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Defence Committee

Defence Support Group

Seventh Report of Session 2008–09

Report, together with formal minutes, oral and written evidence

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The current staff of the Committee are Mike Hennessy (Clerk), Richard Ward (Second Clerk), Karen Jackson (Audit Adviser), Sara Turnbull (Inquiry Manager), Richard Dawson (Senior Committee Assistant), Christine McGrane (Committee Assistant) and Miguel Boo Fraga (Committee Support Assistant).

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. Media inquiries should be addressed to Alex Paterson on 020 7219 1589.

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1 Introduction

The Inquiry

1. The Defence Support Group (DSG) is a wholly-owned UK Government Trading Fund established to support the Armed Forces and to deliver wider defence objectives in support of the Defence Industrial Strategy (DIS). It was launched on 1 April 2008 following the merger of the Army Base Repair Organisation (ABRO) and the Defence Aviation Repair Agency (DARA). As the Ministry of Defence (MoD) set out in its memorandum to us, the four main DSG business streams cover Armoured Vehicles, Land and B (unarmoured or 'soft') Vehicles, Large Aircraft and Electronics and Components. These business streams operate across eighteen sites supported by the DSG Head Office, currently located at Andover.¹

2. We announced our intention to examine DSG in November 2008, following our seminar at Shrivenham when we considered our forward programme for 2009. Our formal call for evidence was issued on 17 December 2008 and set out our key areas of interest:

- the future work, role and status of DSG;
- the viability of DSG, particularly with regard to its remaining aviation business;
- the success of the merger of ABRO and DARA;
- the strategic importance of maintaining current DSG skills and abilities within an MoD Trading Fund; and
- the impact of the increased tempo of operations on DSG's current and future activity.

A memorandum was received from the MoD in connection with the inquiry. Unfortunately, on account of the pressure of parliamentary business, a visit to DSG Donnington planned for before our scheduled evidence session had to be cancelled. On 20 January we took oral evidence from Archie Hughes, DSG's Chief Executive, and from Major General Ian Dale, Director General Land Equipment from Defence Equipment and Support (DE&S), DSG's main customer within the MoD. We are very grateful for the excellent, clear and comprehensive, evidence they gave to us.

3. There were a number of reasons for our deciding to conduct this inquiry. We had touched upon key elements of DARA's work in a previous Report, *Delivering Front Line Capability to the RAF*,² but had not dealt in this Parliament with the activities of ABRO. We felt it was important to examine how successful the amalgamation of ABRO and DARA had been. We were mindful also of the duty laid upon all select committees periodically to examine the work of departmental agencies and trading funds. Furthermore, we had already decided, following the Shrivenham seminar, to conduct an inquiry into recuperation issues early in the New Year. DSG has a vital role in rolling recuperation, particularly with regard to Armoured Fighting Vehicles (AFVs), and in respect of Urgent

1 Ev 18, paras 1-33

2 Defence Committee, Third Report of Session 2005-06, *Delivering Front Line Capability to the RAF*, HC 557, paras 81-101

Operational Requirements (UORs); and likewise its contribution to the planned, more thorough, programme of recuperation following drawdown from Iraq would be significant. The DSG inquiry would therefore also assist with other elements of our programme of work.

Background: the Merger

4. We do not intend in this Report to examine in any detail the rationale behind the Government's decision to merge ABRO and elements of DARA (selling off or closing other parts of that latter business). However, it is important to set out the background to the decision, the Government's intentions behind the decision, and an account of how amalgamation proceeded, in order to provide proper context for an examination of DSG's current performance, role and likely future.

5. The merger was announced in Parliament by Lord Drayson, then Minister for Defence Equipment and Support in the MoD, on 22 May 2007 following a number of reviews over preceding years into the future of both ABRO and DARA.³ A short time later, and nine months before the merger was due to take place on 1 April 2008, the two executive teams in ABRO and DARA were replaced by a single team, in order to manage the merger more effectively.⁴ At the merger, DARA's Rotary and Components Business, based at Almondbank and Fleetlands, was sold off, eventually passing into the hands of Vector Aerospace, a Canadian company.⁵ The Fast Jet and Engines Business had already been closed down in March 2007 as no longer viable. The defence engineering activities previously carried out by the Defence Storage and Distribution Agency (DSDA) at Stafford were transferred *into* DSG from the MoD.⁶ (After the merger, on 1 September 2008, a cadre of DE&S procurement and distribution staff based at Sapphire House in Telford was also brought within DSG.⁷)

6. There were a number of clear reasons cited by the Government for the amalgamation. The Government wanted to rationalise its equipment support activities as then carried out by ABRO and DARA⁸ in the light of the thorough consideration of the defence industry's support for the Armed Forces undertaken in preparing the Defence Industrial Strategy, which was published at the end of 2005.⁹ Assessing what the defence industry could best provide and what the MoD needed to retain in-house lay at the heart of this rationalisation. We will consider the MoD's thinking about strategic need later in this Report. The MoD decided that the Fast Jet and Engines Business and the Rotary and Components Business could without detrimental impact upon support for the UK Armed Forces be closed and sold off respectively. The Large Aircraft Business at St Athan, dealing with ageing VC10s,

3 HL Deb, 22 May 2007, col WS38

4 Ev 18, paras 8–9

5 Qq 17–30

6 Q 5

7 Ev 18, para 11

8 HL Deb, 22 May 2007, Col WS38

9 *Defence Industrial Strategy: Defence White Paper*, Cm 6697, December 2005

was not sold off as it became “apparent that sale was unlikely to offer best value for defence”.¹⁰

7. Lord Drayson in his May 2007 statement said that the merger reflected the

“commitment from the MoD to sustain essential levels of capability and capacity which will provide the new defence support group with greater clarity and allow it to implement a programme of continuous improvement. At the same time, the new organisation will look to consolidate and build on ABRO’s and DARA’s existing defence industry relationships and partnerships, by entering into agreements on future equipment programmes. Those will ensure that the MoD retains the intellectual property and design skills required to maintain operational sovereignty in key areas as set out in the defence industrial and technology strategies.”¹¹

8. Archie Hughes, then Chief Executive of DARA, was put in charge of the amalgamation and led the merger of the two executive teams into one, in time for 1 April 2008. The majority of those on the final, DSG, executive team were his colleagues from DARA. Archie Hughes explained to us that this was the result of a mix of factors, and was not what he had initially set out to accomplish: “it happened a bit by design, a bit by default, but the clear intent was to have a reduced, slim-lined, more effective board.”¹² There were also a number of significant challenges which had to be faced in the amalgamation. It was important for the Chief Executive and his team to understand the businesses both of ABRO and of DARA, to look at merging management structures, to put together “all the necessary legislative work to formulate the new trading fund”, to run both businesses effectively, to sell off the unwanted parts of the DARA business, and to put in place all the mechanisms to allow DSG to begin operating without pause or drop in effectiveness from 1 April 2008.¹³

9. The new executive team also had to overcome what Archie Hughes termed a “number of cost surprises in the ABRO side of the business”.¹⁴ While DARA, with a turnover of some £133 million, had an operating profit of some £10 million in its last trading year, ABRO, with a turnover of some £147 million, had made a £3 million loss in the same year.¹⁵ This was unexpected, following as it did profitable years of trading. Archie Hughes explained to us that there has “now been put in place the actions to improve” the performance of the land business, “and there are much better financial cost control mechanisms in place”.¹⁶ He added that he expected “the land constituency and the air constituency... both to be profitable this year.”¹⁷

10 HL Deb, 22 May 2007, Col WS38

11 *ibid.*

12 Q 12

13 Q 3

14 Q 14

15 The 2007–08 Posted Accounts for both ABRO and DARA are available on the DSG website at www.dsg.mod.uk/accounts.asp

16 Q 14

17 Q 15

10. Operationally, the merger appears to have been a considerable success. Major General Ian Dale stressed to us that at amalgamation “the Defence Support Group ... had not dropped the ball on any occasion” and that “despite the turbulence of the change and amalgamation and the internal drive for efficiency... we have not had any perturbation in the outputs whatsoever.”¹⁸ He also noted that the benefit of dealing now with “a single point of contact” was making the DE&S-DSG relationship “so much simpler and so much clearer”.¹⁹ **The workforces of both ABRO and DARA, now within DSG, are to be commended for their conscientious and flexible approach to the merger. The executive team implementing the merger should also be praised for ensuring that there was no hiatus in DSG’s support for the Armed Forces nor any diminution to the quality of that support.**

11. Lord Drayson's statement setting out the MoD's decision to amalgamate ABRO and DARA made no direct or explicit reference to the level of cost savings from the merger. However, an emphasis on cost savings to be made from the amalgamation is apparent from the MoD memorandum, and from the evidence we took from Archie Hughes. The memorandum stressed that even “the formation of a single executive management and trading fund board... delivered annualised savings in the region of £1 million”.²⁰ It added that “overall benefits of £10 million have already been achieved primarily through manpower reductions at corporate level”, while “a tranche of further measures will drive down costs across the whole of the business.”²¹ The continuing efficiency and effectiveness of the businesses represented by both bodies obviously relies to a great extent upon keeping costs down. The MoD’s explicit rationale for the merger was to create a business that could better support the UK's Armed Forces, with the private defence sector playing its proper part and the MoD keeping in-house those elements it felt it most needed for strategic or other needs to retain within trading fund status. However, the focus on savings only serves to suggest that the expectation of cost benefits on amalgamation and thereafter might significantly underpin this. While cost will always be part of any consideration of the best model for maintaining those elements, **we expect the MoD in its response to this Report to make categorically clear that the ability of DSG to continue to deliver cost savings will not alone determine its future, and that the rationale of the creation of DSG is broader and deeper than the cost considerations that supported the reasoning behind the merger.**²²

12. DSG's footprint immediately after the merger was as follows: DSG’s Head Office was located in Andover from where it directed the activities of the organisation’s main sites in Bovington, Catterick, Colchester, Donnington, Sealand, St Athan, Stafford, Stirling and Warminster; smaller sites were located at Aldershot, Bicester, Edinburgh, Kinnegar, Sennybridge and York. Small support teams were also permanently embedded at other UK military sites, with other small teams serving as required in operational theatre. Except for

18 Q 8

19 Q 16

20 Ev 18, para 9

21 *ibid*, para 12

22 See DSG website, www.dsg.mod.uk

the addition of ex-DE&S staff in Telford in September 2008, there have been no changes to this footprint since the merger.

2 DSG Performance

13. We took evidence from DSG some two-thirds of the way through its first operating year. The memorandum we received from the MoD set out the performance of DSG to date and gave the full year forecast at that point. This information clearly showed that DSG was to that point performing well and was expected at least to meet all of its targets, and to exceed its Financial Performance and Efficiency Targets by 50% and 100% respectively.²³ Major General Ian Dale noted in evidence to us that “outputs have been fine,... they have been timely,... they have been on cost, and they have been to quality”.²⁴

14. **The first DSG Annual Report is expected to be issued in the early summer. It will contain fuller information relating to DSG's performance in its first full year, together with its set of future targets. We fully expect the first year's performance to correspond to the forecasts given to us in January.** The appropriateness of the targets set for the following period will be important. They need not just to challenge DSG to become an even more effective body, but to stress the high levels of performance required better to support the UK's Armed Forces, especially while they are still engaged in significant and complex attritional operations in Afghanistan.

15. **Continuing pressure exists for the Government, and its departments of state such as the MoD, to realise further cost savings.** There needs to be some attempt to identify an appropriate level of efficiency savings from all associated bodies, including agencies and trading funds such as DSG, where possible. **The efficiency savings captured from ABRO and DARA during amalgamation, and from DSG during its first year of operation, have already contributed to departmental savings: seeking further cuts which might compromise DSG's operational capabilities and skills according to some arbitrary allocation of savings expected would be wrong-headed.**

DSG Personnel

16. The quality and integrity of the work conducted by DSG for the MoD and the UK's Armed Forces depends to a very great extent upon the skills and vigour of the workforce of DSG. Maintaining the level of skills available in both ABRO and DARA through the process of merger and beyond, retaining such skills, recruiting effectively in order to allow such skills to be passed on and keeping high the level of DSG commitment to supporting the Armed Forces, were all therefore vital.

17. DSG in the first part of its first year of operation seems to have dealt well with this challenge. As was noted above, the MoD noted no hiatus in the service of ABRO and DARA personnel – now within DSG – to the Armed Forces, nor any lessening in the quality of that service. Unique skills within DSG connected with its work on legacy equipment or in areas of operationally sovereign capability have been maintained and the organisation continues to seek to take on capable new employees, to train apprentices and to ensure that its skills base endures over time.

²³ Ev 18, para 7 and Ev 21–22, Annex A

²⁴ Q 8

18. DSG is rightly proud of the tradition of apprenticeships it inherited from ABRO and DARA. As Archie Hughes acknowledged in his evidence to us:

“...we do not have any difficulty in recruiting for apprenticeships. People who go through a DSG apprenticeship... come out at the end with a passport that will last them their entire life... because it is an excellent set of training they get.”²⁵

Such apprenticeships will remain important to maintain DSG's skills. Given the need for similar skills in the private sector, both within and without the defence industries, careful attention will have to be given to the quantity and quality of those accepted for apprenticeships in order to protect the historic and evolving skills sets available within DSG. **We are impressed by DSG's commitment to apprenticeships which we feel shows a real determination to provide over the long-term a continuing high level of support to the UK's Armed Forces.**

19. In oral evidence we also asked Archie Hughes about skills shortages. We were told that DSG does not have skill shortages “at the base skills level in entering in technical and engineering apprentices”. However, there is a problem with geographical distribution:

“We tend to have some skills shortages in the geographical bases that make it difficult. We have a facility in Colchester where we employ through Colchester about 140 people. It is a bit more difficult recruiting people in that area than, maybe, Catterick.”²⁶

This difficulty was however offset to some extent by the organisation's ability to “move the work to the people and vice versa”. Moreover, applications for permanent jobs with DSG were very popular because DSG is “seen as a good employer by most places in the country”.²⁷

20. However, while engineering and other relevant hard skills are available, there was a difficulty in getting people “up through the business and into the managerial areas.”²⁸ There was a need to grow DSG's “capability of programme management, project management, and some of the high level managerial skills”.²⁹ While some people could go from apprenticeships to permanent junior posts and then to management, it was still felt that DSG needed to bring in some key managerial people from outside. This seems to reflect what was a possible weakness in ABRO and DARA which the executive team intends to remedy. **We would be grateful for the MoD's assessment of the particular weaknesses in the area of high level managerial skills which DSG inherited from its predecessor organisations, ABRO and DARA.**

21. Key to maintaining a full complement of capable staff within DSG is being able to provide pay that does not suffer too much in comparison with what could be obtained for similar work in the private sector. While no doubt a good proportion of DSG's staff by

25 Q 55

26 *ibid.*

27 Q 57

28 *ibid.*

29 Q 57

preference work in the public sector, a degree of comparability of pay is helpful to retention. Archie Hughes explained to us that while DSG does not offer “industry benchmark levels of pay” it does offer “sufficient levels of pay to retain the people” that it has.³⁰ Current economic conditions no doubt favour recruitment and retention; but some of the weaknesses noted above in terms of variable conditions across DSG’s sites for recruitment and retention are the result of the availability of alternative, better remunerated, employment of a similar nature as DSG offers in the areas concerned. **We request a note from the MoD setting out how DSG intends to deal with distributional problems relating to the recruitment and retention of its workforce, bearing in mind that its unique geographical footprint is an asset it presumably does not want to lose.**

22. A question was also raised in oral evidence about comparative levels of productivity or performance between DSG and analogous private sector bodies. Archie Hughes claimed that it was difficult to set up comparative data between DSG and the private sector since “the private sector does not do what DSG does”, but he said that he paid considerable attention to internal benchmarks. He noted that different sites operated at different levels of productivity. He was committed to using best practice to drive up productivity where it was less than satisfactory. Overall, he told us that DSG's productivity was “no different to an engineering manufacturing business elsewhere.”³¹

Support for Operations

23. A key incentive for keeping high levels of performance within DSG is its personnel’s awareness of the direct link between what they do and maintaining the capabilities of the Armed Forces in operational theatre. The flexibility and responsiveness of DSG is also to a good extent founded upon an understanding between its staff and the military personnel whom they support that they are all working together as one team. Clearly, not all of DSG’s work is focused directly or explicitly upon operational theatre. Archie Hughes was asked in evidence what proportion of his business was dependent upon operational requirements and what proportion of his staff was engaged upon such work. While he claimed that only 15% of his funding came from the Treasury—directly to support operational activities—it is clearly the case that a much greater proportion of DSG work sustains the capability to maintain UK operations in Afghanistan (and in Iraq up to drawdown) directly and indirectly. Major General Ian Dale made the point to us that DSG's dealings with “the land district load” is a support to operations because it frees up military personnel for the front and immediate support lines, even though the nature of the work seems routine and otherwise unconnected to operations abroad.³² Below is a table setting out the nature of DSG’s support to operations.

30 Q 58

31 Q 59

32 Q 60

Table 1: Summary of operational impacts on DSG

OPERATION TELIC	
a. Current:	Continued support through Programme and District Load work provided in UK for equipments/assemblies returned and repaired under the main Land commercial agreement.
b. Future:	Regeneration of TELIC equipment in 2009 will sustain demand for maintenance, repair and overhaul of returning Armoured Fighting and Support vehicles plus a wide range of other war-fighting equipment.
OPERATION HERRICK	
a. Current:	Continued support through Programme Load and District Load work provided in UK for equipments/assemblies returned and repaired under the main Land commercial agreement and on-going support to fitment/integration of UORs.
b. Future:	Continued support to HERRICK will be required and will likely see; <ul style="list-style-type: none"> i. A continued requirement to fit/integrate UOR's. ii. A continued requirement to repair battle damaged equipments in UK. iii. A likely requirement to supply manpower to the Equipment Sustainability Solution (ESS), Camp BASTION; planned In-Service Date Apr 2010. iv. Continued support to manage the Operational Training Equipment Pool (OTEP). v. A re-distribution in overall workload for DSG through the creation of the ESS in Camp BASTION³³. vi. DSG flexibility to adjust priorities at short notice including the potential to deploy in support of the ESS.

Source: Ministry of Defence³⁴

24. This desire within the DSG workforce to help support and sustain UK operations abroad is made more concrete still by the deployment of DSG personnel to theatre. This is something about which we sought information in preparation for the session with Archie Hughes on 20 January. The MoD stressed in its written memorandum, received before the evidence session, how the deployment of its personnel to theatre characterised “its utility and flexibility during critical Front Line Operations”.³⁵ A table below sets out DSG deployments to theatre between April 2007 and January 2009, involving some 63 personnel, some of whom were deployed on more than one occasion.

