



House of Commons
International Development
Committee

**DFID's use of private
sector contractors:
Government Response
to the Committee's
Eighth Report of
Session 2016–17**

First Special Report of Session 2017–19

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International Development Committee

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First Special Report

The former International Development Committee published its Eighth Report of Session 2016–17, *DFID's use of private sector contractors*, on 4 April 2017 as House of Commons Paper HC 920. The response from the Department for International Development was received on 19 July and is appended below.

Appendix: Response from the Government

1. *We urge the Department to ensure that the choice of implementing a given programme through contractors is always driven by the strategic value of that delivery channel. DFID Smart Rules should include more detailed guidance on the appraisal portion of the business case, and business cases should clearly justify why the particular channel was chosen, with reference to the relative benefits over other types of delivery. DFID should ensure that the emphasis on commercial expertise associated with the increasing use of contractors does not make generalists of DFID staff at the expense of technical knowledge and depth.* (Paragraph 18)

Agree

DFID is fully committed to ensuring that the choice of delivery channel for every programme is driven by strategic value, through a robust appraisal of all delivery options, including delivery through multilaterals, civil society organisations, private sector contract, and co-funding with other donors.

DFID's Business Case Smart Guide directs staff to consider the strengths and weaknesses of each viable option, present evidence for outcomes and impact and assess value for money. Key considerations include: the capacity and capability of the partner to deliver the programme; the costs and benefits of each option; timing and resources; and controls over risk and delivery.

We are now reinforcing this by introducing *Strategic Sourcing Strategies* for all contracts over £5 million, which will strengthen the Commercial Case for our programme interventions. We will also have a light-touch sourcing strategy for all contracts under the £5 million threshold. The Strategies will recommend a sourcing route on the basis of a detailed consideration of: the available sourcing options, benchmarking data, the key cost drivers, an analysis of the supply market (including the opportunities for SME and micro-suppliers), supply chain analysis, and the findings of early market engagement. They will also include key contract management considerations, such as Key Performance Indicators, payment mechanisms, Payment by Results and programme governance. The new Strategies will be quality assured by a new DFID Procurement Steering Board and require Cabinet Office approval at two key stages in the procurement process: before issuing a tender and before appointing a preferred bidder, which will ensure every case demonstrates how value for money will be delivered over the life of a programme.

We fully recognise the importance of maintaining appropriate technical development expertise, including commercial expertise, within DFID. Technical advisers make up one third of our workforce and contribute high quality knowledge and expertise to the content and delivery of strategy, policy and programmes worldwide. Our advisory cadres

are replenished through targeted recruitment and talent schemes, undergo a rigorous accreditation process and maintain and develop their skills through active programmes of professional development, overseen by a Head of Profession.

A typical programme team brings together specific commercial expertise from our commercial cadre, which we continue to reinforce and policy expertise from a sectoral adviser with the general commercial acumen and in-depth knowledge held by the programme managers and Senior Responsible Owners.

2. *We repeat earlier calls for DFID to investigate the idea of an arms-length body to assume programme management responsibilities. This should be done as part of its Supplier Review and the outcome reported to us. If DFID disagrees with this or believes it is not feasible, it should set out why in its response to this Report. (Paragraph 20)*

Agree

The Supplier Review has been set up specifically to address DFID's management of its supplier base, within the current operating model and resource constraints. The question whether DFID should have an arms' length body for programme management lies outside the scope of this review.

More broadly we agree that DFID should continue to improve its delivery practices and evolve its operating model. We have already seen substantial evolution of our model in recent years and will look to change and adapt as we go forward.

In particular, we have provided CDC with an additional £735 million in capital since 2015, effectively outsourcing to them delivery of a significant portion of our scale-up in economic development investment. As the UK's own Development Finance Institution and 100% owned by DFID, CDC is one of the few organisations in the world with the skills and appetite to manage the risks of investing in the growth of businesses in the world's poorest countries.

Our response to natural disasters and other sudden-onset humanitarian emergencies has also evolved. DFID's Humanitarian Operations includes both a core team of civil servants and specialist contractors (which we have expanded by 30% over the last year), and a contract to bring in external support as and when needed. It provides the logistical capability and a flexible facility to scale humanitarian operations both up and down according to need, ensuring that DFID can mobilise quickly and has access to specialist expertise when it is required, but does not incur unnecessary costs over longer periods of time.

