

PRIMES & SME'S SOVEREIGNTY

And The Global Supply Chain



Arran Brown Raquel Zundel Michael Buttignol Brody Mincham

Executive Summary

“Primes engage SME’s to enter global supply chains for various reasons. Is there a relationship between businesses entering the global supply chain and the development of a sovereign industrial capability?”

The question posed to the group was initially considered as a straight ‘yes’. However, as the research provided in this study will illustrate to the reader, it is a ‘yes’, but with conditions. This paper focuses on the challenges identified between Prime and SME relationships to facilitate the development of various sovereign capabilities foremost; whilst also highlighting the challenges Australian SME’s encounter to step competitively onto the global stage.

As found during various interviews with SMEs, given the inherent small size of these organisations, this drives the CEO/owner to shoulder much of the business development burden whilst also absorbing the related costs. Navigating the complexities in successfully obtaining grants is again problematic, along with the usual match funding criteria and specificity to project use. Exploring the assistance frameworks which exist in the form of advisory groups and monetary funding is a promising step forward, however, as the group has identified, there are various areas where these could be better adjusted and focused.



Contents

<i>Executive Summary</i>	1
Introduction	3
Definitions and statistics	3
The importance of a sovereign capability for Australia	4
Primes and SME engagements and relationships	5
SMEs and their challenges entering the Global Supply Chain	6
Assistance programs and grants for Defence businesses	6
Australian Industrial Content and Sovereign Capability	9
Recommendations and where to next?	11
Acknowledgements and references	12



Introduction

Throughout this paper we will explore the underlying theme extracted from the question. That is how does Australia build a larger sovereign capability within Australian SMEs. How can the SME leverage the SME to Prime relationship to enter the global stage via the Global Supply Chain. There are several areas and initiatives found during the research and interviews which are and are not working to achieve this core goal. The team's recommendations to better facilitate this ideal outcome are shared during the conclusion.



Definitions and statistics

Primes:

Primes are companies that execute Major Defence contracts, they have an annual revenue over \$500 Million and they typically employ over 200 people. Primes also account for 50% of employment in the Defence industry

Small to medium enterprises (SMEs):

In Australia, SMEs account for 97% of our businesses and employ 40% of the workforce. A SME is considered a company that employs between 5 and 200 staff.

Sovereign Industrial Capability (SIC):

Are industrial capabilities considered critical to Defence and for which Australia must have access to, or control over, the skills and technology, intellectual property, financial resources and infrastructure that underpin those capabilities.

Global Supply Chain (GCS):

A global supply chain in this context means working with multinational Defence companies or Primes. It is a dynamic worldwide network of suppliers.

The importance of a sovereign capability for Australia

Due to the nature of Australia being an Island, there is a heavy reliance on goods and services being shipped/imported. The world globalization movement has been good for imports and exports, however Australia's Defence industry not only imports materials and goods, but also capability and Intellectual Property (IP).



Building a Sovereign Industrial Capability (SIC) for Australia through the Defence industry has multiple benefits for Australia as a whole. It means the local and national economy is being invested in by spending more money in the country, it also creates jobs and develops our indigenous capability. In the case of a regional or international crisis where material or information supply lanes are "cut-off" Australia needs to have the ability to self-sustain its Defence industry.

