



TAKING OFF:

OPENING UP DEFENCE PROCUREMENT FOR SMALL BUSINESSES

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Experts in Business

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WHO WE ARE

The Federation of Small Businesses (FSB) is the UK's leading business organisation. Established over 40 years ago to help our members succeed in business, we are a non-profit making and non-party political organisation that's led by our members, for our members. Our mission is to help smaller businesses achieve their ambitions. As experts in business, we offer our members a wide range of vital business services, including legal advice, financial expertise, access to finance, support, and a powerful voice in government.

FSB is the UK's leading business campaigner, focused on delivering change which supports smaller businesses to grow and succeed. Our lobbying arm starts with the work of our team in Westminster, which focuses on UK and English policy issues. Further to this, our expert teams in Glasgow, Cardiff and Belfast work with governments, elected members and decision-makers in Scotland, Wales and Northern Ireland.

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FOREWORD

Small businesses can make a huge contribution to public and private sector procurement offering innovative solutions and adaptability, greater value for money and also delivering real social value by often being routed within their local community.

The Government has recognised the value that small businesses can offer, which is why it has committed to spending every one in three pounds it spends on public procurement, either directly or indirectly with SMEs by 2022. The original goal, announced by the Prime Minister, was for this target to be delivered by 2020. However, the Government has moved the deadline back to 2022, and there is no real sense of the urgency required to achieve this extended deadline. Success will depend upon a concerted cross Whitehall effort.

The Ministry of Defence has one of the largest procurement expenditures of any Government department, but faces distinctive challenges in relation to procuring with SMEs given the nature of the products and services it buys. This is due to the highly varied nature, security and sometimes necessary secrecy of its procurement. MOD is also one of the most organisationally complex central government departments, with multiple different areas and practices within it.

As such the procurement practices used in other Government departments may simply not be suitable for the type of work carried out by the MOD and their specific procurement requirements. This is reflected in the reduced target for the MOD to spend every one in four pounds with SMEs by 2022. However, despite this reduced target, there is still a lot of work to do to increase spend between MOD and SMEs in the UK to deliver on this reduced target by 2022.

There is a solid base to work from; the MOD has already taken important strides towards improving its relationships with SMEs and has an exemplary record on payment to those suppliers it directly contracts with.

Areas such as the Defence and Science Technology Laboratory (DSTL), within the MOD, are already taking steps to help find innovative SMEs through its Searchlight programme, but there are some key difficulties still to be overcome for MOD to meet its target.

This report assesses some of the core challenges faced by SMEs when trying to work in the UK defence sector public procurement system, such as access to contracts, payment practice, vetting and accreditations and working in the supply chains of larger defence contractors.



Tim Colman
FSB Cabinet Office Policy Chair

MOD SME ACTION PLAN

FSB welcomes the publication of SME action plans across government departments, and are pleased to see that the MOD has already published their plan

We also welcome appointment of Andrew Forzani, MOD's Chief Commercial Officer, as MOD's SME Champion. It is clear from the Action Plan that the contribution made by SMEs towards national prosperity and innovation is well recognised by the MOD – with the MOD wishing “to become the customer of choice.”¹

The Action Plan also highlights a number of positive case studies which show real improvements in the way in which the MOD is contracting and working with SMEs directly. For example, the MOD Action Plan highlights how Army Commercial broke down the tender for Tranche One of the Army Apprenticeship Programme so that it was more attractive to SMEs. After generating a significant amount of SME interest, five out of the eight lots went to SMEs.² This is an excellent example of where work to disaggregate a contract has delivered greater SME engagement, and shows that the capability and desire to work directly with SMEs is clearly present within commercial teams at MOD.

The Action Plan itself largely focuses on four key areas: supplier engagement; procurement policy and process; doing business with defence; and innovation. It is clear that the MOD has already progressed in improving engagement with SMEs, such as, for example, ensuring that primes comply with legal requirement to advertise subcontracting opportunities on the Defence Contracts Online portal (DCO), and improving commercial expertise including improved awareness about SME engagement strategies.

There are also a number of commitments going forward which are promising, such as addressing the issues surrounding flow-down of contractual terms, and complying with other Government policy such as potentially excluding suppliers who cannot demonstrate fair, effective and responsible supply chain payment practices.³

However although the Action Plan is clearly a step in the right direction, both acknowledging the role SMEs have to play and adopting some of the wider government commitments, there is still more to be done to improve SME engagement with MOD. For example, a lot of the Action Plan focuses on the role of SMEs in the supply chain, rather than SMEs working directly with MOD. Given the nature of the products and services procured by MOD, it is not surprising that the vast majority of SME spend is indirect (in the supply chain), however an over reliance on indirect spending places a lot of emphasis on the role of key primes, and can create a disconnect between SMEs and the MOD.

This report looks at how both MOD and primes can improve their relationship with SMEs, highlighting some of the good work carried out already, and that none of the issues raised are insurmountable. We also make the case that although we still expect the majority of MOD spend with SMEs to be indirect, there are multiple benefits for SMEs and MOD to have a direct relationship.

1 MOD SME Action Plan, April 2019, available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/793101/20190405_SME_Action_Plan_2019.pdf

2 Ibid page 8

3 Ibid page 12

RECOMMENDATIONS

Accreditations

1. Many SMEs find it difficult getting the correct accreditations and arrangements in place to compete for MOD contracts. FSB would like Central Government to create a small access fund to help SMEs meet extra security and accreditation requirements that are required. This can be introduced as a grant for those smaller businesses likely to be bidding for MOD contracts. The fund should be supported by access to expertise from MoD. Capacity-building within SMEs will lead to more small businesses able and bidding for work, which will improve competition and quality of the work delivered for the taxpayer.

