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Final Report

Evaluation of the Industrial and Regional Benefits Policy

Volume I: Evaluation Findings

Prepared for:

Industry Canada

Prepared by:

Hickling Corporation

January 19, 1999
HAL Ref: 6721

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Regional Benefits Policy**

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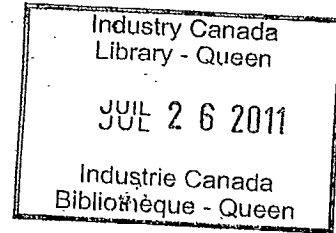
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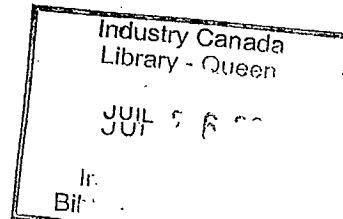
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1. Introduction

1.1 *Background*

The Industrial and Regional Benefits (IRB) Policy, as approved by Cabinet in May, 1986, provided the framework for using federal procurement as a lever to promote industrial and regional development objectives. The Policy established long-term, high quality industrial and regional development as a primary objective for major federal procurements.

Since that time, there have been numerous important changes on the international and domestic scene that have affected the scope and process of implementing the Policy. Major trading blocs have been forming at the same time as trade liberalization is being sought. Internally in Canada, the Agreement on Internal Trade (AIT) is having an increasing influence on federal procurement. Defence procurement, the major area for application of the Policy, has been decreasing. The transfer of government services to the private sector is further limiting opportunities for applying the Policy. Resource constraints are affecting the roles of Industry Canada and the Regional Agencies in the implementation process.

These changes, and others, have had an impact on the effectiveness of using federal procurements to achieve industrial and regional development. The Auditor General commented on the IRB Policy in 1992 and 1993 and noted that an evaluation of the Policy had not been done. In a 1992 OAG review, the Auditor General suggested that Industry Canada take measures to improve strategic planning, provide decision-makers with an adequate assessment of benefits and costs associated with industrial development initiatives, and improve information reporting on IRBs to Parliament.

In response to the OAG, an Evaluation Framework for the Industrial and Regional Benefits (IRB) Policy was completed in March, 1995. The evaluation issues identified in the Framework were reviewed in early 1997 by an informal working group from Industry Canada and the Regional Agencies. Following this review, the issues and the selected evaluation options were revised to include a fuller examination of the continuing relevance of the IRB Policy and the linkage of the evaluation to the AIT.

1.2 Evaluation Approach

The IRB Policy evaluation was guided by an IRB Steering Committee and an IRB Advisory Committee (representation on these committees is given in Appendix A). The evaluation was conducted in two phases based on the Evaluation Framework as revised. Phase I reviewed the rationale, objectives, and objectives achievement of the IRB Policy. The approach in this phase was to broadly investigate the benefits of the IRB Policy across the population of Major Crown Projects (MCPs) and Procurement Review Cases (PRCs) (procurement categories are defined in Chapter 2) by conducting mini-studies. The Phase I report was a stand-alone report suitable as a basis for the federal review of the IRB Policy in compliance with the AIT¹.

Phase II focused on the remaining evaluation issues of process efficiency and effectiveness. The approach in this second phase was to conduct case studies of a number of MCPs and PRCs. The following list indicates how the evaluation issues (as identified in the Evaluation Framework and set out in Appendix B) were divided between the two phases. The division is one of emphasis only and the issues of Phase II were kept in mind during the data collection tasks of Phase I.

Phase I (Objectives Achievement)

Policy Rationale

1. Public Interest
2. Legal Mandate
3. Appropriate Role

Policy Objectives

4. Strategic Goals
5. Barriers

Policy Impacts and Effects

6. Actual Impacts and Effects
7. Incremental Benefits and Costs
8. Longer-Term Benefits and Costs

1 The AIT requires the federal government to conduct a review...no later than January 1, 1998 to ensure that (the IRB Policy) meets (its) regional and economic objectives.

Phase II (Process)*Policy Impacts and Effects (process components)*

9. Competing Interests
10. Industry Participants
11. How Does IRB Work
12. Monitoring and Verification
13. Mechanisms Regarding Incrementality
14. Accountability
15. Early Involvement

The data for Phases I and II was collected by means of extensive document review, interviews, case studies and economic analysis. Details on the use of these methodologies are contained in the separate reports on Phase I and Phase II (interim) in Appendices D and E respectively. The findings are presented in Chapter 3 according to the three themes of Rationale, Objectives Achievement, and Process.

