The defence procurement process and its vulnerabilities

July 2004

Output from the project 'Preventing Corruption in the Official Arms Trade' (PCOAT)

Introduction

Transparency International is working to reduce and prevent corruption in the official arms trade. In this endeavor we are working with governments, defence companies, TI national chapters around the world and other civil society representatives to develop and implement tools that strengthen anti-corruption measures in defence procurement. This work has been carried out as part of Phase 1 of the Preventing Corruption in the Official Arms Trade Project, January – July 2004, and TI gratefully acknowledges the input of Patrick Brown. Further documents can be found at: www.transparency.org.uk

The official arms trade specifically, and defence procurement more generally, is an important sector in which to achieve improvement: it is estimated to be responsible for more than 50% of all bribes paid worldwide, and its reform is an essential precursor to building a strong and stable society in many countries of the world.

The Generic Process

An essential underpinning for this work is a sound understanding of the defence procurement process and its main areas of vulnerability. There is a wide variety of procurement processes in use by purchasing governments around the world - some sophisticated, some bureaucratic and some almost non-existent – and as many forms of parliamentary or external oversight as there are countries. The detail of such defence procurement environments has been extensively documented by others, most notably by Ravi Singh at the Stockholm International Peace Research Institute, and is not entered into in this document. Rather, this document outlines a process that could be considered generic to defence procurement. It tends to have more steps than the simplest procurement processes, and may have more than are used for the smaller procurements: but we believe that most defence procurement professionals will recognize their own national process within this one.

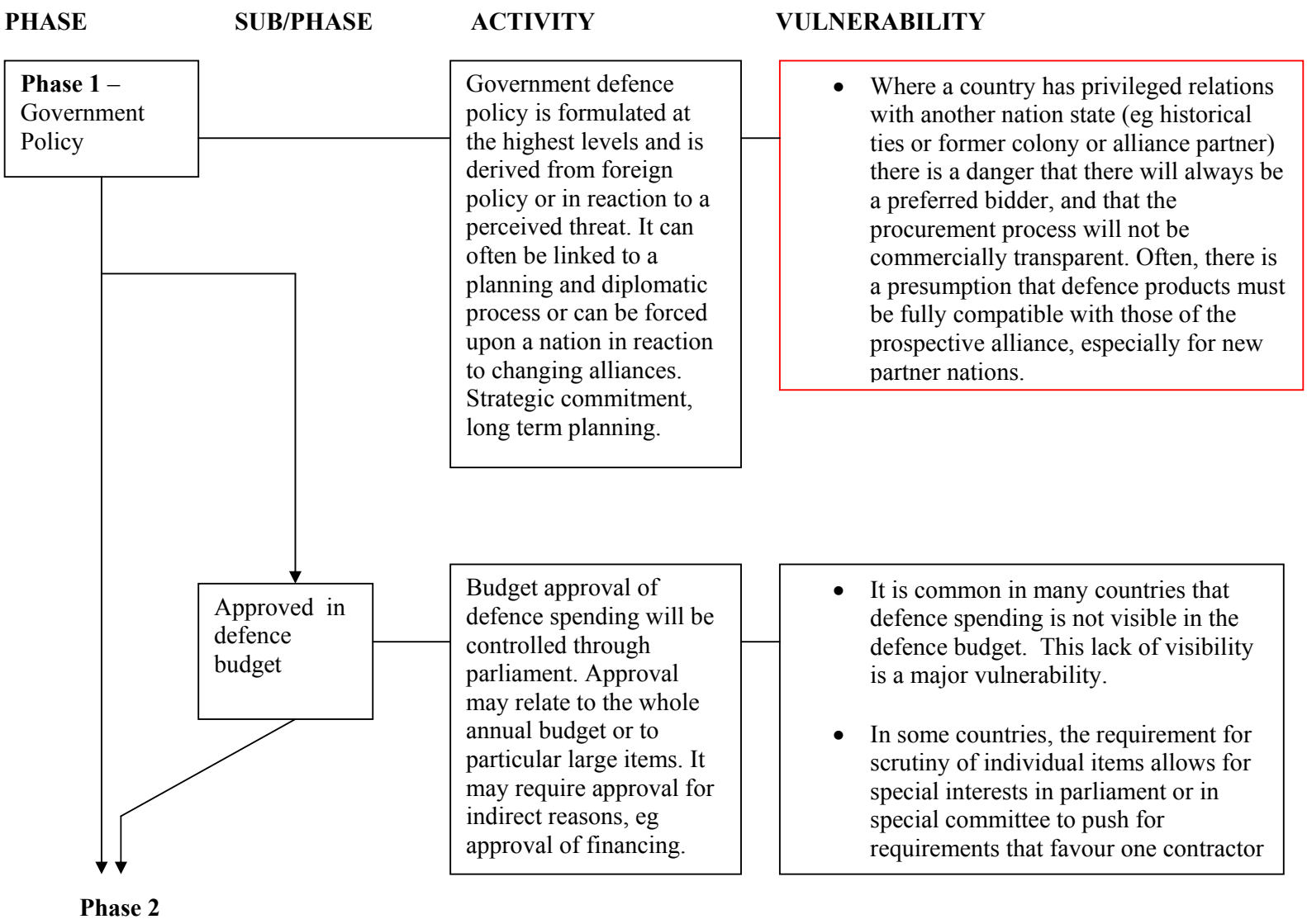
Ten phases have been defined and descriptive terminology used in order that a simple model can be followed. Within several of the main phases are quite substantial pieces of work, which may be distinct sub-phases. There can be cycles between the various phases in the light of output from later phases e.g. the output from Phase 5 (Project Costing) might require new work in Phase 3 (Requirement Definition) in the event that the preferred technical solution is not affordable.

