

## Step 9: Tender

### Tool 4: Guide to developing a financial evaluation model

This tool is for use in conjunction with Step 9 of the Commissioning Toolkit document

#### What is the objective of this guide?

The objective of this guide is to provide commissioners with guidance regarding the structure, inputs and outputs of the financial evaluation model in the context of procuring pathology services. This guide does not include a template for such a model due to the need to tailor the financial evaluation model to the unique characteristics of each individual procurement project, and therefore the need to avoid creating the impression that a single template could suit all pathology procurements. If a sample model is required, the commissioner could contact the reference organisations mentioned in the toolkit.

#### How to use this guide?

The guide provides information regarding the general structure, inputs and outputs of the financial evaluation model. This information should be taken into consideration when creating the specification for the model. Experience from past projects suggests that the complex nature of procuring pathology services often requires the involvement of external specialists in the creation and quality assurance of the model. This guide is intended to help the commissioner define the necessary outputs of the model.

#### What are the objectives of the financial evaluation model in the procurement of pathology services?

The financial evaluation model (FEM) measures the impact of the project's outcomes on the current cost of pathology service. It is used during the tender evaluation process, subsequently forming part of the full business case (FBC) and is intended to achieve two main objectives. The primary objective is to test the financial impact of the project on the commissioning organisation's financial position and to confirm whether the outcome is financially affordable, which in most cases translates to generating a financial savings compared to the option of doing nothing or the current financial cost of the service. The secondary objective is to provide bidders with a standard format for presenting the financial elements of their bids to the commissioners, thus facilitating the comparison and ranking of competing bids during the tender evaluation process.

#### Key considerations

There are several key considerations, relating to the unique characteristics of the project, which should be taken into account when designing the FEM:

- 1) **Complexity** – at its simplest form the FEM conducts a comparison of current prices/costs of pathology tests to the future prices/costs following the procurement exercise. In many cases however, it will be necessary for the FEM to include additional inputs, pending the nature of the project. In a project involving the transformation of pathology services within the local NHS health economy, additional inputs would be required to allow a comparison of the cost of staff hires and/or redundancies, new equipment such as analysers, and the cost of installing a new LIMS. This level of complexity serves to ensure a standard approach for costing (and hence pricing) is used and provides an insight into bidders' cost assumptions which can in turn be challenged to help achieve a more competitive price for the commissioning organisation.
- 2) **Length** – the length of the period covered by the FEM should align with the proposed contract term, including a transition and/or transformation periods if necessary. In the context of pathology services it is important to consider the potentially long period necessary for achieving a return on investment where significant capital expenditure is required. As a result it is likely that FEMs (and contract terms) in projects involving the creation of new facilities and/or the procurement of new equipment (e.g. LIMS, analysers) will cover a longer period in the financial assessment of affordability.
- 3) **Charging/payment mechanism** – the FEM will be built around the charging/payment mechanism designed for each individual procurement separately. As a result a FEM for a tariff-based

commissioning project will be different to that of a commissioning project using an alternative mechanism, for example block contracts. This is due to the need of the FEM to simulate the cash flows that will be generated following the contract award stage and throughout the project's lifecycle.

- 4) **Variations to the number of tests** - Any increase in the quality of pathology services as a result of the commissioning project, which attracts a cost, need to be quantified in the assumptions. For example investing in new equipment to reduce the number of repeat tests required per patient, should appear as an input factor to balance investments with the reduced volumes (and hence overall cost) of tests. In a similar manner an improvement in the process and technology for sharing tests that would lead to a reduction in tests' volumes should be included as an input. Using the above as bidder's inputs allows a better overview of the merits of individual bids and their financial implications.
- 5) **Risk** – most FEMs are MS Excel-based calculators and as such have a high risk of calculation errors. Errors in the FEM's output could result in a decision made on moving forward with the wrong option as well as lead to the appointment of the wrong supplier and/or legal challenges to the process. In order to mitigate the risk many organisations choose to outsource the production of the FEM to external advisors. In addition the FEM should be tested thoroughly and include a sufficient level of transparency regarding the inputs, calculations and outputs.
- 6) **Automation** – FEMs are designed to provide an answer using a standard calculation process for all suppliers. This process is driven by altering the information in the input cells according to each supplier's bid and recording the outcome from the FEM's calculation engine. In order to further facilitate the comparison of bids, it is possible to use scenarios where all inputs are recorded in a separate table as set scenarios and can then be switched instantaneously without the need to re-type the information in the input cells. These scenarios could be used to ask bidders to highlight the differences between various proposed contract lengths or a projected increase/decrease in tests' volumes as part of the sensitivity analysis of the overall project affordability.

