

## Sustaining Capability

Launch of CEDA National Publication:  
The Business of Defence - Sustaining Capability

South Australia, 3 August 2006

**Lieutenant General DAVID HURLEY AO DSC**

Chief, Capability Development Group  
Department of Defence

Minister has commenced the defence industry policy consultative process, the purpose of which is to provide guidance for a policy characterised by:

- A realistic, achievable and transparent basis for planning and decision making that sets out priorities, objectives and values for our Defence industry
- A transparent, innovative and economically prudent framework that explains how government makes procurement decisions

this morning he stressed that the review was to build on the implementation of the Kinnaird reforms.

The review should address issues that are summarised by Catherine Baldwin in the forward to the report: summarised by Catherine Baldwin in the forward to the report and to which the minister referred:

- tension between need for domestic capabilities and the benefits of buying from high volume overseas sources
- tension between benefits of market competition and the need to help suppliers thrive in a single buyer environment

O the alignment of procurement and maintenance with national defence strategy

- Outcomes will lie between a left and right of arc

From market competition to a mixed market competition and supported strategic capabilities, mindful that competition is typically worth 10% of contract price. (i.e. many hundreds of millions of dollars each year)

- The govt will determine the outcome. Reports such as this will assist the debate, but some leavening from a defence perspective is required. I think it would be helpful for those participating in the consultative process, or those trying to understand the issues, if I updated you on what the department and dm0 are doing today in relation to defence and defence industry relations i.e. establish a baseline. I will use the framework Ian Marsh constructed in his introduction when he listed what he believed would be expected from defence in its response to this policy review. I will also comment on the defence and defence industry relationship, identifying strategic defence industries and, while I have the con, some recent press reports.

#### **A defence update to assist discussion**

Ian presented the following elements that he believed should be included in defence's response:

- More investment in concept or strategic phase of projects
- Closer links between the services and industry specialists in the development of equipment requirements
- More transparency (in relationship between defence and defence industry)
- Novel approaches to working together
- More directly catalytic role by government

#### **More investment in concept or strategic phase of projects**

This echoes the Kinnaird recommendation that up to 10-15% should be invested pre second pass, that is government approval, to better define options, conduct risk reduction activities etc. In the two years since the recommendation came into effect a significant increase in earlier investment has occurred. We spend on average 6% of total project funds pre 2<sup>nd</sup> pass plus approximately \$66m pa (i.e. another 1.5% or 7.5% in all) on project development funds, ctds and RPDE before 1

pass. I expect this level of expenditure to grow but of course we will only spend what we need to spend for each particular project - 10% per project is not a rule. The quality of work and the appropriate engagement with industry are the factors that effect the outcomes from this early stage of capability consideration.

### **Closer links between the services and industry**

Specialists in the development of equipment requirements and role of cde. I will consider this element in conjunction with the recommendation for more transparency.

- release of the public version of the DCP 2006 – 16. Defence’s intent to continue to release dcps as a basis for industry planning and a framework for engagement with industry.

- cdaf: CEO level consultations

Most recent meeting

O outcome of 31 July

- Dc u – 07-17; 08-18 dcps

\* Successful call for bi-annual meetings from industry

O intent this year to release a version of DCP that considers schedule only to enable industry input

O EWGS undefine CDAF

O adiesa and work on OCDS and fps reviews – a model for development.

### **Industry participation in pre-entry into DCP of projects.**

A very real, innovative and contemporary example that has been in place since February 2005, is the RPDE program - a collaborative partnership between defence, including DSTO, and 84 Australian companies and academia, not all directly defence-related, whose mission is to:

“Enhance the ADF war fighting capacity through accelerated capability change in the NCW environments”

In effect, RPDE is a ‘virtual company’ operating much like any organisation in the public or private sector, controlled by a board of directors and the interests of stake holders. The RPDE program engages people, facilities, technologies and other context information

from our industry participants and defence. With these resources, RPDE addresses high priority now problems by working collaboratively to rapidly develop solutions to solve pressing NCW-related problems, which when implemented enable defence to quickly, effectively and efficiently make changes that will directly benefit the war fighter. I believe its greatest success has been in the creation of a new method of engagement between defence and defence industry.

- could i also add that Australian industry requirements are considered during the formulation of the DCP and in the entry into DCP selection process. Also an important component of all submissions to govt.

### **Novel approaches**

Any move to support particular industries in Australia will require novel commercial approaches.

Defence already has a number of long term relationships in place with industry to support a variety of key capabilities, for example the hornet industry coalition, the

P3 accord, LWT alliance, ANZAC alliance, Jindalee and AWD alliance. Major differences between these alliances and say “the team complex weapons” recently announced in the UK is that they do not commit to capabilities beyond the current capability nor include a r&d component for future capability developments. We therefore have basis to move forward if directed. There are issues however related to long term partnering that i will refer to in relation to the UK dips proposals in a few moments.

