Independent Commission for Aid Impact

Achieving value for money through procurement

Part 1: DFID's approach to its supplier market

A performance review

November 2017

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We operate independently from government, reporting to Parliament, and our mandate covers all UK official development assistance.

Overall review scores and what they mean

GREEN	Strong achievement across the board. Stands out as an area of good practice where UK aid is making a significant positive contribution.
GREEN/ AMBER	Satisfactory achievement in most areas, but partial achievement in others. An area where UK aid is making a positive contribution, but could do more.
AMBER/ RED	Unsatisfactory achievement in most areas, with some positive elements. An area where improvements are required for UK aid to make a positive contribution.
RED	Poor achievement across most areas, with urgent remedial action required in some. An area where UK aid is failing to make a positive contribution.

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DFID's spending through suppliers has doubled over the past five years, reaching £1.4 billion last year and making it an increasingly crucial component of securing value for money. In this review we examine how DFID is shaping its supplier market so as to improve value for money over time.

Since 2015 DFID has put in place a more ambitious approach to market shaping. It has introduced a range of measures to analyse its market and derive lessons. There has been a concerted effort to build up commercial capacity within the procurement department and beyond. It has identified issues within its procurement practices that might inhibit competition and launched a number of initiatives to address them. The International Development Secretary has committed to prevent "excessive profiteering", and DFID is also acting to improve the transparency of supplier fee rates and costs and increase its scrutiny of supplier profits.

These initiatives are welcome and constitute an important part of our green-amber assessment overall, but it is still the case that many actions are too recent to have achieved their full potential impact on DFID's supplier market.

DFID has exceeded the UK government target of delivering a third of its procurement through small and medium-sized enterprises by 2020, but its efforts to promote the participation of small and micro suppliers and suppliers in developing countries are still at an early stage. From the available data, DFID's 'global' market is not overly concentrated, but there is limited competition in particular sectors and partner countries, holding back efforts to diversify its supplier base. There has been a modest increase in the number of bids per tender and the overall number of suppliers bidding for contracts, but more progress is needed on reducing potential barriers to competition. DFID's Key Supplier Management Programme and framework contracts are both potentially useful initiatives, but lack clear objectives on market shaping and are yet to have a measurable impact. Both are now being reformed based on lessons learnt.

After a slow start on market shaping, there is now evidence of positive progress and a serious effort by DFID to get to grips with the challenges of achieving value for money through its engagement with its supplier base. We have therefore awarded DFID a green-amber score.

Individual question scores

Question 1

Relevance – Does DFID's approach to shaping its supplier market support the objectives and priorities of the aid programme?

Question 2

Effectiveness and value for money – Do DFID's efforts to shape its supplier market support value for money?

Question 3

Learning – Does DFID capture and use learning and knowledge from its interactions with suppliers to improve its use of suppliers and its market-shaping efforts over time?

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Executive Summary

DFID's spending through suppliers has doubled over the past five years, reaching £1.4 billion in 2016-17 or 14% of its budget.[1] As this figure has increased, DFID's procurement practices have become the subject of intense public interest. In 2017, the International Development Committee published two reports on DFID's use of contractors.[2] The International Development Secretary also commissioned an internal review of DFID's work with suppliers, which was completed in October 2017.[3]

As procurement is a key driver of value for money in UK aid, the Independent Commission for Aid Impact (ICAI) is undertaking two reviews on DFID's practice. This first review assesses whether DFID influences and shapes its supplier market in order to improve value for money over time. The next review, to be published in 2018, will explore whether DFID has maximised value for money from suppliers through its tendering and contract management practices. The two reviews assess different aspects of progress made in addressing concerns raised in ICAI's 2013 report on DFID's use of suppliers.[4]

In this review we explore whether DFID has an appropriate approach to market shaping, taking account of some of the more recent initiatives. In carrying out our review, we conducted financial and statistical analysis of DFID's procurement data, assessed its rules and practices against UK government guidance, and collected feedback through interviews with DFID staff, suppliers and external observers.

This is a dynamic area of practice for DFID, as shown by the International Development Secretary's announcement of further reform initiatives on 3 October 2017, which have emerged from DFID's supplier review.[5] Our assessment necessarily focuses on evidence from existing actions and initiatives, capturing the impact of DFID's procurement practices on its supplier market over the past few years. We do not seek to evaluate the effectiveness of the further initiatives announced on 3 October, but of course recognise them as evidence of DFID's intentions where relevant to our analysis and conclusions.

Does DFID's approach to shaping its supplier market support the objectives and priorities of the aid programme?

DFID has been making a concerted effort to strengthen its procurement function since 2008, when a cross-government commercial capability review pointed to a number of weaknesses. From 2015 onwards, its reform efforts began to include a substantial emphasis on market shaping – namely, understanding how DFID's procurement influences the market and taking measures, where required, to stimulate competition and build market capacity, so as to achieve better value for money over time. While market shaping is recommended in UK government guidelines, it is a relatively recent focus for most departments.

Since then, DFID has been progressively developing a more comprehensive approach to market shaping. Its commercial vision commits the department to building its supply base and stimulating greater competition. It has identified a range of potential barriers to competition, including lack of visibility of future ('pipeline') procurement opportunities, the size and complexity of its contracts and a lengthy procurement process. In 2016 DFID adopted an unpublished Market Creation Plan, setting out action to address these barriers. The action includes:

- improved communication with suppliers
- measures to promote the participation of small and medium-size enterprises (SMEs) and suppliers from developing countries
- refinements to its Key Supplier Management Programme and framework contracts
- the development and implementation of a market segmentation tool.

1. Calculated from internal procurement data provided by DFID.
2. *DFID's use of private sector contractors: Eighth Report of Session 2016–17*, International Development Committee, 4 April 2017, link; *Conduct of Adam Smith International: Seventh Special Report of Session 2016–17*, International Development Committee, 12 February 2017, link.
3. *DFID's Supplier Review*, DFID, 3 October 2017, link.
4. *DFID's Use of Contractors to Deliver Aid Programmes*, ICAI, May 2013, link.
5. *DFID's Supplier Review*, DFID, 3 October 2017, link.

DFID has worked to improve communication with suppliers, including through an annual supplier conference and 61 early market engagement events in 2016-17. A further strengthening of this work was announced last month, together with action to simplify processes and improve information sharing for small and micro suppliers.

DFID has also been developing market-shaping strategies in particular sectors and countries which present their own procurement challenges. These are supported by commercial delivery advisors attached to particular country offices or spending departments. For example, DFID Nigeria is working to broaden its supplier base through more effective communication of opportunities and measures to promote the participation of Nigerian firms as subcontractors, consortium partners or as suppliers of specialist services. While we welcome this initiative, of the 32 country and sector commercial strategies that we reviewed, only a small number contained specific steps for strengthening the supply chain. We also found that DFID is yet to settle on an approach to promoting the participation of local suppliers. Despite a stated objective to increase their participation, and a 2017 study of the barriers they face, we encountered a mixture of views among DFID stakeholders as to whether the participation of local suppliers should be treated as an objective in its own right.

DFID is in the process of increasing transparency over supplier costs and profits, and the International Development Secretary has made a commitment to prevent "excessive profiteering".[6] DFID has included open-book accounting in its contracts for some time, but capacity constraints have prevented it from exercising its rights. It has plans to move ahead in this area for priority contracts in 2017. DFID has also been introducing measures to improve transparency of costs, including through benchmarking of fee rates, and to increase its scrutiny of supplier profits. The International Development Secretary's October announcement included new standard terms and conditions entitling it to monitor and intervene over suppliers' profits. The impact of these measures on the market is difficult to predict and will need to be carefully monitored.

Overall, we welcome DFID's increased ambition in this area. The outlines of a credible approach to market shaping are emerging, even though many of the individual activities still need to be tested and refined. We have therefore awarded DFID a **green-amber** score for its emerging approach, reflecting a significant increase in activity in this area and an overall positive direction of travel.

Does DFID's shaping of its supplier market support value for money?

Over the past five years, DFID's top six suppliers have accounted for 45% of total contract value. They in turn engage second and third tier suppliers – including from developing countries – as subcontractors for delivering programmes. While the data suggests that DFID's global supplier market is not overly concentrated, it appears to face limited competition in certain sectors and countries.[7] There has been a modest increase in the overall number of suppliers and in the number of bids per tender, reaching 2.9 in 2016-17, but still falling short of DFID's target of four.

There are a range of features of DFID's procurement that may make it more difficult for new entrants to challenge existing suppliers. DFID contracts are often large and complex, despite some decline in average size in recent years. In the view of suppliers we interviewed, the level of risk transfer associated with the contracts has also increased. DFID procurement can also be slow, due to its complexity, which can disadvantage smaller firms unable to manage the cost implications. A lack of sufficient notice from DFID of future pipeline opportunities was identified as a further barrier for new entrants. While some of these challenges are inherent in the nature of DFID's procurement, the department acknowledges a number of areas where it needs to improve.

Despite clear intentions, there has been mixed progress towards the objective of improving market diversity. DFID has met and exceeded the UK government target of delivering a third of its procurement through SMEs, defined as firms with under 250 employees and an annual turnover of less than €50 million. This is positive, but DFID also acknowledges a need to do more to foster a diverse eco-system of suppliers from micro to small and medium-sized enterprises, and to improve its engagement across the different categories.

6. *DFID's use of private sector contractors: Eighth Report of Session 2016–17*, International Development Committee, 4 April 2017, p. 6, link.
7. We use the definition of market concentration used by the UK Competition and Markets Authority and described in the *Guidelines for market investigations: Their role, procedures, assessment and remedies*, Competition Commission, April 2013 p. 87–88, link. The Competition and Markets Authority was formed in 2014 as an amalgamation of the Competition Commission and the Office of Fair Trading.

In 2016-17, 92% of DFID contracts by value went to UK-registered suppliers and only 3% to suppliers in developing countries as prime contractors. More local suppliers participate as subcontractors to international firms and some of DFID's country commercial strategies include measures to help them, although these are at an early stage. DFID is now undertaking delivery chain mapping, but a figure for the value of local supplier participation as subcontractors is not currently captured in DFID's management information. We found that a systematic approach to promoting the participation of local suppliers is not yet in place and information gaps continue to be a weakness in DFID's market-shaping work.

DFID's Key Supplier Management Programme is intended to strengthen its strategic relationships with its most important suppliers. The programme has been operating since 2013, involving structured communication and regular performance appraisals at the portfolio level. It was put on hold during 2017 pending the outcome of DFID's supplier review, and in October 2017 DFID announced that it would be developed and extended. We agree that a Key Supplier Management Programme is valuable to communicate expectations, raise performance and strengthen DFID's understanding of its major suppliers. However, we found that the objectives of the programme were not defined clearly enough and that monitoring is not strong enough to identify the programme's contribution to improving value for money. There are also widespread concerns that additional engagement with DFID could offer key suppliers a competitive advantage. We therefore welcome DFID's ongoing efforts to improve the programme and maximise its value-added while managing associated risks.

Framework agreements are a tool used across the UK government to simplify procurement in high-volume areas. Suppliers that qualify to be part of a framework can bid for contracts through simpler and quicker mini-competitions. DFID has been using frameworks since 2011, covering around half of its centrally awarded contracts. They have succeeded to some degree in reducing the time and costs involved for DFID, but have had a lower than expected impact on simplifying the process for suppliers. Second-tier suppliers report that the work is dominated by the major suppliers. At this point we find limited evidence that the frameworks have made a significant contribution to developing the supply base. However, DFID is now developing a new generation of frameworks that split contracts into small parcels of work (known as 'lotting') to encourage a wider range of suppliers. It is also introducing new systems for allocating work among participating firms and challenging efforts by prime suppliers to tie subcontractors to particular contracts through exclusivity clauses.

Overall, and based on an assessment of tangible achievements to date, we score the effectiveness of DFID's market-shaping efforts as **amber-red**. This reflects the fact that the bulk of DFID's market-shaping initiatives are still in process and not yet mature enough to have had a significant impact on the market. Given recent increases in staffing and the range of positive actions it is now implementing as part of the Market Creation Plan, we would expect to see performance improvements in this area in the near future.

Does DFID capture and use learning and knowledge from its interactions with suppliers to improve its use of suppliers and shape its supplier market over time?

Our 2013 review assessed DFID's learning on procurement as amber-red. Since then, DFID has taken a range of actions to acquire and apply learning about shaping its supplier market. It has participated in a series of cross-government commercial capability reviews, and various recommendations have been implemented or are ongoing, including commercial reviews of country offices, appointing commercial advisors and introducing compulsory commercial training for all senior civil service staff and senior responsible owners.

At the beginning of 2017, the Secretary of State launched a comprehensive review of DFID's work with suppliers, and DFID announced action following the review in October. While we cannot yet assess the impact of this action, the review shows the seriousness with which DFID is taking this issue and its awareness of the need for continuing improvement.

We have found evidence of learning in a range of areas. Both the Key Supplier Management Programme and the framework agreements are being analysed, through a process involving broad consultation, and improvements are in the pipeline. DFID has also improved its communications with suppliers on a number of levels.

While we are satisfied that a significant amount of learning has informed the current reform effort, the learning process is still held back by weaknesses in DFID's management information systems. DFID currently holds

information about suppliers on two parallel systems, which are separate from its main project management system. Integration between them is poor, which limits the depth of analysis that can be undertaken, and the system does not include information on supply chains or on contracts let through country offices. DFID has recently approved a business case for the development of a new management information system.

We have awarded DFID a **green-amber** for learning, in recognition of the substantial effort that has gone into the area and that the work is ongoing.

Conclusions and recommendations

Over the past two years, DFID has been developing a more comprehensive approach to its supplier market, with a view to securing additional value for the taxpayer beyond that offered by individual procurements. It has identified aspects of its procurement that might restrict competition and diversity, and has begun to develop initiatives to address them. Many of these remain at a relatively early stage of development and will need to be tested and refined, but we welcome the more ambitious approach and the learning that has gone into it.

Because of the timescales involved, we cannot yet give these efforts a positive score for effectiveness. We nonetheless assess that there are good prospects for improvement in the coming period, meriting a **green-amber** score overall.

The research and writing of our review has taken place in parallel to DFID's own supplier review. We note that several of the actions announced by the International Development Secretary on 3 October affect DFID's market-shaping activities and are relevant, in particular, to our first two recommendations below. Some of the announced initiatives resonate with our findings, but DFID's supplier review had a different scope and emphasis, and did not cover all the issues we highlight.

Against this background, our recommendations are as follows:

Recommendation 1:

DFID should adopt a more systematic approach to its stated objective of promoting the participation of local suppliers, to the extent permitted within procurement regulations, including measures at the central, sector and country office levels to encourage the emergence of future prime contractors from developing countries. This might include identifying opportunities for local suppliers to compete directly for DFID contracts, increased supervision of the terms on which prime contractors engage local suppliers, and more inducement of DFID's prime contractors to invest in building local capacity.

Recommendation 2:

DFID should develop clear plans for how it will progress its use of open-book accounting and improve fee rate transparency, and ensure that its plans are clearly communicated to the supplier market, to minimise the risk of unintended consequences.

Recommendation 3:

DFID should accelerate its efforts to improve communication of pipeline opportunities to the market. It should also assess what potential information advantages are gained by participants in its Key Supplier Management Programme, and ensure that this is counterbalanced by more effective communication with all potential suppliers. Internally, DFID should provide clearer guidance to staff as to what can and cannot be discussed during key supplier meetings.

Recommendation 4:

The next phase of DFID's commercial reform plans should be accompanied by a stronger change management approach, with explicit objectives that are clearly communicated to staff. Its plans should be supported by robust monitoring and management information arrangements, to enable full transparency, regular progress reporting and mitigation of potential negative effects.

1. Introduction

1.1 Over the past five years, as the UK aid programme has grown, DFID's spending through suppliers has roughly doubled in cash terms, reaching £1.4 billion in 2016-17 or 14% of its budget.[8] Contracting out to suppliers is only one route by which DFID delivers aid. Others include contributions to multilateral organisations, grants to non-governmental organisations (NGOs) and financial assistance to governments in developing countries.

1.2 As spending through suppliers has increased, it has become a matter of considerable public interest, amid concerns about the level of profits made by some suppliers and their ethical standards.[9] In 2017, the International Development Committee published two reports on DFID's use of contractors[10] and the International Development Secretary commissioned an internal review of DFID's work with suppliers, which was completed in October 2017.[11]

1.3 In light of the importance of the subject to the overall value for money of UK aid, the Independent Commission for Aid Impact (ICAI) is conducting two reviews of aspects of DFID's procurement practices. This first review assesses how DFID influences and shapes its supplier market in order to secure the best value for money over time. The next review, to be published in 2018,will explore whether DFID has maximised value for money from suppliers through its tendering and contract management practices. They are both performance reviews, as they focus on a core DFID business process (see Box 1).

Box 1: What is an ICAI performance review?

ICAI ***performance reviews*** examine how efficiently and effectively UK aid is being spent on a particular area, and whether it is likely to make a difference to its intended beneficiaries. They also cover the business processes through which aid is managed in order to identify opportunities to increase effectiveness and value for money.

Other types of ICAI reviews include: ***impact reviews***, which examine results claims made for UK aid to assess their credibility and their significance for the intended beneficiaries; ***learning reviews***, which explore how knowledge is generated in novel areas and translated into credible programming; and ***rapid reviews***, which are short, real-time reviews of emerging issues or areas of the UK aid spending that are of particular interest to the UK Parliament and public.

