliance with the recognition conditions**

- 5.3.1 Once an awarding organisation is recognised we will require its board or governing body to assure us that it complies annually with the recognition conditions. In addition, our monitoring team will undertake monitoring activities to understand whether the awarding organisations are compliant.
- 5.3.2 Compliance with the recognition conditions is necessary but not sufficient to secure efficiency. The conditions and our compliance function operate alongside our wider monitoring and research functions that are intended to provide a filter to enable us to identify causes of inefficiency at the system level, including, for example, misaligned incentives, lack of competition and regulatory burden.
- 5.3.3 As well as monitoring at the awarding organisation level to ensure compliance with the recognition conditions, we will also monitor:
  - selected fee and service information for particular units and qualifications
  - a series of financial indicators for awarding organisations.
- 5.3.4 This data will help to inform our views on the efficiency with which awarding organisations are providing particular qualifications over time, and will also help us to identify whether there are any gaps in our recognition criteria and conditions that we need to address in order to more effectively promote efficiency within awarding organisations.

## 5.4 Monitoring activities

- 5.4.1 Below we set out at a high level the types of information that are likely to fall within our information requirements. We will set out more detailed proposals in March 2011 as part of our consultation on information requirements.
- 5.4.2 A key part of our monitoring activity will involve tracking trends in fees and service provision over time. Given the number of different units and qualifications, it is not feasible for us to routinely monitor all fees and services. Therefore we will implement a filter to enable us to target this aspect of our monitoring in a proportionate way. The fees and services we are likely to monitor include those of:
- high volume qualifications such as GCSEs, A levels and other commonly taken units and qualifications<sup>20</sup>
  - new or significantly revised qualifications such as those that form part of the Diploma
  - units or qualifications for which we have received feedback from stakeholders regarding fees or service provision.<sup>21</sup>
- 5.4.3 We will also set out for consultation in March 2011 detailed proposals for monitoring selected financial information from awarding organisations. This will be informed by the findings of the recent report *Collection of Economic and Financial Information*<sup>22</sup> undertaken for us by Grant Thornton, the feedback we have received on this, and feedback on the approach to monitoring set out in this paper.
- 5.4.4 We anticipate collecting from all awarding organisations annual revenue and cost information disaggregated to the level of the UK regulated qualifications business. Feedback we have received on the Grant Thornton report suggests that awarding organisations are broadly supportive of this proposal.
- 5.4.5 In some cases we may also require information broken down by functional business area. In addition, where we do not already hold the data, we may

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<sup>20</sup> These may include, for example, the most commonly taken units and qualifications by sector skills council footprint, by level and type, and/or the most commonly taken in terms of achievements.

<sup>21</sup> Our proposed complaint form for issues relevant to economic regulation is included in Annex C.

<sup>22</sup> [www.ofqual.gov.uk/how-we-regulate/90-articles/325-developing-a-framework-for-economic-regulation](http://www.ofqual.gov.uk/how-we-regulate/90-articles/325-developing-a-framework-for-economic-regulation)

also require selected volume information, such as the number of standard and non-standard entries and the number of re-sits.

5.4.6 This data will enable us to understand and track trends in the size of the qualifications sector, service offerings and the cost pressures that awarding organisations are facing. In some cases it will also enable us to undertake benchmarking analysis across qualifications and awarding organisations where appropriate. Benchmarking may be particularly useful where:

- Sufficiently similar qualifications are offered by different awarding organisations and it is possible to compare the prices, costs and returns associated with these qualifications.
- We can identify sectors or organisations with sufficiently similar characteristics to those in the qualifications sector and it is possible to compare the costs of business functions and overheads.

5.4.7 In some cases we expect that awarding organisations' published accounts will provide sufficient financial information to meet our data requirements. However, in other cases, such as when an awarding organisation undertakes other activities or is part of a larger parent group, the level of disaggregation required may be more than is provided in publicly available accounts. We recognise that there may be costs to awarding organisations of providing this information, particularly where costs of qualification provision are common to a number of business or group activities and these cannot be allocated easily. Therefore we will only collect data where we are confident that the costs to awarding organisations of providing this information do not outweigh the benefits from improvements in efficiency.

## **6. Incentivising efficiency within the qualifications system**

### **6.1 Introduction**

6.1.1 In addition to promoting efficiency at the awarding organisation level through our core recognition and monitoring functions, we will also work with other regulators and public bodies where possible in order to incentivise efficiency within the qualifications system. In this section we set out our approach to encouraging the efficiency at the system level. Our approach is based on:

- conducting research to inform our understanding of the drivers of behaviour and outcomes across the sector
- undertaking stock-take exercises to stimulate debate of topical issues

- informing policy and minimising regulatory burden.

## 6.2 Research

- 6.2.1 Our research function is critical in informing our understanding of the qualifications sector and the efficiency with which the system is delivering desired outcomes. As such, research plays a fundamental role in enabling us to achieve all of our statutory objectives.
- 6.2.2 We will undertake research driven by our economic regulation function as part of Ofqual's broader research function. Engagement with stakeholders across the sector, in particular through the use of surveys, and joint work with other public bodies and regulators will form a key part of our economic research.
- 6.2.3 One of the key aims of our economic research function will be to gather aggregate information on the drivers of expenditure on qualifications over time. These drivers include not only changes in qualification fees, but also changes in the volume of qualifications taken, switching between different types of qualification (for example switching between general and vocational qualifications), and changes in expenditure on components of fees other than entry fees, such as late fees and re-sits. This will provide us with an understanding of how and why the qualifications sector is changing over time and will inform our annual market reports.
- 6.2.4 We will also set out our priorities and proposals for specific areas of economic research at the start of each year. These will be informed by our strategic business priorities and current work-streams. In addition, they may also include proposals to undertake targeted *segment level* research in particular areas of the sector.
- 6.2.5 Segment level research will be aimed at gathering and analysing information on:
- the drivers of behaviour in the area of the sector in question<sup>23</sup>
  - the extent to which desired outcomes and/or policy aims are currently being achieved in the segment.<sup>24</sup>

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<sup>23</sup> Including, for example, the legal status of firms, the extent of connected activities, the structure of the segment, policy and regulatory drivers, the processes underpinning public funding for qualifications in the segment and the most common types of purchasers and their accountability processes.

