



## **AUSTRALIAN INDUSTRY GROUP DEFENCE COUNCIL**

### **SUBMISSION TO THE SENATE INQUIRY INTO**

### **SOVEREIGN NAVAL SHIPBUILDING**

## **Introduction**

The Ai Group Defence Council (the Defence Council) is the peak representative body for the Australian Defence industry.

The purpose of the Defence Council is to:

- bring Government, Defence and defence industry together for the benefit of Australia's national security and the growth and development of locally based defence industry;
- provide trusted advice to Government and champion the best policies to support the Australian Defence Force and industry;
- be a lead voice representing the capabilities of Australia's defence industry, defence-related capabilities in other industries and the associated supply chains;
- bring thought leaders together to foster and exchange ideas; and
- build our community through the provision of high quality information and networks.

The Defence Council welcomes the opportunity to provide a submission to the inquiry into Australia's sovereign naval shipbuilding. We note that the Senate referred this inquiry on 19 September 2019 and the committee will report by the last sitting day in June 2020.

The terms of reference for the inquiry are broad and cover a range of matters concerning the development and delivery of Australia's sovereign naval shipbuilding capability.

This Defence Council submission is particularly focussed on the delivery of the Australian Industry Capability program, the development of local supply chains and the Government programs that have been designed to support this involvement.

## **Executive Summary and Key Recommendations**

In summary, this submission notes that:

- The Government has made an unprecedented investment in the Australian Defence industry, including through release of the Naval Shipbuilding Plan and major acquisition decisions. The Defence and industry partnership has strengthened considerably in recent years.
- The Naval shipbuilding program is a transformational endeavour requiring extraordinary levels of effort, resources and capacity building to deliver on the Government's intent.
- The Australian Industry Capability program requires a time-critical review to effectively meet the requirements of Defence projects and to capture the investment benefits set out in the Naval Shipbuilding Plan.

We recommend:

- An immediate strengthening of the Australian Industry Capability (AIC) program across major Defence projects by:
  - The appointment of a senior person with industry experience to head the Australian Industry Capability function. This person should be sufficiently senior and appropriately resourced to ensure the AIC program is delivered effectively to meet the Government's intent.
  - Improving the AIC program's ability to identify capability, measure and enforce AIC plans in contracts.
  - Applying a methodology to capture the long-term value of AIC, including whole-of-life costs and a sovereign industrial base.
- A review of some of the major supporting Government programs (as discussed below) to help ensure effective implementation and delivery of services.

The rest of this submission sets out our views in more detail, including additional recommendations.

### **The Naval Shipbuilding Plan and Australian involvement**

The Ai Group Defence Council acknowledges the importance of recent decisions made in relation to development of the industry, including the release of the Naval Shipbuilding Plan in May 2017. There has been a significant improvement in the Defence and industry relationship since release of the 2016 White Paper and Defence Industry Policy Statement.

We understand and appreciate that industry issues are a much greater part of Defence committee considerations than in the past. We also appreciate the commitment of the senior leadership within Defence to industry issues and to growing the Defence and industry partnership.

The Naval Shipbuilding Plan is a landmark document setting out the Government's vision for the establishment of three continuous shipbuilding programs for minor naval vessels, major surface combatants and submarines. The Plan notes that 'this national endeavour is the most significant nation building project Australia has ever undertaken' (p11). The Plan also states that 'the investment that the Government is making through this Naval Shipbuilding Plan will also generate significant economic growth across Australia, revitalise Australia's heavy engineering and advanced manufacturing industrial capability and capacity, and grow and sustain thousands of Australian jobs.' (p13)

Accordingly, the stakes are high for achieving success in this endeavour for both Defence and industry, including:

- the impact on Australia's national security through delivery of first-class capability to the Australian Defence Force,
- the development of a strong industrial base that helps provides strategic weight to our nation,
- the development of a sovereign Australian industrial base to help reliably and cost-effectively secure the operational and availability requirements of ADF assets,
- the economic and industrial benefits of the \$90 billion being spent on naval capability, and ensuring that funding flows into Australia,
- the development of local supply chains, with the associated benefits of developing advanced manufacturing techniques, and

- enriching the community and social benefits which flow from the programs.

## **Key issues and discussion**

### **The Australian Industry Capability program**

The central Government program driving Australian capability, industry and economic outcomes in the shipbuilding projects is the Australian Industry Capability (AIC) program. The purpose of the AIC program is to (taken from the Department of Defence website):

- Provide opportunities for Australian companies to compete on merit for defence work within Australia and overseas.
- Influence foreign prime contractors and original equipment manufacturers, including Australian subsidiaries, to deliver cost-effective support.
- Facilitate transfer of technology and access to appropriate intellectual property rights.
- Encourage investment in Australian industry.

