

04 October 2012

Mr Michael Shoebridge
First Assistant Secretary Strategic Policy
Department of Defence
Russell Offices
Canberra ACT 2600

Dear Mr Shoebridge,

AUSTRALIAN BUSINESS DEFENCE INDUSTRY UNIT SUBMISSION TO DEFENCE WHITE PAPER

The Australian Business Defence Industry Unit (ABDIU) represents a wide range of Australian-based companies undertaking defence work in Australia. These companies are distributed across the country and extend from the major Prime Contractors to very small businesses comprising only a few personnel.

The development of a Defence White Paper represents an opportunity for a review and restatement of the importance to Australia's strategic planning and positioning of a robust, healthy indigenous industry sector.

On behalf of our diverse membership base the ABDIU makes the following submission to the Department of Defence for consideration in the development of the Defence White Paper 2013.

Should you wish to discuss any of the issues presented in this response please contact me at Graeme.dunk@australianbusiness.com.au or on (02) 6230 1137.

Yours sincerely



Graeme Dunk
Manager

Attachment: ABDIU letter to CCDG dated 18 September 2012

AUSTRALIAN BUSINESS DEFENCE INDUSTRY UNIT SUBMISSION TO DEFENCE WHITE PAPER

CURRENT SITUATION IN AUSTRALIAN DEFENCE INDUSTRY

The current situation with respect to Australian defence industry can best be described as challenging, and at worst bleak. These challenges arise from a variety of factors, some externally generated, some influenced by the actions of Government (including the manifestation of Government through the Department of Defence) and some from the structure of the local defence industry base itself.

The way in which Australia addresses these challenges will dictate the future health of the local defence industry, and by extension the overall capability of the Australian Defence Force.

Structural Issues

The current Australian defence industry environment could be described as somewhat unique among developed countries (apart from Belgium and New Zealand) in that there are no large locally-owned Defence companies, and certainly none that could be considered as a key international player. Rather, the Australian defence industry scene is dominated by overseas companies, and is increasingly being consolidated into a small number of key participants.

Australian-owned companies are invariably small, in niche technology areas, and increasingly finding it difficult to compete with the major overseas competitors. Anecdotally there seems to have been a reduction in the level of local innovation being supported by Defence and undertaken within indigenous defence companies.

The comments made in the United Kingdom Defence Industrial Strategy in 2005 that “If we do not make clear which industrial capabilities we need to have onshore (and this includes those maintained by foreign-owned defence companies), industry will make independent decisions and indigenous capability which is required to maintain our national security may disappear”¹ are equally pertinent to the Australian situation in 2012. The corollary to this statement is that a level of monitoring and, potentially, support of the specified capabilities is also required.

¹ *Defence Industrial Strategy*, presentation to UK Parliament by The Secretary of State for Defence, December 2005; page 6. Accessed online at http://www.mod.uk/NR/rdonlyres/F530ED6C-F80C-4F24-8438-0B587CC4BF4D/0/def_industrial_strategy_wp_cm6697.pdf on 07 September 2012.

Government and Departmental Issues

There are a number of Government-driven factors that play upon the viability and capability of the local defence industry sector, some of which were evident prior to the “new fiscal reality” as evidenced in the 2012 Defence Budget. These factors can be summarised as:

- Reducing risk appetite in capability procurement and an increasing preference for Military Off-The-Shelf (MOTS) and Commercial Off-The-Shelf (COTS) solutions;
- The publication of Defence planning information that is inadequate as a basis for subsequent industry planning and investment decisions;
- Engagement with a small number of Prime Contractors being the preferred contracting model, and with the expectation that these Primes will subsequently engage and foster small and medium Australian companies²;
- A focus on acquisition of equipment that comprises part of the Global Supply Chains of the major Prime Contractors. This preference appears to extend to the point that local capability is not seriously considered unless it has already been accepted into a Global Supply Chain.
- The reduction in programs where Australian companies can participate and thereby build indigenous capability. The cancellation of the Round 16 of the Capability Technology Demonstrator (CTD) program, and a recent significant reduction in the spend profile for Minor projects is evidence of this; and
- Improperly defined and utilised Priority Industry Capabilities (PICs) and Strategic Industry Capabilities (SICs).