6.2.6 For our research purposes, these segments will not be based on formal market definition exercises. We will only formally define markets if required as part of an efficiency study (see section 7.3). Studies that we have recently undertaken have indicated that a comprehensive market definition exercise in the qualifications sector would be very complex and time consuming, and would likely be subject to considerable difference of opinion. In addition, as markets in this sector are constantly changing as products, services, policies and regulations evolve, were we to attempt to define all markets upfront the results would in all probability be out of date before we completed the task. Therefore we are proposing to only formally define markets in a particular area of the sector if we have determined that there is a likelihood of inefficiency in this area (section 7.3 sets out in more detail the role of market definition in our proposed framework).

6.2.7 For the purposes of our segment level research, there are a number of ways in which we may segment the qualifications sector; for example:

- qualifications (by subject) commonly taken by various age groups such as 14- to 16-year-olds, 16- to 19-year-olds and post-19-year-olds
- general qualifications at each level and/or by subject
- vocational qualifications at each level and/or by subject
- qualifications that are most commonly used for particular progression routes
- qualifications that are most commonly used by various centre types.

### **6.3 Stock-take exercises**

6.3.1 We will also seek to encourage efficiency within the system by undertaking stock-take exercises. The aim of these exercises is to stimulate debate and encourage a joined-up approach to topical issues by participants across the sector, and, where possible, to identify and share good practice. A number of principles will underpin our approach to stock-take exercises:

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<sup>24</sup> To inform this aspect of our research, where available we will collect evidence from our other regulatory functions, in particular from our monitoring and standards teams. We will also undertake targeted information gathering and analysis to understand the level of purchaser and end user satisfaction in the segment in question and the extent to which any clearly articulated policy objectives, for example take-up rates for particular types of qualification in the segment, are being met.

- **Collaboration:** We will adopt a collaborative approach with our stakeholders in determining areas of common interest when scoping our stock-take exercises.
- **Informality:** The studies will not necessarily focus on any particular market, group of awarding organisations or qualifications. They will not be undertaken on the presumption of a problem in the area in question, and they will not form the basis for remedy implementation, although information gathered during the exercises may highlight specific areas where further research may be warranted.
- **Inclusion:** We will seek views from interested participants across the sector, both on the supply side, demand side and at the regulatory and Government levels. Where possible we will seek to stimulate debate of key issues between different participants.
- **Relevance:** We will seek to choose themes for our stock-take exercises that are topical and of interest and importance to our stakeholders.

6.3.2 We have identified innovation as a suitable area for a stock-take exercise over the coming year.<sup>25</sup> The study will seek to answer the following questions:

- What do we mean by ‘innovation’ in the qualifications sector in practice?<sup>26</sup>
- Why is innovation important to awarding organisations, purchasers and end users of qualifications?
- What have been the most successful innovations to date and have there been any failures?
- What are the key drivers of, and barriers to, innovation in the qualifications sector?
- What steps might characterise the innovation ‘process’?

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<sup>25</sup> Under the Act we must have regard to the desirability of facilitating innovation in connection with the provision of regulated qualifications.

<sup>26</sup> In particular, in meeting our innovation duty should we focus on some or all of the following: the development of new technologies, services, delivery and assessment processes; the improvement of existing products and services; and/or the extent to which new technologies are adopted?

- When might there be a need for a proactive regulatory approach to innovation and when might we be able to rely on markets to adequately deliver innovation?

**Question**

D. Do you think stock-take exercises, as set out in section 6.3, will be useful in helping us to encourage the efficiency of the qualifications system?

Strongly agree	Agree	Neither agree nor disagree	Disagree	Strongly disagree	Don't know

Comments .....

**6.4 Informing policy and minimising regulatory burden**

6.4.1 We will also encourage efficiency within the system by ensuring that our own actions are as efficient as possible. We will seek to achieve this by:

- launching a review in 2011 of the burden that existing policies and regulations impose on awarding organisations
- ensuring that any new policies and regulations implemented by us going forward are informed by economic input and minimise regulatory burden
- reducing the bureaucracy associated with our regulatory processes and streamlining our regulatory interventions
- encouraging the use of regulatory impact assessments within Ofqual, and wherever possible elsewhere in the sector.<sup>27</sup>

**7. Our approach to remedying inefficiency**

**7.1 Introduction**

7.1.1 The final strand of our approach to securing efficiency is to remedy inefficiency when this occurs. Our approach to *remedying inefficiency* has four stages:

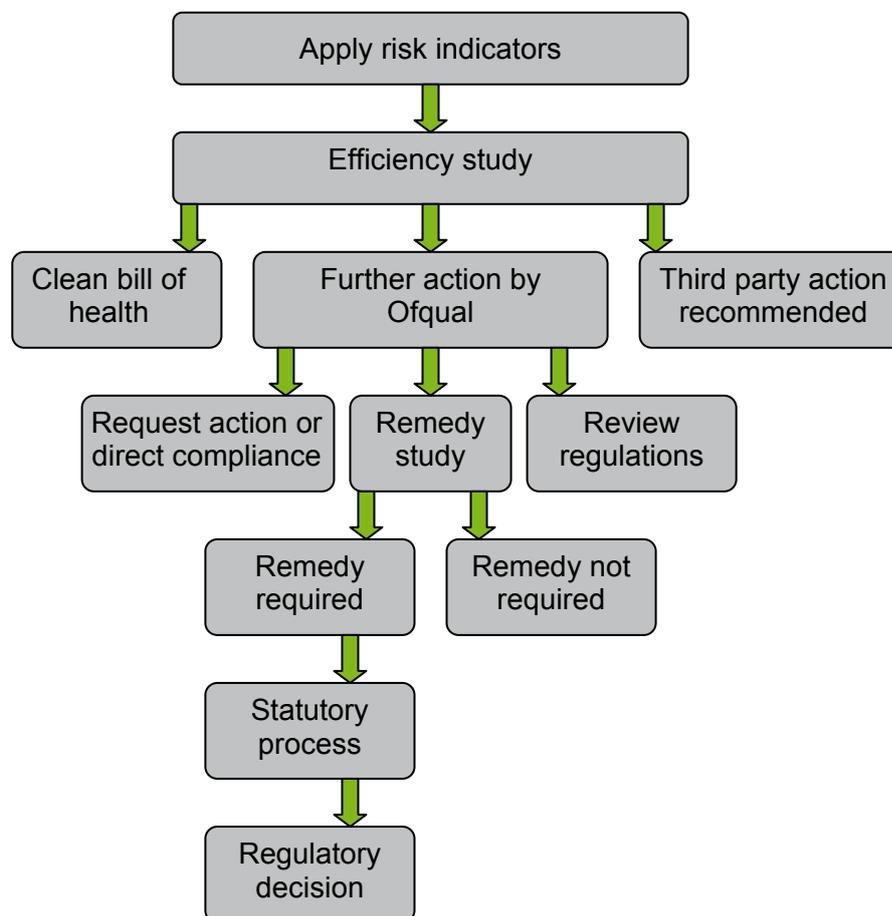
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<sup>27</sup> We will be publishing our framework for regulatory impact assessments in October 2011.

