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Parliamentary Secretary for Defence Procurement

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**Speech by the Parliamentary Secretary for Defence
Procurement to the
Australian Industry and Defence Network ACT**
*****Check against delivery*****

Thank you Errol

Ladies and Gentlemen.

I am pleased to be here today in my role as Parliamentary Secretary for Defence Procurement and delighted to address Defence industry once again. I'd like to talk today about:

- Defence industry policy;
- The challenges SMEs face;
- The range of Government programs designed to assist SMEs;
- Defence exports; and
- What constraints there are to growing the industry.

Defending Australia and its interests means, for all of us here today, the ongoing support and enhancement of the Australian Defence Force. The Government is committed to ensuring that the

ADF has the equipment, protection, training and support it needs. Defence industry, of course, has a major role to play in this.

Over the next 10 to 15 years, in the order of 80 per cent of the ADF's war-fighting equipment will need to be either replaced or upgraded. This major technological transformation poses a challenge to both the Defence Materiel Organisation (DMO) and defence industry.

In the financial year that is almost upon us, the Government will invest the equivalent of 1.8 per cent of GDP or \$21.7 billion into the ADF. The Government has met its commitment to maintain real growth in the Defence budget at an average of three per cent in real terms every year to 2017-18.

Industry Policy

A significant element of my role is defence industry policy, including maximising the opportunities for Australian companies to compete for defence acquisition and sustainment work, promoting defence exports and not least, increasing the number of skilled people in the defence sector.

We want to ensure that as much of the defence budget as possible will be spent in Australia through making Australian defence companies as competitive as possible.

The integration of defence SMEs into the supply chains of the international primes, and the identification of the strategically

significant indigenous industry capabilities are basic elements in developing an effective defence industry policy. We need to identify those strategic industry capabilities that will be vital for industry to develop and maintain in Australia for national security and strategic defence purposes.

Over 3,000 SMEs are involved in supplying Defence, with many at the innovative end of the spectrum. Many SMEs have niche capabilities that the ADF relies upon.

As a Government, we are committed to encouraging SMEs, and our policies aim to maximise the opportunities for Australian companies to compete for work, not only in our own market, but in overseas markets as well. As large suppliers will be busy with increases in demand over the next decade, we will need more SMEs to become involved throughout the defence supply chain.

SMEs are often the sources of innovation that allow the ADF to maintain its capability edge. Just as importantly, SMEs underpin industry's capacity to respond to changes in Defence demand because they tend to be more agile than larger firms. For these reasons, a competitive and sustainable SME sector is an essential feature of Australia's defence industrial base, and the Government has as an objective the creation of an environment where capable SMEs can prosper as defence suppliers.

The most straightforward way to encourage SMEs in the defence sector is to give them the opportunity to bid directly for work. Currently, around 15 per cent of Defence's acquisition and

sustainment budget goes directly to SMEs. It is my fervent desire that Defence continues to offer opportunities of a scale and scope amenable to delivery by SME provided that it is consistent with achieving best value-for-money. Inevitably, however, many SMEs will continue to work as sub-contractors to larger defence firms. For this reason, we have an interest in influencing the interaction between prime contractors and SMEs.

One of the stated goals of the defence and industry policy statement last year was that at least 20 per cent of Defence acquisition, sustainment and support budgets flow to Australian defence-related SMEs by 2009. I wish to continue this aspiration within the new government.

I'm confident that Canberra-based SME's are making, and can continue to make, significant contributions to ADF capability.

One example is Australian Technology Information, or ATI.

This Canberra-based SME is now taking its innovative products to the global marketplace. In February I was proud to announce that ATI had been able to secure a contract from Boeing to develop technology and provide subject matter expertise for tactical data links such as Link-16.

Their MAC² networking product can be tailored to uses in everything from the Defence to Emergency Service sectors. It is a commercial off-the-shelf (COTS) solution for naval security forces, fire fighter command centres, port security managers, public safety

organisations and in support of disaster relief and security operations.

Since its inception in 1990 ATI has been steadily growing in numbers and in skill base. It is contributing to the national economy in a very real way through its involvement in the high technology market.

Challenges of being a SME

However, I recognise that SMEs face a number of challenges that must be overcome if we are to build a strong defence industry. These challenges range from the management capacity of SMEs, the need to commit to continual process improvement and the need to invest in skills.

A defence industry survey by ACIL Tasman found that 81% of industry participants found financing an issue. I see two aspects to this issue. The first is the actual access to financing and the second is the level of necessary financial management capacity to operate in the defence industry. On the first issue, beyond ensuring a stable macroeconomic environment and appropriate business and lending regulation, the Commonwealth has little role to play.

