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Overcoming Problems Faced by Small and Micro-Consultancy Companies in DFID's Procurement System¹

1. Introduction

Public Administration International (PAI) was established in 1995 and specialises in management consultancy, training and development services for public sector organisations worldwide. We provide advice and support to governments undergoing political, economic, legislative and structural changes. PAI's key objectives are promoting good governance and good practice. PAI is currently classed as a micro firm (fewer than ten fulltime equivalent employees), though a few years ago it was in the small firm category.

PAI has read with interest the National Audit Office's cross-government report, "Government's spending with small and medium-sized enterprises" (9 March 2016). We share the NAO's concerns with the difficulties faced by small and micro firms in competing for UK government contracts.

2. Executive summary

This submission is concerned with two major topics:

- The disadvantages in the current DFID procurement system experienced by small and micro-consultancy companies (see definitions below), even though DFID more than meets its targets for contracting with Small and Medium Enterprises (SMEs).
- The advantages small and micro-consultancies could bring to development projects, if they were given improved opportunities to bid for lower value contracts. These would be particularly important in Fragile and Conflict Affected States (FCAS), to which DFID now intends to direct at least 50% of its aid.

The Conclusions and Recommendations of the International Development Select Committee's Report on DFID's Annual Report for 2013/14 include the following paragraphs:

We recognise that it is not DFID's main function to keep suppliers in business, but we are concerned that DFID is making too little use of small, expert, technical suppliers and pays too little attention to how its commissioning affects small suppliers. This situation may have been exacerbated by DFID's need to increase its spending rapidly. We welcome the Permanent Secretary's agreement to look at whether restrictions on staff numbers are affecting the extent to which DFID uses smaller suppliers.

We recommend that DFID review its approach to project design and commissioning to ensure it does not exclude smaller suppliers. DFID should aim to increase in 2015 both the absolute value of business going to SMEs, either directly or in its supply chains. DFID's review should also consider the risks of its reliance on larger suppliers and multilateral organisations. We recommend that DFID assess other departments such as Health or DWP,

¹ Written evidence submitted to the International Development Committee's inquiry on 6 June 2016 into DFID's use of contractors by Public Administration International, 56 Russell Square, London, WC1B 4HP

where government is the dominant customer, to learn from their successes and failures in this area.

PAI is aware of DFID's SME Action Plan, published in August 2015². But we wish to continue to make the case for an increased focus on and a better deal specifically for small and micro suppliers, given the important role they play in the UK economy.

3. SMEs and definitions

3.1 The UK Government is bound by EC Public Contracts Regulations³. These define SMEs as follows:

Enterprise Category	Employees	Annual turnover	Balance sheet assets
Medium	< 250	< € 50 million	< € 43 million
Small	< 50	< € 10 million	< € 10 million
Micro	< 10	< € 2 million	< € 2 million

Source: EC, The New SME Definition-User Guide and Model Declaration - Annex : "Definition of Micro, Small and Medium sized Enterprises Adopted by the Commission", Article 2.

3.2 Increasing the share of SMEs being awarded central government contracts is a priority for HMG. The Department of International Development is rightly proud of its success in contracting with SMEs, amounting to 30% of total contract expenditure in 2014/15 and well in excess of the UK Government's target of 25%. Figures for 2015/16 are not yet available, but we understand that DFID has set a 33% target of direct spending with SMEs (as stated in DFID's SME Action Plan).

3.3 The problem in the development consultancy sector is that the co-joining of the 'small' and 'medium' categories in the term 'SME' allows medium sized businesses to dominate DFID's procurement. Many small and micro enterprises have a core of permanent staff well below the threshold of 50 people and hire in experienced consultants on a needs basis, allowing a focus and access to specialist expertise not available in larger organisations. Formally, micro and small enterprises enjoy no contract differentiation in DFID's eyes from medium-sized businesses.

3.4 The reality, as shown by DFID statistics, is that 60% of all DFID contracts go to eleven of DFID's "key strategic suppliers". Figures for staff numbers and turnover of key suppliers are hard to obtain, but it is possible that as many as half can be classified as 'medium' sized firms according to the EC definition. They dominate the SME category.

² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/455544/SME-Action-Plan-August2015.pdf

³ <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32003H0361>

3.5 While it has to be admitted that the main reason for this dominance is the size of DFID projects which require considerable implementation capacity, it does mean that small and micro consultancies are squeezed to the margins and do not get a fair share of project work, or often even the chance to be full participants in the tendering process. It also makes it doubly hard for small businesses to develop and grow into medium sized businesses over time, meaning that DFID's contract supply channels are effectively monopolised by the same key suppliers without effective competition to produce improvement of service. Such competition that the "key strategic suppliers" face is often from large-scale American and Australian firms.

4. Consortia arrangements for contract tendering: framework agreements

4.1 The characteristics of the system described above are exacerbated by the current arrangements for contract tendering. In an effort to speed up the process and ensure the appointment of the most appropriate service providers, DFID has introduced a system of framework agreements that includes pre-formed and pre-qualified consortia of consultancy companies in priority sectors for the aid programme. Examples are "Governance and Security", "Fragile and Conflict Affected States", the "Global Evaluation Framework" and "Professional Evidence and Applied Knowledge" (PEAKS). Under each sector heading, there may be several sub-headings (lots) with separate sets of consultancies forming consortia in each. For example in Governance and Security, there are "Governance", "Public Finance" and "Justice". Consortia consist of groupings of up to 10 -15 companies that have come together voluntarily and which have been assessed by DFID as potentially suitable contractors. These consortia are regularly reviewed for their continuing relevance to needs.

4.2 Each consortium is convened by a lead consultancy that acts as focal point for organising team responses to DFID invitations to tender. These lead companies play a decisive role, first in deciding whether the consortium will respond to the possibility with an Expression of Interest (EOI); and then, if shortlisted, in determining which organisations in the consortium are to participate and in finalising the proposal submitted. Lead consultancies are self-appointed and are usually instrumental in forming the consortium. They are recognised by DFID and are predominantly the key strategic suppliers which have become the major contractors in the aid programme. They meet the financial criteria that DFID looks for to reduce procurement risk and are easily able to accommodate the pattern of retrospective payments (increasingly payment-by-results) for work completed.

4.3 For the increasing number of projects that DFID tenders through such frameworks, the procurement process is as follows:

- Invitations to express interest and to tender are only sent to the lead consultancy in each consortium.
- This firm then decides whether to express interest, usually after consulting other members of the consortium. Perhaps understandably, the decisions seem to be made primarily on the basis of the interest and potential involvement of the lead consultancy itself.
- Proposals eventually submitted have to go through and be finalised by the lead consultancy.

- While the names and capabilities of consortium members are included in tender documents as sub-contractors, sub-contractors find that they rarely get a commensurate share of the paid work in implementation. This is largely completed by staff of the lead consultancy in the bid.
- Timetables for submissions are so tight that it is hardly possible for consortium members to produce alternative proposals, if the lead consultancy eventually decides not to put in a bid.
- The larger companies in lead positions build up strong track records and project references for previous work and, on this basis, strengthen the likelihood that they will be chosen again for similar projects elsewhere.
- Larger companies have the financial resources to carry start-up costs, while smaller companies often do not. As a policy, DFID pays in arrears for work completed and does not give advances on contracts. Increasingly, it is making use of payment-by-results or milestone contract payment arrangements which can mean quite long delays before payment is made.

4.4 The “jury is still out” on the effectiveness of the framework system, and we understand that DFID itself has conducted an internal review of its use of framework contracts. Seen from the small and micro end of the SME category, the system seems to have the effect of excluding them from bidding and from being included as genuine partners in work programmes, as opposed to having their names included to add superficial credibility to proposals. We would welcome greater scrutiny on indirect spend with small and micro enterprises by larger consultancies contracted by DFID.

4.5 The net result is that small consultancies are at a severe disadvantage, essentially winning only what can be described as ‘crumbs from the table’. They are also in a “Catch 22” situation. They cannot grow and enhance their capabilities and, for example, establish in-country offices (an important advantage for many programmes) until they win more contracts or larger shares of big contracts; and they cannot win more business until they have stronger track records and cash flows adequate for start-up costs.

