

Written Evidence submitted by The Centre for Development Results (CDR)

1. Summary

- 1.1 Contractors are key partners to DFID. They provide specialist technical expertise and enable DFID to deliver its development objectives.
- 1.2 DFID has continually improved its procurement, contract management, risk management and programme management processes. Contractors welcome these improvements and DFID's focus on demonstrating the impact of its work overseas and value for money for the taxpayer.
- 1.3 Despite this, changes to commercial contracting processes have had unintentional consequences, such as increasing the cost of delivering programmes and creating barriers to entry for smaller firms. Changes have often been made without sufficient consultation and without proper guidance for suppliers or support from the Department.
- 1.4 The sector is more transparent than other parts of the development community. Contracted suppliers comply with a rigorous code of conduct and DFID has oversight of the design, implementation and monitoring of all contracts. Ensuring that transparency and compliance requirements are uniform across all government departments and DFID partners should be a priority.
- 1.5 DFID requires a more coherent strategy for engagement with contractors. It should work in a more open and consultative way with these partners – particularly in the current political and media environment. Contractors would welcome the opportunity to work with the Department to design solutions to help DFID achieve its development and commercial objectives as well as raise standards in the industry.
- 1.6 CDR is well-placed to support the Department in its engagement with contractors. We would welcome a forum for regular engagement and consultation with DFID.

2. Introduction

- 2.1 DFID's use of contractors is crucial to its ability to deliver the UK's development objectives. They provide specialist technical expertise and are key partners to DFID, helping to achieve transformational change. Contracting is one of the most cost-effective and transparent means through which DFID can deliver impact overseas and value for money for the taxpayer.
- 2.2 As a result, the proportion of DFID's budget which is contracted has risen. In 2015-16, 13.5% of the Department budget was disbursed through an approved public procurement process – up from 12.7% in 2014/15ⁱ. In 2015/16, the top 10 recipients of DFID contractual funds were Crown Agents, PwC, Adam Smith International, Mott MacDonald, Palladium, DAI Europe, Voluntary Services Overseas, IMA WorldHealth, Oxford Policy Management and KPMG LLP.ⁱⁱ
- 2.3 Contracting is rightly placed under regular scrutiny. It is important that the taxpayer is confident that all public spending is delivering value and impact. DFID is already one of the most, if not the most, transparent government departments with robust controls on its spending. Despite this, recent media coverage of contractors, and aid and development more generally, has presented an overly negative picture of how the Department works and the impact it delivers.
- 2.4 In May 2013 ICAI gave DFID a Green-Amber rating for its use of contractors. Since then contracting processes and supplier compliance requirements have been significantly improved. This has included improvements to its procurement, contract management, risk management and programme management processes, as well as improving its partnership and communication with contracts. Most recently, the Department has expressed a desire to increase transparency and diversity in its supply chain and extend open book contracting.
- 2.5 CDR welcomes improvements to the contracting process and seeks to be a greater partner to DFID as it seeks to improve the way it works with contractors, ensuring that it is delivering best value, promoting a competitive market place and reaching UK development objectives.

3. Working with private sector contractors

- 3.1 In recent years, DFID has taken action to improve the way it engages with its suppliers. The Key Supplier Management programme and Supplier Conference have sought to improve communication between the Department and its suppliers. These have been beneficial, however, DFID could benefit from a more coherent and comprehensive engagement strategy, which covers both communication of information about pipeline and consultation on changes to its commercial processes.