- applying a series of indicators to our market intelligence to determine where there may be a significant risk of inefficiency
- undertaking efficiency studies in areas where we have identified a risk of inefficiency
- identifying the next course of action, and where necessary undertaking remedy studies
- implementing remedies.

Figure 2 summarises our process for remedying inefficiency.

**Figure 2: Ofqual's approach to remedying inefficiency**



## 7.2 Indicators of inefficiency

7.2.1 In order to identify areas where there may be a significant risk of inefficiency either at the qualification, awarding organisation or system level, we propose using the risk indicators set out in Tables 2 and 3.

**Table 2: Qualification and awarding organisation level risk indicators**

Fee indicators	Lack of fee transparency, including excessively complex pricing structures
	Significant fee increases without evidence of corresponding exogenous cost drivers or sound justification that the fee increases are necessary to secure desired outcomes
	Evidence that fees have not been set in accordance Ofqual's pricing principles
Cost indicators	Lack of processes for allocating costs
	Significant increases in costs without either evidence that these cost increases are exogenously driven or sound justification that they are necessary to secure desired outcomes
	Evidence that changes in provision of support services may be impacting unfairly on the costs incurred by centres
Compliance indicators	<p>Evidence of non-compliance with the recognition conditions, in particular in relation to</p> <ul style="list-style-type: none"> <li>■ fair packaging of products and services</li> <li>■ fair invoicing</li> <li>■ appropriate marketing, promotion and selling</li> </ul>
Outcome indicators	Purchaser and/or end user dissatisfaction, including complaints <sup>28</sup>
	Evidence of restrictive practices, including those in

<sup>28</sup> Our proposed complaint form for issues relevant to economic regulation is included in Annex C.

	relation to connected activities
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**Table 3: System level risk indicators**

Volume indicators	Significant increases in the volume of re-sits
	Significant increases in the volume of transfers
	Significant increases in the volume of non-standard entries, including late entries
Cost indicators	Evidence of regulatory burden and/or unnecessary costs driven by public policy or regulations
Outcome indicators	Evidence of distortionary incentives on awarding organisations and/or purchasers as a result of policies or regulations
	Evidence of barriers to investment or innovation
	A high concentration rate of firms within a particular segment of the sector and evidence of potential barriers to entry
	Evidence of a significant mismatch between intended policy objectives and actual outcomes
	Evidence that desired outcomes are not being secured in particular segments or the system as a whole

These indicators will be used to inform our decision on whether to undertake an efficiency study.

**Question**

E. Do you agree that the indicators of inefficiency, as set out in Tables 2 and 3, are suitable for helping us to identify where there may be a risk of inefficiency in the qualifications sector? If not, please explain why and provide any suggestions you have for how we could improve the indicators.

Strongly agree	Agree	Neither agree nor disagree	Disagree	Strongly disagree	Don't know

Comments .....

### **7.3 Efficiency studies**

7.3.1 Where our indicators suggest a significant risk of inefficiency, we will seek to assess the extent and impact of the potential inefficiency through an efficiency study. The outcome of an efficiency study may be

- a clean bill of health
- a requirement for Ofqual to take further action, which could involve a decision to progress to a remedy study, where necessary in conjunction with the OFT, to further investigate the need for targeted intervention by us
- a recommendation of further action by, or joint work with, third parties such as Government or its agencies.

7.3.2 We will carry out efficiency studies only when evidence suggests a potentially significant efficiency problem that warrants further study.

#### **Scope of efficiency studies**

7.3.3 The scope of an efficiency study will depend on the nature of the potential inefficiency identified. It may be undertaken in relation to individual qualifications, parts of the qualification service bundle, targeted groups of related qualifications, particular awarding organisations or specific parts or features of the qualifications sector that may be impacting on the efficiency with which qualifications can be provided. As such, there are many different questions an efficiency study may seek to answer. These include, for example:

- Is the qualification or particular aspect of qualifications provision fit for purpose and does it meet the needs of purchasers and end users?<sup>29</sup>
- Is the awarding organisation complying with all of the economic recognition conditions summarised in Table 1?
- Is the qualification sold at a fee level that represents value for money?

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<sup>29</sup> This may involve gathering evidence from key purchasers and users of the qualification(s) on the demand side (including centres, learners, employers and universities), and may also involve collecting feedback from the demand side on whether the qualification(s), component(s) of service, policies or regulations could be improved to better meet needs.

- Is there competition in the area of the sector in question, is it delivering efficient outcomes, and:
  - How will further competition impact on the ability for desired outcomes, including the maintenance of standards and comparability, to be secured?
  - Will efficiency benefits of further competition be negated by inefficiencies on the demand side?
  - Are there any regulatory, policy or structural barriers to further competition?
- To what extent are factors other than the current market structure contributing to inefficiency, including for example:<sup>30</sup>
  - incentives on awarding organisations stemming from their business objectives, connected activities or governance arrangements
  - a lack of incentives on purchasers to make effective choices or the presence of barriers to exercising choice<sup>31</sup>
  - inefficient purchasing processes on the demand side
  - regulations or public policies that are imposing unnecessary costs on awarding organisations?
- Is the area of the sector in question delivering intended policy aims in a cost-effective way?
- What is the extent and impact of the inefficiency?

