



House of Commons  
Defence Committee

---

**The Defence Industrial  
Strategy: Government  
Response to the  
Committee's Seventh  
Report of Session  
2005–06**

---

**Eighth Special Report of Session  
2005–06**

*Ordered by The House of Commons  
to be printed 11 July 2006*

**HC 1488**  
Published on 14 July 2006  
by authority of the House of Commons  
London: The Stationery Office Limited  
£0.00

## The Defence Committee

The Defence Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Ministry of Defence and its associated public bodies.

### Current membership

Rt Hon James Arbuthnot MP (*Conservative, North East Hampshire*) (Chairman)  
Mr David S Borrow MP (*Labour, South Ribble*)  
Mr David Crausby MP (*Labour, Bolton North East*)  
Linda Gilroy MP (*Labour, Plymouth Sutton*)  
Mr David Hamilton MP (*Labour, Midlothian*)  
Mr Mike Hancock MP (*Liberal Democrat, Portsmouth South*)  
Mr Dai Havard MP (*Labour, Merthyr Tydfil and Rhymney*)  
Mr Adam Holloway MP (*Conservative, Gravesham*)  
Mr Brian Jenkins MP (*Labour, Tamworth*)  
Mr Kevan Jones MP (*Labour, Durham North*)  
Robert Key MP (*Conservative, Salisbury*)  
Mr Mark Lancaster MP (*Conservative, North East Milton Keynes*)  
Willie Rennie MP (*Liberal Democrat, Dunfermline and West Fife*)  
John Smith MP (*Labour, Vale of Glamorgan*)

The following Members were also Members of the Committee during the Parliament.

Mr Colin Breed MP (*Liberal Democrat, South East Cornwall*)  
Derek Conway MP (*Conservative, Old Bexley and Sidcup*)  
Mr Desmond Swayne MP (*Conservative, New Forest West*)

### Powers

The Committee is one of the departmental Select Committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the Internet via [www.parliament.uk](http://www.parliament.uk)

### Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at: [www.parliament.uk/defcom](http://www.parliament.uk/defcom)

### Committee staff

The current staff of the Committee are Philippa Helme (Clerk), Richard Cooke (Second Clerk), Ian Rogers (Audit Adviser), Stephen Jones (Committee Specialist), Adrian Jenner (Inquiry Manager), Sue Monaghan (Committee Assistant), Sheryl Dinsdale (Secretary) and Stewart McIlvenna (Senior Office Clerk).

### Contacts

All correspondence should be addressed to the Clerk of the Defence Committee, House of Commons, London SW1A 0AA. The telephone number for general enquiries is 020 7219 5745; the Committee's email address is [defcom@parliament.uk](mailto:defcom@parliament.uk). Media inquiries should be addressed to Jessica Bridges-Palmer on 020 7219 0724.

# The Defence Industrial Strategy

---

The Defence Committee published its Seventh Report of Session 2005–06 on the Defence Industrial Strategy on 10 May 2006, as House of Commons Paper No. 824. The Government's response to this report was received on 7 July 2006. This is appended below.

## Appendix: Government response

---

### Introduction

1. This memorandum constitutes the Government's response to the House of Commons Defence Select Committee's report, *The Defence Industrial Strategy* (Seventh Report of Session 2005–06, HC 824, published on 10 May 2006). The Government welcomes the Committee's Report.

2. In responding to the Committee's specific conclusions, this memorandum outlines what is being done to implement the DIS. The MOD is improving how we interact with industry, developing the means by which we procure and support our equipment and working to sustain critical capabilities in the industrial base. Noting the Committee's concerns about the relationship between partners and other tiers of the supply chain, we also take this opportunity to set out in some detail how the risks, which we recognise, can be managed.

3. As the Committee knows, we have recently announced, on 3 July, the results of a review of our acquisition processes and organisational construct which identified the extent to which our current ways of doing business hindered or supported excellence in defence acquisition. This, the 'Enabling Acquisition Change' report, was a robust study which concluded that we should make some significant changes to the MOD's organisation. Subject to consultation with the trade unions, the MOD intends to move rapidly to implement this report, to have the changes in place by April 2007. We welcome the Committee's continuing interest in this subject.

### Production of the DIS and initial reaction to it

**We welcome the publication of the Defence Industrial Strategy and congratulate the Minister for Defence Procurement and his team for delivering the Defence Industrial Strategy to a tight timetable. (Paragraph 9)**

4. We are grateful for the Committee's sentiments. The DIS would not have been possible without the input of hundreds of people across MOD as well as other Government Departments, trade unions and industry. We are now putting the same commitment and urgency behind implementing the Strategy.

**During the production of the Defence Industrial Strategy a wide consultation with industry took place, but we are concerned about the adequacy of the consultation with Small and Medium Enterprises and with the MoD trade unions. We look to the MoD to consult more fully with both Small and Medium Enterprises and the MoD trades unions as work on the Defence Industrial Strategy is taken forward. (Paragraph 13)**

### Small and Medium Enterprises (SMEs)

5. All possible effort was made to consult with defence companies at all levels in the supply chain, including SMEs, during the development of the DIS. Ministers and senior officials met with key suppliers and representatives from SMEs several times during this period,

and throughout the process the door remained open for any defence company to engage. Indeed, we actively encouraged companies at all levels to send in their views, even setting up an internet site open to all to participate in an open debate on the DIS. We also engaged strategically with industry through the National Defence Industries Council (NDIC), which includes the major national trade associations associated with the defence industry (Society of British Aerospace, Defence Manufacturers Association, Intellect and British Naval Equipment Association) and other representatives of the defence industry as a whole. The evidence offered by the Defence Manufacturers Association and Defence Industries Council amongst others demonstrated the significant effort that both MOD and industry had expended to ensure as full a debate as possible in the time available and recognising individual companies' commercial sensitivities.

6. The DIS gives a framework against which industry will be able to make rational investment decisions for the future. This applies as much to SMEs as to larger companies. We will continue to seek to engage the defence industry as effectively and efficiently as possible, recognising that smaller companies at lower tiers of the supply chain may have limited resources to engage directly with MOD rather than with their immediate customers. The MOD is working to develop our understanding of key supply chains and where vulnerabilities may exist at lower levels which provide critical military capability. We are also seeking to understand better the factors that impinge on the innovation process, including in smaller suppliers. In short, we are changing our focus from key suppliers to key supply-chains and want to highlight the opportunities available to all suppliers in the provision of military capability both now and in the future. In developing proposals for taking this forward, the MOD has again engaged industry through the NDIC and trade associations, as well as other government agencies. We are also already delivering on the commitment to greater transparency, through briefings open to defence SMEs (described in more detail at paragraphs 46–47).

## Internal Trade Unions

7. The DIS is a development of the Defence Industrial Policy (DIP) of 2002, and a document of government policy. While it reflected ongoing change initiatives, many of which had been or were subject to formal consultation, its publication did not of itself affect the employment of MOD civilian staff. As a result, the MOD Trade Unions were not formally consulted on the DIS as a whole, but were nevertheless informally engaged, two meetings were held with the Minister for Defence Procurement and a further four meetings with officials in the latter half of 2005.

8. In the implementation period, we remain fully seized of our obligations to our Trade Union stakeholders. Trade Unions representatives have met officials several times since December for informal discussions and briefings, as well as discussions at the Whitley Councils. We are also committed to consult formally, in accordance with existing Departmental procedures, on firm proposals affecting MOD staff as they develop. In particular, formal consultation has now begun on the Enabling Acquisition Change report, which clearly has implications for the organisation and structure of the MOD, and hence MOD civilian staff.

