

INTERNATIONAL DEVELOPMENT COMMITTEE (IDC) INQUIRY
DFID's use of Contractors
Memorandum by the Department for International Development (DFID)

This memorandum provides a response to the International Development Committee's inquiry into DFID's use of contractors. It aims to give an overview of DFID's use of contractors and responds to the following questions;

1. What are the comparative costs and advantages of DFID using large contractors, as opposed to managing programmes itself, via NGOs and other community-based organisations, or through multilateral partners? Could these costs be reduced and, if so, how?
2. a) How does DFID decide when and where to use contractors?
b) To what extent is DFID finding the right balance between the use of contractors and the development of in-house skills to meet changing needs?
3. How effective are DFID's procurement, contract management, risk management and programme management processes in achieving value for money and effective long-term development? How could these processes be improved?

Definition of terms used

Contractor or Supplier: any organisation with which DFID has a contract.

Expert: individuals who work for DFID contractors, such as those in the case studies in Annex T.

Summary

DFID is one of the most important and active international development donors in the world. The department leads the delivery of the UK's commitment to spend 0.7% of GNI on overseas development assistance (ODA). This includes the UK's commitment to the Sustainable Development Goals in areas such as education, health, economic growth and the youth and women and girls agendas. DFID aims to ensure that UK aid goes where it is most needed and where it will deliver the best value for taxpayers' money. To do this, DFID works with a wide variety of partners in some of the most hostile environments in the world. To achieve the best results we ensure the most relevant expertise in any given situation to deliver aid.

DFID contractors include a diverse, dedicated and professional group of international development experts who live, work and deliver important results in some of the most dangerous places in the world. In the last 3 years, 7 people working for DFID's main contractors have been killed and a significant number have suffered injuries or trauma while carrying out this important work.

These contractors work in places like Afghanistan, Nigeria and South Sudan. They are the first to be deployed in crisis response situations such as the Nepal earthquake, Ebola crisis and to conflict affected areas, work on protracted crises like the Syria conflict and also work on long-term development solutions. Annex T contains two case studies sharing the experiences of two experts working for DFID contractors based in Somalia and South Sudan delivering excellent results in the face of unimaginably difficult conditions.

Spend via contracts totalled £1.24 billion in 2014/15 which represents approximately 13% of DFID's annual spend with all partners. Use of contractors is therefore a relatively small, but nonetheless operationally important part of DFID's delivery route mix, alongside the United Nations, World Bank, other multilateral organisations and

not-for-profit delivery organisations. This £1.24 billion is further split between different types of organisation with 77% spent with private sector companies (including small and medium enterprises (SMEs)¹), 17.5% with not-for-profit organisations (including Non-Governmental Organisations (NGOs) and Civil Society Organisations (CSOs)) and 5.5% with educational/research institutions.

To place this in the context of broader government spending, the NAO estimated that the UK Government spends £40 billion overall with contractors. Government spending with just one supplier, Serco, totalled £1.2 billion² worth of contracts in 2013, equal to the total amount spent by DFID on all of its contracts.

DFID contracts with a range of external suppliers to provide services including technical assistance where this has been considered the most appropriate approach. Although frequently referred to in the media collectively as 'consultants', these external contractors are a mix of private sector companies, employee owned companies, academic institutions and NGOs who have expertise in international development and perform a wide range of roles and activities.

By benchmarking DFID's rates for contractors against those achieved by government, we can see that DFID typically achieves rates that are 50% cheaper than other government departments and executive agencies. This represents excellent value for money, especially when we consider that DFID's contractors are working in much more challenging and dangerous environments than typically experienced.

DFID achieves value for money in its contracted work through excellent procurement practices, effective contracts, active market engagement and its contract management processes. Core to the activities of DFID's Procurement and Commercial Department (PCD) is a commitment to continuous improvement in commercial practices. A total of £535 million in savings has been achieved in the last five years via effective procurement.

Overview

Contractors: who they are, what they do and how we work with them

The high quality work performed by DFID contractors has a global reputation for excellence and continual improvement, and has been endorsed by the Independent Committee for Aid Impact (ICAI). ICAI stated: *"Our report in 2013 assessed DFID's use of contractors to deliver aid programmes. Our case studies show that contractors are an effective option for delivering aid. DFID has selected contractors that have delivered positive results at competitive fee rates."*

DFID contractors have delivered a range of major achievements on behalf of the UK Government including,

- end preventable maternal and childhood deaths by providing antenatal care and births assisted by skilled healthcare workers.
- the installation of land registration systems enabling people to have clear title to their property;
- saving countries hundreds of millions of pounds by rationalising their debt burden;

¹ Small and medium-sized enterprises (SMEs) are as defined by NAO. <https://www.nao.org.uk/wp-content/uploads/2016/03/Governments-spending-with-small-and-medium-sizes-enterprises-Summary.pdf>
² <https://www.nao.org.uk/wp-content/uploads/2013/11/10298-001-Governments-managing-contractors-HC-811.pdf>

- enabling fragile states to raise billions more pounds each year by fixing their tax administrations;
- boosting the security systems of countries under threat from radical elements and
- helping countries raise billions from exploiting their resources effectively and honestly.

