13 July 2023

Committee Secretary
Senate Standing Committees on Foreign Affairs, Defence and Trade
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

RE: Inquiry into the performance of the Department of Defence in supporting the capability and capacity of Australia's defence industry

Dear Senate Standing Committees on Foreign Affairs, Defence and Trade,

The Defence Teaming Centre (DTC) welcomes the Senate Foreign, Defence and Trade Legislation Committee's inquiry into the 'Performance of the Department of Defence in supporting Australia's defence industry' capability and capacity.

Based in South Australia, the DTC is a not-for-profit industry association with over 26 years of experience in connecting, developing, and advocating for Australia's defence industry. Our membership consists of over 220 companies spanning from small to medium sized businesses (SMEs) to defence primes, plus a stakeholder cross-section of an additional 120 organisations which include other industry associations, academia and special interest groups.

The DTC approached the membership base to provide comments on the Terms of Reference provided through the Parliamentary website - https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Foreign_Affairs_Defence_and_Trade/PerformanceofDefence47/Terms_of_Reference

The enclosed report summarises written submissions provided by member companies and feedback gathered through targeted interviews with members including defence primes, SMEs and researchers. The report can be summarised into six key recommendations:

1. Defence should clearly articulate their expectations of industry, including non-contracted contributions to Defence policy and discourse,
2. Defence should assess the barriers to entry, including length and cost of procurement processes for industry,
3. Consideration should be given to which key capabilities are required to be sovereign and supported onshore, and the ease by which industry can support Australia's allies' Defence capability to sustain industry where Australian Defence processes cannot,
4. Security of supply chains can be ensured, to an extent, by requiring onshore support within industry,

5. Defence should seek to remove regulatory barriers that complicate technology sharing within companies across borders; and

6. Defence should consider whether programmes and initiatives will incentivise involvement or encourage innovation and competition, or whether this will further complicate the burden placed on Defence in procurement of capability.

We are all acutely aware of the importance of a strong and developing defence industry to our nation's security. We welcome the review of the Terms of Reference (ToRs) and provided feedback for a unified industry response.

We would be grateful if you considered the submissions contained within the report and contacted us should you have any questions.

Yours sincerely,

Tim Dore
Acting Chief Executive Officer

DTC Member Submission

How Defence can support Australia's Defence Industry

2023

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Terms of reference being addressed

Pursuant to standing order 25(2)(a)(v), the committee has resolved to inquire into the performance of the Department of Defence in supporting the capability and capacity of Australia's defence industry, with particular reference to the department's:

Support to Australia's defence industry in meeting the current and future needs of the Australian Defence Force

The definition and role of Australia's defence industry are crucial in assessing the effectiveness of Defence's support. The 2020 Defence Strategic Review acknowledged industry as a Fundamental Input to Capability (FIC), contributing to the development, delivery, and sustainability of capabilities. However, Defence lacks understanding and a plan for the industry's role in capability.

Input to a FIC and capability is funding, and a capability needs to have an operational and strategic effect. *(Defence Procurement Manual)* For the industry to deliver either an operational or a strategic effect, it is defence and not industry that needs to define what Industry has to provide for each project (as a FIC) or as a capability. Unfortunately, a narrative binary is articulated in the Defence Strategic Review (DSR), which places the use of distinct FMS/off-the-shelf products against and compared to Australian-developed content. This narrative limits the processes involved in developing a solution that integrates both types of capabilities.

This is also factored in with the failure of successive innovation models. Defence's innovation models have consistently failed, hindering the embrace of Australian innovation solutions. Despite industry efforts, many local solutions are disregarded in favour of acquiring capability through FMS. To address the future needs of the ADF, Defence must prioritise leveraging Australian innovation to advance capability and support the warfighter. Most industries that have an input into Defence are looking to the future, but there is a gap between the present and the future, and the problem is how to bridge that gap. The industry would be happy to bridge and potentially fund that gap, but we are businesses and must have reasonable certainty in return for their investment.

The general observation is that Defence has little to no understanding of what value industry can offer towards strategic objectives relating to defence outcomes.

Recommendations

- Defence should explore the value of a framework outlining the situation in which FMS, off the shelf, Australian sovereign or situations in which a solution integrating both is preferred,
- Defence should clearly articulate their expectations of industry, including non-contracted contributions to Defence policy and discourse; and
- Defence needs to articulate as an outcome the operational and strategic outcomes it requires from Industry as it ultimately is responsible for delivery.

Role providing and supporting opportunities for adjacent industries to contribute to the sustainability and viability of Australia's defence industrial capability

The reality of the Defence acquisition process undermines the concept of adjacent industries supporting Australia's defence industrial capability. Slow and costly procurement processes discourage businesses from engaging in Defence work compared to commercial ventures.

The speed of decision-making in Defence procurement is a central issue. Shifting decisions due to demand changes, internal challenges, and priority adjustments creates unpredictability, dissuading adjacent industries from considering defence projects. The unstable market environment, combined with limited competition, diminishes the overall industry's contribution to defence capability.