**The initial reaction to the Defence Industrial Strategy has been generally very positive. However, while the initial reaction of the defence industry, defence academics, trade**

**unions, and other organisations has generally been positive about the publication of the DIS and the broad thrust of what is proposed, a number of areas were identified where further work was required. These included:**

- **Research and Technology (R&T);**
- **SMEs and the supply chain;**
- **security of supply;**
- **the procurement process. (Paragraph 16)**

9. The Government acknowledges that the DIS left work to do in some areas; indeed the Minister for Defence Procurement recognised in his first major speech on the DIS that ‘by December, we will not be able to cover all the sectors to the same depth, and there will be an element of ongoing work’. The Government itself identified in the DIS areas where further work was required, and MOD has in hand work that encompasses these, as set out briefly below, and more fully elsewhere in this memorandum.

## **Research and Technology**

10. For research & technology, the MOD is, as indicated in DIS Chapter C2, reviewing the research programme with a view to improving its alignment, quality and military exploitation; conducting further work to better understand the underpinning technologies that the UK must have for sovereignty reasons; and working with industry to develop a better understanding of the innovation process and to map the technology trees for major capabilities, systems and platforms. Informed by the outputs of this and lessons from other work, including a recently launched study of MOD research and development, we expect to publish a revised Defence Technology Strategy in the autumn.

## **SMEs and the supply chain**

11. The Government agrees with the Committee on the need to develop a greater understanding of the defence supply-chain, its key players, where vulnerabilities may exist and the impact our decisions could have on SMEs. We also recognise the concern that the development of long-term partnering arrangements could, if not managed appropriately, limit the scope for innovation and new suppliers’ entry into the market.

12. We have launched a joint MOD-industry study on the factors that encourage innovation in the supply-chain, using recent case studies as evidence to understand what factors influence successful innovation. Additionally, we are working with industry, DTI, Regional Development Authorities and others to improve our knowledge of defence supply chains, including work on the Defence Technology Strategy which aims to locate more precisely where critical industrial capabilities currently reside. As part of this, the Supplier Relations Group is developing a process that will help provide early warning of potential supply-chain vulnerabilities, particularly those that provide us with key sovereign capabilities, to ensure that these remain acceptable, sustainable and secure. We are also reviewing our existing Codes of Practice for Tier 1 suppliers that guide the management of the supply-chain to ensure SMEs have the opportunity to compete for follow-on work, especially within long-term partnering arrangements.

## Security of supply

13. Even where an industrial capability is not specified as needing to be retained in the UK as a national security priority, security of supply will continue to be investigated for all procurements. While we have benefited from access to the global supply base in many areas, this is always based on assessment of the potential risks to supply.

14. We recognise the Committee's particular concern regarding assuring security of supply for general munitions, following BAE Systems' announcement of their intention to close their Bridgwater and Chorley plants. This issue is addressed at paragraphs 75–76 below.

## The procurement process

15. Since publication of the DIS the MOD has conducted a major review of its acquisition systems, processes and organisational construct, entitled the 'Enabling Acquisition Change' review. The results of the review were reported on 03 July and we are now engaging in detailed consultation with industry, trade unions and staff on how its recommendations will be taken forward. Implementation of acquisition reform is very important, not only in promoting consistent excellence in defence acquisition but also to demonstrate our commitment to the DIS. We expect industry to respond positively to this signal.

## How the Defence Industry needs to change

**We welcome the clarity that the Defence Industrial Strategy has provided to industry about future defence requirements, which should help to make the UK an attractive market to defence companies. (Paragraph 23)**

16. The Government agrees that this clarity is, together with other factors including the UK's stable macroeconomic environment, an important factor in maintaining the attractiveness of the MOD as a customer and the UK as a base of operations. The UK already has a successful and sophisticated industrial base with a broad range of capabilities that deliver a large proportion of our defence equipment and services. In order to equip the Armed Forces effectively, it is important that this remains the case. This includes encouragement of overseas investment where this creates value, employment, technology or intellectual assets in the UK. The clarity the DIS provides will help investors to see the long-term, attractive propositions that our business, and our support to exports, can offer.

**We note that BAE Systems is considering selling its stake in Airbus, which makes us uncertain of where it leaves their commitment to the UK. Given the possible impact on UK jobs, and the fact that the MoD is procuring A400M transport aircraft from Airbus' military arm, we shall keep a close eye on this matter as it develops. (Paragraph 23)**

17. The Government notes the Committee's interest in the progress of BAE Systems intention to sell its stake in Airbus. The proposed transaction is a commercial decision for BAE Systems and the European Aeronautic Defence and Space Company (EADS). There are however existing inter-company agreements between EADS and BAE Systems designed to safeguard UK jobs and work. These agreements would transfer to the UK Government and EADS on the sale of BAE Systems' interest. The Government is working, as a precautionary measures to strengthen these undertakings.

18. The MOD has current and potential business involving Airbus aircraft, namely the A400M military transport aircraft, under contract through OCCAR (Organisation Conjointe de Coopération en matière d'Armement), and the Future Strategic Tanker Aircraft, where negotiations on acquisition of a PFI service are proceeding with the Airtanker consortium. The Government does not expect the sale of the BAE Systems stake in Airbus, if it proceeds, to have any impact on these programmes.

**The defence industry has accepted that future work will focus on the insertion of upgrades and new capabilities and through-life maintenance of existing platforms, rather than new platforms. (Paragraph 25)**

19. We welcome the Committee's conclusion. A key principle of the DIS is the importance of through-life capability management. We signalled strongly that, even in sectors such as the defence maritime sector where the demand for new platforms is currently strong, industry and the MOD would generally need to change focus from new platform design and development to platform upgrade and maintenance over lengthy service lives. This shift has been reflected by some companies, others are working now to adjust their business models accordingly. The Enabling Acquisition Change report has also identified changes which the MOD itself needs to make to promote through-life capability management, and subject to consultation with the trade unions, we intend to make rapid progress to implement the necessary measures.

20. Our experience will also be informed by lessons identified by:

- the two Pathfinder programmes (which are testing tools to deliver through-life capability management, such as techniques for capability trade-off and integrating projects across the Defence Lines of Development; both programmes consist of MOD and industry personnel and are directed by a Pathfinder steering group consisting of senior MOD and industry stakeholders);
- and by the Through Life Management Group (TLMG), a joint MOD-industry working group. The TLMG has begun to develop a through-life 'concept of operations', a guide to assist MOD and industry project leaders to embed through-life management within their projects.

**The Defence Industrial Strategy will lead to job increases and job decreases in different sectors of the defence industry. We look to the Government to assist, where appropriate, those sectors where job decreases are likely. (Paragraph 27)**

21. The Government accepts the Committee's recommendation. Where employment levels cannot be sustained, a decrease in the number of jobs may be achieved by active management of hiring and retirement patterns, as well as voluntary or compulsory redundancy. While the nature and extent of redundancies are a commercial matter for the company concerned, the Government recognises the anxiety and distress caused to employees and their families in such circumstances and the personal tragedy of redundancy arising from the consequences of industrial and commercial restructuring and contraction.

22. In general, the Government provides support in such situations through its regional partners—RDAs and the Devolved Administrations—and Job Centre Plus, doing



everything it can to support those affected and to help them find new employment and where required, to retrain. Where employers anticipate redundancies of 20 or more at one establishment they are legally obliged to notify the DTI, giving either 30 or 90 days notice depending on the numbers expected to be affected. Job Centre Plus assesses the impact of the redundancies on the local labour market before declaring whether or not a redundancy is large scale. The term Large Scale Redundancy (LSR) is used by Job Centre Plus and other partners to allow redundant workers early access to provision designed to help individuals back into jobs, such as assistance with job application techniques and retraining.

23. There is also a Rapid Response Service (RRS) designed to enhance the Job Centre Plus response to a LSR judged to have a particularly significant impact on the local labour market. An essential element of RRS support is partnership working in the locality affected. The minimum partnership comprises Job Centre Plus, RDAs/Devolved Administrations and Learning and Skills Council. In practice local partnerships also include local authorities, Chambers of Commerce, MPs and Trade Union representatives. RRS support is directed to the needs of individual employees and is intended to be made available during the 12 weeks prior to and the 12 weeks after the date of redundancy.