All the phases and sub-phases will involve, to a greater or lesser extent, depending upon the resources of the Government concerned, research and input from a variety of departments and agencies. This aspect is not shown here in any detail.

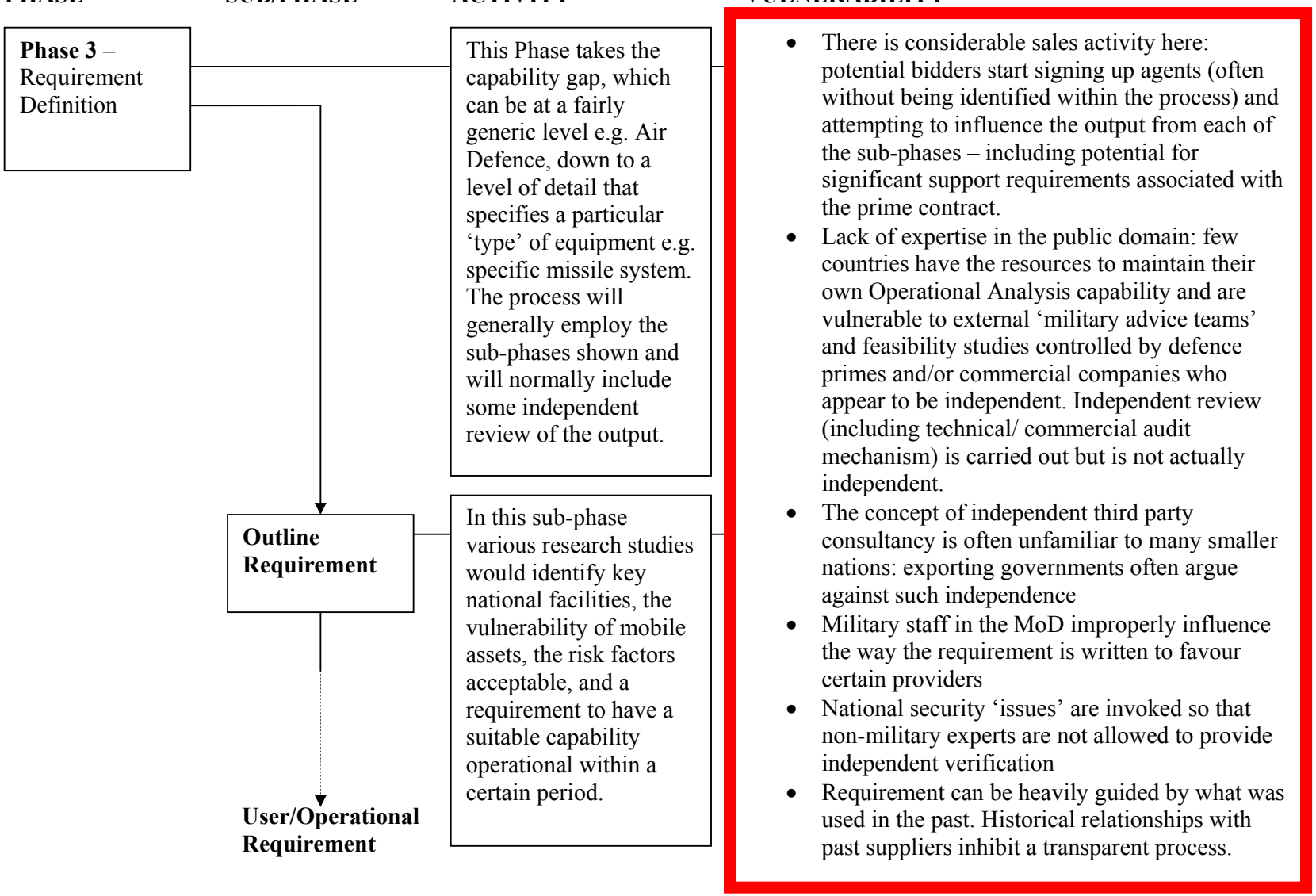
Format of the process flow

The diagrams on the following pages show the steps in the generic procurement process down the left side, describe the activities at each step in the middle of the page, and then describe the vulnerabilities that are present at that step, and the way in which the step may be vulnerable to manipulation.

Some vulnerabilities occur at several places in the process. We have tried not to duplicate them, but leave them where they first arise.


PHASE
SUB/PHASE
ACTIVITY
VULNERABILITY
Phase 1 – Government Policy
Government defence policy is formulated at the highest levels and is derived from foreign policy or in reaction to a perceived threat. It can often be linked to a planning and diplomatic process or can be forced upon a nation in reaction to changing alliances. Strategic commitment, long term planning.
Where a country has privileged relations with another nation state (eg historical ties or former colony or alliance partner) there is a danger that there will always be a preferred bidder, and that the procurement process will not be commercially transparent. Often, there is a presumption that defence products must be fully compatible with those of the prospective alliance, especially for new partner nations.
Approved in defence budget