1.3 Structure of the Report

This final report on the IRB Policy encompasses the findings and conclusions of the earlier reports on the IRB Policy Description (September 15, 1997), Phase I: Objectives Achievement (January 30, 1998), and Preliminary Findings, Phase II: IRB Process (May 27, 1998). The report is organized as follows:

Chapter	Content
1	Introduction
2	IRB Policy and Application
3	Evaluation Findings
4	Study Conclusions and Recommendations

2. IRB Policy and Application

2.1 *Introduction*

In mid 1997, a comprehensive description of the IRB Policy, its implementation, the domestic and global trade environment and the procurement preference policies in selected countries was developed in consultation with the IRB Advisory Committee and approved by the IRB Steering Committee in June, 1997. The full IRB Policy Description paper is attached as Appendix C; a short summary follows.

2.2 *IRB Policy Description*

Rationale for 1986 IRB Policy

Reviews of IRB practices in 1985 concluded that an opportunity existed to improve the effectiveness of the IB programming through more selective application of the tool and the introduction of measures designed to maximize procurement leverage. These measures included long-term planning, establishment of an approach more sympathetic to private sector objectives, and improved coordination with other federal industrial development programs.

A major reorientation of IB programming appeared to offer the best prospect of improving the effectiveness of procurement as a means of promoting long-run industrial/regional development. Operationally, this was to be achieved by negotiating industrial commitments with potential contractors within the framework of their long-term business plans, and emphasizing projects characterized by investment, world product mandates or strong export potential, import substitution, technology transfer or development, and long-run supplier relationships. In this vein, volume guidelines would be abandoned and offset purchase would be de-emphasized.

IRB Policy Directions

The new approach of the IRB Policy put in place in 1986 provided that:

- ▶ Long-term industrial and regional development be adopted as the primary industrial benefit objective to be achieved through public procurement programming on the understanding that special provision may be necessary for developing regional economies and the defence industrial base;
- ▶ Future industrial benefit programming focus on achieving benefits of lasting value, and de-emphasize short-term job creation;
- ▶ Offset maximization objectives generally be abandoned and offset activity be limited to those cases which have the potential of offering significant economic benefit;
- ▶ Where difficult economic circumstances exist in a particular region, every effort be made to maximize benefits flowing to that area from large procurements;
- ▶ Where required, the effectiveness of industrial benefits programming be enhanced through the use of complementary expenditure¹ programming to realize procurement-related investment opportunities (where such expenditures are consistent with our GATT (WTO) commitments);
- ▶ Emphasis be placed on developing Canadian sources through research and development support to assist Canadian firms in prepositioning themselves to bid on major federal projects;
- ▶ Domestic sourcing requirements considered essential to national security by the Minister of National Defence (e.g. repair and overhaul requirements) be included directly in the statement of requirement of key defence purchases; and,
- ▶ All future industrial benefits assessments include a detailed analysis of any broader implications of competing industrial benefits proposals (e.g. their conformity with Canada's international trade obligations and trade development objectives, international relations, national security, etc.).

These policy directions have driven the IRB process since that time.

1 While identified in the IRB Policy framework of 1986, complementary expenditures from program mechanisms such as the Defence Industry Productivity Program (DIPP) were never used to support the development of IRB related activities or strategies.

Benefits of the IRB Policy

As defined in the IRB Manual (January 1995), the specific benefits of the Policy are to include but not be limited to:

- ▶ Canadian content
- ▶ Technology transfers;
- ▶ Joint ventures and strategic alliances;
- ▶ Product mandates, licences, marketing agreements;
- ▶ Regional and small business development;
- ▶ Licencing arrangements; and
- ▶ Access to new international markets.

Additionally, it was expected that Canadian industrial capabilities would be brought to the attention of prime contractors, whether Canadian or foreign, for the purpose of the procurement and to encourage the development of ongoing business relationships and new business ventures in Canada.

2.3 Application of IRB Policy

IRB Policy Coverage

The IRB Policy is applied to procurement opportunities valued at greater than \$2 million which are not subject to NAFTA or GATT (WTO). Sectors excluded from these agreements include defence, shipbuilding, telecommunications, transportation, space, health and culture. In the last few years, most procurements subject to the Policy have been in the defence sector.