24. Although not part of any formal process, from time to time and in response to a specific LSR, a 'community' task force has arisen spontaneously because of the significance to the locality of an employer and the close working relationship between regional partners and local partnerships. These task forces, such as the Clyde Shipyards Task Force, have in general enjoyed central government support. They have successfully brought together local partnerships and regional partners with other local representatives of central government and DTI sector experts who, through better coordination of their resources and activities, seek to:

- minimise the extent of current and possible future redundancies by assisting the company to improve its product or develop its market as well as through the retraining and reskilling of employees within the company;
- assist redundant workers find alternative employment, again, including through retraining and reskilling; and
- assist the local economy to reduce its dependence upon the single major employer.

25. However, in general, we anticipate that the clarity given by the DIS will allow industry to plan for the long term, in some cases while it still has a significant peak of work to come. As we have clearly indicated, several sectors will thereafter face a lower level of business, and companies will need to adjust to this reality. Given the clarity of the long-term perspective, we expect industry, with the trade unions, MOD, DTI and others, to be able to manage the changes effectively and prepare those who may be affected well in advance. With increased understanding of our plans, and the opportunity for dialogue, industry can work with us to avoid 'boom and bust' and establish sustainable businesses, maintaining the key capabilities we need with improved productivity and delivering a lower but steadier workload once the major platforms have been delivered.

**We shall take a keen interest in any developments in the restructuring of the dockyards. (Paragraph 33)**

26. The Government welcomes the Committee's continuing interest. The proposed BAE Systems and VT bid for Babcock in the spring of this year saw the first post-DIS attempt at consolidation in the UK naval maritime sector. That attempt was unsuccessful in overall commercial terms; however our work with industry in recent months has demonstrated the potential for consolidation. We continue to believe that such consolidation is necessary to ensure balance in supply and demand over the long term. We will encourage and support deals which add value, truly transform the business and deliver the substantial performance improvement the sector needs. We are working with industry to develop the best way forward for all parties.

**We look to the MoD to ensure that the Maritime Industrial Strategies are produced, and the strategies implemented, to the planned timetable. (Paragraph 34)**

27. Implementation of DIS in maritime sector is being driven with purpose and determination by industry and the MOD. We have asked the defence industry to help identify better ways of doing business in the future and have been pleased by the response but much work remains to be done if we are to achieve greater efficiency, long term sustainment and stability within the industry, while ensuring that our needs as the customer are met.

28. In the submarine domain, officials have been engaged in detailed discussions with industry on the scope of a possible Programme Level Partnering Agreement and invited industry to consider consolidation, as such action offers substantial performance improvement. These discussions were necessarily suspended while BAE Systems and VT considered a bid for Babcock and the MOD is considering their re-initiation.

29. In parallel, the MOD's Submarine programme management has recently been unified under Director General Nuclear, who is responsible to both the Chief of Defence Procurement and the Chief of Defence Logistics for managing delivery of the submarine acquisition programme through-life. Industry has responded well to this appointment.

30. On surface ship build and design, we are making progress on assessing the Core Work Load required to sustain the maritime Key Industrial Capabilities (KICs), though we have not achieved the target of completing this within six months. This work is complex but it is important to ensure the links and coherency with the submarine and support programmes are right. Industry has been, and will continue to be, involved. As the sustainability strategy for key maritime equipments is intimately linked to this work, this will also be delayed. We will ensure that this work is completed efficiently and effectively and as quickly as possible.

31. On surface ship support, MOD has moved forward with the three dockyard companies (Babcock Support Services Limited, Fleet Support Limited and Devonport Management Limited) to put alternative contracting arrangements in place, initially for a package of surface warship upkeep work (refits and docking periods) which is currently planned to begin in autumn 2006. This work will be managed through the exploratory phase of the new surface ship support alliance announced by the Defence Secretary on 14 February 2006. During this exploratory or 'transition' phase, which could last up to two years, competition policy has been suspended (an exclusion order to the 1998 Competition Act was tabled by DTI on 8 March 2006 and came in to force on 4 April 2006).

**In the fixed-wing sector, future work on Typhoon and Joint Strike Fighter will provide work for engineers for some time to come, and there will be an increasing focus on Unmanned Combat Aerial Vehicles (UCAVs). (Paragraph 40)**

32. We agree with the Committee that the introduction into service of Typhoon and the Joint Combat Aircraft (JCA), two highly sophisticated fast jet fighters with long service lives, will provide highly skilled employment for some time to come. At the same time, we need to ensure we have access to the correct skills mix in industry to maintain and develop these platforms through-life. This will be a challenge, as there is no UK requirement for a new-design manned aircraft beyond our current plans although future procurements of uninhabited and/or manned platforms are envisaged. As with other sectors such as Complex Weapons and Maritime, which have reached or are close to reaching an investment peak, we and industry must plan for the future now, to enable the industrial transformation required to ensure a long term sustainable industrial base in the Fixed Wing sector.

33. The DIS recognised that this transformation is likely over the long term to involve industrial rationalisation that will lead to significant job decreases. The MOD is working with BAE Systems to manage this transition and explore the viability of a Long Term Partnering Agreement (LTPA). The objective will be to sustain a healthy fixed wing sector and thereby the industrial capabilities, skills and technologies that will be so important to our ability to support and upgrade our fast jet aircraft fleets, through-life, over the next 30 years. Discussions with BAE Systems over an LTPA are continuing. Although the complexity of the issues and the transformation required make this a challenging task, we remain on course to agree the way ahead in 2006, for implementation from 2007 onwards.

34. This work will need to expand to embrace the wider defence fixed wing sector, including other companies besides BAE Systems. As progress is made in developing a LTPA, MOD will also continue to consult other key stakeholders, including the Treasury, DTI and RDAs. We are also encouraged by the Society of British Aerospace Companies (SBAC) initiative to improve the management and performance of the aerospace supply chain, and look forward to the publication of their 21<sup>st</sup> Century Supply Chain report later this summer.

35. We will also continue to invest in Unmanned Combat Aerial Vehicles (UCAVs) to understand and de-risk the technologies that are likely to play an important role in future military capability. This investment will also help sustain aerospace engineering and design capabilities in the UK, providing further assurance of our ability to operate and support our current and future fixed wing aircraft. Appropriate funding and commercial arrangements for a substantial UCAV Technology Demonstrator Programme (TDP) are currently being negotiated between the Government and the companies involved. We continue to expect to announce the commencement of the TDP this year.

**We note that substantial job decreases are likely to be seen in the complex weapons sector as the MoD's investment in such weapons is to be substantially reduced. We look to the MoD to work closely with this sector so that this important capability and the current skills are not lost. (Paragraph 44)**

36. The Government accepts the Committee's conclusion. The DIS makes clear that following our planned reductions on current investment, there will be overcapacity in the UK Complex Weapons industrial base. Industry is aware of this, and of the need to work with us throughout 2006, in order to be in a position to implement solutions in 2007. To this end a joint MOD and industry virtual team was established in February, including key players such as MBDA, Thales, QinetiQ, Raytheon Systems Ltd and BAE Systems Underwater Systems. The team is investigating projected workloads against industrial capacities and is considering a wide range of proposals for industrial restructuring.

37. This work is being taken forward at pace. We are developing an initial joint sustainment strategy, to inform industrial decisions so that our critical capability requirements can be met by a sustainable industry at value for money in the long-term. We plan to announce this shortly.

38. In the latter half of 2006 we intend to implement this strategy with industry. We are also considering wider restructuring options with our European allies to identify if a co-ordinated approach to sustain key capabilities is possible, and will explore this in more detail in the same period.

### How the MOD needs to change

**We agree with the Minister for Defence Procurement that the MoD needs to demonstrate through its own change that it is serious about the Defence Industrial Strategy and we look forward to being “surprised” by the pace of change that the MoD achieves. (Paragraph 47)**

39. The Department welcomes this support from the Committee and wishes to emphasise that it remains committed to change—DIS implementation is a top priority. Whilst significant work remains, we have achieved much already.