Frameworks and DPS

2. FSB believes, on the basis of the qualitative research that has been undertaken, that purchasing systems such as the Aurora Engineering Delivery Partnership (EDP) are the least effective and transparent way of spending public money, improving spend and engagement with SMEs.
3. Ideally MOD should further explore the introduction of Dynamic Purchasing Systems (DPS) where appropriate to do so, and continue using Framework Agreements where not.
4. MOD must take steps to open up accessibility and transparency of EDPs. This should include publishing a formal process to join the EDP, feedback on all failed applications, and publishing the bidding structure within the EDP.
5. The maximum limit of seven years should be applied to the Aurora EDP, and not extended to cover a further 10 years without substantial changes to the EDP.

Payment

6. Those businesses working directly with MOD typically receive payment within five (95 per cent of the time) or within 30 days (99.99 per cent of the time), however SMEs working in the supply chain are often paid late or outside of the prompt payment code (which sets an outside limit of payment within 60 days, but working towards a maximum payment term within 30 days). Where businesses are found to be in serious breach of the prompt payment code but still of strategic importance, any future awards to that businesses should have to involve the use of project bank accounts for all awards above £5m (in line with the construction sector).
7. Payment performance should also be taken into consideration during the bidding stage (explored more in the weighting chapter), with poor payers excluded from non-vital contracts, as the government has already committed to.

Contract management capability

8. FSB would welcome more centrally funded resource for contract management capability across Government departments, but particularly focused on MOD. This would be with a view to improving the standard of contracts management within departments, but also to encourage and facilitate disaggregation of contracts, helping SMEs to engage and provide their specialist services through directly contracting with MoD.

Engagement with SMEs

9. The DSTL SME Searchlight programme should be evaluated within the next 18 months, with the appropriate lessons learnt and rolled out across different areas of the MOD
10. A longer term SME engagement programme focusing on core themes across the MOD should be put together and rolled out through a series number of workshops and events. This programme would be in part advised by major defence contractors (Primes) who may also benefit from setting the core themes and exposure to new to industry SMEs. This should also consider how MOD can help boost early market engagement with SMEs when specifications are still open to some adjustment.

UK Prosperity (social Value)

11. Although FSB agrees that an emphasis and weighting should be put on UK prosperity, we would also like to see payment performance and engagement of SMEs in the criteria defining UK prosperity. This should then be given a level of weighting when contract bids are being considered.

A. Any criteria should be explicitly clear, so that bidding businesses know exactly the practices and evidence needed to achieve high marks in this section of any bid.

PROCUREMENT AND MOD LANDSCAPE

In 2017/18 the UK defence budget sat at £36.9bn with over £20bn spent on procurement, accounting for over 40 per cent of all UK central government procurement spend⁴. Added to this, over the ten years from 2016, planned spend on equipment alone is set to exceed £185bn. This means that the UK's defence budget is the fifth largest in the world, as the UK continues to meet the NATO commitment to spend two percent of GDP on defence each year.

The MOD itself is unlike any other Governmental Department, in regard to the: size of its budget; the tasks it is asked to carry out; and the organisational structure within the Ministry. The Government has a target of increasing procurement spend with SMEs to 33 per cent by 2022, but the MOD has a target of 25 per cent –reflecting the size of its budget and the nature of its procurements. We consider the target of 25 per cent by 2022 to be correct, but significant progress will need to be made by MoD if it is to be delivered.⁵

Department	FY 2016/17						FY 2017/18					
	Total Procurement spend (£m)	Direct Spend with SMEs (£m)	Direct Spend with SMEs as %	Indirect Spend with SMEs (£m)	Indirect Spend with SMEs as %	Total Spend with SMEs as %	Total Procurement spend (£m)	Direct Spend with SMEs (£m)	Direct Spend with SMEs as %	Indirect Spend with SMEs (£m)	Indirect Spend with SMEs as %	Total Spend with SMEs as %
BEIS	£1,205	£303	25.2%	£58	4.8%	30.0%	£1,232	£336	27.3%	£75	6.1%	33.4%
CO	£226	£24	9.1%	£21	7.9%	17.0%	£192	£14	7.3%	£27	13.9%	21.2%
DCMS	£422	£176	41.7%	£9	2.2%	43.9%	£353	£141	40.1%	£22	6.1%	46.2%
DEFRA	£1,142	£176	15.4%	£109	9.6%	25.0%	£1,033	£160	15.5%	£111	10.7%	26.2%
DFE	£442	£101	22.7%	£44	10/0%	32.7%	£523	£88	16.8%	£36	6.8%	23.6%
DFID	£1,383	£461	33.4%	£181	13.1%	46.4%	£1,262	£230	18.3%	£312	24.7%	43.0%
DFT	£11,323	£1,238	10.9%	£2,142	18.9%	29.9%	£11,672	£1,229	10.5%	£2,424	20.8%	31.3%
DHSC (1)	£1,189	£190	16.0%	£69	5.8%	21.8%	£2,443	£442	18.1%	£94	3.9%	22.0%
DWP	£2,943	£105	3.6%	£319	10.8%	14.4%	£2,669	£155	5.8%	£255	9.6%	15.4%
FCO (2)	£98	£6	6.4%	£10	10.4%	16.9%	£230	£25	10.7%	£11	4.9%	15.6%
HMRC	£1,577	£216	13.7%	£126	8.0%	21.7%	£1,470	£151	10.3%	£132	9.0%	19.3%
HMT	£76	£7	9.6%	£3	3.4%	12.9%	£78	£10	12.3%	£1	1.3%	13.6%
HO	£2,187	£205	9.4%	£290	13.3%	22.6%	£2,109	£289	13.7%	£254	12.0%	25.8%
MHCLG (3)	£164	£25	15.2%	£13	7.7%	22.9%	£156	£29	18.6%	£7	4.3%	22.9%
MOD (4)	£19,091	£707	3.7%	£1,803	9.4%	13.1%	£20,158	£835	4.1%	£2,483	12.3%	16.5%
MOJ	£4,305	£1,257	29.2%	£317	7.4%	36.6%	£4,915	£1,341	27.3%	£188	3.8%	31.1%
NDA	£1,625	£11	0.7%	£401	24.7%	25.4%	£1,696	£15	0.9%	£470	27.7%	28.6%
OTHER (5)				£18						£0		
Total	£49,438	£5,210	10.5%	£5,933	12.0%	22.5%	£52,192	£5,490	10.5%	£6,901	13.2%	23.7%