Potential IRBs are identified and managed through a process known as *procurement review*. Procurement review is conducted by one of two committees, depending on the nature of the candidate procurement. For Major Crown Projects (MCPs), and for all project-managed procurements valued at \$100M or more, procurement review is conducted by a Senior Project Advisory Committee (SPAC). For all other procurements over \$2M, procurement review is conducted by the Procurement Strategy Committee (PSC).

SPACs: For all procurements defined as MCPs (usually over \$100 million, but sometimes less if the related project risk is considered by Treasury Board to be relatively high), and for all non-MCP project-managed procurements over \$100M, Senior Project

Advisory Committees (SPACs) are established in accordance with Treasury Board's policy and management guidelines for procurement review and project management.

PSCs: All other procurements over \$2M, including non-project-managed procurements over \$100M, are submitted by operating departments to the Procurement Strategy Committee that screens them for socio-economic development (IRB) potential.

Outline of IRB Process

IRB Strategy

The initial step in the IRB process is the identification of a procurement opportunity with significant size and lead time that provides a lever for industrial and regional development. Once the operational and technical requirements, and the proposed procurement strategy are developed, then an IRB strategy is prepared.

For MCPs and non-MCP project-managed procurements over \$100M, Industry Canada, in cooperation with the regional agencies, develops an IRB strategy that identifies opportunities to promote both strategic sectoral and regional development objectives. In the case of an MCP, Cabinet may direct that a particular objective is to be incorporated as one of the IRB and/or procurement strategy objectives.

Procurement strategies for cases that require review by the PSC are developed jointly with PWGSC and the operating departments. In its consideration of these cases, the PSC examines the socio-economic development (IRB) potential of their procurement strategies. When the PSC determines that such potential exists, usually for cases of strategic value or size, it requests that more detailed review take place with a view to incorporating formal IRB programs into the procurement strategy.

IRB Proposal Evaluation

Under the competitive process, bids are evaluated on a best overall value for money basis which includes consideration of the technical merit, risk, cost and schedule. The IRB package is evaluated separately on a qualitative basis, e.g., Excellent, Acceptable, Unacceptable. The winning bidder does not necessarily have to present the best IRB package. Approval to proceed into contract for MCPs is sought from the Treasury Board. For PRCs, approval of the IRB bid packages is obtained from the PSC but Treasury Board will often have to approve as well depending on the sponsoring department's contracting authorities.

Monitoring and Enforcement of IRBs

The winning bidder's IRB proposal forms the contractual basis for the IRBs. Once agreed to, IRB commitments are embodied within the procurement contract and become legally enforceable obligations of the prime contractor, usually stipulated by means of a withholding of payment clause or payment of liquidated damages based on non-achievement of IRB commitments. Generally, the prime contractor flows-down the IRB commitments to its major sub-contractors.

Industry Canada, the Regional Agencies and PWGSC are collectively responsible for monitoring the contract to ensure that contractors are delivering the IRB commitments. Industry Canada has the operational responsibility for the audit and verification process.

3. Evaluation Findings

3.1 Introduction

The evaluation issues from the Evaluation Framework for the IRB Policy (see Appendix B) have been grouped under three themes: Rationale, Objectives Achievement and Process. The Framework included a fourth theme, Value for Money, whose evaluation issues have been covered by the Objectives Achievement theme.

3.2 Theme 1: Rationale

Issue 1: Public Interest

In general, the IRB Policy is seen to operate in the public interest because it supports industrial activity in Canada that might otherwise go offshore. This has been the case particularly where an offshore prime has had to satisfy IRB requirements by establishing a Canadian capability and establishing a Canadian supplier network. The public has benefited through the direct creation of jobs and the export business generated by these new or expanded contractors and suppliers. The advocacy role of the Regional Agencies in the selection of subcontractors has led to many of these jobs occurring in the regions.

The Policy has a low level of public visibility so the public is often not aware of the Policy's benefits. Similarly, through a lack of publicity, subcontractors often do not appreciate that the source of their work may be an IRB.

Issue 2: Legal Mandate

The IRB Policy helps to fulfil the mandates of Industry Canada and the Regional Agencies. WD is unique among the Regional Agencies in that its Act has a specific reference to industrial and regional benefits giving the Minister responsibility for such benefits in the West. The present, relatively small share of total government procurement subject to the Policy has, however, reduced the opportunities for IRBs to contribute to the achievement of industrial and regional development objectives. The IRB Policy is not essential to these mandates but could be a strategic tool (see comments under Theme II: Process).