33 Assuming DSG are invited to provide a direct labour workforce at the ESS under acceptable commercial arrangements.

34 Ev 23

35 Ev 20, para 31

Table 2: DSG staff in operational theatres

	Op Theatre	From	To	Duration (days)	No of Personnel Deployed	Activity
1	Iraq	29 Apr 07	24 May 07	26	17	Fitting of Electronic Counter Measures (ECM) Installation kits on vehicles.
2	Iraq	21 Jun 07	1 Jul 07	11	6	Fitting of WARRIOR UOR upgrades including: Environmental Control Units (ECU), and ECM kits.
3	Afghanistan	8 Aug 07	20 Aug 07	13	7	Fitting of WARRIOR UOR upgrades including: ECU, ECM and Additional Protective armour (WRAP 2). This was a continuation of DSG work carried out in barracks in Germany.
4	Kuwait	22 Oct 07	8 Feb 08	Up to 108	Up to 15	Fitting of WARRIOR UOR upgrades; ECM and WRAP 2. Teams/individuals changed throughout the period.
5	Iraq	14 Jan 08	6 Feb 08	24	8	Fitting of Mine blast protection to CHALLENGER 2 Main Battle Tanks.
6	Iraq	17 Mar 08	8 Apr 08	33	5	Fitting of Mine blast protection to CHALLENGER 2 Main Battle Tanks.
7	Iraq/ Afghanistan	13 Jun 08	3 Jul 08	21	1	Specialist support to ECM eqpts.
8	Iraq	8 Sep 08	18 Oct 08	41	3	Fitting of Mine blast protection to CHALLENGER 2 Main Battle Tanks and CHALLENGER Armoured Recovery Vehs.
9	Iraq/ Afghanistan	5 Jan 09	26 Jan 09	21	1	Specialist support to ECM eqpts.

Source: Ministry of Defence³⁶

25. DSG only deploys volunteers to theatre and is oversubscribed for volunteers when it advertises such deployments.³⁷ Some DSG sites are inevitably more involved in deployments than others, considering the skill sets and experience required: deployed personnel have come from DSG sites in Donnington, Bovington, Catterick, Colchester, Stirling and Warminster. While in theatre, DSG staff work under REME command; many

36 Ev 21

37 Q 77 and Ev 21, para 32

have won campaign medals for their work.³⁸ Indeed, the day before we took evidence from Archie Hughes, on 19 January 2009, General Sir Kevin O'Donoghue, Chief of Defence Materiel, presented medals to seven DSG staff for their contribution and commitment to supporting the Armed Forces in theatre manifested by their voluntary deployment to Basra.³⁹ **We express our gratitude to all those DSG employees who have volunteered, sometimes on more than once occasion, to deploy in theatre in support of operations. Such commitment is of great value to DSG and to our Armed Forces and clearly indicates the high level of dedication amongst the staff within DSG.**

The Equipment Sustainability Solution

26. One important development in which DSG hopes to be involved during the latter half of 2009 and into 2010 and beyond is the construction and operation of the Equipment Sustainability Solution (ESS) at Camp Bastion in Afghanistan. This is an equipment support facility that it is hoped will be operational from April 2010, in recognition of the enduring nature of operations in Afghanistan, which will be able to deal with recuperation, repair and modification in that theatre.⁴⁰ It is expected to be a more efficient, cost-effective and operationally sound way of dealing with equipments. Much of this would otherwise have to be shipped out of theatre, perhaps to the UK, replaced or otherwise dealt with at greater cost and over a longer period of time.

27. We asked Major General Ian Dale about this facility and about DSG's role in setting it up and operating it. He explained that it would be:

“.. a static facility inside a secure compound. It is therefore amenable to being staffed and run by civilian components. That could be a combination of the Defence Support Group expertise at various stages... It could also be forward support representatives for industry... So it could be a combination of contractors, DSG and REME soldiers... I would probably envisage REME soldiers being the backbone of it, supplemented and augmented as demanded by the requirements by DSG and industry.”⁴¹

In supplementary evidence to us, the MoD noted that DSG staff have been invited to participate in “a very small way” in the construction phase of the ESS—“by giving specialist advice... on infra-structure and facilities aspects.” The contract is being managed by Permanent Joint Head Quarters (PJHQ) and the prime contractor (for both construction and operation) is KBR. Following construction, which is expected to end in April 2010, KBR will supervise under sub-contracts various elements of delivering repair capability. DSG will be invited to participate in the competition for these sub-contracts on account of “its position within MoD; ... its proven track record; ... its knowledge of equipments, and ... its security status in regard to repairing certain sensitive equipments.” It is currently expected that sub-contracts will be awarded later in 2009.⁴²

38 Ev 21, paras 33–34

39 Q 77

40 Ev 24, A4

41 Q 70

42 Ev 24, A4

28. **The Equipment Sustainability Solution (ESS) provides an excellent opportunity for DSG to maintain its strong partnership with industry and continue to provide excellent quality support to the UK's Armed Forces in theatre. We very much hope that DSG is successful in the competition for sub-contracts for work on the ESS. This would be a positive development for DSG, for industry and for the Armed Forces, who will all need to work in ever closer cooperation as the conflict in Afghanistan persists.**

Urgent Operational Requirements and Recuperation

29. As we have seen, DSG staff perform a very important role in theatre, and in support to operations in the UK, assisting with the modification of equipment, its repair or its general recuperation. Work in carrying out Urgent Operational Requirements (UORs) on vehicles does not fall only to DSG, nor is most of it done in theatre. At least until the ESS in Camp Bastion is up-and-running, most UOR work is carried out away from theatre by the defence industry and DSG, the latter sometimes working on a sub-contract for the former.

30. While it is not easy to specify how much time or manpower DSG dedicates to UORs, the continuing significant presence of UOR costs in the MoD Estimates can only mean that some staff and resources within DSG need to be redeployed to UOR tasks, and sometimes at short notice; and, as we saw when conducting our inquiry into DE&S staff and UORs, often the more able and experienced employees and teams find themselves working on UOR programmes.⁴³ The Government response to our Report, *Defence Equipment 2009*, acknowledged that this extra burden of work and shift of expertise was causing some challenges for DE&S.⁴⁴

31. While overall UOR expenditure this Financial Year (FY) is expected to be less than that for the last FY, expenditure this FY for Afghanistan will not be so different than that last year for the same theatre (drawdown from Iraq creating the difference in overall figures). The rate of UOR activity is showing no real sign of diminution in that theatre. (This activity of course covers more than equipment – it also covers structures and other urgently provided assets or modifications.) In FY 2008–09, it was expected that £1,054 million would be spent on UORs, £791 million of which would be for the Afghan theatre. FY 2009–10 is expected to see costs of £635 million on UORs for Afghanistan.⁴⁵ (Further costs of £424 million, urgently required but kept separate from the UOR budget in this FY, relate to the Protected Mobility Package.⁴⁶ this raises urgent operational costs to £1,057 million for the Afghan theatre alone this FY.)

32. Major General Ian Dale noted that DSG is already taking on more work as a result of operations, covering for UK military personnel deployed overseas or otherwise busy in support of operations.⁴⁷ UOR activity presents a distinct challenge to DSG even if the

43 Defence Committee, Third Report of Session 2008–09, *Defence Equipment 2009*, HC 107, para 58

44 Defence Committee, First Special Report of Session 2008–09, *Defence Equipment 2009: Government response to the Committee's Third Report of Session 2008–09*, HC 491, response to recommendation 15

45 Defence Committee, Fourth Report of Session 2008–09, *Spring Supplementary Estimate 2008–09*, HC 301, para 15

46 This is from the Government response to the Committee's Fourth Report of Session 2008-09 on the Spring Supplementary Estimate (response to recommendations 9 and 10) currently at:
http://www.parliament.uk/documents/upload/Memo_submitted_by_the_Government.pdf (to be published in the Committee's forthcoming Report on the Ministry of Defence Main Estimates)

47 Q 60

number of people in its workforce directly involved is not great. In addition to this, DSG hopes to play a key part in the expected programme of equipment recuperation following drawdown from Iraq.⁴⁸ We have taken evidence on this programme, during our inquiry into *Readiness and recuperation for the contingent tasks of today*, and we are aware that a significant amount of work will fall to be done by defence contractors and DSG once this major recuperation programme is given the green light.⁴⁹

33. We are concerned that current uncertainties with regard to the size and timescale for the MoD's recuperation programme following drawdown in Iraq might create difficulties even for an organisation as flexible and committed as DSG. We call on the MoD to ensure that DSG is as well apprised as possible of what it will need to do and over what time period within the recuperation programme. DSG will itself need to monitor the continuing, if not increasing, demands being placed upon it, directly or indirectly, by current operations. We recommend that the MoD, in its response to this Report, make clear the anticipated levels of future manpower and resource commitment within DSG to the ESS, to the recuperation programme, and to UORs, set alongside its capacity to deal with its core non-operational areas of activity.

34. The sustained and thorough commitment of DSG staff to supporting our Armed Forces in operational theatre is there for everyone to see. We commend DSG staff for this full-hearted commitment and for maintaining a high level of performance in support of operations.

48 Qq 61 and 78

49 See Defence Committee website, transcripts of oral evidence for 3 and 10 March and 28 April (to be published in the Committee's forthcoming Report on *Readiness and recuperation for the contingent tasks of today*.)

3 DSG: Strategic Need

35. Central to Lord Drayson’s announcement of the amalgamation of ABRO and DARA, made in May 2007, was his statement of the strategic need to keep some of the businesses of those two organisations within MoD ownership. In his statement he made reference to the need to ensure that the MoD retains “the intellectual property and design skills required to maintain operational sovereignty in key areas as set out in the defence industrial and technology strategies”.⁵⁰ This was echoed by Baroness Taylor, in an interview in DIGEST, DSG’s in-house magazine, in the summer of 2008, shortly after the merger (and while she was still Minister for Defence Equipment and Support within the MoD). In this interview she made clear the strategic need for retaining operational sovereignty in relation to the Joint Strike Fighter (JSF), where the Government needs to “own the knowledge” on key systems:

“An agreement has been reached with the US Government on the basis that the security of their systems is maintained by having our own in-house capability when it comes to upkeep and repairs, and DSG will be crucial in achieving this objective.”⁵¹

36. However, this strategic need does not refer only to operational sovereignty on JSF. The Defence Industrial Strategy, issued in December 2005, before the merger of ABRO and DARA was planned, says of the former:

“ABRO... provides pivotal support to operations by implementation and support for UORs. ABRO also provides the capability for our armoured fleet base repair and maintenance.”⁵²

The Strategy, which sets out the industrial capabilities which the MoD wishes to see retained in the UK for defence reasons, and those particular capabilities retained within the UK which it wishes to see retained by Government, goes on to say:

“...we... recognise that ABRO provides us with a core capability in the repair and overhaul of the armoured fleet which must be retained in the UK. We judge that until strategies for the future provision of support for the armoured fleet have matured, any change in ownership of ABRO represents an unacceptable level of risk.”⁵³

This sets out a requirement to retain a capability currently part of DSG within the MoD ‘family’ only until circumstances change: this requirement is contingent on industry’s current inability to provide the capability in question.

37. In its memorandum to us, the MoD sets out what it considers to be DSG’s strategic core capacity and capability. This is contained in the table below.

50 HL Deb, 22 May 2007, col WS38

51 DIGEST June/July 2008 available to download on the DSG website, www.dsg.mod.uk/digest_overview.asp

52 *Defence Industrial Strategy*, B3.25

53 *Defence Industrial Strategy*, B3.31

Table 3: DSG key strategic core capacity and capability

LAND EQUIPMENT	
1.	<p>Unique on-shore⁵⁴ Armoured Fighting Vehicle (AFV) Hull repair capability, (to maintain hull ballistic integrity), including:</p> <ul style="list-style-type: none"> —Large aluminium milling machines —Hull manipulators⁵⁵ —Aluminium Armour “approved” welders —Expert knowledge of aluminium armour repair
2.	<p>Small Arms repair and upgrade capability including:</p> <ul style="list-style-type: none"> —Full Small Arms weapons test facility —Secure storage and repair facility located next to the main Defence Storage & Distribution Agency (DSDA) Armoury —Knowledge and ability to repair and upgrade in-service small arms.
3.	<p>Repair of legacy Electronic and Communications systems typically:</p> <ul style="list-style-type: none"> —PTARMIGAN Radio system, repair, modify, test, and manage out of service —Encrypted radio systems requiring secure repair and test facilities.
4.	The unique footprint; 18 Workshops strategically located, [most of which are] close to the customer training base to mitigate downtime and transport costs of repairable equipment.
5.	The ability when required to embed staff within UK based Army units.
6.	Level 1 to 4 maintenance, repair and overhaul of the Army’s Inventory ⁵⁶ , (if required).
7.	Flexibility, the ability to haul and veer a workforce at short notice to meet changing Customer demand.
8.	Management of the supporting supply chain through DSG Land Supply and its own in-house Procurement Group (PG).
9.	Ready availability of a security-cleared multi-skilled workforce.
AVIONICS (specific to the avionic business at DSG Sealand);	
1.	<p>For the combat air platforms, DSG Sealand has played a key role in driving value for money support for the fast jet platforms. In the last 5 years they have ‘leaned up’ significantly and their prices are highly competitive. At one end of the scale, they are able to deliver low cost through-life solutions for equipments that Industry would not necessarily be interested in supporting i.e old/obsolescent equipment and would probably charge premium rates. At the other end of the scale, they have a world class diagnostic and repair capability for the support of modern equipments where they are able to access the intellectual property rights.</p>
2.	In summary, the MOD sees a viable DSG as a key component to delivering value for money support for current and future fast jet platforms in partnership with Industry primes.
LARGE AIRCRAFT	
1.	<p>DSG’s Large Aircraft business unit located at St Athan provides strategic maintenance and support for the VC-10 fleet. DSG will continue to provide these services, as a sub-contractor to BAE Systems, until the out of service date of the aircraft in 2014.</p>

Source: Ministry of Defence⁵⁷

54 Required to be retained in UK in accordance with DIS v1

55 Heavy tooling that can lift and rotate complete hulls to facilitate repair activity.

56 Subject to certain IPR constraints.

57 Ev 22

38. The MoD memorandum itself focused on the appropriateness of the model of Trading Fund as the best means of keeping together the key strategic core capacity and capability currently within DSG.⁵⁸ We considered it important to discuss this issue in oral evidence with DSG in order to gain a better understanding of what was set out in the written evidence to us: after all, the continuing sense of the need to keep together “key strategic core capacity and capability” lies at the heart of the MoD’s decision to maintain DSG as a public body. The lack of any such need with regard to DARA’s Fast Jets and Engines Business and Rotary and Components Business led to them being closed down and sold off respectively.

39. In evidence before us, Archie Hughes distinguished between those parts of DARA closed or sold off and those elements retained within DSG. In the former instance there “were a number of people who were in the same space, essentially doing the same type of work”, and in the latter DSG was “the unique and sole provider”.⁵⁹ Later in the session, Archie Hughes again stressed the importance of DSG’s unique role:

“In the broad range of what we do as DSG, for a large part of it we are the only people that do it and we are the only people who have ever done it.”⁶⁰

Other important DSG activities pointed out to us in evidence by Mr Hughes included “small arms at Donnington... which is another area of capability... that is pretty key” and “the Sealand electronics facility – crypto...avionics – of great benefit to the MoD to retain... in-house.” He also noted that it would not make any sense for anyone else to pick up the work currently undertaken by DSG on the VC10s at St Athan (The current out-of-service date (OSD) for the VC10s is 2014: Archie Hughes anticipates no further extension to this OSD).⁶¹ He also added that as well as its unique facilities for armoured vehicles, DSG was also uniquely positioned for dealing with soft vehicles such as Land Rovers: aside from DSG there was “not anyone who could do the totality of the job...., the one-stop shop activity that brings in the geographical positioning of our business.”⁶² Indeed, DSG recently won a contract from the MoD worth £875 million which success was to a large part founded upon this particular characteristic of DSG.⁶³

40. When the question of DSG’s unique capabilities was put to Major General Ian Dale, he set out a number of points where he felt DSG’s contribution to the MoD was particularly important:

“I can change the priorities for work very quickly and very easily with the Defence Support Group and they have the capacity to swing the resources around as the operational requirement demands it much more flexibly and probably more cheaply than industry ever could, so that would be my first point. ...I can draw people out of the Defence Support Group at fairly short notice and deploy them for urgent

58 Ev 19, paras 15–18

59 Q 18

60 Q 30

61 Qq 52–54

62 Q 31

63 Ev 20, paras 26–29

operational work in Afghanistan and Iraq. ... Many of the DSG work spaces are co-located or very close to garrison areas and airbases, and it is very easy for us to swing work in and out and it is very flexible again, so an industry that takes that on would have to disaggregate in some way in order to achieve that geographic synergy. The one thing that I come back to that I do not think industry can substitute there is one element of DSG – Sealand – which is a government-owned capability and through them we can get better access to foreign intellectual property rights than any industry ever could. That is a really important thing to do.”⁶⁴

Major General Ian Dale also pointed out that one of the key things he sees in DSG is its ability “to support legacy equipments or equipments that are running towards obsolescence”.⁶⁵

41. Both Archie Hughes and Major General Ian Dale set out a range of capabilities and characteristics of DSG that support its retention within the MoD. However, only one of these, the Government-owned JSF – related capability maintained at Sealand, appears to be one which could not in any foreseeable circumstance be provided otherwise by the private sector. Major General Ian Dale himself made this clear when he told us “with one possible exception [Sealand] there is nothing in theory that industry cannot substitute in DSG so long as they throw their minds and their money at it.”⁶⁶ Indeed the “key things that DSG can deliver” which the General cited were not impossible for industry, but “cost prohibitive”.⁶⁷

42. Major General Ian Dale repeated this point later in the evidence session.⁶⁸ With the MoD increasingly looking to industry for ‘providing capability’, for packages of support, maintenance and modification, which will more and more rule out DSG from future contracts, except as a sub-contractor to industry, this strategic need that DSG fulfills is clearly not permanent. In the future it is likely that its relationship with industry will be as important as its relationship with the MoD. However, as it begins predominantly to subcontract from industry rather than contract from the MoD, its place in the public sector will become less secure and its future as a Trading Fund less certain.

