House of Commons
Defence Committee

Defence Acquisition

Seventh Report of Session 2012–13

Volume I: Report, together with formal minutes, oral and written evidence

Additional written evidence is contained in Volume II, available on the Committee website at www.parliament.uk/defcom

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Defence Committee

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Conclusions and recommendations

Based on our analysis, we have identified a number of areas of risk in the MoD’s acquisition policy. Further, the length of time taken by some acquisition projects means that it may be many years before success or failure is visible, and by that time irreparable damage may have been done. In an attempt to mitigate these risks we have made the following recommendations:

1. The decision in 2010 to change to the carrier variant of the Joint Strike Fighter was the largest single procurement decision in the SDSR. It is clear that the decision was rushed and based upon incomplete and inaccurate policy development. It was taken without the MoD understanding how the change could be implemented. Perhaps the primary example of how little the MoD understood about this decision is the fact that it was supposed to improve interoperability. This turned out to be incorrect. This decision ultimately led to increased costs to the carrier strike programme and a delay in the in-service date of the carrier. It could also be argued that it provided a rationale for the early decommissioning of the Harrier. We urge the MoD to learn the lessons of this closed, rushed and flawed decision of 2010. (Paragraph 15)

2. We note that the problems leading to the overheating of the defence budget have been identified and the expressed willingness of the parties to address them. We shall be monitoring progress on this. (Paragraph 21)

3. We sympathise with the impatience of the defence industries in the face of the slow timescale for producing promised information and urge the MoD to accelerate the publication of further material to flesh out the bones of the White Paper. The Equipment Plan should be published as a matter of urgency without awaiting any NAO input or commentary. (Paragraph 28)

4. We believe that the absence of a defence industrial strategy which supports appropriate national sovereignty puts the UK at a disadvantage against competitor countries. Furthermore, we do not understand how we can have confidence in a national security strategy which does not show a clear grasp of what is needed for the defence of the United Kingdom, and how this can be ensured. We recommend that the Government reconsider the wisdom of not having a defence industrial strategy. (Paragraph 41)

5. The White Paper accepts that there are some capabilities possessed by defence suppliers that are critical to our national sovereignty and must be protected on-shore. We expect the MoD to be clear about the capabilities that fall into this category and to have a clear sustainability plan developed with UK industry. (Paragraph 45)

6. We recommend that the MoD work with industry and other Government Departments to ensure that where it is appropriate to use open standards these should be consistent, widely publicised and promoted as a matter of course. (Paragraph 53)
7. We recommend that the Department reviews and benchmarks itself against the US “Fast, Inexpensive, Simple and Tiny” initiative. (Paragraph 58)

8. While we commend the Government’s commitment to encouraging defence exports it is clear that the playing field is not level. We recommend that the Government keep under review the reciprocation by other countries of the UK’s commitment to open procurement. If it transpires that others are not prepared to give to UK industry the opportunities the UK gives to theirs, it might become necessary for the Government to reduce its open procurement. (Paragraph 68)

9. The overriding reason for the purchase of any item of defence equipment must be its quality and the requirements of the Armed Forces. We consider nonetheless that the Government should take into account in buying equipment the enhanced opportunities for export of equipment in use by UK armed forces. Defence equipment sales carried out within all the constraints of national and international law bring with them significant benefits to the UK in terms of employment opportunities, economies of scale and enhancement of influence. (Paragraph 69)

10. Defence Equipment and Support should be directed to take account of tax revenues when conducting investment appraisals and this should form part of a rounded government decision-making process. (Paragraph 70)

11. We believe that the UK strategy for defence acquisition should be based on a coherent level of commitment to a requirement for an ability to act nationally, to an understanding of where a level of mutual interdependence or partnership is acceptable, and where the risks of dependence on the US are acceptable to our national interest. A government with the ambition for the UK to retain its status as a major international power enjoying considerable operational sovereignty should address these issues in that order. (Paragraph 77)

12. We recommend that when entering into contracts, the MoD pays due regard to the need to effectively understand and manage risks originating with private sector partners and in the supply chain, especially the practicality of the placement of civilians, and in particular civilians who are non-UK nationals, into harm’s way. (Paragraph 85)

13. We recommend, therefore, that the MoD, industry and the Treasury develop collaborative behaviours and methodologies for delineating the competitive and collaborative phases of defence acquisition. This should overtly identify and manage risks where they arise and as they are identified so that less emphasis is placed on the, sometimes flawed, concept of risk transfer. We also note that the movement of personnel, especially at the senior level, can be effective for defence, but recommend the promotion of a culture of overt openness, visibility and transparency so that public confidence in defence leaders does not wane. (Paragraph 94)

14. We recommend that the MoD include in its annual report and Accounts information about the number and value of contracts awarded to SMEs, by both the DE&S and prime contractors. (Paragraph 97)
15. We were told that the requirement to bear unlimited liability is a disincentive to SMEs to bid for Government contracts. We expect to be told in the response to this Report what action has been taken to ease this burden on business. (Paragraph 103)

16. We expect to learn in the response to this Report what the MoD is doing to encourage prime contractors to speed up the process of engaging with SMEs as potential suppliers. (Paragraph 105)

17. The emphasis placed on SMEs by the White Paper is welcome in principle, but more needs to be done in detail. It should not be to the detriment of larger concerns: both have a role to play, both singly and in combination. We look forward to learning what has been done to address the specific difficulties faced by SMEs. (Paragraph 106)

18. It is important that spending by the MoD on defence Science and Technology is increased. The reduction in this spending in recent years (even though it has now been halted), together with the emphasis on off-the-shelf procurement and open competition, offers a serious threat to the technical skills base, specifically though not exclusively to the defence skills base, within the United Kingdom. This in turn threatens the defence body of knowledge and may come to threaten the UK’s ability to defend itself. (Paragraph 111)

19. We do not regard the Minister’s suggestion that additional science and technology spending could be funded from the departmental unallocated provision as likely to be fulfilled, given the number of conflicting demands on this resource. There are two distinct but separate purposes to a Government funding research and development. Firstly, to provide our Armed Forces with the most up to date equipment, and secondly, to support indigenous military industrial capability. We believe that the UK Government should therefore commit to a target of 2% of MoD budget being spent on UK based R&D. (Paragraph 114)

20. We recommend also that, when the Government publishes its defence and security themes, it should provide sufficient guidance to industry to enable it to focus its research spending. (Paragraph 115)

21. We recognise that there is a need for flexibility with defence capital expenditure and we look forward to receiving information on the results of the dialogue between MinDEST and the Treasury. (Paragraph 116)

22. We accept that the decision on the future of DE&S, while urgent, is too important to be rushed. It is clear that a GoCo is not universally accepted as the best way forward, and that there are particular concerns about how the MoD’s overall responsibility for acquisition could be maintained within a GoCo. In particular, we believe problems might arise if a non-UK company were given responsibility for UK defence acquisition. We further believe it is vital that consultations are satisfactorily concluded with allies, to ensure that there is no adverse impact on co-operation, before any proposals are implemented. We expect to be given more detail about the GoCo proposals once the further inquiries requested by the Secretary of State have been concluded and before any decision is taken. Much of this will depend on the
detail of what is proposed—and on the other possibilities of dealing with the constraints currently experienced by DE&S. (Paragraph 133)

23. We recommend that, in order to recruit and retain particular staff with the requisite skills and experience, the MoD urgently develop and bring forward proposals for making the terms and conditions of civil servants and uniformed staff at DE&S more flexible pending the full implementation of the Defence Matériel Strategy. (Paragraph 136)

24. We realise that the staff reductions required of DE&S are likely to necessitate either outsourcing or reduced output or both. We expect to be informed in detail of what has been decided. Nonetheless, we commend Bernard Gray on his determination to optimise the new structure and ensure that safety should not be put at risk. (Paragraph 140)

25. We commend the government’s plans to bring together military capability and finance branches as an important way of shortening and simplifying decision-making. We also commend the decision to rebuild the MoD’s Cost Assurance and Analysis Service, whose function is to enable the MoD to make better value for money decisions through life, and we expect the work to continue. We expect to be updated on progress on these points. (Paragraph 145)

26. We commend the MoD on the creation of the Major Projects Review Board as a review and monitoring mechanism. (Paragraph 151)

27. We accept that not every threat can be predicted, and that therefore some system for urgent procurement will remain necessary. We recommend that further work be done to align the main equipment programme with the UOR system, to establish how the speed and other benefits of the UOR system can be imported into the main equipment programme. One method might be to consider and learn from the ‘FIST’ (Fast, Inexpensive, Simple and Tiny) process about to be considered by the US Government. (Paragraph 160)

28. We note that some progress has been made on programme and project controls and applaud the Department’s emphasis on costing, forecasting and the use of a broad range of performance indicators. However, it is unacceptable that major projects such as the A400M programme have slipped. Whilst it is still early days, this suggests that the Department’s Major Projects Review Board is not performing especially well. We recommend, therefore, that Key Performance Indicators and communication protocols are reviewed to ensure that senior leaders receive early notice of project difficulties. (Paragraph 168)

29. We note that there is acknowledged risk of single-Service stovepiping, with each Service looking only to its own needs without considering the programmes of the others, and acknowledge that the MoD is aware of this potential structural challenge to effective acquisition. We expect to be kept abreast of organisational mitigation plans to counter this tendency and would welcome examples of effective corporate intervention. (Paragraph 173)
30. We commend the MoD’s decision that in principle the terms of the Senior Responsible Owners of projects should be extended. We hope that this will include uniformed specialists, even though this may require changes to conventional military career patterns. We recommend that information on the average length of these terms be included in the Department’s Annual Report. (Paragraph 175)

31. It is important that emphasis on management skills in MoD is not allowed to sideline the contribution of military specialists, particularly now that the military, and indeed scientific, membership of the Defence Board has been reduced. (Paragraph 183)

32. We note also that reducing MoD staff, including DE&S staff while at the same time maintaining and improving the quality of the work carried out presents an intractable problem. The danger of a displacement of work from a reduced civilian staff to a reduced military staff would be unacceptable. Neither is it clear how the application of FIST and/or a new management construct for DE&S would provide any early alleviation of these problems. Particular consideration should therefore be given to both the pace and shape of civilian staff and military staff reduction, to avoid these problems and protect critical technical skill-sets. (Paragraph 184)

33. We recommend that the Department establish a clear knowledge of which equipment and support solutions are critical to national security and expect to be informed of the measures taken to secure supply. (Paragraph 188)

34. We recommend that when making acquisition decisions the MoD should explicitly bear in mind the need to preserve and regenerate the national skills base. (Paragraph 198)
1 Introduction

1. The acquisition\(^1\) of defence matériel—that is providing the Armed Forces with the equipment and services they need to carry out their work—is one of the primary functions of the Ministry of Defence (MoD).

2. It is all the more important that money is spent wisely, given that defence spending was 7% of GDP in 1955, 5% of GDP in 1985 (the year of maximum spending during the Cold War) while the defence budget today is 2.2% of GDP with an additional 0.4% paid from the contingency reserve for operations.\(^2\)

3. Successive Defence Committees have carried out regular inquiries into defence procurement, the last Report being published in March 2010\(^3\). We delayed the current inquiry pending the publication of the White Paper *National Security Through Technology*, which was expected in the summer of 2011 but which was in the event published in February 2012.

4. We announced the inquiry on 14 March 2012. The terms of reference were as follows:

   - The interaction between and mutual compatibility of the Gray and Levene reforms, and the extent to which the reforms are achievable in the light of the current and foreseeable restrictions on resources, including personnel, and the need for MoD Head Office and DE&S to continue to perform their primary functions.
   - How the requirements of national defence and security and the required capabilities are determined; how decisions are taken between alternative solutions and on whether and when projects should be initiated; how the balance of needs and resources is allocated between different services and commands; how the provision of support to the required capabilities is integrated into the acquisition; oversight of equipment budget; and the MoD’s relationship with industry.
   - The procurement processes used; relationship between principles of open competition and technological advantage; input from industry (including SMEs) and from the end military user; making the chosen acquisition strategy work; recruitment, training and retention of skilled personnel at both customer and procurement roles at all levels; transparency and accessibility of the processes; monitoring and control of projects.

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\(^1\) *Procurement* is simply buying a service or a piece of equipment.  
*Acquisition* involves knowing the whole life-cycle of the set of capabilities and capacity needed and the best means of delivery, employment, support and disposal.  
*Procurement* is measured in cost, *acquisition* is measured in value.

\(^2\) For the 2.2% budget figure, see Oral Evidence from Secretary of State on Securing the Future of Afghanistan, Q294. Expenditure Figures supplied by House of Commons Library, based on British Historical Statistics, Mitchell, UK Defence Statistics, DASA (provided by DASA official) and GDP Deflator Series - HMT

- Maintenance of the UK military industrial base; the provision of UK research and development by both MoD and industry; how far the White Paper provides clarity for industry; support for exports and the extent to which the principle of off-the-shelf procurement is compatible with this; how lessons have been learned from past successes and failures including in the acquisition of Urgent Operational Requirements; and the implications of bi- and multi-lateral procurement.

5. We received fifteen pieces of written evidence (counting multiple responses from the MoD as a single submission) and held three oral evidence sessions, one with ADS, (the trade organisation advancing the UK aerospace, defence, security and space industries), one with Peter Luff, MP, the then Minister for Defence Equipment Support and Technology (Min (DEST)), Bernard Gray the Chief of Defence Matériel (CDM) and Air Marshal Hillier, Deputy Chief of Defence Staff (Military Capability) (MilCap) and the third with the new MinDEST, Philip Dunne, MP. At a subsequent general evidence session with the Secretary of State for Defence we took the opportunity to question him about some acquisition developments.⁴ We were grateful for the Ministry’s willingness to engage closely on the issue both in London and during our visit to DE&S in Bristol, which we found very useful. We are grateful to all those who have helped us in the course of our inquiry, and to our advisers and staff.

⁴ The Work of the Ministry of Defence and the Armed Forces, HC 525-i MoD ev
2 The problem

6. The ultimate customers for defence equipment are the citizens of the UK through the front lines of the individual Armed Services. The acquisition process must provide a method whereby the equipment needs of the individual Services can be identified, costed, reconciled into an affordable portfolio, funded and satisfied throughout the lifetime of the equipment. Failures in the acquisition process can lead to loss of life. The organisation responsible for procuring the equipment is Defence Equipment and Support (DE&S), headed by the Chief of Defence Matériel. This organisation faces both ways: in its relationship with the Ministry of Defence it is a supplier, in its relationship with the actual providers of the equipment it is a customer. (It is also responsible for the equipment support chain, HM naval bases and the British Forces Post Office.)

7. Over the years defence acquisition has presented intractable problems, as the cost of programmes increased and they were delayed. The MoD said that it had been “the subject of numerous attempts at reform, including Smart Procurement, Smart Acquisition, the Defence Acquisition Change Programme and the Defence Acquisition Reform Programme. While each made progress in addressing key issues, serious problems remain”.5

8. Some caution may be appropriate when criticising MoD’s procurement performance. Lateness and greater-than-expected cost are not in themselves necessarily indicators of failure: Professor Taylor and Dr Louth pointed out that “a late and over-budget project can still be a success if it yields major benefits: the Houses of Parliament [the building] are a demonstration of this truth”.6 Moreover, the extension of the life of an acquisition programme post approval can frequently lead to cost escalation as a natural relationship between the dynamics of time and cost against fixed requirements and a change in the environment. Nor is UK defence procurement uniquely bad compared to other countries, though, as the Chief Operating Officer of Defence Equipment and Support observed in 2010, “it is always cold comfort to observe that others are failing in the same way as oneself”7

9. On 14 May 2012 the Secretary of State, Rt Hon Philip Hammond, MP, announced that, with the completion of Planning Round 2012 (PR 12), the defence budget had been brought into financial balance. He announced that over the next 10 years, the Government would spend almost £160 billion on new equipment and data systems and their support. This expenditure reflected the planning assumption agreed with the Treasury of a 1% per annum real increase in the equipment and support budget from 2015). Of the total planned spend, £152 billion was in the core committed equipment programme covering investment in new equipment and data systems, and their support. For the first time that committed sum included an effective, centrally-held contingency reserve of more than £4 billion. £8 billion remained unallocated. The ten-year equipment plan, which includes some 900

5 Ev w49
6 Ev w35 para 11
7 Paper by Chief Operating Officer DE&S, DES/COO/117/6(19)
projects, would be published once it had been examined by the National Audit Office (NAO)\(^8\) and this was expected to be repeated annually.\(^9\)

10. Further information as to how the budget had been brought into balance was provided by the Secretary of State in a letter to the Committee dated 13 August.\(^10\) He declined, for reasons of both commercial and national security sensitivity, to provide details of the breakdown.

11. Whatever the exact size of the deficit, it is common ground that the defence budget had previously been out of balance for many years. The main component of this imbalance has been the equipment budget.\(^11\) Commitments were made for which insufficient money was available, unrealistic costings were offered and accepted and projects delayed in order to reduce immediate financial commitments with resulting increased costs at a later stage. In 2009, Bernard Gray (now Chief of Defence Matériel), in his Report *Review of Acquisition for the Secretary of State for Defence*\(^12\) found that projects overran on average by 80% or five years and cost more than 40% or £300 million more than estimated. He told the Committee on 15 May 2012 that the problem was costing £1.5 billion a year on average.\(^13\)

12. The MoD wrote that the problems over the equipment budget had arisen as a result of complex and inter-related factors, and that the underlying reasons varied, but ‘Matériel Strategy analysis has identified three root causes:

- the overheated programme;
- the weak interface between DE&S and the wider MOD that results in poor discipline and change control; and
- insufficient levels of business capability [and programme management competence] in DE&S for the size and complexity of the programme it is asked to deliver.\(^14\)

13. There are several reasons for the cost overruns, one directly related to time. Peter Luff said:

If you look at the catalogue of late-stage cancellations of projects, direct cost overruns, the indirect cost of spending time on projects that were extended, the cost of interim consultations when things were delayed, life extensions and legacy platforms, it adds up to a very big bill that we want to get rid of to improve the capability we have for the Armed Forces.\(^15\)

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\(^8\) HC Deb (2012–13) 14 May 2012, col 263
\(^9\) Q55
\(^10\) Written evidence appended to oral evidence given by Secretary of State in the Work of the MoD and the Armed Forces, 12 July 2012
\(^11\) Q70
\(^12\) *Review of Acquisition for the Secretary of State for Defence: An Independent Report by Bernard Gray*, October 2009
\(^13\) Q96
\(^14\) Ev w49
\(^15\) Q92
One aspect of this has been the deliberate extension of projects to save money in-year, which has had the effect of increasing costs in later years, to which we drew attention in our Sixth Report of Session 2009–10:

According to the NAO, in recent planning rounds the MoD’s strategy for managing its unaffordable equipment plan has been to re-profile expenditure by delaying projects so as to reduce costs in the early years of the plan. However this practice increases overall procurement costs and represents poor value for money. It is clear from NAO data that the 2008-09 re-profiling exercise added £733 million to the future costs of the core equipment programme.16

14. In some cases the problem is not only one of cost and time overruns. If a decision is taken on the basis of inadequate information, the consequences can be serious. One of the latest, and most spectacular, examples of the procurement system getting it wrong must be the decisions regarding the aircraft to be flown from the Queen Elizabeth class aircraft carriers. In 2010 the MoD decided to change from the F35B variant of the Joint strike Fighter to the F35C. It was subsequently discovered by the Department that the design of the ship was not, in fact, easily convertible to accommodate the F35C and the aircraft will now be the F35B as originally planned. The MinDEST told us:

I think the fundamental misunderstanding that many of us had was that these carriers would be relatively easy to convert and had been designed for conversion and for adaptability. That is what we were told. It was not true. They were not. They were physically big enough to accommodate conversion, but it came at a higher price than was apparent at the time when the decision was taken...It is not my belief that they were genuinely designed for conversion, or that the contract allowed them to be designed for conversion. It was an assertion that was probably unfounded. That is my view.17

This policy change may already have cost £100 million in nugatory expenditure18, but the final through-life cost and strategic implications are as yet uncalculated.

15. The decision in 2010 to change to the carrier variant of the Joint Strike Fighter was the largest single procurement decision in the SDSR. It is clear that the decision was rushed and based upon incomplete and inaccurate policy development. It was taken without the MoD understanding how the change could be implemented. Perhaps the primary example of how little the MoD understood about this decision is the fact that it was supposed to improve interoperability. This turned out to be incorrect. This decision ultimately led to increased costs to the carrier strike programme and a delay in the in-service date of the carrier. It could also be argued that it provided a rationale for the early decommissioning of the Harrier. We urge the MoD to learn the lessons of this closed, rushed and flawed decision of 2010.

17 QQ153,154
18 Q143
16. Another problem identified by Bernard Gray was the weakness of the interface between MoD Head Office and DE&S. He explained that the problem was partly about decision-making and partly about programme control: the department was being asked to cost “more and more changes to the programme all the time, so that the whole programme is in a constant state of flux”, which was very destabilising and expensive in terms of staff time. Such requests, running at a rate of 1,000 a year, were very distracting and, in the event, even if no changes were made, absorbed a huge amount of effort in the organisation.¹⁹

17. There is also cumulative pressure from the individual Services. Bernard Gray said in evidence on 15 May that these had “argued relentlessly for their thing” and that the end result had been “a number that was significantly bigger than the amount of cash. There wasn’t a process that existed to prioritise those things”.²⁰

18. Last but not least is the problem of over-optimistic cost estimates. The Public Accounts Committee concluded, in its Thirty-Third Report of Session 2007–08 that the MoD and industry were combined in a “conspiracy of optimism”, a term which has now become a commonplace of the debate:

There is a ‘conspiracy of optimism’ in the project teams and industry which also extends to the leadership of the Department, who often appear willing to accept an estimate that is the nearest match to the available resources. There is a perception that equipment can be brought into service at a lower price, but with little hard evidence to support such an assumption.²¹

19. They gave as an example the Landing Ship Dock (Auxiliary) project for which the initial budget for which the cost of the initial contract—£332 million—was exceeded by 80% when historical trend analysis showed the price of £589 million for the four ships to be within the expected likely range. Another example of over-optimistic costings involved the Type 45 Destroyer where the NAO concluded that the omission of development costs from the estimate resulted in each ship costing over £100 million more than would be typical for a similar type of warship.

20. ADS, the trade association of the UK aerospace, defence, security and space industries, agreed that industry had got its costings wrong in the past, adding that industry had recently suffered financially for this under the penalty system now in place. ADS cited the £5 billion write-off on the A400M aircraft as an example of industry’s bearing these costs, adding that there would be no more “cavalier” or “optimistic” costings.²² It resisted as cynical the suggestion that a weak or fragmented MoD procurement system would be in the interests of industry, Sir Brian Burridge saying “we do not want contractual terms that are flaky, ambiguous or particularly beneficial to ourselves” and that industry’s greatest wish was that the MoD should be “a great customer” in order that they might be “a great supplier”.²³

¹⁹ Q90
²⁰ Q87
²² Q11
²³ Q19
21. We note that the problems leading to the overheating of the defence budget have been identified and the expressed willingness of the parties to address them. We shall be monitoring progress on this.
3 Acquisition Principles: The White Paper

22. The White Paper *National Security Through Technology* is explicitly part of “the process of transforming both the Ministry of Defence itself and the UK Armed Forces, as embodied in the vision of Future Force 2020” (the “defence transformation process”). The requirement for it is set out in the foreword over the names of both the Minister for Defence Equipment, Support and Technology and the Home Office Minister for Crime and Security:

This is a huge task. It is not enough to tackle the serious over-commitment in the defence equipment and support programmes that we inherited from the last Government; nor to implement the Levene review and give the military the ability and responsibility to make real capability trade-offs. It is not enough to turn Defence Equipment and Support into an organisation fit for purpose through Bernard Gray’s Matériel Strategy work; nor to bring our regulations for single-source contracts up to date, as outlined in Lord Currie’s independent report. It also means taking a new approach to buying and supporting defence and security equipment from industry.

23. The White Paper sets out the principles according to which defence acquisition is to be carried out:

Wherever possible, we will seek to fulfil the UK’s defence and security requirements through open competition in the domestic and global market.

Which will be qualified by the principle of Technology Advantage:

We will take action to protect our operational advantages and freedom of action, but only where this is essential for national security.

24. Other major themes are:

- off-the-shelf procurement where possible
- the desirability of a common set of open principles ensuring flexibility and interoperability
- increased access to MoD contracts for small and medium-sized companies (SMEs)
- greater integration of support services provided by industry (little detail is provided here)
- more working with other countries
- spending on science and technology
- support for exports

25. According to the Ministers, the White Paper is “our high-level statement of our approach. Coupled with the publication later this year of the MoD’s ten-year equipment
plan, it will give the clarity that will help industry to invest in the right areas, protecting both our security and the contribution these companies make to the UK economy”. It is “our high-level policy until the next strategic review, which is expected to be held in 2015. It supersedes previous strategy documents”. The Ministers claim that “it provides a clear guide to industry and to the acquisition community that should endure beyond the next SDSR”.

26. As industry representatives told us, and as the MoD admitted, there remain a number of gaps in the information. While the review of the single source pricing regulations (the “Yellow Book”) conducted by Lord Currie has now been completed, the publication of the ten-year equipment plan (see paragraph 9), a decision on the future of the DE&S, and the publication of the Government’s key technological priorities are still awaited. All these contribute to the uncertainty felt by industry. As Sir Brian Burridge put it, any uncertainty is, from a business point of view, unhelpful. Peter Luff agreed, but thought that “at the end of the process... there will be a greater level of certainty than the defence industry has ever had in this country”, and Bernard Gray thought that the defence industries already had a very enviable degree of certainty on the basis of which to plan.

27. On 13 November 2012 we invited the new MinDEST, Philip Dunne, MP, to update us on the outstanding information. We were told that the ten-year equipment plan was with the NAO, that it was expected back “soon” and would then be published. Asked about the priorities for science and technology the Philip Dunne said that the work was “ongoing”:

> There is a meeting next month to review where that work has got to. I have had meetings with the Chief Scientific Adviser and the chief executive of the Defence Science and Technology Laboratory...I have regular briefings. I chair the Defence Research Board, which is meeting before the end of the month, so there is work going on. I do not have a precise timetable for when we will produce the output from that work, but it is ongoing.

28. We sympathise with the impatience of the defence industries in the face of the slow timescale for producing promised information and urge the MoD to accelerate the publication of further material to flesh out the bones of the White Paper. The Equipment Plan should be published as a matter of urgency without awaiting any NAO input or commentary.

29. A degree of ambivalence is apparent in the White Paper’s view of the UK’s defence requirements. On the one hand, it states that “in many respects the UK’s defence and security requirements are just like the requirements of the National Health Service” but

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24 National Security Through Technology, foreword
25 Ibid 1.1.3
26 Ibid foreword
27 40% of defence procurement is single-source procurement conducted under the Single Source Pricing Regulations
28 Q5
29 Q75
30 Q75
31 Q163
32 National Security Through Technology 1.3.8
goes on to say that "defence and security sectors are in two fundamental respects different from other fields." Or, as Professor Kirkpatrick put it:

The White Paper appears to be torn between an ideological faith in open competition, reinforced by its perception that the UK’s defence requirements 'are in many respects just like' other areas of public procurement, and its admissions elsewhere that defence procurement is fundamentally different.

30. While most witnesses broadly welcomed the White Paper, we received adverse comments on a number of specific aspects. We consider some of these below. While we address them individually, there are linkages between them.

**Value for money**

31. The White Paper emphasises the importance of achieving value for money in defence spending. However, value for money is difficult to measure, and can be subjective. Dr Louth and Professor Taylor, not entirely facetiously, suggested that the term should be rested for a year so that Ministers were obliged to say what they actually meant. Asked what he meant by it, Peter Luff quoted the definition in a footnote to the White Paper:

Value-for-money is the optimal combination of time, cost, and effectiveness, within available resources. It is a relative concept, which involves the comparison of potential and actual outcomes of different procurement options. Value-for-money for each programme is determined on a case-by-case basis, depending on the circumstances. Non-quantifiable factors may be relevant to value-for-money assessments, such as a supplier’s track record and financial robustness.

32. CDM drew attention to importance of time as a factor in value for money decisions:

There is an art here of balancing when the appropriate time is to make a decision that allows you some degree of flexibility and optionality about the future, but does not make you either wait so long that you never deliver anything and therefore you have zero capability, or you try to guard against every possible outcome and then spend a huge amount of money, 90% of which might be wasted because a lot of those options never turned up.

33. The concept of value for money used by the MoD takes no account of wider economic or social effects. In its definition of "value for money", the White Paper states that MoD "does not consider wider employment, industrial or economic factors in its value for money assessments". In this, the MoD differs from its French equivalent, and indeed from the United State of America. EADS wrote:

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33 Ibid 1.4.11  
34 Ev w36, para 17  
35 Ev w36, para 17  
36 National Security Through Technology, 1.2.4 fn 6  
37 Q82  
38 National Security Through Technology 1.2.4 fn 6
The White Paper’s feeble support to British Industry is in striking contrast to the model in continental Europe where for major projects a cross-Departmental approach focuses on cost and value to the nation as a whole. There appears to be no mechanism in the UK to measure the cross-government impact of a contract going overseas, where short-term redundancies and long-term loss of skills shift the problem from MOD to the DHSS and other Departments: good value for money for MOD perhaps, but poor value for the nation.39

A defence industrial strategy?

34. It is clear from the White Paper that it is not intended to be a defence industrial strategy. This is a departure from the approach of recent administrations (for instance, an explicit Defence Industrial Strategy was promulgated in 2005).

35. ADS confirmed that the White Paper should not be seen as a defence industrial strategy. Rather it represented a methodology. Graham Chisnall said:

I do not believe, as we look at it, that the White Paper was designed to be a defence industry strategy. There is an underpinning methodology to the White Paper; it is about the procurement model that the MoD has engaged with. It states that the procurement model is driven by the underpinning criterion of value for money, and the value for money definition precludes any account of manufacturing or industrial impact on the UK. It actually states emphatically and clearly that it has nothing to do with manufacturing or industry in the UK, so it is not a defence industry strategy by definition.40

36. The written evidence of some of ADS member companies was much more critical of the absence of a UK defence industrial strategy than the ADS oral evidence. Finmeccanica wrote that “the White Paper does not promote a defence industrial strategy. Rather, it articulates an argument whereby a minimalist approach to operational sovereignty is gap-filled by a wholesale preference for off-the-shelf acquisition”. Others suggested that it put UK manufacturers at a disadvantage when compared to countries which have one. EADS wrote “the result is beginning to show with France, where the UK is beginning to adopt or be guided by the French industrial strategy”.41

37. The French approach attaches more explicit importance to the domestic defence industrial base. It was summarised in 2007 by General Auroy, Head of the Delegation Générale de l’Armement (the French Armaments Agency)

As far as France is concerned, defence-acquisition policy is considered an important lever for developing the performance of this defence industrial base. This policy is based on a principle of competitive autonomy relying on domestic suppliers but also on European capabilities. Our main goals include optimizing the economic efficiency of the investments made by the Defence Ministry to meet the French armed forces’ requirements. To do that, a large priority is given to market mechanisms and

38 Ev w11, para 35
40 Q4
41 Ev w11, para 38
competitive bidding, whenever possible. Another goal involves guaranteeing access to the industrial and technological capabilities needed for the long-term fulfilment of these requirements. This, in turn, involves three important objectives: long-term security of supply for the armed forces (a matter clearly of paramount importance); unrestricted use of the equipment procured; and the possibility of exporting the equipment to friends and allies in accordance with international regulations.  

We note, however, that the French *Livre Blanc*, the equivalent of the SDSR, is currently being rewritten.

38. Sir Brian Burridge explained the importance of a national defence industrial base in terms of a "body of knowledge", and why the UK, in particular, needed that body:

A nation decides what its military power is going to be, and that military power has two elements: an envelope of capability and its intent to use that capability. The UK is somewhat different from other nations, because its intent is very forward-leaning—the notion of standing alongside our allies...means that we tend to need to react to the unexpected, react quickly, and get it right. So that capability envelope has to be constantly manipulated, and we manipulate that—as a former senior commander—by absolutely understanding how our kit works and training aggressively...When it is necessary to go into an operation—and targeting is a good example—it may often be necessary to modify weapons and the way they work, or accelerate the introduction to service of weapons, and in 2003 in the Iraq war we accelerated Storm Shadow into the inventory...this can be done because you can reach out and touch the body of knowledge... So when it comes to explaining to Ministers that you need to use that weapon to address particular targets—in Iraq, air defence bunkers with 3 metres of concrete on was a classic example—then you have to be able to explain to the Minister, but not in terms of "Well, we’re not quite sure, because it says it will do this, but we really don’t understand it". You have to be able to say with certainty, “The collateral damage implications of this weapon are:” and then the Secretary of State will go to the law officers and say, “This is a legitimate approach.”...Other nations do not do it that way—they wait, they use whatever standard they have, and they address only those targets for which they have weapons that are well proven and so on.  