Budget approval of defence spending will be controlled through parliament. Approval may relate to the whole annual budget or to particular large items. It may require approval for indirect reasons, eg approval of financing.
It is common in many countries that defence spending is not visible in the defence budget. This lack of visibility is a major vulnerability.
In some countries, the requirement for scrutiny of individual items allows for special interests in parliament or in special committee to push for requirements that favour one contractor
Phase 2

PHASE	SUB/PHASE	ACTIVITY	VULNERABILITY
Phase 2 - Capability Gap Definition		The identification of a gap in capability is derived from Phase 1 and is very much at a strategic or corporate level. An example might be an acknowledgement that there is a requirement for specialist forces/units to counter terrorist activity or the need for a modern Air Defence system. Defining the capability gap is subject to considerable pressure and lobbying, both diplomatic and commercial, but is not often associated with *cash* corruption as the arguments are normally of an intellectual rather than specific solution nature.	• Where there appears to be no driving policy, then intense activity by political, diplomatic and/ or commercial interests, especially those with a 'unique' or perceived unique product, can attempt to influence the capability gap definition. • It is here that 'aid packages' and other inducements start being mentioned (eg Malaysia).
			• Government sponsored 'military advice teams' conducting review of third party military defence policy and requirements can be self-serving. Reviews may be slanted in favour of the donor nation's defence sector.
Phase 3			


