



House of Commons
Defence Committee

**Defence Support
Group: Government
response to the
Committee's Seventh
Report of Session
2008–09**

Third Special Report of Session 2008–09

*Ordered by The House of Commons
to be printed 27 October 2009*

The Defence Committee

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

Current membership

Rt Hon James Arbuthnot MP (*Conservative, North East Hampshire*) (Chairman)
Mr David S Borrow MP (*Labour, South Ribble*)
Mr David Crausby MP (*Labour, Bolton North East*)
Linda Gilroy MP (*Labour, Plymouth Sutton*)
Mr David Hamilton MP (*Labour, Midlothian*)
Mr Mike Hancock MP (*Liberal Democrat, Portsmouth South*)
Mr Dai Havard MP (*Labour, Merthyr Tydfil and Rhymney*)
Mr Adam Holloway MP (*Conservative, Gravesham*)
Mr Bernard Jenkin MP (*Conservative, North Essex*)
Mr Brian Jenkins MP (*Labour, Tamworth*)
Robert Key MP (*Conservative, Salisbury*)
Mrs Madeleine Moon (*Labour, Bridgend*)
John Smith MP (*Labour, Vale of Glamorgan*)
Richard Younger-Ross MP (*Liberal Democrat, Teignbridge*)

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

Mr Colin Breed MP (*Liberal Democrat, South East Cornwall*)
Derek Conway MP (*Conservative, Old Bexley and Sidcup*)
Mr Kevan Jones MP (*Labour, Durham North*)
Mr Mark Lancaster MP (*Conservative, North East Milton Keynes*)
Willie Rennie MP (*Liberal Democrat, Dunfermline and West Fife*)
Mr Desmond Swayne MP (*Conservative, New Forest West*)

Powers

The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the Internet via www.parliament.uk.

Publications

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

Committee staff

The current staff of the Committee are Mike Hennessy (Clerk), Georgina Holmes-Skelton (Second Clerk), Karen Jackson (Audit Adviser), Judy Goodall (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.

Third Special Report

The Defence Committee published its Seventh Report of Session 2008–09 on *Defence Support Group* on 22 June 2009, as House of Commons Paper HC 120. The Government's response to this Report was received on 18 August 2009. This is appended.

Government response

The Government welcomes the House of Commons Defence Committee's report on the Defence Support Group (DSG).

We agree with the thrust of the report and can confirm that where the Committee has raised concerns or cautionary warnings work is in hand to address them. The Government would also take this opportunity to provide an update on developments with a number of wider issues of Committee interest highlighted in the report—in particular the sub contract role for DSG in providing the skilled labour force for the Equipment Sustainability Solution at Camp BASTION. Equally, we have provided additional information on how DSG's position in the market has, in our view, been strengthened over the last six months as a result of the Trading Fund's own partnership building initiatives with industry together with Government decisions on the maintenance, repair and overhaul (MRO) and assembly, integration and test (AIT) strategies on a number of key Armed Forces' current and future land and air equipment programmes. The announcement of the Armoured Fighting Vehicles Sector Strategy by Min(DES) on 23 June is especially important in this respect. These points are covered in more detail later in the Government's response.

We are especially pleased that the Committee has acknowledged DSG's strategic importance and value to Defence and praised the organisation and its staff's high level of performance and commitment in supporting the Armed Forces both at home and on operations overseas. The Government as owner, and the military as DSG's customer, share the Committee's sentiments.

As DSG's published annual report and accounts confirms the business has exceeded the Government's expectations in its first year of trading, vindicating the ABRO and DARA merger decision and the new organisation's Trading Fund status. DSG has met every demand placed upon it to date by MoD and the Services and continues, in consultation with Government and industry, to align its capacity and capability to meet customers' future requirements.

The Government's response to the Committee's individual conclusions and recommendations as set out on pages 22-23 of the report are as follows:

1. (Recommendation 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 the support. (Paragraph 10)

The Government welcomes the Committee's commendation of both the DSG executive and wider workforce. The Committee's praise has been communicated to all DSG staff.