- 3.2 Transparency is important and DFID has rightly sought to continuously address concerns about the delivery of UK aid, including through contractors. A number of changes have been made to DFID's contracting processes as a result. While many of these changes have been well intentioned, they have often been implemented without consultation and without proper guidance for suppliers or support from the Department. This has had a number of unintended consequences such as increasing the cost of delivering programmes and making it more difficult for smaller firms to compete.
- 3.3 There is a concern that future changes DFID seeks to implement will be made without proper consultation and consideration of the full commercial and development impacts. Suppliers have been advised of a number of changes to transparency requirements and contracting processes, including the extension of open book contracting. There is a concern that DFID's intention to extend open book principles throughout its supply contracting is incompatible with its current Payment by Results (PbR) approach. It has the possibility of leading to worse development outcomes and requires significant additional resources from DFID staff. Similarly, DFID's intention to increase supply chain transparency requires consideration of due diligence processes and the impact on sub-contractors, particularly SMEs and developing country organisations. Contractors could help develop best practice guidelines and solutions to support DFID in implementing these changes.
- 3.4 Where DFID has consulted suppliers on issues regarding contracts, they have been slow to implement the changes. For example, in 2015, suppliers requested clarification from DFID on insurance requirements as they pertained to sub-contractors within DFID's Standard Terms and Conditions (STCs) version 2.0. Working with DFID they proposed a number of updates. DFID assured suppliers they would update the STCs and release a version 3.0, but they have yet to do so.
- 3.5 At present, the priorities and objectives of the Ministerial Team are unclear. The Secretary of State has also stated on a number of occasions that she is undertaking a review of contracts. Suppliers have little information on the timeline or process for this review, or its impact on procurement.
- 3.6 In the recent Bilateral Development Review, DFID stated its desire to work in an open and consultative way with its partners. As key implementing partners, private sector contractors welcome this and are willing to work with DFID to help it achieve its commercial and development objectives. Their expertise can help DFID design solutions that address their concerns and improve impact and value for money in UK aid funded programmes.

4. Delivering Value for Money

- 4.1 Value for money (VfM) is rigorously monitored and evaluated across DFID's portfolio. Prior to commissioning a programme DFID undertakes a robust value for money assessment of delivery modalities in order to select the best mechanism. Contracting is selected where it is deemed to provide best value for money and to be the most effective way to deliver a programme. Contracting is a transparent and competitive process, open to anyone, regardless of organisational status. Private sector contractors compete against NGOs and other organisations or bid together with them in consortia.
- 4.2 Contracting also gives DFID greatest oversight and control of programmes. DFID staff are involved in every stage of the process from design through to implementation and monitoring and evaluation. Every project has an annual review process and is graded against its projected targets. Where programmes are not reaching their targets, they are put on Programme Improvement Plans. PbR contracts also shift the commercial risk of delivering programmes to supplier and incentivize them to reach key milestones.
- 4.3 Contractors are open to working with DFID to ensure its portfolio of contracted programmes is delivering VfM, including helping to better define VfM and improve its programme design and monitoring processes. VfM can be further improved by increasing investment in monitoring and evaluation capabilities to assess how aid modalities are performing and undertaking a robust assessment of the cost of compliance to suppliers and understanding how these impact the ability of contractors to deliver value.

5. Improving Industry Standards and Transparency

- 5.1 On the whole contractors and the contracting process are far more transparent than other parts of the development community. DFID's contracting process is one of the most transparent government procurement processes.
- 5.2 Suppliers are bound by DFID's Statement of Priorities and Expectations and full programme details are publicly available on DevTracker. From 2015, suppliers were required to provide a Cost Modelling Methodology for each contract. This commitment requires the implementation of a transparent, open book approach which enables scrutiny on VfM choices. This includes details of how costs are constructed in terms of percentages in relation to each fee rate by breakdown of overheads, salary, and net profit margin. All new DFID contracts also set out a requirement within the terms and conditions for specific direct and downstream supply chain spend data to be published to the International Aid Transparency Initiative (IATI).
- 5.3 More recently, in response to media allegations, suppliers have been asked to provide details of executive salaries, the percentage of revenue that comes from DFID including the 3-5 year trend, written evidence that they are compliant with the Required Conflict of Interest and Security Obligations, and written evidence

of subcontractor governance arrangements. Suppliers must also provide DFID with policy details on tax transparency, on request. This includes information pertaining to net profit, tax of profit in all operating countries, and tax compliance in all operating countries.ⁱⁱⁱ