40. We have completed the Enabling Acquisition Change review, as announced on 3 July. This represents achievement of a key milestone in implementation and highlights our willingness to embed in our working practices and structures the key principles of DIS. The proposed changes will enable us to take a better view of what we can afford, and allow us to plan for new military capability in the round. In particular, running costs will become a greater focus of attention when we decide what to buy, and as we plan with industry for its support from the outset, we will be able to improve support for our Armed Forces, and get the best value for money for the tax-payer. Equally, as we organise ourselves to buy and support our equipment in a more joined-up way, industry too will reform itself.

41. We have developed a plan, with industry, to embed the Defence Values for Acquisition across the acquisition community, and will continue to work with the National Defence Industries Council to ensure that they are the foundation upon which working relations within the MOD, and between the Department and industry, are based. Within the MOD's acquisition community, the values are being reflected in individuals' personal objectives and reward arrangements. Individual companies are already using the Values to inform their in-house corporate values and behaviours. The Defence Academy will introduce joint training courses with industry to embed the values, and we are also ensuring that partnering agreements with industry reflect the values explicitly.

42. We are also making senior appointments on a through life basis as envisaged in the DIS, for example the appointment of Director General Nuclear to both the DPA and DLO boards as the first dual-accountable Operations Director, as well as the Director General Typhoon. We also announced the appointment of a pan-Defence Commercial Director, as envisaged in the DIS (C1.16, page 134), on 26 June.

43. We have also established Pathfinder teams in the Maritime and Land environments. These are now beginning to test solutions that will enable the MOD acquisition community to deliver through-life capability management in and across projects.

44. We have recently concluded negotiations with AgustaWestland on the terms of a Strategic Partnering Arrangement. The arrangement provides for a sustainable onshore industrial base in the Helicopter sector, whilst at the same time placing hard targets for supplier improvement. Negotiations with key suppliers will continue apace during the rest of 2006 in order to put into place the other sector sustainment strategies as outlined in the DIS.

45. We will keep the Committee updated on the progress of DIS implementation initiatives, and welcome its continuing interest in this subject.

**We look to the MoD to build upon the DIS and provide more information to industry in the future. (Paragraph 50)**

46. The Government accepts the Committee's recommendation. One of the aspirations of the DIS is to be more transparent to industry so that we can help our suppliers, and their investors, to plan for the future, and retain and develop the right industrial capabilities for our Armed Forces' needs. We expect to see resulting benefits, in terms of cost-base and overhead reduction, increased readiness and reduced cost of capital through better investment. In the DIS itself, we have provided more detail of our future plans than ever before, but also signalled that, where it is in our mutual interests to do so and subject to appropriate safeguards, we are prepared to share even more detail with industry. We have begun delivering on this policy already, with a series of briefings to industry setting out more details of our forward plans (for instance, for armoured fighting vehicles, cryptography and Deep Target Attack). Industry has welcomed these.

47. Learning lessons from these events, we have produced guidelines on the conduct of such information release to embed the revised policy into normal business, and these will be discussed with industry in the next month. We have also been reinforcing existing partnering arrangements by providing industry with a clearer view of our planning assumptions, recognising that these are subject to final investment decisions by Ministers and the MOD, and that plans necessarily change over time.

**We welcome the fact that the MoD is seeking to identify improvements to its acquisition arrangements, including ways to speed the process up, and we look to the MoD to implement quickly the improvements identified. We expect the MoD to ensure that best practice is promulgated and the commercial skills of its officials are improved, particularly the legal and contract compliance skills needed to ensure well-drawn legal and production agreements involved in the new long-term partnering approach. (Paragraph 51)**

48. The Government accepts the Committee's recommendation. The MOD's acquisition arrangements have been reviewed by the Enabling Acquisition Change Team. Its report is subject to consultation with the trade unions, but in principle the MOD agrees strongly that it must implement speedily the necessary reforms in order to deliver consistently excellent acquisition.

49. The DIS also highlighted the existing schemes to train our acquisition and commercial staff, including our Business Graduate Development Scheme, the Acquisition Leadership Development Scheme and the MSc in Defence Acquisition Management run by the Defence Academy. Nevertheless, the DIS recognised the need to do more to address shortages of commercial skills across the Department. The Department has completed an initial skills gap analysis, with industry, of the skills, behaviours and training needed to transform commercial and procurement approaches. Further analysis of skills and training requirements and the design of solutions will be taken forward in the second half of 2006.

## Research and technology

**We are concerned that the decline in defence research spending will impact upon the quality of future equipment for the armed forces. We look to the MoD to address the level of spending on defence research in its Technology Strategy to be published this year. It would be useful if the Technology Strategy could set out clearly the level of defence research spending by Government and industry over time. (Paragraph 63)**

**We look to the MoD to make a strong case for increased funding of defence research during the discussions with HM Treasury on the Comprehensive Spending Review. We see this as a key investment for the future. (Paragraph 64)**

50. The Defence Technology Strategy will provide a strong base for dialogue between industry and MOD, recognising that in most sectors companies would expect to undertake the majority of investment in new research and developing products for market themselves. The Government has recognised the importance of investment in Science and Technology and has set a target to raise the Nation's Research and Development spend to 2.5% of GDP by 2014, working in cooperation with industry. Over the past three years the MOD research budget has remained broadly level, and this year has increased. The current plan is for it to rise in line with inflation over the next four years. The balance of investment when next reviewed, taking into account other priorities, will also reflect the work underway this year (including the Science & Technology Capability and Alignment Study which will be published by the end of the summer and the work informing the Defence Technology Strategy) to ensure that the value of the budget is maximised. We are discussing the Comprehensive Spending Review with the Treasury and acknowledge the Committee's concern, but we note that the Comprehensive Spending Review will not conclude until next year. The Defence Technology Strategy will reflect the planning assumptions as they stand at the time of publication, now scheduled for this autumn.

**Lord Drayson acknowledged that the Centres of Excellence in military research worked well and was a model which had been used very successfully in the pharmaceutical industry. He told us that "Centres of Excellence are definitely working for us. It is an example of a new approach to the management of R&D which is giving benefits". We**

**expect the further work on Research and Technology to encourage and maintain the Centres of Excellence for defence-related research. (Paragraph 66)**

51. The Government notes the Committee's expectation. MOD is seeking to increase the early sharing of Defence needs with industry to facilitate joint planning and the development of research roadmaps for important Defence technologies and capabilities. This enables both MOD and industry to plan their investment and to work cooperatively to build Defence capability in the UK. The National Audit Office has recognised that MOD has made progress in encouraging joint working with industry through the establishment of Towers of Excellence and Defence Technology Centres.

52. Towers of Excellence are selective partnerships with industry and academia, directing resources into priority areas of technology research. The development of technology through to a final product and more general technology transfer to industry are a major benefit of operating Towers of Excellence. Defence Technology Centres are examples of an alternative partnering approach which are jointly funded by MOD and industry (usually as consortia). The Centres are based around topics which are critical to Defence and where investment is judged likely to produce significant returns. A range of suppliers, including SMEs and academia, provide input to the Centres, which are managed to allow a flexible response to emerging needs and priorities. We intend therefore to maintain the use of both Defence Technology Centres and Towers of Excellence as a means of managing research for defence.

### **Small and Medium-size Enterprises and the supply chain**

**We note that the MoD has sought to become more “user friendly” to Small and Medium-size Enterprises which are a vital part of the UK defence industry. (Paragraph 76)**

53. The Government welcomes the Committee's acknowledgment of MOD's efforts, and notes its expectations for future progress.