DFID recognises that the use of contractual relationships to deliver development work requires the organisation to have an internal set of skills and processes that enable delivery of the very best value for money and performance from these contracts. PCD works to ensure that the markets from which DFID procures are as diverse as possible to support value for money and works to continually encourage new entrants to the market, either as a prime or sub-contractor. PCD has an excellent reputation both in the international development sector and in the wider procurement profession, as evidenced by the four Chartered Institute of Procurement and Supply (CIPS) awards won by the team in the last three years (see Annex S). 50% of the DFID PCD team are MCIPS qualified³, with a further 15% currently studying for their qualification. The team also has 3 CIPS Fellows, the highest grade of CIPS membership.

Under Secretary of State Justine Greening, DFID has been the first government department to introduce a supplier charter, the “Statement of Priorities and Expectations for DFID’s Supplier and Partner Relationships” (SoPE). All suppliers must sign up to the SoPE which sets out DFID’s expectations of suppliers in areas such as performance, profit and tax (see Annex A). In June 2015, the Secretary of State wrote to suppliers re-iterating DFID’s expectations around tax, profit and treatment of sub-contractors, requiring major suppliers to respond confirming their compliance with these key areas. There has also been enhanced ministerial scrutiny of contract decisions, with all contracts worth over £1 million now subject to ministerial review and approval.

DFID’s commitment to continuous improvement and best practice means that while we are rightfully proud of our processes, we aim to constantly update and improve these, for example:

- DFID’s ambitious and innovative market creation plan aims to widen the market for DFID work, increasing competition and ensuring the organisation has a broad range of partners.
- PCD actively seeks out and embraces new and innovative approaches to procurement, for example being one of the first teams in UK Government to adopt the new ‘Competition with Negotiation’ EU procurement process in 2015, ensuring that incumbency is not by any means a guarantee of winning future contracts.
- At the contracting stage, PCD drive value in the contracting process, and delivered £129.9 million of procurement efficiency savings in financial year 2015/16 (beating its target by £19.9 million).
- The department actively contributes to the central government priority for engaging with SMEs and now has the second highest spend with SMEs across government, representing 32% of contracted spend. This means DFID is on track to achieve the Cabinet Office target of 33% direct spend with SMEs well in advance of the 2020 aim.

³ A fully qualified member of the Chartered Institute of Purchasing and Supply (MCIPS) is someone who has achieved an internationally recognised award which represents the global standard within the profession, either through studying for a CIPS qualification or through completion of an accredited degree.

Question 1: What are the comparative costs and advantages of DFID using large contractors, as opposed to managing programmes itself, via NGOs and other community-based organisations, or through multilateral partners? Could these costs be reduced and, if so, how?

‘Make vs Buy’ - the DFID Context

As a government department DFID is structured as a commissioning organisation. Taking a commissioning approach ensures that systematic consideration is applied to decisions concerning all relevant delivery options that exist for meeting needs within the development sector. These will include external delivery routes using contractors, NGOs and other community-based organisations, or multilateral partners, as well as options to manage the programme internally. The choice between internal and external options is often referred to as a ‘make vs buy’ decision (‘make’, sourcing services in house, ‘buy’, sourcing services externally), to determine which is more advantageous. This approach allows DFID’s focus to remain strongly on its strategic priorities regarding the allocation of resources.

‘Make vs Buy’ Case Studies

Through DFID’s business case process, delivery options will be appraised which may include ‘make’ or ‘buy’ options, or hybrid options of both. Two case studies are provided below; for the WASH programme a hybrid approach using a ‘make’ element was used, whereas the Global Evaluation Programmes were ‘bought’.