39. In previous generations it was widely accepted that ‘life cycle’ or ‘through life’ costing should form the basis for selecting the contractor, ie bringing together up-front costs, the likely cost of upgrades and maintenance to assess value for money. The purchase of equipments from a contractor which may not be available to update the equipment or maintain it arguably represents a significant step backwards.

40. The then Minister, Peter Luff, accepted that the MoD’s stance, in not taking wider considerations into account, was “quite controversial”.  

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43 Q45
44 Q78
process and funded it from the industrial budget, the use to which it is put being secondary. In explanation he said:

We are one of two nations in Europe of significant size that routinely deploy, engage in overseas operations and actually fight wars and maintain the peace—ourselves and France. When we buy equipment, we have to be very ruthless about the purpose to which we are putting it. It is there to make our military capability robust and to ensure that our soldiers, sailors and airmen are able to fight the wars we ask them to fight. The overwhelming requirement must always be the military capability it delivers. We have to be quite hard-hearted about the other considerations—regional impacts and so on. We need to protect our people and make sure that they can do their jobs well. The value-for-money assessment does not take account of those wider economic factors.45

Given that we have here two nations with similar-sized defence budgets which routinely deploy, engage in overseas operations, fight wars and maintain the peace in the same way, and yet take different approaches to defence acquisition, this explanation says nothing more than “we have decided to do it differently” and takes the argument no further forward.

41. We believe that the absence of a defence industrial strategy which supports appropriate national sovereignty puts the UK at a disadvantage against competitor countries. Furthermore, we do not understand how we can have confidence in a national security strategy which does not show a clear grasp of what is needed for the defence of the United Kingdom, and how this can be ensured. We recommend that the Government reconsider the wisdom of not having a defence industrial strategy.

**Open procurement**

42. The White Paper insists that the UK must protect its operational sovereignty. It describes the essence of sovereignty for a state as “having the ability to determine our internal and external affairs and act in the country’s interests free from intervention by other states or entities, in accordance with our legal obligations”.46

43. The White Paper specifies that the MoD will use open procurement wherever possible. This means fulfilling the UK’s defence and security requirements through open competition in the domestic and global markets [our italics] unless it is necessary for UK national security to protect our operational advantages and freedom of action which are necessary to protect sovereignty (the principle of technological advantage). It suggests that as well as resulting in the greatest possible advantage for the UK’s defence forces and security agencies this approach will “offer the best catalyst for UK-based industry... to be efficient and competitive and provide them with the best chance of increasing their profits and market share and reducing the tax-payer’s cost of purchase”.47

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45 Q78
46 National Security Through Technology 3.1.1.53
47 Ibid 1.3.19
44. In response to the Green Paper which preceded the White Paper, many companies requested that the White Paper should include a list of the areas which would be protected for reasons of national sovereignty. The White Paper’s response to this is that “at a time of constrained budgets and unpredictability of threat, we believe it is more appropriate to set out our understanding of what operational advantages and freedom of action we need to protect and what steps we will take to preserve the minimum elements necessary to protect our national sovereignty”.48 When asked to be more specific, the MoD said:

   The Chairman has already indicated that this is likely to be a running discussion. We are determined to allow open competition for as many projects as we possibly can, recognising that there are certain capabilities where single-source procurement is the logical and appropriate way to go.49

45. The White Paper accepts that there are some capabilities possessed by defence suppliers that are critical to our national sovereignty and must be protected on-shore. We expect the MoD to be clear about the capabilities that fall into this category and to have a clear sustainability plan developed with UK industry.

Commercial off-the-shelf acquisition

46. The White Paper emphasises that equipment is to be purchased ‘off-the-shelf’ when possible. Commercial off-the-shelf purchasing is usually known as ‘COTS’. The White Paper explained:

   In our drive to deliver value-for-money, we will buy off-the-shelf where appropriate, in accordance with the policies set out in this paper, because this generally allows the UK to take full advantage of the cost benefits of buying from a competitive market. This approach applies to systems, sub-systems, and components.

   Off-the-shelf procurement usually involves less risk, in terms of capability, timescale, and cost because we are buying mature solutions to our capability requirements, based on well-developed and understood technologies.50

47. ADS agreed that the advantage of COTS procurement lay in avoiding development costs, shortened delivery timescales, possible use of established training systems and other operational user support. They suggested that on the downside, modifications, some of which might be necessary for legal and mandatory reasons, might be expensive and even impossible or unaffordable, and compromises in performance, characteristics, cost and sovereignty might be necessary. The UK defence-industrial base, and the skills base which it fed, was thus at risk of degradation.51

48. Another disadvantage, noted by Intellect (who nonetheless supported COTS in principle) was the danger that security of supply might be disrupted.52 Circumstances in

48 Ibid Foreword
49 Q165
50 National Security Through Technology 2.2.25
51 Ev w2
52 Ev w18, para 11
which this might occur would include, in the event of purchase from company based outside the UK, that the home country would require the equipment itself at short notice or would decline, for political reasons to supply it.

49. Off-the-shelf equipment may be modified, in which case it becomes Modified Off-the-Shelf or MOTS. Modifying off-the-shelf equipment in itself carries a risk: the White Paper cites the successful modification in 2006 of the Mastiff protected personnel vehicle (originally a US model) to bring it into line with UK standards and the less successful acquisition of eight Chinook Mk 3 helicopters in the 1990s where the modification of the cockpit caused difficulties. Nonetheless, MOTS has the advantage of not closing down export opportunities because equipment can be bought from abroad, modified and then re-exported.

**Open systems and the modular approach**

50. “Open systems” is a term taken from computing. An open system is an open source operating system typically composed of coordinated modular components from a number of sources and not reliant upon any proprietary elements. Characteristics of open systems include the exposure of the source code, which is thus available for understanding and possible modification and improvement; portability, which allows the system to be used in a variety of environments, and interoperability, which allows the system to function with other systems.53

51. The White Paper emphasises the utility of open systems for defence acquisition:

To allow maximum use of open competition from the domestic and global market and enable us to buy off-the-shelf as far as possible, we will make greater use of open systems. These are systems which are based on publicly known standard interfaces that allow anyone to use and communicate with equipment that adheres to the same National Security Through Technology 22 standards. Open systems enable us to join together and use equipment that was made in different times and places, thus creating more scope for upgrading and easing interoperability with new capabilities. Further, they allow the use and replacement of high-volume generic components within systems, opening up opportunities for off-the-shelf components.54

52. Once again, some witnesses, while agreeing in principle that open standards were desirable, felt that insufficient detail had been provided. Intellect said:

Industry requires a clear definition of what the MOD means by open standards. Industry felt that this was not sufficiently addressed in the white paper, as there are multiple versions of open standards. As a result, Intellect recommends that the MOD develops a list of open standards that it and industry must adhere to. The standards on this list must not be bespoke, UK-developed standards, as this would drive suppliers to developing bespoke capabilities, close off export markets, and make it difficult for the MOD to purchase OTS solutions. Instead, the MOD should leverage commercial and international standards (where they are the norm) when drafting

53 http://searchenterpriselinux.techtarget.com/definition/open-system
54 National Security Through Technology 2.3.37
this list—this would enable both the MOD and industry to tap the widest possible market.\textit{\textsuperscript{55}}

53. We recommend that the MoD work with industry and other Government Departments to ensure that where it is appropriate to use open standards these should be consistent, widely publicised and promoted as a matter of course.

54. Related to open systems is the concept of modularity, whereby new platforms (ships, vehicles, aircraft) are designed in such a way that individual pieces of equipment could be replaced easily as events dictated or new versions became available. It is no longer simply a way of replacing equipment that is broken. Sir Brian Burridge explained:

\begin{quote}
The nearest equivalent to a modular approach is the personal computer that we all take for granted, where it has a veritable open system architecture and you can buy whatever applications you like, and you know they'll work. You can buy any printer you like and 90\% of the time it will work. And you can plug it into a network, and it will work because there is a universal open system of architecture, which is defined as standard.

If we reach this nirvana, say with aircraft, we will have a central architecture into which you as a customer can plug your own bespoke capability, whether that be a certain sort of radar or a certain sort of infra-red sensor, or whatever. If the baseline architecture comes with modules, either stated by you because that is what you want or this is the standard and they can be switched around, that is a modular approach. As technology changes and as you wish to spiral develop a platform's capability, you substitute different modules. Frankly, the science of armoured vehicles is moving in this direction. The science of aeroplanes is just about there, but not entirely.\textit{\textsuperscript{56}}
\end{quote}

MinDEST Peter Luff, MP, also talked about the flexibility that came with modularity:

\begin{quote}
The generic vehicle architecture, for example, that enables you to plug systems into existing vehicles—the Type 26 global combat ship that will be based on a very modular approach will mean that you can actually take things out and put things in much more easily and ensure that what you do acquire is inherently more flexible as well. It is not just flexibility in our approach to buying things, but the actual platforms will be more flexible and be able to cope with those change requirements and threats as well.\textit{\textsuperscript{57}}
\end{quote}

While open systems, allowing a wider variety of suppliers, facilitate modularity, it can be achieved in other ways through MoD specifications or if only one supplier is used.

55. CDM said that modularity carries its own specific risks, saying “if you try to maintain complete flexibility for ever or to allow a platform to be ultimately flexible to do everything, either your never make a decision or you end up with a platform which is an all-singing, all-dancing, very expensive thing”.\textit{\textsuperscript{58}} Equally, a completely new development might arise,

\begin{footnotes}
\textit{\textsuperscript{55}} Ev w20, para 27  
\textit{\textsuperscript{56}} Q42  
\textit{\textsuperscript{57}} Q74  
\textit{\textsuperscript{58}} Q81
\end{footnotes}
invalidating all previous assumptions. We question whether the notion of modularity has been properly understood; it is possible to have a relatively simple platform to which different pieces of equipment can be added as they become available or need arises.

56. In this context we were interested by the views of Colonel Dan Ward, of the Office of the US Secretary of the Air Force for Acquisition who argues that rather than focusing on the acquisition of large, technologically-advanced projects with a long time-scale (and therefore enhanced opportunities for going wrong), Ministries of Defence should implement a policy of fast, inexpensive, simple and tiny (FIST). Colonel Ward said that such an approach could be used even in the case of large pieces of equipment such as submarines. Such a policy might be expected to encourage modularisation.

57. The thrust of Ward’s premise is that the more money that is budgeted, the larger the team fielded to do the work, and the longer the time scale allocated to any project, the more likely it is to fail by being over time and over budget. He suggests that “when we do not have a lot of time or money, we find interesting ways to use the tools around us” and recommends that complex programme and project decisions across a full spectrum of defence acquisition activities should be undertaken following these principles of “fast, inexpensive, simple and tiny.” There is some evidence that these values have been implemented by a small, but growing, band of practitioners across the US Departments of Defence and Homeland Security. It would be sensible for MoD to benchmark current practices against this US initiative, especially as Ward has been appointed to the White House to promote his thinking across broader governmental procurement and acquisition initiatives.

58. **We recommend that the Department reviews and benchmarks itself against the US “Fast, Inexpensive, Simple and Tiny” initiative.**

**Exports and economic benefits**

59. Having announced that many defence contracts will be subject to open competition, the White Paper goes on to stress the importance of exports and the efforts the Government is making to promote them, saying:

> A well-regulated trade in defence and security products helps the Government to underpin strategic relationships and enhance the security capacity of our allies. We value highly the important role of defence and security exports in strengthening the UK economy and are clear in our commitment to promoting them overseas.61

60. The Government, including the Foreign and Commonwealth Office (FCO), is to take a more dynamic approach to fostering exports.62 According to the White Paper:

> The FCO launched its “Charter for Business” in May last year. The Charter is a public expression of what the FCO can do for UK business and demonstrates the

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61 National Security Through Technology, Summary para xiii
62 Ibid
FCO’s determination to play its part at home and overseas in building Britain’s prosperity. The Charter clearly sets out the FCO’s commitment to help UK business capitalise on every opportunity available overseas as well as promoting the UK as a place to invest.\[63]\n
A Director has been appointed to take overall responsibility for export issues within MoD, and “the MoD will consider exportability issues early in the acquisition cycle”.\[64]\n
The White Paper also followed by the announcement of the Defence and Security Industrial Engagement Policy (DSIEP), “a new approach towards engagement with overseas-based defence and security suppliers [aiming] to encourage those companies to invest in defence and security sectors in the UK. We note that Ministers, including the Prime Minister, have been actively promoting exports in the course of visits abroad.

61. The number of defence attachés has been shrinking annually since 2006, from 127 in that year to 111 in 2012, and the number of defence sections has reduced from 84 to 73 over the same period.\[65]\n
We asked Mr Dunne about this apparent discrepancy between the encouragement of exports in the White Paper and the reduction in the number of specialist FCO personnel and his answer suggested that concentration of effort was more important than numbers:

I do not have figures in my head for six years ago, but compared with two and a half years ago when the Administration came in, we have gone through a rejuvenation of enthusiasm for ambassadors, commercial attachés and defence personnel as to the relevance of defence exports as part of their role. Once we have decided that we are prepared to sell equipment to a country, the individuals in post have a refreshed vigour in their step when it comes to speaking up for defence contractors and seeking to help them secure contracts overseas. That goes not just for the civil servants and military personnel engaged, but for the politicians.\[66]\n
62. As we have pointed out above, not all countries open their defence equipments markets as freely as the UK. The Government response is to suggest that the policy of other countries could be influenced in the direction of more open markets. The Government will:

Continue to promote open markets in defence and security capabilities. Our overall aim is to secure freer access to these markets, improve the flow of defence information and technology across borders, and to enable the UK defence industry to compete on merit in other markets.\[67]\n
Peter Luff said that the tide was turning in the UK’s favour:

The European Commission has made it clear that it wishes to drive forward the single market in defence equipment and support, which is something that I welcome.

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\[63\] National Security Through Technology 5.2.2.173
\[64\] Ibid 5.4.212
\[65\] HC Deb 2012–13, 1 November 2012, col 372w
\[66\] Q208
\[67\] National Security Through Technology 4.4.155
Britain has got an open market, and I think that the European Union presses that agenda more robustly through the Defence Procurement Directive. That has been incorporated into law across Europe now, I think in every member state; certainly it has here in the UK. As those requirements are enforced through the European Court of Justice, we will see more and more opportunities open up for British defence equipment manufacturers to supply in the European market, so we are on a level playing field within the European Union. The same rules apply, and the same exemptions for warlike stores apply, under article 346, and I think you will see them enforced with increasing robustness by the European Commission. That is not something we have anything to fear from. The openness of our market should mean, in fact, that we gain from that process.\(^{68}\)

63. Several witnesses put to us the argument that if the UK does not buy a piece of equipment there is little to encourage others to do so.\(^{69}\) Peter Luff’s response to this was:

> I do not accept that it is an absolute precondition for an item of defence equipment that is to be sold to an overseas customer that it should be sold first to the British MoD. It is desirable and it often helps—of course it does—but we have outstanding Armed Forces with outstanding equipment, and all kinds of advantages accrue from co-operation in export sales—not just financial and capability ones, but ones relating to the relationship between armed forces and countries. There are huge soft power diplomatic advantages, too.\(^{70}\)

64. The evidence of some witnesses suggested that, in contrast to the vigorous support given by competitor (and even partner) countries to their domestic industries, Peter Luff’s view that things were getting better looks unhelpfully Panglossian. As the Royal Aeronautical Society put it “hoping that others will follow by example or persuasion offers little protection in a hard commercial environment where other national industries are well supported by government and access to markets closely monitored and controlled”.\(^{71}\)

65. Moreover, the Royal United Services Institute for Defence and Security Studies (RUSI) published in January 2012 a briefing paper which addressed tax revenues from defence acquisition in the United Kingdom.\(^{72}\) The authors argued that in defence acquisition the tax revenue implications of specific programme choices are frequently overlooked and, given that the government is committed to reducing the public budget deficit as both a fiscal and national security imperative, the tax revenue implications of MoD decisions must represent a salient issue to any acquisition process.

66. When a government spends money with a defence contractor, some element of that money is paid to one government or another in the form of taxes. If the government spends money on a UK contractor with a largely British supply chain the great majority of that tax will flow back to the British Government, whereas a

\(^{68}\) Q119

\(^{69}\) Eg Ev w20, para 29

\(^{70}\) Q115

\(^{71}\) Ev w29, para 4

significant part of money spent with an overseas contractor typically becomes a source of revenue for another country. Using data and assumptions drawn from an actual programme of work, a project-based financial model was constructed demonstrating that an MoD contract placed with UK industry yielded 36 per cent of the contract value back to the government in the form of tax and national insurance payments. This represents a significant national discount to the taxpayer and should be taken into account.

67. The Government is faced with a serious dilemma and one it does not address in the White Paper: whether to encourage national protectionism, with the risks of greater cost, less efficiency and interoperability or to allow the national industry to decline, with all the consequences in loss of skills, intellectual property and, eventually, military, capacity that would follow.

68. While we commend the Government’s commitment to encouraging defence exports it is clear that the playing field is not level. We recommend that the Government keep under review the reciprocation by other countries of the UK’s commitment to open procurement. If it transpires that others are not prepared to give to UK industry the opportunities the UK gives to theirs, it might become necessary for the Government to reduce its open procurement.

69. The overriding reason for the purchase of any item of defence equipment must be its quality and the requirements of the Armed Forces. We consider nonetheless that the Government should take into account in buying equipment the enhanced opportunities for export of equipment in use by UK armed forces. Defence equipment sales carried out within all the constraints of national and international law bring with them significant benefits to the UK in terms of employment opportunities, economies of scale and enhancement of influence.

70. Defence Equipment and Support should be directed to take account of tax revenues when conducting investment appraisals and this should form part of a rounded government decision-making process.

Working in alliances

71. The White Paper stresses the importance of working with other countries on defence and security procurement. It gives two reasons for this: first, the economies of scale and ability to pool resources, and secondly, the possibility of sharing technologies and aspects of capability. The Government feels that national sovereignty need not be diminished by this, provided that the UK retains the operational advantages and freedom of action it judges necessary. The Government’s preference is for bi-lateral co-operation as offering the best balance of advantages and disadvantages (though it will continue to work multi-laterally, through, for instance, NATO and the EU). The two partners cited in the White Paper are the USA and France, and most witnesses concentrated on these, though Saab, not surprisingly, put in a plea for co-operation with Scandinavian countries.
72. Witnesses accepted that collaboration with other countries on the production of major weapons was probably inevitable. As the Royal Aeronautical Society put it, “given the economics of weapons development, the approach has been the only way to maintain key capabilities on shore”. Nonetheless, such collaboration has disadvantages.

73. One disadvantage is delay: the more countries involved and the more sets of rules had to be complied with, the longer a process is likely to take. Another is that where one country had a strong industrial or defence-industrial policy and the other does not, the companies in the former tends to benefit more. EADS talked of the “feeble” support given to British industry compared to what happened in other countries and gave the example of the bi-lateral agreement with France:

UK does not have an effective national defence and security industry strategy. This is in contrast to France, Germany and most other advanced industrial countries. The result is beginning to show with France, where the UK is beginning to adopt or be guided by the French industrial strategy. ...The bi-lateral agreement with France is supposed to be just that, two-way. But there is no evidence that France is opening up its defence market to UK based companies, yet the UK actively encourage French companies to go after UK domestic defence contracts. Recent announcements on UK-French collaborative Unmanned Air Systems showed that the technology study contract is to be let by DGA, not MOD UK as originally planned.

74. Similar problems arise when collaborating with the USA. The White Paper cites the USA as the UK’s major bilateral acquisition partner, saying that “collaboration with the US offers access to cutting-edge research and technology and improved interoperability with our major ally” and refers to the US-UK Defence Trade Co-Operation Treaty, which aims to speed up the delivery of equipment and enable easier sharing of information, by removing the need for US export licences in some circumstances. Industry witnesses were less optimistic, ADS pointing out that the ‘US has a “buy America” policy, which is protectionist with a small “p”’. They said “they did an awful lot to ensure we did not sell 500 air-to-air refuellers—even though we won twice, they kept on taking us back until they ended up winning—but they are very comfortable selling Chinooks and C-17s for cash to the UK”. And when the US has sold the UK equipment, as in the case of the Chinook Mark 3, the necessary background information for its operation has not always been forthcoming.

75. Professor Taylor and Dr Louth pointed out that two bilateral agreements could be in conflict:

Government has looked historically both to the US and to Europe when it has sought partners, but has often failed to take account of the clashing pressures that can arise by trying to be faithful to all. At present we have the UK-US Defence Trade Treaty as well as legislation to enact the EU Directives on Defence Procurement and
Technology Transfer. The former is intended to ease technology transfer restrictions on some goods, services and information moving from the US to the UK but will cause, in consequence, the tightening of UK export controls to the rest of the world including Europe. This, of course, is at a time when government claims it wants to champion defence exports. Significantly, the EU Technology Transfer Directive is meant to ease the cost of moving controlled goods within Europe. No wonder industrialists are confused and frustrated, and government ministers fairly silent, on this inherent contradiction.\textsuperscript{79}

76. The Committee considered this to be a significant point. The UK-US Defence Trade Treaty is overtly bilateral in intent and practice, deliberately seeking to lock-out third-party nations from the technologies and capabilities developed and shared between the US and the UK under the specific treaty terms. For materials in question, the effects of the Treaty could, in practice, strengthen export controls from the UK to elsewhere, potentially clashing with legislation to enact the EU directives on Defence Procurement and Technology Transfer which conceptualises the EU as a single defence and security market.

77. \textbf{We believe that the UK strategy for defence acquisition should be based on a coherent level of commitment to a requirement for an ability to act nationally, to an understanding of where a level of mutual interdependence or partnership is acceptable, and where the risks of dependence on the US are acceptable to our national interest. A government with the ambition for the UK to retain its status as a major international power enjoying considerable operational sovereignty should address these issues in that order.}

\textit{Relations between Government and Industry}

78. The relationship between MoD and industry has in the past been characterised by mutual suspicion. EADS said:

\begin{quote}
Despite recent efforts to replace an adversarial approach by partnership, deep mistrust persists, particularly at desk level, centred on a belief on the one hand that the defence industry is determined to ‘rob’ the taxpayer, and on the other a belief that DE&S has little grasp of real commercial issues and the need for business to make a reasonable return. An overdue streamlining of acquisition processes is needed, of which there is little evidence so far, but it must be accompanied by a change of attitudes on all sides.\textsuperscript{80}
\end{quote}

Peter Luff referred to “defence manufacturers ... playing fast and loose with the taxpayer for at least a century”.\textsuperscript{81} Jag Patel, a defence and security consultant, was also critical of the behaviour of many contractors.\textsuperscript{82}

\begin{flushleft}
\textsuperscript{79} Ev w37, para 36  
\textsuperscript{80} Ev w10, para 32  
\textsuperscript{81} Q87  
\textsuperscript{82} Ev w49, para 25
\end{flushleft}
79. Sir Brian Burridge explained the cultural difference between the defence industry sector and the MoD, saying that the former was numbers-based and the latter words-based and that led to a difference of approach:

Defence manufacturing is a numbers-based business: we live and die by the quality of our data. The MoD and its acquisition organisation is a words-based organisation, and that is where the difference is. We invest heavily in financial systems and we have a universal financial system over the entire business—80,000 people. We have data that are correct, valid and timely. On that basis, we can take—or see—early warning. We can take action and we can use that data in the sense that everybody is quite literally on the same page. So a project manager down there on the Wildcat line at Yeovil worrying about undercarriage can see something going wrong and can—and is expected to—act. Now, one of the aspects of the material strategy is for the MoD to be in that sort of area with the quality of its financial data, but we absolutely live and die by numbers.

80. Despite the history of mutual suspicion, the White Paper suggests that in future industry should be encouraged to work more closely with the Armed Forces. The White Paper talks about “a whole force concept”, comprising regular and reserve forces, including contractors:

Under the umbrella provided by the Whole Force Concept, the MOD is working with industry to develop a concept known as Total Support Force (TSF). This provides for a fully integrated and sustainable military (Regular and Reserve), Civil Service, and contractor support force, which includes the use of contractors in the Sponsored Reserve role. Under TSF, support capabilities can be analysed to determine what manpower mix is most appropriate to their delivery. Factors which will be considered include readiness, the nature of the environment (and threat level) in which the capability will be delivered, assured support for the Operational Commander, acceptable reward for industry, and value-for-money. Contractors and Reserves may be integrated into Regular structures against readiness and agile force generation requirements. TSF capabilities would exist in the Home Base and be deployable when necessary. The TSF mantra will be ‘right person, in the right role, at the right readiness, with the right skills at the right cost’.

This presupposes a close and trusting relationship with industry.

81. ADS thought that the White Paper had nonetheless missed an opportunity.

It is integral that support to the required capabilities are considered part of the acquisition process as the majority of equipment costs are now incurred in maintaining and upgrading existing systems through life, rather than in the acquisition phase.

However, neither the existing depth and breadth—and success—of the support services already provided by industry to MoD are reflected in the White Paper nor the potential to do more. In this sense, ADS sees the White Paper as a missed
opportunity to consider what contribution the support sector can make to driving ever greater efficiency in MoD expenditure.  

Robin Southwell (ADS and EADS) gave an example of where the allocation of support costs had not been taken into account early enough in a process:

A400M is another one where we are in a process now, close to introducing the equipment into use. We are involved, even now, in a very strong and sometimes emotional debate internally within the supply forum about who will stand the risk of that programme through life. I am looking at things like providing guaranteed maintenance costs for the engines on the aircraft. That process is in play now, and I think best practice is that that should have been undertaken at the very beginning of the requirement stage—that it would be an underpinning requirement before we move forward that that is addressed. So that is where we have a misbalance.  

Reactions to the trend towards closer integration between industry and MoD naturally varied depending on the viewpoint of the witness. The PCS union were concerned that “by embedding industry further and further up the support chain... in-house resources, skills and expertise wither on the vine”. ADS would have liked more emphasis on the whole force concept and thought that “the nearer you get the industry boundary to the front line, the more you are providing incentives for availability of a combat-ready platform, or whatever it is, to be there on the day”. Certainly there is something to be said for having a personal stake in the outcome. The change is consistent with the transfer of risk from the MoD to the manufacturer which has marked the last few years in defence acquisition.

The notion of transferring risk is a contested concept. From an operational perspective, military commanders, and the men and women on the front-line, always carry the threats or risks impeding the successful conclusion of operations. The idea of the MoD being able to transfer these sets of risks to an industrial partner is flawed. The parallel concept of the Department transferring project or financial risk from itself to the private sector through some kind of ‘decider-provider’ construct remains disputed. Indeed, within public sector contracts generally, it is difficult to transfer the costs associated with identified projects risks and issues as generating a risk mitigation net present value that is contractually robust is hard to achieve. Consequently, in many cases, transferring financial risk from MoD to industry based on the projected cash flows of an investment appraisal within a business case remains more an admirable aspiration than an effective contractual reality.

Moreover, the processes, behaviours and protocols necessary for managing operational and financial risks within contracts that rest at the heart of international treaties, such as the Anglo-French Treaty of 2010, are not understood. Nor is the impact of statutes of limitations on contracts placed abroad with a lifetime of more than a few years. This is

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85 Ev w3, para 2.2.2.4
86 Q24
87 Ev w28, par 3 (a)
88 Q24
especially significant when non-UK registered businesses may be obliged to place non-UK citizens in danger when under contract to provide direct support to UK forces on operations.

85. We recommend that when entering into contracts, the MoD pays due regard to the need to effectively understand and manage risks originating with private sector partners and in the supply chain, especially the practicality of the placement of civilians, and in particular civilians who are non-UK nationals, into harm’s way.

86. We were given examples of good co-operation between industry and government. Intellect told us of a workshop between Intellect members and the heads of IS&S (Integrated Systems and Services) and ISTAR (Intelligence, Surveillance, Target Acquisition and Reconnaissance) within DE&S to discuss what drives industry as a means of improving incentivisation in defence contracts. While visiting DE&S we were told of a fruitful collaboration with industry over submarines, involving DE&S and three major companies.

87. Bernard Gray, who has been on both sides of the fence, told us that sometimes industry could be frustrated by inflexible MoD demands:

> I have been on the other side, trying to supply the Government and thinking, “Why on earth are you asking for this? It does not make any sense.” Trying to talk to a Department—not this one, but another one—and say, “Listen, you could do what you are trying to do in a completely different way”, you run into a juggernaut that has decided it is going in this direction and it is not for turning.

88. We were given some evidence of an increased willingness on the part of Government to bring industry into the acquisition process earlier and to allow it opportunities to suggest solutions rather than simply responding to tenders. Air Marshal Hillier gave an example:

> Perhaps I can give a couple of practical examples from my personal experience. In relation to operations in Afghanistan and prior to that in Iraq, one of my previous capability responsibilities was to do with platform protection. Very much as the Minister described, rather than us doing all the work and saying to industry, “Can you now go and build us one of these or manufacture one of these and put it on to our platforms?” we ran a number of sessions in which we just described the problem. We ran it at a suitable level of classification for the cleared companies and said, “This is the situation that we are facing. Can you join with us in that solution space?”

> Out of that came a number of equipment enhancements, but very pleasingly out of it also came a number of training enhancements where they said, “The balance between your capability is partly your equipment and partly how you train and how you use that kit.” There were some proposals in that side. That then washed through and we spent a considerable amount of money—quite rightly—in enhancing protection for our forces in Afghanistan. So that for me is a very practical example of
not just us looking at the landscapes and saying, "We want this. Can you now go and manufacture it?" It was involving industry in the solution space.90

89. However close co-operation is, there must remain an inevitable tension between customer and supplier. As Peter Luff said:

You have to recognise that at the end of the day we are the customer and they are the suppliers. There will always be a limit to the degree of openness we can have with them, for example, about our forward equipment programme. There will be things we want to conceal from them simply to make sure that we not put at a commercial disadvantage in our negotiations. That is the real world in which we live, but I do think we need to engage them in our requirement setting process much more thoughtfully than we have done up to now.91

90. One distinctive feature of government procurement as opposed to the private sector is that the necessary strict and visible adherence to rules and procedures can inhibit free dialogue. This can militate against a free exchange of information. Bernard Gray said:

I definitely think that a richer dialogue between companies and the Department would be helpful. However, it is constrained in a number of ways. One of those ways is that the mechanics of the procurement process means that there is a sort of Caesar’s wife component—people have to be seen to be very careful about what they say—which actually works against the Government’s interest in understanding the full richness of the picture that they could perceive.92

Intellect also pointed to the problem posed by government competition rules, and suggested that the MoD, industry and the Treasury work together “to develop a collaborative relationship where there are clear lines delineating the co-operation and collaborative phases of the acquisition process from stage at which companies compete and one is selected”.93

91. Bernard Gray and others said that DE&S lacked business experience. It was suggested that there should be greater two-way interchange at senior level between the public and private sectors, as recommended by EADS, who suggested that the continental European mode, where by procurement officials move regularly between government and industry, could lead to better mutual understanding of the requirements and drivers on both sides.94 In the UK such transfer has historically been at high level and (Bernard Gray himself being an example to the contrary) been from public to private sector and at the end of a public sector career. Such transfer has been very much the subject of criticism as “the revolving door”.

90 Q140
91 Q 139
92 Q142
93 Ev w17, para 7
94 Ev w10
92. The Minister, Philip Dunne, told us:

We accept that there are a large number of retired officers who take positions in the important defence companies in this country, and they have an important part to play in providing advice in their new roles, but it is absolutely vital that we maintain transparency about relationships and abide by the rules of the ACoBA [the Advisory Committee on Business Appointments], to use one acronym.95

93. The relationship between government and industry is critical to the generation, successful operation and sustainability of our defence capabilities. We recognise that both the public and private sectors have skills and competencies that are mutually reinforcing and necessary across the national security spectrum.

94. We recommend, therefore, that the MoD, industry and the Treasury develop collaborative behaviours and methodologies for delineating the competitive and collaborative phases of defence acquisition. This should overtly identify and manage risks where they arise and as they are identified so that less emphasis is placed on the, sometimes flawed, concept of risk transfer. We also note that the movement of personnel, especially at the senior level, can be effective for defence, but recommend the promotion of a culture of overt openness, visibility and transparency so that public confidence in defence leaders does not wane.