DSG and Industry

43. DSG, although owned by the MoD, sits in the market-place with the defence industries and bids for contracts from the MoD or for sub-contracts from industry. While most of its work, approximately 80% according to Archie Hughes, is carried out directly with the MoD as its customer, some 20% of DSG's work is done for industry under sub-contract.⁶⁹ Given the increasing responsibility that the MoD is growing into its contracts with industry for new equipment, where the industry ‘provides capability’, and therefore takes on repairs, maintenance and modification work itself, it seems sensible to suppose that this proportion

64 Q 35

65 Q 18

66 Q 35

67 *ibid.*

68 See Q 36

69 Qq 83, 87; also Ev 24, A5

of work that DSG undertakes for the MoD can only decrease while the amount of work it carries out for industry grows.

44. As we have seen, many of DSG's unique capabilities are not *of necessity* unique: they are unique because no-one else has historically undertaken them, no-one would now want to undertake them—as they relate to obsolescent or legacy equipments—or industry has not yet moved to the position, with regard to armoured vehicle repair, for example, where it yet wants to develop its own facilities and challenge DSG on price and performance. It has also to be borne in mind that with regard to some legacy equipments, the VC10s at St Athan, for example, DSG already carries out the work under sub-contract from the design authority, BAE Systems in this case, and not directly for the MoD.⁷⁰

45. In evidence to us, Archie Hughes properly made much of DSG's currently unique capabilities, but he also spoke about the need for DSG to be competitive in the marketplace.⁷¹ Given the significant proportion of DSG's work that depends upon its unique capabilities, DSG's competitiveness can only properly relate to bidding for work outside these areas. He told us that one of the reasons for DSG existing as a Trading Fund “was to maintain the focus on us being competitive and commercially competitive”.⁷² He pointed out that Sealand, for example, provided work at costs “between 25% and 65% cheaper in our electronics activity than similar quotes from industry for that work”.⁷³ However, DSG lost a bid for work on Bulldog to BAE Systems, who subsequently let a sub-contract to DSG for some of that work.⁷⁴

46. Archie Hughes stressed in evidence to us that the way DSG is working with BAE Systems on Bulldog “is a model with one or two modifications that we can use on other potential programmes”.⁷⁵ No doubt, as some aging systems, such as VC10, pass from obsolescent to obsolete, as work on legacy equipment diminishes, DSG will need more than ever to bid competitively outside its remaining unique areas of work for sub-contracts from industry. There have been fears, which we raised in evidence with Archie Hughes, that DSG might suffer from sub-contracts which pass on to it all of the risk and none of the profit, which industry retains. Mr Hughes denied vehemently that this would be the case.⁷⁶

47. Currently, it would seem that DSG is assisted in its positioning as a customer to the MoD by DE&S Standing Instruction 20, which requires that, “as a retained defence capability, DSG's capabilities and resources should be maximised and the core capability and capacity sustained to ensure their continued availability to the MoD customer”.⁷⁷ It was put to Archie Hughes that this Standing Instruction gave DSG a preferred customer status that was at odds with open competition. Mr Hughes responded that “most of

70 Q 87

71 Q 85

72 Q 82

73 Q 87

74 Q 88

75 *ibid.*

76 *ibid.*

77 Ev 20, para 25

industry understands what we are the preferred in-house option because of the heritage and history and skill set that we have”.⁷⁸

48. It seems likely that this preferred status will last while DSG's unique role lasts: Major General Ian Dale on a number of occasions during our evidence session emphasised that the unique character of DSG was not a permanent fixture—“it is only unique... at the moment because industry is not in a position to provide it”.⁷⁹ As we have seen, some elements of this unique role will disappear over time while others might be challenged by developments within industry.

49. Increasing pressure for competition, as DSG becomes more vulnerable to the market-place in the future, may threaten the viability of some areas of DSG's work, both geographically and in terms of its range of businesses. **DSG has shown since the merger its ability to trade efficiently and effectively both with the MoD and the Armed Forces and also with industry. Managing these relationships while maximising performance and keeping as buoyant as possible its remaining unique and historical capabilities will be key to DSG's future. The MoD should do nothing to threaten this, unless it takes serious stock of DSG's position and decides that the Trading Fund model is no longer appropriate and that DSG's future lies elsewhere. This is a decision that must not be taken likely. We wish DSG well and hope that our successor Committee in the next Parliament will revisit DSG at an appropriate time to consider its continuing performance and progress as a Trading Fund.**

The Future

50. DSG is currently looking at its own operations to discover where there might be duplication either within DSG or between DSG and industry which might be resolved. The Electronics and Components Businesses at Sealand, Stafford and Donnington are currently being examined in a synergy study.⁸⁰ Clearly DSG will also be keeping under review other areas where its own work mirrors capacity and capability in the private sector. Underpinning DSG's continuing activities, of course, is the vision established by the Defence Industrial Strategy. Already it has been acknowledged that the Strategy could do with revision.⁸¹ Having promised such a revision as early as the second half of 2007, the MoD has so far failed to provide any update. The current view of the MoD is that an update is not needed at this time.⁸² This appears effectively to condemn the appearance of any revised Strategy until after the next General Election, when it might itself fall victim to other developments. The hiatus between the original Strategy and any post-Election follow-up will not help in clarifying either DSG's continuing *raison d'être* or the nature of its developing relationship with industry. This cannot be good. **We recommend that the MoD in its response to the Report takes the opportunity to set out a clear vision for DSG's future, taking into account the growing reliance of DSG upon industry.**

78 Q 81

79 Q 86

80 Ev 19, para 14

81 Defence Committee, Sixth Report of Session 2006–07, *The Defence Industrial Strategy: Update*, HC 177, para 95; see also HC (2008–09) 107, paras 206–207

82 HC (2008–09) 491, response to recommendations 42 and 43

Conclusions and recommendations

1. The workforces of both ABRO and DARA, now within DSG, are to be commended for their conscientious and flexible approach to the merger. The executive team implementing the merger should also be praised for ensuring that there was no hiatus in DSG's support for the Armed Forces nor any diminution to the quality of that support. (Paragraph 10)
2. We expect the MoD in its response to this Report to make categorically clear that the ability of DSG to continue to deliver cost savings will not alone determine its future, and that the rationale of the creation of DSG is broader and deeper than the cost considerations that supported the reasoning behind the merger. (Paragraph 11)
3. The first DSG Annual Report is expected to be issued in the early summer. It will contain fuller information relating to DSG's performance in its first full year, together with its set of future targets. We fully expect the first year's performance to correspond to the forecasts given to us in January. (Paragraph 14)
4. Continuing pressure exists for the Government, and its departments of state such as the MoD, to realise further cost savings, the efficiency savings captured from ABRO and DARA during amalgamation, and from DSG during its first year of operation, have already contributed to departmental savings: seeking further cuts which might compromise DSG's operational capabilities and skills according to some arbitrary allocation of savings expected would be wrong-headed. (Paragraph 15)
5. We are impressed by DSG's commitment to apprenticeships which we feel shows a real determination to provide over the long-term a continuing high level of support to the UK's Armed Forces. (Paragraph 18)
6. We would be grateful for the MoD's assessment of the particular weaknesses in the area of high level managerial skills which DSG inherited from its predecessor organisations, ABRO and DARA. (Paragraph 20)
7. We request a note from the MoD setting out how DSG intends to deal with distributional problems relating to the recruitment and retention of its workforce, bearing in mind that its unique geographical footprint is an asset it presumably does not want to lose. (Paragraph 21)
8. We express our gratitude to all those DSG employees who have volunteered, sometimes on more than once occasion, to deploy in theatre in support of operations. Such commitment is of great value to DSG and to our Armed Forces and clearly indicates the high level of dedication amongst the staff within DSG. (Paragraph 25)
9. The Equipment Sustainability Solution (ESS) provides an excellent opportunity for DSG to maintain its strong partnership with industry and continue to provide excellent quality support to the UK's Armed Forces in theatre. We very much hope that DSG is successful in the competition for sub-contracts for work on the ESS. This would be a positive development for DSG, for industry and for the Armed Forces,

who will all need to work in ever closer cooperation as the conflict in Afghanistan persists. (Paragraph 28)

10. We are concerned that current uncertainties with regard to the size and timescale for the MoD's recuperation programme following drawdown in Iraq might create difficulties even for an organisation as flexible and committed as DSG. We call on the MoD to ensure that DSG is as well apprised as possible of what it will need to do and over what time period within the recuperation programme. DSG will itself need to monitor the continuing, if not increasing, demands being placed upon it, directly or indirectly, by current operations. (Paragraph 33)
11. We recommend that the MoD, in its response to this Report, make clear the anticipated levels of future manpower and resource commitment within DSG to the ESS, to the recuperation programme, and to UORs, set alongside its capacity to deal with its core non-operational areas of activity. (Paragraph 33)
12. The sustained and thorough commitment of DSG staff to supporting our Armed Forces in operational theatre is there for everyone to see. We commend DSG staff for this full-hearted commitment and for maintaining a high level of performance in support of operations. (Paragraph 34)
13. DSG has shown since the merger its ability to trade efficiently and effectively both with the MoD and the Armed Forces and also with industry. Managing these relationships while maximising performance and keeping as buoyant as possible its remaining unique and historical capabilities will be key to DSG's future. The MoD should do nothing to threaten this, unless it takes serious stock of DSG's position and decides that the Trading Fund model is no longer appropriate and that DSG's future lies elsewhere. This is a decision that must not be taken lightly. We wish DSG well and hope that our successor Committee in the next Parliament will revisit DSG at an appropriate time to consider its continuing performance and progress as a Trading Fund. (Paragraph 49)
14. We recommend that the MoD in its response to the Report takes the opportunity to set out a clear vision for DSG's future, taking into account the growing reliance of DSG upon industry. (Paragraph 50)

Formal minutes

Tuesday 9 June 2009

AFTERNOON SITTING

Members present:

Mr James Arbuthnot, in the Chair

Linda Gilroy
Mr Dai Havard

Mr Bernard Jenkin
Richard Younger-Ross

Draft Report (Defence Support Group), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 50 read and agreed to.

Resolved, That the Report be the Seventh Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report, be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was *ordered* to be reported to the House for printing with the Report, together with written evidence reported and *ordered* to be published on 20 January 2009.

[Adjourned till Tuesday 16 June at 10.00 am

Witnesses

Tuesday 20 January 2009

Page

Mr Archie Hughes, Chief Executive, Defence Support Group and **Major General Ian Dale CBE**, Director General Land Equipment, Defence Equipment and Support, Ministry of Defence

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List of written evidence

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List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2008–09

First Report	Winter Supplementary Estimates 2008–09	HC 52 ^A
Second Report	The work of the Committee 2007–08	HC 106
Third Report	Defence Equipment 2009	HC 107 (HC 491)
Fourth Report	Spring Supplementary Estimate 2008–09	HC 301
Fifth Report	Ministry of Defence Annual Report and Accounts 2007–08	HC 214 (HC 534)
Sixth Report	The UK's Defence contribution to the UK's national security and resilience	HC 121

^A Government response published as Memorandum in the Committee's Fourth Report (HC 301)

Session 2007–08

First Report	UK land operations in Iraq 2007	HC 110 (HC 352)
Second Report	Costs of operations in Iraq and Afghanistan: Winter Supplementary Estimate 2007–08	HC 138 ^A
Third Report	UK/US Defence Trade Cooperation Treaty	HC 107 (HC 375)
Fourth Report	The Iran hostages incident: the lessons learned	HC 181 (HC 399)
Fifth Report	Ministry of Defence Annual Report and Accounts 2006–07	HC 61 (HC 468)
Sixth Report	The work of the Committee in 2007	HC 274
Seventh Report	Medical care for the Armed Forces	HC 327 (HC 500)
Eighth Report	Operational costs in Afghanistan and Iraq: Spring Supplementary Estimate 2007–08	HC 400 ^B
Ninth Report	The future of NATO and European defence	HC 111 (HC 660)
Tenth Report	Defence Equipment 2008	HC 295 (HC 555)
Eleventh Report	Ministry of Defence Main Estimates 2008–09	HC 885 (HC 1072)
Twelfth Report	Scrutiny of Arms Export controls (2008): UK Strategic Export Controls Annual Report 2006, Quarterly Reports for 2007, licensing policy and review of export control legislation	HC 254
Thirteen Report	The contribution of Unmanned Aerial Vehicles to ISTAR capability	HC 535 (HC 1087)
Fourteenth Report	Recruiting and retaining Armed Forces personnel	HC 424 (HC 1074)
Fifteenth Report	UK operations in Iraq and the Gulf	HC 982 (HC 1073)

^A Government response published as Memorandum in the Committee's Eighth Report (HC 400)

^B Government response published as Memorandum in the Committee's Eleventh Report (HC 885)

Session 2006–07

First Report	Defence Procurement 2006	HC 56 (HC 318)
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Second Report	Ministry of Defence Annual Report and Accounts 2005–06	HC 57 (<i>HC 376</i>)
Third Report	Costs of operations in Iraq and Afghanistan: Winter Supplementary Estimate 2006–07	HC 129 (<i>HC 317</i>)
Fourth Report	The Future of the UK’s Strategic Nuclear Deterrent: the Manufacturing and Skills Base	HC 59 (<i>HC 304</i>)
Fifth Report	The work of the Committee in 2005 and 2006	HC 233 (<i>HC 344</i>)
Sixth Report	The Defence Industrial Strategy: update	HC 177 (<i>HC 481</i>)
Seventh Report	The Army’s requirement for armoured vehicles: the FRES programme	HC 159 (<i>HC 511</i>)
Eighth Report	The work of the Defence Science and Technology Laboratory and the funding of defence research	HC 84 (<i>HC 512</i>)
Ninth Report	The Future of the UK’s Strategic Nuclear Deterrent: the White Paper	HC 225–I and –II (<i>HC 551</i>)
Tenth Report	Cost of military operations: Spring Supplementary Estimate 2006–07	HC 379 (<i>HC 558</i>)
Eleventh Report	Strategic Lift	HC 462 (<i>HC1025</i>)
Twelfth Report	Ministry of Defence Main Estimates 2007–08	HC 835 (<i>HC 1026</i>)
Thirteenth Report	UK operations in Afghanistan	HC 408 (<i>HC 1024</i>)
Fourteenth Report	Strategic Export Controls: 2007 Review	HC 117 (<i>Cm 7260</i>)
Fifteenth Report	The work of Defence Estates	HC 535 (<i>HC 109</i>)

Session 2005–06

First Report	Armed Forces Bill	HC 747 (<i>HC 1021</i>)
Second Report	Future Carrier and Joint Combat Aircraft Programmes	HC 554 (<i>HC 926</i>)
Third Report	Delivering Front Line Capability to the RAF	HC 557 (<i>HC 1000</i>)
Fourth Report	Costs of peace-keeping in Iraq and Afghanistan: Spring Supplementary Estimate 2005–06	HC 980 (<i>HC 1136</i>)
Fifth Report	The UK deployment to Afghanistan	HC 558 (<i>HC 1211</i>)
Sixth Report	Ministry of Defence Annual Report and Accounts 2004–05	HC 822 (<i>HC 1293</i>)
Seventh Report	The Defence Industrial Strategy	HC 824 (<i>HC 1488</i>)
Eighth Report	The Future of the UK’s Strategic Nuclear Deterrent: the Strategic Context	HC 986 (<i>HC 1558</i>)
Ninth Report	Ministry of Defence Main Estimates 2006–07	HC 1366 (<i>HC 1601</i>)
Tenth Report	The work of the Met Office	HC 823 (<i>HC 1602</i>)
Eleventh Report	Educating Service Children	HC 1054 (<i>HC 58</i>)
Twelfth Report	Strategic Export Controls: Annual Report for 2004, Quarterly Reports for 2005, Licensing Policy and Parliamentary Scrutiny	HC 873 (<i>Cm 6954</i>)
Thirteenth Report	UK Operations in Iraq	HC 1241 (<i>HC 1603</i>)
Fourteenth Report	Armed Forces Bill: proposal for a Service Complaints Commissioner	HC 1711 (<i>HC 180</i>)

Oral evidence

Taken before the Defence Committee

on Tuesday 20 January 2009

Members present:

Mr James Arbuthnot, in the Chair

Mr David S Borrow
Linda Gilroy
Mr David Hamilton
Mr Mike Hancock
Mr Dai Havard
Mr Adam Holloway

Mr Bernard Jenkin
Mr Brian Jenkins
Robert Key
Mrs Madeleine Moon
John Smith

Witnesses: **Mr Archie Hughes**, Chief Executive, Defence Support Group, and **Major General Dale CBE**, Director General Land Equipment, Defence Equipment and Support, Ministry of Defence, gave evidence.

Q1 Chairman: Good morning and welcome. I hope that this session will be helpful in reminding the Committee about the merger of ABRO and DARA and bring us up-to-date with where things are in relation to that merger. We hope that you will be able to look a bit into the future as to the role of the Defence Support Group into recuperating and regenerating Armed Forces' equipment, partly as a result of the drawdown from Iraq and partly in the light of the current study by the MoD on recuperation. If I may ask you both to introduce yourselves, please, and you are welcome as witnesses in front of the Committee.

Mr Hughes: I am Archie Hughes and I am the Chief Executive of the Defence Support Group.

Major General Dale: Good morning. I am Ian Dale. Just by way of background I am a 30-year front-line soldier and I am now working in Defence Equipment and Support where I have been for four months now. I am the Director General of Land Equipment, which means that I am responsible for the acquisition and sustainment of all land equipment to the Armed Forces. My role with the Defence Support Group is to act as the defence equipment and support customer focus.

Q2 Chairman: Thank you very much. I warn you, General Dale, that most of these questions are likely to be addressed to Archie Hughes in the first place but do feel free, please, to come in on any of the answers or any of the questions that you want because, as you have just pointed out, you are very important to this whole process.

Major General Dale: Thank you.

Q3 Chairman: Mr Hughes, before the merger you were the Chief Executive of ABRO and of DARA for a period of some months in order to help meld the two together. What were the main challenges that you faced in that amalgamation between the two organisations?