Water, Sanitation and Hygiene Results Programme (WASH)

A ‘make vs buy’ approach was adopted for the Global WASH results programme which had an aim of providing access to better water and sanitation for 4.5 million people with a budget of £109 million (see Annex C). A ‘make vs buy’ business case review concluded that a stronger ‘make’ element should be applied to ensure closer management and oversight for specific parts of the programme. A fund was set up to be managed in-house rather than using an external fund manager. The model enabled staffing resource efficiency with DFID advisors working across a number of human development programmes but dedicating only around 30% of their time on the oversight of WASH programmes. This resulted in savings of £4.24 million. The WASH programme still contains a significant ‘buy’ element provided by a supply chain of NGOs and contractors providing development expertise and services on the ground. The sourcing of these contracts through a comprehensive tendering process led to a 28% reduction in the cost per person reached (see Annex C).

Global Evaluation Programmes

The ‘buy’ principle was applied to all DFID global evaluation programmes from 2012 to 2015 in support of the requirement for the independence of evaluations from programme management. Global Evaluation Programmes at a total cost of £114 million were tendered within the structure of a framework agreement of pre-qualified specialist service providers. Each programme evaluation was still commissioned and managed by 21 specialist DFID evaluation advisors in-house. A review in 2015 supported a continuation of this out-sourced ‘buy’ model. This review concluded that the average cost to ‘buy’ is 50% lower than an equivalent ‘make’ option for this particular service.

Question 2a: How does DFID decide when and where to use contractors?

Delivery Routes Selection

Once a need has been identified for a development intervention DFID personnel write a business case. This process is used for all programme design work that DFID is considering and assesses the strength of the programme being presented and whether it should be progressed or rejected. There are 5 elements to each business case assessment – strategic context, appraisal of the strategic case, financial principles, management requirements and commercial aspects.

Either in parallel or following this stage, an early market engagement may be carried out to assess the potential market. This will typically involve multilaterals, NGOs and private sector actors and enables the relevant team to assess the market appetite and strategic advantages of the different delivery routes available.

A final assessment of the business case then considers whether there has been sufficient consideration of the various delivery routes available. DFID commercial advisers will input into the assessment to determine whether the preferred option is commercially viable and delivers value for money. The delivery route for an overall programme is typically made up of several components, only some of which will recommend tendering a contract to be the most appropriate option. The preferred delivery route is fundamentally determined by value for money considerations, for example which model delivers the maximum impact and outcome for DFID money.

Contracting as a Delivery Route

Tendering a contract was considered to be the most appropriate delivery route for only around 13% (£1.24 billion) of DFID's £9.67 billion spend with partners in 2015/16 (12% in 2014/15). If the decision is reached to contract out work then further commercial considerations take place. This involves an assessment of the most appropriate Public Procurement route to take, ensuring that sufficient competition is created, prices are kept competitive and value for money is delivered. Background work also takes place to establish if a market exists. If no market, or a limited market exists then steps may be taken to create or stimulate a market.

The UK has a smaller contractual proportion of spend than other major bilateral donors, for example USAID's contractual spend represented 28% of total funds awarded in fiscal year 2014 and 30% in fiscal year 2015⁴ and 24% of Australian 'official support' was spent through the private sector in 2014/15⁵.

⁴ <https://www.usaspending.gov/Transparency/Pages/AgencySummary.aspx?AgencyCode=7200&FiscalYear=2014>

⁵ <http://dfat.gov.au/about-us/publications/Documents/statistical-summary-2014-15.pdf>

Question 2b: To what extent is DFID finding the right balance between the use of contractors and the development of in-house skills to meet changing needs?

DFID undertakes programmes in a range of different contexts including fragile and conflict affected states such as Syria and South Sudan, places in the grip of humanitarian disaster, most recently Nepal and Sierra Leone, and more stable environments such as Ghana and Zambia. The interventions themselves range from large scale health interventions such as global WASH programmes through to humanitarian relief. In addition to this is the excellence in research and evidence that makes a critical contribution to global poverty reduction efforts.

This range of contexts and types of intervention means that DFID must have excellent, specialist partners that can deliver the ambitious change DFID aims to achieve. This need for a broad range of deep specialisms in a wide variety of contexts means that the most efficient model for DFID to adopt is that of an intelligent commissioning organisation, using its 'in house' expertise to ensure limited funds available have the most impact possible on the lives of the poor

This model allows DFID to access the resources, skills and specialist expertise it requires for its interventions and to ensure that UK aid is spent in the most efficient and effective manner possible. DFID's focus therefore is on the development of in-house excellence in policy making, deep advisory expertise, commissioning and programme/partner management skills.