3. *DFID should ensure the use of contractors in fragile states is carefully managed and that output targets are designed to align profit incentives and development objectives whilst still taking account of drivers of conflict. DFID should be particularly cautious about shifting risks onto contractors in fragile states through PbR. It should also ensure that all overheads and profits are benchmarked against other donors and recipient countries to ascertain whether DFID is achieving value for money. (Paragraph 26)*

Agree

We agree that careful management of contractors is required in challenging market situations, and that risk and reward should be consistent with the scale and nature of the programme and delivery of its objectives. In accordance with recommendation 24, we will strengthen our understanding of how and where Payment by Results (PbR) can best be applied, with further training for relevant staff.

DFID's Smart Guide to PbR contracting stresses that care should be taken when assessing the most appropriate form of contracting, and that contracting mechanisms should be adjusted so that they are appropriate to the programme context—including a careful assessment of risk, impacts on potential suppliers, cost and the possibility of perverse incentives. These are especially important considerations in fragile and conflict affected areas, whether using PbR or alternative contracting types. DFID has a number of successful PbR programmes in FCAS environments, including WASH Results and the Girls Education Challenge, which deliver vital water, sanitation, hygiene and education outcomes in some of the most challenging circumstances

DFID already regularly benchmarks costs. The Supplier Review will consider options to improve our benchmarking and assess options to improve value for money through further transparency from our suppliers.

4. *As part of DFID's Key Supplier Management (KSM) system, it should apply a metric on the contractor's contribution to DFID learning, including how cooperative they are with other contractors. Other innovative approaches should also be explored in the Supplier Review. DFID should use guidelines on best practice to set out clear regulations in its updated Smart Rules on when programme evaluations should be done completely independently of both DFID and contractor staff. It should also foster closer relationships with the procurement departments of other donors as well as multilateral agencies to try to learn about what works in different procurement models. (Paragraph 34)*

Agree

Where responsibility for delivery is passed to contractors it is important that DFID retains the ability to act as an intelligent customer. We will continue to harness our suppliers' expertise, drive that learning through our future programme development and share it throughout the sector to improve the capability of the development community as a whole. We will assess all options to deliver these objectives in the Supplier Review including introducing a suitable metric as part of our expanded Supplier Management Programme.

DFID's Evaluation Policy and Smart Rules require all programme leads to consider the feasibility, merit and value for money of an independent evaluation to complement monitoring and review at the time the programme is designed. All evaluations must fulfil the three conditions of independence: objectivity (those conducting the evaluation must be objective and not connected with the intervention); transparency (the results must be publicly available); and a robust methodology.

The Evaluation policy distinguishes between external and independent evaluations (no involvement of those being evaluated) and internal and independent evaluations (financed

and managed by the same institution that manages the programme being evaluated, but with strong independent quality assurance mechanisms). All DFID evaluations are encouraged to undergo independent quality assurance.

DFID engages with the procurement departments of a number of other donors and agencies, including Australia's DFAT, USAID, the World Bank, UN agencies and the Global Fund to share best practice and learning and identify opportunities for collaboration. Areas of commercial collaboration have included fee rates, strategic relationship management, professional standards and market engagement. In October 2016 DFID initiated a cross development round table with the Chief Procurement Officers of the large multilateral development organisations to accelerate harmonisation and collaboration in purchasing and supply across the multilateral and humanitarian development system. A Terms of Reference for this group was agreed and the forum will continue to meet.

5. *DFID must make every effort to level the playing field in terms of information available. While we recognise that mistakes can be made in the way procurement-sensitive information is handled by staff, this can be overcome through greater transparency from the outset—publishing all information so that no single or group of bidders is at an advantage. Where a procurement is delayed or cancelled, DFID should take lessons away from this so similar events can be avoided in the future. Additional bidding requirements that come out of the Supplier Review should not impose significant additional costs on contractors, as these may drive those least placed to bear them (i.e. smaller organisations) out of the market thus reducing competition.* (Paragraph 43)

Agree

DFID is fully committed to ensuring that no bidder or group of bidders is placed at a real or perceived advantage. We adhere to the EU Public Procurement Regulations, and carry out Early Market Engagement events for potential suppliers to question programme teams and allow dissemination of information produced by previous phases and incumbents. Our tendering documentation sets out how information will be shared and communicated through the DFID Supplier Portal and we will review to ensure its clarity for bidders. If a supplier has a concern this may be raised immediately with the procurement lead through the portal.

We will continue to capture lessons learned from delayed or cancelled procurements on a case-by case basis to ensure similar events are avoided where possible in the future. This includes weekly lesson sharing sessions in the Procurement Team. The supplier review will consider how we strike an effective balance between encouraging bids from smaller suppliers with an appropriate level of compliance and due diligence to drive high standards among suppliers.