The last point is of particular concern as Priority Industry Capabilities (PICs) have been defined in the 2009 Defence White Paper as being “those industry capabilities which would confer an essential strategic capability advantage by being resident within Australia, and which, if not available, would significantly undermine defence self-reliance and ADF operational capability.”³ This position was reinforced by the Minister for Defence Materiel, the Hon Jason Clare MP on 30 April 2012 when he stated that “The defence industry’s most important capabilities are our Priority Industry Capabilities.”⁴ The issue of PICs will be revisited later in this submission.

² See also Caruso, H., Falzon, K., McInnes, L. and Williams, C.; *Successful and profitable acquisition programs rely on an effective Defence Industry Policy: A review of the 2010 Defence Industry Policy Statement Building Defence Capability*; South Australian Defence Industry Leadership Program. Nov 2010; p.1 that stated “The Government’s approach to supplier management and contracting is explored and is found to be optimised for Primes, with an emphasis on Primes engaging SMEs.” Accessed online at <http://www.dtc.org.au/Documents/140.pdf> on 20 September 2012.

³ *Defending Australia in the Asia-Pacific Century: Force 2030*; Commonwealth of Australia; Canberra, 2009; paragraph 16.21.

⁴ Media Release - Minister for Defence Materiel – More than \$12 million investment in priority industry capabilities, 30 April 2012. Accessed online at <http://www.minister.defence.gov.au/2012/04/30/minister-for-defence-materiel-more-than-12-million-investment-in-priority-industry-capabilities/> 19 September 2012.

The current status of the local defence industry base, coupled with planning information upon which industry is loath to make investment decisions, means that the retention of the engineering skills required for the maintenance of Defence capability in the medium to long term appears increasingly problematic. The ABDIU recognises that efforts are being made in this area, as evidenced by the recent Skills Australia report on *Building Australia's Defence Supply Capabilities*, but these efforts will be less than successful without clear direction, planning and, where appropriate, support. The Skills Australia report noted that "The complexity of Defence procurement and ebbs and flows in procurement activity inhibit the ability of organisations in Defence to grow, attract and retain specialist skills."⁵

PROJECTED OUTCOME FROM CURRENT SITUATION

A robust, healthy defence industry base is a vital component of military capability. If there is no change to the current way of doing business the implications for the indigenous Australian defence industrial base, and by extension for the development and support of the Australian military capability, will be dire.

The tacit arguments that Australia can acquire the necessary capability as MOTS/COTS from offshore entities, that the Primes will look after local SMEs, and that only a local sustainment capability is needed within Australian industry are fallacious. This logic train seems to be centred on the mistaken belief that sustainment is merely the maintaining of an extant capability, and does not take into account the ongoing development and upgrade required if a capability is to remain relevant over its lifetime. The 2005 UK Defence Industrial Strategy specifically recognises the importance of a defence industry capable of undertaking capability improvement, not just maintenance, in stating:

The complex, technologically challenging and high-value systems which we are introducing – and which take many years to design and bring into service – will last for many years. This places increasing emphasis on an ability to support and upgrade them through life ...⁶.

As with operational capabilities, Defence industry capability cannot be turned on and off at a whim and the results of today's decisions will manifest themselves for many years to come. Once lost, a required industrial capability takes time to rebuild and this inevitably impacts on overall defence capability. An example of this is evident in the time and effort required to re-establish the Navy engineering capability following the Rizzo Review⁷. Irrespective of the source of major defence acquisition, both capability and capacity within the local industry

⁵ Skills Australia; *Building Australia's Defence Supply Capabilities: Main Report for the Defence Industry Workforce Strategy*, Commonwealth of Australia, 2012; p.8.

⁶ *Defence Industrial Strategy*, page 2.

⁷ Rizzo, P.J. *Plan to Reform Support Ship Repair and Management Practices*, Commonwealth of Australia, 2011.

base are required for the development and maintenance of the skills necessary for the sustainment of advanced defence systems.

The current situation will increasingly see market dominance concentrated into a few large foreign-owned companies. Under this scenario it is important that Australian SMEs are able to engage directly with Defence, particularly for those capabilities deemed as strategically important, and are not simply treated as an adjunct to a Global Supply Chain for the sake of convenience.