4 Procurement at MOD, available at <https://www.gov.uk/government/organisations/ministry-of-defence/about/procurement>

5 Central Government spend with SMEs 2017 to 2018, available at <https://www.gov.uk/government/publications/central-government-spend-with-smes-2017-to-2018>

The MOD has the lowest direct SME procurement spend (as a percentage of its overall procurement budget) than any other government department, except the Nuclear Decommissioning Agency (NDA procurement spend is 12 times smaller than MOD). In terms of absolute procurement spend, MOD has the biggest total procurement spend (direct and indirect) with SMEs but is outspent on direct procurement SME spend by the Department for Transport (£11.6bn direct procurement spend) and the Ministry of Justice (£4.9bn direct procurement spend).

Although MOD procurement is qualitatively different to that of other departments by its very nature, there is clearly real progress that still needs to be made if the MOD wishes to reach its goal of spending one in every four pounds with SMEs by 2022. This short report explores some of the areas and practices that need to change to help increase SME procurement spend, and the overall health of supply chains.

The landscape of MOD procurement and nature of its work means that large sums of spend are distributed through relatively few Prime contractors, meaning a heavily reliance on indirect spend and the publication of subcontracting opportunities for SMEs.

In 2018 the top ten suppliers to MOD by spend were:⁶

1. BAE systems
2. Babcock
3. Airbus
4. Rolls-Royce
5. Lockheed Martin
6. Leonardo
7. QinetiQ
8. DXC Technology
9. General Dynamics
10. Thales

The majority of MOD procurement spend goes through the top five suppliers (although sizeable amounts still go through other top ten), with BAE and its subsidiaries being the largest MOD supplier. Due to the nature of some MOD contracts this is not in itself surprising, although more can be done to disaggregate some contracts to improve direct SME spend with MOD.

The current situation shows the importance of supply chain practice of these contractors and better understanding the barriers faced by SMEs in relation to the sub-contracting opportunities offered by these PRIME contractors.

Arguably better understanding these complicated and difficult supply chain relationships will itself help boost indirect spend with SMEs; it is likely that indirect spend is higher than figures officially show.

The following chapters will look at each of these in consideration.

⁶ Finance & Economics Annual Bulletin, Trade Industry & Contracts 2018, MOD, available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/761434/Finance_and_economics_annual_statistical_bulletin_trade_industry_and_contracts_December_2018.pdf p9

ACCREDITATION AND VETTING

Over recent years, acquiring the required accreditation and vetting to work on MOD related contracts has become more and more common as a prerequisite for bidding for government contracts. The benefit of this is that it gives the buyer a level of assurance about the contractor's ability and suitability to deliver on a contract. Although these accreditation requirements exist in most areas, they are particularly prevalent for MOD contracts.

For example, the vast majority of contracts advertised on Defence Contracts Online (DCO) require Cyber Essentials + (CE+) accreditation. The requirement for companies bidding for MOD contracts to be Cyber Essentials Accredited was introduced in January 2016 under the Cyber Securities Model. This requires all potential suppliers bidding for sensitive or personal information handling contracts to be accredited.

Cyber Essentials offers a range of benefits for all businesses, not just those involved in MOD contracts. However, many MOD contracts require further assurances beyond the standard CE+ system.

As with almost any professional level work, and especially those selling to government, there are a whole host of accreditations and requirements that businesses must achieve in order to sell.

Vetting is often the most complicated and can be the most costly process for small businesses to go through if they wish to work on MOD contracts. As it stands, there are currently three types of basic vetting a business can go through, before it can be even awarded any work with the MOD.

The three most common forms of security checks are:

- Counter Terrorist Check (CTC): is carried out if an individual is working in proximity to public figures, or requires unescorted access to certain military, civil, industrial or commercial establishments assessed to be at particular risk from terrorist attack.
- Security Check (SC): determines that a person's character and personal circumstances are such that they can be trusted to work in a position which involves long-term, frequent and uncontrolled access to SECRET assets.
- Developed Vetting: (DV) in addition to SC, this detailed check is appropriate when an individual has long term, frequent and uncontrolled access to 'Top Secret' information. There is also Enhanced DV.⁷

On top of this some MOD contracts require ListX accreditation, although this is rare. ListX accreditation is required for any commercial company seeking to hold government information that is classified as SECRET or above on its own premises. Although a business cannot apply to become ListX accredited (they are invited) the costs and processes in becoming so are substantial. This can include CCTV, boundary control, approved windows and doors, document safes and potentially a number of physical defences that are too numerous to list here. Again, although List X accreditation is rare, some SMEs are required to hold it for their current MOD contracts.

At the top end, these checks and changes can cost tens of thousands of pounds and can take years to complete. In 2017/18 government considered over 170,000 cases (including applications relating to civil servants, contractors and specialist staff) for vetting⁸ and in 2017-18, MOD (where the UK Security Vetting provider sits) recovered £8m through charging for its services and expects to make £8.2m through client fees in 2018-19.⁹

Although security is paramount, these changes can represent a major barrier to SMEs accessing procurement opportunities through the MOD or MOD supply chains, and can often be time consuming and expensive. Further, these are likely to deter some SMEs who are completely new to working with the MOD. Many of the businesses we interviewed for this report were ex-forces owned, and so were not as deterred by these requirements, but understand the impact this may have of a standard SME.