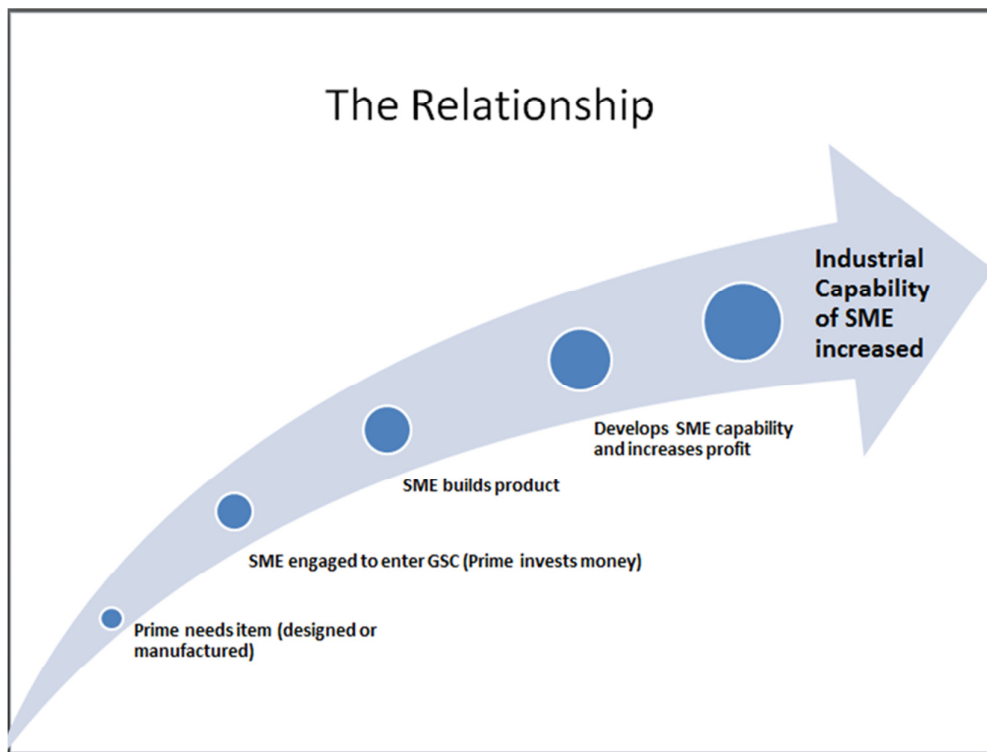
Primes and SME engagements and relationships

Whilst the government have introduced Australian Industry Content requirements that require Primes to engage with 50% Australian content, there are downsides to Primes disengaging relationships with their current providers which can outweigh the possible benefits of engaging with new Australian SMES's.

There is an inherent risk with bringing on a new supplier such as:

- It requires a lot of effort to find an SME that has the capability the Prime requires.
- Once they are engaged, there are costs in getting the new SME up to date with their system requirements and ISO standards.
- Entrusting that the new company will live up to the standards of an existing supplier's relationship.

The examples listed above highlight the possible financial and time burden that impacts a Primes decision to engage with local SME's. For the SME to leverage the Prime to best effect it ideally occurs at the front end of the process as seen in the diagram below. This however requires trust and a common strategic goal between each party.



To facilitate AIC growth, Australia must determine ways in which we can reduce the financial and time onus on the International Prime so they can see the benefits of engagement with Australian SME's.

SMEs and their challenges entering the Global Supply Chain

Through our interviews we have found that there are two ways in which an SME enters the global supply chain (GSC). This is either by a prime approaching the SME to provide a service, or by the SME actively engaging various primes to offer their services.

It was noted that without a prime seeking the SME the task of engaging primes by the SME is executed generally by a senior member of the SME, in most cases this being the CEO/owner. Now as the name suggests, SME's are small to medium businesses with not a lot of bandwidth or resources, and usually lack someone dedicated to a position such as "Business Development manager". This means that the task of engaging a prime is generally a high time and cost burden that the CEO/owner needs to invest in to ensure that the business is being promoted adequately on a local, national and international scale.

Assistance programs and grants for Defence businesses

There are several types of generic grants available that can assist SME's to be more competitive on a global stage such as:

- Research and Development Tax Incentive:
 - o This program encourages companies to engage in R&D to develop new products, processes or services with flow on benefits to Australia.
- Accelerating Commercialisation
 - o This program provides small and medium businesses, entrepreneurs and researchers with access to expert advice and funding to help get a novel product, process or service to market.
- Export Market Development Grant (EMDG)
 - o This program assists SME's in developing and expanding export markets.

Assistance programs and grants for Defence businesses (cont.)

From 2018, the Government have also introduced Defence specific grants to assist in growing the small to medium enterprise (SME) industrial base to be capable of providing a significant contribution to the Sovereign Industrial Capability Priorities.