### **The role of market analysis**

7.3.4 In many cases our efficiency studies will require us to undertake economic market analysis. This will be founded on a formal market definition exercise

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<sup>30</sup> For more information on these issues see the OFT's publications *Choice and Competition in Public Services, A Guide for Policy Makers* ([www.of.gov.uk/shared\\_of/business\\_leaflets/general/of1214.pdf](http://www.of.gov.uk/shared_of/business_leaflets/general/of1214.pdf)) and *Competition in Mixed Markets, Ensuring Competitive Neutrality* ([www.of.gov.uk/shared\\_of/economic\\_research/of1242.pdf](http://www.of.gov.uk/shared_of/economic_research/of1242.pdf)).

<sup>31</sup> This may also involve consideration of whether there is a limit to the amount of choice that is optimal.

for the qualification(s) in question. We can then use this definition to determine the degree of competition faced by the relevant qualification(s).

7.3.5 We will be setting out our proposed framework for undertaking market definition exercises in March 2011. In developing this framework we will build on the initial work on market definition undertaken by Frontier Economics in July 2010<sup>32</sup> and we will have regard to the guidance provided by the OFT.<sup>33</sup> Whilst the OFT's guidance is set in the context of the Competition Act 1998, we believe that their broad approach is generally appropriate for considering market definitions for the purposes of efficiency studies within the qualifications sector. As part of the Memorandum of Understanding that we will be developing with the OFT we hope to explore the opportunities to share resources should market definition be required as part of our efficiency study.

7.3.6 Within the approach set out by the OFT we have identified some specific aspects of qualifications markets that might affect the appropriate market definition, including:

- **The nature of the customer purchasing the qualification:** The final customer is the learner taking the qualification, but the contract for the provision of services is generally between the awarding organisation and the institution where the learner takes the qualification; for example a school, college or training provider. As such the demand for qualifications is a derived demand rather than a direct demand and it is important that we consider the behaviour of learners and institutions when defining the market.
- **The range of potential substitutes:** Use of the hypothetical monopolist test (HMT) as set out in the OFT's guidance for market definition relies on considering the impact of potential substitutes to the qualification(s) in question. The conclusions of the HMT can be sensitive to the order in which potential substitutes are considered. Given the wide range of potential substitutes for some qualifications it will be important to consider the sensitivity of conclusions about market definition to the order in which substitutes are considered.
- **Price sensitivity of customers:** Compared to many other markets, purchasers of qualifications may be less price sensitive and more

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<sup>32</sup> [www.ofqual.gov.uk/how-we-regulate/90-articles/325-developing-a-framework-for-economic-regulation](http://www.ofqual.gov.uk/how-we-regulate/90-articles/325-developing-a-framework-for-economic-regulation)

<sup>33</sup> [www.offt.gov.uk/shared\\_offt/business\\_leaflets/ca98\\_guidelines/oft403.pdf](http://www.offt.gov.uk/shared_offt/business_leaflets/ca98_guidelines/oft403.pdf)

concerned about perceived and actual quality. There are a number of possible reasons for this. For example qualifications fees form a relatively small part of overall tuition expenses; quality and related features such as customer support are reported as being important criteria for choice; and the person making the decision within the purchasing organisation is often disconnected from its system of financial control. Therefore, analysis of market definition that focuses primarily on price rather than quality risks reaching inappropriate conclusions.

- **Switching costs:** For institutions offering qualifications, such as schools, a decision to switch qualifications can be very costly if it necessitates switching curricula and buying new textbooks. Often the decision must also be taken in advance. This suggests that switching decisions may happen less frequently, which can have implications for the approach to market definition.

7.3.7 These factors are not the only issues that may arise when considering market definition in the qualifications sector. However, they provide an indication of the types of factors that our framework on market definition will incorporate.

7.3.8 Once we have defined the market(s) for the qualification(s) in question, our market analysis will involve an assessment of actual competition, where relevant including a detailed investigation of market shares and profitability. As with market definition, we will have regard to the approach to assessing competition used by the OFT. Some of the factors discussed in relation to market definition will also be relevant to assessing competition; for example switching costs.

## **7.4 Approach to efficiency studies**

7.4.1 We will adopt a staged approach to our efficiency studies. This will include:

- a preliminary review phase
- a detailed study phase.

7.4.2 We will only progress to the detailed study phase if the results of our preliminary review suggest this is warranted. If it becomes evident at any point during either phase of the study that it is not necessary to continue the investigation, we will end the study and notify the affected parties. If we are in the detailed study phase, we will also make a public announcement. However, if a substantial part of the efficiency study has been completed, we would expect to finish the investigation irrespective of the nature of the conclusions, as this would constitute good administrative practice.

### **Preliminary review phase**

7.4.3 The aim of this phase of the study is to tease out the issues in question in order to determine whether they need to be explored in more detail. In the review phase we will:

- Gather all readily available relevant information from our other regulatory functions, Government departments and other official sources. If the trigger for an efficiency study is a complaint(s), we may also seek additional clarification and evidence from the complainant(s).
- On the basis of this information, come to an informed decision as to whether it is proportionate to undertake more detailed analysis in the next phase of an efficiency study. In reaching this decision we may consider a range of factors, including, for example:
  - total expenditure on the qualification(s) in question (as an indicator of the potential scale of any inefficiency)
  - the number of certifications (as an indicator of the potential scope of any inefficiency)
  - fee level(s) (as an indicator of the potential detriment to purchasers of any excess fees)
  - the level of stakeholder concern about the issue in question
  - the number of desired outcomes that are potentially impacted by the issue
  - whether there is a potential breach of legislation; for example competition law
  - whether the issue could provide us with an opportunity to influence public policy or reduce regulatory burden
  - the costs of the study in relation to the potential benefits
  - whether we have sufficient resources to undertake the study.
- Develop detailed terms of reference for the next phase of the efficiency study if this is the course of action decided. The time required for the detailed study phase will be proportionate to the scale and scope required to effectively consider the issue(s) under investigation.

7.4.4 During the review phase we will not routinely seek information from market participants, although where helpful to our review we may ask for clarification

or background information from awarding organisations and other involved parties on matters of relevance to the concern.