1.4 This review covers DFID's engagement with actual and potential suppliers in order to shape its supply chains and achieve better value for money through its procurement. Market shaping is a common element of public procurement and is recommended in UK government guidelines.[12] Our scope is limited to procurement for the delivery of aid programmes by DFID, not the procurement of goods and services for DFID's own administrative purposes. The review is also limited to DFID's performance; the behaviour and practices of DFID's suppliers fall outside our scope. Our review questions are set out in Table 1. A glossary of key terms can be found in Annex A.

8. Calculated from internal procurement data provided by DFID.
9. *DFID's use of contractors: Call for evidence*, International Development Committee, April 2016, link.
10. *DFID's use of private sector contractors: Eighth Report of Session 2016–17*, International Development Committee, 4 April 2017, link; *Conduct of Adam Smith International: Seventh Special Report of Session 2016–17*, International Development Committee, 12 February 2017, link.
11. *DFID's Supplier Review*, DFID, 3 October 2017, link.
12. *Government Commercial Operating Standards: Iteration ii*, Government Commercial Function, October 2016, link. *Good practice contract management framework*, National Audit Office, December 2016, link.

Table 1: Our review questions

Review criteria	Review question
1. Relevance: Does DFID's approach to shaping its supplier market support the objectives and priorities of the aid programme?	• Does DFID have a clear and appropriate strategy and approach to influencing the shape and structure of its supplier market? • Does DFID have a credible strategy for assessing suppliers' costs and whether they are making excessive profits?
2. Effectiveness: Do DFID's efforts to shape its supplier market support value for money?	• Is DFID's monitoring and influencing of its supplier market supporting improvements in value for money over time? • Does DFID's management of its key suppliers and frameworks improve value for money? • Does DFID pay adequate attention to the need for competition and diversity in its supplier market?
3. Learning: Does DFID capture and use learning and knowledge from its interactions with suppliers to improve its use of suppliers and its market-shaping efforts over time?	• Does DFID have a suitable mechanism for learning around supplier market shaping? • Is there evidence of learning?

1.5 The review builds on the International Development Committee's recent report on DFID's use of contractors.[13] It also updates the relevant findings of a wider 2013 ICAI review, *DFID's Use of Contractors to Deliver Aid Programmes*.[14] Our assessment of DFID's progress against the recommendations from that report is summarised in Annex B. That review assessed DFID's overall use of contractors as green-amber. It concluded that contractors can offer an effective option for delivering aid, but that DFID lacked a clear strategy on how to deploy the right contractors, including major, niche and innovative new entrant organisations, to best effect. Four of the recommendations of that review were within the scope of our current review, and Annex B shows progress on all four.

1.6 ICAI is currently undertaking a review of DFID's approach to value for money in programme and portfolio management.[15] Programme management and procurement are two of the most important drivers of value for the UK aid programme. The reviews are therefore complementary, selected to provide a holistic assessment of DFID's approach to value for money.

13. *DFID's use of private sector contractors: Eighth Report of Session 2016–17*, International Development Committee, 4 April 2017, link.
14. *DFID's Use of Contractors to Deliver Aid Programmes*, ICAI, May 2013, link.
15. *DFID's approach to value for money in programme and portfolio management: Approach paper*, ICAI, April 2017, link.

2. Methodology

2.1 There are six methodological components to our review.

i) We conducted a **review of DFID's procurement policies and strategies**, analysing the quality of analysis and reasoning behind DFID's procurement approach to assess its relevance and effectiveness. This included assessing how DFID oversees its suppliers, ensuring that they meet its expectations, and promoting value for money and diversity in its supply chain. We conducted in-depth interviews with DFID and reviewed relevant documentation, including 32 commercial delivery plans provided to us by DFID showing how commercial strategy is planned to be implemented across a range of country offices and other spending departments.

ii) We conducted **process benchmarking**, assessing DFID's procurement approach against UK government guidelines and best practices, and considering how well DFID learns from, and responds to, examples of best practice.

iii) We conducted a **financial and statistical analysis** of DFID contract data to identify patterns and trends. In addition to reviewing the outputs of DFID's management information system, we performed our own analysis of DFID's data.

iv) We conducted a **survey** of 57 suppliers who had either attended or been invited to attend DFID's 2016 supplier conference,[16] to ascertain their views of DFID's approach to shaping its supplier market. We also conducted in-depth interviews with a sample of both current and former key suppliers and participants in framework agreements, and a number of other interested parties and commentators.[17] In addition, we held two roundtables with members of British Expertise and Bond, the UK NGO network, to gather views from both private sector organisations and NGOs.

v) We carried out **in-depth analysis** of DFID practice in the following areas:

- Key supplier management: how DFID manages its relationships with its most important suppliers.
- Framework agreements: DFID's use of pre-qualification processes to simplify procurement in particular thematic areas.
- Supplier engagement: how DFID communicates with its suppliers and potential suppliers, in order to promote competition.
- Working across country contexts: we explored how DFID's relationship with local suppliers varies in different country contexts, particularly fragile states. We conducted desk-based case studies of Nigeria, India and Sierra Leone, as well as of DFID's central Children, Youth and Education team as one of the highest spending central departments. For each case study, we conducted interviews with relevant DFID staff in-country and in the UK, as well as reviewing procurement data and relevant documents.

vi) We conducted a **literature review**, looking at past International Development Committee, ICAI and National Audit Office recommendations relevant to our review, and identified examples of best practice from other UK government departments and bilateral donors.

2.2 We acknowledge that firms and individuals involved in the preparation of ICAI reviews are also suppliers in the UK aid market. We have taken steps to control against any resulting risk of bias. We have staffed the review team from outside our usual supplier consortium, and the team was led by individuals who are not active as contractors in the UK aid market. Furthermore, we have appointed a reference panel of distinguished procurement experts to peer review the methodology and the report.[18]

16. Since 2013, DFID has held a one-day conference each year that is open to all current and prospective suppliers.
17. These included the National Audit Office, journalists, firms operating in related areas and suppliers' representative organisations.
18. For more on the peer review panel, see the Approach Paper to this review, ICAI, April 2017, link.

2.3 Procurement has been a dynamic area of practice for DFID in recent years, with a number of reform initiatives. During 2017 the department has conducted its own review of its work with suppliers, leading to the announcement by the International Development Secretary on 3 October of further reform initiatives.[19] It may take some years for new initiatives to influence the shape of the supplier market. In this review, we take account of recent changes in DFID's procurement policies and systems under our first review question on relevance. Our second question, on effectiveness, is necessarily backwards-looking at the results of DFID's procurement practices over recent years, and does not attempt to predict the results of ongoing reforms. The review should therefore be read as a snapshot of a situation that will continue to evolve in the coming period.

19. *DFID's Supplier Review*, DFID, 3 October 2017, link.

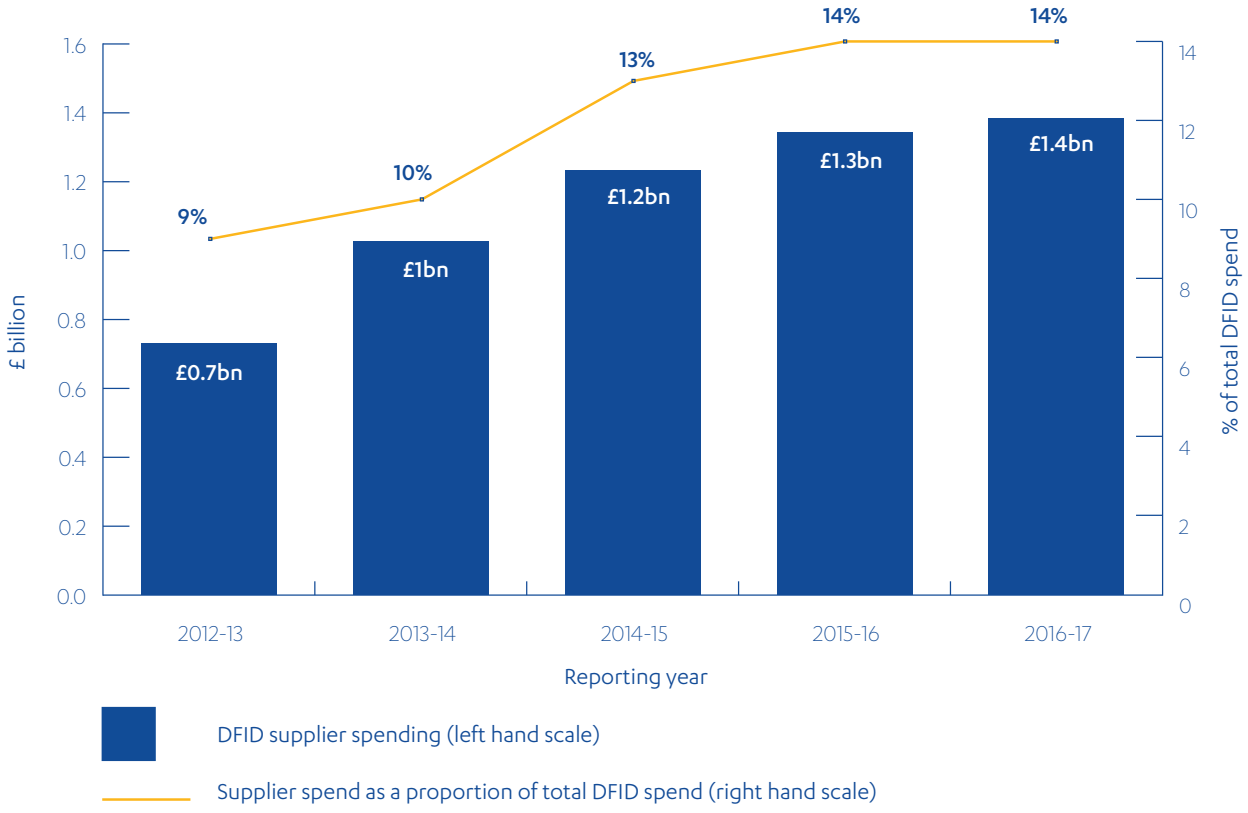
3. Background

The challenging context for DFID procurement

3.1 Over the five years to 2016-17, DFID let 700 contracts worth £5.5 billion to around 170 unique suppliers.[20] The amount of procurement has increased steadily over that period (see Figure 1), reaching £1.4 billion or 14% of DFID's £10.2 billion budget in 2016-17.[21] It remains much less than the proportion of aid spent through multilateral organisations, developing country governments and NGOs. It is also below the proportion of some other bilateral donors, such as the United States Agency for International Development (29%) or Australia's Department of Foreign Affairs and Trade (24%).[22]

3.2 Suppliers are usually commercial entities, but can also be charities, universities, or other not-for-profit organisations. It is the legal nature of DFID's agreement with the recipient that determines whether entities are considered to be suppliers, rather than the legal form of the recipient.

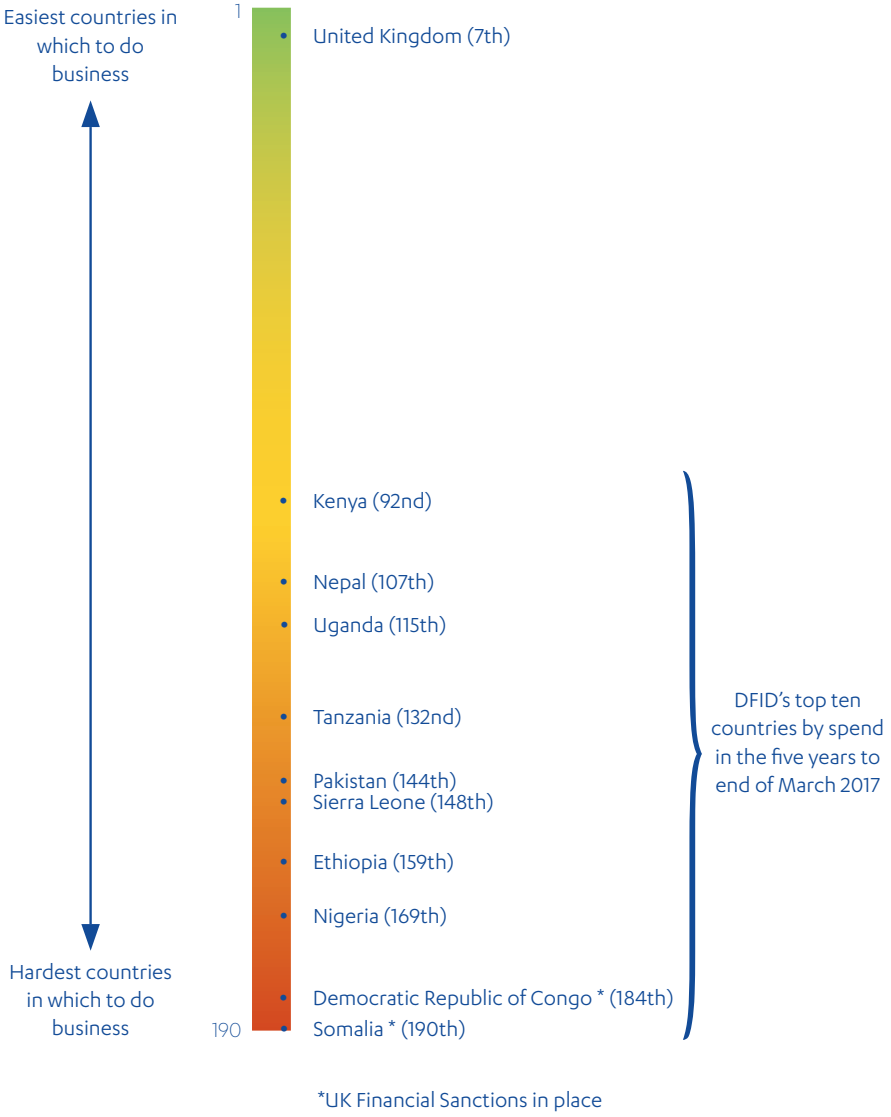
Figure 1: DFID's supplier expenditure over the last five years



3.3 DFID's procurement needs are complex and its markets diverse. It uses suppliers for a wide range of functions, such as the supply of goods (eg humanitarian or medical supplies), the management of grant mechanisms, construction projects and technical assistance to recipient governments. Its programming spans a wide range of country contexts and sector specialities, each offering different supplier markets and procurement challenges. DFID's target countries are among the poorest in the world, with limited private sector capacity, and many are affected by conflict and insecurity. The risks involved in delivering complex aid programmes in difficult environments add substantially to DFID's procurement challenges as shown in Figure 2.

20. The number of suppliers used here is based on a manual assessment of DFID's procurement data that included eliminating three apparent duplicates to identify unique suppliers.
21. Calculated from internal procurement data provided by DFID. DFID's budget as per *Department for International Development's settlement at the Spending Review 2015*, DFID, 25 November 2015, link.
22. *DFID's use of private sector contractors: Eighth Report of Session 2016–17,* International Development Committee, 4 April 2017, p. 8, link

Figure 2: The position of DFID's top ten countries by contractor spend, and the UK, in the World Bank's Ease of Doing Business ranking[23]



3.4 The procurement challenge has also been complicated in recent years by the rapid scaling up of the UK aid programme to meet the government's 0.7% commitment. There has also been a high level of budget volatility, as DFID has responded to the domestic fiscal environment and shifting priorities of government.

Roles and responsibilities

3.5 The spending units in the delivery arms of DFID (country offices and central spending departments) through the senior responsible owner[24] for each programme, and the central Procurement and Commercial Department, all have responsibilities for procurement at DFID (Box 2).

23. *Doing Business*, World Bank, as accessed on 12 October 2017, link; *Financial Sanctions Targets by Regime*, HM Treasury and Office of Financial Sanctions Implementation, 25 August 2017, link.
24. Under DFID's Smart Rules, an official is designated to act as senior responsible owner for every programme, who is accountable for its design, delivery, closure and archiving: see *Smart Rules: Better Programme Delivery: Version VIII*, DFID, 1 October 2017, p. 10, link.

Box 2: Responsibility for procurement within DFID

Procurement and Commercial Department responsibilities:

- Ensuring DFID's procurement complies with the law and UK government policy, and meets DFID's procurement needs.
- Meeting cross-government targets, such as at least 33% of procurement value to be delivered through SMEs.[25]
- Supporting senior responsible owners with day-to-day responsibility for procurement within country offices and other spending departments.

Senior responsible owner responsibilities:

- Developing the specification of DFID's needs.
- Ensuring compliance with DFID Smart Rules on procurement.
- Managing smaller contracts directly, and working with the Procurement and Commercial Department on larger and more complex procurements.

3.6 DFID's Smart Rules require that the senior responsible owner ensures that procurements with a value above the European Union (EU) threshold (£106,047) are commissioned for tender and awarded through the Procurement and Commercial Department, competed for in line with the EU Public Procurement Directives, and advertised in the Official Journal of the European Union (OJEU). Any exemptions (eg emergency procurement) must be agreed with the Procurement and Commercial Department.

3.7 The senior responsible owner must seek ministerial approval for all supplier contracts over £1 million. Cabinet Office approval is also required for contracts over £5 million. Procurements below the EU threshold should be undertaken by departmental procurement officers, or others accredited by the Procurement and Commercial Department, in line with the principles of the EU Public Procurement Directives of non-discrimination, equal treatment and transparency, under the direction of the senior responsible owner.

DFID's procurement goals

3.8 Procurement is a dynamic area for DFID where the systems and processes have been evolving rapidly. An internal commercial capability review undertaken in 2015 found that DFID had undertaken "a significant commercial transformation programme" over the previous five years, strengthening commercial capability across the department and introducing a commercial leadership course for senior civil servants.[26] However, it found a number of shortcomings in capacities and processes, which DFID has since been addressing.