Mr Hughes: The first challenge was obviously in understanding both businesses. I had previously been Chief Executive of DARA for a number of

years so I obviously understood the DARA business and the DARA people, the products and the processes. There was then a process of trying to understand the ABRO business and to look at the similarities and differences between the two businesses to see how they could come together. It was relatively rapidly evident that although they worked on different products they were very similar businesses. They were both in maintenance, repair and overhaul of defence equipment, and so what we had to do initially was look at how we would best bring the two businesses together from a managerial point of view, so the early part of the work was in looking at the management structures of DARA and ABRO and what the management structure should be for DSG, and how best to bring the two businesses together, whilst at the same time doing all the necessary legislative work to formulate the new trading fund that was going to be DSG. We had to run DARA, run ABRO and do the work to create a new trading fund called DSG, and therefore it was a pretty busy time in looking at how the two would come together. Also remember at the same time we were looking at selling some of the constituent parts of DARA, which was the rotary wing part of the business and the components part of the business, so it was quite a complex arrangement that happened at the time. We brought the new management teams together and did a lot of quite intense work to come up with the new structure for DSG. We did that quite successfully and therefore DSG was able to vest from 1 April 2008.

Q4 Chairman: What remains to be done in terms of difficulties to be overcome?

Mr Hughes: I do not believe there are any difficulties to be overcome now. I would say that ABRO and DARA are now merged and we are very much the Defence Support Group now. We regard ourselves as the Defence Support Group and everybody in the business sees themselves as the Defence Support Group and we now operate as a new single trading fund. There is still lots and lots of work to do because you do not overnight immediately become one

harmonised entity. We have still got a lot of work to do in relation to the people dimension of the business in how we bring together the disparate human resources policies and procedures and terms and conditions of employment. Some have been harmonised already but we have more still to do over time and we are working closely with the employee representatives in doing that. We have lots of work to do in terms of delivering the benefits associated with the merger in embedding best practice both ways between what was DARA and ABRO and in delivering the best value for the defence customer. We are continually looking to the future as to what the future size and shape of the business needs to be. I regard it now that we are DSG and we are operating as DSG. We are proceeding with a degree of pace in transforming the business, trying to make it better, and taking the best out of both businesses. There is an awful lot of work going on at every level in the business to try and do that.

Q5 Chairman: What do you think the timescale is for completing that amalgamation so that for example the human resources rules all become the same?

Mr Hughes: We are looking to August this year to harmonise where appropriate the terms and conditions that apply to the various bits of DSG because, although it formed out of ABRO and DARA predominantly, we have also taken on board an element of what used to be DSDA at Stafford and we have taken on an element of what used to be DE&S at Sapphire House in Telford, so in actual fact there are four constituencies of people who are now under the DSG banner. August of this year is when we are targeting because that is our normal annual pay point with the trade unions as to when we are working between now and then to get the major stuff in place. Thereafter, we will roll out on a process-by-process basis improvements as and when we deliver them but that is a key point in time for us.

Q6 Chairman: Are the IT systems the same, do they talk to each other or what?

Mr Hughes: The IT systems are different. Both businesses operate in a manufacturing/engineering type of environment, so the air side (ex-DARA) operates on a BAAN system and the land side operates on a CINCOM system. They do come together and we have done an awful lot of work already to bring together the next level up in terms of financial control and management, so the management information is already harmonised into one set of figures, one set of documentation. The operating sides can work quite effectively on their existing systems and we have no immediate plans to harmonise one to the other or one new system. It would be a very complex and very expensive process to put them on one system at the operating level but as time progresses and we reach a natural point to review the IT systems then we might make some decisions to harmonise. Effectively, the land system operates on its system, the air system operates on its own, and we have brought them together at the information-sharing level, one level above. Quite a lot of work went in in the latter part of the year in the

run-up to DSG and then the first six months of being DSG to get that information, which gets presented to the likes of me as management and then I present further up the chain, to be consistent between the air and the land side. I think we have now got to the position where I get one report as opposed to I used to get two. I used to get DARA reports and ABRO reports; I now get DSG reports.

Q7 Mr Jenkins: Mr Hughes, in your answer you mentioned that you identify good practice and move it across the company. Who exactly is responsible for identifying and evaluating and then embedding that across your company? Which section of your management team does that, the accountants?

Mr Hughes: No, not just the accountants. I have a Chief Operating Officer who runs most of the businesses, and what I have now got in place is a transformation programme and it runs on a classical programme project management basis, so I run a change board, which I chair, and on that change board are all the various directors of the different bits of the business. John Reilly, who is my Chief Operating Officer, runs most of the businesses and because he runs most of the businesses he employs most of the people and therefore most of the change is in that area of the business. Underneath him there are a whole lot of change programmes that he runs. There are certainly change programmes in the finance area and the Finance Director is looking at change programmes in finance and he also looks at the pull-through of financial data across functions. Every one of the directors has got their own series of change initiatives, change programmes, and improvement initiatives that they run. I run a change board and each of them then run workstreams and have project boards. The project boards are made up of subject matter experts, and the subject matter experts might be an ex-DARA person or an ex-ABRO person. They come together and they will look at for example benchmarking ABRO/DARA or they might look outside to benchmark best practice outside, and through a process of proper investigation, trialling and piloting and so forth they will implement across the business what they believe is the best practice. All of that comes up to the change board for endorsement and ratification and so forth. There is a very clear, rigorous and disciplined process of implementing best practice across the business which is on classical industrial lines. It is generally the same way that you would do it anywhere else.

Q8 Mr Hancock: Before I ask my first series of questions, can I ask the General a question: how have you found this challenge so far as your role in the Army is concerned?

Major General Dale: I guess the bottom line is that the Defence Support Group has not dropped the ball on any occasion and so, despite the turbulence of the change and the amalgamation and the internal drive for efficiency that Mr Hughes is following, we have not had any perturbation on the outputs whatsoever. As I understand it, our outputs have been fine, so

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they have been timely, they have been on cost, and they have been to quality, so we are quite happy with the outputs at the moment.

Q9 Mr Hancock: What would be your route for taking complaints from lower down through you on to the new organisation? What is the route for that?

Major General Dale: There are several routes actually. There is almost a daily interaction between the staff in my project teams and the relevant staff within the Defence Support Group, so many of the issues are discussed face-to-face at the working level, and if there is something that goes beyond that then there are regular meetings between the IPT team leaders and the section leaders within the Defence Support Group. Personally I attend a regular board together with the Chief Executive and his main players, so if there are any issues that need to be resolved at that level that is where it is done. There is connection at almost every level and I think our communications and liaison with the Defence Support Group is pretty sound.

Q10 Mr Hancock: You said that you had spent 30 years as a front-line soldier, and I do not know how you feel about three months in a backroom in Whitehall or wherever you are located at the moment, and during that experience you would have come into testing times when you wanted modifications or changes to equipment and there was a process for doing it. How do you feel our commanders now in the field, and more importantly the people who use the equipment, feel about the way in which they can get their modifications made to suit their needs? Is it that your staff, Mr Hughes, go out to theatre or do some of the soldiers intimately using equipment come back to advise about what they actually need?

Major General Dale: There are a couple of ways again of doing that. We have a regular process in the Armed Forces of equipment failure reporting, so if there is an issue with an item of equipment that needs attention, it is highlighted through that process of reporting, and the integrated project teams at Bristol monitor the trends so they can highlight where there is a particular issue on particular equipment. It is the IPT that will then through that connection engineer a solution directly with the Defence Support Group. The requirement to change equipment would then be implemented through the Defence Support Group capability before the equipment is deployed, or indeed when the equipment has come back from deployment they will be upgraded as they come through, so there is a routine process for updating equipments. To give you an example, I had a team out in Afghanistan a couple of weeks ago checking through the equipment status and it was quite good news. I do not think we got any complaints about the type of equipment that we were delivering to them. It all seems to be quite fit for purpose. There were glitches in the communication systems on the equipment failure reporting system, but nothing that could not be resolved by liaison. I have officers permanently embedded in the headquarters both in Afghanistan and Iraq that monitor the situation,

and the Defence Support Group regularly deploy people into both Iraq and Afghanistan so that they can help where help is needed.

Mr Hughes: I do not think I have anything further to add; we send people where they need to go.

Chairman: By the way, may I commend you both on the clarity and brevity of your answers because they are hitting the point straight on.

Q11 Mr Hancock: Can I then raise with you the amalgamation and when it took place. You had experience, as you said, of being the head of DARA. You went over to ABRO and you saw that in the time that you were Chief Executive there. Now you are in sole command of the operation, what was the duplication that you found, and have you been successful in eliminating that duplication to your satisfaction or is there still work to be done?

Mr Hughes: When you look at DARA and ABRO there were a number of functions that were the same in both and therefore they overlapped, for example we had two corporate head offices, so there was an obvious overlap at the head office side of the business. There was a DARA head office and there was an ABRO head office and therefore there was a degree of duplication at the support staff side of the business; there were two boards, two chief executives, etc., etc. Therefore there was an immediate synergy that could be gained by looking at the way the senior management was structured and the corporate head offices were structured in ABRO and DARA. Therefore relatively quickly I was able to put together a single board and look towards generating a single head office and a head office with a reduced number of people because there was synergy benefit to be had. We have moved pretty quickly there and we have slimmed down the head office somewhat already. I believe there is probably more to do over time because you might want to slim it down but you do not want to reduce your capability at the same time, so you need to work through a pretty steady process of getting there. We have slimmed down the head office and we have also combined the two boards into one board and there was obvious synergy benefit there. There was very little operational overlap because we were repairing tanks in one factory and electronics in another factory and there was not an operational overlap to any great extent. Although there were different operational organisational structures, I have also streamlined the operational management for DSG compared to what the ABRO and DARA businesses were. In terms of looking forward we have instituted a number of studies to seek out where there might be more synergy benefit to be had. An example of that could be in relation to the electronics activity that we do across DSG. There is an electronics business in DARA at Sealand; we do electronics and electrical work at Donnington in the TESS business; and we do some electronics work at Stafford, so we have three different sites all doing electrical work. I have instituted a study to see whether or not there is any potential synergy or harmonisation benefit to be had there, but we are not going to mix the aircraft product with the land product because they are

different. To date we have done quite a lot and we are continuing to look for future synergy benefit as it arises.

Q12 Mr Hancock: Thank you for that. If I had been an executive team member on ABRO I would have been slightly cheesed off that I and most of my colleagues went out the door and most of the DARA executive team remained. What was the motivation behind that, was it competence, ability, or just that it was better to keep one team in place than try to mix two?

Mr Hughes: It was a mixture of a range of factors. I do not think we set out when we amalgamated the two boards to end up with a primarily DARA-related board as opposed to an ABRO-related board. Some of it was through my choice; some of it was through the individuals' choice. For example, the Deputy Chief Executive of ABRO retired at 60. I do not have a Deputy Chief Executive anyway, but he chose to retire at his normal retirement age, and that played my hand for me in that regard. The Finance Director of ABRO moved to DE&S in Abbey Wood. Others chose to leave and others' jobs were not there any more. The intent was not to set out to have a DARA board; it happened a bit by design, a bit by default, but the clear intent was to have a reduced, slimlined more effective board, and I am more than content with the board I now have. There were a number of non-executive directors in both businesses and we also streamlined that down as well.

Q13 Mr Hancock: In your memorandum to us you said that you have already identified £10 million-worth of savings and they have been achieved. Did most of that come from the corporate management part of the business or did it fall mainly elsewhere in the business of actually repairing equipment?

Mr Hughes: Most of the saving came out of the support areas of the business, primarily first of all in having one board, you save a fair amount of money having one board, and you save a fair amount of money with the direct support staff who support those two boards. We also saved a fair amount of money in reducing the corporate head count. As I mentioned earlier, we brought two into one. We saved another bit of money in relation to people when we brought on board the land supply business from Sapphire House because we now have something like 219 people in Sapphire House in Telford and the previous activity was done by over 300 people, and it came across. Then a further element is in the operational area of the business where we have saved a fair amount of money in material cost and things of that nature. The initial tranche of savings, if you like, were primarily to do with the support areas of the business. We are obviously focusing quite heavily this year and going forward into how we make the operational end of the business more effective and efficient and better value for money. I am pretty sure there are more savings to come at that level of the business. Looking at the operational management for example, in the

ABRO bit of the business we used to have a director, a regional manager, a local manager and ops manager. At least two of those layers no longer exist.

Q14 Mr Hancock: That is good. Would you say the rationale for the amalgamation is as sound today as it was nearly two years ago when it was first put together? Would you say there were any surprises that you have discovered since the amalgamation has taken place which you did not foresee but which have actually arisen, and are they to the benefit or detriment of that amalgamation?

Mr Hughes: I would say the rationale has been proven by the implementation of DSG. The output, as the General said, is at least as good if not better in terms of the quality and delivery and so forth, so we have maintained the output at reduced cost and therefore the rationale for producing the DSG out of ABRO and DARA was sound and has been proven to date by delivering those types of benefits. Obviously when you take on any new role you find things that you never knew were there, and in relation to the ABRO business in the last six months of last year prior to the DSG being formed we unearthed a number of cost surprises in the ABRO side of the business and we unearthed some financial forecasting/financial control surprises in the land side of the business, which were a bit of a surprise to me in terms of running the DARA side of the business. The good news is that we have recognised them and we have now put in place the actions to improve them and there are much better financial and cost control mechanisms in place. Taking over any business every week you find a new thing that you never knew; that is running a business.

Q15 Mr Hancock: Despite all the obstacles that were in the way, DARA came into this partnership in profit and ABRO came with a loss situation, and one could argue that this was done to smooth over the loss-making one to make it an organisation where one carried the other. Has that proven to be the case or is it now that you will see this organisation stand on its own two feet, both elements of it now one, which will actually turn a profit?

Mr Hughes: If you look at last year, obviously DARA made a profit and ABRO did not, and the cost situation in relation to ABRO was one of the surprises that I unearthed. I think the way we have set the business up now DSG will be profitable and I believe the land constituency and the air constituency will both be profitable this year.

Q16 Mr Hancock: That is great, thank you.

Major General Dale: Can I throw in a customer perspective on this. One of the advantages to me as a customer of the DSG formation is that I have now got a single point of contact that I can deal with which makes my relationships with the organisation so much simpler and so much clearer. I am assured now that the organisation is beginning and has made quite a lot of progress in getting to grips with its costs, which is important to me as a customer of

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course because the more they can drive down their costs the more I can push through the organisation, which is what we want.

Q17 Robert Key: In his May 2007 statement Lord Drayson said that the MoD wished to retain the intellectual property and design skills required to maintain operational sovereignty in key areas. Can you remind us therefore why the rotary, components, fast jet and engine businesses were not included in the merger?

Major General Dale: It is a difficult one for me to answer because I am afraid I do not have the legacy history of that so what I am going to say to you is dredging my memory and, if you wish, I can get a clearer written answer back to you after the meeting. As I understand it, one of the tenets of the Defence Industrial Strategy was to optimise and lever more effectively the power and capacity of industry, and one of our mantras within defence equipment and support is to move our support contracts up what we call the transformation staircase. That is to say moving away from support solutions that rely on DE&S to manage, procure and deliver support to in-service equipment to contracting with industry for them to do it instead, because they have a greater capacity, they can drive down costs more effectively, and they can provision more accurately, so one of the reasons for moving to that kind of support for helicopter engines was exactly to achieve that kind of efficiency in support.

Q18 Robert Key: Is it because you no longer have the volume and the capacity to cope with the high level of requirements from theatre?

Major General Dale: I do not think that is the issue. In terms of volume and capacity I think Mr Hughes can answer more directly.

Mr Hughes: Just going back to the earlier part of the question, because I was around at the time and was involved in the selling of the businesses and whatever, from a strategic point of view in the air side of the business there were a number of people who were in the same space, essentially, doing the same type of work. We have reviewed in other fora the fast jet decisions in terms of rolling forward, because there were people other than DARA who did fast jets. The same was true in the helicopter world. The contracts we had in the DARA business on helicopters, on Chinook for example, were through Boeing and there were a number of other alternatives to DARA doing it, so the strategic options were wider for MoD than just actually in relation to DARA, as opposed to some of the businesses we do now where we are the unique and sole provider. In terms of the capacity question, there is certainly capacity in what is now the Vector Aerospace business at Fleetlands to do all of the requirement for helicopters that is currently around, and we would still have had the capacity to do it. In actual fact, there is more capacity out there than just the helicopter facility that is in Fleetlands because a range of different industry players also do the helicopter MRO.

Major General Dale: One of the key things I might add about the Defence Support Group that I look for as a customer is the ability to deliver services and functions that are not readily available in industry, so for example support legacy equipments or equipments that are running towards obsolescence. Where the knowledge and the skill sets required to support those equipments is beginning to fade through industry and where the capacity exists in industry, the aim would be for them to support it because it is cheaper and they are better at doing it. Where the capacity demands a particularly unique skill then that is where we would lever the power of DSG. We would hope in the future as part of our contracting for availability work with industry to have DSG included in that as a sub-contractor delivering those unique capabilities that industry cannot.

Q19 Robert Key: So you do have the technological skill, including computer software and design and so on, to handle the most sophisticated helicopters? You could do it but it is just more efficiently done somewhere else?

Major General Dale: Correct.

Q20 Robert Key: So can you please explain your relationship with QinetiQ and tell me why it is that the eight Chinooks are being worked on by QinetiQ at Boscombe Down and not by you? These are the ones that are being brought into service now after sitting in hangars for many years.

Major General Dale: It is a decision that I do not have any information on.

Mr Hughes: I think I can give you a little bit of information on that. By 'you', you mean the ex-us, now Vector Aerospace, because we are no longer in the helicopter maintenance business. It was purely a case of the engineering activity associated with the helicopters had been derived through the QinetiQ business as opposed to through us, a lot of the technical information and the technical proving etc. had been done through the QinetiQ business and therefore having done all of that activity there it was felt that was the most cost-effective way to do those eight aircraft. To a certain extent that also proved the point that there were people other than just the DARA business that could do this work on helicopters.

Q21 Robert Key: But it was not competed, was it?

Mr Hughes: The DARA business did have the option of looking at doing the work on those aircraft but the most cost-effective solution was to do them in QinetiQ.

Q22 Robert Key: How do you know that if it was not costed?

Mr Hughes: We put forward costed proposals when we were part of DARA. Obviously since we sold the business the contract has been let on a different basis, so I cannot comment on what happened with Vector Aerospace. The best solution for defence that was

arrived at in terms of value for money, and I am sure to a certain extent not to interrupt the repair activity at Fleetlands, was to do this work at QinetiQ.

Q23 Robert Key: So you regard yourselves as being in competition with QinetiQ?

Mr Hughes: I do not do helicopter maintenance, repair and overhaul anymore so I am not in competition with QinetiQ at all. Whether Vector regard themselves as being in competition I could not answer.