**Small and Medium-Sized Enterprises**

95. A distinctive subdivision of the defence and security sector is the Small and Medium Enterprise (SME). It is overall Government policy to assist SMEs, and the White Paper lays great stress on their role in defence acquisition.

SMEs typically possess characteristics that are particularly important when meeting defence and security requirements. These include agility, flexibility, genuine innovation, commitment, customer focus, lower overheads, and often niche or specialist skills and capabilities. These competitive advantages can help us get more value from our investment in defence and security capabilities.96

It adds that there is a Government aspiration that 25% of contracts by value should benefit small businesses, including those in the supply chain, during the spending review period. In the year to March 2011 42% of MoD contracts were placed directly with SMEs, representing £953 million or 13.2% by contract value.97

96. Giving oral evidence on 13 November, Philip Dunne went into more detail about the MoD’s relations with SMEs and the work being done by the Department to encourage them.98
97. We recommend that the MoD include in its annual report and Accounts information about the number and value of contracts awarded to SMEs, by both the DE&S and prime contractors.

98. The White Paper also points out that as well as being awarded contracts directly, SMEs also benefit substantially from work further down the supply chain. In recent years the MoD has increasingly made use of prime contractors for many of its major procurements (to transfer risk and responsibility from MoD to the contractor). Saab, for instance, told us that they had “a significant SME chain in the UK, with the majority of our suppliers based here, comprising a 100-firm supply chain nationally”. The Royal Aeronautical Society reminded us that “without large prime contractors ... working on substantive programmes life would be hard for most UK-based supplier companies”, and Dr Louth and Professor Taylor said that:

It is a mistake to consider just SMEs, and to focus the development of policies merely for this economic area, without considering the role larger companies provide in bridging the requirements of the Department to the skills of the niche, small specialist provider. Rather, defence capabilities have to be seen as a complex value chain whereby prime contractors, other large businesses and SMEs all combine to generate effective defence solutions. Focusing on just one component of this value chain is, at best, dysfunctional.

99. All reservations taken into account, SMEs do have a specific contribution to make to defence acquisition. The White Paper seeks to help them in three ways: by changing and simplifying MoD processes; by improving the way MoD manages its direct relationship with SMEs, giving them access to key decision-makers; and by expecting prime contractors to alter the relationship between themselves and the SMEs they deal with. Other principles of the White Paper also have the potential to benefit SMEs: Saab suggested that COTS was likely to do so.

100. SMEs have some specific problems which are not shared with larger companies. Some of these are likely to be common to SMEs in all sectors, such as the need to get to contract quickly to sustain cash flow, the particular urgency of cash flow, the need for a greater profit margin as they have no financial cushion, and the need for a secure route to market.

101. Others problems faced by SMEs may be more specific to the defence sector. We were told that SMEs particularly feared losing what is in many cases one of their main assets, that is, their intellectual property (IP), through working with larger companies or the MoD. Witnesses from ADS, including the SME representative, were careful not to make

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99 Eg para 139 National Security Through Technology
100 Ev w32, para 1.8
101 Ev w30, para 17
102 Ev w38, para 32
103 Ev w33, para 4.7
104 Q3
105 Q137
any accusations. Sir Brian Burridge pointed out that “in our business we actually have a methodology of protecting the intellectual property and we invoke a licence scheme whereby we will buy a licence for an SME’s intellectual property”.\textsuperscript{106} The MoD equally denied the charge of being “careless with the intellectual property belonging to ... small and medium enterprises” and suggested that any problem was more perceived than real; they thought, however, that to the extent that there was a real problem, it was more often among the higher tier companies than in the MoD itself.\textsuperscript{107} Despite this, the Department had taken a number of steps, including: working with the Intellectual Property Office to explore how to promote greater confidence among SMEs, considering the development of a Code of Conduct for the supply chain companies, obliging prime contractors to respect the IP of subcontractors and raising awareness of the potential for licensed technology transfers and setting up new types of organisations with a protected legal environment.

102. We were told that one of the most onerous barriers faced by SMEs in getting government contracts is the unlimited liability placed on MoD contracts with small contractors. ADS explained that “to try to insure against unlimited liability is very expensive, if doable at all”.\textsuperscript{108} Peter Luff appreciated the concerns of the SMEs, but explained the policy was not confined to the MoD but was Government policy; the MoD was bound by Treasury rules. Limitations of contractors’ liability of £250,000 and over could only be accepted by the MoD following HM Treasury approval, though there were specific exemptions for specific categories of equipment. The matter had been raised at the SME forum and a workshop would be arranged. He felt that in truth unlimited liability represented an empty threat, because “once you have got the contract with the company, for example if your firm is a builder, once you have actually started the building works, you cannot actually sack it; you have to stick with it”.\textsuperscript{109} It may be, again, mainly a problem of perception, but even so it needs to be addressed.

103. \textbf{We were told that the requirement to bear unlimited liability is a disincentive to SMEs to bid for Government contracts. We expect to be told in the response to this Report what action has been taken to ease this burden on business.}

104. It was also suggested to us that a further problem for SMEs was the length of time it took prime contractors to accept SMEs as accredited suppliers.\textsuperscript{110} There can often be an advantage to prime contractors in keeping work in house, both in increasing their own value added and in reducing the burden of dealing with an outside source. Bernard Gray thought that:

\begin{quote}
There is always a debate about becoming a qualified supplier, either as a firm and what financial guarantees you are prepared to give to the prime, not necessarily directly to us and also about whether the piece of equipment—the sub-components that you are supplying into the prime—get qualified on any particular platform... The amount of time that the Department or the large companies put SMEs to, when they
\end{quote}
do not have large numbers of staff to be able to go through large bureaucratic processes, and then the kind of hurdles that industry and we have required them to clear historically are an issue.

Like the cash flow problem of small companies, it was a perennial problem, “like living in Holland and dealing with the sea”, but he accepted that it was a problem to which the MoD must pay serious attention.

105. We expect to learn in the response to this Report what the MoD is doing to encourage prime contractors to speed up the process of engaging with SMEs as potential suppliers.

106. The emphasis placed on SMEs by the White Paper is welcome in principle, but more needs to be done in detail. It should not be to the detriment of larger concerns: both have a role to play, both singly and in combination. We look forward to learning what has been done to address the specific difficulties faced by SMEs.

**Science and technology spending**

107. The equipment of today is the fruit of spending on science and technology and research and development in the past, and without continued investment, the UK defence manufacturing base will degrade. If we cease to have a high level of technological competence, we are likely to be less highly regarded by our key allies. In its last Report on MoD acquisition, our predecessor Committee concluded that “to compromise the future development of defence technology, in order to make proportionately small short term contributions to the management of the equipment programme funding gap, is ill-judged. The research programme cannot be turned on and off at short notice and the benefits can only be realised with a consistent and long term commitment of resources.”

111 We share that view.

108. The UK now spends 1.2% of its defence budget on science and technology compared to 2.6% a decade ago, and the budget itself is also significantly smaller: expenditure has declined from £670 million in current terms to around £410 million.

112 Spending on research and development (described by the Peter Luff as “taking things through to higher levels of technology readiness into actual production”) has also declined, from 8.3% in 2005 to 5.3% in 2009. These figures compare unfavourably with competitors, though more so with the USA than with European countries. In 2009 the USA was spending 2.8% of its budget on science and technology in 2009 and 16% on research and development. In 2008, when the UK was spending 1.5% on science and technology and 7.6% on research and development, the equivalent figures in France were 1.8% and 7.2%.

113 ADS told us that the defence industry invested 8% of annual sales revenue in research and development. The overall UK Government science budget has been frozen in cash terms at £4.6 billion annually over the spending review period, sparing it the deepest cuts but nonetheless a reduction of nearly 10% over the four year period.

112 Q34
113 Q123
114 Ev w1
109. All witnesses who addressed the subject agreed that it was important that MoD reverse the decline in MoD spending on science and technology, and also that it was important that science spending should be taken forward to the stage of manufacture.\textsuperscript{115} The impact of investment in defence science and technology is not restricted to industries directly related to defence. ADS wrote “Technologies and capabilities originating in the defence arena are deployed across numerous sectors (civil aerospace, oil and gas, civil, nuclear etc) the lower down the supply chains one goes”.\textsuperscript{116} The Royal Aeronautical Society referred to the strong relationship between defence and civil activity, for example in propulsion and avionics.\textsuperscript{117}

110. In recognition of the importance of spending on research and development, the White Paper announced that it is the intention to sustain investment at a minimum of 1.2% of the defence budget (which is the current figure), and also to provide ‘a small cash rise’ in defence science and technology spending over the period of the Comprehensive Spending Review.\textsuperscript{118} The Minister, Peter Luff, said that placing a floor on science and technology spending was something of which he was proud, but he readily admitted that it was not enough. His own estimate was that about 2% would be right (a figure also suggested by Intellect) and he had asked the MoD scientific community to come up with a more evidence-based figure. Once that was available he hoped that it would be possible to use departmental unallocated provision to increase spending on research. In-house spending (mainly by Dstl, the Defence Science and Technology Laboratory) was restricted to what was necessary for national security or to ensure that the Department remained an “intelligent customer”, some 60% being spent on research commissioned from outside bodies.\textsuperscript{119}

111. It is important that spending by the MoD on defence Science and Technology is increased. The reduction in this spending in recent years (even though it has now been halted), together with the emphasis on off-the-shelf procurement and open competition, offers a serious threat to the technical skills base, specifically though not exclusively to the defence skills base, within the United Kingdom. This in turn threatens the defence body of knowledge\textsuperscript{120} and may come to threaten the UK’s ability to defend itself.

112. EADS was concerned that even what the MoD did spend on science and technology, spending would be too narrowly directed

\hspace{1cm} Much of this will be spent paying for the MOD to be an intelligent customer. In addition, the areas of technology investment will be limited to those critical to the nation e.g. Cyber. Moreover, the implication that industry will invest in future technology when the UK Government is unlikely to purchase the resulting product is fundamentally flawed. It should be remembered that defence exports have always

\textsuperscript{115} Ev w5, para 4.2.2
\textsuperscript{116} Ev w5, para 4.1.5
\textsuperscript{117} Ev w29, para 9
\textsuperscript{118} National Security Through Technology, Foreword, para ix
\textsuperscript{119} Q128
\textsuperscript{120} See paragraph 32
depended on a strong home market and on the effective endorsement by the UK forces themselves.121

113. The MoD has undertaken to publish its defence and security priority themes annually, thus providing supporting strategies for defence and security science and technology.122 Witnesses welcomed this, but some, for instance ADS, suggested that the publication should be accompanied by more detailed information in language that would be useful to physicists.123

114. We do not regard the Minister’s suggestion that additional science and technology spending could be funded from the departmental unallocated provision as likely to be fulfilled, given the number of conflicting demands on this resource. There are two distinct but separate purposes to a Government funding research and development. Firstly, to provide our Armed Forces with the most up to date equipment, and secondly, to support indigenous military industrial capability. We believe that the UK Government should therefore commit to a target of 2% of MoD budget being spent on UK based R&D.

115. We recommend also that, when the Government publishes its defence and security themes, it should provide sufficient guidance to industry to enable it to focus its research spending.

Wider government involvement

116. The White Paper acknowledges the need for cross-government working to support defence exports:

UKTI DSO [United Kingdom Trade and Industry Defence and Security Organisation] will operate a robust prioritisation mechanism to ensure that the Government is able to identify and focus on those campaigns which have the best prospects for the UK. However, as the SDSR acknowledged, many Government departments have to play a role in delivering defence and security overseas. The MOD, the Home Office, the Foreign and Commonwealth Office, and the Department of Business, Innovation and Skills will all support defence and security exports.124

To this list might be added the Treasury. On 13 November, the new MinDEST Philip Dunne told us that he was attempting to persuade the Treasury that the MoD should not be subject to the same in-year accounting rules as other Departments because its major capital projects extend over many years.125 He said:

As far as relations with the Treasury are concerned, it is also fair to say that one of the issues that surprised me, and others who are less used to Government accounting, is
the extent to which major capital projects—we and, perhaps, the Department for Transport are probably the two Departments that have the largest individual items in procurement, which last over many years—are subject, still, to the same in-year accounting rules, which mean that funds need to be deployed within the fiscal year if they have been allocated. We have started a discussion as to whether it would be appropriate to consider an accruals system of accounting under which other enterprises operate very successfully. It seems peculiar that we are potentially forced into a tight box for reasons that lead us to make decisions that are not, in other respects, logical... It is early days.126

We recognise that there is a need for flexibility with defence capital expenditure and we look forward to receiving information on the results of the dialogue between MinDEST and the Treasury.

117. Despite the White paper protestations, some witnesses suggested that not enough was being done to promote the defence industry by the wider Government. ADS, for instance, suggested that the Department for Business, Innovation and Skills (BIS) had in recent years been less active than it once had been in promoting understanding of the UK defence and security industrial base.
4 Solving the problem: the emerging solutions

Structural

118. The two most relevant recent reports on the structure and functions of the MoD are the 2009 Report from Bernard Gray and the 2012 Report of Lord Levene. The recommendations from these reports form part of the defence transformation process set in motion with the publication of the 2010 National Security Strategy and Strategic Defence and Security Review, which is designed to fit defence to meet the challenges of the future.

119. The Levene Report made recommendations about the structure and management of the MoD. Top-level decision-making was henceforth to be the province of a strengthened and slimmed-down Defence Board, including for the first time the Secretary of State (in the Chair) and another Minister (the Armed Forces Minister). The other members were to be the Permanent Secretary, the Chief of the Defence Staff (supported by an Armed Forces Committee), the Chief of Defence Materiel, the Director General Finance and non-executive Board members. The individual service chiefs, the Vice-Chief of the Defence Staff, the Second Permanent Secretary and the Chief Scientific Adviser (who had previously headed a board which agreed major projects and has been reduced in rank from a four- to a three-star) were no longer to be on the Board. Many capability planning and delivery responsibilities would be devolved to the individual command headquarters. The MoD explained this change as follows:

Under the Levene reforms, the three individual Service Chiefs, and the Joint Forces Command, having received strategic direction from the Defence Board are to carry out detailed military capability planning across equipment, manpower and training and propose how best to deliver that strategic direction through the provision of an annual Command Plan. The principal supporting staff of each of the service chiefs is to be based at the respective Command Headquarters, which will take over many of the current capability planning and delivery responsibilities of DCDS MilCap but he will retain responsibility for joint capability coherence and be part of the Head Office budgetary control system, working closely with the Director General of Finance.

These recommendations were subsequently amended and the Defence Board currently comprises: the Secretary of State, the Armed Forces Minister, the Permanent Secretary, the Chief and Vice-Chief of the Defence Staff, the Chief of Defence Materiel, the Director General of Finance and three non-executive Board members. We return to the possible consequences of the Levene changes in Chapter 8 of this report.

DE&S Reform

120. Witnesses were united in believing that the MoD, and DE&S in particular, should be an “intelligent customer”. The White Paper defines an “intelligent customer” as “having a clear understanding and knowledge of our requirements and of the products or services
being supplied in response, including the management of their supply, as well as the ability to use those products or services safely and effectively”. The collective view of witnesses was also that MoD and DE&S currently lacked the necessary skills in the quantity required to be an intelligent customer, and risked losing even more. Intellect’s view was typical:

Intellect members feel that DE&S lacks the intelligent customer experience and skills needed to make smart decisions about how to contract for information superiority (iSup) capabilities and services. DE&S’s commercial personnel are very familiar with developing contracts for platforms, which are characterised by a firm pricing paradigm. They have much less experience and skill in developing contracts for ICT capabilities and services, which require a more flexible and agile contract. With personnel cuts on the horizon, DE&S is on the verge of experiencing a further loss of corporate memory in terms of commercial expertise and skills.

In 2009 Bernard Gray’s review found DE&S to have significant weaknesses in its business skills and in the interface between it and the wider MoD. The Report included around 50 specific recommendations, related to three main areas of concern:

- balancing the equipment programme and keeping it in balance;
- providing better leadership and separating and clarifying roles and accountabilities between the MoD Centre (which sets out strategies for delivering future military capability) and DE&S (which is responsible for considering how these capabilities should be resourced); and
- injecting key skills and tools into DE&S, possibly through a partnership with a private sector programme management organisation.

It argued that greater private sector involvement would increase efficiency and the overall thrust was to centralise decision-making. This is in apparent contrast to the Levene Report, which tends to the decentralisation of decision-making.

Bernard Gray has set out a number of options for the future of DE&S: the status quo, a trading fund, an Executive Non-Departmental Public Body (ENDPB) with a private sector partner and a Government-Owned Contractor-Operated organisation (GoCo). These options were presented to Minister in December 2011.

Giving evidence before us on 15 May 2012, Bernard Gray explained the two favoured models:

The first is a model like the Olympic Delivery Authority, which partnered with—as it turns out—a consortium, which included a consulting engineering firm, among others, that managed the contractors that delivered the Olympic parks as a sort of

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127 National Security Through Technology, fn 8
128 Ev w18, para 14
joint venture between the public and private sectors. The private sector was, essentially, an adviser. That is one possible model.

The second possible model that we are evaluating is like the Atomic Weapons Establishment. Effectively, we have turned that into a Government-owned company, which we control as the Ministry of Defence. We have a consortium company then running that, being responsible for the management of it on our behalf. The essential difference between the two is that, in the second case, it has management control of the entity and its fee and profitability is driven by what it does with the incomes. In the first case, it is more of an advisory component, advising the public sector.\textsuperscript{129}

124. We asked Peter Luff what would be the relationship between a GoCo and the MoD. He replied:

> What we need to be clear about is that a new entity would be incentivised by way of fee. The risk for the asset stays with the Department, and the structure of the fee is something that Bernard can touch on in a moment. One issue that came up last time you were discussing this was whether the risk passed to the contractor—the project manager. The analogy is that the GoCo operator would essentially be a project manager, delivering the projects for a fee.\textsuperscript{130}

Whichever model is selected, the MoD does not intend to abdicate responsibility for leadership. On 17 July 2012 the then Minister for the Armed Forces, Nick Harvey, MP, told the House that the department would remain responsible to Parliament and if there was a failure, “the buck will stop with the MoD”.\textsuperscript{131}

125. At the time of writing the ENDPB and the Go-Co are the front-runners, though the other options have not been discarded.\textsuperscript{132} On 17 July the Minister for the Armed Forces announced that “as resources and commercial appetite constrain our ability to pursue these two options simultaneously to the next stage, we have decided that the Department should focus its effort on further developing and testing the GOCO option”.\textsuperscript{133} Bernard Gray explained on 13 November:

> We are currently going through a second round of soft market testing, as we called it, discussing with a variety of companies the kind of structure that we will use. I am having meetings over the next few weeks with our internal team to decide how a competition would be structured, if Ministers decide that they wish to pursue one. We are discussing with the companies the kind of things that they think they could sensibly bid on, in a pre-competitive phase, so that we are not prejudicing any outcome, but we are making sure that we ask the most sensible set of questions that we can. Broadly speaking, we then have two or three procurement routes that we can go down in technical terms and we will settle on which of those we think is the most sensible that leads to the right answer. Broadly speaking, there is a trade-off between

\textsuperscript{129} Q91
\textsuperscript{130} Q183
\textsuperscript{131} HC Deb (2012–13) 17 July 2012, c845
\textsuperscript{132} Q181
\textsuperscript{133} Ibid
ones that offer dialogue and which allow competitors to offer innovation, which is in principle a good thing for them in the process, versus the difficulty of potentially deciding between apples and oranges when you get to the end of that process, because different bidders have produced different answers. That is versus a boilerplate model that says, “Here are the answers and you must come up with something that is completely compliant with this and no other thing will do.” That makes it easier to compare, but potentially less supple for implementation. If we do decide to go forward with a competition, we would hope to launch that some time in the first quarter of next year.  

126. We asked the Minister and Bernard Gray whether the success of the Olympic Delivery Authority, an ENDPB, suggested that DE&S should also be one. The Minister, Philip Dunne, explained that the difference lay in the bounded nature of the Olympic project: it had to be delivered by a certain date or it would be a failure. He added:

We don’t have that same forcing discipline from most of the activities that we conduct because the timelines have proved flexible. So a key difference—it was both in the explicit pushback and the self-censorship—was that people tended not to come to the Olympics and attempt to change the specification because they knew that they could personally be blamed for causing the problem.

An additional disadvantage of the ENDPB model, to Bernard Gray’s mind, was that the independence of ENDPBs had been eroded over the years, to the point where “it is possible, within a Department, for the accounting officer to disestablish the ENDPB with a memo, so you don’t get the same degree of independence as you do by being outside the Department”.

127. Bernard Gray told us of the problems he experienced in recruiting and retaining the personnel he needed for the effective working of DE&S:

We have seen a leaching away of that talent. We don’t have the flexibility to hire at the moment, but we cannot hire one person at a time to get the kind of change that we need in the time scale that we need it. The complexities of managing programmes of the scale of the successor deterrent, the aircraft carrier programme or armoured fighting vehicles are such that what I might describe as a relatively traditional amateur approach that says, “We’ll give it a bit of a go”, is not a viable way to do it.

There are systematic, scientific ways of approaching this that we just do not have, so it is our belief that we need two things in order to answer the problems. First, we need substantial increases in management flexibility to be able to do the things we need to do to hire and retain good people. Secondly, we need an injection of skill from the outside. We just don’t have the time for a kind of youth academy that will grow it over 20 years; we have to go out and get something today.  

134 Q186  
135 Q182  
136 Q90
128. We asked whether an ENDPB DE&S could be given the employment freedoms sought by Bernard Gray, but he replied that “I have had a number of conversations that imply that if I apply for a derogation in relation to all that I would not get it”.  

129. CDM told us that an ENDPB would certainly, and a GoCo might, require legislation, and this would not be possible until the next parliamentary session at best, which leaves Bernard Gray with the problem of continuing to operate his section in the meantime.  

130. Most witnesses and commentators agreed that change was necessary and indeed urgent (though the PCS Union suggested that work on changing the structure and accountability of DE&S should be paused pending the implementation of defence transformation). There was less agreement on the best way forward.  

131. ADS thought there was little to choose between the two main options. Sir Brian Burridge thought the main problem in any event was the inflexibility of public sector pay and employment conditions:  

Between the two, in terms of skills, they are broadly similar, because they will give the DE&S, as a non-departmental body, the ability to hire and fire at what we might regard as market rates. In terms of being able to have the flexibility and adaptability to surge particular expertise in finance, for example, if there were a follow-on to PFI, which takes a real horsepower to understand from a customer point of view, it is possible that a GoCo—someone like CH2M, Bechtel or whatever—with global resources, would be able to bring those resources to bear. But it is hard to judge until we know precisely what the framework will be.  

Robin Southwell added that the main criteria for success would be the ability to bring in specialist knowledge and, since “it is not about acquisition but about through-life acquisition” it was necessary “to have someone involved at an early stage who is committed personally to deliver the outcome throughout”.  

132. A document produced for the Labour Party (Ideas for Future Defence Procurement), prepared by Admiral Lord West, Bill Thomas and Tony Roulstone was in favour of an ENDPB. The RUSI Acquisition Focus Group proposed a number of detailed questions, about the selection, powers and responsibilities of any lead company, the distribution of financial risk, the duration of any appointment, relations with foreign governments, ministerial and parliamentary oversight, the propriety of allowing a private entity authority over the spending of about £14 billion a year of public money and the practicability of a company making money while the MoD saved it. The MoD provided a detailed response on its current thinking, but its overall response was:
The questions posed by the RUSI paper are among those MOD is already considering. The Defence Secretary’s announcement represents the beginning of detailed work to mature the GOCO proposal and ensure careful consideration is given to all the issues. MOD will continue to engage with a wide range of stakeholders in this work. It is undoubtedly challenging. But the deep-rooted problems of defence acquisition have defied previous reform and radical action is needed to address them. Doing nothing is not an option.\textsuperscript{143}

133. We agree that the current arrangements, constrained by public sector employment rules, are unsatisfactory, and we accept that the decision on the future of DE&S, while urgent, is too important to be rushed. It is clear that a GoCo is not universally accepted as the best way forward, and that there are particular concerns about how the MoD’s overall responsibility for acquisition could be maintained within a GoCo. In particular, we believe problems might arise if a non-UK company were given responsibility for UK defence acquisition. We further believe it is vital that consultations are satisfactorily concluded with allies, to ensure that there is no adverse impact on co-operation, before any proposals are implemented.\textsuperscript{144} We expect to be given more detail about the GoCo proposals once the further inquiries requested by the Secretary of State have been concluded and before any decision is taken. Much of this will depend on the detail of what is proposed—and on the other possibilities of dealing with the constraints currently experienced by DE&S.

134. An additional problem Bernard Gray faced was that the staff of DE&S currently comprises both civilian and military personnel, and the military retire earlier than civil servants. It was possible to recruit them again as civilians but the process took months.\textsuperscript{145} It had once been easier but:

I am guessing that at some point somebody said that people were migrating too easily between one status and another, and that we should tighten it up and put some formal process in place. However many years later, that has evolved into a situation where it takes me nine months to re-employ the same person.\textsuperscript{146}

135. Peter Luff made the point that changing rules across the way Government does business could improve the commercial decision-making of the Government generally but that it was not possible to do so for reasons of propriety and transparency:

We tie our hands behind our back when it comes to commercial processes in government, and transparency is often an enemy of effectiveness. Sadly, I do not think it is possible within the current general cross-Government regime to make those changes, although I can’t disagree with you.\textsuperscript{147}
136. We recommend that, in order to recruit and retain particular staff with the requisite skills and experience, the MoD urgently develop and bring forward proposals for making the terms and conditions of civil servants and uniformed staff at DE&S more flexible pending the full implementation of the Defence Matériel Strategy.

137. Whichever solution is adopted, DE&S has the problem of carrying on its work in the interim and doing so in difficult conditions. Bernard Gray told us that he was working on an interim plan for the DE&S pending reconstruction.¹⁴⁸ Like the rest of the public sector, including MoD Head Office, DE&S is expected to make major staff reductions. The requirement to reduce staff has not been accompanied by a commensurate reduction in workload (a point also made by the PCS Union¹⁴⁹). Gray told us in May 2012 that about half the required staff reduction could be achieved through genuine efficiency gains. The prioritisation currently being carried out in Head Office would provide some benefit. Unfortunately, reducing the number of pieces of equipment, as opposed to the number of types, did not reduce DE&S workload by much, “the problem is that we have to maintain the Tornado platform whether we have one squadron or five”. He thought “in an order of magnitude our work load might come down by 5%, where we have a 28% reduction in staff”.¹⁵⁰ Beyond savings resulting from this small reduction in workload, it would probably be necessary to identify some low-priority tasks that he could not afford to support any more, certainly until the future of DE&S had been decided and implemented, simply because he did not have the staff.¹⁵¹

138. On 13 November, he updated us on developments, emphasising that matters had reached the point where output would have to be reduced:

During the first half of this year, we have gone through an extensive period working with the management team within DE&S to look at what we could achieve through efficiency savings. We pulled together the plan...that allowed a reduction from something over 20,000 to a little under 17,000, on an agreed basis. That has been discussed not only with the management team but with our trade union....The question arises around what we do about the last 10%. ...We are then saying, “Okay, in relation to the balance of the reduction of about 2,000 to 2,500 people, the question is how to achieve it.” It depends what the Department wants to achieve. Broadly speaking, if it is a nominal headcount, it can do what the Department and many others have done over many years, which is to say that you can transfer that service to a private contractor. You might do that for efficiency reasons anyway. That does save some of the cash, but not most of the cash, because those people keep working and you therefore maintain your output. You have the same amount of output available.

If, however, you want to reduce by that amount of cash, what we are being clear about, unlike previously, is that I am not saying that I can maintain my output to the armed forces on that basis. I am saying that I have to give, particularly to Steve and

¹⁴⁸ Q98
¹⁴⁹ Ev w27, para 1(d)
¹⁵⁰ Q98
¹⁵¹ Ibid
his organisations, less output. I can give you fewer services, because I do not have enough people to supply the total range of services.

139. One element of the work that DE&S would not skimp on was safety assurance. Bernard Gray said:

I am acutely aware of the problems that the Defence Logistics Organisation got itself into, and the issues and tragic circumstances leading up to Haddon-Cave [the review of the 2006 RAF Nimrod crash]. We intend to draw down to have a fully populated establishment structure, and a wiring diagram that has a sustainable set of outputs. All the safety-related posts should be tagged within that, and the safety processes should be appropriately assured by my technical director and by the centre of the Department, to ensure that we are safe at all times in operating that.152

He re-iterated this point on 13 November, saying that all safety and safety-related posts were starred and would not be left vacant.153

140. We realise that the staff reductions required of DE&S are likely to necessitate either outsourcing or reduced output or both. We expect to be informed in detail of what has been decided. Nonetheless, we commend Bernard Gray on his determination to optimise the new structure and ensure that safety should not be put at risk.

152 Ibid
153 Q191
5 The Acquisition Process

Identifying the requirements

141. In May 2012, Peter Luff explained that the National Security Council, through the medium of the SDSR, set the broad direction for acquisition policy, which it was then the role of MoD (and DE&S) to deliver.

142. The first step in the acquisition process is the identification of requirements. Air Marshal Hillier, Deputy Chief of Defence Staff (Military Capability) [MilCap] explained how decisions were taken:

It starts off with the strategic direction, which eventually comes down [through the Defence Board] to my area. We put a strategic force development process together, one of the components of which is the requirement for new pieces of equipment. We also compare that against what the front-line commands have got at the moment and measure the gap between them. Science is involved and industry is involved—the art of the possible. All that process goes on, but ultimately, if we are going to buy a new piece of equipment, that has to be approved, not least given the size of the financial commitments and the strategic implications either for industry, international relations or whatever. That approval process for the large pieces of equipment eventually comes back through Ministers and, if necessary, to the Prime Minister, so it goes through that whole cycle from setting the strategic direction to individual approvals of significant pieces of equipment.154

143. The MoD told us that the process now placed a wholly new emphasis on affordability. Bernard Gray said that following the PR12 process [the public spending planning round for 2012], MoD was taking decisions on priorities:

we have made priority decisions that have led to a set of activities that we are definitely going to do, which we can afford to do; and then some choices about some other things that we would like to do, but it is not yet clear whether we will have all of the money to do them, and we are going through an evaluation of which ones are the highest priority among those competing other choices... that is a crucial change of approach that I hope will give greater focus to high-level decision making about what we do.155

144. Air Marshal Hillier told us that the merging of the military and financial capability sections of MoD Head Office had brought about a great improvement in planning in the last four to five months:

One part of my analysis, when I took over the organisation four or five months ago, is that it did tend to be either side of a divide. If we are going to do this properly and efficiently, and get to the point about, “Let’s do this quickly”, we need to plan right alongside the people who have the resource envelope. If you like, there is the output

154 Q83
155 Q87
side, which I look after, and the input side, which the finance director looks after. You have the two of us, and literally, we would be sitting alongside each other, doing that on a constant basis. I think that sort of constructive dialogue is absolutely at the heart of our future operating model. It sounds simple, but it is not something we have done before, and it is all part of being realistic and practical about how we approach our budget and military capability plans.

Peter Luff told us that the Cost Assurance and Analysis Service (CAAS) had been run down in recent years, but was now being built up again to provide accurate costings about programmes, both when they were begun and as they progressed. The NAO have commended this decision. Modelling work with CAAS had contributed to the decision to change back to STOVL aircraft for the new aircraft carriers.

145. We commend the government’s plans to bring together military capability and finance branches as an important way of shortening and simplifying decision-making. We also commend the decision to rebuild the MoD’s Cost Assurance and Analysis Service, whose function is to enable the MoD to make better value for money decisions through life, and we expect the work to continue. We expect to be updated on progress on these points.

146. A new piece of equipment would not be the first choice for filling an identified gap in capability. Air Marshal Hillier said that only when other methods of closing an identified gap (other “lines of development”) such as better training or logistic support, or more personnel, had been excluded was the decision taken that a new piece of equipment was necessary. Only at this point did he begin dialogue with DE&S to establish what the equipment options were, and the discussion was taken forward from that point.

Approval

147. All equipment decisions must be approved, the level at which this is done depending on the size and importance of the decision. If cross-governmental issues are involved, a ministerial committee may be convoked, and sometimes the National Security Committee is involved, as it was when the type of aircraft to be accommodated on the Queen Elizabeth type carriers was changed.

