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Dr Kathleen Dermody
Committee Secretary
Senate Foreign Affairs, Defence and Trade References Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Dr Dermody

AIDN SUBMISSION TO THE SENATE INQUIRY INTO PROCUREMENT PROCEDURES FOR DEFENCE CAPITAL PROJECTS

Thank you for your letter dated 16 February 2011 inviting the Australian Industry & Defence Network Inc (AIDN) to lodge a submission in regards to the inquiry by the Senate Foreign Affairs, Defence and Trade References Committee Inquiry into Defence Procurement. On behalf of AIDN I welcome the invitation and herewith offer our input for consideration by the Committee. AIDN would welcome the opportunity to appear before the Inquiry to further explain its input if the Inquiry believes it would assist its deliberations.

Executive Summary

AIDN is the peak organisation representing Australian defence industry Small and Medium Enterprises (SMEs). AIDN's submission provides comment against the four reference points detailed in the Inquiry's terms of reference.

In regard to the procurement procedures used for major defence capital projects, AIDN has witnessed a slowdown in the approval rates for such projects, which has had a negative impact on the defence industry, has the potential to delay capability needed by the ADF and, through the delay, increase the cost of providing that capability.

AIDN's submission highlights that Military-Off-the Shelf (MOTs) procurements which may mitigate risk and cost in the acquisition phase of a capability, can actually increase risk and costs when sustainment and whole of life costs are analysed. The sustainment of ADF capability, an area where many SMEs operate, is the area of greatest cost to the Government in acquiring and maintaining capability yet draws relatively minor focus and analysis.

In assessing proposals from Defence Accountability reviews; AIDN highlights the importance of the Priority Industry Capability Innovation Program (PICIP) to defence industry innovators and future ADF capability, AIDN also requests a report on the implementation of the Mortimer Review recommendations. AIDN proposes that acquisition decision cycles and a more Commercial-like focus within the DMO would be assisted by empowering middle-level Managers with the jurisdiction to make decisions within their area of responsibility.

AIDN's submission contains a number of recommendations for enhancing the availability of public information of defence procurement including; the appointment of a defence industry Ombudsman, transparency of Rapid Acquisition requirements, the inclusion of Priority Industry Capability (PIC)/Strategic Industry Capability (SIC) value in developing Project value for money determinations and base lining current defence industry PIC/SIC capabilities to identify industry capability 'gaps' for delivering of the Force 2030 ADF capability.

Submission

AIDN is the peak organisation representing Australian defence industry Small and Medium Enterprises (SMEs). AIDN represents the interests of the SME defence Industry sector by advocacy, representation and member services. Our mission is to maximise Defence-related business for Australian SMEs.

AIDN is represented on the two most significant Defence and industry forums; the Defence Industry Innovation Board (DIIB) and Capability Development Advisory Forum (CDAF).

AIDN provides the following comment to the Inquiry against the four reference points detailed in the Inquiry's terms of reference.

Reference Point A – Assess the procurement procedures utilised for major defence capital projects:

1. AIDN and the Australian defence industry has observed that there has been a significant 'slow down' in the number of new Defence Projects obtaining Government approval in the past 18 months. This 'slowdown' is evident when comparing actual approvals against the scheduled approval time line detailed in the Defence Capability Plan. While the Government has argued that a considered approach is needed to evaluate each Project the delay has resulted in a reduction of work for defence industry and more importantly increased risk that the ADF capability detailed in Defence White Paper, *Defending Australia in the Asia Pacific Century: Force 2030*, will not be achieved.
2. The delays in progressing decisions to contract also result in increased cost, due to the affect of inflation,' the increased cost of later technology, the cost associated with Government and defence industry resources 'treading water' while a decision is made.
3. The DMO's Procurement procedures and processes as detailed in the Procurement Manual appear sound but the acquisition and sustainment of ADF capability is regularly adversely impacted by poor implementation and apparent non compliance with the Defence Capability Plan (DCP), Defence Procurement Policy Manual (DPPM), and Defence Capability Manual (DCM) schedules and processes.
4. There is a significant opportunity to foster a stronger Defence and defence industry relationship as detailed in Chapter 5 of the Building Defence Capability: A Policy for a smarter and more agile Defence industry base (DIPS) and enhance the output of Defence reviews and reports by engaging defence industry in the review or report process early in its development, rather than the current practice which includes industry input late in the process often at very short notice, or not at all. This engagement could be easily achieved through the defence industry associations.
5. The argument for the use of Military-Off-the Shelf (MOTs) procurement to deliver capability is that such purchases reduce technical and schedule risk and thus save on costs. While MOTS may achieve a saving in the acquisition or 'up front' costs, MOTS solutions are generally more expensive in terms of 'whole of life' costs; as sustainment costs are not fully assessed. The sustainment or maintenance of the MOTS capability is usually achieved either through Foreign Military Sales (FMS), or directly through an overseas based Original Equipment Manufacturer (OEM), which