REQUIRED WHITE PAPER OUTCOMES FOR LOCAL INDUSTRY

The ABDIU is of the position that the key outcomes required in the Defence White Paper for the local defence industry base are fourfold, namely:

1. Recognition that better and more visible capability planning information is required to enable industry to make the investment decisions necessary for the continuation and development of the local industry base;
2. Recognition that retreat to a “sustainment only” industry capability is not in the national interest, and that a healthy defence industry must include the local development of innovative technologies;
3. Defence to review and refine the definition, treatment and utilisation of Priority and Strategic Industry Capabilities; and
4. Defence to move away from the current focus on primarily engaging with industry through a small number of Primes and recognition that more direct engagement with SMEs is required to best develop the local industrial capability.

Planning Information for Industry

The issue of Defence-Industry engagement and the provision of Defence planning information for industry investment decision-making has been a long-running saga. To this end, the ABDIU recognises that the Capability Development Advisory Forum (CDAF) and the associated Environmental Working Groups have been positive developments, but also notes that these initiatives have not provided the visibility into Defence planning that industry has been seeking.

Given the single client status of the Government in the Australian defence market, the plans and actions of the Defence Department are of critical importance to the health of defence-orientated companies. The recent Senate Foreign Affairs, Defence and Trade (FADT) References Committee report into Defence procurement noted the symbiotic relationship between the parties in stating that:

“By providing clear and timely information to industry, Defence can assist these firms to undertake more informed planning, investment and innovation, and as a result, offer better value for money and greater capacity to Defence”.⁸

The ABDIU notes that whilst an attempt at improved clarity for industry has been made in the 2012 release of the Defence Capability Plan, and the pending Defence Capability Guide, the wide timeframes for achieving first and particularly second pass for many projects makes this guidance next to useless for planning purposes. As stated by the Senate FADT References Committee Report, the 2009 White Paper and DCP information “fall short in providing the level of certainty and confidence that industry requires to be an effective partner in capability development⁹”.

The ABDIU recommends a return to a more definitive publication of Defence intentions through a further revision of the DCP/DCG process, and a tightening of windows for first and second pass consideration of projects, in order to provide the certainty and clarity required to underpin industry investment decisions.

Innovation

Innovation is important for a wide range of entities and for a correspondingly wide range of reasons. For companies innovation will affect survival, growth and return on shareholder investment. For nations innovation is a driver of growth and economic activity. By extension therefore innovation is of fundamental importance to an organisation such as the Defence Force for improvements in systems, processes and operational outcomes. As stated by Michael Porter and Scott Stern in a paper on national innovative capacity:

“innovation intensity depends on an interaction between private sector strategies and public sector policies and institutions. Competitiveness advances when the public and private sectors together promote a favorable environment for innovation.”¹⁰

A close engagement of Defence with industry is therefore required if the famed Australian reputation for innovation is to continue in the defence sector. This imperative requires recognition in the White Paper of:

1. the importance of innovation for defence capability,
2. the need for early engagement with respect to developing Defence requirements to encourage and facilitate industry investment decisions,

⁸ The Senate Foreign Affairs, Defence and Trade References Committee, *Procurement procedures for Defence capital projects Final Report*; Commonwealth of Australia, August 2012; para 13.19.

⁹ Ibid; para 15.79

¹⁰ Porter, M. & Stern, S; *National Innovative Capacity*; accessed online at http://www.isc.hbs.edu/Innov_9211.pdf on 20 September 2012

3. the impact that publication of clear Defence intent with regard to capability and procurement intentions has on industry investment decisions and,
4. a holistic and seamless series of policies designed to encourage, foster and develop innovative technologies.

The ABDIU recognises that Defence currently has a series of programs aimed at innovation including the Capability Technology Demonstrator (CTD) program, the Rapid Prototyping, Development and Evaluation (RPDE) program and the Priority Industry Capability Innovation Program (PICIP). The missing portion is the support required to take a development from Technical Readiness Level (TRL) 5/6 through to being ready to be fielded at TRL 8. The lack of this development piece impacts on the ability of local companies to get their innovations to TRL 8, on the take-up of Australian technologies by Defence, and ultimately on the ability of local companies to attract, develop and retain requisite skills and to generate high value-added exports.

