



REVIEW OF DFID APPROACH TO SOCIAL MARKETING

ANNEX 9: CONTRACTUAL RELATIONSHIPS BETWEEN DFID AND SOCIAL MARKETING ORGANISATIONS

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ANNEX 9:

CONTRACTUAL RELATIONSHIPS BETWEEN DFID AND SOCIAL MARKETING ORGANISATIONS.

This annex addresses contractual issues relating to the delivery of social marketing projects funded by DFID. It is largely based on the findings of the case studies. The Annex incorporates comments made by Robert Hyland [Procurement Adviser] of DFID's Procurement Department. However, responsibility for the observations and recommendations in this Annex rests with the author – John Meadley.

1. GENERAL OBSERVATIONS.

All of the social marketing activities funded by DFID are delivered by third parties, generally SMOs, that have been appointed for the purpose. These formal arrangements between DFID and the SMO define (amongst other things) the scope of work, the funds to be provided and the basis of remuneration and are based either on a formal **contract**¹ or an accountable grant **agreement** (A/G)². Accountable grants may currently only be used when the contractor is a non-profit organisation – normally an NGO – which may also be contracted without competitive tendering. Where the organisation is privately owned and operates for profit, tendering is required and a contract is employed³. Being able to enter into a (simpler) **agreement** without competitive tendering makes access to projects easier, and cheaper, for NGOs and is a significant factor in NGOs being the dominant SMO contractors. The pros and cons of tendering are discussed in 2.7 below.

Apart from the absence of the requirement for tendering, these contracts and agreements are significantly different. Table 1 compares the issues raised in a **contract** with those in an **accountable grant agreement** (essentially a two page letter accompanied by a set of accounting instructions). Many issues considered necessary for a **contract** are not included in an **agreement** (A/G). The standard A/G letter currently makes no reference to commodity procurement. In fact there is currently no mechanism, or indeed a requirement, to bring a proposed A/G award to the attention of Procurement Department (PrD). Procurement Department (PrD) would like to have commodity procurement procedures included in the A/G letter. One option is that the relevant programme officer would be responsible for ensuring that A/G recipients have the necessary procurement capacity before any funding is made and that, where there is doubt, capacity building may be required or procurement be channelled through a recognised DFID procurement agent. Where

¹ Comprising:

- a) a contractual letter of appointment, which defines the documents included in the contract, the financial limit and the commencement date). This letter may be superseded by letters of contract amendment;
- b) a contract which lays down the (standard DFID) conditions;
- c) Terms of reference/scope of work
- d) Administrative procedures
- e) Schedule of prices

² Small amounts of funding have also been disbursed through the joint funding scheme, civil society challenge fund and HPD [core discretionary] grant scheme [otherwise known as the Knowledge Fund]

³ It is still possible to single source a supplier (i.e. award a contract through negotiation and without competition) where there is an emergency, a particular urgency exists or a supplier holds the IPR and cannot realistically be changed – but such instances are rare.

the SMO is operating in a core country (where a procurement agent has been granted exclusive procurement rights) procurement may be channelled through them. Even in some non-core countries procurement may still be channelled through a recognised procurement agent if it has representation there. Whilst these developments are welcome, given the high level of commodity procurement it would be preferable to have a single and consistent set of rules covering procurement in all SM projects regardless of whether the SMO is an NGO or a private company or whether contract or A/G.

Table 2 looks at the ten case studies reviewed, noting the value of the contracts, whether tendered or not and whether appointments are based on a **contract** or an **agreement**. The requirement for tendering or for the use of a contract is clearly not dependent upon the size of the project (for example Nigeria ITNs valued at £1.2 million was tendered/contracted whilst Kenya ITNs valued at £17.4 million was a direct appointment/accountable grant agreement). The consistent element is that NGOs **can** be appointed direct whilst private sector companies **cannot** (see footnote 3). However, NGOs may also be required to tender in certain circumstances – although the nature of these circumstances is not formally defined.

2. UNCERTAINTIES ARISING

A number of uncertainties or inconsistencies were identified during the review, which are considered below.

2.1 Defining how earned income should be used.

SMO projects are unusual in that income may be generated from the sale of SM products, which could be used for a number of purposes including being offset against payments due to the SMO or being used to purchase additional commodities. In the case of Tanzania, where substantial income was earned in Phases 1 and 2 through the sale of SM products, the accountable grant agreement (and the subsequent contract for Phase 3) did not address how this income (of around £900,000) was to be used. In practice, based on a **verbal** agreement, it is used for the purchase of additional commodities. In another instance, earned income is retained in an SMO's international head office – to be used in the country where it is earned “when appropriate”. Both contracts and agreements should in future formally address how earned income will be used and accounted for.