54. MOD has sought and continues to seek to become more user-friendly to SMEs, through a number of ongoing SME- focussed activities, and to improve its knowledge of supply chains. In terms of improving visibility to SMEs, the MOD has made significant advances in recent years, including:

- complementing a number of wider Government initiatives to increase support for small businesses, the Small Business Charter introduced by the Defence Export Services Organisation (DESO) in 2004. DESO recognises the vital role played by SMEs in defence exports, either within the supply-chain of the large platforms which DESO has traditionally supported, or as exporters in their own right. DESO also sees the potential for much greater defence export success by UK SMEs. The Small Business Charter is a free and voluntary service designed to provide a “way in” to the defence export field for UK SMEs, raising awareness of the range of MOD and wider Government services available to assist them in winning overseas defence business and enabling them access to this support. It has been warmly received by UK SMEs, with almost 300 Charter members joining the scheme since inception and subsequently reporting overseas defence sales of £80 million in the last financial year;

- in the research area, the MOD science community is developing several initiatives to continue broadening MOD engagement with SMEs, including a “Competition of Ideas” for defence research challenges, industry briefings, and greater engagement with universities. The “Competition of Ideas” concept is designed to encourage all levels of the supply-chain to contribute ideas for innovative research to meet military capability research requirements. Successful proposals will be funded by the MOD. Additionally, a research Supplier Day will be held in November, when attendees will be briefed on the research programme and ways in which they can become involved, including through the “Competition of Ideas”. Last year’s Supplier Day attracted approximately 120 SMEs’ representatives. In addition, relevant SMEs will be welcome at the new briefings for particular sectors or capability areas, which are being offered by MOD as a result of the new transparency policy introduced by the DIS, as described at paragraphs 46-47 above;
- recognising that MOD could be a confusing organisation for new suppliers as well as others to interact with, we published earlier this year a ‘Who’s Who in Defence Acquisition’, available on the Internet, which builds on the explanations given in the DIS itself of our internal processes by explaining the organisations involved, including points of contact. This supplements other material freely available to all industry via the Acquisition Management System (AMS). The AMS is currently being reviewed for ease of use and over the next year is itself likely to become significantly more user-friendly for both industry and MOD staff.

**We look to the MoD to improve its visibility of [SMEs]. (Paragraph 76)**

**We are concerned that the MoD is only at “the start of a journey” in terms of understanding supply chains and how to manage them. We note that the MoD is working with the DTI, the Regional Development Agencies and the agencies of the devolved administrations to understand defence supply chains better. We expect this work to be progressed quickly and good practice to be identified and promulgated. (Paragraph 77)**

55. As industry witnesses to the inquiry acknowledged, there has been substantial work in recent years which has improved the MOD’s knowledge of supply chains. For instance, the Defence Logistics Organisation, under the Procurement Reform Category Management programme which commenced in 2002, has also increased MOD’s visibility of its suppliers including SMEs, both directly and indirectly through larger Primes, utilising an approach known as ‘partnered category management’. For example, we have worked successfully with AgustaWestland to help develop sourcing strategies for its supply-chain, determining the best route to market for specific areas of the supplier base.

56. However, we accept that there is more to do. MOD’s transparency initiative will help improve our knowledge, providing not only mechanisms for transmitting MOD information to industry, but also a forum for discussions on a sectoral basis. But more directly, we are also continuing to develop our understanding of supply chains, especially to identify and locate key underpinning technologies. The objective is to ensure the security and viability of capabilities and technologies critical for appropriate sovereignty, through an improved awareness of potential vulnerabilities which the Department might be able to address, for example through adjustments to its acquisition plans and strategies.



This work is being undertaken in conjunction with the Defence Industries Council (DIC) and the DTI amongst others, taking into account the variety of work underway within MOD which can contribute to this objective, including:

- the continued Procurement Reform Category Management programme;
- the production of the new Defence Technology Strategy, which is helping locate key industrial capabilities for appropriate sovereignty, including those potentially represented by very small teams, within supply chains;
- the ongoing Key Supplier Management (KSM) process, whose aims include deepening our understanding of prime contractors' management of their supply chains. This process is currently being developed to build on the information being derived in particular from the Defence Technology Strategy work. It includes the work mentioned in paragraph 12, to provide early warning of supply chain vulnerabilities;
- the innovation study also mentioned in paragraph 12, which may provide insights into those areas of the supply chain which most repay investigation.

57. Overseen by the new Commercial Director, whose appointment was announced on 26 June, the Department will identify and promulgate good practice across the MOD, ensuring that these initiatives are complementary. We are grateful for industry's continued support for this work to date.

58. We are not seeking however to map all of our supply-chains in their entirety. We are focusing our efforts on those supply-chains which provide us with critical capabilities and technologies for appropriate sovereignty reasons, as outlined in the DIS. In the broader context however, to further put this improved knowledge to use, we are also continuing to work with industry to develop further our supply-chain management techniques, as we will maintain our monitoring of how our major suppliers manage their supplier-base. This work is explained in more detail in paragraph 63 below.

## Competition and partnering arrangements

**In a sector such as fast-jet aircraft, the UK only has one company with the capacity and capability to deliver the MoD's requirements: competition in that environment is not achievable, or at least not compatible with maintaining national capability. We agree that competition is not the right answer for all procurement and that the MoD should move towards long-term partnering arrangements in a number of areas. (Paragraph 85)**

59. The Department welcomes the Committee's recognition that competition is not the right answer for all procurement, and that long-term partnering arrangements in principle are appropriate in a number of areas. Where a monopoly supplier provides us with existing equipment that will be in-service for a lengthy period of time, partnering arrangements can develop mutually beneficial business relationships based on trust, aligned incentives, and predictable demand. However, partnering is but one of a range of commercial tools that we could use when contracting with suppliers for equipment and services. We will ensure that the right tool is used to provide value for money, based on a range of factors, such as the

nature of the market, supplier performance or capabilities required onshore to maintain appropriate sovereignty.

**Concerns have been raised about BAE Systems being in the position of a monopoly supplier in many areas. The company is likely to be the main contractor on a number of the long-term partnering arrangements that the MoD is considering. We look to MoD to demonstrate its awareness of these concerns and to build into long term contracts incentives which encourage performance improvements. (Paragraph 92)**

60. The Government accepts the Committee's conclusion; it is indeed our intent to incentivise partners for continuous improvement. Through the long-term partnering agreements that we are developing with companies such as BAE Systems, we will be looking for significant performance improvements from industry. For instance, our recently agreed Strategic Partnering Arrangement with AgustaWestland includes targets for improved supplier performance, which if met will provide us with better, cheaper service but with incentive payments for the company. We will look to apply the lessons from this agreement to other partnering arrangements in order to share best-practice and realise improvements in other sectors.

**We recognise that some of the contracts for long-term partnering arrangements will be let on a non-competitive basis. But for work underlying these arrangements there must be real competition. This is a matter about which we have considerable concern. We look to the MoD to ensure that there are rules in place which give clarity and transparency to the route to market for 'sub-primes' and SMEs. Other companies must be assured of an opportunity to compete for the work underlying the long-term partnering arrangements. We will return to this subject again. (Paragraph 94)**

61. The Government acknowledges the Committee's concern and agrees that the potential risks need to be managed.

62. Competition will remain a significant procurement tool but it will be used selectively alongside other procurement models, including partnering. The MOD is developing these models so that the capability we require, the nature of the market in the relevant sector and the need to sustain capabilities and technologies that are critical to the UK are all considered properly before a procurement strategy is confirmed. In the following paragraphs, we outline how, when partnership is decided as the way forward, the risks can be managed, by both general tools, and specific provisions in the associated agreements.

63. *General oversight of primes' supply chain management.* The MOD already has contractual mechanisms in place that provide an oversight of underlying work placed with Primes to ensure equitable treatment and value for money, often through sub-contract competitions. As mentioned in paragraphs 12 and 57, given the increasing emphasis on acquiring and supporting capability through-life and on long-term partnering arrangements, the MOD is re-examining these mechanisms, including the Code of Practice— MOD/Industry Commercial Policy Group Guideline No 5, which focuses on relationships between the Department and its prime contractors, and between the primes and their suppliers to ensure they deal adequately with the new commercial challenges. This is to ensure that there is sufficient supply chain focus below prime level and that there are adequate incentives to promote competitive subcontract opportunities, especially for

SMEs. While the Code of Practice is applicable to all kinds of procurement, we expect these mechanisms to help ensure long term value for money within these extended partnering deals, and to continue to promote access for potential new suppliers to commercial opportunities arising from MOD business.