Q24 Mr Hancock: The competition will only be there on this job because QinetiQ had the experience and the knowledge on these helicopters. Even if you had got the job and the helicopter division had stayed you would still have had to buy in that knowledge from QinetiQ anyway.

Mr Hughes: We would have had to have bought some of the technical knowledge in from QinetiQ. One of the options the MoD had in selling the helicopter business was for them to create an even more competitive market-place for helicopter maintenance, and that is what this is an example of.

Q25 John Smith: Mr Hughes, you said you oversaw the selling off of the rotary and component business; what level of interest was there in that business? Were you pleasantly surprised that a significant number of companies expressed an interest in buying that or were you disappointed that some of the key players did not even show an interest?

Mr Hughes: I was not pleasantly surprised, I expected there would be a significant interest from a number of private and industry parties in the rotary and component businesses. There was a wide range of interest in buying those businesses and there was quite a robust competitive process in eventually selecting Vector Aerospace as the company that would buy them, so most of the major players were actually interested to an extent or other in purchasing those businesses.

Q26 Mr Hancock: A key role of DARA, and presumably DSG now, is to provide a benchmark in the defence support industry and a competitive market to make sure that the British taxpayer is getting value for money. Are you satisfied that those areas that you no longer control—fast jet, rotary, components—are providing a competitive environment and providing value for money for the British taxpayer?

Mr Hughes: I do not really know that I can comment now because I am not involved in those businesses.

Q27 Chairman: It is not really a question for you.

Mr Hughes: And therefore I cannot actually make a judgment as to how competitive or otherwise they are because I am no longer involved in the management of them.

Q28 Mr Hancock: One of the issues in my area, which is Portsmouth (and Fleetlands is very much part of that service value there) was that this was more about land acquisition than it was buying a

facility that would long-term manage the helicopters. Did you sense that at all, that this interest was more about occupying very expensive and potentially very rewarding land rather than a business?

Mr Hughes: No, not at all. We sold a business and the party at the other end of the table was buying the business. They were very much focused on growing their business. They were in the helicopter MRO business and they wanted to expand, and this was an ideal opportunity for them, and that has been borne out, as far as I can tell, because they have brought extra work into the Fleetlands facility since they have taken ownership of it and they are doing more engine work and so on and so forth. They bought it to grow their footprint in the helicopter MRO business. Land is always part of a sale but they never bought the business for the land; the land came with the business.

Q29 Mr Hancock: But they can sell the land that is surplus to their requirements for more than they paid for the business.

Mr Hughes: That would be a matter for them. I do not believe that is the case but that would be a matter for them.

Mr Hancock: I think it is very much the case actually, Mr Hughes.

Chairman: Still, it is not your responsibility.

Mr Hancock: Not now.

Q30 Chairman: Can I come back on a question that Robert Key asked that you do have the capacity to do helicopter stuff, it is just that because there is that capacity in the private sector it was thought appropriate to put it out to the private sector. However, does the existence of DSG have any effect such as inhibiting the growth in the private sector of the skills and the capacity that DSG currently undertakes?

Mr Hughes: First of all, we do not have the capacity to do helicopters now in DSG. In the broad range of what we now do as DSG for a large part of it we are the only people that do it and we are the only people who have ever done it, so a big distinction between the aircraft side and the helicopter side, or even the fast jet side, and the land side of the business that is now DSG, was that industry did a lot of the maintenance, repair, overhaul and upgrade of aircraft. On the land side we in the ex-ABRO business are the maintenance, repair, overhaul and upgrade facility for the UK industry. Certainly the heavy end of the business do not do it and have not done it, and therefore on the question about creating or not creating capacity or inhibiting the creation of capacity elsewhere, it is a matter for industry to decide whether or not they wish to move into this market space. That is always a decision they can make but hitherto they have not been in the space we are in for the large part of what we currently do. I do not believe that it necessarily inhibits it because of DSG; that is always a decision that is there for industry to make depending on their business model.

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Q31 Linda Gilroy: It is perhaps clear because you have got the unique facilities there that that applies to armoured vehicles, but does that extend to all the other business elements within DSG apart from the ones we have just been discussing, and which parts of the business could not be handled by the private sector within the UK even at greater cost?

Mr Hughes: The private sector can probably handle almost anything at whatever cost, but they would not because it would be cost prohibitive to move into a lot of the areas. In the land area obviously we have got the armoured vehicle activity which is relatively new. We do small arms at Donnington for example which is another area of capability that we have that is pretty key. A lot of the activity that we do at the Sealand electronics facility—we do crypto, we do avionics, we do a range of things—is of great benefit to the MoD to retain that in-house and retain the sovereign capability to go forward on other programmes of activity. In the large aircraft business we do the VC10. It would not make sense for anyone else to pick that up and do it. It would be extremely cost prohibitive to do that. There are slightly different variations depending on where we are. We do a lot of work on things like Land Rovers for example. There are plenty of individual people who could work on a number of Land Rovers but at the moment at any rate there is not anyone who could do the totality of the job that we do, the one-stop shop activity that brings in the geographical positioning of our business, because we have a lot of sites all around the country which are very, very strategically positioned in relation to the customer which enables us to manage a load of work that a lot of individual companies could not do, so we have got that breadth of capability and capacity as well. There is quite a number of different themes within the DSG.

Q32 Linda Gilroy: I understand that there are about 12,000 Land Rovers in use by the Armed Forces. Does not being able to do the whole job as you were describing apply across the whole range of Land Rover assets?

Mr Hughes: In what sense?

Q33 Linda Gilroy: Well, it is difficult to imagine that somebody could not do the whole job so maybe you could tell us more about that and does that apply across the piece to all 12,000 or so Land Rovers?

Mr Hughes: In relation to Land Rovers we can do everything from changing the tyres to rebuilding them to up-arming them to putting on sophisticated military systems that would go on military versions of them, so there are military dimensions to it that we can manage and there are scale and geographic dimensions to it that we can manage. For the less complicated and less sensitive tasks we subcontract Land Rover work out to local areas. We do a lot of Land Rovers for TA and things like that where the work for that is almost a routine maintenance activity where we can subcontract. It is much easier to contract through us and for us to manage the whole than maybe have IPTs try and manage hundreds and hundreds of ones via their own resources.

Q34 Linda Gilroy: But you do subcontract what you have just described. What sort of proportion would you subcontract?

Mr Hughes: The subcontract work is relatively low in proportionate terms of what we do as a business. It is in the few per cents, not many more.

Q35 Linda Gilroy: So were there other bidders for the MoD contract that is worth £875 million which you recently won?

Mr Hughes: No.

Major General Dale: May I throw a couple of customer perspectives in here. With one possible exception, there is nothing in theory that industry cannot substitute in DSG so long as they throw their minds and their money at it. From my perspective there are a couple of key things that DSG can deliver which I think would be cost prohibitive from industry. The first is that I can change the priorities for work very quickly and very easily with the Defence Support Group and they have the capacity to swing the resources around as the operational requirement demands it much more flexibly and probably more cheaply than industry ever could, so that would be my first point. They are incredibly flexible too. I can draw people out of the Defence Support Group at fairly short notice and deploy them for urgent operational work in Afghanistan and Iraq. Industry could do that too but it would be very costly and I would have to train them. I can train guys in DSG and they stay there and I can reuse them regularly, so that is another element of flexibility. Just to reinforce the point that Mr Hughes made earlier about geography, many of the DSG work spaces are co-located or very close to garrison areas and airbases, and it is very easy for us to swing work in and out and it is very flexible again, so an industry that takes that on would have to disaggregate in some way in order to achieve that geographic synergy. The one thing that I come back to that I do not think industry can substitute there is one element of DSG—Sealand—which is a government-owned capability and through them we can get better access to foreign intellectual property rights than any industry ever could. That is a really important thing to do.

Q36 Mr Borrow: I want to raise a question I was going to pick up a bit later but I think we have touched on it already. In Annex B to the MoD memorandum, they list a number of land equipment areas that are considered to be strategic and core activities. I wanted to test whether or not some of those were desirable rather than absolutely essential to be done by your organisation and could not actually be done by the private sector. I just wonder if I could touch on perhaps some of the areas around maintenance and upgrade of legacy electronic equipment where there are companies such as Thales for example who may have some of the capability. I just want to firm up why you have got that whole list as it is on that Annex B and to know whether everything on there is absolutely firm as far as it is being paid to be done by your organisation and none of it could be done by anybody else.

Mr Hughes: I will just pick up a couple of those points. I think the General has just said that at a price things can be done in other areas, and some are higher up the list than down. At the Sealand electronics business, for example, you are quite right, Thales, Finmeccanica, Smith's, BAE, a whole raft of people work on the existing legacy kit that we work on. In actual fact, we are partnered with most of them and we work in a partnered way with them because they own the IPR for a lot of that kit on the legacy fleet—the Tornado, Harrier, Lynx, and the Chinook—and the electronics avionics that we work on. We have got very good relations with them and they choose to work with us on a contract, partnered basis. Our contract in a lot of that work is through them. When you look to the future, and in relation to different elements that might come into the electronic business, we might work on, let us say, some stuff in the US where we might need access to IPR, which is the point the General was making that because we are MoD-owned there is less of an issue in relation to us being able to work on that kit as opposed to another party. There was absolutely a strategic need to retain that capability. In terms of the list of things that are in the Annex that you have got, these have been generated to a certain extent over history and practice of what we do, and therefore because we do it the customer gets benefit out of us doing it. Some of it is to use us as a competitive lever, as was mentioned earlier, so that by owning us we do give the customer options that otherwise might not be there, so it can be very important to retain us as a competitive leverage elsewhere. We do not always get all the work we would want, some of it goes elsewhere, and some of our utility is actually across this range of capabilities testing from time to time whether or not the customer is getting the best value through the traditional route or through the internal route. I am pretty sure from time to time individual elements of this list will be a higher or lower strategic necessity but certainly at the minute these are the areas where we provide the most utility to the customer in giving best value for defence.

Q37 Mr Jenkins: I want to extend this point because, as the General said, we can deploy forces from DSG to Iraq and Afghanistan because they are trained and retained as insurance, almost like in my town and all our towns we have a fire service. We never want to use them but they are expert, trained, deployable forces where we pay an insurance to maintain them alongside us. Where exactly does this insurance premium fit on the books as far as equating against competitive tenders from outside whereby if we do not have this retained force we lose that degree of flexibility, we lose that back-up and, in effect, it is an insurance premium that we should be prepared to pay as nation. Where does it fit on your books?

Mr Hughes: Obviously there is no financial premium in the books because the people we use are people who are doing a job of work. They are not sitting

around doing nothing; they are working, and we reallocate the people. However, the utility for the customer in defence and part of what the General pays me for in the round is in retaining that capability in DSG ownership. I have got my apprenticeship schemes, I have got all of the various training schemes, I have got the number of people I require to do the job, and all of that works its way through in the cost of what I do at the macro level. When you add up all the little bits, the total price that the General pays me in the rates that he pays me are such that it means that I retain that capability. To a certain extent it comes to me via the workload I get and the General pays for the workload. Firstly, he is happy with the price he gets—hopefully—and secondly, we are retaining that capability. Because we work quite closely in defining the load for the business we can move around, it is not an additional cost to retain these people we have in the business; it is the way in which I manage the manpower loading across the business.

Major General Dale: If there was a cost it would be in the priorities that I set for the output from the organisation. If I wanted to deploy particular skill sets to Afghanistan, as indeed I am intending to do very soon because there is a particular need out there that needs to be addressed fairly quickly, I have to reprioritise the other work that I want done. It is all part of the output process.

Chairman: We will be coming on to apprenticeships and things shortly. Linda Gilroy?

Q38 Linda Gilroy: You were mentioning the JSF and Sealand and its very special role in that and the agreement with the Americans. Are there other elements of DSG work that fall within that kind of category of operational sovereignty?

Mr Hughes: If we are looking at the land side of the business obviously via the Defence Industrial Strategy there is a requirement to maintain an onshore capability for the maintenance, repair, overhaul and upgrade of land vehicles. Looking to the future and future procurements in the land arena, then retaining the capability in DSG to maintain, repair and overhaul any future procurements in the land arena will be key, and having access to the IPR to enable us to do that will be key on potential future land procurement areas.

Q39 Linda Gilroy: So on that issue, has the current uncertainty over FRES caused any concern within DSG on its future workload and what it needs to preserve in the way of the capability that you have just been discussing?

Mr Hughes: We work very, very closely with the customer in terms of DE&S on FRES but also industry and all the various industry players in relation to FRES. Looking to the future of FRES, whether it be the utility vehicle or a scout vehicle, in the immediate time-frame FRES was not part of the DSG plan because you had to go through procurement and then once you had been through the procurement you move into maintenance. We

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still intend to be fully involved in FRES whatever and whenever it materialises—

Q40 Linda Gilroy: Or if ever!

Mr Hughes:—And we will continue to work closely with the customer and industry to make sure we have got the capabilities and capacities required to do maintenance, repair, overhaul and upgrade or anything else that is required via that particular procurement.

Q41 Linda Gilroy: So would you be able to surge to accommodate that because there is a lot of uncertainty over the programme?

Mr Hughes: Surge is one of the key capabilities that we have in general, not necessarily in relation to FRES because FRES will have a planning horizon. Surge tends to come with not a great deal of notice, but we have a planning horizon on FRES where we will be able to work it into our programme.

Q42 Chairman: It is a 20-year surge, is it?

Mr Hughes: I do not think surge is an immediate worry in relation to FRES. We manage surge in close co-operation with the customers because as the General says, we have to prioritise what we do and surge is how we prioritise what we do.

Linda Gilroy: Thank you.

Q43 Mrs Moon: In an interview in *DIGEST* magazine Baroness Taylor said that in contrast to the business that makes up DSG the DARA business, and in particular the rotary components, had a finite life, so is it fair to say that finite life could also be described as the future of St Athan?

Mr Hughes: We operate the large aircraft business out of St Athan now, which is obviously the VC10, so that business in relation to what is now DSG will be there for as long as there is the VC10 and currently it has a secure future up until the out-service date of VC10 which is in and around 2014. It is too early to say what will happen after then, although we are obviously working closely with all interested bodies in relation to St Athan and the workforce that is there, whether it be the Welsh Assembly Government or British Aerospace who we contract the VC10 with, and a range of people, to look at what the options might be post VC10 at St Athan. Given the fact that we have still got five years of VC10, it is a bit too early to say what the end game will be in relation to St Athan. In that time period from an MoD perspective the DTR project should also come on-line to some extent at St Athan and therefore options have to be explored from a workforce point of view as to what does DTR mean. The other element for St Athan is the Welsh aspiration for an aerospace park and what capabilities and skills of the people there may be utilised in that regard. The business is VC10 based and it is there until at least the year VC10 goes out of service.

Q44 Mrs Moon: Are there any plans to bid for work with the FSTA and the FCA?

Mr Hughes: The FSTA programme is one which has been awarded to a private consortium and the maintenance activity associated with that will no doubt emanate from there. The one where we are spending more time at the minute is with the Welsh Assembly Government and with BAE Systems looking at the C17 and whether or not there are any options for doing the C17 at St Athan. One of the things we also have to remember about St Athan of course is that we are currently in what is known as the Red Dragon super hangar and we will be moving out of that back into the Twin Peaks facility where we used to be originally when the DTR activity moves into St Athan. We have to look at the facility limitations that there may or may not be for future large aircraft. We are looking at any and every option we can aircraft-wise at St Athan, but we do recognise that there are going to be challenges associated with the future workload there.

Q45 Mrs Moon: Is there any chance of the corporate strategic plan, which you said you hope to be having agreed in March, might be made available to the Committee?

Mr Hughes: We plan to take the corporate strategic plan to the Minister in March via my Owners' Advisory Council. Obviously the strategic plan contains quite an amount of commercial, financial and other information.

Q46 Chairman: We are very secretive!

Mr Hughes: I will take that back and ask the Minister and if he is content to copy you it then we will.

Chairman: Thank you very much. John Smith?

Q47 John Smith: Part of the thinking, as I understand it, of not selling off the VC10 business was not just value for money but that it would present MoD with a good opportunity to manage the transitional period with the onset of the Defence Technical Academy. I just wondered how that is going, whether there are any problems there given that the Defence Technical Academy will be the largest ever Ministry of Defence investment. You have been there for quite a while, you have interests on that site and I just wondered how it is going.

Mr Hughes: I am not experiencing any difficulties and I hope there are not going to be any difficulties. We obviously work quite closely with all the participants in relation to what was the DTR programme, not just because of the facility that we occupy currently and the fact that it will become part of the new Academy that is going to be there. I am obviously quite well involved with elements of the DTR, for example with Metrix and others, and already discussing whether my skill set meets their skill set into the future. I have meetings coming up shortly with the managing director of Metrix to look at that. You have to see whether the timings, the workload and the skills sets are going to be right or not right and so on. I have not experienced any difficulty in association with that. I am connected via the Welsh Assembly Government activity that goes on as well as the MoD activity that goes on and

everyone involved from a DSG point of view at St Athan is as close to it as we can be. It has not caused us any problems and I do not envisage it causing problems but we need to try and match timetables to best suit the people as much as we can.

Q48 John Smith: Is it the case that should the large aircraft have to move out of the Red Dragon hanger into Twin Peaks there will be a cost associated with that? Will that fall against your organisation's costs or will you be able to recoup some of that from either Metrix or the Welsh Assembly Government?

Mr Hughes: It is highly likely that we will have to move out of the Red Dragon hangar at some point, probably only to do minor maintenance on the VC10s as opposed to the major maintenance in terms of the timetable. You are right, there is always a physical operational cost of moving from one hangar into the other and the costs associated with that will not fall to me other than in respect of any costs I have I will recover from other parties, and some of the recovery might come via the VC10 contract itself up through that customer, and I may be able to recover some via the DTR route because part of moving out is because of the DTR. I expect there will be costs but I will recover my costs associated with it.

Q49 John Smith: What about the cost of maintaining the runway? Again, as I understand it, DSG is paying a disproportionate amount of that annual cost, and I wonder whether any efforts are being made to try and recover some of that.

Mr Hughes: The maintenance of the runway is primarily paid for by the Welsh Assembly Government but we are paying a relatively high cost for the running costs associated with the runway in relation to the number of take-offs and landings of VC10s because not a lot of them happen in any given year. There is an airfield management agreement between MoD, DSG as it is now, and the Welsh Assembly Government where periodically we review who pays what amount of cost. I am in discussion with the Chief Executive of the Welsh Assembly Government to readjust that looking forward, and negotiations will continue.