- 7.4.5 We will complete the review phase within two months of the launch of the study. If we decide to progress to the detailed study phase, we will set out our reasons for this in a public announcement, making reference to the indicators in Tables 2 and 3 as relevant. The affected parties will also be notified of our intention to commence the detailed study. We will also publish our terms of reference for the next phase of our study. In the event that we decide not to progress to the detailed study phase, we will inform relevant parties.

### **Detailed study phase**

- 7.4.6 In the detailed study phase we will undertake a full investigation of the efficiency concerns that have been identified. The methodology for our investigation will be set out in the terms of reference for the study, and may include, for example, proposals to undertake:

- market analysis
- efficiency benchmarking
- purchaser and end-user surveys
- an investigation into compliance with particular recognition conditions
- a review of an awarding organisation's connected activities
- a cost–benefit analysis of our regulations or a particular policy
- joint work with other public bodies, for example Government funding agencies.

- 7.4.7 Our investigation will also be informed by our work on standards and qualification comparability as necessary.

- 7.4.8 We will use all available evidence to come to a conclusion on the drivers of inefficiency in the area concerned and to quantify the impact of the inefficiency. During this phase it is likely that we will need to ask for information from market participants. In this event, an affected awarding organisation(s) will be required to provide, in confidence and within a reasonable timeframe, information and supporting evidence that we consider necessary for an assessment of efficiency to be carried out. We may also publish a public call for evidence to enable stakeholders from across the sector to provide evidence.

7.4.9 We will endeavour to complete the detailed study phase within six months of the launch of the study.

## **7.5 Outcomes of efficiency studies**

7.5.1 There are a number of potential outcomes of an efficiency study. These are:

- **A clean bill of health:** No inefficiencies have been identified and no further action is required.
- **Further action required by Ofqual:** Where we find evidence of non-compliance with a particular recognition condition(s), or evidence that our own policies or regulations need reviewing, we will need to take further action. Depending on the scale and cause of the inefficiency, this may trigger us to:
  - request the awarding organisations to take an action
  - direct the awarding organisation(s) to comply with the condition(s) in question
  - initiate a remedy study to further investigate the need for targeted intervention by us, where feasible in conjunction with the OFT
  - review our regulatory approach.
- **Further action by third parties recommended:** Where we find evidence of systemic inefficiency at the policy level that could benefit from intervention from, for example, the Government or its agencies, our efficiency study may trigger recommendations for further action by, or joint work with, third parties.

7.5.2 Upon completion of the efficiency study we will make public a written report that sets out our evidence-based findings and identifies next steps. Where these next steps include a remedy study, the report will also set out the scope of this study.

## **7.6 Remedy studies**

7.6.1 If our efficiency study finds evidence of non-compliance with the recognition conditions or inefficient practices by awarding organisations, we may need to undertake a remedy study to investigate the need for a targeted and proportionate intervention in the area in question. If our efficiency study finds competition concerns, we may undertake a remedy study where feasible in conjunction with the OFT.

7.6.2 A remedy study will seek to:

- determine the range of viable options available to us to remedy the inefficiency, including, for example:
  - voluntary agreements with the awarding organisation(s)
  - modifications to the recognition conditions if necessary
  - remedies and/or interventions within our statutory powers such as fee-capping or removal of accreditation or recognition status
  - if the study is in conjunction with the OFT, competition remedies and/or interventions within their statutory powers
- assess the costs and benefits of the possible remedies, including the potential unintended consequences of intervention, using the non-intervention option as the counterfactual against which to assess these
- on the basis of the cost–benefit analysis undertaken, reach a conclusion on the most appropriate remedy (if any) to implement
- set out the process by which we will implement the remedy, including the consultation process we will follow.

7.6.3 We will seek to complete the remedy study within six months. If we conclude that a remedy within our statutory powers is required, we will progress to the statutory process for the imposition of the remedy. Annex A sets out our proposed process for fee-capping. If we determine that no intervention is necessary, we will publish the findings of our remedy study.

## Annex A: Fee-capping process

- A1. The Act provides that we may impose a fee-capping condition limiting the amount of a particular fee “*if satisfied that the limit is necessary in order to secure value for money*”. Therefore it is important that we have in place a formal process that sets out how we will determine whether to exercise the fee-capping power, should a situation arise where this becomes necessary. We are seeking views on the following process to ensure that our proposal is both transparent and workable.
- A2. For an individual qualification, or particular aspect of qualifications provision, to offer value for money it must:
- be fit for purpose and be of a sufficient quality and standard to meet the needs of purchasers and end users
  - be provided by awarding organisations as efficiently as possible and be purchased as efficiently as possible on the demand side<sup>34</sup>, such that it reaches purchasers in the most efficient way
  - have a *fee level* that is *appropriately cost reflective*.
- A3. In order for a particular *fee level* for an individual qualification or associated service, or for a package of products and services, to be appropriately cost reflective:
- awarding organisations should have the opportunity through the fees they charge to recover the efficient costs, including the opportunity cost of capital, of this provision<sup>35</sup>
  - in certain cases where it is *necessary* to secure desired outcomes, fees may exceed or be set below the efficient costs of provision for the purposes of cross-subsidisation between charges.<sup>36</sup>

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<sup>34</sup> For example, using an appropriate procurement process or within the applicable legislative framework.

<sup>35</sup> Should we need to determine the efficient costs of provision for the purposes of a fee-capping exercise, we will develop, in conjunction with the awarding organisations in question, a suitable cost model.

<sup>36</sup> Our guidance on pricing principles to be finalised in December 2011 will set out in more detail our principles on cross-subsidisation, including specifying when it will be considered necessary to secure desired outcomes.

