27 October 2014

Defence White Paper 2015
R1-3-A135
Russell Offices
Canberra ACT 2600

A SUBMISSION FROM THE AUSTRALIAN INDUSTRY & DEFENCE NETWORK (AIDN) TO THE GOVERNMENT'S 2015 DEFENCE WHITE PAPER

INTRODUCTION

Australia needs a whole of government approach in order to support a robust and sound defence industry policy. The development of the Defence White Paper should focus on supporting and developing a viable, capable and healthy defence industry to support the Australian Defence Force.

The Defence Industry Policy must be adjusted to ensure it takes into account, and measures, the value industry has to the long term economic development of the nation not just the value to the security of the nation.

Any consideration of national security policy must be mindful of the impact that defence industry has on mitigating sovereign risk and preserving national security.

RECOMMENDATIONS

The Australian Industry & Defence Network (AIDN) makes the following recommendations following consultation with our members and key stakeholders. AIDN proposes that the following be included in the Defence White Paper 2015:

- A definition of Australia’s Defence industry - The breadth and scope of Australia’s defence industry is not well understood because it is ill-defined. Without formal definition the industry’s capabilities and capacities cannot be fully comprehended or appreciated. It also limits the capacity to determine and measure the impact of defence industry on decisions related to Defence capabilities. Consequently, this formal definition is proposed for inclusion in all future Defence policies and doctrine: Australia’s defence industry consists of Australian-based businesses that are actually or potentially involved in supplying military capability and/or are influenced by defence business policies or purchasing decisions;

- Recognition that Defence industry is a Fundamental Input to Capability. Consistent with the proposed definition, Government should recognise that industry contributes significantly to and underpins all of Defence’s Fundamental Inputs to Capability (FIC), not just the Major...
• A reconsideration of the definition of value for money in the assessment of both defence capability and sustainment source selection options and defence industry programs to take into account long term maintenance of Priority Industry Capabilities (PICs) and Strategic Industry Capabilities (SICs) and a range of national interest considerations;

• An Australian Government and Defence/DMO commitment to the establishment and implementation of a rigorous program for the implementation of the PICs and SICs program with clear objectives and milestones, including comprehensive implementation strategies in AIC Plans for individual projects and with appropriate public reporting of implementation status;

• Implementation of a Strategic Sourcing Program to inform rigorous priorities for AIC Plans in projects, and to enhance self-reliance through broadly based support for PICs and SICs;

• The implementation of defence industry policy and related programs be energised through the establishment of KPIs for each key policy or program, and the public identification of the appointment with responsibility for the policy or program development and implementation;

• The DMO be required to provide sufficient resources to ensure the efficient and effective achievement of AIC Plan implementation and scrutiny;

• Prime contractors be held accountable for the achievement of AIC KPIs in their contracts, and the overall progress against current AIC plans be included in the DMO annual report. Failure to fulfil the requirements of endorsed AIC participation plans to have real consequences through the public reporting and impacts on future tender assessment of non-complying companies;

• AIC Plans to include contractually binding deeds of agreement between the prime contractors and supporting SMEs.

• Address the Impact of Foreign Offsets on Australia - The Government must address the issue of the impact of foreign offsets policies on Defence acquisitions and the Australian economy;

• Encourage industry collaboration with a strong supply base via organisations such as the Defence Industry Innovation Centre, Defence Material Technology Centre and AIDN;

• Require the revision of procurement policy to include vastly simplified risk-sharing contract conditions and limited liabilities;

• The Capability Technology Demonstrator program be extended further at the front end of project development with more funding and flexibility to allow for higher risk initial projects for SMEs, with a benchmarked and expedited program entry mechanism for both the CTD and Unsolicited Innovative Proposal Programs, particularly in relation to strategic local capability areas;

• Improve the support for SMEs to grow International Supply Chain opportunities via the Global Opportunities Program in conjunction with the Defence Export Unit;

• Existing Defence initiatives like SADI be supported and expanded, such as through joint AIDN/SADI skilling initiatives;

• Strongly support the civilian recognition of ADF skills and provide support for both the ADF and industry to develop cross skilling platforms to allow a better integration of Defence and defence-related industry;

• Whole of life costs be considered in all procurements to ensure that acquisition and sustainment costs are clearly identified and included in the decision-making process;
• Implementation of Performance Based Contracting to reduce the requirement for Defence to undertake duplicative project management practices;

• Ensure Technology Transfer and Access to Intellectual Property for Offshore Acquisitions. This will ensure Australia’s defence industry is able to provide maximum in-country support through the whole-of-life maintenance, upgrades and overhauls;

• the White Paper must commit Defence to ongoing communication and interaction with industry, including early advice of decisions that change the shape of Defence’s future expenditure program; and

• A single Industry Division be set up within Defence, led by a three-star equivalent Defence industry Ombudsman/Advocate with significant defence industry experience.