TABLE 1. ISSUES ADDRESSED IN CONTRACTS AND IN ACCOUNTABLE GRANT AGREEMENTS (including accounting instructions)

Issue	Contract	Grant Agreement
Construction of contract (e.g. governed by the laws of which country)		
Definitions		
Instruction and approvals		
Personnel (qualifications of, right to substitute)		
Financial limits		
Fees (definition of what is included in fees)		
Subsistence		
Payments (date of, currency, requirement for meeting targets, reasons for withholding)		
Payment of subcontractors (requirement to pay subcontractors within 30 days)		
Procurement of equipment (reimbursable basis, need for procurement agent, insurance)		
Ownership/disposal of equipment, need for inventory to be maintained		
Responsibility for equipment (maintenance of, basis for disposal at end of contract, liability for claims)		
Invoicing instructions (fees and reimbursables)		
Indemnity (of the UK Government)		
Assignment to others (not without permission)		
Associates (considered as subcontractors)		
Termination		
Force Majeure		
Settlement of disputes		
Disclosure of information and copyright ⁴		
Audit		
Access to sites and relevant records		
Impairment of development value – action to be taken		
Use of funds (to be as per project memorandum)		
Use of funds (inc. not for paying import duties)		
Changes to the structure or objectives of the project – not without reference to DFID		
Submission of progress reports		
Continuation being dependent upon satisfactory progress in year 1 (optional)		
Continuation being dependent upon DFID's annual approval (optional)		

⁴ It is into this section that DFID has inserted a clause relating to its having access to brands developed using funds granted by DFID

TABLE 2. BASIS OF CONTRACTUAL APPOINTMENT OF SMO

Country/Status	Contract value ⁵ (£M ⁶)	Competitive tender	Direct appointment
Mozambique ITNs	2.5 ⁷		
Mozambique condoms	1.425 ⁸		
Kenya ITNs	17.8		
Tanzania ITNs	8.02 ⁹		
South Africa condoms	2.5 ¹⁰		
Nigeria Condoms and FP products	52.8 ¹¹		
Nigeria ITNs	1.2 ¹²		
China Condoms ¹³			
Pakistan A ¹⁴			
Pakistan B			
SADC	2.5		

2.2 The contractual basis for paying for services.

Within the 10 case studies the following mechanisms are used for paying fees or for calculating contribution to overhead.

- a) Number of man days involved – the rate being based on salary plus superannuation (total salary cost) plus a % of the total **salary** cost (33% in one instance);
- b) Number of man days involved – the rate being based on salary plus superannuation (total salary cost) plus a % of total **project** costs (varying from 5.5 to 7.0%)
- c) A % of the project costs **including** commodity costs (ranging from 5.0% through 5.5% to 8%)
- d) a % of the project costs **including** commodity costs (only example is 5%) plus % of commodities procured (4%) to be shared where appropriate with the procurement agent
- e) A % of the project costs **excluding** commodity costs (only example is 6.0%)

⁵ Includes funding provided by DFID or co-financing managed by DFID unless otherwise noted

⁶ US\$ values converted to sterling at £1 = US\$1.6

⁷ Plus supplementary funding of £313,000 from UNICEF

⁸ For commodities only. Other funding from USAID (£3.4M) and Netherlands (£1.25M)

⁹ Covers 1998-2005. Phases 1&2 accountable grant; phase 3 (from 2001) competitive tender). Netherlands funded additional £4.64M

¹⁰ For new/current project. Previous DFID funding of £5.1M plus other funding (GoSA, USAID, Netherlands, PSI) of £2.12M).

¹¹ Other funding from USAID (£14M over 7 years)

¹² Plus extension funding of £0.6M.

¹³ Based on a request for proposals rather than tendering for delivery of a project memorandum

- f) A % of the project costs **excluding** commodity costs (only example is 12%) plus % of commodities procured (4%) to be shared where appropriate with the procurement agent

In 10 projects there are six different mechanisms (with variations) for estimating the income to be paid to the SMO. Most of these are based upon a % of the value of the project – with or without commodity costs included. In general, a % of project cost is a poor mechanism for valuing effort in a socially focused project. More sales may not necessarily result in more sales to the target group. Increasing the commodity budget may not necessarily involve any more work on behalf of the SMO itself, particularly if there is a well-established distribution mechanism or team of subcontractors delivering the promotional message. Where there is co-financing, the DFID input may only involve commodities, whilst other costs are borne by another donor. Some services (such as promotion) may be borne by the SMO or could be contracted out. Whilst a **sliding scale** of fees based on the project budget may be a useful first step, there are too many local variables which influence the real cost of delivering a service.