- A4. This annex summarises our process for fee-capping, including the key criteria that we will consider when determining whether or not a fee represents value for money and whether a fee cap is necessary.
- A5. When exercising our fee-capping power we will have regard to the following issues:
- We only expect to be concerned about the level of fees charged by an awarding organisation where the fees are not considered to be value for money for the product or service provided. Paragraphs A2 and A3 set out our proposed definition of value for money in the context of a fee-capping exercise.
  - We recognise that costs and fees can vary from year to year, so it will be important to consider not just the level of fees at a point in time, but also historical trends in fees and cost drivers over time.
  - We recognise that costs and fees can vary by subject, although some awarding organisations may prefer to charge similar fees for each subject.
  - Because the power to impose a fee cap arises only if “*necessary*”, and having regard to the significant implications of direct market intervention through fee-capping, we expect to treat fee-capping as a power to be used only in the absence of a more readily available and effective means of achieving the efficiency objective. In deciding whether it is necessary and proportionate to impose a fee-capping condition, we will therefore always consider whether there are alternative forms of intervention that would be capable of delivering efficiency and value for money within a reasonable timescale. Such considerations will include an assessment of the effectiveness of existing recognition conditions that are designed to promote efficiency, and will have regard to the feasibility, resource implications and likely efficacy of potential alternative forms of intervention.
  - As per section 136(10) of the Act, we will have regard to any guidance given by the Secretary of State in performing our functions in relation to fee-capping.
- A6. We have identified seven distinct stages in the process leading to the imposition of a fee cap:
- identification of inefficiency and failure to deliver value for money
  - consideration of necessity, including cost–benefit analysis of a fee cap
  - statutory notice
  - consideration of representations

- decision to impose a fee cap
- review
- final regulatory decision on fees.

### **Stage 1: identification of inefficiency and failure to deliver value for money**

- A7. As set out in section 5.4, to ensure we are aware of market developments we will monitor, using publicly available information and other information available to us, developments in qualification offerings, including their fee levels. The purpose of our monitoring activity is to determine whether there is prima facie evidence to indicate that there is inefficiency in the provision of regulated qualifications, including evidence that the level of fees for certain qualification(s) is a cause for concern and should be subject to more detailed investigation.
- A8. The results of our monitoring and other market intelligence will feed into our risk framework and may trigger further investigation through an efficiency study. Tables 2 and 3 set out the triggers for an efficiency study.
- A9. If the efficiency study progresses to the detailed study phase, the affected parties will be notified and we will make a public announcement of our intention to commence the study. Section 7.3 sets out our approach to efficiency studies.
- A10. Depending on the precise scope of the efficiency study, our assessment may be informed by use of a number of tools, including, for example, market analysis, efficiency benchmarking, a study of compliance with the recognition conditions, and purchaser and end user surveys. Where necessary we will appoint an external contractor with appropriate economic and financial expertise to assist us in undertaking this work.
- A11. The affected awarding organisation(s) will be required to provide, in confidence, information and supporting evidence that we, in consultation with the contractor, consider necessary to carry out our efficiency assessment. The awarding organisation(s) must provide the information and supporting evidence within a reasonable timeframe, to be determined based on the information required in each case, after we have given formal notice of the requirement.
- A12. Upon completion of the efficiency study we will make public a written report that sets out our evidence-based findings and identifies next steps. We will not implement a fee cap on the basis of the findings of the efficiency study alone. We will undertake a remedy study to determine the necessity of a fee cap before implementation.

## Stage 2: consideration of necessity

- A13. Our power to fee cap will only be triggered where we are satisfied that a fee cap is *necessary* to secure the value for money of individual or specific groups of qualifications. Ofqual will address inefficiency that does not compromise the value for money of individual qualifications in other ways.
- A14. We will consider the necessity of a fee cap as part of a remedy study, where feasible in conjunction with the OFT. The remedy study will investigate the need and options for a targeted and proportionate intervention in the area in question.
- A15. As part of the remedy study we will conduct a cost–benefit analysis of the range of possible regulatory measures that we could use to address the lack of value for money. This will consider whether measures other than a specific limit on prices, such as changes to the general conditions of recognition or competition remedies, would better secure value for money within a reasonable timescale. As part of this analysis we will also consider the possible unintended consequences of a fee cap.
- A16. In order to undertake a rigorous cost–benefit analysis of a fee cap we will need to consider the level and structure of the cap as part of the remedy study. In considering this we will take into account a number of factors, including:
- The volume of the qualification (or part of the bundle) to be used as the basis of the fee cap.
  - The efficient cost of producing the desired volume, including the cost of intangible assets used in the development and/or delivery processes where relevant, an appropriate cost of capital (incorporating a suitable risk reward) and the cost to the awarding organisation(s) of securing the maintenance of appropriate standards.
  - The stage in the lifecycle of the qualification.
  - The appropriate methodology for allocating common costs where necessary.
  - On the basis of our pricing principles, whether the fee can be set above or below the efficient cost of provision to facilitate cross-subsidisation, and if so, by how much.
  - The most appropriate type of cap; for example an individual price cap, revenue cap or cap applied across a basket of services. In deciding between the types of cap we will have regard to the incentives for efficiency each type of cap will create for the awarding organisation(s) in question.

- The duration of the fee cap. In determining this we will take into account the dynamics of the market in which the qualification is sold, impending changes to the qualification specification or assessment method and changes in public policy. Where we consider that limits on fees might be necessary for a number of years into the future, we will also consider whether we should impose a price limit for a short period and review it on a regular basis; for example annually.
- The number of awarding organisations or qualifications that will be subject to the fee cap and whether the cap should be the same across organisations.

A17. If as a result of our cost–benefit analysis we find that a fee cap is the most appropriate remedy to use to secure value for money within a reasonable timescale, we will proceed to the next stage of the fee-capping process.

### **Stage 3: statutory notice**

A18. In the event that we identify that a fee cap is necessary, we will commence the statutory process for its imposition. A formal decision to propose a fee cap will be made and a notice issued to the recognised organisation(s) in accordance with section 136(3) of the Act. This notice will set out our reasons for proposing the fee-capping condition, and will specify the period during which, and the way in which, the recognised organisation(s) may make representations about the proposal.

### **Stage 4: consideration of representations**

A19. In stage 4 we will consider any representations received from the recognised organisation(s) and will make amendments to our proposals as necessary in light of these representations.

### **Stage 5: decision to impose a fee cap**

A20. In stage 5, if in the light of the considerations in the previous stage it is still appropriate to do so and subject to any modifications of the proposal arising from those considerations, we will make the decision to impose a fee-capping condition.

### **Stage 6: review**

A21. Our decision to fee cap will be subject to review as provided by section 136(5) of the Act and will not become effective until the expiry of the period during which review can be requested, or the completion of any review.