64. *Information requirements in partnering arrangements.* In the particular field of partnering, MOD is at the outset establishing the need for shared information between MOD and its partner; for us to understand (and by implication agree) the means by which the primes intend to deliver their contracted output, as well as for industry to understand our forward plans. This includes an understanding of the cost drivers and within that an understanding of their supply chain. It is inevitable, in these long term relationships, that our needs will change and that technology will offer opportunities to either enhance effective capability or reduce the costs associated with its delivery. The contracts we place must allow such flexibility, driven by a real understanding of the business models that underpin delivery—including the relationship and contracts between the prime and those supplying the prime. This will be a requirement that the Department will place on primes in the negotiations to reach contract.

65. *Partnered category management.* To illustrate this approach in practice, we are working with AgustaWestland to develop sourcing strategies for key elements of their supply base, through a partnered category management approach (also discussed in paragraph 54 above). Here a joint team is engaged using modern procurement techniques to determine the best route to market for specific elements of the supplier base. The ability to do this is a direct result of the investment the MOD has made in its successful Procurement Reform programme, extending these processes into key areas of the defence supply chain. Similar work is being discussed with BAE Systems and a partnered category management approach similar to that with AugustaWestland is likely to result.

66. Also relevant is the work entitled ‘Commodity Availability Procurement Strategy’ (CAPS). This looks directly at the suppliers who provide the current common components of support to both Fixed Wing and Rotary Wing Platforms. It is anticipated that the management of this ‘commodity’ supplier base will be transferred to the prime contractor to ensure that the supply risk of these commodities is held by the prime. However, in transferring those responsibilities, both formal requirements and financial incentives will be built into the Contracting for Availability contracts to ensure proper management of the supplier base. Within this will be the need to demonstrate the delivery of value for money through the supply chain, including through competition where suitable markets exist. Innovation, including through the full engagement of SMEs, will also be encouraged through incentives to improve performance and the contracted delivery of support which meets rigorous value for money tests.

67. *Armoured Fighting Vehicles:* Through the development of a Joint Business Plan under the AFV Partnering Agreement, BAES Land Systems (BAES LS) are planning a major improvement programme addressing overheads, margin improvement and operational strategy with the aim of transforming the value of the business to shareholders, and improving value for money to the MOD as the major customer. A key element of the business plan is the transformation required by both BAES LS and their supply chain. A Joint Business Plan specifically addresses BAES LS’ management of its supply base, and the contribution of those suppliers to an effective end-to-end solution for the supply of goods,

services, technology, and information. BAES LS will develop improved Supply Chain Management, including the creation of long-term supply chain and technology development partnerships with other companies where appropriate.

68. *Fixed Wing*: MOD is exploring with BAE Systems the viability of a Long Term Partnering Agreement (LTPA) to sustain a healthy fixed wing sector. A key requirement of any deal will be that it not only meets MOD requirements but also offers clear value for money for the taxpayer. It also has to make sound business sense for BAE Systems. Accordingly, MOD will be negotiating the inclusion of robust incentivisation arrangements that will drive down costs by focussing attention on the effective and timely removal of surplus capacity as well as the delivery of improved efficiency through better ways of working, joint overview of capacity management to smooth out workloads and open book accounting to monitor costs. The Agreement will also incorporate exit and step in provisions as well as a change mechanism to facilitate enhancements based on experience and future changes in MOD requirements. It is not the intention to ossify the relationship; it needs to be both flexible, as requirements change, and agile, to react quickly to changing needs.

69. Clearly, an optimised use of the BAE Systems and the wider fixed wing supply chain to promote effective access to innovation and to reward innovation and continuous improvement where it arises is a key objective for MOD. In this sector however we are likely to face similar challenges in the supply chain in terms of rationalisation and sustainment of key capabilities consequent upon the long term decline in new programme work in fast jets. Although we are at an early stage of exploring these issues with BAE Systems and other defence companies there is a possibility that we may find key capabilities at subcontract level that are only available from a single supplier. It follows that in such instances, for example, subcontract competition may not always be appropriate—but we would expect these cases to be limited and where they arise, we would expect the robust incentivisation arrangements to be included in the LTPA with BAE Systems to flow down to the associated suppliers, so that productivity improvements and innovation are rewarded at the level at which they arise. The position will become clearer over the coming months as discussions mature, and we will take into account the observations of the Committee.

70. *Key Supplier Management scrutiny*: More generally, MOD has established Key Supplier Management arrangements with its most significant suppliers. These arrangements include systematic measurement of performance across MOD business with a view to developing jointly plans for improvement. One of the areas specifically addressed is the management of lower tiers in the supply chain, which might include providing access to innovative suppliers, promoting competition, best practice and security of supply for the future. These factors will also be considered more explicitly in future in developing procurement strategies.

71. MOD also is involved in exploratory discussions with a group of regional trade bodies who are seeking to represent small to medium size company capabilities directly to MOD to meet our capability and technology needs, particularly where there might be supply base vulnerabilities. If this seems likely to be effective, such contacts would supplement, but not replace, our established mechanisms for engaging industry, including the Key Supplier Management process and through the national trade associations.

72. We hope this detail provides some reassurance that MOD is alive to the concerns the Committee raises, and is taking practical steps in the agreements it negotiates with partners, as well as other modes of procurement, to address them. We will continue to consider any further improvements that can be made, not least any policy implications identified as a result of the study of the innovation process, mentioned in paragraph 12.

## **Sovereign capability and international issues**

**We consider it vital that the UK can maintain and upgrade equipment independently. We expect the MoD to obtain all the information and technology transfer it requires to do this. We will continue to monitor the progress on technology transfer in relation to the Joint Strike Fighter. (Paragraph 99)**

73. The Government agrees that it is important that the UK can maintain and upgrade critical equipment independently. Accordingly, when the MOD places contracts for the development of equipment, contract conditions provide the MOD with broad rights to use information generated by its funding. This includes the maintenance and rights to use information for upgrades and modifications either by the Department or other contractors.

74. In cases where information originates from foreign contractors, the administration of export controls can impact on our ability to obtain information, and/or pass it to UK contractors. We note the Committee's intention to monitor progress on technology transfer for JSF in particular and welcome its continuing interest. The MOD is seeking sufficient assurances from the US for timely access to data and technology required to provide the sovereign capabilities required to operate, maintain and upgrade the UK JSF fleet and so meet national requirements.

**We welcome the assurances given by the MoD that the Royal Ordnance Factory sites at Bridgwater and Chorley would not be closed until it was "absolutely sure" a secure alternative supply of the munitions existed. We consider that, in an area as vital as general munitions, the UK should never be in a position where it cannot guarantee security of supply. (Paragraph 107)**

75. DIS recognised the importance of ensuring long-term security of supply and identified a number of General Munitions capabilities that we would wish to retain onshore noting that the key is to ensure a sustainable and secure supply that provides best value for money. Further DIS gave explicit direction on the need to retain onshore a Design Authority for munitions manufactured in the UK, Insensitive Munitions and related energetic material capabilities, and an intelligent customer capability for non-UK designed munitions, to deliver a robust onshore through-life management capability. Nonetheless, DIS is also clear that whilst it is desirable to maintain a more general onshore manufacturing capability it is not essential and in the case of Small Arms Ammunition we would aim to do so, but not at any cost

76. Regarding the ongoing site rationalisation of the former Royal Ordnance Factory sites at Bridgwater and Chorley, BAES LS remain responsible for successful transition to the new arrangements and are currently implementing contracts to manage the new suppliers. The MOD has formed a joint project team with the company to oversee the transfers and verify that they are taking every reasonable step to guarantee supply to our armed forces.