2. (Recommendation 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. (Recommendation 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)

The long-term future of DSG will be determined by a number of factors, the main consideration being the continued requirement for MoD to retain DSG's strategic capabilities "in-house". While the Government expects the disciplines of the Trading Fund business model to deliver efficiency savings and higher levels of performance in the provision of its services, there is no expectation that efficiency savings will continue to accrue on an indefinite basis. The ability of DSG to continue delivering cost and efficiency savings will not be the single factor in determining its future.

The efficiency targets and the dividend requirements that MoD sets DSG are developed in consultation with the Trading Fund management team. They are designed primarily to improve the long-term value of the business by improving its cost-effectiveness and competitiveness in the MRO and AIT market place. This is achieved by, among other things, driving out unnecessary operational overheads. The Government can therefore assure the Committee that DSG's efficiency targets are not dictated by shorter-term departmental cost saving considerations. Indeed, by taking the Trading Funds "off-vote", they are excluded from any direct involvement in such initiatives, although as mooted obliquely in the report, any significant reduction in MoD customer funding levels could impact on DSG and require some adjustment in the Trading Fund's capability and capacity levels.

While DSG cannot be ring-fenced from customer funding reductions, the negative impact of the latter is offset through the application of the DE&S Standing Instruction 20, which has been strengthened and will be reissued in the light of the Committee's report. It requires preferential consideration of DSG in equipment maintenance contracts and sub-contracts to maximise the utility of the Trading Fund's retained capacity and capability where this represents best overall value for Defence.

4. (Recommendation 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 of operation, 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)

DSG's first set of Annual Report and Accounts were laid before Parliament on 7 July and fully reflect a strong business performance during this first year of operation. This is all the more commendable given this was achieved during a sustained period of change as the merger evolved. A copy of the Report and Accounts was issued to the Committee and one is also enclosed with this formal Governmental response.

5. (Recommendation 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)

The Government is grateful that the Committee has highlighted and acknowledged the wider importance to Defence of this key DSG initiative. DSG is continuing its apprentice scheme across its various businesses with the aim of nurturing home grown talent and developing individuals based on its future needs.

6. (Recommendation 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)

It is our assessment that DSG is no different from any comparable organisation when assimilating two senior management teams. The current Executive Board and senior management team possess great depth of skill and expertise across a range of managerial disciplines. However, it is recognised that as DSG seeks to secure future contract opportunities and take the business forward it has to have a broader pool of in-house experience in areas such as programme and project management, as well as in the professional areas of commercial and finance. This can be achieved through career development for existing employees with talent and ambition as well as looking to the open market. In the short to medium term it is addressing, with appropriate succession planning and personal development, the needs of its management board and senior management team.

7. (Recommendation 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)

We welcome and endorse the Committee's assertion that DSG's geographical footprint is unique and a key asset. Retention rates within DSG remain well above industry averages and we recognise that to recruit staff with the right skills set is important to the future success of the business. Any difficulties in recruitment based upon geographical locations are resolved through payment of allowances based on local market rates and trends.

8. (Recommendation 8) We express our gratitude to all those DSG employees who have volunteered, sometimes on more than one 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. (Recommendation 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)

The Government is pleased that the Committee shares its high regard for the commitment and high level of performance of DSG staff in support of UK Armed Forces' operations—

particularly in respect of employees who have deployed in-theatre on Ops HERRICK and TELIC. The Committee's commendation has been passed on to all DSG staff.

10. (Recommendation 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)

DSG has been intimately involved in the development of the ESS capability since April 09. All parties (MOD, PJHQ, KBR as the Prime Contractor) are fully aware of the skills which DSG would bring, if contracted, to the facility in regenerating war-winning equipment. DSG would also use its relationships with Prime Contractors, Original Equipment Manufacturers and the Armed Forces to enhance the delivery of support provided.