In an effort to facilitate this development and to achieve better outcomes for indigenous innovative technologies the ABDIU recently made a submission to Chief Capability Development Group (CCDG) specifically targeted at getting developments from TRL 5/6 to TRL 8. The proposal also encouraged broader Defence – Industry engagement through the use of the Environmental Working Group process. A copy of the proposal to CCDG is attached to this submission.

Priority Industry Capabilities

As noted previously the PICs are acknowledged as being capabilities that are of fundamental importance to the achievement of Defence White Paper strategic objectives, whilst the SICs can be simply described as “PICs in waiting”; that is, capabilities that may become PICs as strategic circumstances and capabilities change. A proper definition of PICs and SICs, and a clear understanding of how PICs will be monitored and treated, is therefore important to Australian industry as a guide to planning and internal investment.

The ABDIU believes the following should apply to PICS and SICs:

1. A clear and logical link should exist from each PIC to the Defence White Paper through the definition of ADF tasks and associated capabilities required to successfully execute the defined tasks.
2. PIC health requires detailed and regular assessment, and intervention and support strategies developed should PIC health be assessed as less than satisfactory. The criteria for assessment and evaluation strategies should be released to industry for comment.
3. Once clearly defined and assessed, PICs should be a formal component in the evaluation of defence capability tenders according to the following PIC health criteria:

- a. For a healthy PIC – capabilities to be assessed against a MOTS/COTS baseline as per the current arrangements;
- b. For a marginal PIC – additional consideration to be given to award of contract to local company; and
- c. For an unhealthy PIC – tender to be restricted to local companies only (if more than one option is available) or awarded to a local company by direct negotiation.

A policy of direct, focussed intervention into the local defence industry may be required for some PIC areas to best develop/maintain/sustain a capability and to avoid the “series of random outcomes” that a slavish devotion to open competition will provide.

The ABDIU believes that the introduction of a new category of National Defence Industry Capability (NDIC) is also required to facilitate the consideration and planning of industry activities that are predominantly non-Defence, but which could have a significant Defence impact in time of need. The national petroleum industry capability is an example where Defence operations may be seriously impacted through decisions taken by other authorities.

Direct Australian Industry Engagement

The final point relates to direct engagement between Defence and Australian SMEs and is therefore relevant to the earlier discussion on innovation; particularly to what Porter and Stern have described as a favourable environment. Engagement with the Primes is, and will continue to be, a fundamental part of the Defence-Industry landscape. This is particularly true in the field of major capability acquisition and is inescapable given the structure of the defence industrial sector in Australia. Engagement with Primes will, in some circumstances, bring smaller companies into the picture as sub-contractors. Unfortunately, reality has shown that the Defence objective of the Primes acting as a benevolent “big brother” has not worked consistently as the Primes are often unwilling or unable to provide a work share for an Australian SME due to a conflict with a capability already globally held with the Prime, the desire of the Prime to protect its bottom line by maximising its involvement, or limited opportunities for the unique skill sets that a particular SME can offer.

The ABDIU notes the Defence initiative that has introduced mandatory Australian Industry Participation (AIP) Plans to provide improved opportunity for SME engagement, but also notes that these are somewhat ineffective due to lack of rigorous enforcement. SME engagement through a Prime should not be seen as a proxy for a more complete and direct engagement between the Defence Department and the SMEs. Indirect engagement with local SMEs works against the development of Australian defence industry capability and capacity by removing opportunities to grow skills and management expertise, and therefore limits the ability of local companies to expand into larger projects.

Whilst it is acknowledged that it is somewhat unrealistic to expect direct SME engagement in a large number of DCP projects, the mooted “favourable environment” necessary for innovation is actively negated through recent Defence actions in cancelling Round 16 of the CTD program, and in substantially reducing the spend through the Minor projects. In a similar manner, a more direct engagement is required for companies engaged in PIC-related activities, particularly should a PIC be assessed as either marginal or unhealthy, as “forced” engagement through an overseas Prime may inhibit innovation and/or investment decisions.

CONCLUSIONS

The development of a Defence White Paper is an important opportunity to restate, reaffirm and, importantly, reset strategic priorities that impact on national security. Given the importance of industry capability as a contributor to national defence capability, a proper and detailed treatment of industry is required within the White Paper.

The ABDIU posits that more directed engagement is required from Defence in order to build the capabilities required within the local industry base for the support of the Australian Defence Force.