The Naval Shipbuilding Plan sets out 'an ambitious but achievable agenda to rebuild the Australian shipbuilding and sustainment industrial base; foster Australian innovation and research and development; realise substantial national economic benefits; and create thousands of new jobs' (p79).

Each shipbuilding project has its own AIC plan (or project-specific equivalent). We understand and appreciate that significant effort goes into the development of each plan from various areas across Defence and we applaud the intent of the program. We also note that Defence is currently working on an AIC assurance program.

We are, however, of the view that the effectiveness of the AIC program needs to be improved to achieve the Government's vision as stated in the Naval Shipbuilding Plan. There is a need for decisive action given the rapidly progressing nature of the projects.

Australian industry is, in many cases, at or above world benchmark standard. In some instances, Australian companies are struggling to compete with overseas suppliers for a variety of reasons. The playing field is, in some cases, tilted against them.

The following key issues have been raised with us by different members in relation to AIC:

- In many cases AIC requirements lack clarity, are without clear measures, and are not supported by adequate monitoring and enforcement arrangements.
- The AIC program is not being led at a sufficiently senior level in Defence to be treated with equal priority to other Fundamental Inputs to Capability.
- There is a lack of emphasis on the benefits of using competitive Australian industry for whole of life capability.

Our view is that the AIC program can and should be significantly improved and we make the following recommendations:

- The appointment of a senior person with industry experience to head the Australian Industry Capability function. This person should be sufficiently senior and resourced appropriately to ensure the AIC program is delivered effectively to meet the Government's intent. The AIC team in the Department of Defence also needs to be at a sufficiently senior level to lead development and implementation of AIC plans in equal partnership with other stakeholders and senior leaders in the Department. This new approach should involve increased involvement of the Capability, Acquisition and Sustainment Group at senior levels.
- Strengthen the AIC program's ability to identify capability, measure and enforce AIC plans in contracts. Once agreed, ideally the key performance indicators should be made transparent to industry and enforceable by Defence (including quantum and quality of supply chain purchase orders).
- Development of a new methodology for assessment, including that any AIC 'premium' be assessed against the benefits of developing sovereign industrial capability and long-term value, including:
  - Sustainment costs,
  - Sustainment time critical capability,
  - Technical evolution capability versus creating technical orphans,
  - Skills created which can benefit Australia's overall complex project needs beyond Defence,
  - Development of advanced technology exports, and
  - Facilitation of long-term investment by companies in the technology areas covered by AIC and sovereign priorities.
- Further prioritise and resource the Shipbuilding Sovereign Industrial Capability Priority Implementation Plan. The Continuous Shipbuilding program is considered a sovereign industrial capability priority as set out in the Defence Industrial Capability Plan. The implementation plan for Continuous Shipbuilding needs to be a serious underpinning for capability and industry decisions moving forward. This work should also include the maritime elements of the implementation plan for the Test and Evaluation sovereign industrial capability priority.
- Provide additional recognition of the importance of high value technology transfer and intellectual property to develop internationally competitive high tech and advanced manufacturing industries in the country. It is not just the quantity of Australian involvement that is important, but the quality of that involvement in building ongoing and sustainable capabilities.
- Particular attention should be given to the advantages of bringing design activity into Australia for both for the development of enduring domestic capabilities and for leverage into the sustainment process.

- Ensure the creation of an environment in which Australian industry can be truly competitive and enduring. There is significant effort currently focussed on building capability within small businesses, but we need to also focus on the requisite business maturity and health factors, including security. The CDIC Business Maturity Framework is critical here.
- AIC should not be stove-piped but looked at as a coherent whole with the Global Supply Chain program and related policies.

In summary, the AIC program is a critical underpinning for Australian sovereignty, assurance of supply, capability development, sustainment and Australian industry and economic outcomes. We recommend a time-critical review of the program, with a key focus on proper resourcing by Government and Defence to improve the effectiveness in the way AIC plans are developed and implemented in the naval shipbuilding programs. The default position should be that competitive Australian businesses are given opportunities to show that the work can be done in Australia.

### **Government programs to build Australian industry**

Australian industry is highly supportive of the Government programs that have been set up to help build Australian industry and meet the high demands of the acquisition projects in shipbuilding (and more broadly).