## Structure

The FEM can be divided into two sections:

1. **Bidder's input** – providing the bidders with input cells to upload the bids' financial sections, which will then be automatically calculated by the FEM's formulas to provide an overall financial outcome.
2. **Value for money calculation for the commissioner's organisation** – providing the commissioner with the final cash flow position for the period covered by the model. If an overall value for money analysis is required for the entire health economy in the commissioner's region (covering both direct and indirect access) this section may be split into two parts, the first accounting for the cash flow outcome of the commissioning organisations, the second accounting for the cash flow outcome of residual services located in NHS provider organisations. Conducting the analysis this way may not necessarily impact the final outcome of the process, but will assist in ensuring the outcomes are fully understood.

The following elements are normally included in each of the two sections of the FEM:

1. Inputs
2. Phasing of inputs (capacity ramp up, only included if relevant)
3. Calculations
4. Cash flows

At a high level it can be said that the cash flows figures are the output of the model, giving the commissioner a high level indication on the financial outcome of the bid's details. The inputs allow the commissioner to test the output, by providing him with the ability to understand the mechanics of the bid and assess the impact of different elements within the bid on the financial outcome. For example, reviewing the bidder's inputs will allow the commissioner to confirm the winning bid allowed for sufficient allocation to cover staff costs during the transition period.

## Inputs

The bidder's input section provides the framework for breaking down the bidders' costs and assessing whether the cost elements represent good value for the commissioning organisation. The level of complexity of this section will depend on the complexity of the commissioning initiative.

For example, a GP clinic which is re-commissioning its pathology services may only be interested in the tests' prices and volumes, whereas a regional reconfiguration of services will require an understanding of capital investments, staff-related costs, and the cost of IT and logistics.

It is also important to note that several of the inputs will be defined by the commissioner while others will be provided by the bidder. The division between these two types of inputs may depend on the level of flexibility which the commissioner is allowing the bidders, for example the length of the necessary transition period until new operations are running at full capacity could be determined by the commissioner or left to the individual bidders.

Relevant inputs to the Bidder's section will include all or some of the following, depending on the nature of the commissioning project:

1. Model set up
  - Identifying the overall model timeline in years. This section also includes standard variables such as 12 months in a year or 365 days in a year.
2. Project's dates and milestones
  - The operational period for review could be different from the model timeline. This could include start of operations, operations reach full capacity, and operations end (for the purpose of financial evaluation)
3. Indexation
  - Providing a list of the indices used in the model to calculate net present value and other time-based analysis. Indices could include, but are not limited to, inflation, increase in opex or salary increases.
4. Staff costs
  - Number of staff to be employed (i.e. paid) directly by the commissioning organisation (the bidder's staff will not be counted, as the impact of their cost should be included in other inputs such as the cost of IT or logistics). These are likely to be defined using the Agenda for Change bands.
  - Staff salaries – these are likely to be defined using the Agenda for Change bands.
  - Staff salary indexation
5. Other operating costs
  - Recurring non-staff costs
    - Heat
    - Water
    - Electricity
    - Rent – for all relevant locations. Could include labs, call centre, logistics, storage, etc..., unlikely to include rent for provider locations, where those are already represented as part of the price of the test.
    - IT – licences, maintenance and support, equipment costs below the threshold for capital accounting
    - Logistics – the on-going cost of logistics (e.g. fuel, drivers, maintenance) rather than the cost of purchasing new vehicles
    - Lifecycles
    - Test sampling
    - Tests sent for external processing
    - Additional diagnostic and interpretation costs
    - Cost of audit/certification of labs
    - Consumables
    - Reagents

- One-off costs – this would include both costs relating to the transformation of services and any other non-recurring costs
    - Redundancy
    - Legal claims/provisions
    - Transport – upgrade of fleet
    - Back-fill during double running of equipment and/or facilities
    - IT investment (LIMS)
    - Analysers
    - Redundancies in the supply chain to pathology
    - Estates/construction
6. Revenues – note that a commissioning project may result in a reduction or an increase to the overall number of tests by, for example, reducing the number of repeat tests by better recording and communication of results, or by including an investment to increase the range of tests, and thus reduce overall diagnostic spend. If such a fluctuation occurs the change in volume should be included as an input in the financial model. If the supplier is allowed to influence it by, for example, designing an improved recording process as part of their individual solution, the inputs in the FEM may have to be altered by supplier.
- Individual test volumes
  - Individual test price
  - Individual test price indexation

#### **Phasing of inputs**

The phasing of inputs would occur when the ramping up of capacity is done on a gradual basis, taking account for example of the need to install and test equipment prior to using it on a regular basis, thus reflected in a phasing of the cost inputs over the same period.

#### **Calculations**

The calculation element of the FEM combines the input costs in conjunction with the phasing of inputs, the overall timeline for the project, as well as the pre-determined indexing, to provide a nominal costs/prices breakdown.

#### **Cash flows**

The cash flow element of the FEM combines the calculations in to a high level comparison between the current baseline and the projected outcome of each individual bid. The objective of this element is to determine whether the commissioning organisation generate savings over the life of the proposed contract compared with the current cost of pathology services.