We particularly wish to encourage effective competition, particularly in markets which are immature or where barriers to entry constrain the number of suppliers. We are already adopting approaches which reduce the burden on new entrants, such as removing the requirement for significant financial trading history in favour of payment by results.

6. *DFID should undertake a review of framework agreements and justify how their benefits outweigh the costs reported in evidence to this inquiry. Where framework agreements are used, DFID should commit to regular reviews and updates, allowing new market entrants*

access to bid for existing frameworks at more regular intervals. DFID should also consult with smaller organisations on how to make bidding for frameworks more accessible, offering tailored guidance to ensure that its procurement processes are not a barrier to entry. DFID should also justify why it continues to use framework agreements when the trend across government is moving away from them. (Paragraph 53)

Agree

The Crown Commercial Service, which is responsible for HMG's common categories, confirms that an exercise is underway to review and, where necessary, rationalise the number of current frameworks in existence. However, Frameworks continue to be used as a means to procure Common Goods and Services.

Frameworks are an effective component in DFID's procurement portfolio, but we accept they must be designed carefully to maximise their benefits and mitigate any adverse effects, including access by smaller organisations. DFID's newest framework designs take into account a range of commercial considerations, including value and geography, promoting access across a broad spectrum of DFID's supply chain, including small businesses. As access to DFID's market for smaller organisations is often through consortia, or as a supply chain member, we enable lead framework suppliers to add new subcontractors to existing framework consortia. EU procurement regulations prevent DFID from appointing additional lead suppliers to existing frameworks.

DFID will continue to refine its use of frameworks to mitigate adverse effects and maximise their benefits. We will also consult with smaller suppliers during the Supplier Review to understand and address barriers to their access, including to framework contracts.

7. DFID should conduct market analysis, potentially with assistance from experts at the Competition and Markets Authority (CMA), to determine any issues that may be undermining market competitiveness. It should then take necessary steps to correct for these issues in order to create an increasingly level playing field for all potential bidders. (Paragraph 63)

Agree

We aim to strengthen our market analysis activity to ensure that we are providing a level playing field and will consult relevant experts including the CMA. DFID already holds data on actual and potential suppliers in many of the countries in which we operate and holds awareness events to encourage new entrants and understand local barriers to entry as well as early market engagement events on specific programmes. We will put forward proposals from the Supplier Review to ensure that market research and analysis informs our ongoing review and improvement of our procurement and commercial practices.

8. DFID should report on how it plans to increase its efforts, beyond what has already been stated in evidence, towards helping more developing country contractors bid for DFID work. It should ensure that the format of Early Market Engagement (EME) exercises is geared towards greater inclusion, and should report to us on whether greater use of in-country EME's has increased the number of developing country contractor bids. DFID

should also make use of the Untied Aid Public Bulletin Board and, if it continues not to do so, should clearly justify why not and describe an alternative approach to advertising contract opportunities to developing country contractors. (Paragraph 70)

Agree

DFID understands the importance of engaging local organisations and is committed to harnessing in-country expertise. Making greater use of smaller developing country suppliers and ensuring there are clear pathways for them to grow and compete for larger DFID contracts in due course, complements our economic development objectives, helping to build local markets and delivery capacity.

DFID opportunities and Early Market Engagement events are advertised through a wide range of channels, including Contracts Finder, the Official Journal of the European Union (OJEU), the DFID website and social media to reach the widest range of local, national and international organisations. System integration issues have previously prevented our use of the Untied Aid Public Bulletin Board but we will reassess the costs and benefits of adding this advertising channel to our existing mechanisms.

Each EME is tailored to the requirements of the programme and at least one event is undertaken for each bidding round. Over the last year, we have delivered 61 EMEs worldwide and almost 1000 organisations, including smaller and local suppliers, have attended. We make it clear during these events that our programmes must be delivered by a dynamic supply chain, made up of a range of suppliers of different size, scale and expertise.

PCD commenced monitoring the impact of EME's on bidding behaviour in July 2016 but as yet has insufficient data to advise whether the greater use of in-country EME's has led to an increase in developing country contractor bids.

Where the size and complexity of DFID's programmes means that local or smaller organisations are not always best placed to be lead suppliers, we seek to provide opportunity for such suppliers to participate through prime providers.

We also want to encourage and build the capacity of local and smaller organisations to become the prime providers of the future and so in September 2016, we commissioned Dalberg to undertake a research project to understand the barriers for in-country organisations to access DFID's market. The Supplier Review will address the issues raised by Dalberg, including the size of programmes and measures to reduce levels of bureaucracy for less risky programmes.