All of the companies that are potentially substitute suppliers have good track records in meeting our production standards and quantity requirements. MOD officials are also working with the new suppliers, seeking to ensure that the recipient companies are fully content with the transfer of technology and skills. BAES LS have provided an assurance that they will not close their sites until the new supply chain arrangements are sufficiently mature.

**We consider that international co-operation is vital and that the European Defence Agency is likely to have an important role in the future in many areas covered in the DIS. (Paragraph 111)**

77. As the DIS makes clear, the Government recognises the benefits that international co-operation can bring. The European Defence Agency will play a crucial role in facilitating co-operation within Europe, but we will continue to co-operate with our allies in the US and elsewhere where there is benefit from doing so, and where the industrial implications do not conflict with our policy.

78. In addition to facilitating co-operation to improve military capability, the EDA also has an important role to play in encouraging greater openness within the European Defence Equipment Market. We fully support the code of conduct on defence procurement being introduced by the Agency, which is an integral part of this aim. We also expect that the EDA will help strengthen the defence technology base in Europe and contribute to the improvement of European defence capabilities overall.

## Implementation of the DIS

**We welcome the impetus that the Minister for Defence Procurement is giving to the implementation of the Defence Industrial Strategy and his aim to make a difference to the UK's defence capability and strengthen the UK's defence industry. (Paragraph 115)**

79. The Government welcomes the Committee's conclusion. The aim of the DIS was 'driven by the need to provide the Armed Forces with the equipment which they require, on time, and at best value for the taxpayer.' In undertaking this aim, we recognise the vital contribution played by industry and believe that the clarity provided by the DIS will promote a dynamic, sustainable and globally competitive defence industry.

80. We will continue to work hard to achieve this. The DIS, under Minister (DP)'s leadership but with support from across Government, is the vehicle for driving this forward and we will maintain this impetus through an aggressive programme.

**The checklist set out the actions that are to be taken in the various areas, such as completing the Maritime and R&T strategies. The vast majority of the actions are to be completed in 2006. We expect the MoD to meet the deadlines set for the additional work flowing from the Defence Industrial Strategy, in particular the Maritime Industrial Strategies, the Technology Strategy and the review of its acquisition arrangements. (Paragraph 117)**

81. The Government notes the Committee's recommendation. As noted above, the Maritime Industrial Strategies work is progressing but it has not been possible to meet the original timescale, while the Defence Technology Strategy will now be delivered in the

autumn. The Enabling Acquisition Change review, however, notably one of the deliverables entirely within the Department's control, has been delivered, and we have also passed a number of other significant milestones, including agreement of a Strategic Partnering Arrangement with AgustaWestland, establishing joint teams for Armoured Fighting Vehicle partnering and complex weapons, and completing the Science and Technology Capability Alignment study, which will be published shortly. We expect to be in a position to make further announcements, outlining progress to date, in the next month.

**Given the importance of the Defence Industrial Strategy, we plan to monitor closely the progress in implementing it and whether it delivers the expected benefits. We expect to inquire further into other aspects relating to the Defence Industrial Strategy. (Paragraph 119)**

82. The Government welcomes the Committee's continuing interest in this subject.

**Restructuring the defence industry, and ensuring that research and skills are maintained despite reduced production, will cost money. Adequate funding will be vital for the success of the Defence Industrial Strategy. This will be a key issue for the MoD to negotiate with HM Treasury in the Comprehensive Spending Review. (Paragraph 121)**

83. The Government and industry both recognise that the DIS will necessitate industrial restructuring, as the emphasis on large platform procurements shifts to one of through-life provision of support services and incremental capability upgrades, and maintaining key industrial capabilities in the absence of major new platform programmes will require some companies to change their business models. Indeed, recognition of the need for business change and restructuring was one of the reasons for the DIS' urgent production. We will not micromanage industry's restructuring, but it must be customer-focused, delivering benefits to both MOD and industry. Fundamentally, we expect industry in the long-term to be more productive and efficient, not least as a result of better alignment with the MOD customer's current and likely future demand, and even better able to compete for civil and export work. We will not dismiss options which require upfront investment by the Government, but we expect the overall outcome, in terms of both improved industrial productivity and more consistently excellent acquisition practice within MOD, to demonstrate improved value for money for the taxpayer in the longer term. MOD and the Treasury, as well as other Departments and agencies, will continue to coordinate closely as the DIS is implemented.





## Summary Progress Report on significant DIS Milestones: as at 7 July 2006

DIS Commitment		Milestone	The Current Position
MARITIME (1)	<p><i>We will immediately start negotiations...to achieve a programme level partnering agreement with a single industrial entity for the full lifecycle of the submarine flotilla. This will be matched by the implementation of a unified submarine Programme Management organisation within the MOD.</i></p>	<p>For the award of the contract for the fourth and subsequent Astute class submarines.</p>	<p>MOD is engaged in detailed discussions with industry on the scope of a possible Programme Level Partnering agreement and remains convinced of the need for consolidation in the industry. Improved supply-chain management must also take place to safeguard capability and to incentivise better performance and we continue to negotiate with the key elements of industry on this basis. Given the number of industrial players in the submarine market, consolidation to one entity may not be possible; other solutions are also being examined.</p> <p>The MOD's Submarine programme management has recently been unified under Director General Nuclear, responsible to both the Chief of Defence Procurement and the Chief of Defence Logistics for managing delivery of the submarine acquisition programme through-life.</p>
MARITIME (2)	<p><i>For surface ship design and build, we aim within the next six months to arrive at a common understanding of the core load required to sustain the high-end design, systems engineering and combat systems integration skills...</i></p>	<p>Within six months from publication</p>	<p>Work is being undertaken to assess the Core Work Load required to sustain maritime Key Industrial Capabilities (KICs). Although good progress has been made in developing our understanding of a Recognised Maritime Industrial Picture, which is an essential first step, the overall task which has links to the submarine and support programmes is highly complex and is taking time to get right. Industry has been, and will continue to be, involved.</p> <p>The June 2006 deadline for production of a sustainability strategy for the key maritime equipments has not been achieved. This is linked to, and will flow from, the work to determine the core workload and KIC sustainability plans. We are working hard to ensure that this work is completed as quickly as possible.</p>
MARITIME (3)	<p><i>For surface ship support, we will start immediate negotiations with industry with the aim of exploring alternative contracting arrangements and the way ahead for contracting the next upkeep periods, which start in the autumn of next year. Key maritime equipment industrial capabilities will be</i></p>	<p>June 2006</p>	<p>As announced last December, the Department is moving forward quickly with the three dockyard companies (Babcock Support Services Limited, Fleet Support Limited and Devonport Management Limited) to put alternative contracting arrangements in place, initially for a package of surface warship upkeep work (refits and docking periods) which is currently planned to begin in autumn 06. This work will be managed through the exploratory phase of the new surface ship</p>