3.9 As part of the reform programme, the Procurement and Commercial Department set a high-level vision and strategy to "support the ambitions of the department to become a world-class commercial organisation".[27] Its objectives are summarised in Box 3.

25. In 2010, the government announced a goal of 25% of spending to go to SMEs by 2015. In August 2015, the government announced that it would increase this target to 33% by 2020: see *Government's spending with small and medium-sized enterprises*, National Audit Office, 9 March 2016, p. 4, link.
26. *Commercial Capability Review 2015*, DFID, 2015, unpublished.
27. *DFID's Procurement and Commercial Vision*, DFID, April 2016, link.

Box 3: Extract from DFID's Procurement and Commercial Department 'Vision'

First class commercial and procurement service within DFID	• Providing expert commercial advice to design and manage development programmes • Robust assurance and governance: agile and flexible, with appropriate control, risk and contract management • Service excellence, enabling the business to be ambitious and innovative in programme delivery • Meeting the Government Commercial Standards as set out by Cabinet Office
Maximising and shaping markets	• Shaping both international and local markets alike • Collaborates with other donors, multilateral organisations and across UK government to ensure opportunities are visible to the market, to include both local and UK SMEs • Developing key markets that grow the supply base, build local sustainable capability and increase choices • Creating greater assurance on market capability and capacity, increases competition and improved value for money
Our commercial influence and impact on the wider sector	• DFID understands the wider international development system and the impact of its commercial choices, not just on its own programmes, but on the work of others • Developing ever-stronger links with the private sector and bring about economic growth • Ensure policy decisions consider commercial effectiveness and drive sustainable commercial reform across the multilateral system

Increased scrutiny of DFID procurement

3.10 As aid spending has grown, the focus on DFID's procurement practices, particularly its use of suppliers, has intensified. The 2013 ICAI report on DFID's use of contractors, while positive about the use of contractors to deliver UK aid, pointed to the need for more sophisticated practices to manage the growing complexity of the portfolio.

3.11 In an April 2017 report on DFID's use of suppliers,[28] the International Development Committee, while noting progress, raised concerns that DFID did not have enough capacity to manage the full range of its commercial vision and lacked a sufficient understanding of how its procurement processes were shaping the supplier market. In particular, the Committee was concerned that certain procurement practices, including DFID's use of framework contracts, were working against the department's stated aim of expanding market access for smaller suppliers.[29] The Committee also published a report that was highly critical of alleged unethical practices by one of DFID's top suppliers, Adam Smith International.[30] These and other concerns led to a forensic investigation by DFID, which, at the time of writing, was still underway.

28. *DFID's use of private sector contractors: Eighth Report of Session 2016–17*, International Development Committee, 4 April 2017, link.
29. *DFID's use of private sector contractors: Eighth Report of Session 2016–17*, International Development Committee, 4 April 2017, pp. 20–23, link.
30. *Conduct of Adam Smith International: Seventh Special Report of Session 2016–17*, International Development Committee, 12 February 2017, link.

3.12 In the face of this scrutiny from Parliament and the public, the International Development Secretary ordered the department to undertake a review of DFID's work with suppliers. In January 2017, she wrote to the International Development Committee to explain the priorities of this review, saying:

> "There should be no room for excessive profiteering or unethical practices. All of DFID's suppliers and partners need to be fully open and transparent with UK taxpayers about where their money is going and how it is being spent to meet development outcomes. They need to uphold the highest standards and be held to account for those standards. DFID needs to reduce its reliance on a limited number of suppliers, and encourage healthy competition in what is often a challenging development sector."[31]

3.13 On 3 October 2017 the International Development Secretary announced a number of actions resulting from this review. Some of these relate to DFID's market-shaping activity and are considered in the relevant parts of this report insofar as it is practical at this early stage.[32]

31. *DFID's use of private sector contractors: Eighth Report of Session 2016–17*, International Development Committee, 4 April 2017, p. 6, link.
32. *DFID's Supplier Review*, DFID, 3 October 2017, link

4. Findings

4.1 This section sets out the findings of our review. We first assess relevance – whether DFID's approach to shaping the supplier market is appropriate, given the objectives and priorities of the aid programme. We then turn to effectiveness – whether DFID's market-shaping interventions are successful in driving better value for money. Finally, we assess DFID's processes for capturing and using learning to improve its efforts to shape the supplier market over time.

Does DFID's approach to shaping its supplier market support the objectives and priorities of the aid programme?

From 2015 DFID moved from conservative to more ambitious market-shaping goals

4.2 DFID has been making a concerted effort to strengthen its procurement function since 2008, when a commercial capability review by the Office of Government Commerce – the predecessor to the current Government Commercial Service and Government Commercial Function – raised concerns regarding its overall vision and approach, the quality of its management information, and its risk management processes.[33] DFID responded to this assessment with a process of reform that has included a sustained effort to build commercial capacity and to strengthen procurement systems and processes. In our 2013 report, we found that the reform plan was not well prioritised and that there were a number of gaps. Since then, the reform strategy has continued to evolve.

4.3 Until 2015, market shaping was not a significant part of DFID's procurement reforms. The department took a relatively conservative approach to market shaping, concentrating on core procurement processes, the management of key suppliers, and building capability within the department, rather than on measures to strengthen the supply base.

4.4 This caution was common at the time among Whitehall departments. In 2016, the Public Accounts Committee reported that commercial capability reviews of the major procuring departments had found that they were "overwhelmingly focused on the procurement process at the expense of crucial market shaping and contract management activities".[34]

4.5 Market shaping is clearly recognised in UK government guidance as both appropriate and consistent with regulations if it helps to promote better value for money over time. Arm's-length competitive tendering, combined with effective market engagement, are key ingredients in delivering value for money in supply contracts in public procurement, but research and evaluation evidence acknowledges that market-shaping initiatives may be required in addition.[35]

4.6 Office of Government Commerce guidance from 2009 encouraged departments to develop a better understanding of how their own purchasing power and procurement practices influenced markets and to take corrective action as required.[36] The National Audit Office has produced a *Good practice contract management framework* that endorses 'market making' when appropriate to stimulate competition and build market capacity.[37]

4.7 Since 2015 DFID began to increase its ambition on market shaping. A commercial vision, adopted in 2015-16, sets out DFID's aspiration to "take responsibility for maximising market responses".[38] Market shaping was specified as one of three overall objectives (see Box 3), in order to expand the size and diversity of its supply base. The market-shaping objectives include:

33. *DFID's Use of Contractors to Deliver Aid Programmes*, ICAI, May 2013, link.
34. *Transforming contract management: progress review: Thirty-second Report of Session 2015–16*, Public Accounts Committee, 23 March 2016, p. 9, link.
35. Klemperer, Paul, "Competition Policy in Auctions and Bidding Markets" in Buccirossi, Paolo (ed.), *Handbook of Antitrust Economics*, MIT Press: London, 2008, pp. 585-589; Graells, Albert, *Distortions of Competition Generated by the Public (Power) Buyer: A Perceived Gap in EC Competition Law and Proposals to Bridge It*, University of Oxford Centre for Competition Law and Policy, 2009, link.
36. *GEMS Guide to Effective Market Shaping*, Office of Government Commerce, 2009, link.
37. *Good practice contract management framework*, National Audit Office, December 2016, p. 16, link.
38. *Procurement & Commercial Vision v2*, DFID, current version dated April 2016, unpublished.

- ensuring opportunities are more visible to the market, including to SMEs and local suppliers in partner countries
- developing key markets that grow the supply base, build sustainable local capability and increase procurement choices
- creating greater assurance on market capability, increasing competition and improving value for money.

Box 4: Building procurement capacity across DFID

DFID has supported its Commercial Reform Plan with a significant increase in the resources allocated to procurement. The number of approved posts in procurement increased from 41 in April 2011 to 95 in April 2016 and 123 in April 2017 (including 27 commercial delivery managers attached to spending departments), and the Procurement and Commercial Department forecasts a total of 136 by April 2018. As well as recruiting staff with specialist procurement skills, DFID has provided additional training for non-specialists, and all Senior Civil Servants have been given commercial awareness training. The increased capacity includes the establishment of a specialist Market Creation Team.

A comprehensive market-shaping approach has begun to emerge

4.8 Since the commercial vision was adopted, DFID has progressively articulated its approach to market shaping. In 2016, the Procurement and Commercial Department developed an unpublished Market Creation Plan, with detailed objectives around increasing the number of suppliers (including SMEs and suppliers from developing countries), improving the choice of delivery channels, and achieving greater visibility over costs and profits. The plan included a brief diagnosis of challenges that may discourage participation by new or small suppliers, although these barriers were not analysed in any depth. Challenges cited include:

- a lack of visibility over future procurement opportunities ('pipeline') to facilitate future planning by suppliers
- the size and complexity of DFID programmes
- the length of time involved in procurement
- working in fragile states, DFID's fiduciary risk policies, and the use of payment-by-results contracting, which may increase supplier risks.

4.9 The Market Creation Plan combined ongoing and scheduled activities and proposals for activities for which approval would be sought at a later date. Ongoing initiatives included:

- simplifying the pre-qualification process to make it quicker and less costly
- improving pipeline planning
- increasing early market engagement
- improving market analysis
- establishing the Key Supplier Management Programme
- creating more opportunities for SMEs
- commercial training of senior civil servants and senior responsible owners
- improving communication with suppliers, including on issues such as fair and reasonable profits, treatment of subcontractors, and ethical standards.

4.10 Planned activities included:

- increasing the division of contracts into smaller lots to increase access for smaller suppliers
- measures to improve market intelligence and supply chain visibility

- stronger ethical and transparency standards for suppliers
- the introduction of open-book contracting (see Box 6) to provide greater visibility of suppliers' costs and help mitigate the impact of potential supplier dominance.

Since 2016 DFID has been working to implement the Market Creation Plan; Annex C includes the full list of activities and summarises their status in September 2017.

4.11 DFID's activity has included work to improve communications with suppliers, to publicise future work, and to gain input from suppliers. Since 2013, DFID has held a conference each year open to all suppliers, with an agenda focused on generic issues relevant to suppliers. The 2016 conference, for example, included sessions on DFID's expectations of suppliers and its market creation work. In addition, DFID has established a system of early market engagement events for potential suppliers, each focused on a forthcoming DFID project or programme of work, using remote access facilities to enable participation from both UK-based and in-country suppliers. In 2016-17, DFID held 61 such events, with 2,167 registered attendees from 1,198 organisations.

4.12 The Market Creation Plan and the increase in communications with suppliers show a clear ambition by DFID to identify the barriers that limit or discourage suppliers from competing for DFID business. It identifies a broad range of concrete actions to address these barriers by both procurement and programme staff. While some of the activities have been completed, many are still ongoing, and the third and final phase of the plan has yet to be finalised. The depth of analysis behind the initiatives is lacking in some areas, due in large part to weaknesses in DFID's management information systems that we explore below. Some of the key initiatives require further design work, and will need to be tested in practice and refined before DFID can be confident it has found the appropriate approach. Nonetheless, the establishment of a five-person Market Creation Team with expertise from the private and public sector, and with the development of the plan, has provided welcome impetus and structure to DFID's market-shaping work, and a solid framework for moving forward.

4.13 DFID's supplier review is giving further impetus to a number of the activities set out in the Market Creation Plan. For example, pipeline planning and visibility were identified in both our supplier consultations and in DFID's own documents as key constraints on supplier participation. Knowledge about the pipeline is helpful for suppliers so they can plan for preparing bids and resourcing projects, and decide where best to invest their efforts. Improving this knowledge is a challenging area to address in the short term because of weaknesses in DFID's information systems (see para. 4.100). DFID reports that it had begun implementing an improved pipeline from August 2017 and will implement it across the department from October 2017.

DFID has been developing market-shaping strategies in particular sectors and countries

4.14 DFID's procurement challenges differ substantially across its market segments and many of the solutions will need to be identified at this level. To support this, DFID has developed a network of commercial delivery managers attached to spending departments – both in country offices and in UK-based departments responsible for centrally managed programmes. These managers work with programme teams to develop and implement programmes including those involving commercial suppliers. That work includes elements of market shaping, for example supporting offices in engaging with international and local supplier markets or shaping the local supply market and developing its capacity to support DFID programmes.

4.15 With this additional resource, DFID has been developing commercial strategies for particular sectors and countries. For example, it now has a commercial strategy in health,[39] which until recently was DFID's largest sector by expenditure at £1 billion or 13% of UK bilateral aid.[40] Health spending uses a variety of channels, including multilateral organisations, governments, NGOs and projects delivered by suppliers. The strategy offers a market and supply chain analysis, so as to identify opportunities for improving value for money and collaboration between DFID and its different types of delivery partners.

39. *DFID's Commercial Health Strategy*, unpublished.
40. *Statistics on International Development 2016*, DFID, November 2016, p. 36, link.

It identifies a number of opportunities for action, including: market shaping to support product innovation and reduce global pricing; encouraging greater supply chain integration and exploring changes in delivery routes; improved management information; and developing local markets for service delivery and supply chain support. DFID has already achieved some success in this area (Box 5) but we understand that implementation of these initiatives remains at an early stage.

Box 5: GAVI, the vaccine alliance – market shaping at the global level

Development commodities, such as vaccines, bed nets or humanitarian supplies, represent only a minor share of DFID's procurement. However, some of its multilateral partners are major purchasers, and their procurement activities have a significant impact on global markets and the prices at which developing countries can access such commodities.

For example, GAVI, the vaccine alliance, was formed in 2000 as a public-private partnership to improve access to immunisation in developing countries. Prior to GAVI, international development agencies purchased vaccines in an unplanned way to meet the needs of individual countries. GAVI has successfully pooled demand for vaccines across developing countries through a collective procurement mechanism. This lowers prices for developing countries, while providing greater certainty for manufacturers, encouraging them to produce more vaccines. For example, annual global production of the pentavalent vaccine (designed to protect children against five childhood diseases) has increased from 20 million to 400 million doses. This has resulted in a more diversified market, with more manufacturers based in developing countries. GAVI is able to purchase the vaccine for as little as US$1.15 per dose, compared to over US$30 in the US market. DFID was instrumental in the founding of GAVI and remains engaged in its market-shaping activities.

4.16 DFID provided us with 32 commercial delivery plans which are now in place for country offices,[41] including two of our three country case studies (India and Nigeria),[42] and other spending departments. Some include useful analysis of the local supplier market, acknowledging market barriers for local suppliers and the risk in various countries of an over-reliance on a small pool of suppliers, particularly for specialist functions, and proposing a range of measures to address these. A few of the plans, such as Afghanistan, India, and Nigeria, contain a clear strategy for shaping the market and strengthening the supply chain at country level.

4.17 For example, the Nigeria plan notes that, while programmes are generally performing well, too few suppliers are winning tenders and there is a growing risk of sole suppliers for niche programmes.[43] It commits the country office to broadening the supplier base through more effective communication of opportunities and by identifying ways to promote the participation of Nigerian firms as subcontractors, consortium partners, or as suppliers of specialist services. Our next review will include more detailed country case studies.

4.18 Partly because they predate the Market Creation Plan, the majority of country-level commercial delivery plans do not contain a fully-fledged market shaping strategy. To guide its actions, DFID has begun using a market segmentation tool. The purpose of the tool is to provide a systematic basis for classifying markets and programmes by reference to the value of DFID spend, the importance for DFID's strategic aims, risk and complexity. DFID plans to use the classifications to guide its approach to managing each market and programme, analyse conditions in particular segments of the market and identify corrective actions.

DFID is yet to settle on a clear approach to promoting the participation of local suppliers

4.19 During our interviews with DFID staff, we heard mixed views on the importance of participation by local suppliers in its priority countries. Some thought that developing the capacity of local private sector suppliers represents a development outcome in its own right. Others believed that DFID's obligation is

41. *Procurement and Commercial Department slides for Executive Management Committee Q4 2016-17*, DFID, unpublished.
42. The plan for Sierra Leone had not yet been developed due to disruption in the aftermath of the recent Ebola outbreak.
43. *Commercial Strategy for DFID Nigeria 2015-2017*, DFID, unpublished.

to ensure the highest quality programme delivery, irrespective of the nationality of the supplier. There were concerns that measures to promote local suppliers – such as letting smaller contracts – would increase DFID's administrative costs and thereby detract from value for money in other ways.

4.20 DFID's strategy documents nonetheless identify local participation as an objective. Local suppliers already perform an important role as subcontractors to the prime contractors appointed by DFID, and can offer advantages over international suppliers such as lower costs and better local knowledge and understanding. DFID recognises that there may be scope for it to do more, and that increasing local suppliers' capacity may be one way of improving access to valuable local knowledge and increasing competition for contracts in the future. Some of DFID's country commercial strategies include measures to help local suppliers, but these are at an early stage of development.

4.21 As part of its effort to understand the barriers to local firms from partner countries, DFID commissioned a study investigating access to market, which was completed in April 2017 (see para 4.59 for our own analysis of the data).[44] The report suggested that greater use of local suppliers would provide "better insights into specific local contexts" and better long-term development outcomes. However, it also found that local firms generally lacked the capability to win DFID contracts directly and that active work would be needed to enable them to compete.