Q50 John Smith: Finally, you mention the C17 work; are you looking at any possibilities to bring into the business and are you in any discussions with BAMC, which is a major MRO British Airways facility in the vicinity? I just wondered whether there was any synergy there given that you are going to have to move and it is a big challenge.

Mr Hughes: In relation to BAMC we speak periodically with BAMC in relation to MRO. Up until now we have not identified synergies between us and them from a work moving either way point of view. In relation to the VC10 moving into Twin Peaks and then C17 in Twin Peaks, the C17 is there because it is a requirement that has been on the table. From time to time A400M comes up, goes away, comes up, goes away, in relation to the maintenance activity associated with it. We may be facility-constrained in relation to the type of aircraft that can

fit into our facility. That may or may not go away as a problem depending on what happens with the aerospace park from a Welsh Assembly Government point of view. We have an open mind and are continually looking for opportunities, recognising that there are very few low-hanging fruit in relation to the opportunities that are there for that business.

Q51 John Smith: But it is worth remembering that even after the Defence Technical Academy is built there is still a huge area with potential for development as a British Aerospace park, in excess of 200 acres, with runways.

Mr Hughes: Yes. And I believe the Welsh have aspirations to do things from an aerospace park point of view.

Q52 Mr Hancock: What is your estimate of the continuing life of the VC10s as far as you are concerned from what it was?

Mr Hughes: The out of service date is 2014; 2013/2014 is the current out of service date for the VC10.

Q53 Mr Hancock: You have not been asked about whether or not that can be extended, maintenance-wise?

Mr Hughes: No. It used to be earlier than 2013/14 but 2014 is the latest extended VC10 out of service date.

Q54 John Smith: And a decision would have to be made now, would not it, because of the age of the aircraft, and if there was any possibility of extending if any further with the delay on the new tanker?

Mr Hughes: From my perspective I am not anticipating an extension beyond 2014. If events change then we will obviously react to whatever comes out of the customer community, but that is the current position with the VC10.

Chairman: Apprenticeships and Madeleine Moon.

Q55 Mrs Moon: DSG, you have said a couple of times in your presentation that you are particularly proud of the skills and apprenticeship bases of ABRO and DARA. Are there any particular skills areas or knowledge areas that are currently lacking that are impacting on the business, and are apprenticeships actually becoming more important because of the nervousness at losing that skills and knowledge base?

Mr Hughes: If we take it from an apprenticeship end we do not have any difficulty in recruiting for apprenticeships. People who go through a DSG apprenticeship or an MoD apprenticeship come out at the end with a passport that will last them their entire life, their entire career because it is an excellent set of training that they get. So we are always heavily over subscribed to apprentices when we are looking for them. So at the base skills level in entering in technical and engineering apprentices we do not have skill shortages at that level. We tend to have some skill shortages in the geographical bases that make it difficult. We have a facility in Colchester where we employ through Colchester about 140 people. It is a bit more difficult recruiting people in

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that area than, maybe, Catterick, just because of the geography and because of alternative employment options. But because of my geographical footprint I actually have the ability to move the work to where the people are as well as vice versa. So I do not have skills shortages and I have more than enough applications for apprentices for those that I identify. And in most areas of the business when I am recruiting we get a lot of high quality people applying for the jobs. So in Telford last year we were recruiting some permanent staff and we brought the Telford town centre to a halt because about 1000 people turned up for the jobs there.

Q56 Chairman: How many people were you applying for?

Mr Hughes: We wanted about 50.

Q57 Chairman: And you had 1000?

Mr Hughes: We had hundreds of people. That is by the way, though, because we are seen as a good employer by most places in the country. As part of DSG and as part of a human resource work stream in terms of transforming a business we are looking at our development programmes beyond just the apprenticeship stage, such as how do we get people up through the business into the managerial areas. It can be more difficult and we do need to grow our capability of programme management, project management and some of the higher level managerial skills. We have just recruited I think three new financial controllers for some of the various businesses because we did not have those skills inside and we had to go outside. So we are trying to get a bit more development to try and pull people up into some of those roles, although in relation to apprentices a number of people on the DSG board are ex-apprentices, so you can go from an apprentice to be on the board and run the businesses. So I do not experience much in the way of skill shortages and I certainly do not experience much in the way of trying to attract people in the business where I need them, other than the odd geographical hotspots where employment, up until last year—I do not know what it is going to be like the next time we do it—there were lots of jobs.

Q58 Mrs Moon: It is interesting because you said that taking on one of your apprenticeships was a passport. What about actually keeping people after you have trained them, in terms of remuneration? Where do you sit in terms of perhaps pay in the private sector and how much are you losing people once you have trained them, once they have their skills, into the private sector; or are you paying better or are you paying worse? What is the ratio?

Mr Hughes: I think we are paying at a level that retains the people. In terms of from an apprenticeship, shop floor, technician level, attrition rates are very low. Whether they come through the apprenticeship scheme or whether they come through other means in terms of us employing people from outside we offer quite a good rate of pay. I am not saying that we offer industry benchmark levels of pay—we are civil servants—but we

certainly offer sufficient levels of pay to retain the people that we have. They do not leave in droves. The passport for the apprentices is one of the things that attract them in and then once they are in most of them like it and most of them are good and most of them progress in a career sense if they want. A lot of them are quite happy, they want to keep a technical career and others want to move through management.

Q59 Mrs Moon: In terms of productivity output, what do your hours for your skilled engineering staff look like in comparison, say, to equivalent hours of output that you get in the private sector?

Mr Hughes: It is quite difficult for us to draw comparisons directly between us and the private sector, primarily because the private sector does not do what we do; they do not maintain and overhaul the armoured vehicles. What we have is internal benchmarks. I operate across a wide range of sites and it is fair to say that they operate at different levels of productivity. So I have an internal benchmark and marker to utilise my best practice on whatever site it is to try and drive up the productivity on the less productive sites. So we do have quite a close look at this and we monitor it every month and we use it every month to drive up productivity. When I look at the average and I compare it to my industry days we are no different to an engineering manufacturing business elsewhere. That is what we do.

Q60 Mr Hancock: Can I ask you what proportion of your business at the current time is dependent on operational requirements and what proportion of your staff are engaged on that?

Mr Hughes: It is difficult to give an absolute number in terms of what is operational versus what is not because everything that we do is preparing, maintaining and going out and back from theatre. A fair degree of our funding comes via the Conflict Prevention Fund and that is maybe 15% in the round comes via the Conflict Prevention Fund across DSG. But most of what we do ends up in operations.

Major General Dale: It is a difficult question to answer in absolute terms and I will give you a “for example”. One of the elements of DSG’s work is often called the land district load and when I was commanding my brigade ten years ago we relied very much on what was then ABRO, now DSG, to come into our barracks to undertake tasks that we could not undertake in inspection overhaul and repair because my soldiers were deployed on operations and there was still kit left back behind in barracks. So that is an indirect support, if you like, to operations, and there is a lot of that going on. In terms of equating the source of funding directly to operations, that is to say those elements of work that attract contingency funding money, that is vested essentially in the embodiment of urgent operational requirement equipments on to vehicles, so there is a direct linkage with the operational requirements with the UOR, which is funded by the contingency fund. Again, when we look forward to withdrawing

equipment from operations and refurbishing it that too will be a direct support of post-operation activity and will attract contingency funding.

Q61 Mr Hancock: Are you working on the assessment of the equipment that is currently in Iraq and will actually be removed from the country as opposed to being left somewhere in the Middle East, or not even bother to be brought back to this country because of the costs involved and the life of the vehicles. Is that assessment being carried out by you at the present time, or by both of you?

Major General Dale: There is a combinational activity here. There is no doubt that the best way of conditioning equipment is to do that first hand in theatre so that you have early warning of what state the equipment is in and early decisions can be made about where the equipment is to go and what is to be done to it. It is not until that early conditioning exercise has been conducted that we can then work out the sequencing of events and what equipment goes where. There is a great deal of work being done between my staff, the Permanent Joint Headquarters, the DSG and other stakeholders in that process to map that out and that is work that is ongoing.

Q62 Mr Hancock: DARA's rotary and components element was partly sold off because they were simply overwhelmed, it would appear. Do you share that view that one of the reasons behind the sell off was that DARA could not actually carry out the necessary work in the timeframe that the Ministry wanted and consequently it was better to offload it. My second part of the question is, if that was the case then have you recognised anything in your time now as being head of the Joint Operation which could quite easily be overwhelmed and you would find it difficult to cope with?

Mr Hughes: In relation to the first part I would say no; that was not the reason why we sold the helicopter business. I would have managed the capacity of that business to do what was the customer requirement. That is business; that is what we do. So it was not "Vector now owns it, we will be doing what they do"; we would be doing it whatever the requirement was. You have to remember in the helicopter business we doubled the size in two years. It would be harder to double it again but we did what was necessary to do. In relation to the now DSG business, I do not see areas where we could not deal with the currently envisaged future capacities that are coming our way. That is why we work very closely with every element of the General's IPTs; we work with the land command people to get a view on the workload going forward. We need a decent sight going forward to enable to react. We can surge relatively quickly but you cannot do massive amounts of extra work without some degree of notice and that is why we have regular meetings at every level of the business to look ahead in sufficient time to manage that capacity. So I do not see problems in my current capacity.

Q63 Mr Hancock: Taking that point of looking ahead, do you see that your organisation will remain profitable if the level of operations, where you are a fundamental part, were to decline to an extent where you could see the business profitability being threatened?

Mr Hughes: At some point or other if the workload disappeared then obviously the profitability of any business gets affected but we will match the capacity of my business to suit the workload that is there and provided I have the notice and the time to do it I will be able to hopefully match the capacity and the cost of the business to the revenues to retain the profitability that is required in the business. That is just part of my planning process and getting enough sight ahead to do that. The only other major difficulty is if the workload disappeared very quickly, because you are not then going to have the ability to smooth or attack your costs to the same extent as the workload. But I certainly envisage us managing the business to achieve the required profitability going forward in the current version of the five-year plan I am working on to give to ministers later this year.

Q64 Chairman: So you will not be overwhelmed in capacity terms even though the Ministry of Defence has still not decided in its timescale for recuperation of equipment?

Mr Hughes: Yes the planning horizons are enough for me that if and when there is a spike, if that what happens, I would be able to take whatever action necessary to address the spike and smooth it to deal, one with my capacity, and two to deal with the output that the customer requires. If it becomes a problem and the spike comes unforeseen and we have not noticed it, I do not envisage a situation where we will be given a surprise in relation to the amount of work that comes via recuperation. Some of it might be done via deciding with the General and his team about prioritising some of the more priority stuff and the higher priority stuff and you will flex timescales and some stuff to meet the high priorities.

Q65 Mr Hancock: Can I ask then what work is being done on getting this timeframe for recuperation solved, from both of your points of view? From the Army's requirement for equipment and your ability to carry out the work? Where is the synergy there that actually allows that to virtually come from a position where you can say, "This is the timeframe now."

Major General Dale: Permanent Joint Headquarters is in overall control of that process and they have regular meetings with all of the stakeholders. My staff and Mr Hughes' staff are very frequently in forum with all those engaged, working out what the demand is likely to be and what the timescales are likely to be. We are constantly pressing Permanent Joint Headquarters to let us know sooner rather than later what the overall time frame is going to be.

Chairman: We will come on to this in just a moment, General Dale, if you do not mind.

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Q66 Mr Holloway: In the papers you have sent us you described your staff as volunteers and it is oversubscribed to go out to the theatres. Can you add a little bit of colour, General, to that, as to how that works? Also do you consider your capacity to carry out these deployments to be a part of your main business or is this a nice add-on to what you are doing now because it is useful?

Major General Dale: Let me give you two examples of how it works. If there was a vehicle, for example, which one has deployed into a harsh environment like Afghanistan and once it has been used to its maximum envelope you often find that some elements of the equipment begin to wear fairly quickly, which is out of the ordinary, and you need to take in hand a rectification, a modification or a programme of repair. This is often driven by the operational demand to use that equipment, so there is a sense of urgency about it. In those circumstances—and it has happened on a number of occasions already—we are able to turn to the Defence Support Group who have the expertise and who are familiar with that vehicle because they go through base inspection and overhaul programmes with it. They are already trained; they are familiar with the requirement; they are in the mindset of the military and it is very easy and very quick for me to turn to the Chief Executive and ask for that assistance and deploy them fairly quickly. We would do that and we do it to solve a particular problem. There is another example in Afghanistan where the Permanent Joint Headquarters have concluded that it is probably wise now that we are moving into a campaign footing to establish an equipment support facility in Camp Bastion, and that is an ongoing process. That is going to need some expertise and knowledge from people like the Defence Support Group who are used to setting up production lines and managing the refurbishment and rebuild of vehicles, and to go to that location and to work out the facility layout, the facility requirement, the tool setting processes and practices. So again I would be using them on a sort of consultancy, if you like, to enable that project to go ahead.

Q67 Mr Holloway: So that is the equipment sustainability solution, is it?

Major General Dale: Correct, yes.

Q68 Mr Holloway: Can you please take us through about what that will do and how it will work.

Major General Dale: One of the issues is—and I have mentioned them earlier—where you find suddenly that an equipment has a particular point of failure, which is only highlighted by the harshness of the environment and the way in which it is being used. Rather than dribble forward capacity to address that particular problem it may well be that it would be more cost effective to undertake a broader modification programme for the whole fleet. Rather than bring that whole fleet out of theatre at great expense it is much more cost effective to address those issues in theatre. But that can only really be done effectively if you have the right capacity and capability in the theatre. Looking at the broad

environment and the long term demands it makes sense from Permanent Joint Headquarters' perspective to establish this equipment sustainability solution. This is probably going to take, I guess, up to 12 months to establish it and get it running properly, and then the sort of equipments and work that will be run through it will essentially be dictated by the style of operations and the state of the equipment at the time.

Q69 Mr Holloway: Will any of Mr Hughes' staff be helping out with tasks that—is it still called REME?

Major General Dale: Yes.

Q70 Mr Holloway: The sort of tasks that REME people might otherwise do?

Major General Dale: Yes. Bear in mind that this is going to be a static facility inside a secure compound. It is therefore amenable to being staffed and run by civilian components. That could be a combination of the Defence Support Group expertise at various stages of the project—in the early design stage, perhaps in some of the modification upgrade work on some of the equipments. It could also be forward support representatives from industry for a particular issue that we have run through. Let us say, for example, British Aerospace, who are the design authority for a number of our armoured vehicles, might decide to deploy forward support representatives to do that piece of work; or maybe to do an investigation on the particular point of failure on one of their equipments for which they have design authority. So it could be a combination of contractors, DSG and REME soldiers who are on hand and permanently there to make sure that the facility runs smoothly. So I would probably envisage REME soldiers being the backbone of it, supplemented and augmented as demanded by the requirement by DSG and industry.

Q71 Mr Holloway: Has there been a need for this earlier, in previous years?

Major General Dale: That is difficult to make a judgment because the operation is only really settling down into its campaign footing now. It is one of those environments that have changed continuously. When I was in Afghanistan three years ago, as the Brits were moving from the north to the south, we only had 3,500 troops there and the operational requirement was very different then to what it is now. You have to accept that the operational environment changes continuously, so it is difficult for me to say that it would have been a thing to do earlier.

Q72 Mr Holloway: Presumably it is more because you have lots of different bits of equipment from lots of different suppliers than that the stuff has become particularly knackered in recent months.

Major General Dale: There is certainly a change in the style of operations and in the nature of it as it was three years ago. When we first set out in Helmand it was very largely a light infantry operation, but when you look now the lessons that we have learnt and the equipment that we have procured recently and

deployed, it is beginning to be an equipment heavy theatre. There are some quite large fleets of protective patrol vehicles there and we are just about to deploy some new tactical support vehicles; and we have improved the mobility of the Armed Forces in Helmand considerably. So the quota of equipment that is now held in theatre is radically different from what it was three years ago. So it is those kinds of developments in the nature of the operation and style of the operation and its demand that drive us into these deductions and conclusions.

Q73 Mr Holloway: Most of that kit has been through UORs so is this partly about how DSG deals with those, or it is mainly an industry problem, the suppliers?

Major General Dale: I am not quite sure I understand the thrust of your question.

Q74 Mr Holloway: You have had an awful lot of UORs and you have now set out the equipment sustainability solution; is that partly because you have so many UORs that DSG need to find a mechanism for dealing with it, or is it primarily industry's problem to sort out the problems with that equipment when it gets out there?

Major General Dale: If I were to be fair I do not think it is UOR focused. The UOR equipment that we deploying is all new and its reliability is generally quite good. The key here is older equipment like the Pinzgauer, for example, that has had problems with its hubs.¹

Q75 Mr Holloway: How old is the Pinzgauer, forgive my ignorance?

Major General Dale: Off the top of my head I could not tell you but it is quite a number of years old.

Q76 Mr Holloway: It was not ordered specifically.

Major General Dale: No, there is a balance of equipment in theatre so, for example, you have legacy equipments like Land Rovers-Snatch, Pinzgauer and RB44s. You have the Scimitar CVRT vehicle, all of which has been subject to urgent operational requirement add-ons to adapt it to work operationally effectively in that kind of challenging environment. So there is a great deal of work to be done on the fleet in the round and none of this sits still. There are always new things cropping up; there are always demands made on these equipments for which they were not necessarily designed, which need to be rectified. It is better and more effective to do that through the equipment sustainability solution than bringing all these things back at great expense and trying to do them in the facilities offered by DSG or industry; better do it in the theatre.

Q77 David Hamilton: My question to Archie is more of a personnel question about the increased activity where your personnel are required to go out there. Do you have any problem with that? And is anybody penalised if they refuse to go, if they choose not to?

Mr Hughes: No, we do not have any problem with that at all. In relation to the earlier question, it is a growing part of what DSG do, to deploy forward, not just to Afghanistan and Iraq but we have a large team in BATUS as well, for example, supporting the fleet out there. The way in which we operate is that we seek volunteers from across the whole of the DSG portfolio and we get lots of people volunteering and we select them on the basis of their skills for the task in hand. Nobody gets penalised for refusing to go because they are volunteers in the first instance and not only do they volunteer to go but when they come back they volunteer to go again because they feel part of the Armed Forces and they feel valued with what they do and they like doing it. In actual fact yesterday we had CDM down at Bovington who presented seven Iraq campaign medals to DSG employees who had been more than once and were keen to go again. So I do not have any problem whatsoever.