However, there is some scope for Commonwealth encouragement of improved financial management competency of industry. I acknowledge that there are an awful lot of SMEs that are very well run. Nevertheless it is fair to say that a fair number of Defence

SMEs are owned and operated by entrepreneurs who have come out of larger defence companies, the ADF or DSTO with great technological capabilities but without necessarily the expertise to commercialise their great idea. And once they have found a niche for their product and have attracted interest in the market, they then have to grapple with issues like cash flow management, managing staff and the general pressures of operating a business on tight margins. Only 22% of defence companies surveyed have a focus on improving their financial processes. We need to examine ways to take the pressure off these innovators, so they can concentrate on their core business.

Another issue for SMEs is their ability to access the latest production processes and technology. This is a neglected part of the innovative process with less than half of the defence companies surveyed in a 2004 paper planning to introduce new production processes. This failure to continually benchmark and improve production performance has a huge impact on the competitiveness of businesses. I understand that many defence primes complain that they deal with SME subcontractors who have a great product, but have cash flow problems or have antiquated production methods. While some mentoring occurs, defence primes are more likely to use this as an excuse to reduce their commercial interactions with SMEs.

This is an area where government can help. It's known as the '8th day problem', that is improving financial management and scouring industry for the latest production processes and technology is something SME owners would only be able to do if they had 8

days in a week. Well Government can't grant you an 8th day, but we can implement policies that provide one stop shops for these sorts of services.

The national system of Enterprise Connect and Manufacturing Network centres is an excellent start. Businesses will be able to access Enterprise Connect centres to find and adapt the latest research and technology; get help in solving identified problems; work out how new processes can help their business; and cut through red tape to identify sources of government support for their innovative activities. Hopefully, Defence SMEs will look at accessing these programs, thereby improving their competitiveness.

Defence and Industry ePortal

In order to further assist Australian companies, I recently announced the establishment of the Defence and Industry ePortal that will be launched in July. This new portal will replace a number of existing systems such as the Defence Small Business Access and the Unsolicited Promotional Products Gateway.

Instead DMO and industry will have one portal - a one-stop shop - that will be more comprehensive but also easier to navigate. It will also incorporate publicly searchable information on defence industry capabilities covering companies in Australia and New Zealand.

Stakeholders involved with Defence procurement will also be able to use the new portal to find out about upcoming Defence business opportunities. This ePortal will also assist industry to access Defence information on grants and funding decisions such as SADI, enhance the flow of information and communication between Defence and industry and improve the opportunities for SMEs to participate in Defence acquisition and sustainment activities.

Australian Industry Capability Program

We will expect defence primes to commit to using the ePortal when designing and implementing their Australian Industry Capability plans. I was delighted to launch the AIC program at the February ADM Congress. This program is designed to ensure that Australian industry has the capabilities and capacity needed to support the ADF's operational capability, both now and in the future.

We recognise that it is hard for SMEs to win defence work on their own let alone defence export orders, so the AIC program, using the leverage of major acquisition projects, will require tenderers for high value contracts to develop detailed strategies for involving Australian industry in their bids.

Prime tenderers will need to show how they have engaged Australian industry, how they have checked the capabilities offered by Australian companies, and how they have assessed their competitiveness.

Furthermore, prime contractors will also be required to show how they intend to involve competitive Australian companies in their supply chains here and overseas. Successful tenderers will be required to implement these strategies as they will be part of their formal contractual obligations.

Outcomes have already been achieved. For example, Boeing and the DMO have signed an agreement to deliver opportunities for Australian defence companies to join Boeing's global supply chain, and EADS has established an office in Europe to facilitate entry of selected Australian companies into their supply chain.

Defence Exports

On the topic of exports I was quite surprised when I looked at who actually in the defence industry exports. Coming from my broader economic background, I had assumed that it was the big defence companies who undertook most of the defence exports. Scale and having a domestic base have traditionally been the key precursors to export success.

However, this is not necessarily true in the defence industry. A 2004 survey of the defence industry found that the greatest export intensity was found in SMEs. Only one defence company surveyed with more than 100 employees exported more than 50% of their output, whereas a significant number of companies with less than 100 employees had a much greater export intensity. This stands to reason as most of the defence primes, especially the

multinationals, were established in Australia to service the ADF with some limited exports back through their parent companies.

Interestingly, of the companies who were successful exporters, half of them exported as part of a supply chain. This is perhaps a recognition of how hard it is for defence SMEs to break into the export market with a stand alone product. Integrating Australian SMEs into global supply chains is probably the best way of boosting defence exports and it is a tactic that government can readily assist in.

Earlier this year I announced the establishment of the DMO Defence Export Unit which has a clear role in facilitating the entry of Australian companies into the global market place and supply network. This in conjunction with the AIC plans is clearly focusing defence industry policy on assisting Defence SMEs into global supply chains.