4.22 Given the government procurement regulations and DFID's obligation to maximise value for money in each of its programmes, DFID cannot set an overall target on the participation of local suppliers, particularly as prime contractors. However, through its processes DFID can encourage prime contractors to use local suppliers. Individual business cases can identify whether there is a development benefit to using suppliers, which is then specified in tender documents and taken into account in the procurement process. For example, DFID Sierra Leone described to us how one of its projects included a requirement on the part of the prime contractor to provide apprenticeships for local people. Furthermore, DFID can take measures to reduce barriers to entry, and encourage its prime contractors to engage local suppliers on terms that enable them to develop their capacity over time.

4.23 We therefore take the view that DFID could develop a more systematic approach in this area. This would help to address the concern rightly raised in the Organisation for Economic Co-operation and Development (OECD) peer review process that the UK aid market remains dominated by UK firms (a point we address further on). As more of DFID's partner countries approach middle-income status and the prospect of graduating from development aid, the scope to build local supply capacity is likely to grow. DFID's partner countries will increasingly fund national development initiatives from their own resources and will need a more mature private sector (including both first and second-tier suppliers) to support them. We therefore welcome the proposal in the as-yet unapproved third phase of DFID's Market Creation Plan to run country office pilots to stimulate and develop local suppliers.

DFID is building its capability to assess suppliers' costs and whether they are making excessive profits

4.24 One of the concerns expressed by some commentators is that DFID's larger suppliers may be making excessive profits, at the expense of UK taxpayers and the intended beneficiaries of UK aid. The International Development Secretary has stated that "there should be no room for excessive profiteering or unethical practices", and that suppliers needed "to be fully open and transparent with UK taxpayers about where their money is going and how it is being spent".[45]

4.25 Information on suppliers' costs and profits is particularly important where there are limits on the power of competition to secure value for money in procurement. In theory, ensuring fair and open competition within a competitive procurement process should ensure fair profits, under certain conditions. However, in practice, these conditions do not always hold true, particularly in the international development field. Most of DFID's procurement is for the delivery of complex, multi-component programmes over a period of years, rather than for the purchase of goods or services with an established market price. This can lead to an imbalance of information between DFID and its

44. *Access to Markets: An Assessment of Barriers to Working with Local Suppliers in DFID Programme Delivery*, DFID/Dalberg Intelligence, April 2017, p. 7, unpublished.
45. *DFID's use of private sector contractors: Eighth Report of Session 2016–17*, International Development Committee, 4 April 2017, p. 6, link.

suppliers – particularly larger suppliers with a track record of delivering DFID programmes, who gain experience in winning DFID contracts. Such firms have advantages over new entrants and the potential to use their market power to increase their profits.

4.26 The challenge does not end with the tendering process. DFID needs to ensure that the package of services delivered by the supplier matches that offered in the tender. As the Public Accounts Committee has pointed out, performance monitoring through the life of the contract is as important as the tender in securing value for money.[46] The commercial terms of the contract may also need to be varied over the life of the programme, owing to changes in conditions or to DFID's objectives. Without the benefit of competition, the asymmetry of knowledge between DFID and its suppliers is even more pronounced after the contract has been signed and the supplier is in place.

4.27 We stress that these challenges are inherent to procurement in the development field, and, indeed, to many other areas of public procurement, rather than a result of any flaws in DFID's procurement system. However, these challenges may be exacerbated by certain DFID practices, such as conducting larger projects or asking suppliers to bear more risk, which the evidence suggests tend to advantage established suppliers.

4.28 There is no single solution to this challenge and DFID is currently exploring a range of possible initiatives. One is a range of measures to increase competition. The Key Supplier Management Programme is another part of the solution. It enables DFID to manage its major suppliers at the portfolio level, as well as within individual programmes, so as to improve communications, set clear expectations and, in principle, develop a shared sense of mission.

4.29 DFID is also moving in the direction of increasing transparency over suppliers' costs and profits. Transparency is an important tool for purchasing authorities to help manage their supply chain. It can be promoted through a range of techniques known under the general term of 'open book'. Public sector bodies use open-book accounting with the aim of gaining a better understanding of the specific costs and profits of their major contracts. If implemented well, open-book techniques are among the tools that can build mutual understanding and trust between government and suppliers, and lead to increased value for money. It is also in the public interest to have greater transparency over the level of profit that government suppliers are able to achieve. When combined with other information, this provides an assurance that the system of public procurement is working properly.[47] Open book has been recommended by the Public Accounts Committee[48] and advice on its use has been issued by the Crown Commercial Service.[49]

Box 6: Open-book techniques in procurement

Open book refers to a set of measures in public procurement intended to increase purchaser understanding of supplier costs and profits. It removes one source of information imbalance between the parties, and can lead to improved procurement outcomes and better contract management.

Open-book accounting, according to the National Audit Office, is "a particular type of supply-chain assurance where suppliers share information about the costs and profits of a specific contract with their client."

Open-book contract management goes a step further to include not just sharing of information but joint working to manage costs and improve value for money.

4.30 In the past, DFID had no reliable means of assessing what level of profit its suppliers were achieving. It lacked detailed information on the costs of inputs. Its suppliers used a range of business models, making it difficult to compare margins across contracts or suppliers. The fee rates charged by suppliers

46. *Transforming contract management: Twenty-third Report of Session 2014–15*, Public Accounts Committee, 10 December 2014, p. 3, link.
47. *Open-book accounting and supply-chain assurance*, National Audit Office, 1 July 2015, p. 6, link.
48. *Transforming contract management: Twenty-third Report of Session 2014–15*, Public Accounts Committee, 10 December 2014, link.
49. *Open Book Contract Management*, Crown Commercial Service, 24 May 2016, link.

for technical assistance programmes encompassed margins for working capital, intellectual property and level of risk, as well as profit, making them difficult to compare.

4.31 Since 2016, DFID has begun introducing open-book accounting rights into its contracts to increase its understanding of supplier costs and margins. This imposes contractual requirements on suppliers to share detailed financial information enabling external scrutiny. It provides a basis for assessing whether suppliers have delivered on their commitments, whether the pricing assumptions underlying the original tender have proved accurate, and whether there are opportunities to improve efficiency. A letter from the International Development Secretary in December 2016 informed suppliers that DFID would be increasing its scrutiny of supplier spending and strengthening checks of fees and expenses, alongside other areas such as tax status and conflicts of interest.[50] While DFID's contractual rights to ask for information on supplier costs and profits has existed for at least ten years, we find that DFID has only recently acquired the necessary compliance capacity to take forward open-book accounting on a systematic basis.

4.32 DFID's standard terms and conditions also require suppliers to declare forecast profit margins at the end of the inception phase of each programme.[51] Measurement and comparisons of costs and profit is notoriously challenging.[52] DFID has required suppliers to provide basic fee rate information for many years. Since November 2016, however, DFID has required bidders to provide more detailed information on fee rates (including profit margins) and other project expenses using a standard template to enable more effective analysis. Using this information, DFID has compiled a database of suppliers' fee rates and used this to begin benchmarking suppliers' costs. Early signs are that rates are being kept in check, although further action in this area is expected.

4.33 A more in-depth open-book technique is open-book contract management. This goes beyond open-book accounting into collaborative working with suppliers to control costs, improve processes and create value throughout the lifecycle of the contract. The Crown Commercial Service issued guidance on its use in May 2016.[53] The guidance advised that open-book contract management should only be applied fully for more complex contracts, and instructed departments to assess where best to use it and to begin mobilising resources to implement it by July 2016.

4.34 At the time of our review, DFID was looking to pilot a more extensive open-book contract management approach. DFID told us that it still had to define its exact objectives for open-book contract management and was consulting with other departments to determine its approach.

4.35 DFID also explored the use of what it terms 'a supplier profit clause' in contracts as part of its supplier review. The clause will give DFID the right to trigger discussions with the supplier, should the supplier's profit margin rise during programme delivery above a pre-determined level.[54] DFID has announced that it is applying this provision to all new tenders from 1 September 2017, to all contract extensions as they arise, and over the coming months to existing high-value strategic contracts.[55]

4.36 While these measures seek to advance the Secretary of State's objective of controlling "excessive profiteering", the effects on the shape and structure of DFID's supplier market are difficult to predict at this stage. They may have the effect of reducing the level of competition for DFID contracts – in the UK and beyond. Alternatively, by engaging directly on profits, they may reduce the incentives on suppliers to limit costs – a well-known problem with 'cost-plus' contracting methods. It will therefore be important, as DFID proceeds with this approach, to consider how the measures are likely to work as a whole, to communicate clearly with suppliers on what use it intends to make of the profit clause, and to monitor closely the impact on suppliers' perceptions and behaviour.

50. *Secretary of State letter to DFID suppliers*, DFID, 16 December 2016, link.
51. *DFID Standard Terms and Conditions – Service Contracts v2.0*, DFID, March 2015, clause 5.1(k), link. New terms and conditions introduced in October 2017 require that projected profits are stated in the contract: *DFID Standard Terms and Conditions – Service Contracts v1.1*, DFID, October 2017, clause 2.1.11 and p. 39, link.
52. For example, see *Report on the Review of Local Fund Agent Tendering Process*, Global Fund To Fight Aids, Tuberculosis and Malaria, 3 September 2009, link, which led to its abandonment of a 'cost-plus' approach to pricing.
53. *Open Book Contract Management*, Crown Commercial Service, 24 May 2016, link.
54. *DFID Standard Terms and Conditions – Service Contracts v1.1*, DFID, October 2017, clause 19, link.
55. *International Development Secretary's open letter to suppliers*, 3 October 2017, link.

Box 7: Do other donors or UK departments try to control supplier profits?

Our analysis of the practices of other donor organisations found that there is no standard approach towards controlling supplier costs and profits.

- The United States Agency for International Development (USAID) uses 'cost-plus' contracts in which contractors are reimbursed for the costs of delivery, and then receive an additional fee that is negotiated at the beginning of the contract. USAID provides guidance to its staff on how to analyse the costs and profit margins in supplier bids, to assess if the projected price is fair and based on reasonable assumptions, and whether or not the proposed cost reflects reasonable economy and efficiency.[56]
- Australia's Department of Foreign Affairs and Trade (DFAT) prescribes fee rates for consultants through its Aid Adviser Remuneration Framework. All consultants engaged either directly or indirectly under Australian government contracts are paid in line with this framework. Guidance states that DFAT staff should also check advisers' past performance before determining the remuneration offer. We note that DFAT is currently undertaking a review of the framework.
- Rather than prescribe a specific contracting method, the UN procurement manual states that consideration should be given to whether the supplier will be paid a fixed fee or 'cost-plus'. The manual notes that 'firm fixed price' contracting is more commonly used: "It places on one hand maximum risk of increased costs on the Vendor and on the other hand maximum incentive on the Vendor to control costs and develop innovative solution for the UN. However, [...] there is greater risk that the Vendor may 'cut corners' in order to maximize its profit." On the other hand, "[Cost-plus ...] minimizes the Vendor's incentive to 'cut corners', but provides little incentive for the Vendor to minimize costs."[57]

In UK government practice, the clearest example of a government body controlling profits is the Single Source Regulations Office (SSRO), a non-departmental public body sponsored by the Ministry of Defence (MOD) to monitor the UK government's procurement of 'single source', or non-competitive, military goods, works and services. The SSRO sets a baseline profit rate for contracts placed under Single Source Contract Regulations. In March 2017, it was announced that the baseline profit rate for 2017-18 for contracts placed under these regulations would be 7.46% compared with 8.95% for the previous year. However, contractors generally enjoy a profit rate well in excess of 10% after all adjustments have been made. As stated in the report relating to the establishment of the single source framework, "in exchange for a fair profit for industry, the new framework will provide the MOD with far greater transparency, helping us to investigate whether suppliers are being as efficient as possible."[58]

Conclusions on relevance

4.37 While market shaping was not the main priority when DFID began its procurement reforms, we are encouraged to see that DFID has now set itself more ambitious goals. It has recognised the importance of promoting greater competition and diversity in its markets, and is exploring – and beginning to implement – measures to bring this about. DFID has begun to develop commercial strategies for particular countries and sectors, and a market segmentation tool, to analyse conditions in particular segments of the market and identify corrective actions. Its Market Creation Plan, Key Supplier Management Programme and use of framework contracts are also potentially useful tools for shaping the market that are consistent with UK government guidance.

4.38 However, some key aspects of DFID's approach to market shaping are still emerging, including in relation to DFID's 2017 supplier review. DFID's plans include some complex new initiatives that may affect the market in unpredictable ways. These initiatives will inevitably require fine tuning as they are implemented and used in practice, and it will be important for DFID to monitor impacts closely and make corrections where necessary.

56. *Cost Analysis Key Components Guidance and Checklist: A Mandatory Reference for ADS Chapter 300*, USAID, 4 February 2014, p. 2, link.
57. *United Nations Procurement Manual: Revision 6*, United Nations, 1 March 2010, s. 9.23, para. 3, link.
58. *Better Defence Acquisition, Improving how we procure and support Defence equipment*, Ministry of Defence, June 2013, para. xiii, link.

4.39 Overall, we are pleased to see that DFID has increased its level of ambition and put in place a range of positive measures on market creation, although we also find that its approach is still at a relatively early stage of maturity and will need to be tested and refined over time. With the information currently available, we have scored DFID a **green-amber** score for the relevance of its approach, reflecting a significant increase in activity in this area and an overall positive direction of travel.

Do DFID's efforts to shape its supplier market support value for money?

4.40 This section assesses whether DFID's procurement practices support its goals of improving competition and diversity, and whether its market-shaping activities to date are having a positive effect. As a starting point, we note that any measures taken by DFID in this area will take some years to affect the shape of the market.

4.41 Most of DFID's market-shaping initiatives have been in development since 2015, making it too early to judge their impact. Some elements, however, such as framework contracts and key supplier management, date back further, although we acknowledge that they are in the process of reform or refinement leading up to and following DFID's 2017 supplier review.

DFID's market is not overly concentrated generally, but it faces challenges in particular sectors and countries

4.42 To assess DFID's success in achieving competition and diversity in its market, we looked at several areas:

- The number of bids received by DFID when putting contracts out to tender.
- The level of market concentration (that is, whether or not the number of suppliers suggests a lack of competition).
- Barriers that might discourage new entrants to the market.
- The level of participation by SMEs and suppliers in developing countries.

4.43 In February 2017, DFID informed the International Development Committee that comprehensive data on the number of bids received for each tender was only available from 2015-16.[59] During this year, the average number of bids per contract was 2.5, which DFID considered "not sufficient". For 2016-17, DFID's management information shows a higher figure of 2.9 for 2016-17, which is an improvement over just one year, but still short of the target of four.

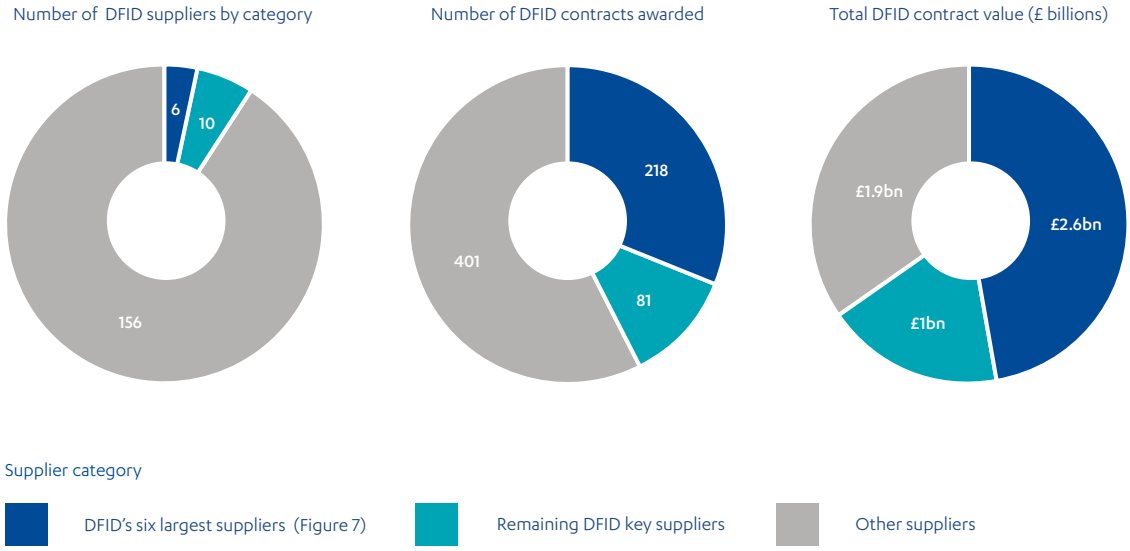
4.44 A high level of concentration in a market – that is, dominance by a few large firms – may suggest that competition is weak, and may in itself discourage new entrants. The picture is more complex than that, however. Spending through larger suppliers may represent good value for money if they are able to achieve economies of scale and reach more beneficiaries per pound spent. Conversely, a lack of concentration at the aggregate level does not in itself guarantee that competition is strong. For example, there may still be strong incumbency advantages that make it difficult for new firms in the market to challenge existing suppliers.

4.45 DFID's management information system collects a range of data about DFID's suppliers, including their country of registration and whether they are part of the Key Supplier Management Programme. The data relates mainly to prime contractors; DFID collates little information about participation further down its supply chains (ie as subcontractors). Due to various errors and anomalies, the data that we have seen is not strong enough to allow detailed analysis of the market. We can, however, identify certain overall trends in the aggregate data reported by DFID.

4.46 As shown in Figure 1 in para. 3.2, between 2012-13 and 2016-17, DFID's expenditure through suppliers has nearly doubled. Over this period, DFID awarded 700 contracts with a total value of £5.5 billion to around 170 suppliers.[60] Within this group, six suppliers accounted for 45% of DFID's total contract value, with an average contract size of just over £12 million (see Figure 3).