necessitates reliance on a long supply chain over which the Australian Government has little control. MOTS purchases generally offer very limited opportunity to develop a domestic defence industry capability to support ADF capability acquisitions. AIDN considers that much greater involvement of Australian industry capabilities in these aspects would both better manage costs and provide Australia with much greater operational flexibility and strategic viability.

6. The cost of sustaining a platform or capability over whole of life generally equates to two thirds of the total the life cycle costs. Currently DMO estimates that it will spend over \$110 billion during the next decade on sustainment. Despite repeated references by government and Defence that sustainment is the capability area where Australian industry will be engaged by Defence, none of the Reviews, Policy Papers to date have had a strong focus on sustainment in any great depth. Additionally, there are few, if any, articulated strategies detailing how the required through life support (TLS) capabilities will be nurtured, maintained and supported in an environment of competing priorities where Defence has a Strategic Reform Program (SRP) that requires substantial savings to be achieved in the cost of sustainment. The current ADF inventory has a large number of ageing platforms which require additional maintenance to keep them in service, sometimes because of prior poor maintenance philosophies and practices, or, in many instances, to extend their operational life due to slippage in the selection and procurement of replacement capabilities.
7. AIDN members have observed that international primes/OEMs are placing more business with a few specific Australian SMEs whereas our own Defence procurement agencies are reducing orders with Australian SMEs. In some instances Australian made product is purchased for the ADF via an overseas market.
8. AIDN believes that the current defence capital acquisition procurement policy and defence industry policy of dealing directly with a small number of Prime defence industry companies to mitigate project management risk, is limiting the opportunity for the acquisition of SME developed innovative solutions and capability alternatives.

Reference Point B – Assess the timeline proposed for defence modernisation and procurement outline in the Defence White paper:

1. AIDN is concerned that the timelines are not being met and, in addition to the aforementioned instances, cites as an example the ongoing delays in project decisions and procurement activities for which numerous reasons are proffered such as: waiting for publication of DCP, setting up and administering the Strategic Reform Program (SRP).

Reference Point C – Assess proposals arising from the Defence accountability reviews:

1. The Priority Industry Capability Innovation Program (PICIP) will be particularly important to Defence and defence industry where gaps exist in capability to establish and maintain the Priority Industry Capabilities (PICs) needed to support new projects in the forward years of the DCP. The development of this program needs to be progressed with greater urgency.

2. In relation to the Mortimer Review, whilst a considerable number of recommendations have been adopted and are positive, a number of agreed recommendations have yet to be implemented. There has been no publication of how the agreed Mortimer Review recommendations have been implemented. Such reporting is necessary for accountability purposes.
3. One solution to accelerating the decision cycle within the DMO is to flow the jurisdiction delegation levels down to the appropriate working level where the Manager has a good knowledge of the platform and capability technologies, rather than the current practice where reports are generated by the knowledgeable Manager and escalated to more senior management who has less knowledge of the alternatives under consideration. This practice would assist in shaping the DMO to a more Commercial-like organisation.
4. The poor implementation of procurement practice and lack of appropriate training for Defence and DMO procurement representatives fosters inefficiencies in ADF capability sustainment and results in much higher sustainment costs. This is particularly evident where corrective action has to be undertaken at short notice to rectify defects or poor maintenance schedules.