- 5.4 This is a level of scrutiny not required of other parts of DFID's supply chain. These same standards should be applied to other government departments and other DFID implementing partners.
- 5.5 With regard to salaries, profits and dividends, they depend largely on the structure of the contracted business. Companies engaged by DFID represent a diverse set of organisational structures including social businesses, employee-owned businesses and commercial subsidiaries of charity organisations. Salaries tend to be below market and in-line with the charity sector. Profit margins for development contractors are typically narrow (0-6%) compared to government contractors outside the development sector e.g. accounting firms (14-20%) and defense contractors (8-13%).^{iv}
- 5.6 DFID's private sector contractors are development professionals with specialist expertise who care deeply about the impact of their work. Poverty reduction is their core purpose. They want to play a proactive role in addressing the criticisms of the sector and improving standards. They would welcome a conversation with DFID about setting industry standards on issues such as what constitutes a fair and reasonable profit.

6. Competition and Barriers to Entry

- 6.1 DFID has an objective to diversify its supplier base and increase SME participation in its supply chain. DFID performs better than most other donors in this respect and already exceeds the government target on the value of contracts that should flow through SMEs. However, addressing barriers to entry and fully understanding the impacts of changes to procurement processes can help further improve this.
- 6.2 In the UK, five firms win around 35% of the contracts by value, 10 win 48% and 20 win 60%. Comparatively, in Australia, three firms win 69% of contracts and 10 firms win 93% of contracts. In the US, five companies win more than 50% of contracts. In Canada, two firms win a majority of contracts, and in Germany it's three. These UK figures also fail to take into account the substantial amount of work that is subcontracted or managed as sub-grants passing through the accounts of the lead implementer. While some contractors are hired to deliver the work themselves, most competitive procurements, particularly for large contracts, result in a partnership between development organisations.
- 6.3 Recent changes to DFID's procurement processes and compliance regulations have unintentionally made it more difficult for smaller companies to bid and win

contracts. For instance, in October 2016 the structure of the Economic Development Framework was changed to introduce one catch-all lot covering economic and private sector development related programming and five new smaller lots covering specific areas like manufacturing and infrastructure. These changes were designed to encourage smaller firms to bid directly for work. However, smaller companies may struggle to demonstrate track record and ability to absorb the risk associated with programmes in such narrowly defined terms. There was also a suggestion to introduce a cascade structure to the lots, which would rank suppliers and give the highest ranked supplier first right of refusal to any new contracts. This would not encourage diversification of the supply chain. While frameworks have the ability to help make and shape markets, DFID has demonstrated a lack of technical understanding of the impact of these changes on the supply chain.

6.4 Suppliers have previously raised a number of issues which would help diversify the supply chain. These include:

- Level the playing field in terms of access to information – Providing an early and more consistent pipeline of information would allow suppliers to better prepare to bid for work. It also allows time for suppliers to provide feedback. The opportunity cost of preparing bids is very high, so any action to avoid delays and provide as much lead-in time as possible will benefit all suppliers in the market – particularly smaller companies who do not have the cash flow available to larger companies.
- Consistency in tax arrangements – Suppliers on a number of occasions have asked DFID to improve the consistency of the application of tax exemptions to UK aid funded programmes. The cost of maintaining a large central tax department capable of dealing with changing requirements in multiple countries, plus the cost of hiring multiple local tax advisers is considerable. These costs are prohibitive for smaller suppliers and could discourage them from proceeding in the country in question. More generally, DFID's approach also disadvantages British companies against those receiving other donors' funds, which benefit from broad tax exemptions.
- Simplification of the contracting process – This has become increasingly complex, with increasing numbers and types of obligations placed on those who bid. This constitutes a significant barrier for smaller organisations.

6.5 As DFID intends to introduce more changes relating to supply chain transparency, it should seek to understand the impact of these changes on sub-contractors and seek to co-design processes which ensure that contractors have a consistent way to implement any transparency requirements.