A22. In advance of this stage being reached we will put in place detailed review arrangements. In this section we summarise likely key features of these review arrangements.

- A23. A review of the decision will only take place if requested by a recognised organisation(s). The awarding organisation(s) will have one month to request a review from receipt of our decision to place a limit on fees. If it wishes to do so, the awarding organisation(s) can state at this stage all the reasons why it considers that our decision is incorrect, together with all supporting evidence. The awarding organisation(s) can also raise concerns about the process and methodology followed by us.
- A24. The review will consider the merits of the decision and will be conducted by a person who is independent of Ofqual and who appears to us to have skills likely to be relevant to decisions to impose fee-capping conditions. These skills may depend on the particular concerns raised by the awarding organisation(s). Specific terms of reference for the review will be developed in each case.
- A25. It will be for the reviewer to decide the process it wishes to follow, but it could, amongst other options, seek further written clarification of issues from the awarding organisation(s) or Ofqual or hold meetings with the awarding organisation(s) or Ofqual. If information that for good and legitimate reasons was not available earlier in the process is subsequently made available to the reviewer by us or the awarding organisation(s), the reviewer could, if it considered it appropriate, take account of such new information.

### **Stage 7: final regulatory decision**

- A26. If the awarding organisation(s) chooses not to ask for a review of our decision, we will confirm our decision shortly after the period for seeking a review has expired. If a review has been undertaken, we will consider the findings and determine the appropriate next steps.
- A27. We will send written notification of the decision to the affected awarding organisation(s) and where our final decision differs from our earlier decision we will provide a written explanation outlining the reasons for the differences to the awarding organisation(s).

### **Timetable**

- A28. It is difficult to set out in advance the precise timetable that the above process will follow, as this will differ depending on the nature and number of qualifications being investigated. Below we set out an indicative timetable for each stage of the process:
- Stage 1: eight months
  - Stage 2: six months
  - Stages 3 and 4: one month

- Stages 5, 6 and 7: three months

A29: When a remedy study is triggered we will write to the affected awarding organisation(s) providing a more detailed timetable for the remainder of the process.

**Question**

F. Do you have any comments on our proposed fee-capping process, as set out in Annex A?

Comments .....

## Annex B: Economic recognition criteria, conditions and associated guidance

Recognition criteria		
The organisation intends to operate efficiently and provide regulated units and qualifications that offer value for money		
	Indicators that an organisation meets the criteria	Typical evidence
6	<p>The organisation demonstrates an understanding of Ofqual's framework for economic regulation, and any associated regulatory requirements</p> <p>The organisation is committed to providing units, qualifications and associated services that are fit for purpose and meet the needs of purchasers and end users</p> <p>The organisation has identified the most efficient way to carry out any processes that it intends to implement in the design, development and delivery of regulated units and qualifications, and in the provision of associated services</p> <p>The organisation has management systems in place to understand the costs of providing units, qualifications and associated services and has committed to a culture of continuous improvement to seek to secure efficiency savings for itself and its customers over time</p>	<p>Evidence of relevant research into the qualifications sector and the organisation's intended customer base</p> <p>The planned operational structure of the organisation and the intended allocation of resources</p> <p>Appropriate management accounting and reporting systems</p>

<b>Recognition conditions</b>		
	<b>Detailed conditions. An awarding organisation must:</b>	<b>Guidance. Behaviours that would provide evidence that an awarding organisation is meeting this condition include:</b>
A9	<p>Cooperate with the regulators as required, and alert the regulators to any incidents or issues of which they would reasonably expect to be aware, including:</p> <ul style="list-style-type: none"> <li>■ any significant changes in its governance, financial, legal or business status</li> <li>■ any significant changes to its cost drivers where these are likely to result in a substantial upward pressure on fees or the viability with which the organisation can operate</li> <li>■ activities undertaken by the organisation connected with the provision of regulated qualifications</li> <li>■ any failures in awarding</li> </ul>	<p>Participating in comparability and monitoring activities and other activities deemed necessary by the regulators</p> <p>Alerting the regulators to matters in relation to civil or criminal law that may impact on its regulated functions</p> <p>Notifying the regulators if for any reason within or outside its control it is incurring significant increases in costs that it anticipates will result in fees increasing significantly more than the rate of inflation</p> <p>Alerting the regulators to incidents, breaches or malpractice that could impact on the integrity of an award</p> <p>Alerting the regulators to difficulties with meeting published timetables for the issue of results/awards</p> <p>Alerting the regulators to loss of assessment materials</p> <p>Notifying the regulators of any other relevant information or incidents that might impact on standards or efficiency</p>

A13	Make available to the regulators, in a format and at such frequency as the regulators may determine, information as specified from time to time including information on qualifications registered and awarded, fees, other charges, revenues and costs	Providing the regulators with timely and accurate information, materials, raw data and reports, in particular in relation to any investigations
F1	Offer regulated units and qualifications that represent value for money	<p>Offering units and qualifications that are fit for purpose and of the sufficient quality and standard</p> <p>Providing units and qualifications efficiently</p> <p>Having fee levels for its units, qualifications and associated services that are appropriately cost reflective</p> <p>Having a clear rationale for changes in its provision of support services over time; and where this involves ceasing to provide certain services, considering the impact on its own costs and whether it could unfairly add to any costs incurred by centres in procuring its units, qualifications and associated services</p>
F2	Have a clear rationale for offering for sale combinations or packages of products and/or services and check that such combinations/packages do not unnecessarily or unfairly restrict purchasers' freedom of choice	<p>Ensuring that value for money and learner benefits of combinations or packages offered are transparent to purchasers</p> <p>Providing transparency to purchasers, informing them where they can purchase services separately and the fees that will be incurred for individual services where relevant</p> <p>Only offering for sale packages or combinations that are also</p>