59. *DFID's use of private sector contractors: Eighth Report of Session 2016-17*, International Development Committee, 4 April 2017, link.
60. The number of suppliers used here is based on a manual assessment of DFID's procurement data that included eliminating three apparent duplicates to

Figure 3: Analysis of suppliers by category from 2012-13 to 2016-17



Notes:
(1) Total contract value includes both the value of the initial award and any later variations.
(2) Key suppliers are those suppliers within DFID's Key Supplier Management Programme, as discussed in para. 4.67.

4.47 To assess whether these figures suggest undue concentration, we drew on the guidelines for market investigations published by the UK competition regulator.[61] The guidelines note that robust findings on whether or not features in a market are harming competition require detailed understanding of how the market operates. Factors to be considered include not just market share, but also other factors such as the legal and regulatory framework and the outcomes that are achieved, in terms of prices, profits, quality, and innovation.

4.48 For assessing market share, the Competition and Markets Authority uses a measure of market concentration known as the Herfindahl-Hirschman Index, or HHI.[62] The lower the score, the less concentrated the market, with a score of 1,000 or above considered as indicating a concentrated market and a score above 2,000 indicating a highly concentrated market.[63] Based on DFID contract award data, we estimate the HHI of DFID's supplier market as a whole to be under 500, which confirms that at the aggregate level the market is not overly concentrated.

4.49 The picture is likely to be considerably more complex when we consider that DFID's market is segmented across different countries and different goods and services. Analysis by DFID's Procurement and Commercial Department has found that, in contrast to the aggregate, the supplier market is highly concentrated within some sectors and individual countries where conditions for smaller and local firms are challenging. DFID sees this as evidence that further work is needed to open up markets and increase competition in the countries where it is working.

Some aspects of DFID's procurement practice may discourage new entrants

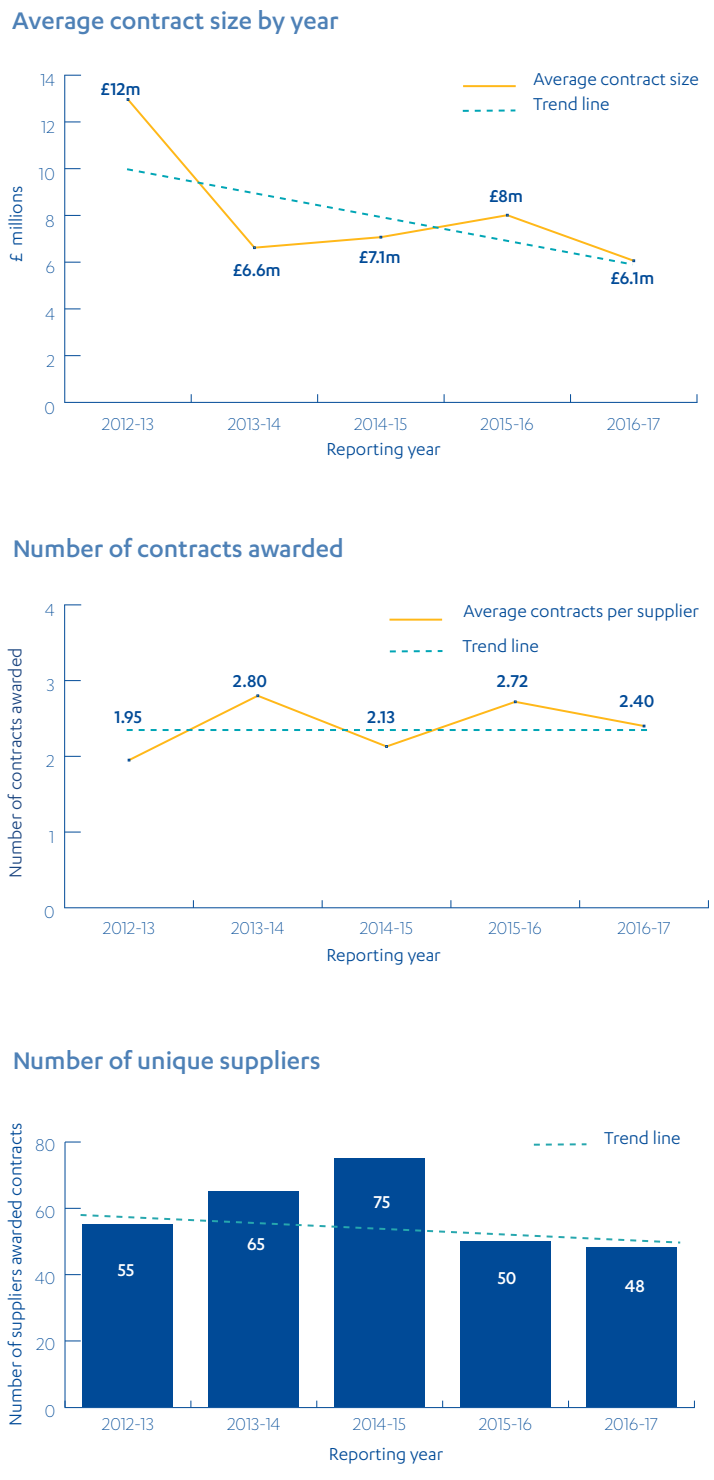
4.50 Another important area to assess is whether aspects of DFID's procurement practice might inadvertently discourage or create barriers for new entrants. For example, the choices that DFID makes about the size and complexity of its contracts and the level of risk that suppliers are asked to bear (particularly in conflict-affected environments) are likely to influence who is willing and able to bid.

identify unique suppliers. The value of contracts used throughout this report is the current value of contracts as recorded by DFID's Procurement and Commercial Department, including the initial award and any post-award variations.

61. *Guidelines for market investigations: Their role, procedures, assessment and remedies*, Competition Commission, April 2013, link.
62. *Merger Assessment Guidelines*, Competition Commission and the Office of Fair Trading, September 2010, p. 39, link.
63. *For HHI scoring, see Guidelines for market investigations: Their role, procedures, assessment and remedies*, Competition Commission, April 2013, pp. 87–88, link.

4.51 One of the concerns expressed to us by stakeholders was that the unit size of DFID contracts had increased as the UK aid budget scaled up towards the 0.7% commitment, and that this, in turn, had advantaged larger suppliers. However, the aggregate figures do not show this (see Figure 4). Based on the current value of contracts awarded in each year (ie taking into account both the initial award value and subsequent variations), the average size of contracts in fact declined between 2012-13 and 2016-17. The average number of contracts going to new suppliers also increased up to 2014-15, followed by a decline. DFID explained that this is due, in part, to the removal of self-employed consultants from the supplier database. DFID informed us that its total number of suppliers increased by 36% from 2011 to 2015.[64] DFID has also introduced some lotting of contracts as part of its SME Action Plan (see below).

Figure 4: Trends in contracting from 2012-13 to 2016-17[65]



64. *Flag C – Background as Provided in Information Note 15th January 2016*, DFID, February 2017, unpublished.
65. Analysis of procurement data provided by DFID.

4.52 In addition to the size of contract, the level of risk associated with DFID contracts is perceived by stakeholders to have increased, due to a number of factors: the increased proportion of the aid budget spent in insecure environments; tighter rules on fiduciary risk management; and increased use of various versions of payment-by-results contracting. Our analysis suggests that increased expenditure in fragile states is unlikely to be a significant factor on its own, as DFID's preferred delivery channels in conflict situations tend to be multilaterals and NGOs. Its use of private sector suppliers in fragile states is still quite limited (see Box 8). The effects of risk transfer to suppliers are more difficult to assess, but we acknowledge the widespread view across all categories of supplier that the level of risk transfer in DFID contracts has increased over time.

Box 8: DFID makes limited use of suppliers in fragile states

DFID is committed to spending at least half of its budget in fragile and conflict-affected states. This commitment has led to a concern in some quarters that the resulting higher-risk profile for DFID programmes would favour larger suppliers, driving more concentration of the market.

This turns out not to be the case. In the most insecure environment, DFID makes only limited use of suppliers, preferring to deliver through multilateral partners and NGOs. For example, in Yemen, the total country budget for 2017-18 is £50 million, with the only current contract for the independent monitoring of the Yemen programme (£2.8 million over five years) by the British Council. In Syria, DFID holds four contracts with a total value of £13.8 million, against a total budget for 2017-18 of £135 million. In Sudan, there are no supplier contracts.

In interviews, DFID staff stated that other delivery channels were preferred for their capacity to deploy rapidly and at scale in insecure areas and their ability to take on the associated risks. For example, we were told that in the highly insecure north-eastern region of Nigeria, where the humanitarian need is greatest, DFID's main delivery channels are multilaterals and NGOs. In other parts of the country, there is a higher use of suppliers, with contracts in place to deliver programmes such as infrastructure and health. In interviews, some suppliers expressed frustration that they were not considered for work in fragile and conflict-affected areas where they did not currently have a presence, despite having demonstrated a track record of good performance in other locations.

By contrast, the recent ICAI review of UK aid in Somalia noted that DFID "has made a significant investment in building up an independent delivery capacity in Somalia" and "has developed a network of international and local private sector suppliers able to operate across most of the territory".[66] Private sector providers now implement a third of DFID's Somalia programme. This enables DFID "to target its programming more rapidly so as to support peace-building initiatives – including by directing aid into newly liberated areas". Furthermore, it gives DFID greater capacity to pursue areas of importance to the UK, as specified in the National Security Council strategy for Somalia.

Overall, our analysis suggests that DFID's increased expenditure in fragile states has not in practice led to increased reliance on large suppliers, and that market shaping is not yet an urgent issue in fragile states. The question as to whether DFID's frequent use of multilateral partners in fragile states, rather than competitive procurement, is based on sound commercial considerations was outside the scope of this review.

4.53 During our consultations with suppliers, the two main barriers that were emphasised were the lack of advanced notice of procurement opportunities and the delays and uncertainties associated with the procurement process itself (see Box 9). A lack of pipeline accuracy is highlighted in DFID's own Market Creation Strategy as a "critical barrier", linked to attributes of DFID's wider business processes and management information systems that will be challenging to address. DFID informs us that it will be implementing an improved pipeline management information system later in 2017.

66. *UK aid in a conflict-affected country: Reducing conflict and fragility in Somalia*, ICAI, June 2017, link.

Box 9: Supplier survey: how could DFID improve its procurement?

When asked in our supplier survey to identify the most important ways in which DFID could improve its procurement practice, the top three responses were as follows:

1. More advance warning and greater transparency and clarity about the pipeline.
2. Shorter and more certain timescales for DFID to assess and select the winning proposals.
3. More direct engagement, collaboration and better communication with suppliers.

Suppliers also suggested that early market engagement events came too late in the process to enable suppliers to contribute to the design of programmes or to prepare in advance for tendering.

Source: ICAI, 2017

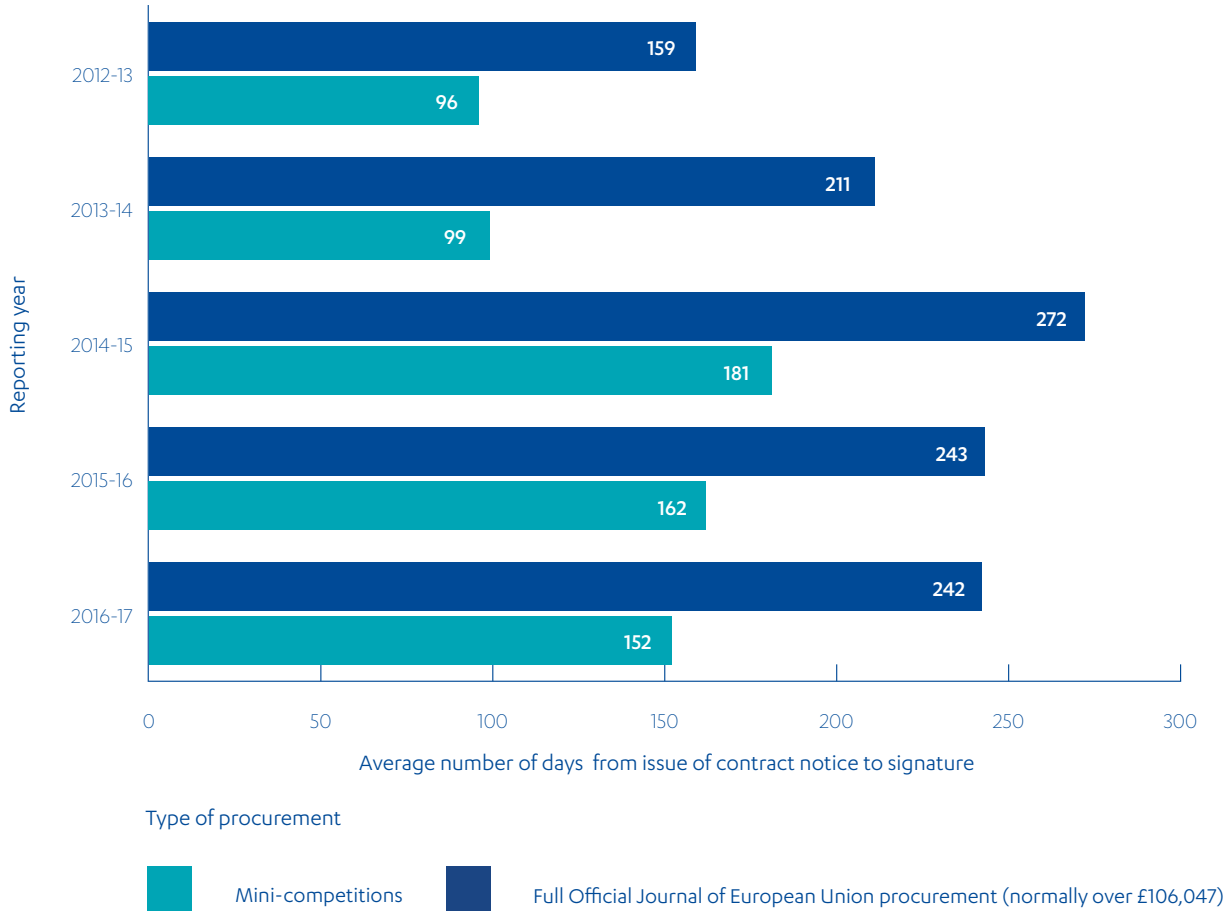
4.54 DFID's procurement processes are complex and also relatively slow. According to its own management information, the average time to complete a full procurement under official EU standards was 242 calendar days in 2016-17, while mini-competitions (principally those run through framework contracts) took 152 days – an average across the two categories of 219 days, or seven to eight months. Recent research shows DFID had the slowest procurement of any of the ten central government bodies for which published data was available – 53 days slower than the next slowest, the Department for Work and Pensions.[67] The government-wide objective is 120 working days (equivalent to 168 calendar days)[68] for all but the most complex procurements.

4.55 Complex procurement is defined by the Crown Commercial Service as being "where the specification is difficult to define or is complex or innovative, the procurement is high risk, the competition is restricted to a limited market, the contract will be based on unusual commercial models (eg Private Finance Initiative or a Private Public Partnership variant) or where the procurement involves spend in a number of categories". DFID takes the view that most of its procurements fall within this description. It has therefore adopted a target of 180 calendar days averaged across all procurements, including non-competitive procurements. Performance achieved against this measure was 171 days in 2016-17 (187 days in 2015-16). Figure 5 shows that, for competitive procurements, the pace deteriorated up to 2014-15, but improved slightly since then.

4.56 While DFID's practice falls within the applicable regulations and guidelines, suppliers nonetheless believe that the length of the bidding process disproportionately disadvantages SMEs, because of the cash flow challenges it creates, and is a potential barrier to entry for all categories of suppliers. In our consultations, a number commented that the length of the tender process reduced their ability or willingness to bid for DFID contracts. Suppliers also mentioned uncertainty as a disadvantage, including the risk of cancellation of tenders after proposals had been developed (DFID states that this happened six times in 2016) and changes in scope once the contract is awarded, reducing its value.

67. McNally, Helen, 'The Waiting Game: Who are the slowest buyers in the UK?' *Open Opps Blog*, 27 July 2017, link.
68. *Procurement Policy Note – Procurement Supporting Growth: Supporting Material for Departments*, Cabinet Office, Efficiency and Reform Group, and Crown Commercial Service, 9 May 2012, p. 4, link.

Figure 5: Average length of DFID competitive procurements



4.57 Overall, the evidence suggests that some barriers to entry are caused by the inherent complexity of DFID's procurement. There is therefore scope for DFID to do more to balance that complexity by further varying the size and risk level of its contracts, improving advance notice of the pipeline and making its procurement smarter in relation to the segment of the market that it is operating in. DFID has begun work in this area as we discuss below.

DFID has been successful at attracting SME participation, but has been slower in encouraging the participation of local suppliers

4.58 As regards diversity, we look at two main measures: the amount of work going to SMEs and the nationality of suppliers. DFID has set itself the objective of increasing diversity on both measures. More use of smaller and local suppliers may help DFID guard against a concentration of market power in a few hands, and help develop new competitors for larger firms in the future. Using smaller suppliers may also give DFID greater access to specialist knowledge and innovative approaches.

4.59 DFID has been working since 2010 to increase SME participation, in line with UK government objectives. Its initiatives are tracked in an SME Action Plan, which is updated each November. Under this Plan, DFID has introduced some lotting of contracts. For example, in complex, multi-year programmes, the monitoring, evaluation, and learning component is often let separately, giving greater access to smaller and specialist firms. Ongoing and planned measures include 'SME-friendly procurement practices', to ease the burden of preparing bids, and measures to ensure that prime contractors treat SME subcontractors fairly in terms of share of work, rates and timeliness of payment.