Inflexible requirements deter some companies from engaging with Defence. Commercial entities can openly explore cost savings and innovation, while Defence places excessive burdens on industry experts to meet standards and provide documentation. The process for change is time-consuming and costly, often resulting in a negative response to avoid additional short-term expenses.

To remain globally competitive, the Australian industry has embraced advanced technology, procedures, and processes. However, Defence's rigid and nation-specific requirements, coupled with the lengthy decision cycle, disadvantage the local industry against overseas solutions. The non-recurring costs and the need to re-tool or unwind innovative processes pose challenges.

Defence's assessment of Australian suppliers for specific projects, requiring retooling and adherence to foreign national standards, incurs non-recurring costs that hinder efficiency. A department-wide approach that assesses capability requirements across multiple projects would promote efficiency and enhance capability. It would also help Defence identify industry gaps that need to be addressed to sustain strategic objectives.

Recommendations

- Assess barriers to entry, including length and cost of procurement processes for industry,
- Defence should look at industry holistically and clearly define what it requires before engaging industry,
- Review and simplify compliance processes on a regular basis to improve the efficiency of procurement processes; and
- Improve communication and transparency by providing clear information on project requirements, timelines, and expectations.

Work to address the reliance of Australia's defence industry on inputs, be they tangible or intangible, from abroad and key capabilities that could form the basis of targeted exports

Australia's Defence industry is incredibly limited in how it can become fully sovereign. We do not have domestic production capacity for the bulk of the equipment. Setting up indigenous production lines beyond build-to-print models is unfit within our current economic set-up. Further, setting up this capability would create a significant workforce drain that Australia's economy cannot currently support, given existing workforce challenges. Additionally, Australia's Defence spending is not significant enough and the procurement processes not efficient enough to support the development of a sovereign latecomer entry to the existing competition between Primes and existing industry.

Defence should define industry-specific strategic objectives, which are funded and evaluated across the portfolio, rather than expecting the industry to develop and detail its own strategic capability. Evaluating Australian industry against foreign government-supported counterparts on a project-by-project basis may seem cost-effective initially, but it fails to account for the ability to sustain, repair, upgrade, or replace systems during times of heightened national security. Assessing industry as a strategic element ensures the capture of sovereign capability. The current Commonwealth Procurement Policy lacks clear direction for the Australian industry, disadvantaging it. Defining the

relative value of technology where intellectual property (IP) can be held in Australia, either through sovereign design or as part of the solution, is essential.

Nevertheless, the role of the Australian defence industry should not be diminished. A sovereign industry excels in sustainment, high technology areas, and niche product support. Prioritising production in Australia for high-use items like critical spare parts, ammunition stocks, and other commonly replaced items during regular maintenance should be considered. This extends to software development and systems engineering to deliver Australian capabilities, particularly in supporting Defence's C4ISR and ICT capabilities. Direct support for local systems integration capabilities or primes willing to invest in these skill sets locally should be encouraged by Defence.

Notably, the Australian defence industry finds efficiencies in supplying to foreign militaries rather than into the ADF. Consideration should be given to how we work to ensure support for Australian businesses that are able to supply internationally but need help to do so in Australia, particularly if they are working to support allied and coalition partners.

Recommendations

- Consideration should be given to which key capabilities are required to be sovereign and supported onshore and the ease by which industry can support Australia's allies' Defence capability to sustain industry where Australian Defence processes cannot; and
- Facilitate international supply chain support.

Assessment and response to the risks that interruptions to supply chains may present to the ready access to such inputs and the benefits of producing defence industry outputs in Australia

There are two primary sectors we have considered hardware with the two sub-sectors, manufacture and repairable, and software that covers communications. Due to the significant amount of equipment purchased through FMS, the support for this equipment is vulnerable as supply lines are affected as they were through COVID. Defence must identify the criticality of each system component to determine Australia's ability to manufacture/maintain the systems and components.

As pointed out earlier, Australia provides incredible capability in sustainment, high technology areas, and niche product support. Consideration should be given to targeting high-use items for production in Australia, including critical spare parts, ammunition stocks, and other items which require common replacement as part of regular maintenance. An additional option is for Australia to increase the stock holding of spares and materials to support the sustainment of the equipment.

A level of mitigation can be achieved to reduce the risk of an interrupted supply chain by holding additional lower-level stock so repairs can be carried out. This is a relatively easy initiative to implement, but there should be a shared cost/risk with Defence so there is an incentive not to overstock the shelves but look at reduced lead times.

There are risks to interruptions to communications that may limit access, particularly in cyber and software upgrades. While cyber breaches and risks are easily remedied by patches, with the downgrading or removal of communications connections between Australia and our allies, we may have ongoing vulnerabilities in software on Australian systems that our allies may rapidly patch.