Q78 Mr Borrow: You have already touched on the question of recuperation of equipment, Chairman, but what I would be interested in getting a reassurance on is that your organisation is intimately involved with the MoD in the current discussions and the current plans for bringing equipment back from Iraq and any possible turns to Afghanistan, and whilst you have mentioned that you can cope with any spikes presumably coping with any spikes is pre-determined on the extent of the consultation with the MoD on any future plans for bringing equipment back?

Mr Hughes: I can definitely give you that assurance. We are working very closely with the customer and looking a number of years ahead about the capacities that we jointly believe are going to come through DSG and we are looking at all the factors that affect the workload for me and the capacities, because some of what I do is if an oil tanker is turned around some of it is quick, and so we are working very closely with the whole customer community across the range of IPTs to understand on a programme by programme, project by project basis exactly what the workload is, and that is absolutely in relation to recuperation and we need to understand that because we are here to provide that service to the customer and we do not want to let them down.

Q79 Chairman: You have made a few mentions of the Defence Industrial Strategy this morning. In November we heard from the defence industry that by and large they seemed to consider that the Defence Industrial Strategy is on hold. Last month we heard from the Minister of Defence Equipment and Supply that he considered that it was well on course and charging ahead. Mr Hughes, what is your view about this?

Mr Hughes: The Defence Industrial Strategy as it currently exists has a clear role for DSG. Although it was written when it was ABRO and DARA to my knowledge it has not changed; what we do as an onshore sovereign capability is cemented into the defence industrial strategy, and that was one of the

¹ *Note by witness:* the vehicle referred to with hub problems is Vector rather than Pinzgauer

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pretexts on the setting up of DSG in keeping it in MoD ownership going forward, and it is one of the things in working with the customer base in furtherance of Defence Industrial Strategy that they look to contract with us where it offers the best value for defence and where it retains the capacity and capabilities that the Defence Industrial Strategy wish to remain onshore. From my point of view the Defence Industrial Strategy was and is a good thing and it enables me to have that contact with industry as well. So being a Trading Fund it gives me that linkage to industry and I talk regularly with industry and we are partners with literally all of the industry players. We contract to all of the main primes as well as direct to the MoD. So I do not see any difficulty in relation to the Defence Industrial Strategy at the version one. If and when version two comes out and we have an input to it and I am sure it will reflect the current status of DSG.

Q80 Chairman: The defence industry seemed to think that the Defence Industrial Strategy was a good thing as well, but they thought that it was not properly implemented because there was not a sufficient amount of money to support it. You nod because you acknowledge because that is what the industry said or . . .

Mr Hughes: I am nodding because that might be the industry view. There has been sufficient money to fund my business, is what I am saying, but I can understand why industry might hold that view.

Q81 Chairman: How do you think that industry reacts to the notion of your being the preferred in-house option?

Mr Hughes: I think most of industry understands why we are the preferred in-house option because of the heritage and history and skill set that we actually have. I mentioned earlier that in actual fact most of what we do no one else does and therefore it is a natural event that will lead on to us being the preferred in-house provider, both strategically and operationally, and most of industry I deal with understands that and, as I mentioned a minute ago, I deal with all of industry—BAE Systems, GD and Lockheed Martin and all of the players, and they understand the role that we have.

Q82 Chairman: Preferred in-house option is not a phrase that appears in the Defence Industrial Strategy, is it? I do not think it appears in the Defence Industrial Strategy. Does it inhibit you from being competitive?

Mr Hughes: No, it does not inhibit me from being competitive; I am driven all the time by the General to be competitive. The major goal that we have as DSG is obviously our mission is to provide that maintenance repair, overhaul and upgrade service but we want to do it at the best value for defence, so we are absolutely driven to be competitive and some of that is driven directly via the MoD customer and some of it is driven via industry and by competition because probably in the order of 20% of what I do I contract through industry as opposed to directly through IPTs. So I am driven to be as competitive as

possible and I do not see anything in the Defence Industrial Strategy that does not. As a Trading Fund and as being retained as a Trading Fund in MoD ownership, one of the reasons for that was to maintain the focus on us being competitive and commercially competitive and enabling us to do some things that otherwise we might not be able to do.

Q83 Chairman: Do you think that industry feels discouraged at some points from putting in bids for work because they might think, “DSG are the preferred in-house option. Not much point in trying to put in for this work.”

Mr Hughes: I have not encountered that so far.

Q84 Chairman: But would you encounter it?

Mr Hughes: There have not been any particular contracts where that has evolved. Where there are contracts with industry and industry are a clear player what tends to happen is that we align with them and we partner with them because we generate the best value by utilising what I am good at, what they are good at to get a better whole is generally the way it works. In my time at any rate there has been very little in DSG where there has been a head to head competition between us and industry.

Q85 Chairman: But are you not in a rather cosy position because the standing instruction number 20 from DE&S is that DSG’s capabilities and resources should be maximised and the core capability and capacity sustained to ensure their continued availability to the MoD customer. In other words, Archie Hughes must continue to be in place no matter what. Is that not rather cosy?

Mr Hughes: I have answered and maybe the General can give you a customer perspective. We do not feel cosy at all in that regard. We have continual pressures the same as any other part of industry to offer the best value for money solution and we recognise that if we, in the eyes of the customer at any rate, have not offered a cost competitive solution they will certainly hold our feet to the fire.

Major General Dale: From my perspective what is really important is to maintain specific types of capability and by that I mean from our perspective the ability to switch priority of work at very little notice and to be able to deploy people wherever I want them to go, whether that is in an operational theatre or in a training organisation like BATUS, to be able to soak up the excess work that is generated within the Armed Forces when units do deploy and there is equipment left behind. That flexibility to me is absolutely vital and indeed the maintenance of the unique capabilities that DSG offers in the maintenance, overhaul and repair of our legacy equipment, and until such time as industry is prepared to take that on then I am focused on preserving that flexibility and capability and I certainly do not give Mr Hughes an easy ride. I attend every four months or so a meeting with his staff and I represent my customer base from DE&S and I am constantly pressing him on efficiencies,

pricing regimes and outputs. So he certainly does not get an easy ride because I have plenty of work for him to do.

Q86 Chairman: Of course you are constantly pressing him, General Dale, but if his capability in some areas is unique how can it be competitive because he has no one to compete against?

Major General Dale: It is only unique I would hazard at the moment because industry is not in a position to provide it. If they were minded to provide it they could, but at a cost.

Mr Hughes: One thing to support it. Because of our position and the relationship the customer probably gets a greater sight of my cost base than otherwise might be the case and they have more scrutiny over, if you like, the way that my costs and my prices come together. They have the ability within the DE&S arena—there might not be an absolute benchmark like for like but they know industry better than we know industry because they are contracting with industry all the time—they have a feeling as to how competitive or otherwise our costs might be, and we certainly do not get a cosy ride.

Q87 John Smith: I am still not clear in my mind in terms of Defence Industrial Strategy. You provide capability where it otherwise does not exist in industry or you want to retain sovereignty for very good reasons, but is your role as a Trading Fund and an agency still to benchmark on quality and price to ensure that we have a competitive market out there, or has that role gone? It is not clear.

Mr Hughes: I still do that. As I mentioned earlier, about 20% of what I do is contracted via industry at any rate. VC10 is contracted via BAE Systems as you know; a large part of the land activity, BAE is the design authority and we contract via them—Bulldog, for example, is a recent one where we contract via industry. Therefore we do still have to commercially contract and have commercial benchmarks. If we take the Sealand activity in terms of electronics there is a continual benchmark between us and industry and it enables the customer to leverage that Sealand capability to get reduced prices in industry and there are examples that they have where we have been between 25% and 65% cheaper in our electronics activity than similar quotes from industry for that work. So those things go on more or less in different areas of the business. That does not give me the latitude to increase prices elsewhere where there is not the same level of competition because the General gets a view of my total rates across the business. So we absolutely as a Trading Fund still have that desire to be lean, be cost competitive and commercially competitive such that the MoD gets the best value it can from me as a provider.

Q88 Mr Jenkins: You mentioned the Bulldog contract just now and I find that one difficult because you went into head to head contest against BAE and you did not get the contract—BAE got the contract. Then they turned round and said to you, “We would like you to become a subcontractor now.” So they

have the contract, they are going to take all the profit and they are going to shove all the risk on to you. With this lifelong provision are we going to see a scenario where I am going to be the main contractor, I am going to build something and then lo and behold I do not want to go with the heavy stuff at the front end and fix it and it goes wrong, so I have muggins to send their people in to Fort Bastion to set about a big works and they are going to sort out the problem, tell me what the problem is and I might send somebody out to say, “Yes, okay, put an extra sleeve on that” and then they go and do the work. So are you not being taken for a ride by industry here? They are going to cherry pick and dump you as a subcontractor with all the work they do not want; is that not the future for you?

Mr Hughes: No, I do not think that is the case at all. There are a number of things there I can pick up. Whatever the competitive regime was in winning Bulldog the skills that BAE bring to the Bulldog contract we do not have; they are the design authority and they have all that design capability that I do not have in DSG. Therefore if you are going to change an engine or do up-armouring or do a whole suite of modifications to a vehicle, turn it into a Bulldog vehicle, I can absolutely see where the prime contract role within BAE Systems is there to do that. I can also see that where they have those skills I have the hands-on technical skills to do the physical work and because that is what we do we are skilled at that and we have the capacity and capability. I actually offer at the best value for money and cost that I can do that work cheaper than BAE could do that work. So the ultimate solution in partnering with BAE and Bulldog gets the best solution for the customer. I get out of it the workload through my factories to actually do the physical work; BAE get their prime contractor role in terms of engineering and the customer, through BAE, who still retain the risk as prime contractor—they do not pass the risk down to me, and that is not to say I do not do a good quality job—so the model of us being a partner with rather than a competitor to the likes of BAE, Bulldog is a good model of it working. Every Bulldog has gone out on time. Last year we had a ceremony for the 500th Bulldog and we have now done over 600 Bulldogs in partnership with BAE, and I think from a DSG point of view, irrespective of whatever the competitive regime was whenever it was bid—when I was not around—it has actually been good for DSG. I think it is a model with one or two modifications that we can use on other potential programmes and I believe that the customer has had the benefit out of that.

Q89 Chairman: But have you not thought since then, “Why did it happen that way round? Why was it DSG that was the subcontractor and not DSG that won the competition and made BAE Systems the subcontractor?”

Mr Hughes: I do not believe we have the prime contractor skills.

Q90 Chairman: So why did you compete?

Mr Hughes: No idea; I was not here.

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Q91 Mr Jenkins: You should look at the Post Office because the regulator there said that all the sorting could be done, could be cherry picked and the manpower they have can do the last mile, the delivery bit. It was not a good deal for them. Be careful when you are dealing with industry, you may not get a good deal.

Mr Hughes: I will bear that in mind next time.

Mr Jenkins: Believe me, I have been there; done it!

Q92 Mr Holloway: It is slightly the other way round to what Mr Jenkins was saying but also going back to what the Chairman was talking about. General, can it really be cheaper for you to subcontract to these guys to service TA Land Rovers than to get a local garage to do it?

Major General Dale: I cannot answer accurately because—

Q93 Mr Holloway: Surely the answer is yes.

Major General Dale: It should be yes, I agree, but I cannot give you the details because I am not party to how that works. Again, one of the advantages of DSG is its local proximity to TA centres and the ability for DSG to understand the problems of the user and to be able to surge and to veer and haul its capacities as needed to.

Mr Hughes: If I could just add to that, there is a management task in putting the work out to individual Land Rover dealers and therefore there is a scale of having somebody manage it as a wider geographical contract. What I would say is I have a Land Rover and I believe Land Rover's rates are more expensive than my hourly rate.

Chairman: I have two and perhaps I will bring it along to DSG!

Q94 Mr Holloway: I do not know anybody who has a ten or 15-year old car serviced by a main dealer and I am just wondering whether or not in this great package of economies that you guys provide it might be buried in that as a fairly nonsensical thing because it does not make sense to me for you to take something on and to subcontracting the servicing of elderly Land Rovers, which is a pretty basic thing which could be done within 100 metres of the front gate of the TA centre.

Mr Hughes: But then the TA centre has to have the procurement skills and commercial skills and the administrative staff, etc. to manage however many events happen. So I accept your point because there are always individual cases where I am sure could go under the arches' garage—if you will excuse the pun!—to do the Land Rover servicing.

Chairman: It would fall short on the armouring, would it not?

Q95 Mr Holloway: They just do not have armour and this is the point—it is a very unsophisticated thing and I wonder whether in this mix there are lots of things that you are doing that are actually costing the taxpayer rather more than they need to.

Mr Hughes: That is something that we continually review to make sure we offer the value that the customer wants.

Q96 Mr Havard: The Trading Fund model that was set up, are we seeing this as a transitional status process? What further changes are we going to see to the DSG? There was a review, as I understand it, a synergy study currently taking place in work streams at Sealand, Stafford and Donnington and so on. So what is the change that is going to take place because I hear a lot of rumours from people in the unions and elsewhere that there are more changes to come? So changes to the commercial model or simply frictional changes within the organisational structure?

Mr Hughes: There are no planned changes to the Trading Fund model so we are not doing any work in relation to the Trading Fund model. The frictional elements that you mention are the continual review that we have of the business to make sure that we are effectively organised to deliver the output at best value. So the synergy study I mentioned earlier, we are looking to make sure that we are making best utilisation of the assets currently under our control. We are looking at the capacity and capability of the business going forward; we are looking with the customer to see what the future workloads are by product, by geographical area, by business. Like any business we have to react to a changing environment, hopefully in advance but certainly as it happens in a planning round. So I would say that DSG operationally veer and haul and shape to take account of the circumstances in which we find ourselves because we are trying to drive the business to best effect. But there is certainly no plan or activity in place at all to look at changing the commercial model of the Trading Fund model; but operationally I will continue to try to get the best out of the business.

Q97 Mr Havard: So the through life capability aspects that came out of the Defence Industrial Strategy and so on, you seem almost to be explaining a circumstance, for example in Camp Bastion, whereby, if you like, your activity in terms of rectification or upgrading things and maintenance of them at the frontline almost, but certainly in theatre is not going to be substituted for by the through life capability requirement that there is on industry. That is going to be done in concert with them rather than being substituted for.

Mr Hughes: I think there will be almost a contract by contract programme by programme basis for through life capability management. We are plumbed into all of the discussions on a product by product basis for that and there is no one size fits all solution for how you support equipment either in the UK or in operation. Where we are is that we are well connected to that network as an expanding network of support solutions and are well positioned within it.

Chairman: Thank you very much indeed. I would like to finish almost as we started by thanking you for your crisp answers to the questions. It has been a very interesting session and extremely helpful.

Written evidence

Memorandum from the Ministry of Defence

THE DEFENCE SUPPORT GROUP (DSG)

Q1. *Developing the role, status and work of the DSG*

1. DSG is a trading fund agency of the Ministry of Defence (MoD). It was launched on 1 April 2008 following the merger of ABRO, the Defence Aviation Repair Agency's (DARA) Electronics and Large Aircraft business units and certain other defence support facilities.

2. DSG has been retained within MoD ownership to support (a) delivery of the Defence Industrial Strategy, and (b) UK military operations, by securing access to responsive, cost-effective in-house capacity and capability for the maintenance, repair, overhaul and upgrade of strategically important Land and Air in-service equipments.

3. The four main DSG business streams covering Armoured Vehicles, Land and B Vehicles, Large Aircraft and Electronics and Components operate across 18 sites supported by the DSG Head Office, currently located at Andover.

4. MoD has set DSG the goal of transforming the ABRO-DARA businesses into a single, viable entity that secures the benefits of the merger and delivers better value for defence in the provision of these support services going forward. Good progress has already been made with £10 million of benefits realised and programmes in place to continue the transformation of the new combined business.

5. MoD will review DSG progress on a regular basis, through the established governance structures, including the Owner's Advisory Council chaired by Minister for Defence Equipment and Support, to ensure that the synergies and benefits of the merger are fully exploited and that DSG's business strategy and capability retention and development plans continue to be well aligned to both MoD customers' needs and developments in the market environment.

6. As required by HM Treasury, MoD will also review DSG's trading fund status regularly to ensure that this business model remains the best way of delivering the services customers need in the most cost-effective way. In this respect, MoD is following developments with the current DBERR review of the Government trading fund model and will examine what this means for DSG, and MoD's three other trading funds, once the review's conclusions are finalised.

Q2. *DSG performance against Key Targets*

7. DSG's performance to date against its 2008–09 key targets is outlined in tabular form at Annex A to this memorandum. The organisation forecasts that all the targets will be achieved or exceeded at year end.

Q3. *Progress in amalgamating ABRO and DARA*

8. Work on the merger of ABRO and DARA began in May 2007 following the Ministerial announcement, and in August 2007 Archie Hughes, then Chief Executive (CE) of DARA, took on the additional roles of CE ABRO and CE DSG Designate, in order that all necessary arrangements to secure the successful vesting of DSG as a new trading fund on 1 April 2008.

9. DARA and ABRO continued to operate as two separate trading funds with separate executive management and trading fund boards until DSG formally came into operation. The formation of a single executive management and trading fund board was the first tangible synergy benefit of the merger and delivered annualised savings in the region of £1 million.

10. Since 1 April 2008, DSG has, in accordance with its business plan, focused on developing a sustainment strategy for the organisation through a number of initiatives at both the strategic and business unit level. This work has, among other things, been designed to identify and fully exploit the synergy and benefit opportunities of the DARA and ABRO merger and set targets for future improvements. The work will also inform the development of DSG's corporate strategic plan, setting out the DSG business agenda for the next five years, for approval by MoD Ministers in March 2009.

11. Transfer of the Sapphire House staff at Telford from MoD Defence Equipment & Support was successfully achieved on 1 September 2008 and significant manpower savings have already been realised. Work will now begin to identify how best to exploit this new DSG capability in the context of availability contracting and support of existing and future in-service equipments.

12. Overall benefits of £10 million have already been achieved primarily through manpower reductions at a corporate level and a tranche of further measures will drive down costs across the whole of the business. Excellent progress has already been made in driving up efficiency in each of the business units. The increase in efficiency in 2008–09 is forecast to be almost double that set in key target 4.

13. DSG has also put in place key changes to streamline the management and business structure across the various businesses to establish operational integrity and give the transparency and accountability necessary to ensure operational discipline. The robustness and credibility of these new measures is being progressively validated by the increasing correlation between financial planning and in-year outturn, and they will be concluded by the end of this financial year.

14. A synergy study is currently underway examining how best to exploit the benefits of merger within the Electronics and Components work-streams currently undertaken at Sealand, Stafford and Donnington.