PHASE
SUB/PHASE
ACTIVITY
VULNERABILITY
Phase 3 – Requirement Definition
This Phase takes the capability gap, which can be at a fairly generic level e.g. Air Defence, down to a level of detail that specifies a particular 'type' of equipment e.g. specific missile system. The process will generally employ the sub-phases shown and will normally include some independent review of the output.
Outline Requirement
In this sub-phase various research studies would identify key national facilities, the vulnerability of mobile assets, the risk factors acceptable, and a requirement to have a suitable capability operational within a certain period.
User/Operational Requirement
• There is considerable sales activity here: potential bidders start signing up agents (often without being identified within the process) and attempting to influence the output from each of the sub-phases – including potential for significant support requirements associated with the prime contract.
• Lack of expertise in the public domain: few countries have the resources to maintain their own Operational Analysis capability and are vulnerable to external 'military advice teams' and feasibility studies controlled by defence primes and/or commercial companies who appear to be independent. Independent review (including technical/ commercial audit mechanism) is carried out but is not actually independent.
• The concept of independent third party consultancy is often unfamiliar to many smaller nations: exporting governments often argue against such independence
• Military staff in the MoD improperly influence the way the requirement is written to favour certain providers
• National security 'issues' are invoked so that non-military experts are not allowed to provide independent verification
• Requirement can be heavily guided by what was used in the past. Historical relationships with past suppliers inhibit a transparent process.

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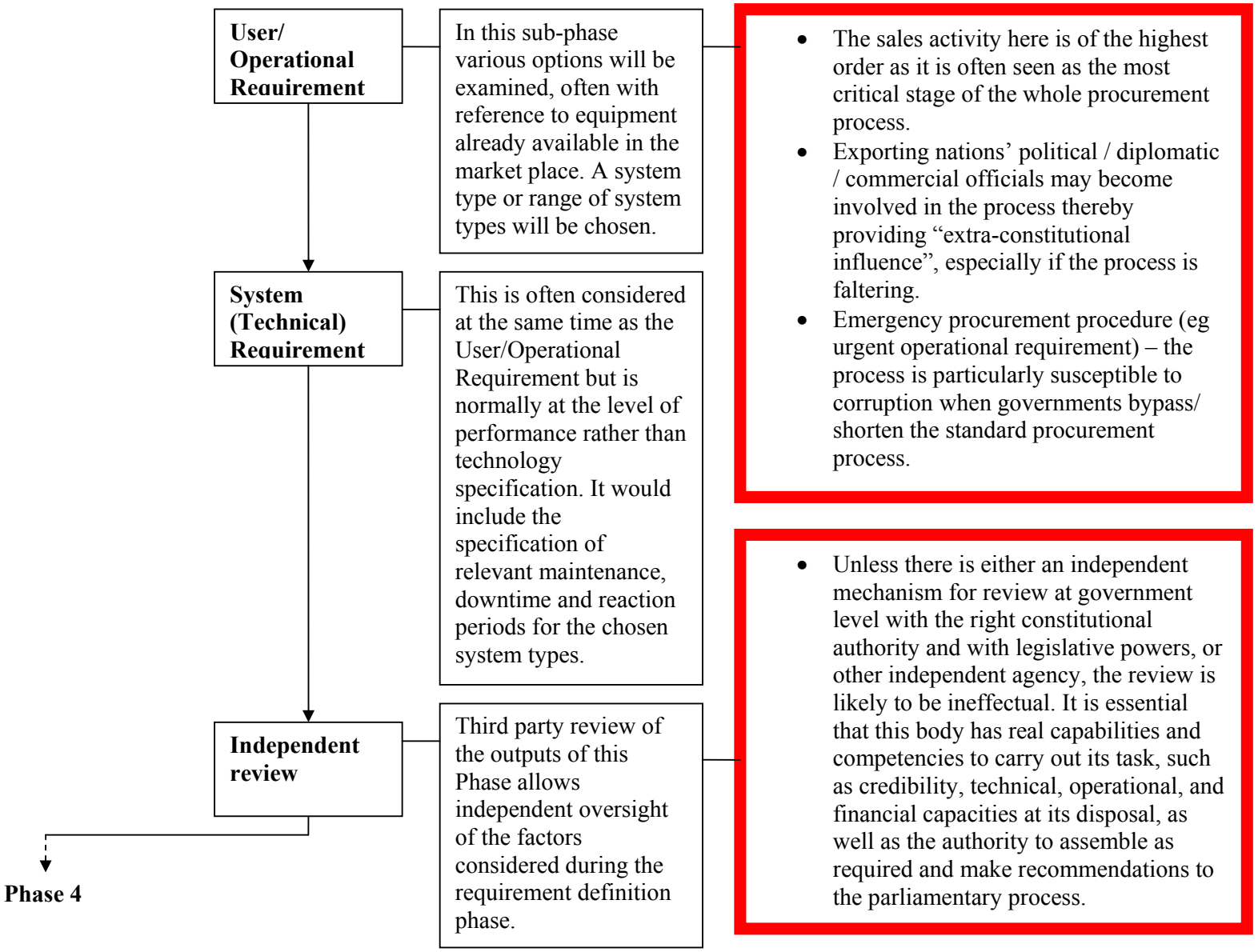