148. All proposed projects are scrutinised before approval, at least once before the main investment decision, to ensure that the evidence provided supports the decision over other options. The scrutiny process will continue to examine projects in terms of whole life costs and ensure that they have considered the wider implications, including implications for training and infrastructure, with input from experts, from industry and the front line commands. This scrutiny is conducted from outside the line management chain of the

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156 Q87
157 Observations on the Ministry of Defence major approval process, National Audit Office, December 2012
158 Q152
159 Q86
160 Q83
project. The involvement of the Prime Minister and National Security Council was “an absolute requirement” for large projects. Air Marshal Hillier again:

We are spending considerable amounts of public money here, so it is an absolute requirement over our approvals process that the large projects—not necessarily large in financial terms; they can be relatively small in financial terms—in terms of capability or international impact, go through that process.

Mr Luff added that the Prime Minister took a keen interest, on a practical level, in many aspects of acquisition, for instance in the improvised explosive device equipment for Afghanistan and in ISTAR (Information, Surveillance, Targeting, Acquisition and Reconnaissance).

149. A report from the NAO on the Department’s major investment approval process was, in general, positive. It found that

- the Investment Approvals Committee is an authoritative body and the approvals process is largely independent, although there are risks arising from perceived conflicts of interests (in that senior DE&S staff had, potentially, too dominant a role)
- the Committee is supported by staff with good expertise
- more probing scrutiny reports are improving the evidence base for IAC decisions
- more could be done to understand and mitigate the burden of multiple review processes. But
- more complete recording of the key considerations underpinning IAC decisions would be helpful.

150. Witnesses from industry suggested that the acquisition process had been, historically, counter-productively slow. ADS suggested that it could take an “amazing” length of time to move from identification of the requirement to the introduction of a piece of equipment into the field, and suggested that these delays could sometimes cost as much as any resultant savings:

So we go through the process with the finest toothed comb, but by doing it in that manner and extracting every last ounce and squeezing every last pip, it ends up taking such a long time that, for example, every pound of saving that you may get from such comprehensive analysis is probably more than offset by the length of time taken to introduce it.
Monitoring

151. Strict monitoring of projects, once agreed, is necessary to prevent costs spiralling out of control, and we were told that monitoring systems have been put in place. The most significant projects are reviewed by the Major Projects Review Board (MPRB), set up in June 2011 and chaired by the Secretary of State with an agenda set by CDM in consultation with Min (DEST), both before and after Main Gate (the point at which approval is given for projects to enter the demonstration and manufacture phase and when targets are set for performance, time and cost). The MoD wrote:

The MPRB responsibilities are to ensure that key investment decisions for the largest projects in MOD are soundly based, that projects are closely monitored and cross-cutting themes or issues that could affect project, departmental or industrial performance are addressed. The MPRB may recommend that a project should be cancelled, subject to formal approval.166

The MRPB has so far met four times. No projects have so far been recommended for cancellation, but one was listed as a project of concern and measures taken to bring it back on track. We commend the MoD on the creation of the Major Projects Review Board as a review and monitoring mechanism.

166 Ev 53
6 Beyond the White Paper

Urgent operational requirements

152. Parallel to and supplementing the main equipment programme is procurement of “urgent operational requirements” (UORs). Equipment in this category is funded by extra Treasury money to provide the fast equipment solutions that ever-changing operations demand. The UOR system is designed to deliver the speed and flexibility necessary to respond to particular operational environments and emerging threats. A great deal of the equipment currently in use in Afghanistan has been procured through the UOR process. The MoD assured us that there was no possibility of using UOR money for equipment that should come from the core budget.167 Under the Levene reforms, responsibility for UORs will not be delegated to front-line commands but will remain with central staff.168

153. While UORs do not come out of the MoD equipment budget, if the MoD decides eventually to keep it, it must meet a proportion of the original cost. Otherwise, the equipment must be given away, sold or destroyed.

154. The UOR system has advantages. It can cut through bureaucracy. EADS pointed out that “its advantage is that those with authority who normally slow down the process, sometimes for cultural reasons, are disinclined in times of war to take the risk resulting from blocking a proposal”.169 UORs allow a swift response to unforeseen circumstances, the sought-after “flexibility” and “agility”. Our predecessor Committee has in the past recommended that the MoD should learn from the UOR process.170 Ideas for Future Defence Procurement, prepared for the official Opposition, comments that “UORs can be acquired much more quickly than business as usual” but that the process does not take the equipment’s life-cycle into account. It suggests that “The UOR model should be expanded so that the process can be employed more widely and become the path to a complete solution. A new UOR-plus process is required”. Intellect suggested that the UOR process enabled the MoD to be aware of the options the supply base already possessed, enabling it to make significant cost savings.171 Bernard Gray also wanted to see more of the urgency of the UOR process injected into the normal course of business.172

155. On the other hand, UORs are open to a number of criticisms. Dr Dover (Loughborough University) and Professor Phythian (Leicester University) argue that in themselves they represent a failure adequately to predict/identify future threats, which runs counter to the thrust of the SDSR. Dover and Phythian also thought that an emphasis and reliance upon UORs represents poor value for money, saying that historically, within the defence sector, value only comes from well-planned work programmes.173

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167 Q71
168 MoD
169 Ev w11, para 39
170 HC (2008–09) 107, paras 27–37
171 Ev w18, para 16
172 Q175
173 Ev w7
156. UORs also have the potential to distort the main equipment programme. Logica suggested that UORs were designed to fill a gap quickly, and only for a short period of time, and then thrown away when they are replaced by the Equipment Programme solution:

The reality is, however, that due to the length of the main acquisition cycle, these solutions can remain in service long term. Such is the concern that coherency projects have now been established to manage the portfolio of UORs. While the UOR has been a useful commercial exercise in cutting through the layers of acquisition process and proving that Defence can procure equipment quickly, until the main equipment programme can be as agile, there will still remain coherency issues with running a UOR portfolio alongside the main equipment programme.174

157. Other criticisms are that (as noted above) “they do not provide proper through life support and like any off-the-shelf requirement, require compromises”.175 Dover and Pythian argued that the system is posited on the assumption that equipment would be available to be bought on a short-time frame, implying equipment surpluses within the global market and also that the UK would possess and retain the skills necessary to maintain and adapt the equipment.176

158. Christopher Donnelly, Director of the Institute for Statecraft and former Senior Fellow at the Defence Academy, and one of our advisers, suggested that UORs were not the only way to acquire essential equipment quickly. He told us that during the Cold War period, two acquisition programmes had been run in parallel. One was the 25-year programme based on maintaining deterrence through a conventional military force. In addition:

Simultaneously, the UK set up and ran for 38 years a highly responsive acquisition system which was able to provide equipment to the troops in Northern Ireland in a matter of days. The “Wheelbarrow” robot for IED destruction took only 5 days from the first requirement being established to a functioning prototype being deployed to theatre. A similarly responsive system was set up to support the 1982 Falklands War deployment. This acquisition process was grounded in “war-time” attitudes and procedures. Better was seen as the enemy of “good enough”. Prototypes and lash-ups were provided at very short notice to the troops, enabling them to experiment and identify the modifications they needed, which were made quickly and easily.177

He thought that the current UOR process was neither as efficient nor as effective as the system existing up to 1994.

159. We asked the MoD to comment on the suggestion that during the Cold War period there had been a better way of acquiring equipment speedily. Their response was that this

174 Ev w26, para 33
175 Ev w11, para 39
176 Ev w7
177 Ev w54
promotes a positive view of acquisition during the Cold War which contrasts with much of the historical evidence, including the succession of significant studies (Gibb-Zuckerman (1961), Downey (1966), Rayner (1971) and Jordan-Lee-Cawsey/Learning from Experience (1988)) that recurrent problems in acquisition necessitated; the Committee’s own Eighth report of Session 1997-98, particularly the section on ‘Equipping the Forces’, is very clear in this regard.178

160. We accept that not every threat can be predicted, and that therefore some system for urgent procurement will remain necessary. We recommend that further work be done to align the main equipment programme with the UOR system, to establish how the speed and other benefits of the UOR system can be imported into the main equipment programme. One method might be to consider and learn from the ‘FIST’ (Fast, Inexpensive, Simple and Tiny) process about to be considered by the US Government.

Single-source contracts

161. At present 40% of defence procurement, amounting to about £9 bn annually, is sole-source, that is awarded without competition, and governed by the “Yellow Book” (the Government Profit Formula and Associated Arrangements (GPFAA). It is expected that this will continue. This means, CDM told us, that “there is a considerable baseline of effectively sole-source suppliers, which are largely UK suppliers.”179 The current arrangement dates back to a 1968 Memorandum of Understanding with the defence sector that determines in advance both profits and the costs suppliers can charge.180 In January 2011 the MoD announced that Lord Currie of Marylebone would chair a review of this system.

162. Following consultation, Lord Currie recommended removing current caps on profit margins to give suppliers a real incentive to cut costs and share savings with the MoD. He recommended that 50/50 sharing of savings should be the default, and that there should also be a move towards a common approach to cost transparency, thus enabling MoD to question how money is spent and see how this changes over time. Changes to those effects have now been agreed and are now to be implemented by legislation. Peter Luff explained the MoD’s approach:

I am grateful to industry for a very constructive approach to what is quite a big change for them. As Bernard says, this is 40% of our procurement, and getting that right is very important.

This is not about attacking their profits; I want a vibrant, competitive defence industry to make decent profits. It is about attacking their cost base, and making sure that costs are not unreasonably high. A good rate of return—that is great by me. That is what they need to do to stay in business and make the investments they need to be there for the future, but I will not have excessively high costs underpinning a level of profit that is, therefore, unreasonable.181

178 Ev 56
179 Q119
180 MoD website
181 Q120
7 Measuring success

163. The White Paper begins:

Defending the UK is one of the Government’s primary responsibilities. To achieve this, we need to provide our Armed Forces and national security agencies with the best capabilities we can afford, to enable them to protect the UK’s security and to advance the UK’s interests, both now and in the long term; and in doing so, to obtain the best possible value-for-money for the tax-payer.\textsuperscript{182}

164. Some commentators were sceptical about the White Paper’s likely success. Professor Kirkpatrick felt that, with the publication of the White Paper, history was repeating itself:

[The White Paper’s] emphasis on open competition reincarnates the principal reform introduced by Mr Peter (now Lord) Levene soon after he was appointed Chief of Defence Procurement in 1984... UK-based defence contractors initially praised the Levene reforms, welcoming the stimulating effect of open competition and the end of the ‘cosy relationship’ between the MoD and its suppliers. However through the 1990s these contractors became progressively less happy about facing (subsidised?) foreign competition for the MoD’s (increasingly-infrequent) defence equipment contracts, and more resentful of the adversarial attitudes of MoD officials. In 1998 Smart Acquisition instituted cooperative ‘partnering’ on individual projects between the MoD and a prime contractor which had been earlier chosen by competition. In the 2005 Defence Industrial Strategy (DIS) the MoD went further away from the Levene approach and accepted, after two decades of relying on open competition, that it did have a strategic responsibility to sustain sufficient onshore technological and industrial capabilities to confer ‘appropriate sovereignty’, allowing the UK to undertake some critical operations independently of other nations... However the MoD now plans to ‘rebalance’ its relationship with industry and restore open competition as its primary procurement principle, departing from that approach only in a few very-exceptional circumstances. But the White Paper does not explain how the MoD expects to overcome the problems which beset that policy after 1984, and which inspired the 2005 DIS.\textsuperscript{183}

165. One measure of success to which the Government attaches great importance is the balancing of the defence budget and avoiding the time and cost overruns found by Bernard Gray (see paragraphs 11). We asked Philip Dunne, if he believed the defence budget would still be balanced in 2020 and, if so, why this should be. He replied that for the first time the Department was not “running around desperately looking for programmes to cut or defer, because we are living within our budget”.\textsuperscript{184} Bernard Gray explained that “one of the problems with defence procurement is that it is a set of post-dated cheques”, which had made it “very easy to announce a new programme without the money, with the bill arriving significantly later”. This had now changed:

\textsuperscript{182} National Security Through Technology, Executive Summary i
\textsuperscript{183} Ev w22, para 8
\textsuperscript{184} Q193
One of the significant changes that has happened over the last two or three years is a real focus on the 10-year programme, to say that the 10-year programme as a whole has to be affordable. That is the first thing. The second thing is a measure of realism being applied to what a programme will really cost, as opposed to what people hope it might cost on its best day. Those two things together, forcing people to recognise the real cost of programmes at the beginning and looking at the long term, make a significant difference to the way that the budget will pan.\(^{185}\)

166. The MoD claims that efficiencies in the core programme have already made it possible to give the go-ahead for additional programmes without touching the unallocated £8 billion or the £4 billion contingency reserve. Air Marshal Hillier explained:

> The philosophy that we wanted to introduce is having a stable, affordable core programme with layers of, if you like, contingency shock absorbers to protect us against cost increases. That still remains in place. As we go through that stable programme, our aim is to add to the programme according to financial opportunity and emerging operational requirements. What we have been able to do, because we have the balanced budget, is on the quarterly basis review the financial performance of the Department, sit that alongside our emerging operational requirements, which continually evolve, and make these decisions about adding to the programme. This is absolutely what we set out to do, and the amount of money we have been spending has not been the £4 billion or the £8 billion. It has been from other efficiencies within the overall core programme.\(^{186}\)

167. The NAO’s Major Project’s Report 2012 was published on 10 January 2013, and its findings were mixed. While there have been no new cases of the Department slipping projects or cutting equipment numbers to bridge the gap between estimated funding and the forecast cost of the defence budget, forecast costs on three major projects (the Future Strategic Tanker Aircraft, the Queen Elizabeth Class Aircraft Carrier and the A400M Aircraft have slipped badly, and the overall conclusion was that while there will always be causes of project instability over which the Department will have limited control (such as fuel costs):

> To achieve value for money in future on individual projects and to underpin an affordable Equipment Plan, the Department must continue to address long-standing issues on project performance to best use the money available.\(^{187}\)

168. We note that some progress has been made on programme and project controls and applaud the Department’s emphasis on costing, forecasting and the use of a broad range of performance indicators. However, it is unacceptable that major projects such as the A400M programme have slipped. Whilst it is still early days, this suggests that the Department’s Major Projects Review Board is not performing especially well. We recommend, therefore, that Key Performance Indicators and communication protocols are reviewed to ensure that senior leaders receive early notice of project difficulties.

\(^{185}\) Q195  
\(^{186}\) Q197  
\(^{187}\) The Major Projects Report 2012, HC 684-i
8 Risks and Unknowns

169. The evidence suggested that risks and unknowns fall into two categories: “personnel and structure” and “acquisition policy and processes”.

**Personnel and structure**

170. The Levene Reforms require the devolution of capability decisions to the individual commands. Some witnesses were worried that that the devolution of acquisition functions to the individual Service heads would tend to result in incoherence. EADS, a company involved in aerospace, defence and related issues, felt “the capability requirements function was difficult enough under the former organisation but at least it was co-located with planning and finance staffs and there was a joint approach. In addition the single Services may drift into specifying ‘stove-pipe’ requirements with the potential effect that a short-term view will be taken”.\(^8\) Sir Brian Burridge, however, thought that there would still be sufficient central scrutiny to prevent this happening, and, pragmatically, ‘the size of the capability that the UK now aspires to actually militates against duplication’.\(^8\)

171. We asked the MoD how, under the new system, projects that cut across more than one Service—such as aircraft carriers—would be assigned and how parochialism could be avoided if they were assigned to one Service. Air Marshal Hillier agreed there was a risk and said that no final decision had been taken but it was likely that individual projects would be delegated to the relevant single Service best placed to look after them while the Senior Responsible Owner would continue to work in his, Hillier’s, department as a two star. Hillier would then be able to detect and prevent any divergence from a coherent and integrated approach.\(^9\)

172. Additionally, the direct military input to the Defence Board is being reduced and the number of Service personnel in the individual Staffs at Head Office is being reduced. There is a risk that this will be to the detriment of the national defence capability.

173. **We note that there is acknowledged risk of single-Service stovepiping, with each Service looking only to its own needs without considering the programmes of the others, and acknowledge that the MoD is aware of this potential structural challenge to effective acquisition. We expect to be kept abreast of organisational mitigation plans to counter this tendency and would welcome examples of effective corporate intervention.**

174. A number of witnesses suggested to us that project leaders turned over too fast, (both in MoD Head Office and in DE&S. Speedy turnover risks leading to loss of corporate memory on the history of decisions, diminishes accountability, as the person who took decisions may no longer be in post if they prove poor, and detracts from any sense of ownership of a project. (This risk increases with the length of a project as staff inevitably change, and Dan Ward used this as an additional argument in favour of short projects.) The MoD has agreed in principle that the span of control and tenure of Senior Responsible

\(^8\) Ev w9, para 18
\(^9\) Q15
\(^8\) Q88
Owners of projects should be addressed, but pointed that the defence transformation changes would mean further turnover of SROs in the short term as staff reductions were accommodated.

175. **We commend the MoD’s decision that in principle the terms of the Senior Responsible Owners of projects should be extended.** We hope that this will include uniformed specialists, even though this may require changes to conventional military career patterns. **We recommend that information on the average length of these terms be included in the Department’s Annual Report.**

176. In common with the rest of the Civil Service, both MoD Head Office and DE&S are undergoing significant reductions in staff, raising significant challenges for the retention of appropriate skilled personnel. Bernard Gray told us that:

> as part of the defence review, we had a mandated reduction in the number of personnel within DE&S as part of the overall—broadly civilian, but to a certain extent military—headcount reductions, which takes us down from just around 20,000 prior to the defence review to around 14,500 by 2014-15. That equates to about a 28% reduction in personnel within DE&S over the spending review period.191

This is occurring at a time when, by general agreement among witnesses the MoD needs more commercial and project management skills both in the DE&S and at Head Office level.

177. The current staff-cutting exercise risks leading to a leaching of such skills as are currently held, and, indeed to staff morale. EADS felt that the effect of staff cuts would be even worse when taken together with other aspects of the Levene reforms:

> There is a clear aspiration to reduce MoD Staff, but the added complexity which will result from the transformation is likely to have the opposite effect. The management of a complex matrix like capability function will require numerous committee and consultation structures to provide the coherence to achieve balanced and joint capabilities. The difficulties in achieving this with reduced staff can only be imagined.192

178. The MoD is in a very difficult position in that it is expected to carry out its core functions simultaneously with reforming itself, and some witnesses doubt whether the organisation—or any organisation—can do this, particularly the simultaneous staff reductions and the long time-scales involved before resolution will be reached. ADS said:

> The implementation of these large scale MoD reforms will take considerable time. DE&S will have to maintain an operating capability whilst suffering major staff number reductions and an outflow of experience and expertise. It is not clear to industry how will they achieve this in the midst of ongoing operations.193

And EADS added:

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191 Q97
192 Ev w9, para 21
193 Ev w6, para 4.3.4
Cohesion in the Gray and Levene reports is found in their aims; however, the changes that are proposed are so radical that the process of implementation will go beyond current timescales.\textsuperscript{194}

179. Intellect, the UK trade association for the IT, telecommunications and electronics industries, suggested that the reforms might distract from the real business:

Ultimately... while the organisation of the Head Office and DE&S are of relevance to the defence ICT industry (in particular, the governance surrounding these models), of greater importance is the development of an agile defence acquisition process that delivers equipment to time and budget. There is a sense that defence reform is distracting the MOD from this pressing issue.\textsuperscript{195}

Professor Taylor and Dr Louth of RUSI put in a plea for a period of stability, suggesting “the optimism that change management programmes are transformative” is one of “ten sacred truths” that need challenging and that “there is an overt belief system that the response to any perceived problem is to implement a change management initiative”.\textsuperscript{196}

180. Despite the reservations of some witnesses about the speed, and some of the implications, of change, it is unfortunately nonetheless clear, as ADS said, that “the MoD cannot put off decisions until such time as reforms are seen to be ‘complete’ ”.\textsuperscript{197}

181. Bernard Gray emphasised the need for actors to accept and internalise the need for change:

I have had conversations in a number of areas of the Department over the past few years where it was as if everything that had been written and said on the subject had never happened, because plenty of people will sit there and assert things that we showed were demonstrably untrue three years ago. There is no substitute in that sense for a managerial approach that goes through all of the issues relentlessly and changes the incentives, the information systems and the people such that you get into a situation where they are eliminated and something different becomes business as usual. Too often we have taken a short-term run at something, made some changes and moved on. It just takes the application of effort over time.\textsuperscript{198}

182. Simultaneously with the Levene reorganisation, the MoD, along with the rest of the Civil Service, is being subjected to severe staff cuts, with the aim of reducing staff—both military and civilian—by about one-third by 2014. We have already expressed doubts as to the wisdom of embarking on a programme of redundancies before the final shape of the Department is known.\textsuperscript{199} EADS felt that the effect of staff cuts would be even worse when taken together with other aspects of the Levene reforms:

\begin{flushleft}
\begin{footnotesize}
\textsuperscript{194} Ev w8, para 5
\textsuperscript{195} Ev w16, para 2
\textsuperscript{196} Ev w27, para 38
\textsuperscript{197} Ev w2, para 121
\textsuperscript{198} Q170
\textsuperscript{199} The Performance of the Ministry of Defence 2009-10, Third Report of the Committee, Session 2010–12,HC 760
\end{footnotesize}
\end{flushleft}
There is a clear aspiration to reduce MoD Staff, but the added complexity which will result from the transformation is likely to have the opposite effect. The management of a complex matrix like capability function will require numerous committee and consultation structures to provide the coherence to achieve balanced and joint capabilities. The difficulties in achieving this with reduced staff can only be imagined.200

183. There must also be a risk that the reduction of command staffs at Head Office reduces the military input to that Office’s work. It is important that emphasis on management skills in MoD is not allowed to sideline the contribution of military specialists, particularly now that the military, and indeed scientific, membership of the Defence Board has been reduced.

184. We note also that reducing MoD staff, including DE&S staff while at the same time maintaining and improving the quality of the work carried out presents an intractable problem. The danger of a displacement of work from a reduced civilian staff to a reduced military staff would be unacceptable. Neither is it clear how the application of FIST and/or a new management construct for DE&S would provide any early alleviation of these problems. Particular consideration should therefore be given to both the pace and shape of civilian staff and military staff reduction, to avoid these problems and protect critical technical skill-sets.

Policy and processes

Flexibility

185. The White Paper stresses the need for the acquisition programme to be flexible enough to adapt to changing needs. For instance:

We will seek to use a common set of open principles, rules, and standards wherever possible, to ensure that we have the flexibility and agility to upgrade capability incrementally and to ensure interoperability with our key allies.201

Or “we will take significant steps to ensure small and medium-sized companies can continue to deliver the innovation and flexibility we need”.

186. Christopher Donnelly did not think that the proposed arrangements would provide the necessary flexibility, suggesting that the MoD system is intent on installing a fixed, un-adaptable programme regulated not by the Services’ operational needs but by rigid, budgetary-driven project management.

187. Given the necessary timescales for defence acquisition, it will be some time before it will be possible to judge whether the acquisition system will indeed prove flexible enough to meet changing circumstances.

200 Ev w9, para 21
201 National Security Through Technology 1.3.9
Security of Supply

188. It must be a risk of open procurement that other countries, even allies, may not be willing to allow manufacturers to sell others the best equipment, or provide all the information that would enable UK forces to get the best out of it. And, as Professor Kirkpatrick put it “with a policy of open competition, it is inevitable that at least some equipment would be acquired from global suppliers, which might in a crisis withhold supply or support”.\textsuperscript{202} We recommend that the Department establish a clear knowledge of which equipment and support solutions are critical to national security and expect to be informed of the measures taken to secure supply.

Degradation of the national skills base

189. A number of witnesses suggested that the policy of open competition, particularly when combined with inadequate investment in military Science and Technology, would erode the national skills base.

190. Not surprisingly perhaps, many of our industry witnesses criticised the commitment to open procurement, believing that domestic industry would suffer. ADS suggested that “there will be little incentive for UK defence contractors to invest large sums of money to develop the next generation of off-the-shelf equipment – in the hope that someone will buy it”.\textsuperscript{203}

191. Dr Dover and Professor Phythian suggested that the White Paper broke the historic link between UK defence procurement and UK-based defence manufacturing, and that this was a serious blow to manufacturers without a strong presence in third country markets, while it might provide a signal to those with global brands that the UK no longer provided a supportive environment for their activities.

192. ADS agreed that the advantage of COTS procurement lay in avoiding development costs, shortened delivery timescales, possible use of established training systems and other operational user support. They suggested that on the downside, modifications, some of which might be necessary for legal and mandatory reasons, might be expensive and even impossible or unaffordable, and compromises in performance, characteristics, cost and sovereignty might be necessary, while dialogue throughout UK industry would be largely unavailable except through contractors. The UK defence-industrial base, and the skills base which it fed, was thus at risk of degradation. Another disadvantage, noted by Intellect (who nonetheless supported COTS in principle) was the danger that security of supply might be disrupted.\textsuperscript{204}

193. Other witnesses thought that reliance on COTS would degrade the UK “body of knowledge”, the total familiarity with, and confidence in the capabilities of a piece of equipment that comes from familiarity with it throughout its lifetime, from its inception, rather than its having been bought in complete. This enabled equipment both to be accelerated through its development and to be deployed with certainty as to its effects. Sir

\begin{footnotes}
\item[202] Ev w21
\item[203] Ev w10
\item[204] Ev w17, para 11
\end{footnotes}
Brian Burridge thought that the UK needed this because the UK was “forward-looking”, and gave the example of the acceleration of the dual-mode Brimstone missile for use in Afghanistan.\textsuperscript{205}

194. While it may save money, at least in the first instance, an emphasis on commercial off-the-shelf purchasing may run counter to the drive to increase exports. ADS thought that:

The extent to which off-the-shelf procurement will undermine the UK’s ability to export depends on the definition of off-the-shelf. To maintain a strong Government-backed export drive, the Intellectual Property and manufacture of exportable technology has to reside in the UK. The UK cannot export what it has imported and this conflict between the UK’s export drive and off-the-shelf procurement must be addressed.

195. There was also the possibility that COTS could lead to less, not more, flexibility, if acquisitions have to be fitted into existing equipment and the designs are incompatible: Graham Chisnall said:

Commercial off the shelf acquisition has a perverse implication for the ability to adapt to changing requirements and new circumstances. I was involved with the Nimrod programme many years ago, and when you are dealing with complex integrated systems that have embedded commercial off-the-shelf systems or subsystems and equipments in them, if you want to adapt, by definition you cannot touch those because they are commercial off the shelf. That causes considerable difficulty because you then have to sub-optimise everything around those systems and at hard points. So there is a perverse aspect at the complex weapons system end of commercial off the shelf systems becoming very inflexible.\textsuperscript{206}

Open competition is excellent in principle, and, as the Royal Aeronautical Society put it, ‘Where they have been able to bid for international contracts, UK companies have won business as “best athlete” in competition with native suppliers. Nonetheless:

the UK remains unique as a major defence industrial power in defaulting to open market solutions; ...Changes in EU procurement and competition law have made overt protectionism more difficult to sustain, but European countries are still reluctant to embrace the virtues of competition. The US, while more open to inward investment, also takes care to ensure that major contracts are sourced from within the US and major programmes led by American prime contractors.\textsuperscript{207}

A number of other witnesses made similar points, in particular drawing attention to the risk to the domestic skills base of a possible failure to achieve export orders.

196. We drew attention at the beginning of this Report to the importance our witnesses attached to the possession of skills as a necessary condition for the possession of strong and well-equipped Armed Forces. A depressing thread running through this inquiry has been

\textsuperscript{205} Q45
\textsuperscript{206} Q3
\textsuperscript{207} Ev w29, paras 3–4
that circumstances (and, according to non-MoD witnesses also MoD policy), are conspiring to reduce the national skills base. Whether it was CDM telling the Committee that he could not recruit or retain the skilled staff he needed to make DE&S an intelligent customer or the young aircraft engineer informally encountered by a member of the Committee staff who had applied for redundancy and was hoping to go to the US “where they still have aircraft to work on”, the story was the same.

197. Our predecessor Committee’s Fourth Report of 2006–07 gave telling details of how skills can be lost by lack of use, concluding:

It is clear that the gap between the Vanguard and Astute submarine programmes had a serious and debilitating impact on the UK’s submarine industry and put at risk the future of the UK’s submarine fleet. If the Government wants the UK to continue to design and build nuclear-powered submarines, it will be essential to maintain a regular rhythm of submarine construction. Reducing the frequency of construction below 22 months would be risky. Without a regular build "drumbeat", the UK skills base will erode and it may prove impossible or prohibitively expensive to recreate.²⁰⁸

198. We recommend that when making acquisition decisions the MoD should explicitly bear in mind the need to preserve and regenerate the national skills base.

Conclusion

199. Based on our analysis above, we have identified a number of areas of risk in the MoD’s acquisition policy. Further, the length of time taken by some acquisition projects means that it may be many years before success or failure is visible, and by that time irreparable damage may have been done. In an attempt to mitigate these risks we have made the recommendations which appear in this Report.

²⁰⁸ The Future of the UK’s Nuclear Deterrent: The manufacturing and Skills Base, Fourth report of Session 2006-07, HC 59, para 64
Formal Minutes

Tuesday 29 January 2013

Members present:

James Arbuthnot, in the Chair
Julian Brazier  Sandra Osborne
Thomas Docherty  Sir Bob Russell
Mr Dai Havard  Bob Stewart
Mr Adam Holloway  Ms Gisela Stewart
Mrs Madeleine Moon

Draft Report (Defence Acquisition), proposed by the Chair, brought up and read.

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

Paragraphs 1 to 199 read and agreed to.

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

Ordered, That the Chair 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 (in addition to that ordered to be reported for publishing on 25 April, 12 June, 9 June and 4 December.

[Adjourned till Wednesday 30 January at 2.00 pm]
Witnesses

Thursday 10 May 2012

Sir Brian Burridge, Vice-President, Strategic Marketing, Finmeccanica UK and Vice-President, Defence, ADS, David Hansell, Managing Director, MSI-Defence Systems Ltd and Chair, ADS Small Companies Committee (SCC), Robert Southwell, Chief Executive, EADS UK and President, ADS, and Graham Chisnall, Deputy CEO and MD Aerospace, ADS

Ev 1

Tuesday 15 May 2012

Peter Luff MP, Minister for Defence Equipment, Support and Technology, Bernard Gray, Chief of Defence Material, and Air Marshal Steve Hillier, Deputy Chief of Defence Staff (Military Capability), Ministry of Defence

Ev 13

Tuesday 13 November 2012

Philip Dunne MP, Minister for Defence Equipment, Support and Technology, Bernard Gray, Chief of Defence Material, and Air Marshal Steve Hillier, Deputy Chief of Defence Staff (Military Capability), Ministry of Defence

Ev 37

List of printed written evidence

1 Ministry of Defence Ev 49: Ev 56: Ev 57: Ev 61

List of additional written evidence

(published in Volume II on the Committee’s website www.parliament.uk/defcom)

1 ADS (UK Aerospace, Defence, Security and Space industries) Ev w1
2 Dr Robert Dover (Loughborough University) and Professor Mark Phythian (University of Leicester) Ev w7
3 EADS Ev w8
4 Finmeccanica UK Ev w12
5 Intellect Ev w15
6 Professor David Kirkpatrick Ev w21
7 Logica Ev w22
8 Public and Commercial Services Union (PCS) Ev w26
9 Royal Aeronautical Society Ev w28
10 Saab Ev w31
11 Trevor Taylor and John Louth Ev w33
12 Prospect Ev w39
13 Alenia Aermacchi Ev w44
14 Jag Patel Ev w47
15 Christopher Donnelly Ev w51
# 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 2012–13

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Oral evidence

Taken before the Defence Committee on Thursday 10 May 2012

Members present:

Mr James Arbuthnot (Chair)
Mr Julian Brazier
John Glen
Mrs Madeleine Moon
Bob Stewart
Ms Gisela Stuart

Examination of Witnesses

Witnesses: Sir Brian Burridge, Vice-President, Strategic Marketing, Finmeccanica UK and Vice-President, Defence, ADS, David Hansell, Managing Director, MSI-Defence Systems Ltd and Chair, ADS Small Companies’ Committee (SCC) Robin Southwell, Chief Executive, EADS UK and President, ADS, and Graham Chisnall, Deputy CEO and MD Aerospace, ADS, gave evidence.

Q1 Chair: Good morning. Welcome to the Defence Committee’s inquiry on acquisition. Can I begin by asking you all to introduce yourselves please—not that that is absolutely essential, but it will be helpful? Robin Southwell: I am Robin Southwell, CEO of EADS UK and President of ADS. Good morning.