Issue 3: Appropriate Role

The IRB Policy is an appropriate role for the federal government in promoting and developing an industrial capability in Canada. In meeting its defence commitments, in particular, Canada has to import more than it exports, and using these procurements to strengthen the Canadian industrial base has always had wide support. In other sectors, such as transport and information technology, where Canadian industry has had the capabilities to meet procurement demands, it has been appropriate for the government to apply the Policy to add to the Canadian capacity through transfer technology or bringing new technology investments from abroad.

Australia, the Netherlands, Great Britain, and Norway, among others, have policies similar to the IRB Policy. The United States, on the contrary, is a major arms producer and a net exporter, and is not in favour of IRB policies, although it has other policies protecting domestic industries.

Our summary of other policies and practices found that Canada involves more agencies in the review process, includes the industrial development package as part of the contract rather than the more common practice of negotiating outside the contract, does not allow benefits to be banked whereas most other countries do, and includes civilian and defence procurements whereas many other countries include only defence.

If there were no IRB Policy, the industrial and regional benefits from procurements would be handled on a case by case basis. There would continue to be political pressure to seek Canadian content in procurements and, in the absence of a systematic review process, the imposition of IRB-like requirements would create a heavier administrative burden. It would also likely impede the effectiveness of the regional advocacy of potential subcontractors. The IRB Policy simplifies the process and gives a voice to all interested parties in government.

3.3 Theme II: Objectives Achievement

Issue 4: Strategic Goals

The broad goals of the Policy have been supported by the IRB strategies supporting MCPs and PRCs with IRB requirements. The strategies consider the particular opportunities offered by individual procurements and propose the objectives to be achieved in the contract, usually in fairly general terms related to Canadian content, regional distribution and small business development. Special initiatives are specified for some procurements,

such as technology transfer, alliances/joint ventures, market development, skills development, investments and R&D.

The degree of success in translating the IRB strategic goals into project objectives varies. In general, achievement of Canadian content has been excellent, resulting in the creation of high quality jobs. The Policy has allowed regional and small businesses to participate. While the absolute value of the work flowing to the regions was not found to be high, the benefits to the companies have been very important. Formal requirements for special initiatives such as technology transfer are rare - though there is evidence that such benefits occur as a matter of course.

MCPs tend to have more formal arrangements, more extensive requirements, and more structured reporting and monitoring of IRBs compared to PRCs. IRB strategic goals appear to be effectively translated into project objectives with the major exception of long term benefits. In the case of PRCs, the IRBs are primarily Canadian content and regional benefits. Recommendations for IRB goals from the Review Committee have not been translated effectively into project outcomes, being realized in only half of the PRC projects recommended for IRBs.

The major objective of the 1986 Policy is long term industrial and regional benefits. In this respect, the achievement of the Policy's objectives has not been clearly evident. While there have been some success stories, such as the continuing viability of the CDC plant in Calgary under the TCCCS project, in general companies have had difficulty in leveraging contracts into product and market development opportunities. This is not surprising given that the Policy is applied predominately to defence procurements. The narrow focus of procurements has been a barrier to achieving Policy objectives (see Issue 5).

Issue 5: Barriers

The state of the world defence industry, and the relative position of Canadian companies in that industry, limits the opportunity for substantial long-term economic impacts from the Policy. It is difficult for Canadian companies, and especially small businesses, to sustain a capability in this sector because the market in Canada is limited and access to foreign defence markets is often protected and highly competitive. Furthermore, the Canadian industry is made up of niche players which again limits potential market opportunities unless a long-term supplier relationship with a foreign prime has been established. The difficulty in commercializing defence technologies is another barrier.

The IRB Policy has created new suppliers in the regions with fully acceptable performance. The wide distribution of suppliers in some projects has, however, worked against the companies and the sector itself from capturing the synergistic benefits of a clustering

approach. Porter¹ and others have pointed to the advantages to the growth of firms in high technology of close geographic proximity to others in allied fields because of a common skill base leading to people mobility, availability of risk financing and joint marketing possibilities. There is, on the other hand, some evidence that the seeding of new regional developments, for example the CDC plant in Calgary, has led to the formation of new industrial clusters.