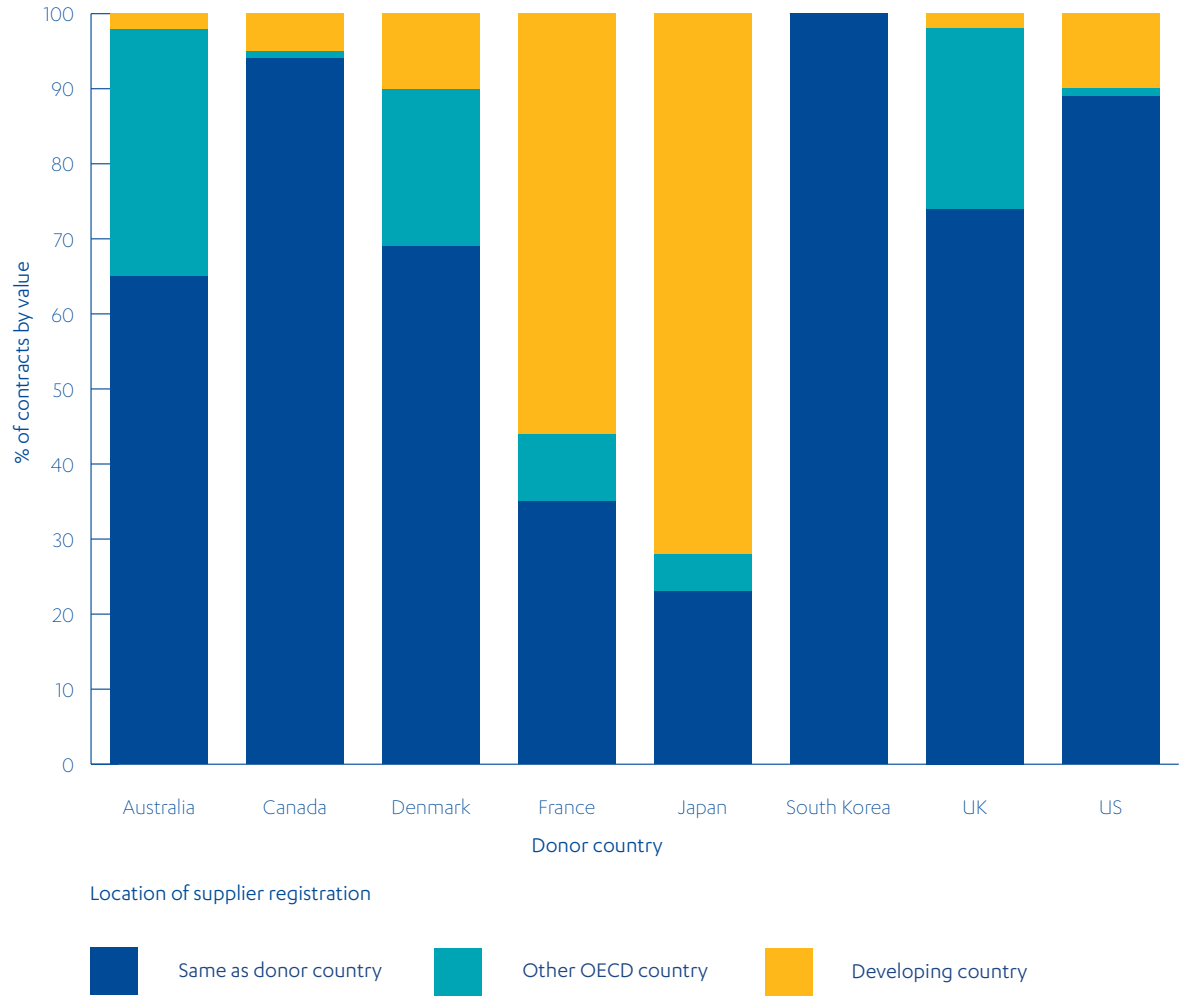
4.60 Compared to other UK departments, DFID's suppliers include a high proportion of SMEs. In 2015-16, 33.4% of DFID's procurement was through SMEs, just exceeding the current government-wide target of 33%. These figures refer only to prime contractors. If subcontracting is taken into account, the level of procurement through SMEs in 2015-16 was 41%, according to DFID's current data. This may increase as DFID improves its collection of delivery chain data.

4.61 Notably, however, in 2016-17, five of DFID's SME suppliers were large enough to be within its top ten suppliers.[69] This is because the definition of SMEs used across the UK government[70] has a threshold of 250 staff, an annual turnover of €50 million or a balance sheet value of €43 million.[71] All but the largest firms specialising in international development fall within this definition. From 2017-18, two of these suppliers will no longer be classified as SMEs, which is expected to result in some regression in DFID's reported performance. A target of 40% direct and indirect spend has been set for DFID by 2020.

4.62 In interviews with us, the Procurement and Commercial Department acknowledged that, while it was bound by the UK government definition, it could do more to segment the SME market into micro, small and medium suppliers, to better understand and engage with each type. So far, the SME Action Plan does not contain any concrete measures in this direction.

4.63 Suppliers from almost anywhere in the world are eligible to bid for DFID UK aid contracts. The OECD reports that DFID is one of a small group of donors for which the share of contracts awarded to suppliers from its own country is above 90% – compared to an average of 39% across all development partners.[72] The share is increasing: in 2016-17, 92% of DFID contracts by value went to UK-registered suppliers, compared to 74% in 2012-13.

Figure 6: Location of supplier registration in a sample of donor countries in 2013[73]



69. The five suppliers classified as SMEs were Adam Smith International Ltd, Palladium, IMA World Health, Oxford Policy Management, and Mannion Daniels Limited; see *Annex D: Additional Information on DFID's use of contractors*, DFID, 13 March 2017, p. 3, link.
70. DFID oral evidence to International Development Committee, 20 February 2017, Q81, link.
71. Firms are counted as SMEs if they fall below two out of three of these thresholds; see *The revised User Guide to the SME definition*, European Commission, 2015, link.
72. Others in the group include South Korea, Finland and Canada; see *Making Development Co-operation More Effective: 2016 Progress Report*, OECD, November 2016, link.
73. *Aid Untying: 2015 Progress Report*, OECD Development Assistance Committee, 9 November 2015, p. 12, link.

4.64 One reason for the low proportion of DFID contracts going abroad may be that the UK aid market is sufficiently large that international firms often establish subsidiaries in the UK, so appear in statistics as 'UK suppliers'. Research published by the European Commission in 2011 found that this was a common feature in public procurement in the EU.[74] Most cross-border procurement is through affiliates, rather than by direct supply.

4.65 A consequence of such a large proportion of aid spent via contracts with UK suppliers is that the level of participation of suppliers from developing countries as prime contractors remains very low, at just 3% or £36 million by total contract value in 2016-17, and £30 million of this was awarded to a single firm, McKinsey Ethiopia. The International Development Committee has noted its concern at the "tiny proportion" of contracts going to suppliers in developing countries,[75] while an OECD peer review of UK aid urged DFID to ensure that there are no "unintended impediments" to foreign suppliers winning contracts.[76]

4.66 While foreign suppliers are free to compete for contracts on the same basis as UK firms, and many do through their UK subsidiaries, few suppliers based in partner countries are of the size or capability to compete with UK-based prime contractors. They may take part as subcontractors, and this is a common feature of many DFID programmes. However, getting to a figure on the share of fees earned by subcontractors (including firms, NGOs and individuals) in developing countries is very difficult. In April 2017, DFID introduced a requirement to map the delivery chains for all programmes, either immediately for new programmes, or from the time of the next annual review for programmes with more than 12 months left to run at that point. DFID plans in due course to collate this information across programmes. However, until mapping is fully in place and the results collated, DFID has no aggregate data on the share of fees subcontracted through suppliers in developing countries, and it is not possible to assess accurately either the flow of funds to subcontractors in developing countries or how these flows are changing over time.

DFID has strengthened its management of key suppliers but is yet to realise the full benefits of the process

4.67 DFID's Key Supplier Management Programme is intended to shift its relationship with its most important suppliers to a more strategic level, focusing more on their overall portfolio rather than each individual contract. It is a tool used across the UK government to maximise buying power and influence, and one of 11 areas highlighted by the National Audit Office in its *Good practice contract management framework* (Box 10).[77] Key supplier management can help to promote a more competitive market by communicating the conduct expected of major contractors and, through better communication, helping to correct imbalances of information between client and suppliers.

Box 10: National Audit Office advice on managing and developing relationships with suppliers

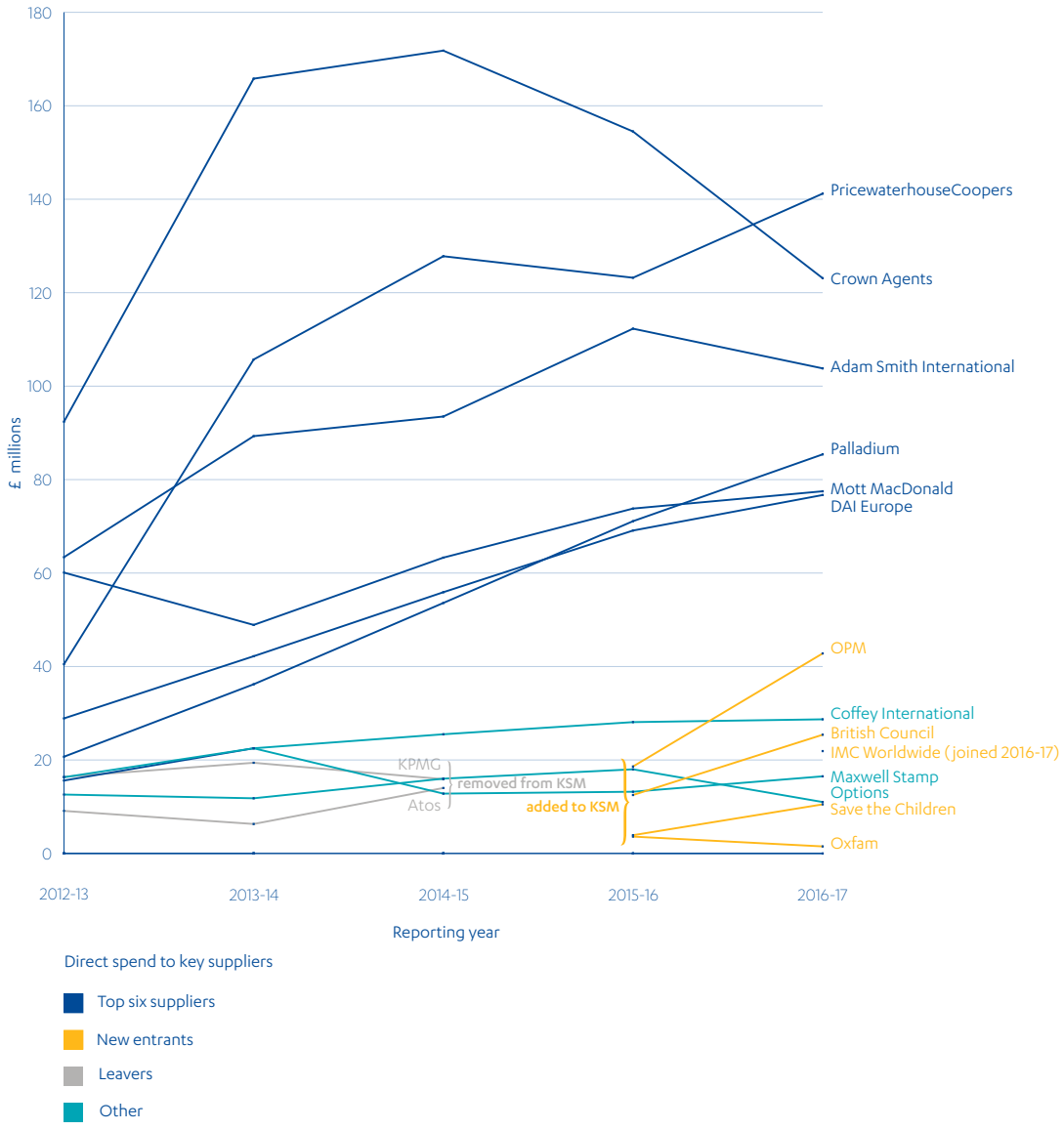
- A supplier relationship programme is planned and structured with appropriate governance and senior ownership.
- A Benefits Realisation Plan is in place for supplier relationship management; there is a clear sense of what value is to be generated for both parties.
- There is a focus on capturing innovation from the supplier where necessary or valuable.
- Knowledge management issues are addressed, including knowledge capture from suppliers.
- The supplier relationship management programme considers all the supplier's interactions across an organisation and on a pan-government basis, including work with the Office of Government Commerce.
- Board level supplier/customer organisation interfaces and relationships are planned and managed in line with overall supplier relationship management objectives.

74. *Cross-border procurement above EU thresholds*, European Commission, DG Internal Market and Services, March 2011, link.
75. *DFID's use of private sector contractors: Eighth Report of Session 2016–17*, International Development Committee, 4 April 2017, p. 29, link.
76. *OECD Development Co-operation Peer Reviews: United Kingdom*, OECD Development Assistance Committee, 2014, p. 19, link.
77. *Good practice contract management framework*, National Audit Office, December 2016, p. 16, link.

4.68 In our 2013 report, we noted the challenges that DFID had faced in developing a Key Supplier Management Programme; its first attempt stalled in the face of competing priorities. Since then, the programme has become more established. Initially, 11 suppliers were included in the programme; by 2016-17, it covered 14 organisations, including 11 commercial firms and three major NGOs (see Figures 7 and 8). DFID selects the participants based on factors such as the volume of contracts, the depth of the relationship and its strategic significance. DFID's objectives for the programme include driving improvements in both costs and performance, aligning strategies and improving contractual outcomes. Secondary objectives include lesson learning and knowledge sharing.

4.69 The process involves one-to-one meetings at a senior level with individual key suppliers every six months. In preparation, the responsible DFID managers prepare feedback on each supplier's principal contracts, while the Procurement and Commercial Department produces an overall performance assessment, on which the supplier can comment. So far, DFID has held seven cycles of meetings. The process was put on hold in late 2016, pending completion of DFID's supplier review.

Figure 7: DFID direct spend to key suppliers – 2012-13 to 2016-17



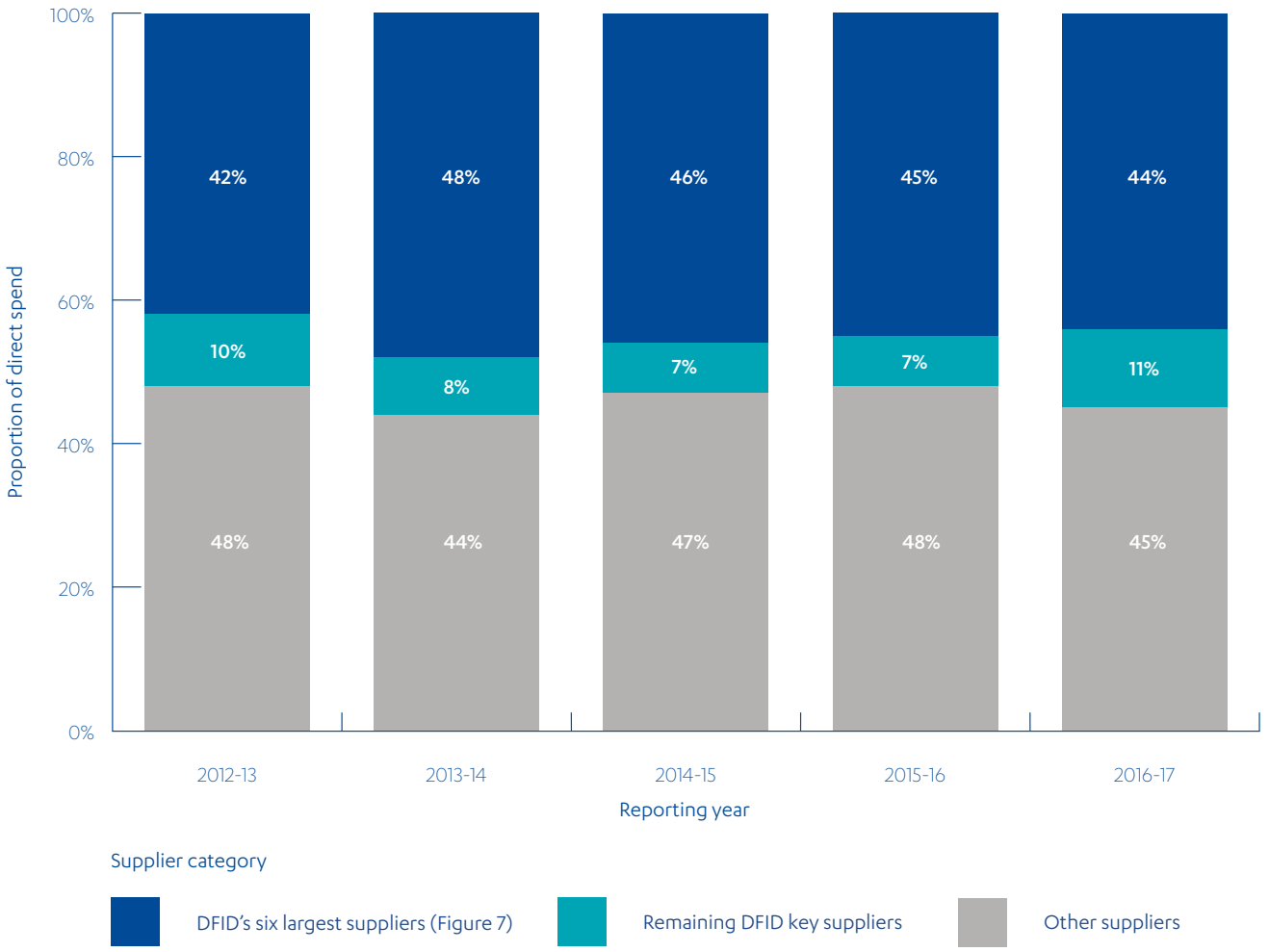
Notes:

(1) Direct spend shows spending by DFID on contracts placed through Procurement and Commercial Department; contracts under the European limit by other parts of DFID are not included.