Sir Brian Burridge: I am Brian Burridge, Vice-President, Strategic Marketing, Finmeccanica UK and Vice-President, Defence, at ADS, the trade association. I chair the Defence Sector Board.

Graham Chisnall: I am Graham Chisnall, Deputy CEO at ADS. I also look after aerospace and space as part of that.

David Hansell: I am David Hansell. I am the Managing Director of MSI-Defence Systems, a medium-sized company in the SME category. I am chairman of the Small Company Committee (SCC) within ADS, which I am representing today.

Q2 Chair: We understand that there may be a defence announcement in the House of Commons later this morning. This meeting will finish at 11 am. Will you bear in mind that we have lots of questions to ask you? I ask the Committee to keep the questions succinct and you to keep your answers succinct.

Let us begin with the White Paper and the question of adaptability. As we know, we face a range of threats that are uncertain and unpredictable. How can we adapt our acquisition system so that that is absolutely essential, but it will be helpful? try to speed up the cycle times.

Robin Southwell: I do not sense that degree of urgency in moving from identification of the requirement to introduction into the field. It is probably something that would require a political effort. It is an amazing length of time. It is actually taking longer now. I remember AirTanker. We were measuring it in decades. I am sure that Brian can bring in anecdotes about how long these things have taken. Yes, there were specific reasons. On the programme I have just mentioned, I remember the importance under the financing structure of making sure that every i was dotted and every t crossed in terms of the arrangements, and that the Treasury was deeply involved. So we go through the process with the finest toothed comb, but by doing it in that manner and extracting every last ounce and squeezing every last pip, it ends up taking such a long time that, for example, every pound of saving that you may get from such comprehensive analysis is probably more than offset by the length of time taken to introduce it, and the service and cost of, say, the VC10s remaining in service for may be two or three years longer than the Tristars.

Q3 Chair: Why do you think that that has not happened already? Do you think people have not been trying to get that to happen? Robin Southwell: I do not sense that degree of urgency in moving from identification of the requirement to introduction into the field. It is probably something that would require a political effort. It is an amazing length of time. It is actually taking longer now. I remember AirTanker. We were measuring it in decades. I am sure that Brian can bring in anecdotes about how long these things have taken. Yes, there were specific reasons. On the programme I have just mentioned, I remember the importance under the financing structure of making sure that every i was dotted and every t crossed in terms of the arrangements, and that the Treasury was deeply involved. So we go through the process with the finest toothed comb, but by doing it in that manner and extracting every last ounce and squeezing every last pip, it ends up taking such a long time that, for example, every pound of saving that you may get from such comprehensive analysis is probably more than offset by the length of time taken to introduce it, and the service and cost of, say, the VC10s remaining in service for may be two or three years longer than the Tristars.

So some sort of time cost-benefit analysis is useful and, in my opinion, if we can work towards significantly reducing that cycle time and the time between milestones and reviews, that would engender a very healthy and cost-effective culture.

Sir Brian Burridge: May I add to that? What Robin has described is seeking not to embark on a path that closes down options over a very long period. There are two aspects to that. The first is that to acquire
a complex system quickly, it is necessary to reduce uncertainty up front and, currently, about 70% of the delay to programmes comes from the MoD’s requirement to re-profile its expenditure and about 30% comes from the uncertainty that is taken into the programme from not fully understanding the technological risk and the degree to which that technology can be engineered. That aspect could be determined much more accurately if we had a propensity to spend 15%, say, of the total budget between the assessment phase and the end of production before main gate. This, as the Committee will well know, is the recommendation that was pivotal in the original Smart Acquisition programme.

I am talking about flexibility and adaptability as a result of not closing off options over a long period, but there have to be some options, and those options are what arise out of your indigenous spend on research and development, leading to capability. I feel sure you will want to pursue that in detail, but I will leave it there for now.

**Graham Chisnall:** I would like to add one extra little but. Commercial off the shelf acquisition has a perverse impetus: the ability to adapt to changing requirements and new circumstances. I was involved with the Nimrod programme many years ago, and when you are dealing with complex integrated systems that have embedded commercial off-the-shelf systems or subsystems and equipments in them, if you want to adapt, by definition you cannot touch those because they are commercial off the shelf. That causes considerable difficulty because you then have to sub-optimise everything around those systems and at hard points. So there is a perverse aspect at the complex weapons system end of commercial off the shelf systems becoming very inflexible.

**David Hansell:** Obviously, getting to contract quickly is paramount to small companies, to sustain cash flow. So we would applaud anything to promote getting the contracts in place earlier in the procurement phase.

**Q4 Chair:** Do you think the White Paper provides a national industrial strategy for defence of any sort?

**Graham Chisnall:** The answer is no. It is quite high level. It does not provide the necessary guidance that industry needs in its resourcing and investment decisions. It gives guidance in certain areas at a high level. It is particularly useful in relation to security. It says some useful things about SMEs and so on. But as guidance for where the MoD is going to spend its money in the future and on what programmes or even on what broad capabilities, it is too high level for industry to be able to plan much.

**Chair:** We will come on to that.

**Sir Brian Burridge:** Can I illuminate that a little more? Chairman, you used the phrase “of any sort”. It is true to say that what appears in the White Paper is part of a strategic view, but in and of itself it does not represent a defence industrial strategy. It is a waypoint on a journey. The outcome of PR 12 is the next significant waypoint. The publication of the equipment programme, which we expect at some stage, is another waypoint. There is the elucidation of the key critical technology priorities, which the Government have undertaken to publish. Taken together, they will form an amalgam that we can use for analysis, but the White Paper is merely the start.

**Robin Southwell:** Graham’s “no”, while emphatic, did not represent necessarily a latent or implicit criticism of the White Paper. I do not believe, as we look at it, that the White Paper was designed to be a defence industry strategy. There is an underpinning methodology to the White Paper; it is about the procurement model that the MoD has engaged with. It states that the procurement model is driven by the underpinning criterion of value for money, and the value for money definition precludes any account of manufacturing or industrial impact on the UK. It actually states emphatically and clearly that it has nothing to do with manufacturing or industry in the UK, so it is not a defence industry strategy by definition.

**Q5 Chair:** Did it matter to you—and if so, to what extent—that it was delayed?

**Sir Brian Burridge:** Any introduction of uncertainty, from a business point of view, is unhelpful. There is no doubt about that. The fact that these key outputs, which I listed earlier, have taken longer and longer to see the light of day gives us greater difficulty in planning investment and in understanding what our domestic customer base is going to look like. It will be there: when we see the equipment programme, we can put it all together. But the underlying point from this type of marketplace—the defence marketplace—is that we value both visibility of intent and, if we can have it, stability of intent, because that allows us to plan. It is not particularly helpful when these things are delayed.

**Q6 John Glen:** I want to draw out precisely what you think about the adequacy of the White Paper and what was missing. Some of you have already referred to other things that are about to come through and how, together, they would work out. But the White Paper said that the Government had the intention of providing “a clear guide to industry and to the acquisition community that should endure beyond the next SDSR.” To what extent do you think that that has been fulfilled? What would you have had in it? What was missing? What would have been in it if you had written it yourselves?

**Robin Southwell:** We have already mentioned that it is enduring. We are sure that the Government are absolutely clear that they do not want manufacturing or industry in the UK to be, in any way, a factor in their procurement strategy, so I am sure that it will be enduring. There are maybe two areas that do concern us. I will give the headlines and then pass over to my colleagues to elucidate—one is exportability and the other is supporting the SMEs. We assume that “SMEs” in the report means UK SMEs. With respect to exportability, in our opinion that is a fundamental dynamic which may make a difference to our industry. Our domestic market is flattened and our near European market is flattened and both will maintain that posture for some time to come. If we can export, that may make the difference, and we are absolutely committed to doing that. If we are to do that, there are things that have to happen.
The second thing is on the SMEs. While there are a lot of very fine words and clear effort, in terms of those actually on the ground—people like David, running his business; it is for him to say—there is a degree of disappointment that we have not got some tangibles in place which will make the difference to his company's survival for another year.

Q7 John Glen: And what would those be? What would you—practically—have wanted to see in the White Paper? Expand.

Robin Southwell: Can I ask Dave? I would love to talk for ever, as James knows, but I will let Dave in.

Q8 John Glen: Yes, of course. I just want to get a clear picture, as a consequence of this question, of what you would have had in the White Paper to address the specific concerns around uncertainty with SMEs or whatever it is.

Robin Southwell: Okay. We will start with SMEs and then maybe we can go on to exports.

David Hansell: There are a lot of good things in the paper that come out in support of SMEs. Coming up through my company, within ADS, is a concern about the implementation of that. Engagement between the Ministry of Defence and SMEs is encouraged in the paper, and that can only be a good thing. However, getting that policy down into practice is probably going to be quite challenging, because, by definition, those contracts are likely to be smaller than the capital equipment projects. To get that message down into the procurement team will be quite challenging, particularly if there are resource constraints implicit in that as well. That is the message coming out from the smaller SMEs.

Graham Chisnall: Coming back to the export theme, from an industrial point of view, it would have been helpful to have had more clarity on a number of connected issues. Around the R & D appetite, the White Paper sets a very helpful and useful minimum figure of 1.2% of the budget. We worry that that will also be a ceiling. That is a very low level of R & D funding compared with prior years.

Q9 Chair: We are coming on to R & D specifically later on in the morning. What else would you say?

Graham Chisnall: Okay. The other piece I was just going to mention was everything to do with the support environment. There was a lot of input into the Government during the Dragon’s Den period about ways of getting value for money on the support side. It would have been nice to have seen some of those ideas, conceptually, into the White Paper.

Robin Southwell: On the exports theme, to build on what Graham has said, we think that this is a fundamental issue. It is not the get-out-of-jail-free card, but it is the dynamic that does not rely on the euro or on our own issues. We would like to suggest that exportability be one of the value-for-money criteria that the MoD is using to decide whether or not to procure a project. That is a very clear suggestion that we are making to this Committee.

The second thing on exports—I will give you just one, but we probably could give you 100—is that our ability to export is umbilically linked with whether or not our forces use that equipment. It just makes it easier in a challenging marketplace where there are a lot of countries with joined-up strategies and where their forces use, or have employed, these products. If our forces are not using it, it is just tougher. At the moment, a lot of effort is going in to exports. If our forces do not use the equipment already, the effect from that effort is diluted. That is one example that shows why we would like exportability to be one of the value-for-money criteria.

On the SME side, as David has said, another issue is the ability to contract. He has to meet some very onerous—probably quite rightly so—terms and conditions in order to supply directly to the MoD, which may preclude his ability so to do. Secondly, the way in which programmes are developing, and we have to welcome this, means that risk is transferred through life to industry. If you are a relatively small company with a relatively narrow balance sheet, it is difficult to accept that project risk. There are real issues that the SMEs are struggling with at the moment.

Sir Brian Burridge: The White Paper lists the reasons why the UK is an attractive place for inward investment, among which is the springboard it represents for exports. In defining value for money and ignoring the export part, in many ways it rather suggests that the role of the Ministry of Defence is merely to equip the Armed Forces. Of course it is about security policy, alliances, and making friends that you might need on a rainy day, and defence exports are a way of doing that. There is a policy aspect to this that is not really the subject of joined-up Government thinking, but it is axiomatic that if we wish to sustain the type of industrial base that we have in this country, with all that that means for revenues to the Exchequer, advanced manufacturing, the pull-through of talented young people into these high-technology industries, then we have got to be successful in export.

The thing that really stands behind that is our ability to compete with leading-edge technologies on the global market. A country like France has absolute alignment between Government and industry—sometimes we overlook this—over what those leading-edge technologies are and how they will develop, and an absolute underpinning guarantee that they will be pulled through into equipment for the French armed forces. Now, that then plays to what we would term brand UK if we did the equivalent. That is a whole area that the White Paper misses.

John Glen: That is very clear.

Q10 Mrs Moon: May I take you back to some of your earlier responses to the Chair? You pointed out that recent large projects in particular had cost half as much again as they were expected to cost and had taken twice as long to come to fruition. In your response to the Chair’s first questions, you placed a lot of responsibility, Mr Southwell and Sir Brian, on the Ministry of Defence. The MoD has been on the naughty step for a long time, but you ignored industry’s role in these cost increases and the length of time for maturity of projects. What role do you think you played and what changes have you made in
your practices to ensure that you are doing your bit to improve this?
Sir Brian Burridge: That is a fair question, if I can start. First of all, a lot of the corporate memory is historical. The major projects report points out that it is legacy programmes that determine the perception of performance. From an industry standpoint, I can speak for our own group. We have 32 programmes with the MoD. All but two are green. We have six major sub-contract—

Q11 Chair: Green?
Sir Brian Burridge: On time, on budget.
Robin Southwell: And, of course, eco-efficient.
Sir Brian Burridge: We have six major subs, which are also all green. The picture 10 years ago might well have been different. The transformation that has taken place has seen heavy investment and a great deal of attention to programme management. That is an area on which we focus, because only by getting that right can you efficiently convert your intellectual property into a product and make it competitive.

Robin Southwell: I obviously concur with Brian. Let’s talk about A400M.
Chair: Not green.
Robin Southwell: It is propellers. I am totally confident that that programme will end up in the RAF.

A fantastic piece of kit, which for many decades to come will be exported around the world and bring real value to the UK. However, during the development phase the comments you made about being late and being over cost are absolutely correct. I was not in any way trying to hide—certainly in the comments I have made so far today—our responsibility. We got it wrong. We made mistakes and we have suffered the consequences in terms of a €5 billion write-off. We have done two things to put that right. First of all, we have reviewed our management and management processes. Secondly, in EADS’s case, that part of the business, which was a separate business entity, is now part of Airbus. So we have integrated into a larger organisation for it to have the resources and the integration that was necessary. So we have learnt, to our considerable expense, what went wrong, and we have undertaken a quite drastic and, I think, perfectly sensible management process to ensure this will not happen again.

In the wider context, industry has very much—certainly at this juncture—got risk fatigue, whereas in the past we would say, “Let’s sign up, let’s make it work.” By the way, I don’t understand this concept, the conspiracy of optimism—never have done. I say that because whenever a programme starts going wrong, you forget about optimism. You end up not making any money. That is a fact. We never, in industry, aim to enter a programme knowing that it will go wrong, which is what the conspiracy of optimism implies. A400M is a good example of that fact because, when it started going wrong, it cost us big time. So in future—for the rest of industry, this is of interest in relation to Brian’s comments—we will approach new programmes and projects with extreme caution. There is the necessity for appropriate contingencies and risk to be applied. We will not do it any more in any sense in a cavalier—and certainly not an optimistic—fashion.

Q12 Mrs Moon: Are you happy that you have improved the reliability of your cost forecasting? You talked a lot about changing management structures and time management, but what about your cost forecasting? There was almost a sense that the Ministry of Defence became a bit of a milch cow and that you could afford to come in under budget because they were going to throw a project forward and you would get the money back then.
Sir Brian Burridge: Defence manufacturing is a numbers-based business: we live and die by the quality of our data. The MoD and its acquisition organisation is a words-based organisation, and that is where the difference is. We invest heavily in financial systems and we have a universal financial system over the entire business—80,000 people. We have data that are correct, valid and timely. On that basis, we can take—or see—early warning. We can take action and we can use that data in the sense that everybody is quite literally on the same page. So a project manager down there on the Wildcat line at Yeovil worrying about undercarriage can see something going wrong and can—and is expected to—act. Now, one of the aspects of the material strategy is for the MoD to be in that sort of area with the quality of its financial data, but we absolutely live and die by numbers.

Q13 Mr Brazier: If I understood the earlier statements by ADS some of you at least see the Gray and Levene reforms as broadly compatible, but I would like to ask you in turn, starting with ADS, if you have any reservations about them. In particular, I would like to focus on one point, which is the fragmentation of—it keeps changing its name; it was the joint capability command, with a co-ordinating body. We now have a compromise in which it has been split between the three Services and the joint capability command, with a co-ordinating body. What are the views on this?
Graham Chisnall: The line broadly compatible in our response basically meant that they are doing complementary things in the main: one is looking at procurement reform and the other one is looking at a broad-based reform of MoD. The reservation in the word “broadly” comes back to a concern that there is the potential for substantial delay while these reforms are worked through and implemented. Delay is something that we cannot afford at this point in the cycle. Coming back to Sir Brian’s earlier point, we are looking for some clarity and a basis on which to make some decisions ourselves on the industry side. These reforms have the potential in our view to delay implementing that stability and efficiency.

Q14 Mr Brazier: But moving on from where they are trying to get to, what about what is now
Sir Brian Burridge: The holy grail in organisations is to align authority and accountability. The front line is accountable for achieving military effect, so it is appropriate that the commander should have his or her hands on the levers that allow that to happen. Defence capability is a pipeline, and where you have a mature in-use system such as Typhoon, it is entirely right that the front-line commander should hold the budget for the support of it and for its spiral development in capability terms, because there is a much more direct understanding of the relationship between the platform and the weapons system and the effect that it achieves at the front line. I think the MoD pretty much sees it this way. It has described to me that, on the one hand, if Typhoon needs a new radar, that is a matter for the front line. They will determine the sort of capability that they require from this piece of spiral development. There is a contract, of course, with DE&S to provide it, and that’s fine.

Conversely, if a decision is taken and we need to be able to get a weapon on a target with a long-range penetrator in 2030, that is a strategic issue, and in those circumstances that will be something for the central MoD capability staff. Nothing about the devolution of this to front-line commands is particularly new. It was, after all, a recommendation in the 2002 Defence Logistics Transformation Study, which was never actually implemented. But it is undoubtedly a method with reduced resources to align authority and accountability in a way that has not been tried before.

Q15 Mr Brazier: That raises two obvious questions. One is how do you prevent problems of fragmentation and lack of inter-operability if you are looking at new systems coming in across the Services as a whole—or the four Services, which we now talk about with the joint command? The other, crucial question then arises: how do you avoid a like-for-like mentality, because, clearly, no one is replacing anything with cyber at the moment, because cyber is not a past concept, so the wholly new steps forward do not have a seat at the table. Sir Brian Burridge: On the inter-operability point, if we just take network enabled capability as the example, the thought police for that is manifest in the joint forces command, so Air Chief Marshal Peach will have the authority and accountability to define what the network is and how you plug into it, otherwise your piece of procurement for spiral development and capability will not be permitted. On your second point, there is no suggestion that we are throwing out scrutiny. The central scrutinisers still have the role of saying that that is within the envelope of what we expect you to do, and thereby prevent the duplication of capability. In a pragmatic sense, the size of the capability that the UK aspires to now actually militates against duplication.

Q16 Mr Brazier: I am sorry; my second question was not about duplication. It was exactly the opposite. It is about the voice for the system that is not in there and that is not replacing anything. Cyber is obviously confusingly called the capability stuff? Is there going to be a strong customer?

Sir Brian Burridge: The holy grail in organisations is to align authority and accountability. The front line is accountable for achieving military effect, so it is appropriate that the commander should have his or her hands on the levers that allow that to happen. Defence capability is a pipeline, and where you have a mature in-use system such as Typhoon, it is entirely right that the front-line commander should hold the budget for the support of it and for its spiral development in capability terms, because there is a much more direct understanding of the relationship between the platform and the weapons system and the effect that it achieves at the front line. I think the MoD pretty much sees it this way. It has described to me that, on the one hand, if Typhoon needs a new radar, that is a matter for the front line. They will determine the sort of capability that they require from this piece of spiral development. There is a contract, of course, with DE&S to provide it, and that’s fine.

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Q16 Mr Brazier: I am sorry; my second question was not about duplication. It was exactly the opposite. It is about the voice for the system that is not in there and that is not replacing anything. Cyber is obviously the high profile example. To take a rather more obscure example, the Americans are now going down the road of these hybrid airships for a whole variety of maritime roles, and possibly wider too. There is no question of like for like. Who is actually going to be the voice for the wholly new concepts, which may be the future of warfare, but are not replacing any existing one?

Sir Brian Burridge: I will use the new nomenclature. The MoD centre will have military strategy and military capability at three star level—two or three stars. Military capability will define that the UK needs to have this capability in its envelope, and this will be led by joint forces command or air command or whatever, but there is no chance that three environmental commands can go freelance on what the capability is.

Q17 John Glen: Can I ask about your impressions of the impact of the cuts in personnel in key roles in the MoD? We have heard concerns from the NAO that the MoD will no longer be an intelligent customer. How do you see that reduction in skills and staff impacting on the relationship, which you have and the dynamics of the negotiations and discussions that you have?

Robin Southwell: First, we have noted on a human level, real uncertainty among the Abbey Wood staff, and a sense of loss of empowerment and authority. That is simply because they spend quite a bit of time looking over their shoulders rather than focusing. In the process of transition that has started, at least emotionally, through to implementation, there will be a period where the level of effectiveness that we all pray for will be difficult to secure, because of the uncertainty.

Q18 John Glen: Was it there before?

Robin Southwell: Before, to a large extent it was propped up by the legion of consultants, advisers and individuals brought in to support the system as it trundled along, so we were working on a patchwork basis. That is actually one of the healthy points about this process, where we all stand up and say, “The emperor has got no clothes. Something has to happen.” That process, of course, creates these levels of uncertainty, which is having an effect on how we engage with the procurement organisation.

You hear comments—this has trickled through; I don’t know if it’s true—that 180 new commercial people are going to be employed within Abbey Wood. What does that mean? How does that fit in? Lots of questions are being asked in the community. That means that in the process of moving forward, the greater clarity there is in the implementation of clear and quick time scales, the better for us all. My view is that it is a disruptive process, which needs to be managed as effectively as possible.

Q19 John Glen: Forgive me, but your answer has focused on the disruptiveness and uncertainties of the current process, not the underlying capabilities that are in the MoD. The concern I have is where has that been and where do you see it going?

Robin Southwell: I was just giving a flavour.
Q20 John Glen: You have also said there are different consultants and different groups playing different roles. Surely, from your perspective that is an ideal situation, isn’t it? You can then have different conversations with different people.

Robin Southwell: That implies a degree of cynicism about me. Anyone who knows me would know that is not the case, that it is misplaced. All we want in industry is a great buyer. We want the buyers to be intelligent, smart, challenging, effective, clear about what they want and extremely effective in negotiating the best possible terms for the buying community. A great buyer makes you a great supplier. Those are the inevitable facts. It challenges you to ensure that what you are doing is right; it holds you to task; it makes you accountable; and it makes deliverable failure an option that is very expensive.

To be clear, the last thing we want is a fragmented accountability, shared to the extent that we do not know who is in charge or what. We do not want contractual terms that are flaky, ambiguous or particularly beneficial to ourselves. We want a fair, balanced contract that we have to deliver, with severe consequences if we fail to do. To clear that up, we want a great buyer, because that is the only way we become great suppliers.

Sir Brian Burridge: No doubt, you will want to talk more deeply on the matériel strategy, but essentially the Chief of Defence Matériel is trying to solve three problems: one of budget, one of skills and one of interface with his ultimate customer. In so doing, a soft market test was done to see what the implications might be of potential solutions. None of those solutions is very early—2014 at the earliest. In the meantime, the DE&S—and that is the only area we can speak to because that is our interface—will need to come down to a manpower level of 14,400 from about 19,500 at the moment. In current circumstances, that is pretty challenging. The DE&S boundary includes the Defence Storage & Distribution agency, the dockyards and the information systems area. It is not only the people who form IPTs and do acquisition. Nevertheless, it is challenging. There will be a need for an interim structure in that time. We are unaware of what that structure will look like or the processes that will underpin it, because, for sure, the processes with a slimmer centre at DE&S need to be different from how they are now. As I said, we crave stability and certainty, and this is just an area where there is uncertainty—for us—at the moment; it may well be resolved soon, but right now, there is uncertainty.

Q21 Chair: So there is a problem of uncertainty over the future of DE&S. What are your views about the options for the way in which DE&S could go—for example, in relation to a Government-owned, contractor-operated organisation?

Sir Brian Burridge: The problem that the CDM is trying to solve is, as I said, threefold: a balanced budget, which is an internal matter; skills; and depth of skills—commercial, finance, engineering, legal and so on. Anything that the Government can do to make our customer a great customer, as Robin has elucidated, has our unmitigated support. That is a good thing. How you get there is an untested matter. Similarly, the matter of an arm’s-length relationship between the procurer and the ultimate customer is, in the Gray report, what sits below many of the problems, where the customer is changing the spec, where there is no stability of requirement and where sometimes technology changes. From all that the management of DE&S say publicly, the need for this arm’s-length relationship, so that you can have a transaction without ambiguity or the cost of change, is quite an important factor in how they go forward. They see that as being best delivered either by an executive non-departmental body or by a GoCo.

That is true, but none of us can say, “Well, is that in the art of the possible?” We look, perhaps, at the Olympic project. The Olympic Delivery Authority used CH2M in an alliance as its project manager—as its strategic partner. The Olympic project was successful. The thing was delivered on time and on budget, albeit that that was much more constrained and perhaps easier to take from beginning to end than defence procurement.

Nevertheless, these models exist and show a degree of success, so the notion of a strategic partner bringing an in-depth knowledge, helping them to do what they require, is perfectly plausible. What remains to be seen is how the interfaces work. How does the interface work between us a prime and what is another commercial organisation, which has a balance sheet, a P&L and a bottom line, and shareholders? These are unknowns, and that is what the next few years will bottom out.

Q22 Chair: What are the pros and cons of the two options that you have mentioned?

Sir Brian Burridge: Between the two, in terms of skills, they are broadly similar, because they will give the DE&S, as a non-departmental body, the ability to hire and fire at what we might regard as market rates. In terms of being able to have the flexibility and adaptability to surmount particular expertise in finance, for example, if there were a follow-on to PFI, which takes a real horsepower to understand from a customer point of view, it is possible that a GoCo—someone like CH2M, Bechtel or whatever—with global resources, would be able to bring those resources to bear. But it is hard to judge until we know precisely what the framework will be. We should not forget that right now we are in something of an unusual context for defence acquisition, because the equipment programme for the next 10 years is pretty much fully committed. We will not see the acquisition of new major platforms coming into the programme, which is always a big test for an acquisition organisation. I would say stand, fast Trident follow-on, of course, but in general, we are in a particular context that is somewhat different from the historical one.

Robin Southwell: I want to come in and support Brian, in terms of his comment about the interaction. There are perhaps two areas of interaction that will, in my opinion, be criteria for the success of this organisation. One will be the ability to bring in specialist knowledge, often from discrete Government agencies or through people in uniform—for example, if you have a platform where you need urgently to bring in some knowledge on defensive aid suites, or
Q23 Ms Stuart: Something was sparked off by Sir Brian Burridge’s comparison with the Olympics. Part of the reason why the Olympics is seen as a success is because there was continuity at the top and a united political and practical will, spanning several Governments. As I look at these various models, in your perception, do any of the models provide for something that will give us continuity of political will at the top, to a degree of certainty? Sir Brian Burridge: Only in as much as none of these models in any way suggests that the MoD and the DE&FS abrogate their responsibility for leadership and management. The point is that they represent the strategic core of decision-making. What they need out of these models, as I said to Mrs Moon earlier, is good, robust data so that they can make decisions, and they need the depth of understanding of how to make them commercially viable—to be a great customer—and to make the finance work.

So the strategic partner is a partner, but the executive authority remains where it is. The degree to which the Ministry of Defence might regard continuity at strategic command level is a matter for the Ministry of Defence, but all I can tell you is that I work in a company where the leadership endures for a very long time.

Q24 Mrs Moon: I would like to go back to your comments, Mr Southwell, about the support sector and through-life capability management. I was really taken by the ADS submission in relation to the White Paper, where you talked about how the support sector can have a great contribution to driving efficiency and, I hope, effectiveness in energy expenditure. Can you give examples of what you think you would like to have seen, and perhaps some examples of where the support solutions have been separated from the acquisition programme? Where has it not been joined up?

Robin Southwell: On the latter part, there is Typhoon, and I will bow to Brian to talk about that. A400M is another one where we are in a process now, close to introducing the equipment into use. We are involved, even now, in a very strong and sometimes emotional debate internally within the supply forum about who will stand the risk of that programme through life. I am looking at things like providing guaranteed maintenance costs for the engines on the aircraft. That process is in play now, and I think best practice is that that should have been undertaken at the very beginning of the requirement stage—that it would be an underpinning requirement before we move forward that that is addressed. So that is where we have a misbalance.

In terms of the importance of this—I am not at odds at all with anyone on this—I think that the underlying principle that availability-based contracting is good news, that risk is applied where it is best managed, is well understood. If you don’t mind, I will give you a very brief anecdote. In my youth, I was involved in the air-to-air refuelling programme, and I went on a VC10—this must have been about seven or eight years ago—and when we turned up three things happened within about 30 minutes. One was that the steps to go on to the plane were not there, so we had to wait 10 minutes for someone to find the steps. We got on the plane and one of the other planes that we were with could not join the mission because it had gone tech—stopped working—and then, as soon as I went to the toilet, the bulb in the toilet was not working. So, within 30 minutes of me turning up, there had been three incidents. Today, under AirTanker, each one would have cost a significant amount of money as a service credit. By now, AirTanker would perhaps have been over £100,000 out of pocket for that failure to deliver. That is an interesting thing.

At the moment, the Armed Forces are well pleased at make-doing and mending, at getting it going on the day, while you have introduced a wholly different and I believe totally appropriate focus on, “What is the output? If you fail to deliver, you will be punished,” because it certainly concentrates minds and gets the behaviours right. There is one view. Another one on this is to do with the amount of money that was spent on what I think were the VC10 wing cracks about 10 years ago. Now, all of that risk would be transferred to industry, in terms of through life—over two and a half decades, if it goes wrong, it is for industry’s account.

In my opinion, the greater engagement with industry in the round on output-based solutions really does make a big difference in terms of effectiveness, accountability and cost-effectiveness. Brian, you have an example on Typhoon, haven’t you?

Sir Brian Burridge: If I may, I will start with Tornado, because this goes back to 2002 and the Defence Logistics Transformation Programme, where it was decided that we would go for an availability contract for the Tornado, run by BAE Systems, based on outputs and with performance incentivised. The NAO crawled all over this in 2006 and determined
that £1.3 billion had been saved in that period on Tornado support. The same is true of the Integrated Merlin Operational Support—the blueprint is used throughout all our helicopters. It is not quite reproduced in Typhoon yet, but the area of interest that the White Paper might have done us justice in explaining was the extent to which you should actually extend those boundaries. The nearer you get the industry boundary to the front line, the more you are providing incentives for availability of a combat-ready platform, whatever it is, to be there on the day. Since the White Paper has come out, or in parallel with it, the Whole-Force Concept is beginning to get flying speed. The Whole-Force Concept, as you know, consists of this blend between uniformed regulars, uniformed reserves and industry, and how you can manipulate that blend in order to provide you even with deployed capability. That is the direction of travel now. Perhaps I would have liked to have seen it given momentum in the White Paper. It was certainly something that we took into the “Dragon’s Den” process of the SDSR.

Q25 Chair: Mr Hansell, can I come to you about SMEs, please? You have said that one of the things that was necessary about the White Paper was getting it into practice, that the implementation of it would be challenging. The White Paper seemed to contain quite a lot about SMEs; it seemed to major on SMEs in general. What would you say are the problems, apart from getting it into practice, that SMEs face?

David Hansell: Bearing in mind that “SME” covers a broad spectrum of people, from one and two-man companies right through to 250-man companies with robust balance sheets, from the trade association and the meetings we have with the smaller of the SMEs, we think that at the lower end of that spectrum engagement directly with the MoD would be helpful for continuity and communication, and so on. Some of the barriers to that, of course, are some of the onerous terms and conditions that naturally flow down in the standard terms and conditions of contracting with the MoD. To that extent, what the trade association has been doing with the MoD is to try to get a smaller set of those terms and conditions that are more appropriate to lower-value contracts, rather like the back of the purchase order terms and conditions you would get in normal contracting between companies, let’s say.

Q26 Chair: How successful is that?

David Hansell: It has been reasonably successful. One of the outstanding things at the moment is the unlimited liability placed on MoD contracts with small contractors—under £250,000. To try to ensure against unlimited liability is very expensive, if doable at all. So that is the dialogue that is currently going on with the MoD to try to resolve the issue, which I think is unique to the MoD in government contracting.

Q27 Mrs Moon: In your responses you have talked a lot about contracting with the MoD, but what about the difficulties of the SMEs contracting, winning contracts and breaking through into contracts with the primes? Is that getting any easier? Can you see this White Paper suggesting that perhaps the primes have to shorten their time scale, in particular for getting on to their approved list of SMEs? Is that improving? Is that an area that needs greater work and greater opening up by the primes?