⁷ UK Security Vetting, 2018, available at <https://www.gov.uk/guidance/security-vetting-and-clearance>

⁸ Investigation into national security vetting, National Audit Office, 2018, available at <https://www.nao.org.uk/wp-content/uploads/2018/09/Investigation-into-national-security-vetting-Full-report.pdf>

⁹ Ibid 2.3

There is a real risk that because of the complex and burdensome accreditation requirements, MOD and other defence contractors may be missing out on vital and innovative products and services simply because the barriers to entry for accessing the MOD procurement 'market' are too high for many SMEs.

Although security is paramount, we believe that more can be done to reduce the perception of these requirements as insurmountable barriers. Some prime MOD contractors, such as BAE actually support some SMEs to navigate this complex and costly system. This is an example of good supply chain practice.

Security vetting with BAE Systems

"Security and safety are paramount to our work, however we recognise that some SMEs struggle with the financial outlay and have difficulty navigating the complicated system of checks, security and vetting. BAE Systems has, on a number of occasions, offered support by way of advice and expertise to help SMEs in our supply chain ensure that they meet and where possible exceed these requirements".

Recommendation

FSB would like Central Government to create a small access fund to help SMEs meet extra security and accreditation requirements that are required. This can be introduced as a grant for those smaller businesses likely to be bidding for MOD contracts. The fund should be supported by access to expertise from MoD.

Capacity-building within SMEs will lead to more small businesses able and bidding for work, which will improve competition and quality of the work delivered for the taxpayer.

This would also be teamed with expertise from MOD to assess and make recommendations depending on the security level and works required.

FRAMEWORKS

Frameworks are often one of the most commonly used mechanisms by which Government departments issue contracts to SMEs and other large suppliers. Frameworks set out the general terms by which goods and services can be purchased, without the need for a full EU procurement process each and every time.

Frameworks across government are governed by a set of regulations laid out in the 2015 Public Contract Regulations (PCR) which set out particular rules and operating standards, the defence sector also has the 2011 Defence and Security Public Contracts Regulations (DSPCR). Some of these are:

- (a) For every contract to be awarded, contracting authorities shall consult in writing the economic operators capable of performing the contract;*
- (b) contracting authorities shall fix a time limit which is sufficiently long to allow tenders for each specific contract to be submitted, taking into account factors such as the complexity of the subject-matter of the contract and the time needed to send in tenders;*
- (c) Tenders shall be submitted in writing, and their content shall not be opened until the stipulated time limit for reply has expired;*
- (d) Contracting authorities shall award each contract to the tenderer that has submitted the best tender on the basis of the award criteria set out in the procurement documents for the framework agreement.¹⁰*

These are some of the requirements laid out in legislation, however the principles of procurement policy apply throughout framework agreements, such as transparency, fairness and equality of treatment. Although Framework agreements have their flaws, such as being closed to entries during its running, they are at least subject to some oversight and regulation. FSB believes that the use of Dynamic Purchasing Systems (DPS) where appropriate are a better mechanism for facilitating smaller business engagement with procurement opportunities, as a successful smaller business can be added to the system at any time during the life of the DPS, and are not required to fill out complicated tenders and pre-qualification questionnaires (PQQs).

In addition, small businesses who do not initially meet the requirements to join the DPS can review their processes, finances and capability, and reapply to the DPS at a later stage. In contrast a framework would lock them out of the opportunity for four (or seven) years.

Some areas of MOD are already using DPS, such as DSTL's R-Cloud, which provides a quick and transparent means for SMEs to access contracting opportunities with DSTL across a number of areas. SMEs are invited to join the R-Cloud at any time and express interest in any one or all of the listed DSTL capabilities. FSB support the use of these types of mechanisms, and would encourage their use wider.

However there are instances where contracting opportunities have been delivered via purchasing structures that seemingly require even less oversight than traditional frameworks.

In 2017 the MOD (DE&S) issued a Prior Information Notice (PIN) seeking an engineering delivery partner that would be able to deliver a wider range of products and services currently procured through existing commercial routes.

¹⁰ Public Contracts Regulation 2015 Part 2 Chapter 2, S44 R33 (11), available at <http://www.legislation.gov.uk/uksi/2015/102/regulation/33/made>

“EDP is a Category A project which will meet the future requirements of DE&S and wider MOD for Engineering Technical Support Services. The requirement will be for a wide range of Engineering products and services, varying in complexity and criticality and will cover the full scope of technical services currently provided through existing Commercial routes and also additional services and support which may be required in the future.”¹¹

Effectively, this PIN seeks to establish an engineering partnership which will be responsible for delivering a wide range of equipment and services that may normally be procured through commercial routes i.e. frameworks or DPS's.

The estimated value of the contract at PIN stage was £2.5bn over four years, with the option to extend the agreement up to ten years.¹² The potential lifespan of this partnership (up to ten years) means that SMEs may be locked out of contracts issued through this partnership for ten years, as opposed to seven if this were a normal framework (Seven years under the Defence and Security Public Contracts Regulations 2011(DSPCR)¹³ – normally this would be four years).

In October 2018 this contract was awarded to the Aurora Engineering Partnership, a consortium of three large MOD contractors, including QinetiQ, Atkins (member of SNC-Lavalin Group) and BMT.

Paul Edwards P&S Automation

Since the inception we have been part of the FATS framework (currently FATS5), where we have routinely won contracts to provide Instrumentation, Control and Automation Systems for Marine and Land Based Industries under the framework agreement for a number of years.

Without any prior information from MOD, I was sent a PQQ from the Aurora EDP asking for all sorts of information, which included a commercial section which would require JOSCAR accreditation (ran by Hellios) at a cost to us of £575 +VAT.

In the end we decided not to go for the Aurora Engineering Partnership as we didn't have enough information and didn't want to go through the arduous process of getting on it. We were also happy and busy supplying the MOD under the FATS 5 framework, so didn't really feel the need.

However we were later informed that our contract would be taken out of the FATS framework and reissued via the Aurora EDP – something which we had little information or knowledge about prior. By this time it was too late to get on the Aurora EDP.