(2) Amounts shown include funds administered on DFID's behalf by the supplier as well as the supplier's own expenditure.

(3) Amounts shown in the chart are shown in tabular form in Annex D.

Figure 8: Spend through key suppliers as a proportion of total DFID procurement[78]



4.70 While the Key Supplier Management Programme follows a format that is widely used across the UK government, assessments of its impact have been mixed. An internal audit report in June 2016 found positive aspects but suggested that it needed further development. It found that the intended benefits were poorly defined and not actively measured. It suggested that the process be more closely linked to DFID's overall strategy for achieving value for money. Since then, Procurement and Commercial Department has been reviewing the programme to identify areas for improvement.

4.71 We also found that the objectives of the Key Supplier Management Programme are not defined clearly enough and that monitoring is not strong enough to enable DFID to assess whether it is working effectively. Quarterly reporting to the Executive Management Committee on key suppliers is limited to total expenditure through these suppliers and trends in their overall performance. The latter takes the form of an average performance score per contract, based on quality of programme delivery and financial management. The average key supplier score has remained stable, rising slightly from 75% in 2015 to 76% in 2016, although the trend in individual supplier scores has been mixed. However, as the internal audit report noted, the scoring methodology has changed over time, making it difficult to identify trends.

4.72 Stakeholders also raised concerns that the Key Supplier Management Programme affords participating suppliers an advantage in the procurement process. While DFID is very careful to avoid preferential treatment of its key suppliers, one of the purposes of the programme is to improve their performance, with the entirely proper aim of achieving better value for money. Even though DFID is careful to avoid discussing future opportunities beyond what is already in the public domain, the risk of creating an advantage is inherent in the key supplier relationship. The International Development Committee noted in a recent report that it had received evidence to the effect that key suppliers gain "real or perceived

78. ICAI analysis of procurement data provided by DFID.

privileged access" to DFID people and information, thereby gaining a better understanding of DFID's preferences and requirements, which can in turn be reflected in bids.[79] We heard similar concerns from some of the suppliers we consulted. One former key supplier felt that being 'dropped' from the programme had led to a loss of insight and access. However, another key supplier said it did not feel that being part of the programme had changed its relationship with DFID.

4.73 On balance, we conclude that DFID needs a Key Supplier Management Programme in order to strengthen its understanding of its major suppliers, and balance to some degree the asymmetries of information between DFID and its large suppliers that give the latter an advantage in the procurement process. In addition, there is value in DFID scrutinising supplier performance at the portfolio level and reinforcing its standards and expectations through regular dialogue. However, we are not convinced that this aspect of the programme is delivering on its potential. We welcome DFID's ongoing efforts to strengthen it and note that the initiatives announced by the International Development Secretary on 3 October included a new approach to supplier management. Counteracting any perceived or actual advantage to major suppliers could be addressed by expanding the number of participants in the programme, but more importantly by significantly improving the flow of pipeline and other information to all suppliers, to minimise the advantage to key suppliers. DFID should also consider specifically addressing this issue with specific training to ensure that staff have clear guidance on the boundaries they need to respect.

Framework contracts have resulted in some efficiencies for DFID, but there is scope to do more to reduce suppliers' transaction costs and make more use of what they can offer

4.74 Framework agreements are a well-established tool in government commercial practice. Under the full procurement process, bidders are required to pre-qualify before they can tender. Under a framework agreement, suppliers pre-qualify at the outset and can then be awarded contracts through direct call-off or compete for contracts through mini-competitions.

4.75 DFID began establishing framework arrangements in 2011, with four aims:

- Provide a faster, more targeted sourcing model.
- Develop the supply base for each sector covered by a framework agreement.
- Improve its knowledge of the market for each sector covered by a framework agreement.
- Deliver value for money.

Spend through the frameworks totals some £1.1 billion since 2012-13, approaching half of DFID's centrally awarded contracts.

4.76 At the time of our 2013 review,[80] DFID had established nine frameworks, covering areas such as global nutrition, reproductive health and wealth creation. That review did not examine the operation of the frameworks in detail, but observed that for simple procurements the use of the pre-agreed frameworks made sense, saving time and targeting suppliers that provide straightforward products and services.

4.77 DFID reviewed the operation of this first generation of its frameworks in 2014. By that point, 143 contracts had been awarded under the frameworks, with a total value of £748 million. The review found that frameworks had reduced the administrative resource required to support DFID's programming, but feedback from DFID suppliers suggested the frameworks had not been as efficient as initially promised, and that the typical timescale for procurements under the frameworks remained high. The review concluded that while there had been some progress on all of DFID's objectives, the development of the supply base outside of the top 11 suppliers had been less than hoped. Since then, DFID has been developing a new generation of frameworks as the original ones expired (see Table 2).[81]

79. *DFID's use of private sector contractors: Eighth Report of Session 2016–17*, International Development Committee, 4 April 2017, para. 58, link.
80. *DFID's Use of Contractors to Deliver Aid Programmes*, ICAI, May 2013, link.
81. Under the Public Contract Regulations, frameworks are limited a maximum life of four years, although contracts placed within the four-year period can extend beyond its end.

DFID informs us that the new frameworks contain measures to save costs – such as caps on fee rates, based on experience, qualification and thematic area.[82]

Table 2: DFID Framework agreements in operation at time of ICAI review (excludes frameworks covering administrative expenditure only)

Framework agreement	Start date	Expiry date	Call-off method	Expected value	Number of suppliers appointed
Wealth Creation	01/01/2013	01/08/2017	Mini competition	£400m	23 (see note 1)
Goods and Equipment	29/03/2015	29/03/2019	Direct award	£100 – 200m	1
Global Evaluation	12/08/2016	11/08/2018	Mini competition	£150m	20 lead (see note 2)
Expert Advisory Call Down Service	01/12/2016	06/10/2018	Direct award	£60m	4 lead (see note 2)

Notes:

[1] There were 24 suppliers when the framework was established but two have subsequently merged.

[2] The Global Evaluation Framework Agreement and Expert Advisory Call Down Service operate on the basis of consortia headed by a lead supplier, supported by subcontractors. In their bids, the lead contractors proposed a total of 470 subcontractors across the two frameworks, but it is for the lead contractors to manage who they actually engage for particular contracts.

4.78 So far, there is limited evidence of the effectiveness of the frameworks in encouraging greater participation. DFID's management information shows procurements through frameworks are faster than full procurement under EU regulations, at an average of 152 calendar days for competitive procurements using frameworks in 2016-17 and 28 days for call-offs, against 242 calendar days for the full OJEU process (Figure 5).[83] This is within the Cabinet Office target, but not especially quick, particularly since these statistics do not reflect the time invested by both DFID and suppliers in the establishment of each framework. While procurements through frameworks have been quicker than those that go through the full OJEU process, we note that the frameworks are designed for less complex procurements.

4.79 Our roundtables and consultations with suppliers revealed a mix of views. There was some recognition of the value of frameworks, especially for meeting urgent procurement requirements; however, we heard that smaller suppliers usually participate in the frameworks as members of consortia led by larger firms. They complain that these larger firms monopolise the work, and when passing on work to subcontractors, levy substantial margins, making it commercially unattractive.

4.80 Based on its own research and consultations, DFID considers that its frameworks remain a useful entry point for smaller suppliers but has included a number of planned changes in its new generation frameworks. These include opening up more of the frameworks to other government departments (two are already open to other departments), encouraging prime contractors to drop exclusivity clauses and separate work into a number of parcels to open up opportunities for smaller suppliers. There are also planned changes to the way work is allocated between firms within the framework, including allocating work between suppliers in rotation. DFID is also trying to increase its visibility of margins down the delivery chain.

4.81 Pending these changes, it remains difficult to conclude that the frameworks have made a significant contribution to shaping DFID's supplier market. We recognise that DFID has sought to learn and

82. For example, according to documents provided to us by DFID, it anticipates fee rate reductions of 7-16% (depending on line of service) for the Expert Advisory Call Down Service Agreement framework compared to its predecessor, Professional Evidence And Knowledge Services (PEAKS).

83. Internal procurement data provided by DFID.

apply lessons from its first round of frameworks, to overcome adverse features that appear to have supported the positional advantage of larger firms, and to apply downward pressure on fee rates. We therefore encourage DFID to push ahead with further reform of the mechanism, beginning with a clearer identification of how frameworks are intended to increase value for money based on a like-for-like comparison with standard procurement.

Conclusion on market shaping efforts

4.82 This is a mixed set of results. Our analysis suggests that the DFID supply base is not overly concentrated at the aggregate level, but that it may be in particular countries or market segments. There has been some positive progress on the number of bids per contract and the total number of suppliers has increased. However, it remains likely that the inherent complexity of DFID's procurement creates incumbency advantages for established suppliers and creates barriers for new entrants. DFID remains at a relatively early stage in adapting its procurement processes to guard against this tendency.

4.83 DFID has met its commitments on encouraging participation of SMEs according to the government definition, but recognises that it needs to do more to create opportunities for smaller firms, to take advantage of the specialist expertise and innovation they offer. At the level of prime contractors, the market remains heavily dominated by UK-registered suppliers, with limited participation of firms from developing countries. Suppliers from developing countries are often included in delivery chains, but DFID's current data and understanding of these delivery chains is insufficient to judge the extent of their participation.

4.84 The Key Supplier Management Programme and the use of framework contracts are potentially useful initiatives that are endorsed as good practice in UK government guidance. However, DFID is not clear enough about how these initiatives are meant to contribute to value for money and is not adequately monitoring the results. While an accepted way to support market shaping, the Key Supplier Management Programme is not yet being managed in a strategic way to ensure that the benefits outweigh the risks of actual or perceived unfair advantage to major suppliers – particularly in the light of wider weaknesses in DFID's pipeline management and communication. Framework agreements may have reduced DFID's procurement costs to a degree, but there is limited evidence that they have helped to broaden the supplier base in particular sectors or service areas, and they may inadvertently have contributed to the advantages held by established suppliers. DFID has responded to this by launching a new generation of frameworks with a range of innovative features.

4.85 On the basis of the evidence available to us, we score the effectiveness of DFID's market-shaping efforts as **amber-red**. This reflects that most of DFID's market-shaping initiatives are still too recent to have impacted on the market. However, given its investment in staffing and the range of actions it is now implementing as part of the Market Creation Plan, we would expect to see performance improvements in this area in the near future.

Does DFID capture and use learning and knowledge to improve its efforts to shape its supplier market?

4.86 In this section of the review, we look at various aspects of DFID's learning around the influencing of its supplier market. These include the development of its commercial capability and the skills and experience of its staff, its various initiatives to analyse the challenges it faces and derive lessons learned, and the application of those lessons to its market-shaping initiatives. We also assess whether DFID's management information is strong enough to support learning about what works.

4.87 Our 2013 review assessed learning across the procurement domain as a whole as amber-red. However, it noted positive developments in some aspects of market shaping, including the establishment of a commercial adviser function. Here, we explore what action DFID has taken since our 2013 review to expand its learning.

DFID has worked closely with central government initiatives to assess and develop commercial capability and is committed to continuous improvement

4.88 For some time, there has been recognition at the centre of government that UK departments need to improve the contracting out of public services.[84] In response, the Cabinet Office launched a cross-government programme to build commercial capability. Jointly with the Treasury, it conducted commercial capability reviews of central government departments, starting with the largest spending departments in 2014-15, followed by a second group in 2015-16, one of which was DFID.[85] Common findings from those reviews included:

- Commercial capability was focused on the procurement process at the expense of crucial market shaping and contract management activities.
- Departments had too few senior experienced commercial people.
- There was a need to improve the commercial skills and awareness of policy officials who were not commercial specialists.

4.89 DFID carried out its own commercial capability review in 2015 to assess the commercial leadership, focus, and organisation of the department. It made a number of recommendations relevant to market shaping. These are discussed as relevant in earlier parts of this report. Taken together these show how DFID sought to draw learning from the review through action to strengthen commercial capability and capacity across the department, delivery route selection, and the department's commercial focus and governance of key programmes.

4.90 DFID has followed up with action in several of these areas. For example, as at 31 March 2017, seven commercial reviews at country office level had been carried out (against a target of ten for 2016-17) and 25 commercial advisors had been appointed.

4.91 DFID has also taken action to improve the commercial skills of non-procurement staff. It has introduced compulsory commercial awareness training for all senior civil servants and commercial awareness training for senior responsible owners. As at 31 March 2017, 76 senior civil servants had received commercial training (78% of those eligible) and 458 senior responsible owners (61% of those eligible) had received commercial awareness training.

4.92 To follow up the commercial capability reviews, the Cabinet Office asked all departments to produce a 'commercial capability blueprint', including a timeline for completing their remaining recommendations and plans for what their future commercial organisation will look like and how to get there.[86] Following review by the Treasury and the Government Chief Commercial Officer, DFID's blueprint was approved in May 2017.

4.93 Another Cabinet Office initiative has been the development of Government Commercial Operating Standards.[87] DFID baselined itself against the standards in early 2017, and undertook peer review activities with other government departments in June and July. The standards include several key market-shaping issues relevant to DFID's baselining, including:

- DFID's senior commercial staff to be accredited by the government Assessment and Development Centre.
- Improving commercial pipeline oversight, planning and decision-making.
- Timely and consistent commercial engagement in the managing of contracts and development of programme or policy needs.
- Appropriate and clearly understood risk allocation in contracting relationships.

84. *Transforming contract management: progress review: Thirty-second Report of Session 2015–16*, Public Accounts Committee, 23 March 2016, link.
85. *Transforming Contract Management: An update on progress made with implementing recommendations from Transforming Contract Management, 23rd Report of Session 2014–15 HC 585*, Cabinet Office, January 2016, link.
86. *Transforming contract management: progress review: Thirty-second Report of Session 2015–16*, Public Accounts Committee, 23 March 2016, link.
87. *Government Commercial Operating Standards: Iteration ii*, Government Commercial Function, October 2016, link.

DFID has undertaken its own review of its relations with suppliers

4.94 In December 2016, the Secretary of State launched a review of DFID's supplier practice, with four main aims:[88]

- Review the practices of DFID's suppliers and staff in their engagement with external suppliers. This included a review of all practice and standards and covered ethical and professional conduct as well as conflicts of interest.
- Establish how to broaden DFID's supplier base to encourage new entrants and smaller suppliers to bid for DFID work, improving competition, choice, and innovation.
- Establish how to achieve greater cost transparency and scrutiny throughout DFID's supply chain. This included accelerating the introduction of open-book contracting and reviewing how best to benchmark fee rates.
- Examine the DFID systems and internal capabilities needed to support the implementation of the review.

4.95 DFID's supplier review was underway at the time of our review, and its key recommendations were published on 3 October,[89] after we had completed our research and analysis and shortly before the publication of our report. While we are aware that considerable work has gone into the review, including analysis of the supplier market, we are unable to review or comment on its outcome beyond noting that it involves a strong learning component. We note that the very wide-ranging nature of DFID's review, launched in response to criticisms made by the International Development Committee and in the media, is indicative both of the range of the criticisms and that DFID has taken considerable time to identify the challenges it faces in the procurement arena and its preferred solutions.

DFID has sought to apply learning in its frameworks and in key supplier management

4.96 As discussed above, DFID has introduced a number of changes to its procurement frameworks and key supplier management processes. Both show evidence of DFID learning lessons and acting on them. DFID's review of the frameworks included:

- Analysis of historical bidding behaviour and cost structures.
- A survey of current framework suppliers and their consortia members.
- Early market engagement events with non-SMEs, SMEs, micro-entities and NGOs.
- Other government departments were approached in regard to their requirements and pipeline for the new frameworks.

These actions have led DFID to identify a number of weaknesses with its frameworks, which it is seeking to address in future iterations.

4.97 The Key Supplier Management Programme has been in place for a shorter time than the frameworks. There is evidence of processes to support learning:

- The broad system draws on the model of strategic supplier management followed by the Cabinet Office and endorsed by the National Audit Office.
- All staff participating in the programme are required to undertake relevant training.
- One of the stated aims of the programme is to maximise value of managed supplier interactions through lessons learning and knowledge sharing (this is a general aim and not specifically related to management of the supplier market).
- The programme has evolved, showing evidence of the application of learning; there was enhancement and revision in 2014 to take account of lessons identified in the earlier rounds of the programme – while we do not yet consider this to be a strategic approach, we understand this was considered as part of DFID's concurrent supplier review.

88. For details see *Letter to the International Development Committee*, DFID, 9 January 2017, link.
89. *DFID's Supplier Review*, DFID, 3 October 2017, link.

Despite these efforts, information remains an important constraint on DFID learning

4.98 DFID's information on its use of suppliers is affected by limitations in DFID's management information system. DFID currently holds information about suppliers mainly on two systems – one covering financial information and the other contract tendering and awards. A third system holds information on aid project management.