		in the interests of the purchaser
F3	Be able to demonstrate a fair invoicing policy for purchasers, with relevant payment terms appropriate to the products and services supplied	<p>Issuing clear and transparent invoices showing the products and services purchased, the fees incurred and any refunds</p> <p>Offering fair and timely payment terms that do not impose an unnecessary financial burden on centres</p> <p>Having a clear process for confirming payment from purchasers</p>
F4	Conduct all marketing, selling and promotion of its qualifications and services in such a way that no misleading information is disseminated to purchasers	Adopting marketing, selling and promotion activities that accurately inform purchasers, learners and, as necessary, end users about the purpose and content of its qualifications, opportunities for progression, services offered and fees
F5	<p>Make available to purchasers and end users, in an open and transparent manner, information on fees for its regulated units, qualifications and associated services in particular by:</p> <ul style="list-style-type: none"> <li>■ avoiding excessively complex pricing structures</li> <li>■ hyperlinking comprehensive fees list(s) to the Register of Regulated Qualifications</li> <li>■ using best endeavours to publish indicative fees and charges in advance to assist centres purchasing and budgeting processes</li> </ul>	<p>Publishing information on fees, other charges and payment dates for its products and services in a format that meets the needs of, and is accessible to, purchasers</p> <p>Providing a clear set of terms and conditions for purchases</p> <p>Providing transparency for purchasers on the cost or refund implications of their changing requirements for products and services</p> <p>Compliance with guidance published by Ofqual on a suitable period for advance publication of indicative fees</p>

F6	Not place unnecessary requirements on centres and other parties involved in the provision, delivery or award or regulated qualifications and units	<p>Actively reviewing and being able to justify any requirements it places on centres and others involved in the provision, delivery or award of regulated qualifications and units; for example by:</p> <ul style="list-style-type: none"> <li>■ seeking feedback on the perceived benefit and effectiveness of its requirements</li> <li>■ identifying and removing any unnecessary requirements</li> </ul>
H1	Develop units and qualifications that are fit for purpose and record the rationale and justification for their development	<p>Researching and identifying demand for any proposed qualifications and units</p> <p>Identifying existing comparable qualifications to check that proposed units and qualifications bring additional benefits to centres, learners and other users</p>
H2	Demonstrate that relevant employment or education sectors support its units and qualifications and confirm they provide progression opportunities for learners	<p>Consulting with, and where appropriate having support from, employers, employer representatives, learners and centres to identify potential learning outcomes and progression routes</p> <p>Consulting with, and where appropriate having support from, further and higher education to identify potential progression routes</p>
H4	Support informed choice by publishing in an accessible format clear, accurate and timely information on its regulated units and qualifications and its associated services	<p>Publishing information on assessment procedures and dates and unit and qualification outcomes</p> <p>Publishing and adhering to comprehensive customer service statements including its policy on communicating with centres</p>

		in Welsh, where appropriate Publishing points of contact Publishing information on products and services
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## Annex C: Complaint form for issues relevant to our economic regulation function

This form can be used by awarding organisations, centres and end users of qualifications (including learners, employers and higher education institutions) to submit to Ofqual complaints relevant to our economic regulation function.

Relevant complaints include, but are not limited to, those in the following areas:

- the value for money of qualifications, in particular their fitness for purpose or level of fees
- the transparency of information provided by awarding organisations on their products and services and associated fees
- packaging or marketing of qualifications and their associated services
- practices, regulations or policies which restrict the efficient operation of the sector
- regulatory burden.

Our *Consultation on Economic Regulation and the Fee-capping Process* sets out more details on the types of issues our economic regulation function deals with. Please refer to this if you are unsure whether your complaint should be directed to our economic regulation function.

<p><b>Your name</b></p> <p>[Please provide your full name here]</p>	
<p><b>Your contact details</b></p> <p>[Please provide details here of how we may contact you]</p>	
<p><b>Your organisation and position</b></p> <p>[If applicable, please provide details here of the organisation to which you belong and your role in the organisation.</p> <p>If you are a learner, please note this here and provide details of the</p>	

<p>educational institution to which you belong, your centre number and candidate number]</p>	
<p><b>Details of your complaint</b></p> <p>[Please provide information on the nature of your complaint here, in as much detail as possible.</p> <p>Where available, please provide supporting evidence, including any copies of correspondence.</p> <p>If applicable, please include the name of the qualification and awarding organisation]</p>	
<p>Please email your completed form and supporting evidence to:</p> <p>info@ofqual.gov.uk</p> <p>Alternatively you can post this form, along with any supporting evidence, to:</p> <p>Complaints Team, Ofqual, Spring Place, Coventry Business Park, Herald Avenue, Coventry, CV5 6UB</p> <p>We will endeavour to acknowledge your complaint within 2 working days of receipt, and provide a substantive response which sets out our next course of action within 10 working days.</p>	

## How to respond

Please respond to the questions we have asked using one of the following methods:

- completing the online response at [www.ofqual.gov.uk/consultations](http://www.ofqual.gov.uk/consultations)
- emailing your response to [consultations@ofqual.gov.uk](mailto:consultations@ofqual.gov.uk)
- posting your response to Economic Regulation Team, Ofqual, Spring Place, Coventry Business Park, Herald Avenue, Coventry, CV5 6UB

Responses should be received by us no later than 31 January 2011.

## **Annex D: Consultation questions**

- A. Do you agree with the definition of value for money, as set out in section 4.2 and summarised in Box 3, that we are proposing to apply in undertaking our regulatory functions? Please explain why and provide any suggestions you have for how we may improve the definition.
- B. Do you agree with our approach to securing efficiency, as set out in section 4.3, which is built on the idea of promoting efficiency at the awarding organisation level, encouraging efficiency at the system level and remedying inefficiency where we find this occurs? If not, please explain why and provide any suggestions you have for how we could improve our approach.
- C. Do you agree that we should place the economic recognition criteria and conditions summarised in Table 1 and set out in full in Annex B on awarding organisations? If not, please explain why.
- D. Do you think stock-take exercises, as set out in section 6.3, will be useful in helping us to encourage the efficiency of the qualifications system?
- E. Do you agree that the indicators of inefficiency, as set out in Tables 2 and 3, are suitable for helping us to identify where there may be a risk of inefficiency in the qualifications sector? If not, please explain why and provide any suggestions you have for how we could improve the indicators.
- F. Do you have any comments on our proposed fee-capping process, as set out in Annex A?
- G. Do you have any other comments on our consultation?

Ofqual wishes to make its publications widely accessible. Please contact us if you have any specific accessibility requirements.

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