We make the following key points in relation to the programs and support of naval shipbuilding:

- **Naval Shipbuilding College (NSC).** We appreciate and applaud the intent of the NSC and general recognition by Defence of the workforce issues surrounding the shipbuilding programs. We are aware of the increased traction being generated by the NSC in recent months as evidenced by the signature of the Shipbuilding Industry Strategic Workforce Plan, and we are looking forward to the implementation of the actions within the plan, in order to address the workforce priorities within the shipbuilding sector.
- The **Centre for Defence Industry Capability (CDIC)** is a critical underpinning for building the supply chain base. The CDIC has made much progress since implementation in 2016. Nevertheless, we are of the view that a proposed review of the CDIC is an important step to measure progress against the Government's policy intent. This review should cover a range of issues, including prioritisation of resources, transparency of the board decision-making and implementation of milestones.

An issue that several members have raised with us is the importance of progress of key supporting programs including the proposed Business Maturity Framework, which has not yet been released. The Business Maturity Framework and Supplier Continuous Improvement program are seen as key enablers to understand the maturity of industry, assess the impact that the AIC plans are having on industry over time, and to identify capability gaps and improvement requirements.

- **Defence Innovation programs** – including the Next Generation Technology Fund and the Defence Innovation Hub. The innovation programs have been well received in terms of supporting Australian industry and bringing coherence to the Defence innovation lines of effort. We are of the view that a specific line of funding for innovation in shipbuilding would assist Australian companies to create linkages into the shipbuilding acquisition programs. We are also aware that Defence is continuing to work on issues that are impacting the effectiveness of the Defence Innovation Hub, including timeliness of assessment and the 'pull through' to acquisition.
- **The Global Supply Chain program.** A number of Defence Council members have raised concerns about the effectiveness and key performance indicators associated with the Global Supply Chain program. This is particularly important in driving Australian industry outcomes in the large programs, including shipbuilding. We recommend a review of the program, specifically focussed on its effectiveness, measures of success and relationship with the AIC program.

Finally, the Defence Council recommends further development of a strong and cohesive eco-system to support prime companies find, assess and develop Australian companies into their supply chains. The current system could be improved through a review of the processes and structures, including the Industry Capability Network (ICN). In particular, members have noted that because ICN has a different operating model in each state, this can cause a lack of consistency in implementation.

ICN is a key tool for Primes and SMEs to engage and provides aggregated data in demand for particular capabilities. ICN should be linked to both the capability maturity model and the supplier continuous improvement program to ensure demand and supply in the Australian market are matched, as well as providing additional flexibility when entering data.

#### **Implementation of industry policies and sufficient resourcing**

The Ai Group Defence Council appreciates the level of industry engagement and consultation on development of the Defence industry related policies and programs.

It is important that these policies and programs are sufficiently well-resourced to be effective. We have some concern that the weight of responsibility for implementation of these policies is falling to a small area in Defence – largely the Defence Industry Policy Division. This Division has responsibility for managing the Defence Export Office, as well as development of the implementation plans for all 10 Sovereign Industrial Capability Priorities, development and implementation of the Skilling and STEM strategy, as well as the Defence Industry Participation Policy. This is a substantive body of work that requires sufficient resources to be delivered in a timely and effective manner.

#### **Clarity of investment plans**

We wish to highlight the importance for industry of the visibility of Government's investment and capability plans. Industry has not seen a public Integrated Investment Program since February 2016. We understand the next version will be released in around mid-2020, and accordingly over four years will have elapsed since an update has been released. Industry needs access to these plans to allow for detailed planning for investment, capability, sustainment and workforce purposes – including for shipbuilding and maritime related projects.

Our view is that there is scope more generally for improving the transparency and reporting information in Defence's major reporting tools to help provide industry with critical information on Defence's priorities, upcoming projects, timelines and investment, in particular:

- Additional visibility of the Defence budget in a clearer, more understandable form than currently presented in both the Annual report and the Portfolio Budget Statements.
- An online and regularly updated Integrated Investment Program, as noted above.
- Additional visibility and clarification where timelines for major projects have been significantly altered.
- Additional information and advice on project budgets and spend profiles.

### **Summary of this submission**

A thriving Australian defence industry is important to national security via the delivery of Defence capability, as well as a significant contributor to a prosperous economy. The Ai Group Defence Council is supportive of the recognition of Australian industry as a Fundamental Input to Capability. We are also very appreciative of the leadership in Government, Defence and other government stakeholders in driving Australian industry outcomes and local supply chains. We believe that the partnership between Defence and industry is strong.

However, there are significant steps outlined above that we think can be taken to properly and effectively implement the government's intent to deliver capability to the Australian Defence Force and maximise Australian industry involvement.