There are a number of issues at play here. Clearly SMEs may be unfamiliar with mechanisms such as the EDP and reluctant to engage with an arduous process. However the central issue is that a contract, was removed from a framework agreement and reissued via the EDP, which the smaller business has been locked out of for potentially up to ten years.

¹¹ MOD PIN available at <https://ted.europa.eu/TED/notice/udl?uri=TED:NOTICE:443904-2017:TEXT:EN:HTML>

¹² Contract notice <https://ted.europa.eu/udl?uri=TED:NOTICE:497168-2017:TEXT:EN:HTML>

¹³ 20, (10) The Defence and Security Public Contract Regulations 2011 <http://www.legislation.gov.uk/uksi/2011/1848/made>

Case study 2 Anonymous

The PQQ submission required to get on to the Aurora Engineering Partnership was extensive and time-consuming which required a pan-company input and therefore cost the company a significant amount in resource. In addition to the time required for preparing our PQQ submission, the portal (Curtis Fitch portal) required an extensive amount of time to be devoted to actually uploading and submitting our response, which in itself was nearly an entire working days' worth of time for the employees concerned.

The PQQ submission was comprised of several 'parts'. Part 1 required us to submit a 250 word case study to support each of the category codes we were applying for (there were over 300 category codes in total). It was possible to group category codes together if a single case study proved relevant to all of them, however this was incredibly difficult to determine given the lack of information we received regarding the category code descriptions. As a result, our Part 1 submission totalled more than 40 pages alone.

There were several instances where bidders would request further clarification on the content contained within the PQQ guidance document and would receive a response simply directing them to "refer to the PQQ guidance document" and on several occasions the response was "no response". In relation to the list of category codes, there were several requests for further information/definition however the response was that "there are no issued definitions by Aurora".

Eventually we were told we had failed in 3 areas to get onto the EDP, but given zero feedback as to why.

Arguably the above again suggests a lack of openness and transparency on the part of the EDP. Our observations are on the inherent structure of the EDP rather than how it has been implemented, however the creation of the EDP does not suggest that, in this instance, MOD is willing to engage directly with SMEs, but rather at a distance, working through its prime contractors.

Although previous frameworks were not necessarily 'easy' to navigate, they complied with the level of transparency and principles of procurement required by the DSPCR 2011 / PCR 2015.

The new mechanism for delivering these contracts (Aurora EDP), does not seem, prima facie, to have the same level of transparency normally expected of public procurement. For example, our research (case studies and public information) suggests that little constructive feedback is given on failed bids and there is a lack of a clear structure of the bidding, awarding and joining processes.

Indeed, if a small business wished to explore becoming part of the Aurora's network of providers, the only publically advertised route is to email a general address run by one of the three companies comprising the EDP.

MOD has already committed to improving SME access to opportunities via its MOD SME Action Plan published in March 2019. In the plan the MOD commits to "opening supply chains to a wider range of suppliers, and advertising sub-contracting opportunities through the Defence Contracts Online supplier portal".¹⁴

MOD also commits to requiring suppliers of contracts over £5m per year to advertise subcontracting opportunities via the Defence Contracts Online portal (DCO) when refreshing their supply chains.¹⁵ Although FSB welcomes this move, we would also urge MOD to seriously consider the scale and use of frameworks and EDPs, which our evidence suggests inhibit smaller business engagement in procurement opportunities.

¹⁴ MOD SME Action Plan 2019, available at <https://www.gov.uk/government/publications/mod-small-and-medium-sized-enterprise-action-plan-2019-2022> page 11

¹⁵ Ibid p 13

Although this report highlights the Aurora EDP, it is unlikely that this is the only instance where large businesses have been asked to run a government framework on behalf of the government.

More traditional frameworks are not necessarily always the answer, however they have two key benefits over practices such as EDP's: a) they are more transparent and accessible given they are subject to the PCR / DSPCR and; b) they add more measures to avoid potential conflicts of interest as decisions are typically made by the central contracting authority (i.e. MOD/DSTL) rather than those running the EDP who could also be hypothetically bidding for the work.

Our research suggests the most small business friendly mechanism is that of Dynamic Purchasing Systems.

DPS's are not new, but first gained "legitimacy" through the PCR. DPS's are seen as being more SME friendly than the traditional framework agreements for a number of different reasons, but mainly because:

1. New suppliers can apply to join the DPS at any time
2. New suppliers who meet the basic criteria must be added to the DPS – provided that they are not tied up by exclusion clauses
3. The amount of time taken to be accepted to a DPS may not exceed 15 working days, with the normal length closer to 10 working days
4. There is no limit to the number of suppliers on the DPS

Again, DPS are not new to the MOD who have already had some success with the use of R-Cloud. We would thoroughly encourage MOD to explore its use in other areas to help SMEs engage directly with MOD, rather than via a complicated and opaque system, that gives little impression of direct engagement between SMEs and MOD.

Recommendation

FSB believes, on the basis of the qualitative research that has been undertaken, that purchasing systems such as the Aurora EDP are the least effective and transparent way of spending public money, improving spend and engagement with SMEs.

MOD must take steps to open up accessibility and transparency of EDPs. This should include publishing a formal process to join the EDP, feedback on all failed applications, and publishing the bidding structure within the EDP.

Ideally MOD should further explore the introduction of Dynamic Purchasing Systems (DPS) where appropriate to do so, and continue using Framework Agreements where not.

The maximum limit of seven years should be applied to the Aurora EDP, and not extended to cover a further 10 years without substantial changes to the EDP.

PROMPT PAYMENT

Poor payment practices remains one of the top risks for many small business suppliers in both public and private supply chains.