DFID takes the need for all staff to have good levels of commercial awareness and skills very seriously. In 2014/15 the department mandated that all Senior Civil Servants (SCS) must complete a Commercial Leadership course. This 2.5 day course was developed and run jointly by Ashridge Business School and DFID. Attention was focused on the senior leadership in DFID, with the approach designed to instill a commitment to and understanding of driving commercial practices, recognising this as a key tool for poverty reduction. Specifically, we wanted within a 12 month period, to increase commercial understanding throughout the 100 SCS staff in DFID and up to 50 more selected deputies.

The Global WASH programme referred to in question one is an excellent example of DFID's ability to take ambition and policy making through to delivery route selection and implementation. In this example, the DFID team chose the optimal delivery route (multiple contracts with NGO and private sector partners), recognised the contract and programme management challenges this would pose and ensured that appropriately skilled DFID resource was available to manage this in-house.

Question 3: How effective are DFID's procurement, contract management, risk management and programme management processes in achieving value for money and effective long-term development? How could these processes be improved?

a) Procurement Processes

Scale of DFID's Procurement

In 2015/16 PCD awarded 138 contracts and is currently running 203 live pieces of procurement. There has been growth in the number and total value of supplier contracts awarded, however as a proportion of DFID's overall spend with partners, contracted work remains relatively low (at approximately 13%). Growth is driven by the shift towards fragile and conflict affected states where financial aid and delivery route options are limited, and also an increased use of competitive tendering to improve value for money where accountable grants were previously used. An example of using contracts instead of accountable grants to maximise value for money can be found in Annex D. Going forward DFID expects the proportion of overall spend through contracts to remain at around the current level.

Context - Untied Aid and the Procurement Regulatory Framework

The UK untied its aid in 2002⁶. Untied aid maximises value for money to the UK taxpayer and ensures more of the poorest people in the world benefit, by ensuring we get the best, competitively priced goods and services from the UK development programme. In addition, increasing the competition faced by UK firms for UK aid contracts encourages UK companies to innovate and maintain their position as world leaders in the international development sector. UK businesses continue to win the majority (over 85%) of centrally issued UK Aid contracts, demonstrating the competitiveness of UK companies.

The untying of UK aid has also encouraged other countries to follow suit. This means many more business opportunities for UK firms to compete for and win. British businesses continue to be world leaders in the field of international development and are winning aid contracts from both bilateral and multilateral donors, particularly in the provision of technical assistance services.

DFID contracts are tendered in compliance with EU Public Procurement regulations. The focus of these regulations is on ensuring open and fair competition between bidders. This means our contracts are competitively tendered following a set of standard processes for tendering as set out in the regulations.

Tenders are managed by a professional procurement team (PCD) supported by technical stakeholders following a robust process and with strict controls. This is an award winning, highly qualified team with experience from the private sector, public sector and international development. Supplier bids are assessed against pre-defined and published evaluation criteria by an evaluation panel with relevant expertise, following the Public Procurement principle of selecting the "most economically advantageous tender".

Innovation in the Procurement Process

⁶ Untying aid – removing the legal and regulatory barriers to open competition for aid funded procurement – generally increases aid effectiveness by reducing transaction costs and improving the ability of recipient countries to set their own course. It also allows donors to take greater care in aligning their aid programmes with the objectives and financial management systems of recipient countries

The context within which DFID operates requires PCD to be able to work at the cutting edge of best procurement practice. PCD has developed a rapid response procurement process, which is fully compliant with the regulations but enables DFID to source rapidly in cases of extreme urgency such as during the Ebola crisis. This process enabled DFID to source the Ebola treatment centres in Sierra Leone within 11 days, while providing high levels of assurance, due diligence and value for money (see case study in Annex E). In addition, PCD has quickly taken advantage of the new “competition with negotiation” procedure allowable under the revised Public Procurement regulations to ensure that large, complex programmes are now sourced with the maximum opportunity for DFID to negotiate with suppliers. In the 12 months since this approach was introduced, the DFID team has used the procedure on a number of large procurements, with excellent results including a £15 million saving on one project and introduction of new suppliers to Nepal in another (see case studies in Annex F and Annex G).

Profit and Rates

DFID controls the costs associated with contracts in a number of ways. These include:

- Competitive tendering processes to ensure the best market rates are proposed and agreed at the time of contracting;
- Cost transparency requirements at the bidding stage, requiring suppliers to breakdown their proposed costs to provide visibility of key cost drivers, including profit, overheads and pay costs;
- Benchmarking against other government departments and through comparison of similar programmes within DFID;
- Use of competition with negotiation to allow detailed negotiations on commercial bids;
- Setting of fee rate caps and fixed management costs in the new generation of DFID Frameworks;
- Use of payment by results models in contracts to ensure payment is linked explicitly to delivery (see Annex M).