Q4. The strategic need to keep DSG capabilities within Trading Fund status

15. The aim of trading fund status and its associated arrangements is to create accountability within the service supplier organisation and to improve its responsiveness to customer requirements. It also imposes commercial disciplines on the trading fund that encourage greater efficiency and effectiveness while providing customers with visibility of the real costs of the services and capabilities they require, allowing them to make informed choices on value for money grounds.

16. DSG operates on these principles, employing the flexibilities that trading fund status bring, to provide responsive key strategic capacity and capability in support of UK Armed Forces. This has proved especially important in allowing DSG to respond at short notice to urgent overseas operational support requirements. MoD has no plans to change DSG's status but is required to keep trading fund status under review, especially in light of the DBERR review of trading funds generally.

17. Trading fund status also provides DSG with the potential to adopt best market practices and skills to sustain value for money advantage against industry competition, as well as the opportunities to engage in, and compete for, wider market work using spare capacity, thereby reducing overhead costs across its MoD programme work. DSG, as a trading fund, plays a valuable role as a competitive lever for driving fair and reasonable industry bids for work that falls within DSG's capability (but outside their capacity). Trading fund status also provides the opportunity to create a separate non-exclusive industry-facing identity that enables partnering and other commercial models.

18. Details of DSG's key strategic core capacity and capability for Land equipment, aircraft avionics and large aircraft are contained at Annex B to the memorandum.

Q5. Long Term viability of DSG

19. DSG is MoD's preferred in-house option for equipment maintenance, overhaul and upgrade support solutions. To sustain this, the business must continue to build on its strengths—particularly its ability to adapt and flex its capabilities to meet MoD customers' changing needs—while demonstrating that it provides best overall value for defence in an increasingly competitive and challenging market environment.

20. Building successful partnerships with the industry prime contractors, responsible for the through-life support of the UK Armed Forces' current and future land and air equipment, will also be critical to the long-term viability of DSG. Maintaining the organisation's competitive edge, and therefore its attraction as a partner of choice for the industry primes, will depend in large part on the capability investment and restructuring choices the organisation implements over the next few years.

21. With the ABRO and DARA merger now complete, DSG is on a sound footing going forward in the short to medium term. Plans are being prepared for MoD Ministers' approval in March 2009 which will aim to ensure that the business is best configured to achieve success in the longer term by continuing to offer the most competitive, high quality output required by the Armed Forces customer.

22. While it is too early to report on the detail of these plans and their likely impact on the future size and shape of DSG, they will address the significant challenges facing the long-term viability of the Large Aircraft business unit at St Athan as the VC-10 tanker fleet approaches its out of service date of 2014. DSG is working closely with MoD, other agencies and government departments, including the Welsh Assembly, to identify what future opportunities exist.

Q6. DSG support to the Defence Industrial Strategy

23. The Defence Industrial Strategy (December 2005) set out the key capabilities that MoD wished to retain in the UK and how this would be achieved. The DSG has contributed significantly in this regard. For example, the DIS stated that the UK requires an on-shore capability to repair and overhaul armoured fighting vehicles both for routine maintenance and in response to operational needs. DSG has the only operational armoured fighting vehicle repair and overhaul facility in the UK. As such, it has a key role to play in development of the market for the support of the in-service and future fleet for armoured fighting vehicles including the Future Rapid Effects System (FRES). Similarly DSG's air support assets provide a unique, operationally strategic capability and utility of this resource should also be maximised and the core capacity and capability sustained.

24. Through application of its unique skills, practical know-how, intellectual capital and platform specific expertise, DSG has demonstrated its ability to meet its primary objective of ensuring continuity of service to a significant number of in-service, operationally critical platforms in support of the Defence Industrial Strategy. In particular, DSG's flexibility in responding to the significant levels of operational activity and urgent operational requirement projects has highlighted the pivotal role it plays in support of operations.

25. In recognising that this resource requirement will change over time in response to changing operational demands, the capacity and capability of DSG will consequently be jointly assured by DSG and the MoD customer. The mechanism that helps ensure MoD provides the necessary sustainment support for DSG into the future is the publication of Defence Equipment and Support Standing Instruction 20. This instruction requires that, as a retained defence capability, DSG's capabilities and resources should be maximised and the core capability and capacity sustained to ensure their continued availability to the MoD customer.

Q7. Status of the £875 million contract between DSG and MoD

26. The DSG Repair agreement¹ covers the five-year period 1 April 2008 to 31 March 2013 and has a potential value of £875 million over the period. It covers the maintenance, repair and overhaul of vehicles and equipments for predominately the MoD Land Equipment (LE) area plus significant repair, maintenance and inspection work for the 3 Services. This work is provided to DSG as follows:

- *Programme Load*—Programme Load is planned and budgeted work identified by Defence Equipment and Support teams, for which DSG is required to provide a firm price. These teams load the work throughout the year and delivery is against a schedule. On completion of repair the tasks are invoiced to the customer.
- *District Load*—District Load work is provided predominantly from the Army customer but also from the RAF and RN. This is essentially unscheduled work and covers a vast array of repair, maintenance and inspection work at a number of sites and in-barracks to ensure convenience to the three Services' customers. This part of the agreement is covered under a yearly Limit of Liability for each customer.
- *Ad hoc Tasks*—*Ad hoc* tasks can be raised on DSG by either the Defence Equipment and Support teams who contribute to the Programme Load work or other MoD customers that require work undertaken at short notice. Urgent operational requirements are also loaded to DSG in this manner. Each task is separately priced.

27. Maximum provisional rates have been agreed for 2008–09 and these rates together with material costs will be the basis of the prices that will be firmed up in February 2009. Rates are currently being compiled for 2009–10 and these will be forwarded to the customer in the early part of 2009 for consideration.

28. Agreement terms and conditions are all agreed. Regular dialogue and meetings are held with CDLE and his team to ensure the smooth operation of the agreement.

29. The estimated total value of this agreement for the period 2008–09 to 2012–13, at the point the agreement was placed in April 2008, was £875 million. This will change as actual requirements are clarified year on year.

Q8. Impact of operational tempo on DSG work

30. There has been a significant increase in demand for DSG support with Land vehicle repair as a result of operations in Afghanistan and Iraq above that originally forecast and funded through the MoD core programme. This increase is due to the high operational tempo, it has been funded via the Conflict Prevent Fund, and met through DSG's ability to surge and flex its capabilities. A more detailed summary of the impact of Operations TELIC and HERRICK on DSG is provided at Annex C to the memorandum.

Q9. DSG staff in operational theatres

31. Besides having a long-established tradition of deploying its skilled personnel to support on-going military operations, operational deployments also characterise DSG's utility and flexibility during critical vital Front Line operations. Deployments have included Operation GRANBY during the first Gulf conflict, through Operation OCULUS in the Balkans to current Operations HERRICK and TELIC in Afghanistan and Iraq. DSG deploys teams of various sizes depending on the unique requirements of the work that needs to be done. The following table outlines, for the Committee's information, DSG's most recent deployments.

¹ As DSG is a constituent part of the MoD, trading between MoD and DSG does not have the same legal force as a contract, and is more properly referred to as being an agreement, as opposed to a contract.

<i>Op Theatre</i>	<i>From/To</i>	<i>Duration (days)</i>	<i>No of Personnel Deployed</i>	<i>Activity</i>	
1	Iraq	29 Apr–24 May 07	26	17	Fitting of Electronic Counter Measures (ECM) Installation kits on vehicles.
2	Iraq	21 Jun—1 Jul 07	11	6	Fitting of WARRIOR UOR upgrades including: Environmental Control Units (ECU), and ECM kits.
3	Afghanistan	8–20 Aug 07	13	7	Fitting of WARRIOR UOR upgrades including: ECU, ECM and Additional Protective armour (WRAP 2). This was a continuation of DSG work carried out in barracks in Germany.
4	Kuwait	22 Oct 07–8 Feb 08	Up to 108	Up to 15	Fitting of WARRIOR UOR upgrades; ECM and WRAP 2. Teams/individuals changed throughout the period.
5	Iraq	14 Jan–6 Feb 08	24	8	Fitting of Mine blast protection to CHALLENGER 2 Main Battle Tanks.
6	Iraq	17 Mar–18 Apr 08	33	5	Fitting of Mine blast protection to CHALLENGER 2 Main Battle Tanks.
7	Iraq/ Afghanistan	13 Jun–3 Jul 08	21	1	Specialist support to ECM eqpts.
8	Iraq	8 Sep–18 Oct 08	41	3	Fitting of Mine blast protection to CHALLENGER 2 Main Battle Tanks and CHALLENGER Armoured Recovery Vehs.
9	Iraq/ Afghanistan	5–26 Jan 09	21	1	Specialist support to ECM eqpts.

32. DSG personnel actively support deployments with many taking more than one tour and requests for volunteers are consistently oversubscribed. There is no shortage of keen, capable volunteers, even when they know they may be faced with the threat and reality of enemy indirect fire.

33. Deployment volunteers are drawn from several DSG sites but are inevitably limited to the various skills available and the business needs of each site. They include personnel from Donnington, Bovington, Catterick, Colchester, Stirling and Warminster. DSG anticipates increasing manpower numbers on deployments to support the future Equipment Sustainability Solution at Camp Bastion in Afghanistan.

34. DSG staff work under REME Command, helping optimise the skills of Service personnel while delivering support at the point of need, and potentially saving on the base workload. DSG manpower are extremely enthusiastic about providing vital support direct to deployed operations and many have won campaign medals for their efforts which are recognised and applauded by their Service colleagues.

Annex A to MoD Memorandum on DSG

DSG PERFORMANCE AGAINST KEY TARGETS 2008–09

<i>Key Target</i>	<i>Description</i>	<i>Status (Year to Date)</i>	<i>Full Year Plan</i>	<i>Full Year Forecast</i>
1—Quality	Deliver Improved Quality Performance.	Green	0	Green
	Air Target—Achieve fewer than 4 Attributable Major Customer Concerns.	Green	< 264	Green
	Land Target—Reduce Upheld Customer Complaints by 5% against FY2007–08 Outturn (Baseline 278, Target 2008–09 is 264)			
2—Financial Performance	To Achieve at least 3.5% Return on Capital Employed.	Green	3.50%	5.83%

<i>Key Target</i>	<i>Description</i>	<i>Status (Year to Date)</i>	<i>Full Year Plan</i>	<i>Full Year Forecast</i>
3—Business Transformation	Establish a Transformation Plan, approved by the DSG Trading Fund Board, by December 2008 that fully exploits the synergies and benefits of merger, including numerical targets for improvements in cost and performance for subsequent years.	Green	Green	Green
4—Efficiency	Improve overall efficiency by at least 4%.	Green	4.00%	8.07%
5—Delivery	Meet delivery targets as agreed with the Customer.	Green	Green	Green
	Air Target—To achieve 95% of Customer Programmes.	Green	Green	Green
	Land Target—To meet Customer agreed targets for delivery schedules on Critical Programme lines and LAND Load tasks.	Green	Green	Green

Annex B to MoD Memorandum on DSG

DSG KEY STRATEGIC CORE CAPACITY AND CAPABILITY

LAND EQUIPMENT

1. Unique on-shore² Armoured Fighting Vehicle (AFV) Hull repair capability, (to maintain hull ballistic integrity), including:
 - Large aluminium milling machines;
 - Hull manipulators;³
 - Aluminium Armour “approved” welders; and
 - Expert knowledge of aluminium armour repair.
2. Small Arms repair and upgrade capability including:
 - Full Small Arms weapons test facility;
 - Secure storage and repair facility located next to the main Defence Storage and Distribution Agency (DSDA) Armoury; and
 - Knowledge and ability to repair and upgrade in-service small arms.
3. Repair of legacy Electronic and Communications systems typically:
 - PTARMIGAN Radio system, repair, modify, test, and manage out of service; and
 - Encrypted radio systems requiring secure repair and test facilities.
4. The unique footprint; 18 Workshops strategically located, [most of which are] close to the customer training base to mitigate downtime and transport costs of repairable equipment.
5. The ability when required to embed staff within UK based Army units.
6. Level 1 to 4 maintenance, repair and overhaul of the Army’s Inventory,⁴ (if required).
7. Flexibility, the ability to haul and veer a workforce at short notice to meet changing Customer demand.
8. Management of the supporting supply chain through DSG Land Supply and its own in-house Procurement Group (PG).
9. Ready availability of a security-cleared multi-skilled workforce.

AVIONICS (SPECIFIC TO THE AVIONIC BUSINESS AT DSG SEALAND)

1. For the combat air platforms, DSG Sealand has played a key role in driving value for money support for the fast jet platforms. In the last five years they have “leaned up” significantly and their prices are highly competitive. At one end of the scale, they are able to deliver low cost through-life solutions for equipments that Industry would not necessarily be interested in supporting ie old/obsolescent equipment and would

² Required to be retained in UK in accordance with DIS v1.

³ Heavy tooling that can lift and rotate complete hulls to facilitate repair activity.

⁴ Subject to certain IPR constraints.

probably charge premium rates. At the other end of the scale, they have a world class diagnostic and repair capability for the support of modern equipments where they are able to access the intellectual property rights.

2. In summary, the MoD sees a viable DSG as a key component to delivering value for money support for current and future fast jet platforms in partnership with Industry primes.

LARGE AIRCRAFT

1. DSG's Large Aircraft business unit located at St Athan provides strategic maintenance and support for the VC-10 fleet. DSG will continue to provide these services, as a sub-contractor to BAE Systems, until the out of service date of the aircraft in 2014.

Annex C to MoD Memorandum on DSG

SUMMARY OF OPERATIONAL IMPACTS ON DSG

OPERATION TELIC

- (a) *Current.* Continued support through Programme and District Load work provided in UK for equipments/assemblies returned and repaired under the main Land commercial agreement.
- (b) *Future.* Regeneration of TELIC equipment in 2009 will sustain demand for maintenance, repair and overhaul of returning Armoured Fighting and Support vehicles plus a wide range of other war-fighting equipment.

OPERATION HERRICK

- (a) *Current.* Continued support through Programme Load and District Load work provided in UK for equipments/assemblies returned and repaired under the main Land commercial agreement and on-going support to fitment/integration of UORs.
- (b) *Future. Continued support to HERRICK will be required and will likely see:*
 - (i) a continued requirement to fit/integrate UOR's,
 - (ii) a continued requirement to repair battle damaged equipments in UK,
 - (iii) a likely requirement to supply manpower to the Equipment Sustainability Solution (ESS), Camp BASTION; planned In-Service Date April 2010,
 - (iv) continued support to manage the Operational Training Equipment Pool (OTEP),
 - (v) a re-distribution in overall workload for DSG through the creation of the ESS in Camp BASTION,⁵ and
 - (vi) DSG flexibility to adjust priorities at short notice including the potential to deploy in support of the ESS.

12 January 2009

Supplementary memorandum from the Ministry of Defence

Q1. *To what extent will continued reliance on separate land and air IT systems (on the operating side) restrict the possibility of realising future synergies within DSG?*

A1. DSG does not anticipate that operating two bespoke IT systems across the land and air businesses will impede or restrict its ability to realise future synergy benefits.

Q2. *In Q13 there is reference to the activity of "land supply" now being carried out by staff at Sapphire House. The Committee would appreciate a short note setting out where this activity was carried out before, and what happened to those staff who carried out this activity when Sapphire House was brought into DSG. It would also like to know how much money was saved from this development within DSG.*

A2. Staff undertaking the procurement and provisioning activities in Sapphire House, Telford transferred internally from DE&S to DSG on 1 September 2008. This followed DSG's proposal to take on these activities with the aim of delivering future synergy benefits and savings to the MOD customer, and this proposal was accepted and endorsed by Ministers in December 2007. This meant that staff based at Sapphire

⁵ Assuming DSG are invited to provide a direct labour workforce at the ESS under acceptable commercial arrangements.

House would not have to relocate to the South West as originally planned under the DE&S Collocation Project but would instead transfer to DSG. Part of the transfer process included a Voluntary Early Release scheme which helped realise staff reductions of 94 with subsequent savings of £3.88 million.

Q3. *In Q13 there is also reference to savings of a “fair amount of money in material costs and things of that nature”. To what specifically does this refer, and how much was saved?*

A3. DSG anticipate savings of £2.2 million on its planned material spend in 2008–09. Further non-staff related savings of £1.9 million are anticipated in Information System expenditure and an additional £1.1 million from areas such as HR, finance and consultancy expenditure.

Q4. *The Committee would appreciate a note setting out DSG’s possible participation in the Equipment Sustainability Solution in Camp Bastion, and when the full extent of this participation is likely to be confirmed?*

A4. The Equipment Sustainability Solution (ESS) at Camp Bastion will be delivered in two distinct phases; construction followed by the delivery of a repair capability. The project is being managed by PJHQ with their prime contractor for both phases being KBR.⁶ DSG are being invited to participate in a very small way for the construction phase by giving specialist advice to the project on infra-structure and facilities aspects. The construction phase is due to complete in Apr 2010. Negotiations continue on aspects of the commercial contract for the repair capability phase, and KBR as the prime will be required to run a sub-contract competition for the various elements of delivering the repair capability. Due to their position within MoD; their proven track record; their knowledge of the equipments, and their security status in regard to repairing certain sensitive equipments, DSG will be invited to participate in that competition, however, successful award of a sub-contracting role in providing a repair and maintenance capability at the ESS, is predicated on DSG’s ability to provide an overall value for money and affordable solution. It is anticipated that sub contract elements to the prime contract will be awarded later in 2009.

Q5. *In Q87, Mr Hughes says that “about 20% of what I do is contracted via industry at any rate”. The Committee would like confirmation of the proportion of DSG’s work for which it is the MoD’s prime contractor, and the proportion of DSG’s work for which it is a sub-contractor to industry. It would also like confirmation of whether this proportion is by turnover or by capacity.*

A5. 81% of DSG’s work, by turnover, is contracted directly to the MOD with 17% as a sub-contractor to industry and the remaining 2% of turnover comes from wider market customers.

Q6. *The Committee would also be grateful for an indication of when DSG expects to submit its five year strategic plan to Ministers and when it expects this plan to be agreed by Ministers. The Committee would also like to know when DSG expects to publish its first Annual report.*

A6. DSG plans to present its Corporate Strategic Plan to the Minister in March when its next Owner’s Advisory Council meets. DSG anticipates publishing its first Annual Report and Accounts once they are laid before Parliament, which it expects will be in early summer 2009.

18 February 2009

⁶ KBR is a US engineering and construction company.