The Boeing Office of Australian Industry Capability (BOAIC) located in Seattle is a very interesting initiative which I'm following closely. I know that Boeing is mentoring half a dozen Australian SMEs who are attending a Boeing supplier fair in St Louis as we speak. They're meeting with over 200 suppliers and hopefully making contacts that will translate into export orders. The DMO is conducting a review of the office's effectiveness at the moment and I will be very interested in the review's conclusion.

Industry Constraints

So we are focused on maximising the local content and looking for export opportunities. Nevertheless, despite Australian defence industry growing very strongly over the last five years, it is true to say that the industry has not been able to keep pace with the concurrent rise in project expenditure over that time.

Skills Issues

One of the factors influencing this is the skills shortage.

Since 2001 the defence industry workforce has expanded from 19,000 to nearly 22,000 workers.

Defence industry is one of the most skilled workforces in the country, with around 37% of the workforce being engineers or other professionals and the remainder (63%) being tradespeople and production workers.

The Government has pledged to continue the three per cent annual real growth in the defence equipment budget for a further two years through to 2018. This will require a corresponding growth in the workforce if we are to sustain or grow the current level of Australian industry involvement.

The DMO has estimated that, over the next decade, industry will need a further 13,700 skilled personnel due to increased demand and to combat the ageing profile of the workforce. Over the next 5 years alone, we will need to introduce into the defence industry

approximately 700 professionals and 1,170 tradespeople and related workers each and every year.

Lifting the number of personnel and the skill levels across the workforce will be central to getting the defence industry to deliver on time and on budget.

Let me make it also clear that if we do not meet this challenge and cost and schedule risk increases, there will be a concerted push to procure more acquisitions overseas. If we are to maintain a significant defence industry and optimise Australian industry involvement to support ADF equipment acquisition and sustainment, we must address these skills issues now.

On average, SMEs do not undertake anywhere near the level of training that is undertaken by larger companies. According to the Australian Bureau of Statistics 98 per cent of companies employing more than 100 workers conduct structured training, whereas for small business it is only 39 per cent.

There are a number of reasons for that, for example cost of training, access to training packages and providers and availability of staff etcetera. However, industry must lift its performance on this issue. Government will assist, but industry must invest.

If the Australian defence industry does not make this investment in skills, then there will be a move by some for more acquisition work to be sourced overseas. This is a situation we must do our best to avoid.

Continuing DMO Reform

Continuing the reform process in the DMO is important to me, and I know that the DMO leadership is engaged in this task through Dr Gumley and his colleagues. On 7 May I announced that David Mortimer, Chairman of Australia Post and Leightons Holdings, will undertake a formal evaluation of the effectiveness of reform in the DMO – these are the reforms implemented following the 2003 Review of Defence Procurement conducted by Malcolm Kinnaird. Mr Mortimer's terms of reference also includes a clear mandate to advise on a program of further reform.

Mr Mortimer's review is not yet complete, but I do want to touch on one issue that is likely to generate some discussion. In its acquisition planning and strategy Defence must consider risks and how best to manage them. This inevitably leads to discussion of the advantages and disadvantages of Military Off the Shelf (MOTS) and Commercial Off the Shelf (COTS) solutions.

However, the consideration of MOTS and COTS alternatives should not be misconstrued as a preference for foreign imports in the Government's decisions on major capital equipment purchases. MOTS solutions can and should be built in Australia, when it offers value for money.

It is clear that in some niche areas the global consolidation of industry capability will lead to foreign-sourced equipment. Australia is certainly not now, nor is it likely to be, a contender in the construction of major aircraft platforms, for example. However this does not close the door on Australian industry involvement. Our companies can still compete for sustainment contracts and for key subcontracts on major acquisitions – the Australian contribution to the Joint Strike Fighter program is just one example. Of course, we do have a strong Australian shipbuilding and maritime sector. Vehicles and equipment, electronic systems and ordnance can also be locally sourced.

Defence Contracting

Finally, I know contracting issues are also very close to your hearts. A survey of defence industry by ACIL Tasman found that 37% of companies regarded the cost of tendering as either highly important or a critical constraint on doing defence business. The Government is very interested in looking at ways to improve defence contracting.

The DMO and I have been engaging with industry and are committed to continuing to do so. This consultative approach is a crucial element of achieving real and lasting improvements to procurement policy and practices.

I have asked the DMO to review and update the primary reference document for Defence procurement, the *Defence Procurement*

Policy Manual, to improve the efficiency and effectiveness of procurement processes.

The DMO will also continue to consult with industry to further improve the Australian Defence Contracting (ASDEFCON) suite of tendering and contracting templates.

Conclusion

I would like to thank you for the opportunity to explore some of these issues today and I will be happy to take any questions you may have.