USAID adopts a method for allocating overheads and administrative costs for NGOs called a NICRA (negotiated indirect cost rate agreement) in which such costs are spread across all projects based on the amount of US-hired (not local) staff and is converted into a % of staff salaries and fringe benefits. The Dutch, in contrast, will permit a maximum of 7.5% of total project costs for overhead and administration, whilst KfW operates on the basis of man days performed.

When seeking to establish a fair basis for the payment of services provided by the SMO, other influences are:

- the wish to encourage SMOs to contract out services as much as possible to local organisations, as part of the process of building local capacity;
- the need to recognise the real costs incurred by SMOs in tendering for projects – which are incurred only by organisations required to tender – and that these costs have to be recovered from fee income;
- the need for all organisations – both NGOs and private sector companies – to generate a return on their investment and/or build up reserves for the future.

It is not possible in such a multi-faceted review as this to come up with a clear recommendation as to precisely how the services of SMOs should be paid for – except that they should be based upon the real costs of delivering services and permit the build-up of reserves. Suffice to say that the current bases are inconsistent and that time and thought is needed to establish agreed criteria for valuing services which encourage professionalism, efficiency and sub-contracting/build up of local capacity. PrD is aware of the inconsistencies, which have in part arisen because it has only recently become involved with overseeing these SM projects, and is now taking steps to address them.

2.3 Project extensions.

Projects have a finite life, which is normally clearly defined in the contract, PM and budget. Reality rarely follows the plan and it is frequently necessary to amend the technical work (as defined in the log frame), the budget (both the financial limit and the internal utilisation of funds) and the term (lapse period) of the project. The

contract letter allows changes to the termination date of the contract (essentially relating to performance), whilst the conditions for contracts allows for changes to the scope of the contract¹⁵ (subject to approval and contract amendment) and the financial limit (section 5). There is currently no reference to the possible extension of the project term, or to the basis on which (or when) such extension might be decided. As a result, it is possible for funding/contractual gaps to occur between the formal project completion date and its extension. This can arise because tendering is required, because funding is not in place or because the issue was considered too late. It is recommended that a clause be inserted to address the issue of project extension, addressing the following:

- a) a specific date on which the issue of project extension will be raised by DFID with the contracting party;
- b) a specific date by which firm decisions are made on whether or not, when **additional** funding is required, the project will be extended;
- c) a specific date by which firm decisions are made on whether or not, when NO additional funding is required, the project will be extended on a no-cost basis;
- d) the circumstances under which the initial contractor may continue to manage an extension or under which tendering will be required

2.4 Budgetary increases.

Assuming that funds are available, the scope for increasing the budget depends upon whether or not the project is a contract or an A/G. Contracts are regulated by the EU Procurement Directive. Where the original ITT or contract made no reference to any extension possibility, it can be extended without difficulty as long as the value of the extension is less than £100k. If the value of the extension is over £100k then technically it has to be re-advertised – although there may still be scope in some cases to apply the Negotiated Procedures and ‘negotiate’ the new contract (which is effectively the extension) with the same supplier. Reference to the possibility of an extension in a contract may make it easier to negotiate future budgetary increases. It is clear that contract extensions are not always straightforward due to DFID’s requirement to adhere to EU procurement directives.

2.5 Contract amendments.

There is a well-established procedure within DFID for making amendments to contracts, reflected in an amendment letter. Normally these refer to issues arising in the **contract** – to do with budgets or timing – and not to issues to do with scope or the log frame. However, in one case-study an instance arose where the log frame had been amended and the changes noted by exchange of letter between the health adviser and the contractor but no formal contract amendment was issued. As a result, the OPR was undertaken according to the original rather than the amended log frame. Clarification on how log frame amendments are formally registered from a contractual viewpoint would be helpful.

¹⁵ Section 3. Instructions and approvals

2.6 Brand ownership.

The issue of IPR/brand ownership is addressed elsewhere in this report, being one of the prime areas of concern to DFID in the TOR. The concern is that DFID may not be able to continue with a specific brand, even though DFID funds were used to develop the brand, if it changes SMO supplier. DFID is now addressing this through adding a clause into its contracts and A/Gs as follows: *“SMO ... has registered the brand but has agreed to a world-wide non-exclusive irrevocable royalty free licence to DFID to use the intellectual property rights – with DFID entitled to sub-license them on any terms that DFID sees fit.* “Whilst this covers new brands developed under contracts containing this clause, brands developed under earlier contracts can be a problem – although there does appear to be greater willingness by SMOs to compromise than previously.