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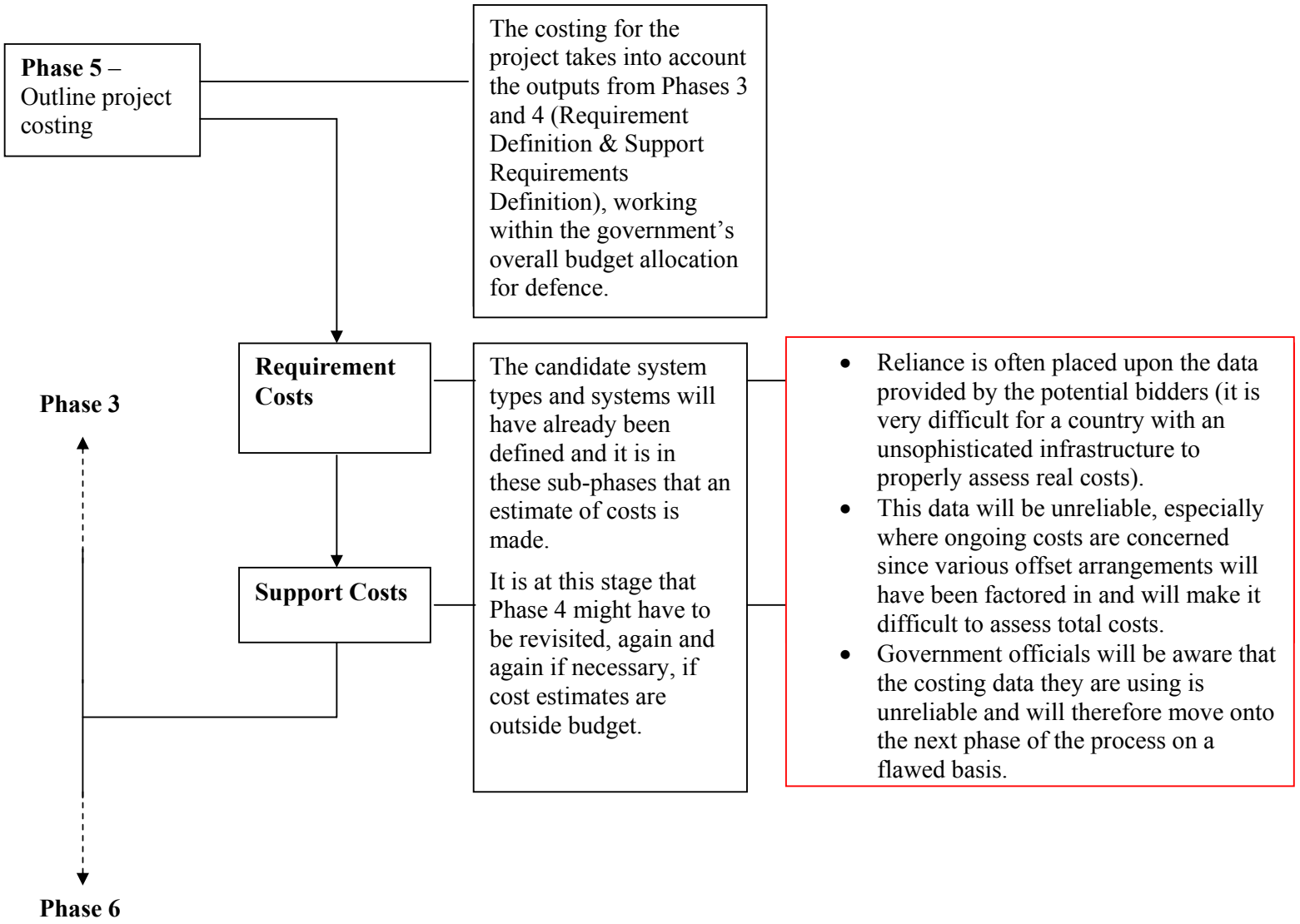
Phase 4 - Support Requirements Definition		This phase is concerned with the identification of the support needs including infrastructure, training, maintenance, spare parts and other through life cycle costs.	• The support requirements will constitute a considerable part of the procurement, and possibly be even more costly and complex than the systems themselves. • However the various potential bidders will downplay the ongoing costs whilst forging alliances with local companies for licensing agreements and infrastructure construction. • Secondary contracts generally occur in this phase, and are sometimes loosely worded. Their scrutiny is less rigorous than of the prime contractor, and the contracts are often not in the public domain. • At this stage, a range of offsets and industrial participation arrangements will be discussed (see "offsets" below).