David Hansell: I think that it depends on where you sit in the supply chain. If you are an integral part of the capability or requirement, historically you have had early engagement. If you are much lower down in the supply chain, contract to delivery—flash to bang, as it were—is much shorter. One of the themes in the White Paper as far as the Ministry of Defence is concerned also applies to the prime contractors, where engagement of the SME community should happen earlier in the process.

Q28 Chair: Have any of you had experience of the Centre for Defence Enterprise?

All witnesses: No.

Q29 Chair: I must admit that I am a bit surprised to hear that. But there remain, according to the ADS paper, concerns about intellectual property and commercial arrangements. What are those concerns?

Sir Brian Burridge: The SME landscape in the defence manufacturing business is potentially 95%, 96% or 97% build-to-print manufacturers—low overhead, high precision, high quality, on time and on cost. Of the remainder, the majority is service, and a tiny part is what we might regard as R and D, or the capability of producing elegant software or some product like that. In that case, the SME owns the intellectual property—quite rightly—and we have found in the industry that there are cases in which the legality of that intellectual property and its copyright is not properly respected by either the customer or the entity higher up the supply chain. In our business, we actually have a methodology of protecting the intellectual property and we invoke a licence scheme whereby we will buy a licence for an SME’s intellectual property. That is beginning to be more and more understood. That is the first point. The second point on terms and conditions is the business of unlimited liability that goes with your product that is being embodied by your customer, whether that be someone else up the supply chain where that would not apply because we would not expect a supplier to take unlimited liability in that sense. It is what primes do. That is why we have big balance sheets. But that is not the same for a direct transaction with the MoD. I think the MoD, Graham will correct me, is unique in still insisting on unlimited liability from its suppliers.

Q30 Chair: Are you suggesting by your previous answer that the Ministry of Defence is careless with the intellectual property of its suppliers?

Sir Brian Burridge: I personally would not say that. I can adduce no evidence myself to say that. I can say that is what I hear in the small companies committee. In fact, in relation to your question on the CDE, the Defence Sector Board is having its next meeting at Porton Down with the DSTL to talk through at board level these matters. The degree to
which actually they do have a process in which small companies can have confidence is one item.

Q31 Chair: Mr Chisnall, do you want to add anything to that? You do not have to.

Graham Chisnall: I will not then. I think that is sufficient.

Q32 Bob Stewart: The ADS memorandum suggests that companies spend about 8% on R and D. The question is whether that really compensates for MoD’s R and D spend as it used to be.

Graham Chisnall: R and D has reduced across the board. That is partly because some of the very large programmes have moved transition out of development into a more mature period. But it is of concern. It does not fully compensate.

Q33 Bob Stewart: When you say fully, in what percentage? Can you put a figure on it? How much is missing?

Graham Chisnall: I do not have a figure to hand. We can supply that very easily.

Q34 Bob Stewart: It would be very nice to know.

Robin Southwell: It is big numbers. The MoD R and D budget has gone from 2.4% to 1.2% over the last 10 years, while the defence budget has, if anything, got smaller. So in actual hard terms we are spending under the MoD R and D less than half as much as we used to spend.

Graham Chisnall: It is several hundred million a year.

Sir Brian Burridge: I can give you some figures. The ‘97–98 spend was £646 million. If I normalise that with the GDP inflator, at 2009 prices that is £670 million; 1.2% of the defence budget 2012–13 sits at around £410 million. It remains to be seen what the defence budget is. But that is the difference. So it is significant. We need to be careful though because the lexicon around R and D is loose. There are these things called the Frascati principles by which you define what is research, what is development and they are not applied universally. But the defence industry generally across Europe invests somewhere around 8% of revenues. So that includes contracted R and D. In the UK, Finmeccanica for example, 2010, £220 million, of which £70 million was co-investment with the MoD. Last year it was £200 million.

Q35 Bob Stewart: I will try to speed this up as I know the Chairman wants us to get through this. I have three questions, one after the other, and I will cut you if I am happy. Have you any comments on the MoD’s science and technology spending that would be of use to us?

Robin Southwell: Can I answer that question—

Bob Stewart: Sorry, I did not mean to cut you off.

Robin Southwell: No. I have not said anything yet. You were talking about R and D—we say R and D in a purist sense. A lot of R and D is undertaken when a project has been placed with a customer. That is where the real practical stuff really starts to come through. If you have an E-scan radar, you really pile in through the actual building, deployment and integration of it within a platform.

What is interesting, going back to the White Paper, is that, when we look at the criteria upon which the Government is acquiring, it talks openly and quite understandably about wanting to be the most open market in the world through competition, and we laud that. The White Paper also emphasises the growing importance of off-the-shelf. When it talks about off-the-shelf acquisition, one of the key criteria is maturity of product. That is not a defined term, but the White Paper defines it as maturity. Maturity means that it is already in operation somewhere, which by definition, if you follow my logic, means that some other country is using it and has invested the R and D, and we are using that. That process means that we will not undertake that key R and D activity here in the UK, which, by the way, removes our ability to export it because we are not building it here. As much as R and D is important in the pure sense, more is spent through actually building programmes and projects here in the UK with us in the industry. If your acquisition process is to buy mature off-the-shelf, we are precluded completely from that opportunity.

Sir Brian Burridge: The White Paper gives us six critical outcomes from science and technology, and they are all very plausible. The White Paper also tells us that every year the Government will publish its S and T priorities. To me, S and T priorities mean precisely what technology you want to develop, and I immediately think of technology road maps, et cetera. I have a bunch of mental criteria by which I judge that, but the area that is missing here is: let’s just make sure we understand where this technology is generally developed, if it is not developed in the UK, and let’s just make sure we understand what our access will be. We might say, “Well, our major partner is the US.” Will that technology be covered by ITAR restrictions? Would we get what we need for competitive military advantage?

Bob Stewart: That is what Robin was alluding to.

Sir Brian Burridge: Yes, or to integrate it into platforms that become commercially competitive in themselves. There are two glaring areas that are missing from here. The most important streams of technology are about sensing—they are about radars, listening to radio frequencies, infra-red detection, etc. They are critical, battle-winning technologies, and they will be until the rules of physics change. That is missing, and that is what we need to see.

Bob Stewart: That is very important.

Q36 Mr Brazier: Sir Brian, you have very nearly answered my principal question, but I just want to be absolutely clear about what you have just said. Are you saying that we need a checklist? “These are the critical technologies that we are going to have to be involved in. Which ones are we going to be looking to the UK for, and who can we trust to provide the others? It has to be an actual list of concrete technologies with an identified basing,” is that what you are saying will be the basis of a serious—

Sir Brian Burridge: Correct.

Mr Brazier: That was my main question. I have another small one.
Q37 Mr Brazier: Do you see, though, any prospect of the MoD producing such a list? One of you—it was either you or Mr Southwell, but I cannot remember which—mentioned at the very beginning the fact that the White Paper was only the beginning and there are other documents expected. Do you see any prospect of the MoD producing such a list?

Sir Brian Burridge: They have undertaken in the White Paper, with two Ministers’ signatures on it, to produce their S and T priorities. The degree to which those S and T priorities are useful to a physicist remains to be seen. Bear in mind that the defence technology strategy did just that, and actually in the White Paper it explicitly states: “In particular for defence technologies, these will replace the on-line Defence Technology Plan and supersede the Defence Technology Strategy 2006.”

That is, these priorities will replace them. Will these priorities be accompanied by technology road maps? I don’t know.

Q38 Mr Brazier: Were the earlier ones in 2006?

Sir Brian Burridge: Yes.

Q39 Mr Brazier: They had technology road maps?

Sir Brian Burridge: There were reasonable technology road maps.

Q40 Mr Brazier: Following on from that, in a sense you are the wrong side of the House to answer this question, but it would be very interesting to hear your view, though. There was the recent announcement of the easing of the controls on who QinetiQ—that is, the very strong veto that the MoD has had up to now as to who QinetiQ, which of course controls a very large body of what would have been the MoD’s in-house stuff until it was privatised—can do business with. Do you think that, in those areas that we continue to control, there is a real danger that we could lose it not just to competitors but potentially to enemies?

Sir Brian Burridge: I cannot comment on that; it is a matter for QinetiQ and its customer.

Q41 Mr Brazier: My last question is a rather more specific one. What do you understand by a modular approach? What are its advantages and disadvantages? For example, the Navy say that it is much harder to repair a ship that’s been hit if you are reliant on replacing modules, whereas you could get sailors to make and mend. What is the view on modular approaches?

Sir Brian Burridge: The nearest equivalent to a modular approach is the personal computer that we all take for granted, where it has a veritable open system architecture and you can buy whatever applications you like, and you know they’ll work. You can buy any printer you like and 90% of the time it will work. And you can plug it into a network, and it will work because there is a universal open system of architecture, which is defined as standard.

If we reach this nirvana, say with aircraft, we will have a central architecture into which you as a customer can plug your own bespoke capability, whether that be a certain sort of radar or a certain sort of infra-red sensor, or whatever. If the baseline architecture comes with modules, either stated by you because that is what you want or this is the standard and they can be switched around, that is a modular approach. As technology changes and as you wish to spiral develop a platform’s capability, you substitute different modules. Frankly, the science of armoured vehicles is moving in this direction. The science of aeroplanes is just about there, but not entirely.

Q42 Mr Brazier: There is a physical modularisation too. As far back as a quarter of a century ago, Dutch warships had whole sections you could just pop in and out. We have moved partially in that direction ourselves. What do you see as the pluses and minuses? The pluses are fairly obvious, but what do you see as the minuses?

Sir Brian Burridge: Twenty-five years ago, modular was merely substituting like for like; in other words, it’s damaged or it’s broken and we can shift this in. What we are saying now is that the advantage is that, as technology changes and as the ability to produce a more discriminating radar arises, you can slot that in. The disadvantage is that there is always the potential that, as with your PC and a printer, your aspirations will ultimately be dented, because it just doesn’t quite work in that way. But as a theory, it is unassailable.

Graham Chisnall: There are different degrees of modularity, and clearly armoured vehicles having applied armour on them, and so on, is a sensible approach. One of the other disadvantages is if somebody comes along and invalidates the operating environment that you’re hanging everything on—there’s a new generation, or whatever else. But as long as one goes in with one’s eyes open and you use it intelligently, then it has significant power.

Q43 Bob Stewart: I have just got one quick point. It’s to you, Mr Hansell, really. From your point of view, as someone who represents SMEs, how hard have you been hit by the decline in R and D in the Ministry of Defence? How has it affected your companies?

David Hansell: I think it’s to do with transparency. What are the equipment programmes? In which areas does technology insertion or innovation need to be focused? Because, for a small company, the investment in doing that and the resource it takes is significant. So you don’t want to spin your wheels and try and develop something that’s not going to be
required. So I think more clarity in what’s required—what capabilities, or what end state is required—would be extraordinarily helpful to make those investment decisions.

Q45 Chair: Sir Brian, I have a question for you, which is aimed at you not really so much as an industrialist but in your role as a former senior commander. What is your view of the consequences of buying equipment off the shelf on the legality of the understanding of what that equipment does in relation to targeting, for example, various different potential targets?

Sir Brian Burridge: This relates to what I call a body of knowledge. A nation decides what its military power is going to be, and that military power has two elements: an envelope of capability and its intent to use that capability. The UK is somewhat different from other nations, because its intent is very forward-leaning—the notion of standing alongside our allies—the US or whatever; the notion of being there on the first day of war; the notion of a force for good in the modern world, mean that we tend to need to react to the unexpected, react quickly, and get it right. So that capability envelope has to be constantly manipulated, and we manipulate that—as a former senior commander—by absolutely understanding how our kit works and training aggressively. We take that capability to the edge of the envelope and beyond, if combat demands it. We do that because we have a body of knowledge. That body of knowledge is enshrined in the military memory, the corporate memory of the MoD, the scientific community, including academia, and industry. When it is necessary to go into an operation—and targeting is a good example—it may often be necessary to modify weapons and the way they work, or accelerate the introduction to service of weapons, and in 2003 in the Iraq war we accelerated Storm Shadow into the inventory. It was just in development. In Libya and Afghanistan the role of dual-mode Brimstone similarly was accelerated—changed; and this can be done because you can reach out and touch the body of knowledge. In other words, there are people at MBDA Stevenage who understand how one piece of that weapons system works.

So when it comes to explaining to Ministers that you need to use that weapon to address particular targets—in Iraq, air defence bunkers with 3 metres of concrete on was a classic example—then you have to be able to explain to the Minister, but not in terms of “Well, we’re not quite sure, because it says it will do this, but we really don’t understand it”. You have to be able to say with certainty, “The collateral damage implications of this weapon are;” and then the Secretary of State will go to the law officers and say, “This is a legitimate approach.” Understanding that legality and understanding how you manufacture that sense of understanding is what we in the UK have been able to do. Other nations do not do it that way—they wait, they use whatever standard they have, and they address only those targets for which they have weapons that are well proven and so on. We could do an analysis of Libya—the Committee is well aware of this—where different nations addressed different sorts of targets, because they were limited by the way their weapons worked. The body of knowledge is what allows you to look a Secretary of State in the eye and say, “This is safe.”

Q46 Chair: That is an extremely helpful answer, thank you.

I want to turn to international collaboration. We do not have long—we have 10 minutes. The ADS memorandum says: “UK Industry is at a disadvantage when taking part in joint programmes with industries which are supported by their own national defence industry strategies.” Can you give an example of that? Mr Southwell, I suspect that you may have views on this.

Robin Southwell: Most of our competitors have joined-up strategies that combine their defence procurement strategies, their R and T and R and D strategies, what their armed forces use, and what they want to do to export. That is what most of them do, one way or another. I will give you one example from the US, which has a “buy America” policy, which is protectionist with a small “p”, which they are certainly very much, to sell copious amounts to the UK. France has a very joined-up strategy, whereby it has a clear national champion in Dassault, and it has thought through, in impressive detail, how it wishes to drive that political industrial strategy forward in its activities. It looks to our market, which is the fourth largest in the world and which we laud as being the most open market and the most available market, as an opportunity, as their market gets flatlined, to develop their strategy. Good on them—they are very good at this and they have, throughout history, brought their resources together in a very cogen and coherent way. We do not do that. We laud our ability not having these strategies. We regard ourselves as world leaders at pragmatism, ad hoc activity and case by case—that is how we do it. When those two very different cultures and approaches meet, there will be issues. In our case, because we do not have that type of strategy and they do, we have defaulted to employing their strategy. We are very concerned about this in industry, because of the issue of initiating the Anglo-French accord, which, when those two very different cultures and approaches meet, there will be issues. In our case, unless the underlying principles of reciprocity, balance, mutual access to each other’s markets and mutual engagement are understood and adopted. That has not been the case to date. I very much welcome the fact that that is now recognised and, moving forward, that it is enshrined how UK plc will engage with the French moving forward. It is the nature of the beast. The point I mentioned earlier, whereby our lack of something and everyone else having it, means that if we are not careful, we will, by definition, adopt their approach. I have one more example, if you wish, Chairman.

Chair: I am not sure that I do, actually.

Robin Southwell: It is very powerful and very quick.

Chair: Very briefly.
Robin Southwell: In the States, I mentioned that they did an awful lot to ensure we did not sell 500 air-to-air refuelers—even though we won twice, they kept on taking us back until they ended up winning—but they are very comfortable selling Chinooks and C-17s for cash to the UK. That is a second example of how their strategies seem to benefit them at our expense.

Graham Chisnall: I would like to make one quick addition to what Robin has said. In a context of commercial, off-the-shelf, declining R and D budgets and so on, if we do not have the capability to act as an equal partner in these bilateral or multilateral relationships, you are on an asymmetric footing from the start. To make these relationships work, in addition to what Robin was saying you have got to bring real capability and technology of your own to the party, to make that relationship equitable.

Q47 Bob Stewart: Do our government Ministers have enough knowledge to do the job properly? I am looking at Sir Brian now because he is grinning.

Sir Brian Burridge: I am going to give you the obvious statesmanlike answer: that is a question that the Committee will wish to address with Ministers.

Graham Chisnall: Could I give you a slightly different answer? On the commercial aerospace side we have an engagement process under way with BIS called the Aerospace Growth Partnership (AGP). It involves the Secretary of State and downwards. An extremely large effort is going on and it encompasses more than 80 senior executives from industry and joint working groups with BIS. It is putting together a plan for the next 20 years for how we can stay pre-eminent in commercial aerospace. It deals with what needs to be done with technology and all the other aspects that go into that plan. It is an excellent role model that we would commend, and elements or analogues of it could apply to the defence field as well.

Q48 Chair: How would you characterise the general dialogue that the Government have with industry? Are you consulted early enough? Are you consulted sufficiently and are they honoured? What are the discussions like between the Government and industry?

Robin Southwell: We mentioned earlier that the White Paper was a wonderful example of how industry was consulted, and we made some very strong recommendations, including the two that I mentioned. If we are going to place the fundamental emphasis on exports, criteria one is that we have to use the kit.

The second major issue that the White Paper talked about is SMEs, and the requirement to help them in some fundamental ways. That came through in the responses. Questions were asked and we gave the responses, but the trouble is that the White Paper did not actually reflect on them in a manner that allowed us to develop that. I gave you the definition of value for money, which completely precludes any of those things that are the underlying assumptions. There is an engagement and an interaction, but obviously we would like greater effect in terms of how policy is driven from that.

Q49 Chair: Mr Chisnall, or Sir Brian, I had the impression that ADS felt that the input that it had had into the White Paper had changed it quite significantly. Is that an incorrect impression?

Graham Chisnall: I do not think that it is an incorrect impression. I think that the consultation effort was worth while and that the thinking matured, and we can see evidence of that in the final White Paper. We would like far more engagement and involvement in the areas that we have talked about, so one could always do more in that regard.

Sir Brian Burridge: The only thing I would add is that the paradox remains in the White Paper regarding export, off-the-shelf, R and D investment pointing downwards. That was the big strategic issue that we pointed out in the consultation phase, and it remains unaddressed.

Q50 Mrs Moon: I am intrigued to pull all this together in my own head and perhaps you can help me. You said, Sir Brian, that the British stance has always been forward leaning. However, everything that you have said today seems to indicate a reduction in our capacity to be forward leaning. Perhaps there is a mismatch in the desire to economise and what we want to achieve. Am I right that that is the flow you are trying to give us, and that what we use our forces for, and their capacity to achieve Government objectives, is going to be reduced by the alteration in our procurement strategy?

Sir Brian Burridge: Correct on two counts. The first is that the SDSR elucidated a force structure within which the combat power was much reduced. That is the sheer combat power that the UK would be able to deploy in mass terms, and it makes it clear that it is something like 30% less than that which we deployed in 2003. I suspect that in a rewrite today it would be even less.

The second point is that by not understanding, or at least not admitting to understanding, those factors that sustain an onshore defence industry, with all that that means in terms of its intellectual property, R and D, and manufacturing capability, in my view the total capability of the UK’s military instrument will reduce, and with it our stature as a military power.

Q51 Mrs Moon: By how much? Are you going to give us an idea?

Sir Brian Burridge: If I could see into the future—it is things that we have taken for granted such as being there on day one for Libya. This doesn’t happen overnight, but ultimately that is something that a nation such as ours would not be able to do.

Chair: Thank you very much. That was an extremely helpful, interesting and illuminating evidence session before we see the Minister on Tuesday. We are most grateful.
Tuesday 15 May 2012

Members present:
Mr James Arbuthnot (Chair)
Mr Julian Brazier
Thomas Docherty
Mr Jeffrey M. Donaldson
John Glen
Mr Dai Havard
Mrs Madeleine Moon
Penny Mordaunt
Sir Bob Russell
Bob Stewart
Ms Gisela Stuart

Examination of Witnesses

Witnesses: Peter Luff MP, Minister for Defence Equipment, Support and Technology, Bernard Gray, Chief of Defence Materiel, and Air Marshal Steve Hillier, Deputy Chief of Defence Staff (Military Capability), Ministry of Defence, gave evidence.

Q52 Chair: Minister, and all of you, welcome to our inquiry on defence acquisition. Many thanks for coming. I wonder, Minister, if you would be kind enough to introduce your team.

Peter Luff: With pleasure, Chairman. What a pleasure it is to be on this side of the table, rather than the other. I am Peter Luff, the Minister for Defence Equipment, Support and Technology. I am accompanied by my colleagues, Bernard Gray, Chief of Defence Materiel, and Air Marshal Hillier, Deputy Chief of Defence Staff (Military Capability).

Q53 Chair: I give you advance warning that, although it is not the focus of this inquiry, at the end of this session, in view of the announcement last week on aircraft carriers, we are likely to ask you a few questions on that. I think you would probably be a bit surprised if we did not. The main focus of the inquiry and this session today is the implications of the White Paper, the way that defence acquisition is changing and how you are all intending to reform the DE&S—defence equipment and support.

Bernard Gray: That is correct, Mr Chairman.

Q54 Chair: I would be grateful if you would do your utmost to avoid speaking in acronyms this afternoon. I will begin, if I may, with a rather open and broad question: how do you see the future of defence procurement?

Peter Luff: That is a very open and broad question, Chairman. “Positively” is the simple answer to that. I believe that the steps the Government have taken, both in the White Paper, to which you have already referred, and in the announcement we had yesterday on the balancing of the equipment budget and the broader MoD budget, give us a very positive future for defence acquisition.

We have balanced the budget. I thought I would never be able to utter those simple words to a parliamentary Committee and believe in them, but I do. It is the first time in a generation that the MoD has had a balanced budget, and it is a great tribute to my colleagues here and the Secretary of State that they have actually achieved that. That in itself is a huge achievement that makes it much easier for us to deal rationally with the challenge of acquisition in the future.

However, that is very far from the end of the game. We now have to make sure that we keep the budget balanced, because that will give industry the certainty that it needs to plan its investment decisions with confidence. I am sure you will want to explore at some length today how we keep it balanced. The simple message is that we will be very robust about one thing: if we cannot afford the capability, we will say we cannot afford it and we will not have it. We face a very challenging situation. Notwithstanding the generosity of the Chancellor in promising a 1% uplift of the equipment programme after 2015, we still have a difficult and tough act. My colleagues here face that on a day-to-day basis.

I believe that spending £160 billion on equipment support in the next 10 years gives industry huge confidence in what it will have to sell to us. It will be able to plan with confidence when the defence equipment programme is published after the audit by the National Audit Office in summary form. There will also be new opportunities that I hope we will start to focus on now—for example, integrating suppliers much more closely with the delivery of front-line capability in a total support force concept. There will be whole new opportunities for them as well. It is a positive future, but the real challenge for us is in making sure that they are delivered and, as I said, in ensuring that the programme remains balanced, which is the essential challenge I think we now face.

Peter Luff: That is my understanding, certainly. That is the intention, Chairman, yes, absolutely. That is very much our understanding. I would welcome the opportunity to scrutinise our budget more carefully, along the lines of the American model, as with the UCC in the US Congress. Sadly, that is not an option at present for this Department or any other, but I personally would welcome the power of this Select Committee to do more work on scrutinising other Departments. The NAO, and therefore the Public Accounts Committee, would be the vehicle by which that scrutiny is achieved.
Q56 Bob Stewart: Can we get this right? PR12 is a balanced budget, so from now on we have a balanced budget.
Peter Luff: Let me reiterate what happened yesterday. We announced that for the next 10-year planning period for the MoD we have a balanced budget. We are planning to spend £160 billion over those 10 years on equipment and support. Within that £160 billion, we have a £4 billion contingency figure for cost overruns on projects, and £8 billion of headroom for a priority list of equipment not in the core equipment programme. That is £12 billion; so £148 billion is committed to the core equipment programme. We can speak with confidence that we have in the course of the headroom figure and the contingency figure, an innovation that Bernard Gray—in his original report to which you referred obliquely earlier—was seeking. I am delighted now to be able to do that because I think it will enable us to plan much more confidently to stay within the budget framework set for us by the Treasury.

Q57 Ms Stuart: Yesterday in Question Time, Edward Leigh, a former Chair of the Public Accounts Committee, pointed out that there was a distinct possibility that you could have a balanced budget but still spend it on the wrong things. What would you say to that?
Peter Luff: We are not, is the simple answer to that question. I agree it is a very real risk and danger. The Armed Forces Committee, which is a crucial component part of the new MoD structure, will ensure that we are not doing that. The Chiefs there meeting the Vice-Chief of the Defence Staff and the Chief of the Defence Staff are responsible for setting military priorities. Yesterday, the Chief of the Defence Staff was very clear in on-the-record briefings and speaking to staff at the MoD main building that this programme was what was needed to deliver Future Force 2020. We have got the resources we need to deliver Future Force 2020; he and the other chiefs signed up that they agreed with that. I would say that Edward Leigh was absolutely right to make that observation, but this budget is the right one to deliver Future Force 2020, as set out in the SDSR in 2010.

Q58 Chair: Does this meet your original specification, Mr Gray, for the analysis and examination of the budget of the Defence Procurement Agency, as I think it then was?
Bernard Gray: It was still DE&S at that point. It meets the broad thrust of it, I think. I have definitely seen the behaviours shift as a result of knowledge that the budget will get external scrutiny. People have been held to a higher standard of account, as a result of knowing that we do not have to do it just internally versus externally. So I think it carries through the required intent. It is not the same formulation, obviously; it is not quite as legally robust. There is a challenge about whether or not that level of robustness was viable. I had in my mind at that time the way in which directors of companies are personally legally liable for trading in an insolvent state, for example. It is a wider Government question, the degree to which either officials or Ministers should be personally liable for the financial affairs of the Departments. Certainly, in terms of driving people towards genuinely balancing the budget, the commitment that the Government made after the election to balance the budget and then publish it, has certainly driven behaviours in a positive way.

Q59 Thomas Docherty: There were a number of programmes that were cut. You have mentioned the 1% uplift from 2015. Is that in its entirety how you got a balanced budget in PR12?
Peter Luff: I emphasise that this has been a very difficult and painful journey. We are at a better place than I expected to be after only two years, but it has been difficult. As you say, we have cut significant capabilities. I think this Committee is taking evidence next week on maritime surveillance, for example: the Nimrod MRA4 project. We have taken the 10-year gap in carrier capability and disposed of the Harriers earlier than intended. Many painful and difficult things have been done that, frankly, we would rather not have done in an ideal world. It has been difficult but we are now in a place, because of those changes and because of the 1% uplift in equipment budget from 2015, to say that we can balance the budget.

Q60 Thomas Docherty: So I am right in saying—I am not putting words in your mouth—that there will be no further cuts needed, other than those already announced, to have a balanced budget. Thus, any requirement for any further cuts is a failure somewhere within the MoD.
Peter Luff: I must caveat my answer in two ways. First, we live in very strange economic times. Our Greek friends are not making life easy for the eurozone. There are wider macro-economic factors that could always intervene; I acknowledge that. Secondly, there could be some kind of change to the threat: a significant accident or change that might make a big difference to the way we approach our defence needs. There might be further challenges, but the simple answer to your question is yes. We believe that the combination of the reductions in capability already made, the new contingency sum, the headroom figure and the 1% uplift give us confidence that we will not need to make any further reductions in capability cuts.

Q61 Mr Brazier: Minister, that would be a very good place indeed if we have made it there. Of course, the whole business that you are in is trying to give an edge to our Armed Forces over the equipment of the enemies they may face. When the last Government privatised QinetiQ and moved a large part of the Ministry’s internal defence know-how into the private sector, one of the things this Committee’s predecessor was particularly concerned about was protecting that know-how. There have been reports in the press that the MoD is reducing the control it has over whom QinetiQ is allowed to do business with. Is that correct?
Peter Luff: I might hand over to my colleague, who is best placed to answer that. The simple answer is that we have changed the special share arrangements. Yes, that has happened in an appropriate and quite
Q62 Mr Brazier: On protecting it from getting to potential enemies, do we still have an absolute veto over whom they are allowed to do business with? Peter Luff: I will just take you through this. It is an important point. I should sort of declare an interest: QinetiQ is almost a constituency company in Worcestershire, very close to me. We have relaxed some of the special terms of its special share to abandon the Department’s right to veto any decision or activity undertaken by QinetiQ. The special share’s detailed prescription is how the company’s compliance regime process is managed. We will retain other existing special share controls over QinetiQ, enabling MoD to reject significant shareholdings built up by investors considered to represent risks to national security, or the defence manufacturers posing risks to QinetiQ’s continuing independence.

Their independence is very important to us indeed. What they do for us in assessing proposals, ideas and technologies is crucial for independence matters. The impartiality and extensive advice in support of the MoD is strategically important. The relaxation of special shares does not mean the MoD is now more prepared to see QinetiQ become a takeover target. We are confident this gives the commercial freedoms that they need to flourish as a company while protecting our sovereign interests.

Q63 Mr Brazier: But they could still sell to somebody whom the MoD regarded as a potential enemy under the new rules.

Peter Luff: No. Mr Brazier: I did not understand the very first part of what you said.

Peter Luff: We have the right to reject significant shareholdings—

Mr Brazier: No, sales rather than shareholdings.

Peter Luff: Sorry, you mean the stocks—

Chair: Sale of technology.

Mr Brazier: Sale of technology.

Peter Luff: That would be constrained by the export licensing regime.

Mr Brazier: Right. Thank you very much.

Q64 Sir Bob Russell: Minister, on the defence cuts and balancing the budget, could you give us a list of the defence commitments and obligations that have been cut alongside that?

Peter Luff: I have already listed the principal ones in answer to Mr Docherty: the Harriers, the aircraft carriers—

Q65 Sir Bob Russell: No, I am talking about our overseas commitments and Britain’s defence around the world. Where have we cut our commitments and obligations and the country’s international activities?

Peter Luff: I cannot think of any international activities. Can you, Steve?

Air Marshal Hillier: Throughout this process, and certainly through planning around PR12, we have been absolutely clear about protecting our priorities, which are the United Kingdom’s standing commitments, our ability to succeed in Afghanistan, and to be prepared for other contingent operations and set the path for Future Force 2020. Those have been our absolute head marks. We have not changed the “what”, if you like—what we are trying to achieve. We have made adjustments in how we would achieve that. We have remained absolutely robust in our international obligations. In fact, we are seeking to deepen our working with allies and with NATO, because all nations are under the same budgetary constraints, so that is the sensible way to do business. I know that we have not undermined our commitments from a UK perspective. I would like to think that what we are actually doing is deepening a lot of our relationships as a result of the work we have been doing.

Q66 Sir Bob Russell: So we are doing the same with less.

Air Marshal Hillier: I would say that we are trying to do our business in the most efficient way possible. The SDSR set out head marks for having agile, adaptable and responsive forces. That is what we are enabling as a result of our plan.

Q67 Sir Bob Russell: Minister, let me make one observation: I have not seen any reduction in the number of Defence Ministers as part of the cuts.

Peter Luff: Ask the Prime Minister about the number of the Defence Ministers, not me. We are all very busy. I can assure you, Bob. This document—the SDSR—remains the guiding light for our actions and positions. Nothing we have done invalidates any of the things we have said in the SDSR, apart, of course, from the change to the carrier, which we will be discussing later on in this evidence session.

Chair: We will come on to the SDSR in a moment.

Q68 Mr Havard: What budget we are talking about? Are we talking simply about the defence acquisition budget, or about the whole of the MoD budget? As you know, the MoD reports and accounts are qualified year after year. Apparently, there has been some discussion with the Treasury about these. What budget are we talking about? Are we talking about a budget within the total budget, or the total budget? Is the NAO going to examine all or part of it? Can you define some terms for me, please?

Peter Luff: I must again try to go back to basics. My colleagues will help me if I miss anything out. We are talking about the total MoD budget—the totality of it. We have announced in earlier statements changes we are making to the number of Armed Services personnel and civilian personnel and other reductions in cost centres across MoD, but the central challenge we faced, after all that was done, was the
imbalance in the equipment budget. So the NAO will continue its routine scrutiny of the MoD's broader budget, but I am here today to discuss just the equipment and support budget, which will be audited by the NAO separately to make sure that the equipment budget, which has caused so many problems over the years and has led to so many cancellations, disappointments, cost overruns and delays—

Q69 Mr Havard: That is why I want to be clear. The statement by the Secretary of State was about “the budget” being balanced.

Peter Luff: We could not balance the total MoD budget without balancing the equipment budget.