4.99 Integration of these systems is limited and the contracts system in particular is old and inflexible. This limits the level of information and analysis possible. Problems include:

- Current systems do not support DFID's ambitions for holding and analysing increased information on lead suppliers' supply chains. For example, the Procurement and Commercial Department have information in contract documentation that lists the suppliers directly subcontracted by the lead contractor but this is not contained in a central database, so cannot be easily collated. Data on actual expenditure along the supply chain and on further tiers of subcontractors is not available.
- Information is not held centrally on contacts under the EU limit placed locally by DFID offices (payments are recorded in the finance system but the contracts are not recorded on the central contract system).
- Information on payments cannot readily be linked to contracts; in some cases this is possible, but in others further manual processes are required to link and clean data and the results are not wholly reliable.

4.100 Overall, the current systems do not provide DFID with the management information and visibility of the commercial pipeline it would need in order to meet its ambition on shaping the supplier market. DFID recognises this and has recently approved a business case for developing a new system. Until such time as that system is implemented, DFID is unable to track the impact of its market-shaping initiatives to inform continuous improvement.

Conclusion on learning

4.101 Overall, we rate DFID's learning in this area as **green-amber**. Although some of the action that DFID has been pursuing originates in cross-government initiatives, DFID is nonetheless working actively to improve its procurement practices in a range of areas, including market shaping, and its efforts show evidence of learning in various ways. It has a number of elements in place for a system for continuous improvement, including regular dialogue with suppliers and active participation in the UK government cycle of commercial capability reviews. It has also been investing in improving the commercial knowledge of skills of its staff across the department and at various levels. However, its overall learning process is let down by weaknesses in its management information system, which make it difficult for DFID to track the performance of its market and monitor the effectiveness of its market-shaping initiatives.

5. Conclusions and recommendations

Conclusions

5.1 Over the review period, DFID has moved from a cautious approach to market shaping towards a more ambitious set of objectives. Its wider commercial reforms, underway since at least 2008, first prioritised core procurement functions and capacities, before turning to market shaping. Since 2015, DFID has begun to articulate a comprehensive approach to market shaping, which was also considered as part of its 2017 supplier review. It has developed a diagnosis of aspects of its procurement that might restrict competition and diversity, such as the size and complexity of its contracts and the lack of adequate notice of the pipeline opportunities. It has progressively identified a range of initiatives to improve competition and diversity, from its framework contracts and Key Supplier Management Programme through to more recent efforts around simplification of procurement processes, lotting of contracts, and measures to improve DFID's understanding of supplier costs and profits. It is also beginning to develop a deeper understanding of its supply base in specific market niches and to develop country and sector commercial plans.

5.2 Its approach is in some ways still at an early stage of development. The depth of analysis behind the approach is also lacking in some areas, due partly to weaknesses in DFID's management information systems which are in the process of being addressed. Some of the key initiatives are still under design and will need to be tested and refined before DFID can be confident that it has found the right approach. Nonetheless, with the investment in staffing, the establishment of a Market Creation Team and the development of a Market Creation Plan, we have seen clear evidence that DFID's efforts in this area now have a greater structure and ambition, and we have reasonable confidence that there will be further progress in the coming years. We have therefore awarded DFID **green-amber** scores for both the overall relevance of its approach and the quality of its learning.

5.3 Our assessment of effectiveness is necessarily backwards-looking, as the current shape of the market reflects DFID's procurement practices in past years. Analysis of the most recent data suggests that, while DFID's market is not overly concentrated generally, it faces a lack of competition in certain niche markets. While DFID has made some progress in improving the overall number of suppliers, there are still aspects of DFID's current procurement practices that are likely to discourage new entrants, including long and complex procurements and poor advance notice of opportunities. DFID has met UK government commitments on SME participation, but acknowledges the need to do more with smaller suppliers, especially those from developing countries. Its framework contracts and Key Supplier Management Programme, while both important and necessary initiatives, have not had a visible impact on building DFID's supply chain. While we acknowledge that DFID has ongoing efforts to address many of these issues, we award an **amber-red** for effectiveness.

5.4 We recognise that this area remains a work in progress for DFID and that new initiatives have emerged from its supplier review. To support that process, we offer a number of recommendations for areas where DFID could strengthen its approach to market shaping. The research and writing of our review has taken place in parallel to DFID's own supplier review. We note that several of the actions announced by the International Development Secretary on 3 October affect DFID's market-shaping activities and are relevant, in particular, to our first two recommendations below. Some of the announced initiatives are also reflected in our findings. However, DFID's supplier review had a different scope and emphasis from ours and therefore does not cover all of the issues we highlight. It also offers some differences in priorities.

5.5 Against this background, our recommendations are as follows.

Recommendations

Recommendation 1: DFID should adopt a more systematic approach to its stated objective of promoting the participation of local suppliers, to the extent permitted within procurement regulations, including measures at the central, sector and country office levels to encourage the emergence of future prime contractors from developing countries. This might include identifying opportunities for local suppliers to compete directly for DFID contracts, increased supervision of the terms on which prime contractors engage local suppliers, and more inducement of DFID's prime contractors to invest in building local capacity.

Problem statements:

- Given the overall objective of helping DFID's partner countries graduate from development aid, building local supply capacity is a legitimate goal for DFID procurement – although this needs to be consistent with the procurement regulations and balanced with the need to maximise value for money in each programme.
- Some DFID country offices have begun to identify opportunities to develop local suppliers of the future, but this could be done more systematically.
- Lack of visibility down its supply chain means that DFID has limited information on the contribution of local suppliers and the terms and conditions under which they participate. Recent initiatives on mapping DFID's supply chain provide an opportunity to remedy that.
- DFID is still in the process of articulating its expectations of prime contractors regarding fair dealings with local subcontractors and support for their development, and needs to incentivise them to engage in this area.
- While the 3 October announcement includes action to improve access for new suppliers, we note that promoting the participation of local suppliers is not a major focus.

Recommendation 2: DFID should develop clear plans on how it will progress its use of open-book accounting and improve fee rate transparency, and ensure that its plans are clearly communicated to the supplier market, to minimise the risk of unintended consequences.

Problem statements:

- DFID has had contractual rights for some time to access certain information on supplier costs and profits, but has not yet actioned its rights due to capacity constraints.
- While DFID has begun to collect detailed data on fee rates, it does not yet have a system for tracking costs over the life of the contract.
- As monitoring of costs is a time consuming activity, DFID will need to decide how to prioritise its efforts.
- There are risks that efforts to control costs and profits will distort market behaviour. These should be minimised through clear communication with suppliers.
- We note that the 3 October announcement includes action to take forward the use of open-book accounting.

Recommendation 3: DFID should accelerate its efforts to improve communication of pipeline opportunities to the market. It should also assess what potential information advantages are gained by participants in its Key Supplier Management Programme, and ensure that this is counterbalanced by more effective communication with all potential suppliers. Internally, DFID should provide clearer guidance to staff as to what can and cannot be discussed during key supplier meetings.

Problem statements:

- Poor communication of pipeline opportunities was identified as a key constraint on competition both in our supplier survey and in DFID's own analysis. In recent years DFID has taken a range of measures

to improve its communication with suppliers. Moving forward, it should actively pursue these and use supplier conferences and early market engagement events as vehicles for improvement.

- There is a widespread perception that participants in its Key Supplier Management Programme gain privileged access to information about DFID's preferences and priorities. This risk could be mitigated through more effective communication to the market at large.

Recommendation 4: The next phase of DFID's commercial reform plans should be accompanied by a stronger change management approach, with explicit objectives that are clearly communicated to staff. Its plans should be supported by robust monitoring and management information arrangements, to enable full transparency, regular progress reporting and mitigation of potential negative effects.

Problem statements:

- DFID's commercial reform agenda is ambitious and will require changes in systems and capacities, not just in the Procurement and Commercial Department but across the organisation. This calls for a strategic approach to change management and clear communications.
- With change also comes risk, and the more ambitious the change, the greater the risk. Using an explicit change management approach will help DFID monitor the impacts of its change and learn more quickly in response to experience.
- In the past, DFID has struggled to demonstrate the effectiveness of its reform initiatives, for two reasons: the expected benefits have not been clearly articulated; and the initiatives have not been designed to include monitoring mechanisms to facilitate continuous learning.
- DFID's management information systems require investment to ensure it has the data it needs to understand and manage its markets.

Annex A: Glossary

Early market engagement: Events hosted by DFID to discuss upcoming procurement opportunities with potential DFID suppliers both to share information with suppliers and to obtain their input.

Framework agreement: An agreement with a supplier or suppliers which sets out terms and conditions under which specific procurements can be made throughout the term of the agreement in the form of 'call-down' contracts.

Influencing the supplier market: The processes by which DFID engages with actual and potential suppliers in order to establish more effective relationships, shape the market for supply of services, and facilitate procurement.

Key supplier management: How DFID engages with its most important strategic suppliers to deliver value for money and improve contractual outcomes.

Market creation / market shaping: Action taken by DFID to stimulate the marketplace to develop a healthy supply base that can meet DFID's needs long term.

Pipeline: Upcoming procurement opportunities.

Prime/Tier 1 supplier: The lead supplier, ie the one that has signed a contract with DFID.

Small and medium-sized enterprise (SME): The UK Government uses the European Commission's definition, which is an entity engaged in economic activity that employs fewer than 250 people, and has annual turnover of €50 million (£39 million)or less or has a balance sheet total of €43 million (£33 million) or less.[90]

Subcontractor / lower tier supplier: Organisations contracted by the prime or tier 1 supplier or by subcontractors further down the supply chain.

Supplier: In our 2013 review we used the term 'contractor' to describe organisations or individuals working for DFID on a contracted commercial basis. In the current review we normally use the term 'supplier', in line with current DFID usage. In practice, the terms can normally be regarded as synonyms.

Supply chain diversity: Having a range of suppliers available in the market, including local and international, and of varying size.

Supply chain management: How DFID manages and oversees its delivery chains, from the lead supplier down to its subcontractors.

90. *Government's spending with small and medium-sized enterprises*, National Audit Office, 9 March 2016, p. 5, link.

Annex B: Follow up to recommendations in ICAI's 2013 report

In this section, we comment on progress made by DFID in relation to the recommendations made by ICAI in our 2013 report, *DFID's Use of Contractors to Deliver Aid Programmes*.[91]

Recommendation	DFID's management response[93]	Our recent observations
Recommendation 1: DFID should support its devolved delivery model with strategic guidance, informed by its sectoral experts, on when and how contractors of different sizes and specialisms can deliver most effectively. This should include a strategic partnering model for how best to use its major and SME contractors.	DFID stated that it had strengthened its business case process to consider the use of contractors on a case-by-case basis, and referred to the use of frameworks. Future action included completion of the strategic review of when the department should be using contractors versus delivering in-house.	This recommendation remains relevant, particularly in relation to the need noted by the original report for strategic guidance to "give 'DFID's central procurement group' (PrG)[93] a better chance of establishing the right sort of contractor community: one that encourages innovation and new entrants and that can grow in line with DFID's corporate needs over the years and fulfil the anticipated demand patterns". We understand that DFID's 2017 supplier review looked at how DFID can best broaden its supplier base.
Recommendation 2: DFID should prioritise its commercial reforms, so that PrG can support more strategic decision-making on the use of contractors and develop more productive relationships with them.	DFID was focused on strengthening the commercial expertise of all staff, and focusing on its commercial reform programme.	DFID has strengthened its commercial expertise, partly by establishing commercial adviser posts in-country. DFID is working on strengthening its strategic approach through, for example, establishing market-shaping plans and undertaking country commercial capability reviews. DFID's supplier review is a key part of this strategic work.
Recommendation 3: DFID should update its bid evaluation process, strengthening the role of the programme's designers during procurement, to enable a more sophisticated and balanced assessment of costs, timings, risks and results.	DFID noted that it was obliged to comply with EU public procurement regulations. DFID acknowledged the need to undertake more early market engagement events, and to review its bid evaluation process to improve the quality of early market engagement.	While bid evaluation and the role of programme designers during procurement were not a focus of this review, we note that early market engagement is now a key part of how DFID engages with current and potential suppliers to share information about upcoming procurement opportunities.
Recommendation 4: DFID should develop a resourced plan for improving its programme management capability, to ensure end-to-end accountability for programme delivery and minimise disruption from staff rotations.	DFID noted its plans to review and strengthen programme management capacity.	Not within the scope of this review.
Recommendation 5: DFID should strengthen learning from contractor-delivered programmes to feed into the design, procurement and delivery of other programmes.	DFID stated that as part of its effort to strengthen relationships with its contractors, "DFID will ask them to propose practical ways to bring their insights and learning from programmes back into DFID and to share these across programmes".	We saw strong evidence of learning in general, but little specifically on learning from suppliers regarding market shaping.

91. *DFID's Use of Contractors to Deliver Aid Programmes*, ICAI, May 2013, link.
92. *DFID's management response to ICAI's report on: DFID's Use of Contractors for Aid Delivery*, DFID, 2013, link.
93. PrG was the name used at the time for DFID's central procurement group, whose function is now carried out by the Procurement and Commercial Department.

Annex C: Progress on actions and activities in the Market Creation Plan

Planned timeframe	Actions identified prior to plan	Phase 1: Activity already ongoing	Phase 2: To start within 12 months	Phase 3: To be developed and approval sought during 2017
Constituent activities	Simplification of pre-qualification process making it less onerous, costly and time consuming for smaller companies to complete when applying for our lower value contracts Improved pipeline accuracy (critical barrier) Introduction of lots through main contracts and Framework Agreements allowing SMEs to tender for lower value contracts, encouraging access Early market engagement, through Prior Information Notices and Supplier Days Creating opportunities for SMEs to access business via subcontract routes with lead contractors Extended information forums – increased interaction with suppliers via website/ pipeline/ UKTI/British Expertise/Bond/ Supplier Conference/We Connect/SBRI Market analysis and targeted communications prior to OJEU release Amendment to Terms and Conditions to ensure non-exclusivity Direct communication with suppliers addressing matters such as fair and reasonable profit, use of subcontractors and tax avoidance Statement of Priorities and Expectations ensuring joint commitment and alignment regarding transparency, integrity and behaviours and IATI commitment Commercial training of senior civil servants, senior responsible owners and Departmental Procurement Officers Launch of Key Supplier Management Programme	Continued Investment in SME Action Plan Increased early market engagement Tier 1 Supply Chain Visibility & Data Collection Exploitation of procurement and commercial options to strengthen competition eg use of negotiated procedure & lotting of contracts Continued emphasis and monitoring of transparency initiatives and strengthened Terms and Conditions and strengthened Statement of Priorities and Expectations Widened supplier engagement forums and improved communications with existing supply base Key Relationship Management Programme	Supplier Profile of top 100 DFID suppliers – bidding activity used to inform EMEs Extend access to DFID framework agreements to include NGOs and other international development partners Formal 'lotting' review of all contracts with consideration given to all large programmes Extended use of supplier dominance restriction tools including price capping and open-book costing Development of supplier facing social media platforms Market intelligence data gathering (International Development Supplier Database) Launch of additional innovation offers via BIS SBRI Tier 2 Supply Chain Visibility & Data Collection with management information scope including SMEs and women-owned businesses Engage with World Bank and UN system to broker access for UK suppliers and SMEs to their procurement opportunities and to leverage and engage development supply chains Development of Fee Rate Benchmarking Tool and launch of wide-reaching fee rate benchmarking pilots across multilateral and NGO supplier platforms	Targeted Market Creation Programme allowing DFID to further invest in the structures required to deliver a 'development supply base' which is sustainable, agile and fit for the future Programming for market access linked to the findings of the barriers to entry research Run country office pilot programmes to stimulate and develop local suppliers and develop capability to bid and win DFID contracts Joint programme funding with multilateral partners to push market creation incentives
Status of activities	Five activities complete, remainder ongoing; planned completion dates later in 2017 and in 2018; training ongoing indefinitely	Three activities complete, two ongoing	Four activities complete, remainder ongoing	Some initial work undertaken but resourcing for implementing phase 3 not yet approved

Source: DFID Data provided by the Procurement and Commercial Department, September 2017

Annex D: DFID direct spend to key suppliers – 2012-13 to 2016-17

Supplier name	Direct spend (£ millions)				
	2012-13	2013-14	2014-15	2015-16	2016-17
Adam Smith International Ltd.	63.4	89.3	93.5	112.3	103.8
ATOS Consulting Limited	16.4	19.4	15.9		
Coffey International	16.3	22.5	25.5	28.1	28.7
Crown Agents	92.4	165.8	171.8	154.5	123.1
DAI Europe	28.9	42.2	55.9	69.1	76.7
Palladium	20.7	36.2	53.6	71.1	85.4
KPMG LLP	9.1	6.3	14.0		
Maxwell Stamp	15.6	22.5	12.8	13.2	16.5
Mott MacDonald	60.1	48.9	63.3	73.8	77.5
Options	12.6	11.8	16.0	18.0	11.0
PricewaterhouseCoopers	40.5	105.7	127.8	123.2	141.2
OPM				18.6	42.8
British Council				12.5	25.4
IMC Worldwide Ltd.					21.9
Oxfam				3.6	1.5
Save the Children				3.9	10.5

Note:
KPMG and ATOS left key supplier management after 2014-15; OPM, British Council, Oxfam and Save the Children joined in 2015-16; and IMC Worldwide joined in 2016-17.

Independent Commission for Aid Impact

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