Issue 6: Actual Impacts and Effects

The impacts of the IRB Policy are subtle and complex. As for so many economic policies, the benefits created by the IRB Policy in one part of the economy can create inequities for other parts. How and when to implement the Policy becomes a juggling act between doing the most good and the least harm. Since the impacts are difficult to measure and slow to react, choosing the correct course has not been easy.

Impact on the Economy

The economic impacts of the Policy consist mostly of increasing the Canadian content of work which otherwise would have been done offshore. There is little evidence of this work being leveraged into significant business development opportunities.

The Policy has been applied primarily to large defence procurements. There are few opportunities to apply it elsewhere because of trade agreements and the characteristics that a project needs to achieve IRBs. The privatization of NavCan has further reduced these opportunities.

The Policy has been successful in increasing the visibility of companies in the western and eastern regions. The benefits of this are large compared to the relatively small value of the work that flows to these regions. The Policy has, however, not always received appropriate credit for this visibility because firms are sometimes not aware that their subcontracts have come about as a result of the Policy.

We have observed that the Policy has not been a particularly successful mechanism for promoting small business development beyond the firms in the regions.

Use of Input-Output Model

¹ Porter, M., *the Competitive Advantage of Nations*, London, Macmillan, 1990.

In order to assess the impact of the Policy, Statistics Canada's Open Interprovincial Input-Output Model was applied to the achievements and incremental achievements for the MCPs and PRCs over the 1988 to 1997 period.

Figure 3-1 shows the impact on GDP and employment. It should be noted that the Input-Output Model estimates GDP to be less than the achievements due to leakages in the economy. These leakages include foreign imports, interprovincial imports, and inventories and other commercial leakages. The Model estimates a leakage of about 34% of the Canadian Content.

The Model estimates that employment results from the GDP impact at a rate of about one person-year for every \$82,600. It should be noted that these employment figures do not necessarily imply the creation of new jobs.

Table 3-1: Summary of Input/Output Analysis

	MCP	PRC	Total
Achievement			
Canadian Content	\$3,500,000,000	\$981,000,000	\$4,481,000,000
Impact on GDP	\$2,313,000,000	\$648,000,000	\$2,961,000,000
Person-Years Employment	27,985	7,844	35,829
Incremental			
Canadian Content	\$2,494,000,000	\$618,000,000	\$3,112,000,000
Impact on GDP	\$1,575,000,000	\$390,000,000	\$1,965,000,000
Person-Years Employment	20,688	5,127	25,815

Impact on Trade

The Policy is inconsistent with the trend towards more liberalized domestic and international trade policies and the scope for applying the Policy may be reduced in the future. However, the Policy is currently similar to those of many other nations and will remain an important instrument until mutual reductions in defence procurement trade barriers can be negotiated. In terms of international trade, the Policy, and its foreign counter-parts, may be restricting the access of large, export-oriented Canadian companies to foreign markets.

Domestically, the Policy is not creating significant distortions in the distribution of federal contracts. Table 3-2 compares the distribution of the impact of the Policy as calculated by the Input-Output Model to the actual GDP distribution by region. The impact of the Policy on GDP is a reasonable reflection of the actual GDP distribution, indicating that the impact of the Policy has no significant regional bias.

One would not expect the Policy impact to mirror the actual GDP distribution since the economies of the regions have different economic foundations. For example, the economy of the West has a large resource component. Since the procurements affected by the Policy emphasize manufacturing, software, and electronics, the portion of the procurements which can be expected to be performed in the West will be less than the West's share of the national GDP.

Table 3-2: Distribution of Impact

	Policy Impact on GDP	Actual GDP
West	19.5%	32%
Ontario	40%	40%
Quebec	30%	22%
East	10.5%	6%

The lack of evident bias is also because 1) the Policy is applied to a small portion of the total value of government procurement, and 2) the regional benefits come more from the opportunity to participate than from the value of contracts which flow to the regions.

Issue 7: Incremental Benefits and Costs

Although the Policy has had positive tangible incremental benefits (see Issue 6), intangible costs may have resulted. While the Policy has typically been implemented in a manner which is supportive of sound business decisions, it is fundamentally a restrictive trade policy which may have produced long-term overall costs to the economy. Market inefficiencies may have led to lower productivity in some industries. For example, the movement of work to the regions may hurt established regional clusters in central Canada, making Canada as a whole less competitive. Whether this has actually happened, cannot be proved or disproved from the results of this study.