Q70 Mr Havard: Okay, but within that, there are other budgets, for example defence inflation—an argument we could doubtless have hours of debate about, but it has some reality to it—is presumably part of a set of calculations for your defence acquisition materiel budgets within the overall budget. So the NAO is going to investigate what? It already looks at the totality of the MoD. Is it going to examine in particular that aspect of the parts that you are in control of? Will the report that is talked about and publication of information relate specifically to that, or to the totality?

Peter Luff: The central challenge remaining for the Secretary of State to balance the MoD’s total budget was the problems within the equipment budget. Those problems of course had important consequences for capability as well, which Bernard Gray’s report in 2009 highlighted.

Bernard Gray: The proportion of the budget we are talking about, which has the 1% uplift after 2015, is what is, in our terms, the equipment plan, which is the money on new equipment acquisition and the support of existing equipment. The two together total up to between £14 billion and £15 billion at the moment. That is the proportion of the budget.

There are three basic elements in the Ministry of Defence budget: that one—the equipment plan for acquisition and support—personnel costs, both military and civilian; and the estates budget. Those are the big three large blocks. The reductions in personnel announced on both the civilian and the military sides are designed to address the excess commitments on the personnel side. There is a separate plan of action for dealing with the estate, which you may look at separately.

The report that we are talking about here, which the NAO will do, is on the equipment budget. That is the bit that was most seriously out of balance. While it is true that the total pay bill has been rising faster than general inflation for the Department as a whole for a long period of time—military pay rises at about 2% real per annum—that does not have a catastrophic deviation. There is a steady compounding problem, but you do not have the problem of the pay bill ballooning. The problem in the equipment budget was different because we saw a very substantial—on average, 40%—increase. Absorbing the whole budget on the basis of the initial proposition, it then expanded by 40% and effectively destroyed the sense of the budget. That is the component that we have been trying to address.

Q71 Ms Stuart: Forgive me if this sounds like a stupid question, but how do Urgent Operational Requirements fit in with your wonderful construct that makes it all balance?

Peter Luff: They are funded separately from the Treasury. There is a separate budget line flowing from the Treasury to meet those requirements for operations.

Q72 Ms Stuart: That bit I understand, but I am just wondering whether this is where we are playing tricks with cards—one budget gets balanced because we are shifting things from one to the other.

Peter Luff: No. The Treasury would not let us do that. UOR money is spent for Urgent Operational Requirements, not for the core budget. I know that.

Q73 Chair: I said that we would get back to the SDSR. How does the White Paper relate to the next SDSR?

Peter Luff: I would expect the White Paper to be refreshed after the next SDSR. My own expectation is that my successor as a Minister in the Department at the time of that SDSR would wish to revisit the assumptions and policies we made in our White Paper, and to refresh it. Until then, it remains the way in which we deliver the technology and equipment aspirations—the support aspirations—of the SDSR itself, so it relates intimately to it. It could not be done until the SDSR was done. It took longer than I would have liked, as you know, but I believe it actually helps us deliver the SDSR.

Q74 Chair: One question was asked just now about the unpredictable nature of the threats that we face. Is the acquisition system sufficiently adaptable to satisfy the need to defend against the unpredictable and changing nature of those threats?

Peter Luff: That is, again, a very big subject. I would defer to Steve to answer it in detail, if I may. The simple answer is that when you had an overhauled equipment programme, it was not sufficiently flexible. An overheated equipment programme was an enemy of that fleetness of foot that MoD must have to counter emerging threats. Of course, the UOR process has helped us mitigate that, but an overheated programme—a totally committed programme—is the enemy of that capability that should lie at the heart of our acquisition strategy.

Air Marshal Hillier: I think it is absolutely that—having the capacity to cope with change because the future will be different and we will not be perfect. The other thing, when we buy the equipment we are planning in the core programme, is to make sure that that in itself is sufficiently flexible, adaptable and multi-role to be able to respond to the changing strategic environment, because it will be different. It is also—this starts to get a little bit into the UOR philosophy—about making sure that we do not commit too early to things and about preserving our decision space. For particular capabilities, we should commit as late as possible. For example, in
information capabilities, we should not be planning in detail 10 years out, because it will change radically. We should get much more in the philosophy, in that area, of “buy little and often” and be responsive as the threat changes and as technology changes. Clearly, that will not work for submarines, for example, so we will have to take a different model for that, but again that is part of the philosophy: “Let’s not approach defence procurement as one size fits all.”

The final thing—I am sure that Mr Gray will want to comment as well—is that one of the things the UOR process has demonstrated is that the Ministry of Defence is pretty good at responding to urgent requirements and delivering quickly. We have got a huge amount of experience that we have built up through the UOR process over the past few years, and we need to make sure that we sustain that. We are actually very good at that part of acquisition.

Bernard Gray: Steve and I have already had a number of conversations about the additional flexibility that comes in with the approach that is being adopted here—that now we will choose to make some different choices about things we had previously just baked into the programme. That offers greater flexibility. We can make different choices than we can if 110% of everything is always locked down. As a practical reality on the ground, those conversations are already starting about that flexibility.

One of the bits that we still need to do is to reform the process of acquisition, which is still very long and quite involved, and as many layers of scrutiny, analysis and bureaucratic process. Part of the material strategy work that I am doing is looking at how we get more effective at all of that. A reason why the UOR process is effective is that there is a very solid deadline. People are saying “I need a piece of equipment in Afghanistan in six months,” and that is a very useful lever for overriding the bureaucratic process, which seeks to slow things down and put more fingers into pies. We need to reform the process such that we get more of that kind of behaviour into the normal course of business and not just where there is an urgent requirement driving it.

Peter Luff: I am trying not to follow too far the logic of what Bernard has just said because it will take us too far into other questions that you want to ask, but I want to emphasise one point that the Air Marshal said just now, which is the point about modularity. The equipment programme itself involves over 900 individual projects, so it takes time just to work through. We want the NAO to be able to give us that reassurance—I see that as being for the MoD, as well as for a wider audience—that we are on the right track.

Peter Luff: To an extent—this is the first time we have done this—we are all learning from the process. The NAO themselves will have to learn what actual level of detail they need from us and what scrutiny they need to give. We have been in the process of dialogue with them for some time now. They are not going to get the information cold at the end of the month—we have had a lot of dialogue with them so they will be ready for it when it comes—but then it will be up to them when they publish. It will be out of our hands although we are all very anxious to get this done because you can understand the importance of it to the industry that serves defence.

Q77 Mr Donaldson: So did I understand Air Marshal Hillier to say it would be September or October?

Air Marshal Hillier: As the Minister said, that is just the guideline. It will take the time that the NAO wishes, but that is our assumption of the time we think it will take.

Peter Luff: That is our assumption of what the NAO will do. I cannot bind them to that. That will be their decision. They may come back for some more information. They may say, “No. This is splendid. We can do it a little more quickly than we thought.” It will be for them to determine.
Q78 John Glen: I should like to turn to how we define or how you define value for money. There seem to be so many different ways of looking at this. I think the White Paper sets out the principle that open competition is something that should guide acquisition unless technological advantage needs to be maintained, but it seems to me that value for money is a very subjective thing, depending on over which time frame, how it is linked to exports and the advantages that could accrue to the wider economy. It would seem that anyone could construct an argument that a given acquisition is value for money given certain different sets of assumptions. What assurances can you give us that your definition is a reasonable one and how do you define it, such that it is verifiable?

Peter Luff: I can read into the record the definition of value for money from the White Paper, page 12, footnote 6: “Value-for-money is the optimal combination of time, cost, and effectiveness, within available resources. It is a relative concept, which involves the comparison of potential and actual outcomes of different procurement options. Value-for-money for each programme is determined on a case-by-case basis, depending on the circumstances.”

John Glen: Exactly what I said.

Peter Luff: That is why I am smiling as I say this. “Non-quantifiable factors may be relevant to value-for-money assessments, such as a supplier’s track record and financial robustness.” Crucially though, “The MoD does not consider wider employment, industrial, or economic factors in its value-for-money assessments.” Let me just stop a second and examine that, because I know that it is quite controversial. Some of our European colleagues fund their defence acquisition programmes from the industrial budget—some regard it as an industrial acquisition process; the use to which it is put is secondary.

We are one of two nations in Europe of significant size that routinely deploy, engage in overseas operations and actually fight wars and maintain the peace—ourselves and France. When we buy equipment, we have to be very ruthless about the purpose to which we are putting it. It is there to make our military capability robust and to ensure that our soldiers, sailors and airmen are able to fight the wars we ask them to fight. The overwhelming requirement must always be the military capability it delivers. We have to be quite hard-hearted about the other considerations—regional impacts and so on. We need to protect our people and make sure that they can do their jobs well. The value-for-money assessment does not take account of those wider economic factors. Every pound we spend in Defence is for defence, and that is a very important test. That is not always agreed—there is some controversy around that statement—but I stand by it robustly. It is particularly true at a time of acute pressure on the national finances, and on the MoD’s finances in particular it is particularly true. For a country like ours, which engages so much in the outside world and has such global ambitions, it is all the more important that we stick by that. Value for money for us is about the defence capability we buy.

Q79 John Glen: Are there any other comments from your colleagues?

Bernard Gray: To tease out this bit about relativity, part of the problem is that a different set of criteria may apply to one capability versus another, so it is very difficult to make a statement in the round about what represents value for money in submarine acquisition versus the acquisition of a missile, for example. I think that is one of the reasons why the language is couched that way. It is saying that to have a sensible frame of reference, you have to look at like activities and then figure out the most cost-effective way to deliver that activity. It may be a contentious issue, but the direction of travel from the White Paper is pretty clear, which is to say that it is a defence priority and we are judging it against cost-effectiveness within a relatively narrow and therefore comparable frame. You may regard that as a locally relative statement, but some much wider statement does not really make sense.

Q80 John Glen: I think one issue that concerns many people in this area is the way that value for money changes over time. At the point of acquisition on a big project, it seems as if there is value for money, but, as we saw last week, different assessments by industry somehow change the value-for-money conclusion. Later decisions are then made on a different basis, because factors change. It is that lack of assurance that seems to have an inherently destabilising effect on the MoD. It seems very difficult.

Bernard Gray: May I try to draw out a distinction between value for money and cost? At one point in time, people may say that some piece of equipment cost x, and at a later time, they may say that it costs 2x. One can make a choice about whether the reasons for the increase in cost look reasonable or not, but that is a statement about the actual cost. We then have to look at whether the first cost or the second cost represents value for money. It might be that, even if the cost of something had gone up, it still represented good value to us, because it was a much cheaper way of doing something than something else was.

Value for money is about the relatively best way of achieving some outcome—some military capability. A classic example might be the use of combat air with conventional munitions on them versus a cruise missile, for example. You might make an evaluation about those two things. Which is the best value for money for destroying bridges deep in some opponent’s territory? That would be a value for money calculation. The actual cost, as it may evolve over time, is a separate question.

Q81 John Glen: The point is that if you had y instead of x at the outset, and two years in y remained at y and x went to 2x, y would have been better. I understand the difference in costs and that you can still have value for money even if costs increase, but the decision making at the start can profoundly affect the likelihood of it going to 2x.

Bernard Gray: That is absolutely true, but there are two components of that. One is that you have to do the best you can to understand at the beginning the best set of circumstances, so there is an obligation on
everybody to do that to make sure that you make the best choice you can. There is also the fact that the real world intervenes and it is not possible to know everything ahead of time, however good you are at anything—stuff happens. You have to be able to cope with that, and that is just unavoidable. You have to strive to make the best decision you can with the best information you can get at the beginning to try to avoid the problem, but that is not to say that you can legislate out any future issue, of which technological innovation is a classic example.

**Peter Luff:** That goes back to the earlier answer about modularity. There again, you can actually ensure that you get value for money from a platform by having a truly modular platform which can be adapted as events unfold. If you are stuck with a particular configuration which you cannot change, you have an exponentially greater likelihood that it will become less good value for money as you proceed through the life of the object. It is really important that what we buy is as flexible as possible to ensure that it offers maximum value for money for the longest possible period of time.

**Bernard Gray:** There is an anxiety, though, that if you try to maintain complete flexibility for ever or to allow a platform to be ultimately flexible to do everything, either you never make a decision, or you end up with a platform which is an all singing, all dancing, extremely expensive thing.

**Q82 John Glen:** Or you qualify the investment in the technology because there is no commitment.

**Bernard Gray:** Yes. There is an art here of balancing when the appropriate time is to make a decision that allows you some degree of flexibility and optionality about the future, but does not make you either wait so long that you never deliver anything and therefore you have zero capability, or you try to guard against every possible outcome and then spend a huge amount of money, 90% of which might be wasted because a lot of those options never turned up.

**Peter Luff:** And probably getting the equipment far later than you expected in the process as well, when something less capable sooner would probably have been a better deal for the Armed Forces.

**Bernard Gray:** That is the trade-off you are always trying to manage.

**John Glen:** Thank you very much.

**Q83 Bob Stewart:** Minister, when the Ministry of Defence identifies the requirement for a new piece of equipment, what involvement, if any, does the NSC and, indeed, the Prime Minister have in the subsequent decision making on that piece of equipment?

**Peter Luff:** I know that this is a subject that interests the Committee very greatly, and I am going to have to hand over to the Air Marshal to take you through it in some detail.

Essentially, of course, the National Security Council, through the SDSR, sets the broad direction, which it is then our role to deliver. Sometimes, in bigger capabilities, there might be some discussions about change—the National Security Council was involved in the discussion about the aircraft carrier variant change, for example. In the White Paper, we explain that there will be a ministerial committee to resolve certain issues, where they touch on cross-governmental issues, or to address opportunities that may emerge.

The high-level answer is that the SDSR—signed off by the Prime Minister and the National Security Council—is our guiding light. I think the Air Marshal can take this in more detail.

**Air Marshal Hillier:** It operates from both ends. As the Minister says, it starts off with the strategic direction, which eventually comes down to my area. We put a strategic force development process together, one of the components of which is the requirement for new pieces of equipment. We also compare that against what the front-line commands have got at the moment and measure the gap between them. Science is involved and industry is involved—the art of the possible. All that process goes on, but ultimately, if we are going to buy a new piece of equipment, that has to be approved, not least given the size of the financial commitments and the strategic implications either for industry, international relations or whatever. That approval process for the large pieces of equipment eventually comes back through Ministers and, if necessary, to the Prime Minister, so it goes through that whole cycle from setting the strategic direction to individual approvals of significant pieces of equipment.

**Q84 Bob Stewart:** So the short answer is they are not normally involved, but for a big one, you at least sign it up or light it up for the NSC and the Prime Minister.

**Air Marshal Hillier:** It is an absolute requirement. We are spending considerable amounts of public money here, so it is an absolute requirement for our approvals process that the large projects—not necessarily large financial commitments and the strategic implications either for industry, international relations or whatever. That approval process for the large pieces of equipment eventually comes back through Ministers and, if necessary, to the Prime Minister, so it goes through that whole cycle from setting the strategic direction to individual approvals of significant pieces of equipment.

**Q85 Bob Stewart:** And, of course, it is important if other Ministries are involved too.

**Peter Luff:** It is fair to add that, on a practical level, the Prime Minister and 10 Downing Street take a very close interest in many aspects of our acquisitions. For example, there is the IED equipment for Afghanistan, which the Prime Minister is rightly passionately concerned about. He is also passionate about ISTAR capabilities, such as unmanned air and vehicle technology, in which he takes a very close interest. There is a number of areas where he takes a very close interest, as he should do as the ultimate guarantor of the adequacy of this nation’s defences.

**Q86 John Glen:** There has been a lot spoken about the need to reform or improve the DE&S organisation, I do not want to focus on the different potential models of reform, but I do want to look at the issue of decision making in defence acquisition, how it works and whether it works well. It seems to me that, beyond getting into a discussion about how you reorganise and what models work, there is the actual issue of the decision-making process, with reference
to the whiteboard process. How does that decision-making process work in terms of defence acquisition and how optimal do you think it is?

Peter Luff: Do you mind if I stand back for just a second and get my colleagues to answer that question? I think that they will both have something to contribute. I started the session earlier by saying that how we actually deliver the balanced budget is really important. Balancing the budget makes it easier to make rational decisions about new items of capability coming into the programme. If you are interested, the Air Marshal, will talk to you about the changes that we are making in the capability and financial area to bring together the financial decision-making basis on capability—the new fin/ml cap, which I think is the correct abbreviation.

The way in which the front-line commands will get new accountability and responsibility under the Levene report is extremely important here. They will be taking decisions about the balance of their investment across the various items of expenditure—they have to juggle with that. That is very important, too. Those are all very important questions which we can and should be answering, but you seem to be addressing your question primarily to the Chief of Defence Materiel, which I understand because the materiel strategy is the other key component here of the progress that we must make to ensure that we take rational decisions and stick by those decisions once they are taken.

At a high level, I emphasise two very important things. The first is getting a better interface between the Defence Equipment and Support organisation and the customer, increasingly now the front-line commands rather than the Main Building. The second is about the skills and processes at the DE&S, ensuring that its decisions are good and well thought through at all times and giving that organisation greater management freedom to pursue things in an appropriate way as well. Those are, in big handfuls, the items that contribute to the more rational decision-making process that you are seeking. Both my colleagues, if you will bear with us, will want to contribute.

Air Marshal Hillier: If I start from the MoD perspective—I think I touched on some of this in answer to your previous question—it starts for me from the SDSR. The SDSR defines what we are required to do in defence. It comes with a resource envelope—how much we wish to spend in defence. That then works through defence policy and defence strategic direction, coming down through the Defence Board. It then comes into my organisation. What we then do is conduct that strategic force development: against what we are required to do, how might we do it? We bring science and technology into that discussion. We bring industry into that discussion. We bring the front-line commands into that discussion, because they clearly have capabilities there at the moment. We do the gap analysis, which tells us, against where we want to be in the future versus where we are at the moment, what we ought to do.

Our first port of call is not to go and decide that we need to buy a piece of equipment, because there are many other lines of development in defence that we should examine first. For example, could we close that gap by doing better training? Is it something to do with logistic support? Could we support our activities in a different way? Is it something that, if we had more people, we could do in a different way? So we run through all of that process and only at the end of it do we specifically say, “Right, we need a new piece of equipment for this.” There is a large amount of being realistic about what we can aspire to have. As the Minister has run through, we can have aspirations as high as we like, but we have to be realistic about whether it is an affordable or appropriate resource envelope. There has to be, therefore, trading between that aspiration and the deliverability and affordability. That realism is very important to the process.

Anyway, once we decide that this is what we think is our equipment ask, we go into the dialogue with Bernard’s organisation—“We think there is something in the equipment side. What are our options for doing that?” It becomes very much an iterative process from there.

Bernard Gray: I am not sure whether to detain us. Do you have enough of an answer to your questions? Is there anything you want to make sure we feel out what dimension of it you really want to be heard.

Q87 John Glen: I think the common understanding is that the decision-making process to this point has not been adequate to deal with the complexity of what is being procured. That has been a very helpful description of part of the process, but it is trying to understand what the gap is in the organisation at the moment in terms of inadequate capability in decision making that needs to be fixed, which is perhaps driving some of the discussions around reorganisation.

Peter Luff: You are looking at the Chief of Defence Materiel when you asked that question. It is more of a question, I think, for the Air Marshal, isn’t it?

Bernard Gray: Maybe. I have an observation on it, which is that the process that we had in the past—the description we have just heard, which placed significant emphasis on affordability, is a wholly new conversation. Previously, an observation I would make about the problem was a failure by the organisation to prioritise. You would have somebody in an individual area of capability who would just argue relentlessly for their thing. The sum of all of those arguments added up to a number that was significantly bigger than the amount of cash. There wasn’t a process that existed to prioritise those things. The process that we have just been through in the course of PR12, and the situation that Steve has described, take us to a very different place. It says we have made priority decisions that have led to a set of activities that we are definitely going to do, which we can afford to do; and then some choices about some other things that we would like to do, but it is not yet clear whether we will have all of the money to do them, and we are going through an evaluation of which ones are the highest priority among those competing other choices. That may address what you are describing as the higher level decision-making process, and, from my perspective, how that is
changing. It is a long-term game and we are just at the beginning of all of that, but that is a crucial change of approach that I hope will give greater focus to high-level decision making about what we do.

**Peter Luff:** Getting this change in place is very important—quite right. It is a mixture of high-level things and practical things. One of the things that went wrong in Britain recently in our defence acquisition was running down the Cost Assurance and Analysis Service—CAAS, as it was known. That organisation has again been rebuilding, because it is so important to have accurate costings about programmes when you begin them, and during their lifetime. Defence manufacturers have been playing fast and loose with the taxpayer for at least a century. The organisation has its origins in the first world war, when munitions manufacturers were trying to rip off the MoD—although it wasn’t the MoD then. It would have been the Ministry of War, I suppose.

**Air Marshal Hillier:** The War Office.

**Peter Luff:** The War Office. The need for this organisation was realised 100 years ago, so you have to be very careful. But also, just getting honest costs about the programmes—even without dishonesty in the process, or an attempt to charge excessive prices—is important, too. That change of saying that this organisation, CAAS, matters to us—getting it right and making sure it gets its costings right really matters to us, to inform our decisions. I said casually just now that we are merging the military capability and finance functions in this new fin/mil cap. It sounds very boring. It is actually very important. Getting the second and third floors at main building to talk to each other more systematically is a game-changer. It really does change the way we do acquisition, and I think the Air Marshal would agree.

**Air Marshal Hillier:** Absolutely, and certainly one part of my analysis, when I took over the organisation four or five months ago, is that it did tend to be either side of a divide. If we are going to do this properly and efficiently, and get to the point about, “Let’s do this quickly”, we need to plan right alongside the people who have the resource envelope. If you like, the input side, which the finance director looks after. You have the two of us, and literally, we would be sitting alongside each other, doing that on a constant basis. I think that sort of constructive dialogue is absolutely at the heart of our future operating model. It sounds simple, but it is not something we have done before, and it is all part of being realistic and practical about how we approach our budget and military capability plans.

**Peter Luff:** One last thing, if I may, just to finish this off. I sense—I do not think I am kidding myself with an over-optimistic view of life—a real enthusiasm, anxiety and eagerness to make this work in the MoD. The MoD is fed up with being the whipping boy of Whitehall, and with being pilloried in the columns of the national media. It wants to get these things right, so ensuring that it makes these decisions in a rational way matters to the organisation. The fact that we are now off special measures with the Treasury and have a normal relationship again as a Government Department of the Treasury is a huge psychological boost for the Department. We are trusted again to get things right and we want to keep it that way, because our civil servants and all those people involved in capability judgments want it that way as well. There is a real hunger, I think, to make it work. Of course, all kinds of civil service behaviours drag you back into bad old habits. That is inevitable, and we have to ensure they get a very strong political lead to keep going on this direct path, but I detect a real enthusiasm to ensure that, and people involved in capability and rational capability judgments and financial decisions are made throughout the organisation.

**Chair:** I am going to call Julian Brazier. Tiny fringes of aircraft carrier questions might creep into this question, but we are reserving most of those for the end of the session.

**Q88 Mr Brazier:** I was rather encouraged by the answers we had to the last question. If I may, I would like to pursue a point in further detail with Air Marshal Hillier. If we take not the last step on the aircraft carrier, but the next as an example, clearly the big change we have not yet discussed that has come out of the reforms is the division of the capability area into five, effectively. You have three single-service, a joint one, and then yourself with the strategic overview. In terms of the new decision on the aircraft carrier, you will clearly have a number of decisions that have to be taken on the detail that comes out of that, including everything from the non-slip surface that will have to be put on the new ones—because you have a different sort of landing on it—and the decisions that may not yet have been taken, such as the kind of airborne early-warning helicopter you will have, which one guesses will be an asset purchased by Joint Helicopter Command.

My question is this: you have five bits of capability, with you heading the senior one. Will it be the head of the naval capability or you who ultimately takes the final decision—the final accountability—for keeping that particular project, which reaches across every part of the capability spectrum, except the Army, in time, budget and all the rest of it? Where does it sit in capability?

**Air Marshal Hillier:** It is a key question, because this capability is absolutely vital for defence. We and the Secretary of State were very clear on the timelines that we are working to and are going to deliver against. We obviously have the current model of how we do this, and then, as you rightly point out, there is now the delegated operating model. What I am trying to do is make sure that I keep the benefits of the delegated operating model under Levene, but still keep that strong, central coherency and integration of the overall programme.

The way I am looking at this at the moment—this has not finally been run through—is that we will delegate individual projects within the overall programme to the relevant single Service, the one that is best placed to look after it. That way, they can work across all the lines of development, as they should do, but the senior responsible owner for the overall programme will continue to work in my area, at two-star level. He will work for me directly with that programme, and through me to the Vice-Chief of the Defence Staff. So
if there is any tendency for those individual projects to be looked at in a parochial way, I will stop that, because I have the overall responsibility for the programme. As part of the overall transforming defence agenda, we want to delegate as much as possible, but we recognise that the centre of the Department still needs to ensure that it has that coherent, integrated approach, which seeks and delivers the best for defence, and that is part of my role in the future. The short answer is that, yes, we have a new governance model going in place to allow for that.

Q89 Mr Brazier: Thank you, but I am not sure that I quite understood the last part of your answer. Are you saying that every major project will continue uniformly? Or are you saying, just specifically for aircraft carriers, that it is so big that it has to continue to report to the centre?
Air Marshal Hillier: I was talking specifically in terms of the carrier strike programme. There are a very few other programmes that will continue to be a head office responsibility, because they are of strategic importance, but the fundamental principle is that we will delegate everything unless it argues that it should not be delegated. It is not a question of us keeping everything and delegating some bits and pieces.

Peter Luff: It is not the size that is necessarily the determinant; it is the strategic nature of the capability or whatever it is. Testing the valuation would merit that level as well.

Q90 Mr Havard: CDM, I need to ask you about the change to your organisation. At some point—maybe later on—I will pick up on some of the stuff that John has just talked about in terms of decision making; I would like to talk to you about your proposals for restructuring your part of the organisation to make it efficient. You have said you are very concerned about the rest of the MoD being perhaps equally or more efficient and becoming a better, intelligent customer to you. That is key to this decision-making issue and perhaps we can return to it a little later.

In terms of your particular part of the organisation and its reform, I understand that—we have discussed this before—I have proposals for you, and I think you think an organisational or structural change should look. Could you talk us through the options for that?

Bernard Gray: Sure. The first issue, which I am not trying to address with this, is the balanced programme, which we have spent a lot of time talking about already. It is an essential pre-condition. We have to have a sensible, balanced request that we have enough money to deliver what is asked of us. The first of the other two parts of the triptych that I am trying to address is the interface between the two, which is partly about decision making, but also partly about programme control. The Department has got into the habit—which I suspect it has been in for a long time, but it has become more frenetic in recent years as the financial imbalance got worse—of costing more and more changes to the programme all the time, so that the whole programme is in a constant state of flux. That is very destabilising for a whole variety of reasons and absorbs a huge amount of effort in my organisation, which is principally responsible for answering questions such as, “What if we did x? What if we did y?” Those requests are running at something over 1,000 a year, which is four a day, and even if they do not actually lead to action in a programme, they are leading to an enormous amount of excess work. We need to stabilise that from two dimensions, one of which is making it clear to people what the real cost of changing your mind is, because it is very significant and it has not always been reflected in what we do. The second is the cost of asking the question and the cost of absorbing the time of people doing that work, rather than actually running the programme.

That is the first part that I am trying to address—the interface—and I clearly need to work with Steve and the front-line commands in working up a relationship that is a work in progress. Steve is standing up his part of things as part of Levene, and I am working on my things. We need to address how that interface works and how things like hard charging, costing, and change control work. Largely within my organisation, I then need to move to the issue of whether we have enough skill and enough management freedom to be able to do what we need to do. I came across an example yesterday. The military retire earlier than the civil service, for example, but we might have a military specialist in a particular technical area. If that military person retires on a Friday, I cannot hire that person to work for us as a civilian on the following Monday. Because of the civil service rule structure, I have to go through an open competition—it takes an average of nine months to re-recruit the same person to do the same job. That is an example of the inflexibility of the management constraints that we sit under at the moment—even with the same people. I think I gave you an example before. It took me nine months to hire one two-star person—to run through a competition. We have an extremely inflexible recruitment process.

We also have an extremely inflexible retention process. I had a conversation about one of my young high-fliers with one of my direct reports yesterday. I know I am in danger of losing, today, one of my key people because I have no flexibility to change his terms and conditions or in any way incentivise him to stay. I am stuck in a completely rigid structure. I have to say to this person, “I am terribly sorry—there isn’t anything I can do.” They have tremendous options in the private sector to go and pursue their careers. We need more management flexibility in the organisation to be able to recruit and retain, and to motivate and develop the talent that we already have—and there is talent there.

We also—this is not just my view; it is now the whole of my DE&S board’s view—have very significant gaps in expertise, which have developed over 20 years. Essentially, it has been leaked out. We recruit people as graduates, by and large, and we intend to keep them through their career structures for life, and we have a one-way membrane, where at various points we lose people to the outside world and almost never get anyone back. By and large, you tend to lose the better people. The danger is of a sort of loss of bone calcium—the organisation becomes embrittled.
over time. We have seen a leaching away of that talent.
We need a significant injection. We don’t have the flexibility to hire at the moment, but we cannot hire one person at a time to get the kind of change that we need in the time scale that we need it. The complexities of managing programmes of the scale of the successor deterrent, the aircraft carrier programme or armoured fighting vehicles are such that what I might describe as a relatively traditional amateur approach that says, “We’ll give it a bit of a go”, is not a viable way to do it.
There are systematic, scientific ways of approaching this that we just do not have, so it is our belief that we need two things in order to answer the problems. First, we need substantial increases in management flexibility to be able to do the things we need to do to hire and retain good people. Secondly, we need an injection of skill from the outside. We just don’t have the time for a kind of youth academy that will grow it over 20 years; we have to go out and get something today.
We are looking at two specific models within that to change from the status quo, to come to your specific question. The first is a model like the Olympic Delivery Authority, which partnered with—as it turns out—a consortium, which included a consulting engineering firm, among others, that managed the contractors that delivered the Olympic parks as a sort of joint venture between the public and private sectors. The private sector was, essentially, an adviser. That is one possible model.
The second possible model that we are evaluating is like the Atomic Weapons Establishment. Effectively, we have turned that into a Government-owned company, which we control as the Ministry of Defence. We have a consortium company then running that, being responsible for the management of it on our behalf. The essential difference between the two is that, in the second case, it has management control of the entity and its fee and profitability is driven by what it does with the incomes. In the first case, it is more of an advisory component, advising the public sector. Those are the models that we are looking at.
Q91 Mr Havard: I know that some of my colleagues want to ask more about the skills. If you were to move to one of those, whichever one you prefer, as I understand it there might be a need for primary legislation to make one or more such changes. Is that correct? Do you have a view of that?
Peter Luff: First, I want strongly to endorse what CDM has just said. The analysis that he has gone through is one that I entirely buy. If anything, I think that, uncharacteristically, he understated the challenges he faces, which is a thing I do not often say to Bernard.
We are in a situation in which 80% of our projects are late and 40% are in cost growth. It is not acceptable. Frictional costs are estimated by the work that Bernard has done at somewhere between £1.3 billion and £1.9 billion a year because of the failures in the relationship and the processes in the relationship between us and the processes at DE&S. It is a really important issue for us.
Q92 Chair: The implication of what you have just said is that the Department itself now accepts the analysis and the figure originally produced in the Bernard Gray report.
Peter Luff: I certainly do; I certainly endorse it. It has not yet been formally endorsed by the Defence Board, so I cannot say that the Department actually formally agrees it. I think that it will. The logic that Bernard has brought to this is impeccable. If you look at the catalogue of late-stage cancellations of projects, direct cost overruns, the indirect cost of spending time on projects that were extended, the cost of interim consultations when things were delayed, life extensions and legacy platforms, it adds up to a very big bill that we want to get rid of to improve the capability we have for the Armed Forces.
I would just like to issue a public apology to DE&S staff for the constant recosting that they have had to do during the SDSR, during the three-month exercise. A lot of burdens were placed on people—sometimes, burdens that those of us in the main building did not appreciate fully in respect of what we are actually asking of the organisation behind this. I am grateful to the staff who again burnt the midnight oil long and hard to get the PR12 announcement out. But the bottom line is that, yes, we do probably need legislation for this.
Q93 Mr Havard: There are political implications with whichever model you choose. If you choose one of the tweezy, trading fan-type options or something that looks more like a GoCo or whatever, the form drives the logic in terms of the political involvement in the process as well.
Peter Luff: We have not yet formally discarded the trading fund model. Personally, I am unconvinced by it as a model. We have not discounted it yet. In the House of Commons yesterday, the Secretary of State talked of a radical change to the structure in the Defence Equipment and Support organisation. He used the word “radical”. “Radical” guides myself to a slightly different place in terms of the political involvement we shall talk about it with our colleagues, but Bernard’s work certainly has the enthusiastic support of Ministers.
Q94 Chair: Mr Gray, you wanted to say something to me.
Bernard Gray: From a purely technical point of view, if we wished to execute an executive non-departmental public body, to avoid the unlovely acronym, that definitely would require primary legislation by definition. In the case of a Government-owned, contractor-operated company like AWE, that would not necessarily specifically require legislation. Although that legislation might be helpful for clarifying its powers, it is not absolutely required.
Q95 Mr Havard: That is what we are trying to tease out. What is the timetable for the predictive “whatever it might be” chosen change?
Peter Luff: If I have learnt one thing in government, it is not to give timetables that cannot be stuck to, because funny things happen to timetables. What is very important therefore is the interim structure that CDM takes.