Data from FSB research shows that a significant minority of businesses (17%) face payment terms longer than 60 days and that most small businesses (83%) have had to deal with payment made after the agreed date (late payments).¹⁶

Although late payment remains a serious issue for many small businesses across multiple sectors, the MOD has a good record of prompt payment. Data from the 2018/19 financial year shows that almost 100 per cent of invoices were paid within 30 days, and almost 95 per cent of invoices paid within five days.¹⁷

Financial Year 18/19	Percentage of invoices paid within 5 days	Percentage of invoices paid within 30 days	Total amount of liability to pay (from April 2019)
Q1	90.83%	99.99%	£65,000 interest paid
Q2	97.38%	99.98%	£114,000 interest paid
Q3	96.22%	99.99%	£104,000 interest paid
Q4	97.04%	100%	£132,000 interest paid

Part of the reason for the MOD's good prompt payment record is the introduction of a Contracting, Purchasing and Finance (CP&F) tool from December 2016. CP&F is an end to end eProcurement system spanning commercial, purchasing and financial accounting for MOD – the successful implementation of which has undoubtedly contributed towards MOD prompt payment performance.

CP&F has not been introduced without difficulty, however in 2017 businesses were left waiting months for payment after an IT upgrade were caused problems within the CP&F system.¹⁸

Overall however, MOD prompt payment remains very good with SMEs who contract directly with MOD being the biggest beneficiaries of their prompt payment practice.

Huw Griffiths – CEO Inzpire

Inzpire makes world-leading mission systems and delivers outstanding training and manages services to the military.

“As an Ex-RAF wing commander I have a long history of working within the military, but as a small business owner I’m incredibly proud to work directly with the MOD. We’ve work directly with the MOD providing mission systems and delivering training and managed services for well over a decade. It’s been challenging but thoroughly enjoyable to help make a difference to those still in service and the MOD.

We mainly work with DE&S, I’m proud to work directly for the MOD. They are excellent customers who generally always pay on time – if you can get the work. Unfortunately at times, it seems that it is far too easy and convenient for them to aggregate contracts, meaning SMEs are locked out and the work can only really realistically be competed for by the prime contractors.”

16 FSB Chain Reaction , 2018, page 52 available at <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/supply-chains-report-final.pdf?sfvrsn=0>

17 MOD Supplier Invoicing and Payment information, 2019 , available at <https://www.gov.uk/government/collections/ministry-of-defence-supplier-invoicing-and-payment-information>

18 Supply Management, CIPS, 2017, available at <https://www.cips.org/en-GB/supply-management/news/2017/february/millions-owed-to-mod-suppliers-after-it-problems/>

Although the MOD has remarkable payment practice, their direct spend with SMEs remains relatively low (4.1% / £835m).¹⁹ This highlights one of the key benefits of SMEs working directly with MOD, in that it is very unlikely that they will have any issue surrounding prompt payment. The same cannot necessarily be said however for SMEs in the supply chain.

In the table below, we taken the list of MOD strategic Suppliers identified in the MOD SME Action Plan, and analysed their payment performance from the duty to report data. We have, for each holding company named, included a range of their best and worst performing subsidiaries across each payment category. Although by no means a definitive demonstration of payment practices within each company, this does give a picture into payment practices across the board.

Name of Holding Company	Invoices paid within 30 days	Invoices paid within 60 days	Invoices paid later than 60 days	Invoices paid outside of agreed terms
BAE	51-86%	87-96%	4-13%	11-41%
Babcock	27-86%	78-98%	2-22%	6-54%
Airbus	4-49%	42-73%	27-58%	4-20%
Rolls-Royce ²⁰	5-12%	33-59%	41-67%	10-18%
Lockheed Martin	66-75%	95-99%	1-5%	23-25%
Leonardo	50%	85%	15%	47%
QinetiQ	52%	93%	7%	14%
DXC Technology (currently trading as CSC Computer Sciences Ltd)	17%	81%	19%	32%
General Dynamics	70%	93%	7%	58%
Thales	50-60%	78-97%	3-22%	13-50%
Leidos	76%	96%	4%	31%
Boeing ²¹	56-75%	73-90%	11-26%	21-27%
Serco	85%	96%	4%	16%
Capita	16-84%	74-96%	4-26%	9-33%
Ultra-Electronics	33%	72%	28%	77%
Raytheon	51%	93%	7%	20%
MBDA	4%	88%	12%	3%
KBR	42%	93%	7%	26%

The above data is from the Duty to Report information which requires large businesses to report their payment performance. Our sweep was conducted in June, the raw data can be access here <https://check-payment-practices.service.gov.uk/export>.

¹⁹ Central Government spend with SMEs 2017 to 2018, available at <https://www.gov.uk/government/publications/central-government-spend-with-smes-2017-to-2018>

²⁰ For Rolls-Royce we have not included the motor car subsidiary as it performs 5 times better than any other subsidiary and little involvement in defence contracting

²¹ Here we have only included Boeing Defence UK, as other subsidiaries relate directly to commercial aviation

As the table above shows, there is a very mixed picture when it comes to the performance of the top MOD contractors and their payment practices. Although none match the MOD for payment within 30 days, a number of leading contractors perform relatively well when we look at payment within the terms of the prompt payment code (payment within 60 days).

At present, only Lockheed Martin, Leidos and Serco currently meet the prompt payment target of 95 per cent of invoices paid within 60 days. This means that fifteen of the eighteen MOD strategic suppliers have at least one subsidiary in breach of the Prompt Payment Code.

Case Study

We submitted our invoice for almost £30,000 to one of the major primes, following some work we had been doing and completed in July that year. Our standard terms for payment were 30 days end of the month which are pretty normal, but I was still chasing for the invoice to be paid up until September. It wasn't until late on in September that I had a phone call from someone in their procurement team saying that I wouldn't be paid until late October as they were sorting out their half year results and weren't doing any more pay runs until then. What makes it worse is that they said I could be paid tomorrow if I agreed to knock about £1,000 off my invoice. Eventually I got paid most of the money in the October run, but still had to wait another month (November) for a remaining amount of about £4,000.