Supplier Engagement

Supplier engagement provides key intelligence that continuously informs DFID contracts. Methods which facilitate engagement with the supply base include:

- Early Market Engagement events where upcoming procurements are discussed and market input is requested;
- Forums and meetings, many organised in partnership with UK Trade and Investment (UKTI) and British Expertise, including SME specific forums;
- Encouraging local capacity building so that new, local or smaller suppliers are developed.
- The Key Supplier Management (KSM) programme to drive performance and cost improvements and provide strategic alignment to deliver increased aid impact.

b) Risk Management

When contracting DFID employs robust due diligence processes in line with DFID’s due diligence framework to assess risk associated with potential suppliers. DFID’s strong contractual terms and conditions contain robust clauses relating to fraud and anti-terrorism and remedies in the event of breach of contract. The use of contracts in

itself results in risk transfer from DFID to the contractor, with suppliers being contractually responsible for areas including the duty of care to their staff, delivery of the programme facilitated further through payment by results, and management of fraud risk.

Programme Risk Register

DFID is further enhancing its approach to risk management and has introduced a new framework. The risk management framework builds on the good work already in place across DFID, joining up risk management activity in a consistent style to provide greater assurance.

DFID's due diligence framework has been reviewed and strengthened with a focus on the risks associated with downstream partners. New guidance has been developed on delivery chain risk management. This will enhance staff understanding of all partners involved in our interventions, the risks involved and how these risks will be managed.

Residual risk (the threat that remains after all efforts to identify and eliminate risk have been made) is being considered against the development return in programmes. The approach makes explicit the implicit choices made when designing, selecting and delivering programmes and portfolios of work. By using explicit assessments of risk and development return in our interventions we can make better decisions and manage our portfolios more effectively.

Work continues to further embed and evolve DFID's approach to managing risks, ensuring UK aid monies are spent effectively and achieve value for money.

c) Programme and contract management

DFID has further enhanced all processes linked to programme delivery in order to achieve maximum value for money and development impact. Since 2014 every programme has operated under a strengthened programme management operating framework, the Smart Rules. The increase in DFID's overall programme portfolio score since 2013 suggests that these efforts have been effective. Specific improvement measures in 2015/16 included:

- over 300 programme staff received dedicated programme management training, with particular emphasis on risk management, commercial awareness and programme leadership skills;
- a new programme management information system was launched which makes key information and documents more accessible to all staff;
- a Risk Management Framework was introduced that joins up risk management activity at programme, portfolio and corporate levels;
- all of DFID's senior civil servants have received commercial leadership training to ensure commercial skills are in place at all levels within the department.

DFID draws on lessons from across Whitehall including the Infrastructure and Projects Authority, and are discussing how we can further improve the programme delivery learning and development offer to DFID staff in the years ahead.

Annual Reviews

Annual reviews examine a programme's progress against its business case, providing an assessment of progress against its accompanying log frame indicators, recommendations for follow-up action, and an analysis of learning. This includes consideration of:

- Recommendations of the business case and previous annual reviews in a continuous process of review and improvement;
- Significant changes to the assumptions made in the business case such as changes to context, risk, value for money, operating or political environment;
- New evidence from public research or evaluations;
- Whether the targets are still realistic;
- The effectiveness of partnerships, including government viewpoint, suppliers' performance and contract implementation;
- The relevance of the programme and whether it should continue, be stopped or reset;
- Whether poor performance has been identified and is being managed, including whether improvement measures are required;
- Evidence of learning and continuous improvement during the project's implementation and how lessons will be shared more widely;
- The impact of the Partnership Principles on the programme;
- Risks identified in the due diligence assessment, fiduciary risk assessment or contracting process and how these have been addressed;
- Specific, time-bound recommendations for action that are consistent with the key findings.

Conclusion

DFID's use of contractors is a relatively small but nonetheless operationally important part of the department's delivery strategy, enabling DFID to respond quickly and efficiently to crises and reach some of the most dangerous places in the world. Each business case stringently considers which delivery route is most appropriate for the proposed programme and which will deliver the greatest value for money. Where there are strong delivery capability and value for money reasons DFID will choose to use a contractor, DFID's Procurement and Commercial Department ensure value for money throughout the contracting process and operate at the cutting edge of best procurement practice and innovation.

Annexes

The annexes are available at: <http://www.parliament.uk/documents/commons-committees/international-development/DFID-IDC-Evidence-Complete-Annex.pdf>