Reference Point D – Make recommendations for enhancing the availability of public information and parliamentary oversight and scrutiny of defence procurement:

1. As Defence and its acquisition organisation DMO is a monopsonistic customer it is very difficult for defence industry companies to seek redress from DMO or defence due to the fear of potential repercussions, such as a lack of future work. While AIDN acknowledges that this is not stated policy, it is a common deterrent within the mindset of defence industry SMEs that prevents a full and frank exchange of views. Currently there is no independent body to seek redress. AIDN strongly recommends that the Commonwealth appoints a defence industry Ombudsman, or a separate entity to review the concerns of defence industry SMEs. This is necessary to create confidence amongst the defence SME community and allow Australian Defence SME's to provide feedback to DMO without fear of repercussions.
2. AIDN notes that Rapid Acquisition Projects are accounting for a greater share of the acquisition budget to provide capability for the ADF war fighter in theatre. Much of capability sought under Rapid Acquisition is sourced and supported by overseas companies. While AIDN believes that Rapid Acquisition is a necessary and critical means of acquiring urgent capability there is a need for transparency in Rapid acquisition procurements (subject to security constraints where appropriate). AIDN suspects that there may be many cases where similar or better capability options to meet operational requirements may already exist in the Australian defence industry.
3. The value for money equation needs to be changed such that project value is balanced by PIC/SIC value and longer-term industry objectives are not overridden by short-term project expediency. Value for money questions by DMO staff should focus on what value for money should really mean - responsiveness, reliability, innovation, economic multiplier benefits, as well as cost.

4. Strategic analysis of the total capability covered by PICs and SICs needs to be undertaken, including definition of the essential elements of them and the broader capability needed to support them.
5. AIDN notes that responsibility for industry policy has recently been moved from DMO to the Department of Defence and is now viewed – correctly – as an element in overall defence strategy. However, care will be needed to ensure that the full range of industry policy concerns is not lost. AIDN believes that a strategic analysis needs to be undertaken to achieve Defence capability, sovereignty, surge, regional business, innovation, efficiency of direct dealing, along with through life support (TLS) for FMS and other purchases.
6. The total PIC/SIC capabilities required to deliver Force 2030 must be compared against the specific capabilities available in the Australian based defence industry Primes and SMEs to determine both relevant available capability that needs to be sustained as well as gaps that need to be addressed. Subject to considered risk analysis, once these gaps are identified actions should be taken to develop Australian based defence industry capabilities to ‘close the gaps’.
7. The impact of the new Aust/USA Defence Free Trade Agreement is currently causing some uncertainty with SMEs and further work is required to clarify implementation issues and the added value if anything that will result for Australian industry. Similarly, continued effort to clarify ITARS related issues remains an issue for Australian defence companies seeking to operate in the US market and deal with US technology in the global supply chain.
8. The DMO managed Defence ePortal purports to be a one stop shop for defence industry to interact with Defence and DMO however, its functionality at present is very difficult to navigate and the information is often out of date. Further functionality could be added to the Defence ePortal to overcome these deficiencies and AIDN would be willing to assist the DMO in achieving this functionality.
9. The Skilling Australia’s Defence Industry (SADI) and Defence Industry Study Course (DISC) programs are positive policies which greatly assist SMEs to be up skilled and better understand how Defence and DMO work.

Graham Priestnall
President, AIDN National

Acronyms

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| ADF | Australian Defence Force |
| AIC | Australian Industry Capability |
| AIDN | Australian Industry & Defence Network Inc |
| AWD | Air Warfare Destroyer |
| CDAF | Capability Development Advisory Forum |
| DCM | Defence Capability Manual |
| DCP | Defence Capability Plan |
| DICM | Defence Industry Capability Map |
| DIIB | Defence Industry Innovation Board |
| DIPS | Defence and Industry Policy Statement 2010 Building Defence Capability: A Policy for a smarter and more agile Defence industry base |
| DISC | Defence Industry Study Course |
| DMO | Defence Materiel Organisation |
| DNSDC | Defence National Storage & Distribution Centre |
| DPPM | Defence Procurement Policy Manual |
| FMS | Foreign Military Sales |
| ITARs | International Traffic in Arms Regulations |
| MOTs | Military off the shelf |
| NSC | National Security Committee of Cabinet |
| OEM | Original Equipment Manufacturer |
| PIC | Priority Industry Capability |
| PICIP | Priority Industry Capability Innovation Program |
| SADI | Skilling Australia's Defence Industry |
| SIC | Strategic Industry Capability |
| SME | Small to Medium Enterprise |
| SRP | Strategic Reform Program |
| SSP | Strategic Sourcing Program |
| TLS | Through Life Support |