Some major defence contractors however have far worse payment performance, with Rolls-Royce and their subsidiaries paying anywhere from 41 to 67 per cent of invoices later than 60 days, and Airbus subsidiaries 27 to 58 per cent. Although the figures for the MOD's payment performance do not include disputed invoices, there is little reason to see why these major companies cannot pay their suppliers within a reasonable time, especially considering that they themselves (where they are working direct with MOD) are likely to be paid within 5 days.

In 2018 Cabinet Minister Oliver Dowden announced that from autumn 2019 if government contractors are late with supplier payment, they could stop winning public contracts altogether.²² Given that nature of the work carried out by some of these MOD contractors, we understand it is more difficult to ban suppliers from bidding for contracts with the MOD altogether. However it is essential MOD should take steps (as outlined in the Action Plan) to encourage prompt payment, such as exclusion from non-vital contracts.

MOD also has a number of non-competitive defence contracts which due to the nature of their work fall under a different set of regulations compared to competitive tenders. The Defence Reform Act 2014²³ sets out these regulations which are designed to help ensure value for money and quality in contracts where only one source (company) can reasonably be expected to fulfil the contract. In these situations, it would be unreasonable for MOD to exclude a supplier on the basis of payment performance as the contract falls under the Single Source Regulations.²⁴

FSB believes that, other than exclusion (which is the preferred option where applicable), there are two main ways of encouraging and enforcing prompt payment within supply chains.

Firstly, where a major contractor is failing to meet the Prompt Payment Code MOD can implement the use of Project Bank Accounts for future contracts with that contractor. Project Bank Accounts are more commonly used in construction projects, they ensure that money due to suppliers is correctly ring fenced and buyers are not incentivised to hold on to their supplier payments.

Secondly, payment performance and engagement could be taken into consideration during the bidding process. This would mean that a company with poor payment performance would score less well than a rival bid from a company with a considerably better payment performance. This was

²² Crack down on suppliers who don't pay on time, Cabinet Office, Oliver Dowden, 2018 available at <https://www.gov.uk/government/news/crack-down-on-suppliers-who-dont-pay-on-time>

²³ Defence Reform Act 2014, available at <https://www.legislation.gov.uk/ukpga/2014/20/part/2>

²⁴ Single Source Regulations Office, <https://www.gov.uk/government/organisations/single-source-regulations-office/about>

emphasised during conversations with some of the MOD's key suppliers who felt frustrated that bids were often assessed 50 per cent on quality and 50 per cent on price. Because bids often secured full or similar marks for the quality of the work, this creates a de-facto price off. Using SME engagement and payment performance would give another key differentiator for businesses during the bidding process. Using this type of metric during the bidding process also helps improve UK Prosperity, as it encourages good supply chain practice and helps encourage greater utilisation of SMEs into government supply chains.

Recommendation

Those businesses working directly with MOD typically receive payment within 5 (95 per cent of the time) or within 30 days (99.99 per cent of the time), however SMEs working in the supply chain are often paid late or outside of the prompt payment code (which sets an outside limit of payment within 60 days, but working towards a maximum payment term within 30 days). Where businesses are found to be in serious breach of the prompt payment code but still of strategic importance, any future awards to that businesses should have to involve the use of project bank accounts for all awards above £5m (in line with the construction sector).

Payment performance should also be taken into consideration during the bidding stage (explored more in the weighting chapter), with poor payers excluded from non-vital contracts.

The MOD has already committed in its Action Plan to champion prompt payment, expecting all major suppliers to comply with the prompt payment code (some strategic suppliers were recently suspended from the code²⁵) and may exclude suppliers which cannot demonstrate fair, effective and responsible approach to supply chain payment.²⁶

²⁵ CICM, 17 businesses removed or suspended from Prompt Payment Code for failing to pay their suppliers on time <https://www.cicm.com/quarterly-update-17-businesses-removed-suspended-prompt-payment-code-failing-pay-suppliers-time/>

²⁶ MOD SME Action Plan, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/793101/20190405_SME_Action_Plan_2019.pdf page 13

ENGAGEMENT WITH SMEs

Creating an environment where SMEs want to engage, and feel that it is worth their time to do so, is incredibly important for the MOD, the taxpayer and SMEs alike. However all too often direct contracting opportunities and sub-contracting opportunities are tied up with paperwork and aggregated to such an extent that SMEs simply feel that they cannot, despite their efforts, get close to winning.

One key boundary to SME engagement is the aggregation of services in a contract. This is where multiple services and products are aggregated into one contract rather than several, on the presumption that it saves the taxpayer money. In reality, the opposite is true, as it often narrows down potential suppliers to a limited number who then subcontract various parts of these contracts anyway – costing the taxpayer more in the long run. Further, SMEs are normally designed to focus on one or two products / services, meaning that although they may be highly qualified to deliver 33 per cent of the contract, they cannot compete because their business is not designed or capable of carrying out the remaining 66 per cent of the contract.

The desire to aggregate services is highly detrimental to fostering good relationships with SMEs nor does it save money, however disaggregation does require more resource at a contracts management level. This is something that has been mentioned both in conversations with SMEs and larger MOD contractors, as it also helps the management of currently running contracts.

MOD has already seen increased levels of SME engagement where it has disaggregated contracts to make them more accessible to SMEs. As mentioned earlier in the report, the MOD Action Plan highlights the Army Commercial team for breaking down the tender for Tranche One of the Army Apprenticeship Programme so that it was more attractive to SMEs. After generating a significant amount of SME interest, five out of the eight lots went to SMEs.²⁷

Recommendation

FSB would welcome more centrally funded resource for contract management capability across Government departments, but particularly MOD. This would be with a view to improving the standard of contract management within departments, but also to encourage and facilitate disaggregation of contracts, helping SMEs to engage and provide their specialist services.