9. DFID should be more inclusive of small and micro enterprises by disaggregating its approach to SME's to target small and micro enterprises. This should include both collecting data on the work contracted to such enterprises and producing a strategy on how opportunities for them to bid for DFID work can be expanded. DFID should also report to the Committee on how it plans to mitigate the impacts of Payment by Results so that it does not preclude smaller organisations from bidding as evidence suggests is currently the case. (Paragraph 75)

Agree

DFID already exceeds the government's existing target of awarding 25% of its business to SMEs and is publicly committed to reaching the government target of 40% by 2020, supported by DFID's published SME Action Plan. The Supplier Review is assessing further measures to level the playing field for small and micro suppliers to access to DFID opportunities, whilst always ensuring that suppliers retain the ability to deliver.

DFID's PbR Contracting Smart Guide stresses the importance of assessing the impact that different PbR approaches could have on the potential supplier base for a programme. We are working to ensure the guidance is used consistently during the design of DFID programmes.

Few of DFID's output based contracts expect suppliers to bear the full risk of not being paid until high level outputs in the logframe are achieved in the outer years of the programme. In most instances DFID agrees interim payments (typically quarterly) against milestones that demonstrate effective progress against these outputs, as we recognise not doing so can place too onerous a burden on the cash flow of suppliers, especially SME's. We are also able on a case by case basis to ask Management Agents to agree payment mechanisms for downstream partners that can help local and small/micro partners manage possible cash flow constraints.

10. *In order to facilitate better engagement between DFID and the sub-contractors that deliver its programmes, DFID should establish a dedicated 'sub-contractors unit' within its Procurement and Commercial Department. Much like the Key Suppliers Management (KSM) system for larger contractors, this would act as the main access point for sub-contractors and offer them a more consistent pipeline of information on future opportunities, provide a channel for raising grievances and allow DFID to better understand the challenges they face and how it can help overcome them. (Paragraph 85)*

Agree

We agree with the need to improve the flow of information to and from sub-contractors. As part of the Supplier Review, we will examine a full range of possible options to level the playing field for sub-contractors, including measures to improve the governance of consortia, new platforms to advertise contract opportunities, whistleblowing arrangements and support for primary suppliers in the management of their subcontractors..

11. *Rather than expand compliance regulations, DFID should do more to ensure that the regulations set out in the current SoPE are effectively enforced. In its Supplier Review, DFID should explore ways that it can track compliance, with a particular focus on the issues raised in this report. DFID should also set out a clear set of consequences for contractors if they fail to comply with the SoPE. While such consequences should be proportionate, they should also be sufficiently firm to act as an effective deterrent against poor conduct. It should also consider extended postings in challenging environments, particularly where contractors are the dominant channel for delivery. This will help ensure that DFID staff have the requisite in-country experience to effectively manage complex programmes and ensure optimal delivery. (Paragraph 94)*

Partially agree

We will bring forward measures to ensure compliance as part of the current supplier review. These will combine clear expectations of our suppliers with mechanisms to monitor compliance and appropriate sanctions where our requirements are not met.

Flexibility in the choice and length of posting is critical if we are to attract and retain individuals to work in challenging environments, particularly as more DFID offices are made “unaccompanied” posts (i.e. without spouses and children.) We have had consistent feedback from those working in challenging environments that the shorter the minimum length of posting, the more easily they would commit to a posting, and then opt to extend the posting dependent on location. In the most challenging environments we normally require a minimum one year posting with the option to extend. Most staff do not opt to extend for more than 2 years. This is consistent with other government departments.

DFID’s Staff Appointed In Country (SAIC) provide vital local knowledge and in-country experience. Typically, they tend to stay longer with DFID’s country offices, providing continuity and institutional memory. We are continuing to build the commercial awareness and capability of all DFIDs in-country staff, both SAIC and Home Civil Service, so that they have the technical skills and tools to manage the delivery of complex programmes more effectively.

12. DFID should rebalance its due diligence efforts to focus increasingly on contract delivery. It should also increase the resources of the Internal Audit Department (IAD) if necessary. Where PbR is used, DFID should use the research it has commissioned— as well as the forthcoming work from ICAI—to create more robust guidance and training resources for staff on how to design effective programming milestones. (Paragraph 100)

Agree

DFID accepts the need to complement our enhanced due diligence of suppliers, with accurate reporting throughout the life of a contract, recognising that the circumstances of suppliers may change from initial contracting.