The natural remedy to this is for Australian-based software development teams from the industry to support Defence across various programs. This capability can only be delivered by an industry based in Australia and staffed by Australians due to the sensitivity, complexity and network access

involved. While it is not a perfect remedy, given software sensitivities, it remains the best possible current solution to enable our systems.

Recommendation

- Security of supply chains can be ensured, to an extent, by requiring onshore support within the industry if Defence articulates the strategic capability it seeks upfront.

Role in enhancing Australia's defence industrial base by pursuing greater advanced scientific, technological and industrial cooperation through AUKUS and other defence partnerships

Defence can better support cross-border technology sharing by encouraging discourse within industry surrounding the improvement of Australia's defence industrial base. Significantly, the challenge of export control and ITAR regulation is predominantly faced by the end-user, which is industry. Thus, the challenge is not just faced by Government but requires industry input to mitigate this issue. Defence should consider how these requirements create barriers between Australian subsidiaries and their parent companies, namely where technology cannot be shared within a company but must go through Government processes. For example, Australian subsidiaries of US defence primes often struggle to gather information from within their own companies – which makes it incredibly difficult to support Defence and the ADF with information about the best possible technologies available.

While Defence's work on the liberalisation of the ITAR regime is admirable, consideration should be given to how Defence interacts with related technologies to support information gathering for Australia. Much more consideration should be given to exploratory interactions with the US, particularly in sending letters for Technical Access Agreements (TAA) to gain further understanding of ITAR-controlled technology to support ADF acquisition efforts.

Through the definition of industrial capability requirements at the outset, the consideration of the effect of ITAR and other trade-related restrictions can be considered at the strategic and operational level and evaluated as part of the overall strategic capability requirement, this then enables Australia to not only define what industry needs to be capable of from a sovereign perspective, but also to inform government to government priorities when it comes to technology sharing.

Recommendation

- Defence should seek to remove regulatory barriers that complicate technology sharing within companies across borders. Where they cannot be removed, then regulatory barriers are heavily weighted as a risk when assessing value for money.

Design and implementation of programmes and initiatives that seek to improve the Australian defence industry's capability and capacity

In designing programs to improve Australia's defence industry's capability and capacity, consideration should be given to realising benefits for industry which provide a tangible contribution. Programmes and initiatives should not aim to increase the number of Australian companies in Defence supply chains to show a large industry base from which to draw capability. These programmes and initiatives should align with the tangible capability needed for projects.

Efforts to develop Australia's defence industry should prioritise encouraging multinational defence primes to establish significant capabilities within the country. Defence must define, fund, and measure its requirements as part of commercial considerations to focus primes on building industrial capabilities in Australia. Without this approach, the industry cannot truly support sovereign capability in the country. Initiatives such as the Guided Weapons and Explosive Ordnance program and Foreign Military Sales (FMS) programs should clearly outline upfront what is required from primes, rather than relying on a best-effort approach. This is especially important considering initiatives in the US to view Australia as a domestic production source for the defence industry and ensure sustained capability in uncertain strategic circumstances. Defence, not industry, should define strategic sovereign capability outcomes, with competitive market forces and government-to-government focus points driving industrial capabilities.

Industry seeks clear capability requirements from Defence, evaluated strategically, to ensure ongoing support for Defence in the future. Defining success criteria for industry as a capability and evaluating industry proposals based on those criteria will elicit positive responses from the industry through contracts. Without clear requirements, industry cannot fulfil the role of a strategic capability. Changes to procurement manuals, Defence white papers, strategic reviews, and project definition documents are necessary to articulate industry as an input and shift the industry's current trajectory away from Defence.

ADSCA should collaborate with Defence capability owners to define sovereign industrial capability priorities, starting with existing priorities, and further define the subsequent layers of capability. Allocating funding to create pathways to success for defence-industry collaboration is crucial. Additionally, when Defence introduces complexity and increased costs for Australian industry through factors like ACE reporting and non-recurring engineering for defence-specific requirements, these costs should be evaluated strategically against overseas industry rather than on a unit-by-unit basis. For example, the comparison needs to be comparable when Australian industry is being directly compared on a unit-to-unit cost basis because of the Commonwealth Procurement Policy against a European or United Kingdom supplier for systems on Hunter Class.

The European supplier may provide the product at a reduced price, but If it isn't delivered to an Australian shipyard, isn't able to be serviced, maintained or repaired in Australia and the supplier is not reporting AIC with the significant cost overhead, this incurs, then value for money should see the Australian industry-led solution as better, however, because these industrial elements are not defined, nor weighted the evaluation often selects the European option.

Recommendations

- Defence should consider whether programmes and initiatives will incentivise involvement or encourage Australian innovation and competition or whether this will further complicate the burden placed on Defence in the procurement of capability,
- Provide certainty of future work, this can be by providing long-term contracts, clear project pipelines and minimising changes in government and procurements processes; and
- Target tangible capability needs that align with the capability requirements of planned projects.

Any other related matters

There were no relevant comments or recommendations provided for this reference point.