FSB recognises Government has been promoting the disaggregation agenda for some time and that building an effective ‘integrator’ capacity within Government is work still in progress but that we need to see an acceleration in activity

Another key barrier to SME engagement is the advertisement and openness of some MOD procurement opportunities. Under current rules (frameworks and EDP’s aside) most defence contracts are advertised via the Defence Contracts Online portal. However because of the nature of some MOD procurements, this is not possible, nor are subcontracting opportunities widely advertised, despite existing legal requirements. Defence Contracts Online, although important, has its limitations.

Where this is the case, more imaginative methods of engagement need to be pursued to find the right SMEs for the work.

One such method is the DSTL new initiative called SME Searchlight, which aims to attract SMEs to help deliver between a £40 and £45 million increase in DSTL spending with SMEs.²⁸ This involves hosting a series of workshops, events and consultations over a year focused on four key areas (Radio frequency engineering, AI, synthetic biology and war gaming).

These types of events are particularly useful, as it allows SMEs who are not perhaps well versed in the world of MOD procurement an opportunity to showcase themselves, and it allows DSTL to see a wide range of SMEs without exposing sensitive details of contract opportunities.

²⁷ Ibid page 8

²⁸ DSTL Launches ‘SME Searchlight’ to harness innovation, 2019 available at <https://www.gov.uk/government/news/defence-science-and-technology-laboratory-launches-sme-searchlight-to-harness-innovation>

Similar schemes have been run by the private sector, such as open call invitations, whereby businesses in certain sectors are invited to display their services and products, without being told what it is the buyer is explicitly looking for. This again allows the buyer to investigate new products and potential SMEs, without compromising the sensitive nature of their work.

Ultimately, programs such as Searchlight hold an advantage over open calls, as they allow SMEs to engage physically rather than through online portals. This helps increase engagement between SMEs who are new to the defence sector and the buyer, as it also lowers the barriers and technical understanding sometimes needed just to navigate the online procurement systems.

Mark Swabey, Risk Reasoning

“We previously tried to get involved with the MOD back in the early 2000’s, but the attitude back then was one of disinterest. We kept getting told “you’re too small for us to deal with” which just put us off for quite some time. It’s only been in the last few years that the attitudes has completely changed. There now seems to be a real recognition of the value of SMEs, especially in innovation, at every level.

We got involved via the RLC (Royal Logistics Corps) who had some money left over at the end of year and decided to pay for a selection of junior officers and NCO to look around them, find out what was wrong and propose ideas to improve the situation. The RLC got them together and asked if any mentors from the business world would be available. As part of a group of SME’s, we took the initiative, volunteered and offered to mentor these guys. They were given explanations about innovations and finding new solutions etc. and we explained what we did (as our SME backgrounds are in finding and developing innovative solutions). We provided help and guidance to show what could be done - which was often to look for the simple solution, not necessarily the High-Tech option.

The Colonels and General in charge were very pleased with our approach to debunking some of the myths around High-Tech, injecting practical suggestions, contacts and even industrial visits to show the junior officers and NCOs practical examples of SME products working in the real world.

The General assessing the proposals that were put forward as a result, by the NCO’s and officers, commented that almost every proposal was a no-brainer in their eyes. He approved the majority for immediate funding, approved further investigation for the other proposals, and has asked for this initiative to be repeated regularly with SME mentors, since it worked so well”.

Recommendation

The DSTL SME Searchlight programme should be evaluated within the next 18 months, with the appropriate lessons learnt and rolled out across different areas of the MOD

A longer term SME engagement programme focusing on core themes across the MOD should be put together and rolled out through a series number of workshops and events. This programme would be in part advised by major defence contractors (Primes) who may also benefit from setting the core themes and exposure to new to industry SMEs. This should also consider how MOD can help boost early market engagement with SMEs when specifications are still open to some adjustment.

UK PROSPERITY & SOCIAL VALUE

Among the UK defence sector, there is a live discourse on achieving UK prosperity. Essentially this can be defined as the impact the defence sector has on life in the UK, not just its ability to produce a product or service, but its role within the community, supporting SMEs and jobs. Weighting is the relevance given to various aspects during the bidding stage which help determine the winner of any bid. For example, a contract may be awarded on the basis of 50 per cent cost and 50 per cent quality of service. At present, very little, if any, weighting is given to the value of UK prosperity.

A UK Prosperity Weighting would in effect place a weighting on contracts that take into account the impact awarding a contract would have on UK prosperity i.e. keeping the work physically in the UK and the impact this would have on wider communities, such as SMEs.

There are two key examples given in the Dunne report²⁹. Firstly the debate around the Type 31e frigate – classified as a Warship which will be built in the UK, and the Fleet Solid Support – a Royal Fleet Auxiliary vessel not classified as a warship and therefore not exempt from EU Procurement rules (meaning no restrictions on where it is built). Although both are open to international competition, only the Type 31e Frigate can be guaranteed to be built in the UK, and so likely to have a more beneficial impact on UK SMEs and social value in the UK more generally.

Although having equipment made and built in the UK can bring greater benefits to UK SMEs, FSB believes there are other ways of demonstrating UK prosperity without needing to change European rules and exemptions. Rather than focus on geographic location, the criteria around UK Prosperity should focus on strategic goals, such as the number of SMEs and their health in the supply chain; this also helps with MOD monitoring indirect spend with SMEs. Another key metric of UK prosperity could include the information from the duty to report data, helping to ensure a system of prompt payment across the supply chain.

Recommendation

Although FSB agrees that an emphasis and weighting should be put on UK prosperity, we would like to see payment performance and engagement of SMEs in the criteria defining UK prosperity. This should then be given a level of weighting when contract bids are being considered.

Any criteria should be explicitly clear, so that bidding businesses know exactly the practices and evidence needed to achieve high marks in this section of any bid.

²⁹ Growing Contribution of Defence to UK Prosperity , Philip Dunne MP, 2018, available at https://www.philipdunne.com/sites/www.philipdunne.com/files/attachments/Philip_Dunne_Defence.pdf

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