BACKGROUND

The Australian Industry & Defence Network (AIDN) is the peak industry organisation which represents defence Small and Medium Enterprises (SMEs). AIDN aims to maximise defence-related business for SMEs. Nationally, AIDN has over 800 members, with a total workforce of over 20,000.

Every Australian State and Territory is represented by an AIDN Chapter. This AIDN submission has been approved by the AIDN National Executive which includes representatives from all State and Territory Chapters. The submission indicates our strong and collective interest in ensuring that the White Paper addresses the key issue of “Defence and Industry”. The representation of the defence SME perspective in the White Paper development process is particularly important given the continuing substantial rationalisation of Australian defence industry.

DISCUSSION

Defence Industry as a Fundamental Input to Capability

Every major statement of Defence policy since 1976 has emphasised that a healthy and dynamic Australian Defence industry is an integral component of national security. To give effect to such statements, there needs to be clear links between the strategies set out in the White Paper and the statement and implementation of Defence Industry policy.

Defence decisions such as the AWD and LHD Acquisition strategies have been uniformly criticised by Australia’s Defence industry for the lack of Australian Industry Involvement. AIDN believes the White Paper should include a strong statement on the importance of Australian industry to Defence capability and sustainment, supported by a benchmarked action program to achieve an effective relationship between Defence and Australian industry.

Defence industry is a long-term business with significant up-front investment requirements. It takes many years to develop an appropriate base of skills, technology and infrastructure. As such, the Australian industry aspects of the provision and support of key ADF capabilities should be an important consideration in the force development planning process.

Australian Defence industry SMEs are committed to Australia’s self-reliance in the support of its Defence capability and are willing to commit over the long term to measurable outcomes in terms of cost effective improvements in ADF sustainability.

AIDN believes the White Paper must recognise that industry contributes significantly to and underpins all of Defence’s Fundamental Inputs to Capability (FIC), not just the Major Systems FIC which has been the traditional area of focus for defence industry policy. AIDN believes that defence industry should be considered to be the ninth Defence FIC. The outcome of this should be the inclusion and consideration of industry in the FIC analysis for all Defence capability decisions.
Value for Money

AIDN’s assessment of current DMO procurement practices makes it clear that despite the policy emphasis on PICs and SICs, procurement decisions continue to be made on a narrow interpretation of value for money concept (i.e. lowest cost grounds) on a project-by-project basis, even if such decisions are to the detriment of the development and sustainment of PICs and SICs.

It is clear that a reconsideration of the definition of value for money is required in the assessment of both defence capability and sustainment source selection options and defence industry programs. This reconsideration needs to take into account a range of national interest considerations to ensure that short-term project expediency and a narrow cost focus does not override the longer-term objective of maintaining PICs to ensure national self-reliance and future project support.

Such a revised definition of value for money in the area of defence capability and sustainment procurement should, in addition to cost, include assessment of the demonstrated responsiveness and flexibility of tenderers, demonstrated reliability in terms of quality and timeliness of project or service delivery, ability to innovate in response to changing operational requirements and the economic multiplier benefits of a contract on both a national and regional basis. Further, where these benefits can be demonstrated without additional cost, a careful consideration of risk should be made so as to not disadvantage Australian solutions where capability already exists, or can be shown to be available through a low risk development path. This is not to say that Australian solutions should always be used where benefits are outweighed by cost and other factors in a value for money equation that includes the above considerations.

While AIDN fully supports the Government’s requirement to achieve best value for money for the Defence budget, the Defence Materiel Organisation does not operate in isolation from the rest of the Australian community and economy. Nor does each equipment project operate in isolation. It follows that the wider national and defence implications of project and sustainment source selection should be taken into account in assessing overall value for money. AIDN is confident that such a wider consideration of value for money would yield overall net benefits to both Defence and to Australia as a whole.