Examples of these grants are:

- Sovereign Industrial Capability Priority
 - o This grants program aims to help SMEs to invest in projects that build capabilities aligned to one of the ten Defence Sovereign Industrial Capability Priorities.
- Defence Global Competitiveness:
 - o This program aims to build export capability to build a stronger, more sustainable and globally competitive Australian Defence industry
- Capability Improvement Grant:
 - o This program works with Small to Medium sized businesses that have, or are developing, products or services that can be applied to Defence. The program provides \$5,000 to \$250,000 to reimburse up to half the cost of engaging a consultant or expert to implement recommended business capability improvements, including training.

Assistance programs and grants for Defence businesses (cont.)

Over the past several years there has been reporting on some of the Programs and this has led Government to revise the programs which has led to burdensome compliance and restricted funding which has seen many SME's reduce or even cease, the amount of R&D they currently undertake due to the reduced ability to claim. In regards to Defence specific grants, there is often specific criteria, for example: The SIC grant must be linked to a specific capability, such as the Collins class. This has potential to exclude worthy 'Defence potential' candidates who may have products that are overarching Defence and other Industry's.

Feedback from SME's indicates that whilst they are aware there is assistance - what assistance, and how to access it, is a common issue and the reason why grants are not readily accessed. Online information, for first time applicants can be difficult to understand and access to government agencies can be complex and time consuming, often requiring third party assistance, through a specialised consultant.

With 90% of the grants competitive, there are further issues of the requirement for matched funding (50:50) for which many SME's do not have the transferable skills or capability. Additionally, applicants seek matching funding from third party capital providers and the this is often at a life cycle stage where the business does not offer a value proposition for such investment and/or needs the ability to move fast which can often be impeded when dealing with non-executive shareholders.

Whilst there are perceived limitations to SME's, there are also organizations and groups which help SMEs to help further develop relationships and connections such as:

- Defence Teaming Centre (DTC)
- Centre for Defence Industry Capability (CDIC)
- Defence Export Strategy and Team Defence Australia.

In 2019, \$15.8 billion was spent on Defence specific grants, through SME's leveraging CDIC capability, and whilst this is a significant amount, from our research, many SME's were unaware of the grant and its capability. We believe that this figure would be at least tripled if there was increased advertising from the government around what grants were out there to assist SME's (Government and Non-Government).

Assistance programs and grants for Defence businesses (cont.)

However, whilst there is assistance, prior to accessing Government and Commercial assistance, SME's must ensure they have the internal capability to utilize and foster the innovation that financial assistance will bring. SME's must own the responsibility of ensure they have the structure, people and processes to facilitate the growth that will occur once they enter a global supply chain. To put this into perspective, a \$1,000,000 grant provides a return that is equal to a \$10,000,000 sale.



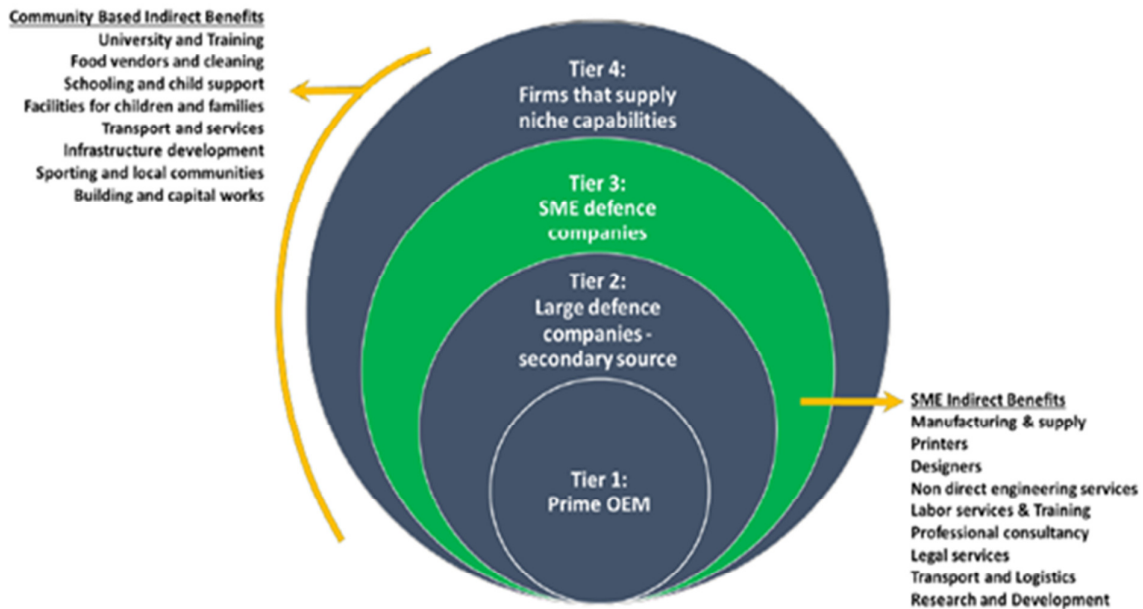
Australian Industrial Content and Sovereign Capability