2.7 To tender or not to tender.

At present, appointing an SMO without tendering is possible only when an NGO is involved (see footnote 3). The advantages of **not** tendering noted at field level are that:

- A proven SMO, with local experience and known to DFID, can be appointed;
- The SMO in question can participate in, and contribute to, the planning and preparation of the project, calling on local experience;
- The appointment can be made quickly;

Against this are the following observations;

- Local presence, whilst it may have advantages, does not guarantee having the best ideas, freshness of approach or the best people;
- Tendering requires each party to undertake detailed research and be innovative, resulting in fresh thinking;
- Competition stimulates careful analysis of costs and pricing;
- Competition ensures that the incumbent does not sleep at his post.

The official reason for not requiring NGOs to tender is that they are developmental and are not motivated by profit. However, the differences between for-profit and non-profit organisations are becoming less well defined.

- Both have a vested interest in getting contracts.
- There is no significant difference between their employment terms and conditions.
- Some NGOs have commercial/trading subsidiaries, which may blur their impartiality;
- The commercial margins made by for-profit SMOs are modest and largely reinvested in tendering for new work and building capacity.

Further, there is no clear evidence that either for-profit entities or NGOs are, generically, any more efficient or effective than the other in delivering development

services. What over-rides all of this is their **capacity** to deliver an effective and efficient service. This being the case, DFID should adopt the same rules in dealing with all SMOs – either all SMOs are required to tender for contracts (above an agreed limit) and incur the costs associated with tendering or all SMOs can be appointed directly when the circumstances are considered appropriate. Given the difficulties of defining “appropriate circumstances”, it is recommended that all new SM contracts be put out to tender.

With regard to project extensions, it is recommended elsewhere that the term of SM projects should be for a minimum of five years - (if necessary on a phased basis) – at the end of which time any contract extensions should be put out to tender. The only exception to this could be when an SMO (NGO or for profit SMOs being given equal consideration) approaches DFID for funds to match a financial commitment by the SMO in order to achieve a common objective, and this is judged to be an effective way of using DFID funds.

The implications of requiring tendering for all new SM contracts is that accountable grants, which are legally weak in relation to increasingly large and complex projects, should no longer be used – or they should be strengthened to an equivalent legal status as a formal contract.

The introduction of tendering across the board is intended primarily to stimulate innovation and cost-effectiveness but not price competition per se. Choosing the cheapest is rarely the best decision. Particularly in a field such as SM, there are different options for achieving an outcome which involve different costs. Some may incur risk but, if successful, open up new approaches. Adopting traditional approaches may be safer and cheaper but offer less potential in the medium term. Willingness to operate on an incentive basis could reduce costs when performance is low but involve higher payouts if successful. Once decisions are made in relation to tendering and the structure of contractual arrangements, DFID staff in the field will need guidance on their interpretation.

2.8 Barriers to entry.

As noted in 1.3.9, there is concern that there are so few credible organisations (for-profit or NGO) capable of delivering SM projects for DFID. Current contractual arrangements are not a barrier to entry for NGOs which can currently be appointed directly and benefit from the accountable grant system. The introduction of compulsory tendering and removal of the accountable grant could be considered as increasing the barriers to entry of new participants, particularly small operations. However, the benefits of tendering and the introduction of legally stronger contracts outweigh this and other mechanisms for reducing the barrier to entry are suggested in 1.3.9

2.9 Procurement procedures.

Procurement procedures as a whole are well regulated by DFID, with procurement agents now being appointed by competitive tender in most countries where DFID operates at a significant level (core countries) and where they have responsibility for all purchases costing more than an agreed figure. The experience of the quality of these agents varies between countries. A common complaint of programme managers is late delivery – including complete stock-outs on some occasions. This could be addressed partly by a better relationship with the procurement agent

(including plenty of advance notice) but also by programme managers having the option to impose financial sanctions on procurement agents when goods are delivered late. Issues relating to whether or not an SMO should be permitted to procure directly are beyond the scope of this report and the subject of procedures established by Procurement Department.

As noted in 1.0 above, commodity procurement arrangements under SM **contracts** are defined by specific regulations, but this is not the case with A/Gs – ironic given that some A/G contracts are bigger than some contracts. PrD is aware of this anomaly and the issue is currently being addressed.

In the SM field, until recently the specification of commodities (condoms and FP products) to be purchased were easily defined and provided the basis for purchase on an international best-buy basis. The situation with **bed nets** is less well clear-cut as is evident in Kenya, where an observant procurement agent (Crown Agents) identified significant variations in the technical and design specification of nets supplied to WHO standards, even from international manufacturers. This led to the development of a more detailed specification, training of the manufacturers and imposition of a thorough inspection process. The procedures arising from this experience should be replicated in all other ITN projects. Details of this can be found in the narrative version of the Kenya case study (not included in this report but available on request) and the Crown Agents/PSI report on this issue.