IAD has increased staffing and technical resources in recent years. Numbers of staff have increased from 18 in 2011 to 40 full time staff in 2017, covering counter fraud and audit and assurance teams. IAD has strengthened senior leadership and management posts which provide substantial experience in audit, risk and assurance. More than 80% of the IAD team are professionally qualified with the remainder completing audit, finance or counter fraud qualifications. IAD has direct reporting lines to DFID’s top management and reports to the DFID Audit Committee, which maintains oversight of their work.

DFID’s Strategy for Payment by Results, sets out measures to expand the evidence base and build our capabilities to implement Payment by Results effectively. We are learning from our portfolio of innovative PbR programmes, commissioning independent research and evaluation and learning from the experiences of other donors, suppliers and Government Departments, in order to deliver this strategy. We will continue to revise and strengthen our training and guidance as new evidence emerges, and look forward to working with ICAI on their upcoming review.

13. *DFID should take a more robust approach to creating performance incentives and demonstrate practical ways it is going to do this in its Supplier Review. This should include setting out clear parameters on the grounds on which a contract might be cancelled, and ensuring that there is a credible risk of cancellation by adhering to these. DFID should also ensure that where a contractor is seriously underperforming, the contract should be cancelled on the basis of default so that the failure of the contractor is recorded and that lessons can be learned. In light of the UK's decision to leave the European Union, DFID should ensure that it has substantial input into any discussions of Government-wide public procurement regulations to be implemented after withdrawal. Such regulations should give DFID greater freedom to take into account contractors' past performance in evaluating bids. Other donors, such as USAID, have this power and use it. (Paragraph 106)*

Agree

DFID has contract management processes in place to agree with our suppliers, performance measures for individual programmes, appropriate to the complexity and type of service being procured. We recognise the need for clear parameters from the outset of a programme on the grounds on which a contract may be cancelled and will review our procedures during the Supplier Review.

DFID agrees that lessons should be learned from contractor performance and applied to future programmes. In the first instance we would work with the supplier to agree options for improvement. Where a contractor continues to seriously underperform, the contract should and would be cancelled on the basis of default, lessons recorded and used to inform future practice.

The UK will use opportunities offered by our exit from the EU to consider longer-term options for the UK's public procurement rules. DFID is contributing to these discussions. As part of the Supplier Review, we will examine options within the current EU regulations to increase our ability to take past performance into account when procuring.

14. *DFID should determine some clear parameters on what constitutes fair but not excessive profits. It should also commission an independent review which benchmarks contractor fees across DFID programmes (including in different locations and comparing fragile and non-fragile states) as well as against other donors. It should also consider whether other donors are achieving better value for money through their differing procurement processes. (Paragraph 112)*

Agree

Our experience of a wide variety of operating environments suggests that the definition of "fair but not excessive profit" will vary according to the nature, location and risk transfer of the programme. We have robust processes in place to ensure that supplier costs and profits are understood, used to evaluate tenders effectively and subsequently managed throughout contract implementation and delivery.

DFID will continue to maintain and enhance these processes and, through the Supplier Review, assess further options to ensure value for money, whilst taking care not to dis-incentivise operational efficiency or interfere with the normal functioning of the market. This includes an extensive benchmarking exercise on contractors' fee rates. The

benchmarking data will be used strategically across DFID to understand and drive down fees wherever possible. We have also brought in Cabinet Office expertise to assess options for greater transparency around contractors' fees, overheads and profits, including through Open Book Accounting and measures to identify and challenge above-expected profit.

We will continue to collect benchmarking data, share best practice and learning with other donors and identify opportunities for collaboration. Such areas of commercial collaboration have to date included fee rates, strategic relationship management, professional standards and market engagement. We are reviewed regularly by ICAI. As an independent review would draw on the same source data to repeat this analysis, it would not represent good value for money.

15. *We recommend that DFID consider an Australian-style consultant remuneration framework as an output of its Supplier Review. This framework should be prepared in collaboration with contractors to take into account their views, and should be designed carefully—building in an appropriate level of flexibility—to avoid any market distortions that may emerge.* (Paragraph 117)

Agree

As part of the Supplier Review, DFID is examining a range of remuneration mechanisms from across the development sector, including those used by donors such as the Australian Department of Foreign Affairs and Trade and international suppliers. We will bring forward final recommendations on conclusion of the review.

16. *DFID should ensure that the principles outlined in its Disability Framework are enforced in programming delivered through contractors and it should require that disability inclusion be written into contracts.* (Paragraph 122)

Agree

DFID welcomes this recommendation and will take steps to enforce the principles outlined in the Disability Framework more explicitly through our competitive tendering procedures.