PICs and SICs

AIDN recognises and welcomes the significant amount of work undertaken by the DMO in conducting a number of the PIC ‘health checks’ and recommends that the remainder of the PIC ‘health checks’ be completed as a matter of priority. The completion of the PIC ‘health checks’ will assist in the further definition of each PIC. A similar program needs to be undertaken to assist in the clearer definition of the SICs. Following the definition activity, AIDN recommends an Australian Government and Defence/DMO commitment to the establishment and implementation of a rigorous program for the implementation of PICs and SICs with clear objectives and milestones for progressing each capability and with appropriate public reporting of implementation status.

Based on AIDN’s assessment of the approach that has been taken to date in the analysis and implementation of PICs and SICs, AIDN considers that higher level strategic planning for the development and sustainment of overall PIC and SIC capability needs to be enhanced. PICs and SICs cannot be considered in isolation from sustainment requirements. Consequently, strategic planning for PICs and SICs needs to take into account:

- The totality of each capability including sustainment,
- Where the capacity to provide capability is located in Australia; and
- The current and future projects that will rely on this PIC or SIC.

Without this, PICs and SICs will not reach their potential in support of Australian defence self-reliance. Further, the potential remains for a narrow interpretation to be placed on each capability to the detriment of the sustainment of the more broadly based industry capability needed to effectively support each PIC.
AIDN considers that the mandatory inclusion of PIC and SIC requirements in AIC Plans is the strongest tool available to ensure their maintenance. However, to ensure that this measure is not compromised, effective integration of PICs and SICs into AIC Plans must include consideration of:

- Their maintenance and enhancement not only in the procurement phase but also in sustainment.
- Where new capability is proposed, the effect on existing capability and the viability of the entire PIC/SIC area as a consequence.
- The inclusion of the strengthened AIC Plan proposals made above, with particular emphasis on reporting requirements and contractual provisions for binding deeds of agreement (see below).

**Strategic Sourcing**

The 2010 Defence Industry Policy Statement (DIPS) makes the very valid point that Defence is well placed to “leverage its weight as a customer” as it was the world’s 8th largest arms importer 2001-2007\(^1\) and its rate of procurement is increasing substantially. However, when looking at barriers to global competition, it states in contrast that other nations take protectionist approaches to their national defence industries while Australia does not, and this reality must be accepted\(^2\). But it is also clear that the alternative – AIC Plan and Global Supply Chain policies - is failing Australian industry, particularly SMEs. The deficiencies in AIC Plans have been addressed above with clear recommendations for improvement. While Global Supply Chain initiatives are worthwhile, the overall successes achieved have been sporadic and the total value significantly less than achieved internationally by alternative policies.

AIDN is strongly of the view that significantly more can be achieved to enhance industry capability and to ensure that Australian companies win more defence work, while at the same time enhancing self-reliance and not reducing value for money in Government procurement. To do this, AIDN proposes the establishment of a Strategic Sourcing Program (SSP).

Rather than the piecemeal and largely project-specific approach currently being taken with AIC Plans, the SSP would rely on the strategic analysis of total capability proposed above under Implementation Strategies for PICs and SICs to produce a Defence Industry Capability Map (DICM). The DICM would consist of:

- PIC and SIC total capabilities
- Capability gaps between PICs and SICs that would enhance the maintenance of the PICs and SICs
- Capability areas surrounding the PICs, SICs and gaps which would also contribute to the maintenance of PICs and SICs

Consequently, the DICM can be seen to be a strategically-focused, broadly-based map of the industry capability required in Australia to ensure on-going self-reliance. Project AIC Plans would then be formulated using the DICM to not only achieve project-specific industry capability outcomes but also to enhance innovation and longer-term capability objectives which contribute to self-reliance. The capability so produced could then be expected to continue beyond individual project timeframes as it would be required for future projects.

It is not expected that the DICM will be a static mapping of capability. As the DIPS rightly points out, PICs and SICs will change over time and so will the DICM change. However, initial determination of the DICM will be an essential step in determining the overall effect on the total capability required as the PICs and SICs change.

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\(^2\) Ibid, para 2.19, p22
While the SSP would inform AIC Plan objectives for all projects, implementation in contracts would only occur where value for money for Defence is achieved through better and broader industry capability, equal or better pricing, improved delivery times, access to innovation, enhanced through-support and consequently enhanced self-reliance. AIDN firmly believes that such benefits will accrue for the majority of projects and urges Defence to make realistic risk assessment for Australian solutions with the undoubted potential to achieve these benefits.

**Impact of Foreign Offset Programs**

In the 2010 DIPS the Government recognised the impact foreign offsets have on Australia’s defence industry and then declared that “offsets don’t work” based on a weak argument based on the F/A-18 acquisition project.