At present, SMOs receive no instructions or guidance from DFID, or indeed from any other donor, on issues relating to social accountability (SA) in respect of procurement. It appears that directives of the EU in relation to public procurement address the issue of SA, but only in relation to member states. Various attempts to establish SA codes have been made¹⁶. There is a lot of confusion and overlap around, but the basic underlying issues remain. DFID itself is the main backer of the Ethical Trading Initiative (focused on working with UK retailers).

It is recognised that forcing compliance on SA is difficult, especially in developing countries – but that does not mean that the issue should not be addressed. Suppliers to SM projects could be required to adhere to a specific international code or, probably more practical in the short term, could be asked to make available their own internal code of conduct addressing SA issues. If they do not have such a code, they could be provided with assistance to produce one. In an increasing number of countries there are organisations capable of monitoring such codes – for which there is a cost. But since there are also benefits, this could be a legitimate charge to a development project. The report therefore recommends that:

For an initial trial period of one year, all suppliers to SM projects should be required to have a voluntary code of social accountability that incorporates the key issues in the Social Accountability 8000 (or similar) code¹⁷ – as a requirement under DFID's procurement regulations. This will extend developmental benefit beyond the SM

¹⁶ AA1000, Global Reporting Initiative, Good Corporation, UN Global Compact, ILO conventions, UN Declaration of Human Rights, OECD Guidelines for Multinationals, Ethical Trading Initiative Base Code and SA 8000

¹⁷ Social Accountability 8000 (or SA 8000) is a common auditable standard seeking to guarantee the basic rights of workers. It was established by the Council on Economic Priorities Accreditation Agency (CEPAA) in 1997 based on ILO conventions and related international human rights instruments. A code which has a similar ethos is the DFID-supported and, UK – based, Ethical Trading Initiative (ETI).

target group. If necessary DFID could provide assistance to these companies to prepare such a code.

A small but realistic budget could be included in each project to assist in this process. Each SMO would be required to report back to DFID at the end of 12 months on its experience so that lessons can be learned and a decision made on whether to extend/amend/discontinue this requirement.

3. RECOMMENDATIONS.

Arising from this review, the following recommendations are made:

3.1 Re the appointment of SMOs, there needs to be:

- a) a single consistent set of rules for **selecting** SMOs where selection is based on merit (quality of proposal, proposed contribution to/participation in a project, experience of staff, participation of local partners etc) regardless of whether the SMO is a private company or an NGO.
- b) Tendering for all projects
- c) a single comprehensive form of contract covering the **appointment** of SMOs
- d) a consistent basis for the **remuneration** of SMOs.

3.2 The contracts themselves should:

- a) state how earned income is to be used
- b) include a clause that addresses the issue of project extension, including:
 - a specific date on which the issue of project extension will be raised by DFID with the contracting party;
 - a specific date by which firm decisions on whether or not, when **additional** funding is required, the project will be extended;
 - a specific date by which firm decisions on whether or not, when NO additional funding is required, the project will be extended on a no-cost basis;
 - the circumstances under which the initial contractor may continue to manage an extension or under which tendering will be required.
- c) continue to address the issue of brand ownership as currently drafted.
- d) Confirm that the log frame is an integral part of the contract and that any changes to the log frame constitute an amendment to the contract.

3.3 Re procurement:

- e) particularly where a product can vary in terms of performance (e.g. strength) and design (e.g. consumer preference) – such as with insecticide treated bed nets (ITNs) – rigorous attention must be given to product specification and to inspection procedures.
- f) There should be a single consistent set of procurement arrangements for contracts and accountable grants.
- g) For an initial trial period of one year, all suppliers to SM projects should be required to have a voluntary code of social accountability

that incorporates the key issues in the Social Accountability 8000 (or similar) code¹⁸ – as a requirement under DFID's procurement regulations. This will extend developmental benefit beyond the SM target group. If necessary DFID could provide assistance to these companies to prepare such a code. TA and other costs associated with such a trial might best be found within the DFID budget responsible for social accountability.

¹⁸ Social Accountability 8000 (or SA 8000) is a common auditable standard seeking to guarantee the basic rights of workers. It was established by the Council on Economic Priorities Accreditation Agency (CEPAA) in 1997 based on ILO conventions and related international human rights instruments. A code which has a similar ethos is the DFID-supported and, UK – based, Ethical Trading Initiative (ETI).