Although DSG is not, as yet, under contract from KBR, the intent is for DSG to provide the majority of the skilled personnel within the ESS Interim Regeneration Capability. KBR will provide the management team for the Interim Capability, with the potential for other Defence manufacturers, such as GD UK, to provide additional specialist capability. This capability will operate from Autumn 2009 until the ESS Full Regeneration Capability starts operation from 1 Sep 2010, for which contractual arrangements have to be developed. We would expect DSG to have a role here.

11. (Recommendation 10) We are concerned that current uncertainties with regard to the size and timescales 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)

12. (Recommendation 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)

DSG staff have been fully engaged with DE&S and HQLF staff in planning for, and delivery of, the recuperation of equipment following the drawdown from Iraq. Levels of DSG activity have varied from depth repair to minor inspections, although the volume of repair has been less than originally forecast, partly due to good equipment husbandry by troops on operations.

The current plan for manpower commitment to ESS is 29 skilled DSG staff for the Interim Regeneration Capability. DSG's potential manpower contribution to the Full Regeneration Capability is still under consideration.

DSG will ensure that direct support to operations; to the ESS, to the recuperation programme, and to UORs, remains a top priority. The very nature of such activity, demands significant flexibility in planning and in the skills of the staff, but DSG's continuing dialogue with the MoD customer will ensure that DSG aligns capacity and capability accordingly.

13. (Recommendation 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. (Recommendation 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)

The Government's vision for DSG, as reflected in the organisation's Framework Document, is to "excel in supporting Defence". The vision requires DSG to be optimally structured and operated to support the delivery of the most cost effective MRO and AIT solutions for UK Armed Forces' equipment either under direct contract with MoD or in partnership with Defence Industry.

We note the Committee's concern that the delay in publishing the revised Defence Industrial Strategy does not help to clarify or strengthen DSG's continued "raison d'être or the nature of its developing relationship with industry". For the reasons highlighted in paragraph 23 below, we do not believe that this is impacting negatively on DSG. As recorded in the report, the Government continues to believe that Trading Fund status provides the most effective means to achieve the DSG vision.

The Government agrees with the Committee's assessment that DSG has been successful in demonstrating its ability to manage a number of challenging factors and trade successfully with MOD, the Armed Forces and industry. The Committee recognises rightly that DSG's future order-book will depend increasingly on winning business through Defence equipment primes, rather than through direct contracting with MOD. Whilst not underestimating the extent of this challenge, the Government believes that DSG can establish and maintain a buoyant position in the market place and that its long-term viability as an "in-house" retained asset looks promising.

There are good reasons to support this view—particularly in light of a number of key Government policy decisions on equipment MRO and AIT strategies since January 2009 that will have a positive impact on DSG's market position. Firstly, DSG is now very much at the heart of the Armoured Fighting Vehicles Sector Strategy launched by Minister (DES) on 23 June 2009. Secondly, MoD has confirmed that the Trading Fund has a key role to play in driving forward an affordable avionics support strategy for Typhoon and

potentially for future aircraft such as Joint Strike Fighter. In addition, DSG has also continued to strengthen its position for MRO and AIT sub-contract work from industry on both current and future land vehicle programmes to the extent that Government is confident that, whichever company eventually wins the “capability” contracts for FRES and the Warrior upgrade, DSG will feature prominently in delivering the MRO and AIT elements.

We take due account of the Committee’s cautionary warning that MoD must do nothing that could threaten DSG’s future viability without careful and deliberate consideration of what Government wants from the organisation over the long-term. The risk of inadvertently compromising DSG’s business position will be addressed through the republication and consistent application of a strengthened DE&S Standing Instruction 20, which will ensure that appropriate consideration across MoD is given to DSG’s strategic capabilities and its wider importance to MoD in all relevant equipment approvals decisions. Any change to DSG’s business model will therefore be determined by design, through regular and strategic level reviews of the benefits of retained Trading Fund status, as required under HM Treasury guidance, rather than as an indirect consequence of MoD equipment decisions taken in isolation.