5. Selection of consultants for projects in Fragile and Conflict Affected States (FCAS)

5.1 This is a more subjective but equally important problem, not only for the signatories to this submission, but also for the IDC Committee, as evidenced in the paragraph of their Conclusions and Recommendations included in paragraph 2 above. Essentially the issue is whether the present system of procurement provides the right kinds of consultants and consultancy experience that can meet the requirements for a successful impact in the unpredictable, insecure environments of the FCASs. In ‘fragile’ conditions where personalities and personal relationships are decisive, the key is not usually in the creation of new technical systems. It is rather in the establishment of relations of mutual trust and credibility with key Government and non-Government partners that will encourage them to change their behaviour and decision-making processes.

5.2 As the average contract size of DFID projects has increased with the Government’s commitment to the 0.7 percent foreign aid target, the large consultancy companies have benefited, taking an ever-increasing share of the aid budget and enjoying generous profit margins. Their strategies are to develop a growing pipeline of projects on different themes

and in different countries. If the company is successful in bidding, assignments are numerous and diverse. There is no incentive for consultants to form long term relationships and stay with an existing project, as normally there are other projects in the company's pipeline. As a consequence, there is a general lack of continuity in the personnel involved, which prevents the development of key personal relationships with partners and a deep understanding of the programme's political, economic and social environments.

5.3 Delivery of conflict-related programming also needs a high degree of local sensitivity. Methods employed in these environments are often experimental and based on small-scale pilots that need to be nurtured to grow. Small and micro businesses are potential sources of specialist expertise in delivering results in the face of such complex challenges. Much of the FCAS expertise in the UK commercial market resides in micro- and small business consultancies.

6. Small businesses as a potential source of increased value for money in DFID contracting

6.1 Lord Young, the Government's Enterprise Minister, has produced a series of reports highlighting the contribution that small business makes to enhancing competition in markets and providing value for money opportunities for public authorities. In development consulting, micro- and small enterprises have the potential to offer DFID substantial savings in contracting through their ability to offer lower overheads and fee levels. But this potential can be realised only if DFID creates suitable bidding opportunities for small business consultancies. The Government has encouraged DFID to adopt a policy of subdividing large projects into smaller lots that can be separately put out to tender. But because of the focus on SME targets for firms with up to 250 employees, there is no specific policy that aims to increase DFID's access to the specialist skills, innovative ideas and efficiency savings that Lord Young believes can be obtained through contracting with the micro and small enterprise sector.

7. Increasing participation of small business consultancies in DFID's lower-value contracts

The lower-value contracts (below the EU threshold of £111,000) present a good opportunity for micro and small consultancies to gain experience in new markets. It appears that many of the lower value projects are currently being awarded by DFID Departmental Procurement Officers (DPOs) and the Heads of Department (HoDs) to "known suppliers" without going out to tender. It is very difficult for micro and small consultancies new to the market to become "known" to the relevant DPOs and HoDs. DFID should proactively encourage its staff to consider new suppliers for lower-value contracts and publish tender notices for such contracts on the central government procurement web portal "Contracts Finder" (<https://www.gov.uk/contracts-finder>).

8. Summary recommendations

8.1 The category of SMEs needs to be divided in DFID's procurement system. "Medium" consultancy companies with up to 250 employees need to be separated from "small/micro" entities, and projects and invitations to tender similarly divided. The separation of projects will be by the nature of the expertise and experience required and the outcome and impact intended, as well as size of budget. We would also welcome a Government target for awarding a reasonable percentage of contracts specifically to small and micro firms.

8.2 The existing system of framework/consortium bidding needs to be re-assessed for its impact, which currently leads to the dominance of "key strategic suppliers" and the de facto exclusion of small and micro companies in terms of practical contributions to implementation.

8.3 In the domain of Fragile and Conflict Affected States, consideration should be given to measures to ensure the recruitment of small and micro consultancies where their specialist skills, experience and methods of operation are particularly suited.

8.4 As highlighted by Lord Young, the Government's Enterprise Minister, small businesses increase competition in markets and provide value for money opportunities to public authorities. DFID contracting policies currently work to the benefit of large and medium sized consulting firms and to the exclusion of small businesses capable of offering superior value for money performance.

8.5 In the interests of increasing competitiveness within the supply chain, DFID should become proactive in encouraging its commissioning staff to consider new suppliers and to prioritise small and micro sized businesses.

END OF SUBMISSION