### **More directly catalytic role by government**

Minister has described one of the possible outcomes as a Realistic, achievable and transparent basis for planning and decision making that sets out priorities, objectives and values for our defence industry. Whether from this Point government adopts an active or passive role in the Implementation and monitoring of policy is to be determined. A decision on which industries are considered as strategic capabilities and for which non – competitive practices will not apply could be seen as a major catalytic step in the history of defence industry.

We note that “non-competitive implies alternative requirements to prove “value for money” like open book, guaranteed annual efficiency and productivity targets, etc. In other words, regulation.

## **Defence and defence industry relationship**

Regardless of the outcomes of the review a prerequisite

For any successful new defence industry policy is a defence and defence industry relationship on which novel and enduring approaches can be founded. This is especially so when we consider that sustainment of capability, which will be the enduring element of most long term partnerships, accounts for 75% of total value of the combined acquisition and sustainment phases. Any policy will not be worth the paper it is written on if the relationship is not right.

To create the appropriate relationship it is important, indeed critical, that dm0 continues its change process.

Dm0 must become more businesslike, more efficient and more effective to ensure that government is advised by an informed and astute customer. A weak DMO, a DMO without strong leadership is not in our collective interests. The corollary to this is that industry must show clear commitment to achieving partnership goals and an improvement in execution. Especially schedule (eg rpd&e). The consequences of poor execution by both players were alluded to in last Monday's financial review editorial which stated: 'the defence establishment must be more selective about sourcing equipment locally. As much as possible should be purchased off the shelves of our major allies'.

1. Responsibility for delay 50% schedule delay o/s

2. Previous criticism for preference for mots

- Behavioural change is required on both sides to enable any changes in the model to succeed, especially when long term strategic partnership agreements are considered.

- an example of the interaction necessary to achieve this relationship is the development of the replacement asdefcon contracts:

### **UK DI**

Could i divert for a moment. Ian marsh also commented that the UK DI would be useful as a model for defence. True but/there are some critical differences in drivers that need to be recognised:

\* UK defence budget difficulties in recent years

- Characteristics of UK industry compared to Australia (dominated by on "national champion" firm)

- Influence of European industry
- Competition with us industry

Some comments on the d1 from Prof Keith Hartley, Centre for Defence Economics, University of York, are worth considering as we look for appropriate lessons.

- partnering.

\* Dis consider pros and cons of capabilities and partnering

O an analysis of the benefits and costs of partnering is needed. Here, (in the dis the language used is interesting and by no means neutral.

O it does not follow that partnering agreements offering firms guaranteed markets will always lead to cost-efficient outcomes.

- if long term partnerships are entered it's then we will need to consider non-competitive contracts and profitability. To Support long term partnering a shift to target cost incentive contracts will be required. "it is not obvious that historic behaviours in agreeing such contracts will deliver value for money benefits to the UK armed forces and the taxpayer."

- Industrial policy issues

O monopoly versus competition

O the price of UK independence

### **Identifying strategic industry requirement**

Ian's three step process to determine Australia's critical

Industry requirements area quite sensible. In considering this issue, the UK dis looked at which industries need to be retained and provided a clear statement of the defence

Criteria to be used. The criteria are:

- Appropriate sovereignty largely undefined
- Through life capability management
- maintaining key industrial capabilities (key is not defined) and
- maintaining intelligent customer-intelligent supplier relationships.

Prof Hartley comments that the application of these criteria will require industrial restructuring and capacity

Reductions in the maritime, aircraft and land system sectors. One may wonder whether this will be achieved by industry alone or be assisted by a 'direct catalytic role' by the UK govt.

In Australia , as mentioned by prof dibb, we have listed key Industry capabilities on numerous occasions but not gone As far as to provide preferential arrangements. Whether we do it or not will be decided by govt. Within my group I have initiated a longer term analysis of our critical Technology requirements which will assist in determining critical industrial capabilities. A critic has been released to industry for comment. The public release is step 2 of 5 steps. Step 4 will be the most important - the development of risk management plans following consultation with industry.

Finally while I have the mike, some recent issues

- f18 flir pod. Poor analysis based on a whiff that resulted in an unfortunate editorial. No significant issues with pod and f18 performance on ex red flag as reported by caf : 98% serviceability and success rate with an 8:1 kill ratio.
- tiger. Unfortunate misinterpretation of anao findings
- awd progress – alliance formation – taken longer than we expected to form alliance but 18mths is well within industrial yardsticks e.g. UK cvf
- jsf progress

We support the process and our input will be evident as internal reports are released.

Kerry Clarke focus group

## End of transcript

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