Phase 5

PHASE **SUB/PHASE** **ACTIVITY** **VULNERABILITY**



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Phase 6 – Tender		This phase will be the culmination of much research by the purchasing government and considerable representation by potential bidders.	• The government may restrict certain bidders for historical, political, diplomatic but not necessarily commercial reasons. • Some 'Primes' will be reticent about the actual work planned to be undertaken by their sub-contractors, especially local ones. • Similarly, the consortium or group may well contain a cluster of local organisations whose name is well known but whose exact contextual purpose is unclear. • Single-source procurement is a major vulnerability. This process flaw is assuming that the contract is tendered.
	Tender list	An assessment is made of the range of 'interested' contractors and consortia as to whether they are competent to conduct the work. The encouragement or discouragement of Prime contractors will be considered, but in reality the use of 'Primes' is standard practice.	
	Invitation To Tender (ITT)	Selected contractors will be invited to bid for all or part of the work; the terms and conditions issued might include the requirements for technology transfer, offsets and licencing. Similarly, the assessment criteria should be clearly detailed.	• The Tender document is absolutely critical and there will have been much pressure to write it in such a way that only one 'already favoured' player can be successful. • In some cases with a small number of bidders, it may be common practice that the bidders collude to choose the winner, and that the losing companies are compensated by the eventual winners.
Phase 7			

PHASE	SUB/PHASE	ACTIVITY	VULNERABILITY
Phase 7 - Bid Assessment & Contract Award	**Technical Evaluation**	The assessment criteria will have been agreed in advance, and indeed the companies bidding may well have been formally informed of the details. Bidders might be asked to clarify parts of their proposal.	• The evaluation criteria are open to manipulation, and can be fashioned to favour a particular company or product eg by combining the technical and economic evaluation into one phase. • Manipulation would be harder if information relating to competitors, political or technical preferences of decision-makers, or financial offers received were kept confidential, while information relating to findings of trials and evaluations, negotiations, scale and scope of potential contract were selectively released.