DIS Commitment		Milestone	The Current Position
	supported by the production of a sustainability strategy for these key equipments by June 2006.		support alliance announced by the Secretary of State on 14 Feb 06. During this exploratory or 'transition' phase, which could last up to 2 years, competition policy has been suspended (an exclusion order to the 1998 Competition Act was tabled by Department of Trade and Industry on 8 Mar 06 and came in to force on 4 Apr 06).
FIXED WING (1)	...we will work with BAE Systems and the other companies in the defence aerospace sector so that it can reach the appropriate size and shape for demand...we aim during 2006 to agree the way ahead – which will be challenging given the scope of the scale of the transformation that is required – and to implement it from 2007.	Agreement of LTPA in 2006. Implementation from 2007 onwards	MOD is negotiating with BAE Systems the terms of a business rationalisation and transformation agreement required to facilitate the effective sustainment of the industrial skills, capability and technologies needed to operate, support and upgrade our fast jet combat aircraft through life. Our aim is to identify the way ahead by the end of 2006 and to implement it from 2007. In time this work will need to expand to embrace the wider defence fixed wing sector, including other companies besides BAE Systems.
FIXED WING (2)	...we intend to move ahead with a substantial Uninhabited Aerial Vehicle Technology Demonstrator Programme in 2006.	In 2006	MOD and Industry continue to make progress towards initiating a UAV Technology Demonstrator Programme. .
AFVs	We will be working hard with BAE Systems...to give effect to the long term partnering arrangement... We intend to establish a joint partnering team within the early part of 2006 and to establish a business transformation plan underpinned by a robust milestone and performance regime.	Early part of 2006	An AFV Partnering Agreement between MOD and with BAE Systems Land Systems was signed on 15 Dec 05. A Joint Partnering Team has since been established. A briefing on the scope of the Partnering Agreement for wider industry was held in March 06.  A Joint Business Plan is being developed and work has commenced on the detailed transformation plan to facilitate better in-service support to the current AFV fleet.
HELICOPTERS	We hope that by the Spring 2006, subject to value for money having been demonstrated, we will have reached agreement on a Strategic Partnering Arrangement (SPA)...	Spring 2006	A Strategic Partnering Arrangement with AgustaWestland was announced on 22 June.
COMPLEX WEAPONS	We [will establish] a multi-disciplinary team charged with working with all elements of the onshore industry to establish how we might together seek both to meet our ongoing requirements and sustain in an industrially viable manner the critical guided weapons technologies and through life support capabilities that we judge to be so important to	Mid-2006	A joint MOD / Industry team has been established and progress is being made to identify the impact on the retention of critical skills in the industrial base in the context of our declining demand for new weapons. The joint team consists of the key members of industry; MBDA, Raytheon Systems Limited (RSL), Thales Air Defence Limited, BAE Systems UWS and QinetiQ.  We are aiming to announce at Farnborough the results of our work so

DIS Commitment		Milestone	The Current Position
GENERAL MUNITIONS	<p>our operational sovereignty... Our intention is that we should have a clearer way ahead by mid-2006.</p> <p>We will be taking forward Project MASS, with a view to making decisions on how best to sustain our required access to general munitions in the summer of next year... We are also actively pursuing partnering arrangements with other [non BAES] suppliers.</p>	Summer 2006	<p>far and our plan for ensuring the delivery of a strategy for the sector at the end of the year.</p> <p>We are building on the DIS commitment (in Chapter B6.45), and will pursue that option which provides the operational capability that we need combined with best long term value for money.</p>
RESEARCH AND TECHNOLOGY (1)	<p>We will [complete] the ongoing Science and Technology Capability Study...by Summer 2006.</p>	Summer 2006.	<p>This work has gone well and the internal study has been completed. Publication for a wider audience is expected in by the end of summer 06. The methodology is now being employed on a wider study looking at MOD's spend on Research and Development.</p>
RESEARCH AND TECHNOLOGY (2)	<p>We will conduct further work better to understand the underpinning technologies that the UK must have...by Autumn 2006.</p>	Autumn 2006	<p>Looking across the scientific and engineering disciplines, this project aims to identify those underpinning technologies that have and are likely to have a significant impact on defence capability and must be retained in the UK for security and sovereignty reasons. In achieving this aim, the project will determine the process by which future assessments of this kind can be coordinated. The results of the study will be included within the Defence Technology Strategy, to be published in autumn 06, alongside a separate report explaining the methodology utilised.</p>
RESEARCH AND TECHNOLOGY (3)	<p>We will by mid-2006 update our Defence Technology Strategy</p>	Mid 2006.	<p>A core MOD/NDIC Research &amp; Technology Sub-group has been established to oversee the required work.</p>
RESEARCH AND TECHNOLOGY (4)	<p>We will develop a better understanding of the innovation process and map out the technology trees for major capabilities, systems and platforms in a report, which we aim to produce by the Autumn of 2006.</p>	Autumn 2006	<p>A series of productive Technology Strategy workshops, involving representatives of MOD and the industrial supplier base have been held and cover each of the main Defence Industrial Strategy sectors. We expect to publish the revised strategy in autumn 06.</p> <p>Under the direction of the NDIC R&amp;T subgroup a dedicated joint MOD/Industry working group has been established to conduct this work.</p>
INTERNAL CHANGE	<p>We will work with industry to develop, roll out</p>	April 2006	<p>Three joint MOD/industry workshops looking at the innovation process have been completed and range of technology trees has also been collated from industry to help enable the analysis work. The final deliverable will be produced in September, findings to be included in the Defence Technology Strategy.</p> <p>The Defence Values for Acquisition have been launched across the</p>

<b>DIS Commitment</b>	<b>Milestone</b>	<b>The Current Position</b>
(1) and implement a joint plan for embedding the Defence Acquisition Values throughout the acquisition community. We expect to be in a position to launch this within three months and will apply the real commitment of resource, time and effort that will be required to effect lasting change through 2006 and beyond.		MOD acquisition community. Action has been taken to embed the values via incorporation into staff performance appraisal and bonus arrangements. A joint plan to embed the values has been developed and was discussed at the last NDIC meeting on 29 June.
INTERNAL CHANGE (2) We are currently scoping two Pathfinder programmes to test and de-risk a programme approach to through-life capability management with the intention that the Pathfinder programme teams will launch in the first half of 2006.	First half of 2006	We have launched two Pathfinder programmes this year: Sustained Maritime Combatant Capability (SMCC) and the Sustained Armoured Vehicle Capability (SAVC) – led by the MOD but with significant industrial input. These programmes are testing tools to deliver through-life capability management, such as techniques for capability trade-off and integrating projects across the Defence Lines of Development.
INTERNAL CHANGE (3) We will address the shortages in Project Delivery Skills within the Department by building on our existing Project Delivery Skills Strategy to deliver an accelerated pan-Defence Project Delivery Skills programme...Key milestones are to be achieved by April 2006.	April 2006	This is an ongoing programme now subsumed within the Skills & Behaviours element of the DIS Acquisition Change Programme. Early milestones, such as an initial skills assessment of the skills required for Programme & Project, Commercial & Procurement, Logistics, Resource, and Engineering & Science Management have been achieved
INTERNAL CHANGE (4) An evaluation of current incentivisation initiatives will be completed by October 2006.	October 2006	A stocktake of current incentives structures in the MOD and their ability to meet the needs of the DIS is now underway.
INTERNAL CHANGE (5) The DPA will be piloting the operating framework during 2006, working in conjunction with the other areas of acquisition to ensure consistency and alignment.	During 2006	The DPA has completed development work regarding the Project and Programme management element of the operating framework, drawing on industry best practice. This work will form the basis of a wider Acquisition Operating Framework encompassing all of the Department's acquisition business.
INTERNAL CHANGE (6) We will review – so that we are in a position to make judgements about this by May 2006 – the extent to which the current process and organisational constructs supports, encourages, hinders or obstructs the delivery of excellence in acquisition. This would allow us to commit to changes that are required this side of the summer recess.	May 2006	Officials have reviewed the Ministry of Defence's current acquisition arrangements, the Enabling Acquisition Change (EAC) review. The outcome was announced on 3 July, and the results communicated separately to the Committee.
INTERNAL CHANGE We are looking forward to discussing further	Early in 2006	The Joint Commercial Policy Group (CPG) meeting on 6 Feb agreed to

<b>DIS Commitment</b>	<b>Milestone</b>	<b>The Current Position</b>
<p>(7)</p> <p><i>with Industry – in the first instance through the commercial policy sub-group of the NDIC early in the New Year – our ideas about alternatives to competition as a means where appropriate of assessing value for money, with a view to developing a concrete action plan for taking them forward.</i></p>		<p>the formation of a joint MOD/Industry working group. This group agreed a joint action plan which was discussed at the most recent CPG meeting on the 9 June.</p>
<p>INTERNAL CHANGE</p> <p>(8)</p>	<p>Immediately</p>	<p>Besides the increased openness in the DIS itself, we have already run several briefings to industry setting out more detail of our forward plans. Lessons identified from these have informed guidelines on the conduct of information release to embed the revised policy into normal business, and these will be discussed with industry in the next month.</p>