In saying that ‘offsets don’t work’ the Australian Government stands alone on not valuing or preserving its national defence industry capability and its importance to the Australia’s security. If offsets don’t work, why do most other countries in the world apply them?

Foreign offsets are a significant barrier to Australian industry being able to compete in the global defence industry marketplace.

Australian industry is often discriminated against because Australia doesn’t have offsets. If an offshore manufacturer has a choice between sourcing products from Australia or a country that has offset obligations, the manufacturer will favour the country with offset obligations before it will source from Australia.

The knock-on effect of offsets is that offshore manufacturers pass on the additional costs associated with servicing those requirements in their price structures. Which means Australia pays a premium on its offshore acquisitions to accommodate other nation’s offset requirements.

**Innovation**

AIDN strongly supports the continued operation and extension of the Capability Technology Demonstrator (CTD) Program as a principal method for the support of innovation in Defence industry. Indeed the CTD program could be extended further at the front end of project development with more funding and flexibility to allow for higher risk initial projects for SMEs with a benchmarked and expedited program entry mechanism. A lack of support from Defence for locally developed products is a disincentive for local industry to invest in product development through to TRL 7/8. Support from Defence as the domestic customer provides a strong case for other countries to consider Australian products.

**Global Supply Chains**

The concept of using the leverage of major acquisition projects to integrate Australian industry into global supply chains is fully supported. AIDN members participate in such programs. However, Defence should actively monitor such initiatives to ensure that they are delivering real outcomes that would have not otherwise been realised. The DMO must exert maximum leverage from its purchasing power and contracting processes to ensure Australian firms, particularly SMEs, get an honest opportunity to earn a place in the global supply chains of overseas prime contractors.

AIDN also supports the further improvement of support for SMEs to grow Global Supply Chain opportunities.
Skills Development
AIDN understands that many SMEs are diversifying into the mining and other commercial and export areas due to the lack of Defence work continuity, higher tendering costs, longer decision cycles and imposing liability and intellectual property requirements. The sustainment of a core level of defence relevant skills remains vitally important to maintain sovereignty.

**AIDN recommends that existing Defence initiatives like SADI be supported but the administrative processes be improved.** The turnaround time in assessing applications needs to be reduced for industry to utilise the funds and skilling opportunities.

Industry Engagement
Changes, delays and unpredictability in Defence's demand for support from industry puts established and specifically developed defence industry capabilities at risk. This uncertainty also lessens the likelihood of companies continuing to invest in Australian Defence industry capabilities, research and development or innovations to the overall detriment of Australia's future ability to sustain its Defence capability.

**AIDN considers that the White Paper must commit Defence to ongoing communication and interaction with industry, including early advice of decisions that change the shape of Defence’s future expenditure program.**

The nation's defence industry must have global credibility, to be considered for exports. It is difficult to generate that credibility when the Government does not support that industry.

The Capability Development Group and the DMO must engage with Australian SME industry players to gain an understanding of whether they have the capability required, or the ability to contribute, to overseas capability being developed for Major Projects.

Defence, particularly DMO, should make better use of AIDN to provide a deeper understanding of the industry and support capabilities of SMEs.

Partnering between DMO and Australian industry avoids costly duplication and promotes the development of indigenous capability. **The White Paper must promote a policy of partnering and risk sharing between the Department of Defence, particularly DMO, and industry wherever practicable and beneficial to both parties.**

Establish a Single Industry Division and a Defence Industry Ombudsman/Advocate
Defence lacks industry experience and its engagement with industry is often inconsistent and confusing. To address this, it is recommended that Industry Division, led by a three star equivalent Defence industry Ombudsman/Advocate with significant defence industry experience, be set up within Defence.

The Ombudsman/Advocate and their Division should be industry’s conduit to all areas of Defence, including DMO, and answerable directly to the Secretary and CDF. To be successful, the Division should include personnel with defence industry experience. This would consolidate the various industry engagement/liaison elements within Defence to create a true "one-stop-shop" for all industry initiatives and issues. It would drive a consistent approach to industry across Defence and ensure whole-of-Defence support from industry.
CONCLUSION

AIDN understands that the high level strategic objectives of the White Paper extend well beyond industry considerations. However, for the reasons discussed, we believe the 2015 White Paper presents a valuable opportunity to recognise the importance of industry to the nation’s defence and to deliver practical strategic guidance that also benefits the Defence-industry relationship.

Yours Sincerely

Alan Rankins
AIDN – National President

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