The evidence from industrial interviews is that the Policy has had a minimal impact on the cost of procurement where there is existing domestic capability. The costs may increase if

a domestic capability has had to be created such as occurred in the TCCCS and CAATS projects. In such cases, the short-term incremental costs have to be weighed against expected long-term returns from the investment.

The administrative costs to contractors of managing their IRBs are considered by the contractors to be small.

Issue 8: Longer-Term Benefits and Costs

Although the Policy has had positive short-term benefits, the achievement of the Policy objective to create long-term, sustainable impacts is not evident. While there have been some success stories, in general companies have been unsuccessful at leveraging contracts into opportunities for product and market development. This is not surprising given that the Policy is applied predominately to defence procurement and subject to the constraints of that market mentioned previously. Longer-term costs to the economy may be a factor as discussed in Issue 7.

3.4 Theme III: Process

Issue 9: Competing Interests

Typically, the IRB portion of a proposal is evaluated separately but along with the components of performance, price, and risk. The IRB component must be acceptable, but rarely is the IRB scoring rolled up with the other evaluated components. This means that all other competing interests are usually given priority over the IRB interests.

Issue 10: Industry Participants

Industry is generally supportive of the Policy. Small, regional companies tend to be the most supportive. Larger firms are less enthusiastic as they become more self-sufficient, even those which can credit their existence to the Policy or former versions of the Policy. We have already noted that, in many instances, firms under subcontract may not realize that their participation in a contract is the result of the IRB Policy.

*Issue 11: How Does IRB Work?***IRB Process in Theory**

The steps in the IRB process are described in the Phase II: Interim Report (Appendix E). These steps include IRB strategy development and approval, IRB criteria in the Request for Proposal (RFP), development of an IRB evaluation plan, bid evaluation and submission of recommendations to the Senior Project Advisory Committee (SPAC) and Treasury Board, contract phase and agreed IRB commitments, and monitoring and verification.

IRB Process in Practice

In general, the steps of the IRB process have been followed. Where the theory and practice have differed has been in the consistency of implementation of each step. Implementation of the IRB Policy has, for the most part, been left to the discretion of Project Officers. While this has provided a high degree of flexibility to react to particular circumstances, it has resulted in very inconsistent application across projects.

The degree and style with which the Policy has been applied seems to have depended primarily on the attitude of the individual officer. When officers have changed on a project, the application of the Policy has also changed dramatically. There seems to have been little formal direction from senior management concerning Policy implementation. There has been no documentation to guide either Project Officers or contractors.

*The MCP Process**IRB Strategy Development*

Industry Canada, in cooperation with the regional agencies, is responsible for developing an IRB strategy for each MCP that promotes both strategic sectoral and regional objectives. The strategies are to optimize the opportunities for obtaining Canadian benefits. Our review of these strategies indicates the strategies have usually been vaguely worded, permitting wide interpretation by industry of the kind of IRB package that would be acceptable. The strategies, sometimes, went no further than calling for a Canadian prime.

The intent has been to encourage bidders to propose specific IRBs that will support company business development strategies as well as meeting the wider government objectives for IRBs. The IRB strategy for ERYX was well defined but, in this case, IRB leverage was considered to be weak because the procurement was sole source, under a preferential price offer in cooperation with France.

On the other hand, in the case of the TCCCS project, the strategy was explicit in terms of stating the need for a Canadian prime contractor and that production of the radio element to take place in Canada. IRB strategies were not, in general, linked to sectoral strategies through, for example, a Sectoral Competitiveness Framework, that would have placed the procurement in the context of an approach to longer term industrial or regional development.

The regional agencies play an advocacy role in exposing bidders to companies in the regions which have the potential to be sub-contractors. Sub-contractors who would not otherwise have been identified have been included in procurement teams as a result of this regional approach. Dependence on advocacy alone may not, however, go far enough. One IRB manager believes a more structured, national approach is needed to address long term industrial development.

Contracting Phase

Industry is informed of the IRB objectives through the RFPs issued for the acquisition phase and, for some projects, the definition phase. The RFPs normally state, often in vague terms, the types of business activities that are eligible for consideration as IRBs and how the IRB packages in the bids will be evaluated. The basis for evaluation is the assessed quality of the IRBs, CCV and the risk of the commitments.