As highlighted above, whilst AIC and SIC are often referred to as going hand in hand, when investigated further, it is apparent that the focus on AIC is not on growing SIC. Currently there is a strong Government emphasis around manufacturing and sourcing of materials and products (AIC) and not on SME's owning the product life cycle (from design, manufacturing and owning the IP).

The key for Australia's SIC to increase, is for SME's to own the IP to their products or processes as IP plays an important role in facilitating taking innovative technology to the marketplace. At the same time, IP plays a major role in enhancing competitiveness of technology-based enterprises, whether such enterprises are commercialising new or improved products or providing services based on new or improved technology.

By SME's facilitating their own organisational growth, it will increase internal skill sets and this transference of knowledge will directly impact our SIC.

This will also allow the SME to grow from an organizational perspective allowing the SME to move from the Tier 3 and Tier 4 categories and move into the Tier 1 and Tier 2 categories thus allowing Australian SME's to develop Australia's Defence capability.



Recommendations and where to next?

Given the previous details, the group has extracted three main focus areas which we believe will support and catapult SMEs onto the global stage as true contenders with real Australian indigenous capabilities. They are:

Get capability onshore to create our own sovereign IP.

This could be achieved by mandating stricter guidelines into AIC policy, and having SME's engaged more heavily in the development and design process of a contract. Rather than merely being a manufacturer playing their part in a large (pre-existing) global supply chain that the prime is already utilising.

Government funding and subsidies - modernise and loosen restrictions.

Enable our SMEs entering the Global stage to be **more** competitive. SMEs should be treated as possible future sovereign primes, and thus assistance should be made easier, or at least clearer, to help facilitate their growth and progress.

Primes and Australian SMEs connections

Optimise how first contact is done through the further development of a user-friendly database and tool. A national database could be established that focuses on identifying all the businesses that are involved or that wish to be involved in the Defence industry; with clear information on the services that they provided. This would be similar to the database that Defence SA provides for the South Australian businesses. A focus also needs to be put on accurately identifying all of the capabilities that the business offers; to assist the Prime into finding a well-suited SME for the job, rather than falling back onto a known international supplier.

Acknowledgements and references

1. – All photographs: “The Defence Image Gallery” (<https://images.defence.gov.au/>)
2. – Shipping lane imagery: <https://www.shipmap.org/>
3. – Interview references:
 - Simon Kennedy, CEO, Smart Fabrication, (<http://smartfab.com.au/about/leadership>)
 - Daryl Mincham, CEO, Mincham Aviation, (<https://www.minchamaviation.com/>)
 - David Zundel, CEO, Inventure Partners, (<http://inventure.com.au/>)
 - Claude Messina, Engineering and Program Manager, PMB Defence Engineering
 - Rob Pitelen, ISC Director, Air Warfare Destroyer Program
4. – Tier reference: *2018 Defence Industrial Capability Plan*
5. – Definition References: *Small Business Counts: Small Business in the Australian Economy*