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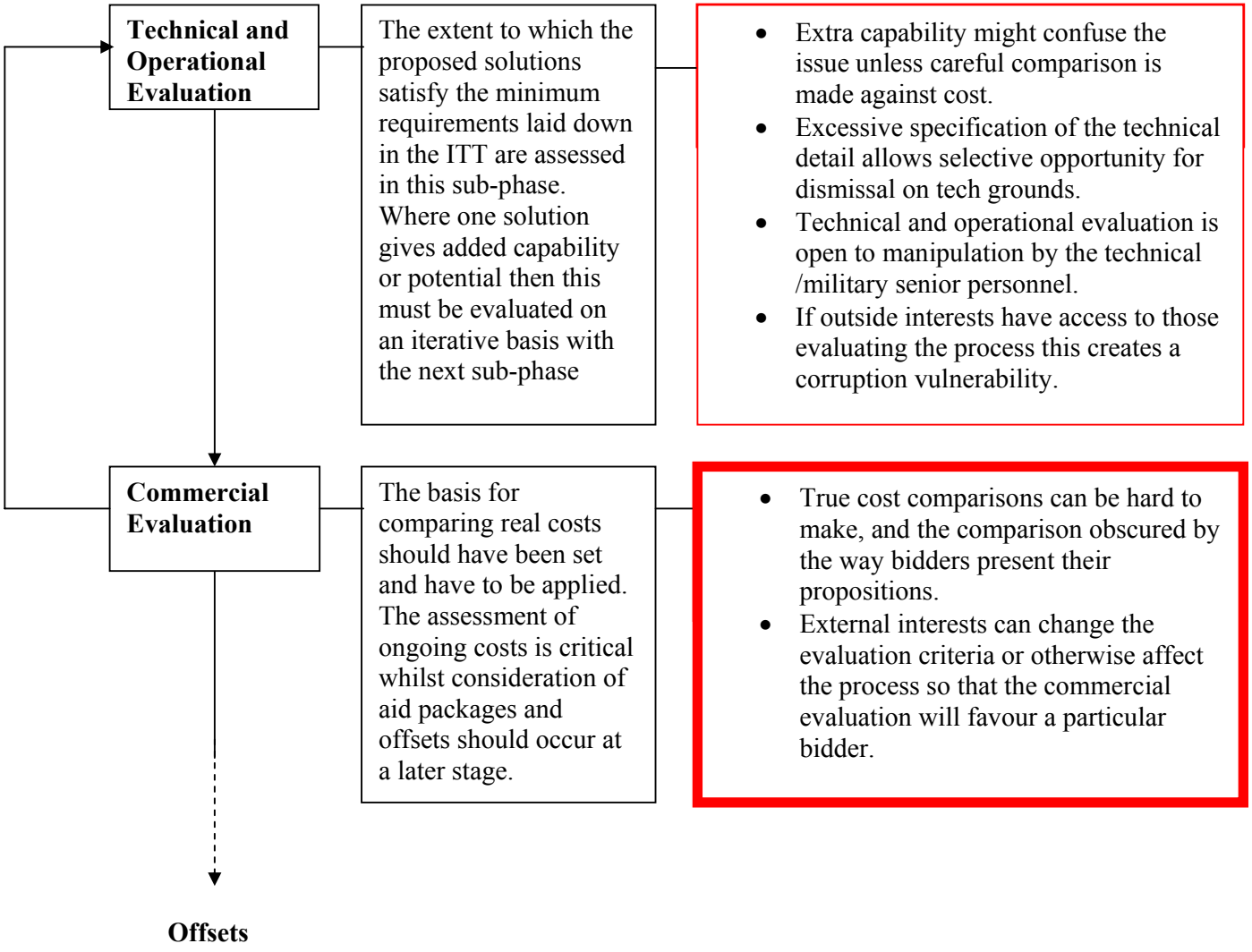

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	Offsets	Offsets, counter-trade, licencing agreements et al will be an integral part of each bid.	• A 'solution' that satisfies neither the technical nor commercial evaluation criteria might be adopted. • Offsets feed into another avenue of political decision-making.
	Aid Packages	Aid packages will coincidentally be offered. Alternatively, expected aid packages might be threatened if a certain bidder is not selected.	• As above, this will taint and devalue the whole assessment process and a 'solution' that satisfies neither the technical nor commercial evaluation criteria might be adopted.
	Contract Award	Contract negotiations can be prolonged and the output might bear little resemblance to the original bid. Similarly, the actual contractual paperwork might be written to favour the contractor.	• At this stage the successful contractor may try to ensure that the contractual environment is so benign that he will be in complete control. • The contract terms specified in the tender document are at risk of differing from those agreed at the award stage and of not reflecting the actual technical agreement reached, while the Ministry of Defence may lack the necessary specialist legal skills to oversee the process.
Delivery			

PHASE	SUB/PHASE	ACTIVITY	VULNERABILITY
Phase 8 – Manufacture and Delivery		This phase is reliant upon Project & Contract Management by both the government and the contractor.	• Governments are generally not good at controlling contracts especially when the contractors have huge teams of legal and project experts on hand. • Similarly, where senior people have been captured by contractors then it can be very difficult for officials to impose any contractual controls. • Contractor initiated variation orders will start appearing at regular intervals.
Phase 9 In-service phase			• Extending contract to call-off contract. • Enabling contracts are often employed with vague and ambiguous specifications. • Government initiated variation orders, and practice by contractors to vary contract considerably beyond recognition. • Contractors may have greater expertise than government staff (unless the government hire external consultants).

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Phase 10 - Disposal		This phase is not normally considered in most international defence contracts, indeed it is only relatively recently that the UK has identified disposal as a part of the procurement process. It is not uncommon for governments to donate old equipment to further their foreign policy. Sometimes these are accompanied by support contracts.	