We found that, in practice, the RFPs varied in the level of detail provided to the bidders on IRB requirements. The TCCCS RFP was specific in its IRB requirements and in its discussion of the consequence of omissions. It stated that the IRB proposal would be an important factor in the bid evaluation and an unsatisfactory commitment of IRBs could result in the total bid being rejected. In the MCDV case, the IRB evaluation focused on the contractors' proposals in the absence of detailed requirements.

We are not sure how important the IRB evaluations were in the overall bid evaluations. IRBs are assigned a pass or fail grade and are not, we understand, normally in a position of overriding technical compliance and price. However, we had no access to evaluation results and could not confirm whether this was always the case. Negotiation of IRBs with the bidders was usually not possible. ERYX was an exception and further interactions with the prime produced higher quality benefits. A two phased procurement process such as occurred with MCDV has also allowed for interactions and modifications of IRB proposals.

We noted certain inconsistencies in the statements of IRB requirements in contracts such as the definitions of direct and indirect benefits, the definition of small business, the emphasis on long term and high quality benefits and on the levels of liquidated damages demanded. On liquidated damages, percentages vary, some RFPs providing minimums.

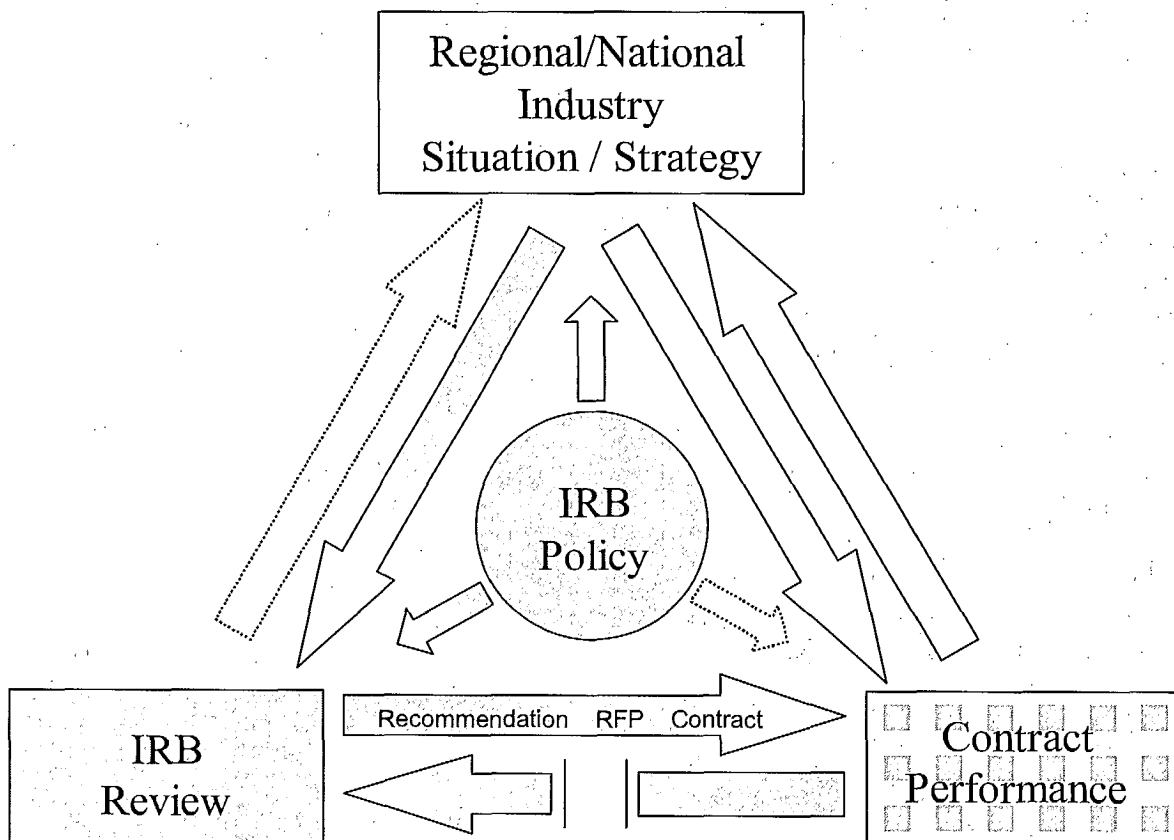
Mechanisms for applying damages also vary. The basis for calculating CCVs appeared changeable; in some projects, only incremental CCVs were included and well defined while in others, CCVs might be approximate, for example, in one project, estimates of CCV percentages were applied for each type of business transaction.