7. Impact of Recent Media

- 7.1 The tenor of recent media reporting of UK aid funded programmes, and particularly the focus on private sector contractors, is a source of serious concern for the sector. There is an evident lack of understanding of the complexity of the programmes DFID is delivering and often a misreporting of results. Private sector contractors are regularly accused of being ‘poverty barons’ and ‘pocketing’ large sums of money, which amount to headline contract values. This deliberately misleads the public about how UK aid is spent.
- 7.2 Whilst as a sector we recognize there is always room for improvement, misreporting of the impact and motivation of private sector contractors is damaging to the sector as a whole. It is part of campaign to undermine the entirety of the UK’s foreign aid commitment, rather than to drive better standards.
- 7.3 DFID needs to be seen to be leading in this environment. If a programme which consistently performed well in DFID annual evaluations can be cut after a concerted media campaign, it does not inspire confidence that DFID knows well how to define VfM and communicate and defend its investment decisions.
- 7.4 The high regard in which contractors delivering UK aid funded programmes are held should be a source of pride to the Department. Historically, private sector contractors have not invested significant resource in communications. This is in part due to their view of their role as an implementing partner of DFID’s objectives. Communication constitutes an overhead cost and programme-specific communications is often cut from budgets in contract negotiations. Given the oversight of programmes it has, DFID should be willing to defend its choice of delivery modality. DFID should also work with its implementing partners to find innovative ways of telling the stories of the impact of its programmes. CDR is ready to provide support to the Department in this respect.

8. Conclusion

- 8.1 Contractors want to play a proactive role in addressing criticisms of the development sector. They are willing to work with DFID to improve impact and value for money of their work and raise industry standards. This includes increasing SME involvement and local content in programming, helping to build DFID’s technical commercial capacity and improving supply chain transparency.
- 8.2 Building on the improvements it has already made, DFID should work in a more open and consultative way with its contractors. They can help design solutions to the development and commercial objectives DFID seeks to achieve. DFID should institutionalise a forum to discuss changes to compliance and transparency requirements, to ensure that it is testing ideas and seeking solutions from the market. CDR can help to convene that forum.

8.3 DFID is rightly regarded as a leader in many areas of its delivery, procurement and commercial capabilities. We hope to see DFID's leadership in these areas spread across other government departments and implementing partners. We are keen to support DFID in being the best in consultation with its suppliers, which we believe will lead to better outcomes. By working together we can reach our shared ambitions to improve impact, accountability and value for money.

9. About CDR

9.1 The Centre for Development Results (CDR) is a new organisation supported by a range of companies working in international development. We promote, support and represent the work and interest of UK international development companies, who have a shared aspiration to improve impact, accountability and value for money in their work. Its aims are:

- To contribute to debate and policy development on the most effective means of achieving results in development
- To facilitate the exchange of views, the conduct of research and the publication of policy work on methods of improving development effectiveness
- To contribute to a better understanding of the role and impact of member organisations

9.2 CDR members are progressively-minded companies that have the shared aspiration to contribute to the aid and development conversation in the UK. They include: Adam Smith International, Coffey, Crown Agents, DAI, IMC Worldwide, Mott MacDonald, Nathan Associates, Options and Palladium.

ⁱ Department for International Development: Procurement: Written Question – 52071

<http://www.parliament.uk/business/publications/written-questions-answers-statements/written-question/Commons/2016-11-07/52071/>

ⁱⁱ Department for International Development: Procurement: Written – 52074.

<http://www.parliament.uk/business/publications/written-questions-answers-statements/written-question/Commons/2016-11-07/52074/>

ⁱⁱⁱ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/433695/expectation-suppliers1.pdf

^{iv} Query run against S&P Capital IQ's database of publicly traded companies that list the UK Government as a major client. NB as a result it excludes privately held companies and other companies that may have UK Government as a client, but not a major one.