The PRC Process

IRB Strategy and Contracting Phases

The PRC process in practice follows theory closely as illustrated in Figure 3-1. There are three components to implementation of the Policy: i) The PSC's review of the IRB potential for each PRC, ii) the industrial situation, and the federal government's industrial strategy, which provides the context for the PRC decision, and iii) the contractor's performance of the terms and conditions set out in the contract. The portions of the process of concern in this evaluation are shaded; other portions of the process are not. Process components which do not exist in theory or practice are indicated by dashed lines.

Figure 3-1



There are, however, important and significant problems in the linkages between components that we have observed:

1. *Linkage between Industrial Situation/Strategy and PRC Review* - This linkage is weak. The PSC decisions appear often to be made in isolation, without an understanding of, or a long-term strategy for, the industry which will be impacted by a procurement.
2. *Linkage between the PSC Recommendation and the terms of the contract* - This linkage is weak. In the majority of cases, the recommendations of the PSC are not translated into contractual requirements. There are almost always valid reasons for this, however it is indicative of problems in the PRC review process.
3. *Linkage between the results of contract performance and the PRC review* - This linkage does not exist. A fundamental tenet of sound decision making is the importance of feedback from previous decisions. In the case of the PRC review, there is no feedback to the PSC committee on the results of PSC recommendations. The severity of the problem is indicated by the fact that there is no way to correlate PRC numbers with PWGSC contract numbers.

Issue 11: Monitoring and Verification

Reporting requirements tend to be standard across projects, that is, progress reports at quarterly, semi-annual and annual intervals, and certificates of compliance. However, how projects have been monitored has depended on the IRB manager, who is often faced with scarce resources. In general, the quality of monitoring has been poor, although this does not necessarily mean that companies are not meeting their obligations.

Liquidated damages are a part of many contracts. While the majority of companies exceed their obligations, penalties have not been imposed when IRB commitments are not met.

We consider a fundamental tenet of sound decision making to be feedback from previous decisions. However, there is a serious lack of feedback within the IRB system about aggregate project performance. This is most evident for PRCs where there is no feedback to the PSC on the results of PSC recommendations. The severity of the problem is indicated by the fact that there is no way to correlate PRC numbers with PWGSC contract numbers.

Issue 12: Mechanisms Regarding Incrementality

IRB strategies have been vaguely worded which has permitted wide interpretation by industry of the kind of IRB package that would be acceptable. Companies as a result have proposed IRBs that supported company business development and not IRBs linked to

industrial or sectoral strategies that would more likely have created incremental benefits.

Mechanisms best suited to ensuring that IRB commitments are incremental are those that require well defined IRB strategies for procurements and a flexibility in negotiating IRBs that probably needs a separation of the IRB component from the contractual components of price and compliance.

Issue 14: Accountability

Industry Canada is the lead authority for IRBs. The Department is responsible and accountable for the identification, negotiation and monitoring of IRBs, in consultation with the Regional Agencies who have a responsibility for guiding, promoting and coordinating industrial benefits in relation to the regional development and diversification of the Canadian economy.

The lack of resources in the last few years and the lack of attention given to the Policy by senior management have diminished Industry Canada's visibility inside and outside government as the key body for IRBs. The Regional Agencies have, on the other hand, continued to use the Policy as an important contributor to achieving their objectives. This contrast has caused some confusion in industry about leadership of and accountability for the Policy.

Issue 15: Early Involvement

Industry Canada was expected to have early involvement in procurements as an integral part of the IRB process. The 1986 IRB Policy statement (see Appendix C) provided that a Canadian Annual Procurement Strategy (CAPS) become the principal mechanism for bringing procurement related economic development opportunities to the early attention of Ministers and private industry. Due to unpredictable changes on the international scene and forced fiscal constraints that severely impacted Canada's defence budget and other departmental budgets, the Strategy failed to provide a reliable, strategic overview of the government's long-term procurement profile. The first CAPS was announced in 1988; the last CAPS document was submitted in 1989.

Industry Canada has, on occasion, been aware of potential MCPs in advance but normally has no lead time in developing an IRB strategy and consulting with industry.

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