Q96 Mr Havard: You have anticipated my next question. If you are not going to tell me when you are going to do it, what are you going to do in between now and then?

Peter Luff: If I could do it tomorrow, I would do it tomorrow. That would be my preference. I do not have that option. It is likely to involve legislation. That is likely to be at the next legislative Session at best. Then there is likely to follow a period of time, but we are discussing, Bernard and I, how we can achieve some of those behavioural changes at this stage, early, because it is important that we make rapid progress. We cannot wait for these changes to make the improvements in process.

Bernard Gray: To be clear, we have not yet made a choice about which model. There are aspects that might not require primary legislation and, at above my pay grade, it were, those sort of factors will get taken into account when deciding. I guess, which route to go. None the less, whichever route is taken, it will take some considerable time to get the full benefit of that into effect. I completely accept that.

To my mind, in case there is any doubt, that is not an argument for not doing it. This has been a problem for 40 years. When he first proposed the setting up of the Procurement Agency, the procurement executive, Derek Rayner said that it should be an independent agency and outside the Ministry of Defence. For 40 years, we have failed to resolve this issue. If it took another 18 months or two years finally to crack this problem, which is costing us £1.5 billion a year on average, it is time well spent. However, we should not just sit there and wait for that, so then there are the interim actions that we are taking, which I would be delighted to move on to.

Mr Havard: Yes, if you would.

Q97 Chair: Before you do, may I remind you that if this gets bogged down in party political discussion before the next election and becomes some sort of party political battle at the next election, it would be a mistake? Presumably, you are going to work to achieve all-party acceptance of the general route that you are taking.

Peter Luff: I was greatly encouraged by one aspect of the Labour party’s review of acquisition policy in which it advocated the creation of an NDPB route for the future of DE&S. It suggests that there is an appetite for radical change on both sides of the House. I wish to take my colleagues on the Labour Front-Bench team through the detailed analysis that we have when we reach our decision. I am encouraged by the open-mindedness of the Opposition to radical change in DE&S because it makes our task a great deal easier.

Q98 Mr Havard: However, between now and then?

Bernard Gray: Between now and then, we have work to do. One of the aspects that we must address is the fact that, as part of the defence review, we had a mandated reduction in the number of personnel within DE&S as part of the overall—broadly civilian, but to a certain extent military—headcount reductions, which takes us down from just around 20,000 prior to the defence review to around 14,500 by 2014–15. That equates to about a 28% reduction in personnel within DE&S over the spending review period. So we have to deal with not only the programme and all the issues that we have highlighted before, but a significant headcount reduction as well.

I have been working with my chiefs of matériel, who are the environment, air, sea and land and joint enablers posts that I created to work through the issues of how we do this. We started that work prior to Christmas and it will come to its conclusion in the June-July time frame, depending on how quickly we make progress. We hope to put forward to the Minister two options about how we do this, which will slice the things in different ways.1 Broadly speaking, we can achieve about half of that reduction through what I call genuine efficiency gains. We have looked at the way in which we do business and how we slim things down and so on. We will get some benefit additionally from the process of prioritisation that the Air Marshal is going through. I caution that, unlike in the force structure of the forces, where we have taken down the number of platforms in the naval escorts, the number of tanks and other equipment and the number of fast jet squadrons, we do not have a proportional decrease in the DE&S work load. Typically, what we are now running is fewer examples of the same range of platforms, by and large. The problem is that we have to maintain the Tornado platform whether we have one squadron or five. We have not yet managed to calculate that number, but I suspect that in an order of magnitude our work load might come down by 5%, where we have a 28% reduction in staff.

There is stuff that we can do to become more efficient. As I have said, about half of the challenge against us we can get from efficiency. We will get a little bit more from the prioritisation work that the Air Marshal is doing. The Department is expecting us to do this and to say that there are some lower-priority tasks that we currently do that we cannot continue to support any more because we do not have enough people to do those things.

An example might be programme boards. We have programme boards that bring together all of the lines of development that the Air Marshal indicated before where we supply all of the staff work. There are probably about 50 full-time equivalent people working on all of that activity. It is a useful thing to have, but the question is whether the centre wants to buy that service any more. If it does, we have to find the 50 jobs from somewhere else. Therefore, we will get into a dialogue over the summer with the centre of the Department about which of the services they want us to drop in order to manage through in the meantime.

There are two other parts that I want to stress. I am acutely aware of the problems that the Defence Logistics Organisation got itself into, and the issues

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and tragic circumstances leading up to Haddon-Cave. We intend to draw down to have a fully populated establishment structure, and a wiring diagram that has a sustainable set of outputs. All the safety-related posts should be tagged within that, and the safety processes should be appropriately assured by my technical director and by the centre of the Department, to ensure that we are safe at all times in operating that. Effectively, the trade off is because once we have got through the efficiency stuff that we have to do, we then have to drop some outputs while we wait for the arrival of matériel strategy. Perhaps we can bring forward some of the flexibilities that we want in the matériel strategy, and we will get into dialogue with the centre at the Department about that.

In fact, I had a conversation with the Permanent Secretary this morning. I said, “Look, these are some problems. Is there anything that we can do about them in the interim as well, because if we can recruit or retain the right people, that will make the job easier?” An active programme is going on, and I am determined that whatever we do, we do in a safe and professional manner. That probably means that we will do less.

Q99 Sir Bob Russell: Can I take you back to something you said a while back about the retention of military personnel who are wearing uniform on Friday but cannot become civil servants on Monday? Are you saying that they cannot move seamlessly?

Bernard Gray: That’s right; they can’t.

Q100 Sir Bob Russell: I asked that because 10 years ago I was contacted by the retired officer corps, which was a bit miffed that it was not entitled to the Golden Jubilee Medal—one assumes that the same will apply this year. There must have been a period when those military men and women were in limbo. They clearly were military and then, in the eyes of the Government, they became civil servants. I understood that on Friday they were military personnel, but on Monday they became civil servants, which is why they did not qualify for the golden jubilee medal.

Bernard Gray: I cannot speak about the specific circumstance but it used to be easier to do that. Part of the issue is the absolute requirement under the Orders in Council for the appointment of civil servants to have gone through an appropriate due and open process, which is a mechanism that takes a significant period of time. I am speculating slightly, which is always a bad idea, but I am guessing that at some point somebody said that people were migrating too easily between one status and another, and that we should tighten it up and put some formal process in place. However many years later, that has evolved into a situation where it takes me nine months to re-employ the same person.

Q101 Chair: Let me ask the daft ladder question. Rather than introduce all these new structures, would it not be easier simply to relax the rigidity of those rules?

Bernard Gray: It might be if that were the only problem. This is an example rather than the totality of the issue.
Peter Luff: I suspect it was an incremental change in recruitment rules in the civil service, but we will find out.

Sir Bob Russell: It is a simple question.

Chair: It was probably me.

Ms Stuart: If it was the Chairman, we wish to know.

Peter Luff: I am sure that it was a good decision at the time and that, based on the facts available to him at the time, it was the right decision to take.

Q105 Ms Stuart: For the record, may I ask Bernard Gray to repeat something? Did I hear you say that you expect the staff numbers to be reducing by 28%?

Bernard Gray: That is correct.

Q106 Ms Stuart: Is that by 2015? What is the timeline for that?

Bernard Gray: The 28% is from 20,000 before the defence review, and, for the financial year 2014–15, at the end of the SDSR period, it will have come down to 14,400.

Q107 Ms Stuart: Do you find that this affects staff morale and efficiency?

Bernard Gray: We are letting a lot of people go through a voluntary severance process on the civilian side. About 1,400 people have left already on that basis, and we have offers out to another 700-odd at the moment as part of that process. There is also a significant reduction in the military inside the organisation, which is roughly proportional, as the military themselves want to draw down their headcount, because the Armed Forces are themselves shrinking. Although our tasking has not gone down, I am not making any complaint about this; I am just observing the fact of it.

Clearly, there is a morale and management issue in drawing down in this way. It is an unavoidable problem. We are trying to tackle it in a number of ways; the first of which is to be as clear as possible to people, as early as possible, on who wants to stay and who wants to go, and to re-brigade and draw down as quickly as we can, so that you get stability as soon as you can.

We had a town hall meeting in Abbey Wood in Bristol yesterday, for me to answer questions after the PR12 statement, and there were about 500-odd people there. I think. The overwhelming sense that I took from that meeting was that, of course, the draw down is an issue in people’s minds, but what they want to do is get on with doing the new thing. They are sick and tired of being sick and tired—sick and tired of being criticised, sick and tired of not having the flexibility to do their jobs, sick and tired of being pulled from pillar to post, and so on and so forth. I had the strongest sense I have ever had at Abbey Wood—certainly since I arrived—that people just want to get on with it. We went through a bit of this same conversation with Mr Havard when talking about the future. There was a kind of general sense of, “Okay, we get it; we understand that, and we want to get on, because we want to be able to go out and be proud of what we do.” Yes, the draw down is an issue, but it is part of a wider issue, where people actually can see the prospect of a better future and want to get to it.

Q108 Ms Stuart: I want to challenge you a little bit. Earlier, you said that you find it difficult to retain the brightest and the best because, out there in the world, they are getting good offers. You want to be an intelligent customer, so you need to keep the best.

Peter Luff: That is more my problem.

Q109 Ms Stuart: At the same time, if you are finding it difficult to keep the best and the brightest, how do you make sure that the best and the brightest of those you still have do not also say, “I am going”?

Bernard Gray: That is a problem right now. I do not think they are inconsistent statements. You have a statistical population—

Q110 Ms Stuart: No, but do you have in your mind a very clear set of people who you know you need to hold on to, or else you will not manage the transition in the face of the reduction in the work force?

Bernard Gray: The problem is that I do not have many levers to pull today that would allow me to change people’s circumstances. I cannot promote somebody, I cannot pay them more money and I cannot give them an interesting and different job, although I might have some flexibility on that. I am very constrained in what I can do. My approach to this—I have turned around three organisations before I got here—is, on the whole, to be honest and straightforward with people and tell them where it is. You gain credibility with people by doing that, including by saying, “Actually, right now it is pretty horrible.” I am not a believer in saying, “The sun is shining and it is all brilliant,” just to try to keep morale up when everybody doing the job every day can see that it is pouring with rain. I do not think that is terribly sensible. So I tell them where it is, and I give them as much information as I can. I work with them to try to develop the plan for how we go forward and what we are going to do. Some people will say, “Yes, I buy that.”

One of the questions I got yesterday was, “Okay, I get what you are saying”—it was a gentlemen who, I guess, was in the second half of his 50s, so it was not some spring chicken—

Ms Stuart: A fine age.

Bernard Gray: He was in his prime, and I am looking nervously at the same prospect myself. The point is that his question to me was, “Is the Department going to let you do this?” Not “Is it a good idea?” but “Can I trust you and the Department actually to follow through on this, or will it be a false dawn?” I would say that the decision about aircraft carriers last week and the PR12 announcement are an earnest of intent that says that the Department is now prepared to take difficult decisions. I pointed to that and said, “The Secretary of State was prepared to take a difficult decision last week because it was the right thing to do, and that is an earnest example of his being prepared to take other difficult decisions because they are the right thing to do, so let’s try to engage and have some trust.” You then try to pull people forward and through that. You take as many of those good people as you can, but you are going to lose some good people in the process because I cannot change the things that I

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need to change today. You have to accept that that is going to happen.

In the case of the person I highlighted earlier, his personal family circumstances probably mean that he will leave, because I cannot pay him more money. Even if he wants to remain in public service, which he does, he has family commitments that mean he cannot afford to. I cannot solve that problem today, so I need to keep as many people with me on the journey as I can in the ways that I have described, and I need to make the changes as quickly as I can in order to be able to keep as many of those people working in the national interest as we can.

Peter Luff: I must make it clear that I meet many people at DE&S and elsewhere in defence who are, of course, concerned about their finances, which I fully understand, but they are actually motivated by a very strong desire to do the right thing for defence and public service. There are many people like that working on low salaries elsewhere in other organisations not directly related to defence who are similarly motivated by a higher calling than just filthy lucre.

Bernard Gray: I am not seeking to say that they are not. I am just saying that there are some people who literally cannot afford to do it any more.

Peter Luff: Exactly so.

Q111 Thomas Docherty: On that very point about public service, have we got into a culture where, uniforms aside, people who do public service do not get enough respect?

Peter Luff: I want to pay a very public tribute to the civil servants, and the civilian staff of the MoD main building and DE&S, whose work is very demanding and very important. They deserve the highest possible respect for what they are achieving. I think the caricature you read in some quite serious national newspapers from time to time is despicable. My genuine belief is that the vast majority, given the right incentives and the right structures, will respond appropriately. The problem is that the politicians and, to an extent, the Service Chiefs, in a conspiracy of optimism, have conspired together to create a difficult situation, to do the right thing. I rejoice at the quality of many of the people I have the privilege of working with at the MoD.

Q112 Mr Havard: Can we take something else now? Commercial off-the-shelf decision making, its relationship with keeping a skills base, industrial space, sovereignty, exports—one or two small questions like that? We are told by various people about the modular approach, and the advantages and disadvantages of it were set out for us, and some of them were illustrated earlier on. I understand that. How does this relate to ideas and concepts like spiral acquisition and incremental acquisition? There is a new linguistic soup developing in both the MoD and industry, it would appear, in terms of how these relationships are going to work. It is this balance between commercial, off-the-shelf, indigenously grown and bespoke. Could you please speak to some of these things and say how you think these things relate to one another?

Peter Luff: I could say, “Read the White Paper,” but that would probably be a flippant reply.

Q113 Mr Havard: There are real questions here. Do they damage the ability to export? If we are not building and using the equipment, does that make the fact that we cannot export it—

Peter Luff: That is another question.

Q114 Mr Havard: Well, there are a number of related issues.

Peter Luff: Let me step back a bit and say something that may slightly surprise you. The White Paper that we published, which has been much commented upon, is radical in some areas, in my view. It is radical—we may come to science and technology in a second—in asserting the importance of technology and putting a floor on expenditure. It is radical in its commitment to SMEs. It is radical in its support for exports, in my view.

I have to say that I do not believe that the underlying procurement strategy it sets out is as radical as some people have claimed. What it is doing is continuing, effectively, with many long-standing policies. Commercial off-the-shelf is not a new idea in defence. If you read the 2005 Defence Industrial Strategy, you will find many areas that say commercial off-the-shelf is the right route to take. I have got them marked up in the document. If you want further and better particulars I will happily provide them, but if you are happy to take my word for it, it is not that new an idea, because it is the right thing to do for defence—the right pragmatic decision.

Open procurement, where you do not damage your sovereign interests—the operational advantage for the action you need—is the right way to get value-for-money defence, and to get equipment to the front line fast, to make sure you can do the job you are there to do, which is to defend the country and promote safety and security in the world. It is not that radical, buying off-the-shelf where appropriate. We will take delivery very soon of our eighth C-17. No one is suggesting we should have a production line to build a C-17. The American Air Force has more than 200 C-17s. There is not going to be a market for selling more C-17s. It is right to buy it direct from Boeing. It is the right way forward.

Controversially, perhaps, I would say that the decision to buy the MARS tankers for the Royal Fleet Auxiliary, taken by the last Government, in international open competition, was the right decision to take, because that is a capability—tanker building—that the UK, very sadly, is no longer capable of taking. We are good at complex warship building; we are good at designing ships—the contract has a British design and has a lot of British content. It was right, in my view, for the last Government to take that decision; and, equally, in the complex weapons sector, we are continuing the pipeline for complex weapons, which the last Government established, through the team complex weapons concept. That is leading to massive investment in British technological skills, through MBDA and the partner nations, in team complex weapons.
I do not think the policy is that radically different, and against that background we have one of the most vibrant defence industrial bases anywhere in the world. We have seen the major defence contractors from America come and set up business here. Lockheed Martin, Boeing, Northrop Grumman, Raytheon, General Dynamics—they want to come here and be here, because they recognise the excellent supply chain, the openness of the environment that we have got here, and the size of our defence budget, which is still the fourth largest defence budget in the world. I actually see this aspect of the White Paper as being less controversial, which may be why industry welcomed it. I could go on for another half-hour.

Q115 Mr Havard: As you will appreciate, we have people making claims to us that it has this effect or it has that effect. Our job is to try to find out what the real effect is. In relation to these processes whereby it seems as though there is a change, that 2005 paper talked about appropriate sovereignty. You would probably say the same thing. That in itself is an interesting discussion that brings in elements of skill, the industrial base, and the question of operability—all these different elements. We understand that, but what is being said is that the relationship is being rebalanced now. That is your statement. So you are going to restore open competition. The default position is almost to say, “Well, if somebody else is building it, we will just buy it.” There is nothing about what cannot be done that way. Industry is expressing concerns about something about that. Could I say something about the question that it put to us very directly on concerns to us about that. Could you say something about exportability?

Peter Luff: I have an interest in ensuring that the British defence industries export a large amount of their products. My interests are simple. That way I can get the benefits of economies of scale, for example, in the production run. I can actually ensure that capability is sustained by more than just the British defence budget. A capability that is being assisted by exports from America, our NATO allies or wherever it may be, is a capability that I do not then have to invest in myself. So exports help me to sustain a capability in the UK that I might need for sovereign reasons, and they are also good for the UK economy. They should give me product benefits and economies of scale, too.

There are a number of ways that you can do that. For example, when we are doing the acquisition process, we need to build exportability in right at the early stage of the process. We have not been good at this in the past, but you will find that what we are doing in the complex weapons pipeline now means we are being told that the complex weapons we are developing there are being designed with exportability in mind. That enables us to sustain the excellence of the companies operating in this area not just off the MoD’s budget, which has, frankly, recently been a shrinking budget. Exporting really matters to me, which is why there are a range of measures identified in the White Paper to boost exportability. However, I do not accept that it is an absolute precondition for an item of defence equipment that is to be sold to an overseas customer or it should be sold first to the British MoD. It is desirable and it often helps—of course it does—but we have outstanding Armed Forces with outstanding equipment, and all kinds of advantages accrue from co-operation in export sales—not just financial and capability ones, but ones relating to the relationship between armed forces and countries. There are huge soft power diplomatic advantages, too.

We really do need exports to flourish, but when I talk to many smaller companies, I find that they begin their commercial journey in the export market. Many of the SMEs I talk to are increasingly important to defence, because of the fast-changing nature of the technological world in which we live. Many of those SMEs begin their life exporting and then turn to the domestic market. There is merit in the argument that the British Government must buy something first before it can be sold overseas, but it is far from the whole truth. There are many, many products, particularly in the SME sector, where that is just not the case, and where exports are occurring despite lack of demand from the MoD.

Q116 Thomas Docherty: I think in your answer to Mr Havard you drew a distinction between MARS tankers and sophisticated warships, and said that you would expect those to be procured in the United Kingdom. Am I right in thinking that you would expect, for example, the refitting and refurbishment of complex, sensitive warships to be retained in the United Kingdom, or might we go overseas?

Peter Luff: I think I can see where your questioning is going, Mr Docherty. The freedom of action to maintain our fleet does have a significant relationship with our ability to maintain it within the UK. In times of tension and international conflict, making sure we can do it within the UK brings real advantages, and it is therefore is something I regard as being of huge importance. However, we have not yet taken decisions about where to refit and maintain the Queen Elizabeth class aircraft carriers, for example.

Q117 Thomas Docherty: Aside from the QE, you would expect frigates, Type 26s and so on to be refitted and refurbished within the United Kingdom.

Peter Luff: Yes, under the existing arrangement we have by normal expectation. However, circumstances do change and, for example, with countries like France, you can see the possibility of some quite bold initiatives to share capabilities. But yes, other things being equal, as they say in economics, that is our expectation.

Q118 Chair: Would that change if there were an independent Scotland?

Peter Luff: It is difficult to see how we can maintain our full freedom of action with a separate Scotland.

Q119 Mr Havard: May I ask you one simple question? In terms of the broad discussion about open markets, competition and so on, there is this question about EU exemption. The Secretary of State was
asked a question about it in the House yesterday. There is confusion about what such exemption applied to, whether it applied to more in the past, and what it applies to now. Could you please clarify for us what exactly the situation is? Claims are made about France and other countries using the process, whereas we are constrained in some fashion.

Peter Luff: I do not think it is true that we are more constrained. I think we have possibly more willingly adopted an open-market principle because we thought that that had brought advantages to the MoD and to the defence industries, making them more competitive. Certainly, that is one of the focuses of the White Paper.

The European Commission has made it clear that it wishes to drive forward the single market in defence equipment and support, which is something that I welcome. Britain has got an open market, and I think that the European Union presses that agenda more robustly through the Defence Procurement Directive. That has been incorporated into law across Europe now, I think in every member state; certainly it has here in the UK. As those requirements are enforced through the European Court of Justice, we will see more and more opportunities open up for British defence equipment manufacturers to supply in the European market, so we are on a level playing field within the European Union. The same rules apply, and the same exemptions for warlike stores apply, under article 346, and I think you will see them enforced with increasing robustness by the European Commission. That is not something we have anything to fear from. The openness of our market should mean, in fact, that we gain from that process.

Bernard Gray: May I make one quick observation on that? Although I understand industry sensitivity and anxiety on the point, there is a danger of overestimating it, and they are often talking about issues that are at the margin. One way of measuring this is that some 40% of our output goes through sole-source, Yellow Book negotiations. That tells you that there is a considerable baseline of effectively sole-source suppliers, which are largely UK suppliers. If we think about it in a different way around our major platforms, our procurement route for Typhoon, for our surface ships and for our submarines, which are very substantial components of the total cost of the programme, are already set and largely UK-based. I have heard the Secretary of State say similar things, but speaking as someone who comes from the private sector traditionally, and echoing something that the Minister said earlier, I would give my eye teeth for the level of certainty that they already have about their forward programme. Many weeks, in the industries that I used to work in, you would not know the next week what your order book would look like, never mind in 10 years’ time. I appreciate that more is always better, but if you think about the forward programme that exists at the moment, there is a substantial programme already out there. We will spend £160 billion over the next 10 years, and quite a lot of that is already programmed.

Q120 Mr Havard: And will the revision of the Yellow Book that is being undertaken change that substantially?

Peter Luff: The review has been completed, and it is being consulted on now. We are looking at the implementation phase. We have reconsulted industry on the outcome, and we are now in a process of discussion to take it forward, changing the rules and changing the enforcement mechanism. Changing the enforcement mechanism may also require legislation, because it means changing the status of an existing public body. That may also require legislation, but we can change the rules notwithstanding that. That debate is being had now, and I am grateful to industry for a very constructive approach to what is quite a big change for them. As Bernard says, this is 40% of our procurement, and getting that right is very important. This is not about attacking their profits; I want a vibrant, competitive defence industry to make decent profits. It is about attacking their cost base, and making sure that costs are not unreasonably high. A good rate of return—that is great by me. That is what they need to do to stay in business and make the investments they need to be there for the future, but I will not have excessively high costs underpinning a level of profit that is, therefore, unreasonable.

Q121 Chair: May I move on to research and development? In 1997–98, we were spending double what we are spending now, in real terms, on research and development. Of our defence budget, 1.2% is spent on research and development. Can you tell us what proportion of the American defence budget is spent on research and development?

Peter Luff: As it happens, I can, Chairman. Before I answer the question, may I thank you for the strong support you have given personally to the maintenance of the MoD’s spending on science and technology? This has not always been properly appreciated within the MoD itself. In recent years, we have seen the budget raided time after time to make an unbalanced equipment budget add up. That has been profoundly unhelpful and completely contrary to the long-term interests of defence.

Can we get our terminology accurate, because these words are quite awkward? For 2009, the most recent year for which I have comparable figures, we were spending 1.2% of MoD’s spending on the science and technology aspect of R and D, which is the centrally controlled and funded part of our work, not the full range of R and D. The US was spending 2.8%, more than twice as much.

Q122 Chair: Of their rather larger budget.

Peter Luff: Yes, of a significantly larger budget. Taking into account research and development, the broader questions about taking things through to higher levels of technology readiness into actual production, not the basic science, the UK was spending in 2009, 5.3% of its budget on R and D, down from 8.3% in 2005. The US was spending 16%. To be fair, comparison with other European countries puts us more on a level playing field.

Q123 Chair: What about France?
Peter Luff: France: the most recent year for which I have figures is 2008, when we were spending 1.5% on science and technology. France was spending 1.8%. On R and D the most recent year for which I have figures is 2008, when we were spending 7.6% and France, 7.2%.

Q124 Chair: It is not enough, is it?
Peter Luff: I agree with you.

Q125 Chair: You do. Good. What are you going to do to increase that proportion of the defence budget?
Peter Luff: When I move on from this job, as one day I surely will, I will regard putting a floor in the science and technology budget as one of my greatest achievements.

Q126 Chair: But it is such a low floor.
Peter Luff: I absolutely agree with you. What I have challenged the scientific community at MoD to come up with is a scientific argument for what is the correct level of expenditure on science and technology. I have no evidential base from which to argue a particular figure, so what I said at the time of the White Paper—

Q127 Chair: You will never get one of those.
Peter Luff: I am told I can. Work has been done in the past and has been happening again. I don’t think it is terribly helpful to say that France spends that so we should spend this; Germany spends that so we should spend this. I do know one thing with absolute certainty: what we are spending is not enough. We should be spending more. My own private hunch is that probably around 2% is the figure that may be right. That is not evidentially based; that is just instinct.

You know the importance of S and T to the future safety of our country. I would argue that, as we make progress on reducing the overheating in the equipment programme, as we use the departmental unallocated provision, which is there as an initial source of money, there are various levers we could pull to increase expenditure on science and technology. But I want to do that off a strong evidential base, with the science community saying what we should actually be spending and not doing that we should be doing at present to safeguard our future. I am with you 100%. If you have any suggestions as to a methodology that I could suggest to my colleagues at the MoD and the Treasury, I would be delighted to embrace it.

Chair: Now that you are basking in the glow of a balanced budget, please concentrate all your efforts on increasing this amount of spend on research and development, and science and technology.

Q128 Sir Bob Russell: The amount of money that is being spent on research and development, is that in-house or elsewhere in the defence industries?
Peter Luff: The programme office based at DSTL knows that it is under an obligation to spend only within its organisation what it must spend on its organisation for security reasons, or for the intelligent customer function as well. We often need to spend money to ensure we know what we are buying. I think from memory it is something like 60% of our science and technology budget is spent outside with organisations such as, for example the best known, QinetiQ. There are many other organisations as well. I believe that we should spend that money outside to bring in the advantages of the private sector, enterprise, all those kinds of things.

Q129 Sir Bob Russell: Are any universities involved in this research and development?
Peter Luff: Yes, but we do not do basic research. We do not do the underlying basic scientific research. We start at the next level up.

Q130 Sir Bob Russell: Does the MoD ever go back and look at what was agreed and decided a few years before when it restructured research and development capabilities, to see whether predictions and projections came to pass?
Peter Luff: I am not sure what you mean by that question.

Q131 Sir Bob Russell: What I am going to tell you is that the clothing and textile research laboratories, or by whatever name it was called, transferred from my constituency to Bicester a decade or so ago. My understanding is that world-leading research capacity no longer exists.
Peter Luff: Well, you’ve told me something I didn’t know.

Q132 Sir Bob Russell: I would be most grateful if you, Minister, could ask your officials to find out what was projected or predicted when that research establishment moved from Colchester to Bicester and what actually happened, because Britain lost a world-leading research capacity.

Chair: Perhaps you will be able to write to us.
Peter Luff: I will do that. 3

Q133 Chair: Some questions about small and medium enterprises. When the defence industry was in front of us on Thursday morning, we heard that there was an impression, rather than actual evidence given, that the Ministry of Defence was careless with the intellectual property belonging to those small and medium enterprises. Any comment to make?
Peter Luff: Yes, quite a lot, actually. This is something that is often said. At the SME forum, which was established as part of our response to engaging more carefully with the small and medium-sized businesses of our country, I raised this issue a couple of meetings ago, and we discussed it. When it came to it, they found that they were hard-pressed to find actual examples when it has been a real problem. The problem is one more of perception rather than reality. Notwithstanding that, in our implementation plan for the White Paper, we have a range of actions to address this precisely and to make sure that we are getting it right.

I have five or six actions here in total. For example, the Government will work with the Intellectual Property Office to explore what could be done to promote greater confidence among SMEs that their

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IPR will be respected. This may include developing a code of conduct for supply chain companies to include the way in which higher-tier companies—often, the problem is with higher-tier companies, not with the MoD—will be expected to treat and protect the IP provided by their suppliers. It may also include changing our approach to contracting, so that our prime contractors and higher-tier supply chain companies are contractually obliged to recognise and respect the IPR of subcontractors, including, of course, SMEs. It may also include raising awareness of the potential for licensed technology transfers, an alternative avenue for SME participation, potentially benefiting SMEs and extending the pool of technologies available for defence. There is a range of things that we are doing.

There are environments in which we would like to explore new ideas of defence, where IPR can be protected. I attach particular importance to organisations such as Niteworks, based in Farnborough, which is an environment where, typically, up to now, it has been the primes that have really engaged with this most enthusiastically. More and more small and medium-sized companies are going there and engaging now. They work in a special legal environment in which their IPR is properly protected, finding new and radical solutions to the MoD’s requirements. So there are a range of actions that we are taking. The evidence that I have at my disposal, notwithstanding all that, is that the problems are more of fear than actuality. But any evidence that I have of particular problems will help inform our policy, and I welcome it.

Q134 Chair: Thank you. That is helpful.

Next, unlimited liability for small and medium enterprises. Is that causing a problem, when the Ministry of Defence insists on SMEs accepting that liability, as we have heard it is?

Peter Luff: I must make it clear that it is not MoD but Government policy, so we are bound by Treasury rules here. Our policy on limits of liability reflects the guidance we get from HMT. Limitations of contractors’ liability of £250,000 and over can only be accepted by the MoD following HM Treasury approval. There are specific exemptions for specific categories of equipment.

This was also raised in the last meeting of the SME forum, proving the value of the organisation; it gives an opportunity to discuss this openly and honestly. We are now going to organise a workshop with the SME group to explore this issue in more detail. If I was a small or medium-sized business, I would not particularly want to sign up to unlimited liability. The truth is, as Bernard Gray often reminds me, that it is an empty threat, because once you have got the contract with the company, for example if your firm is a builder, once you have actually started the building works, you cannot actually sack it; you have to stick with it. So actually, it is often a problem more of perception than reality. Once you have started the work, very often you have to stick with the company. So putting them into bust by an aggressive use of the liability rules would be against our interest. But we are engaging the SME forum on this issue, because it is a real problem. It does put off many non-defence SMEs from getting engaged in defence. If it is a problem of perceptions, it is one that we need to address. Again, specific suggestions will be very much welcomed.

Q135 Chair: One specific suggestion is that you might like to contact the Treasury to ask whether this is actually an essential rule—another daft question.

Peter Luff: There are some issues about us taking on contingent liabilities, each of which we have to notify to Parliament, to you and the Chairman of the Public Accounts Committee.

Q136 Chair: I am perfectly happy to receive letters.

Peter Luff: Excellent. I look forward to writing more such letters to you, Chairman.

Q137 Chair: Next, we have heard that it takes a long time for primes to accept SMEs as suppliers. Have you heard the same thing?

Peter Luff: I am not aware of this. I have not heard this particular suggestion being made before.

Bernard Gray: There is always a debate about becoming a qualified supplier, either as a firm and what financial guarantees you are prepared to give to the prime, not necessarily directly to us and also about whether the piece of equipment—the sub-components that you are supplying into the prime—get qualified on any particular platform. That is not a new observation. That is a long-standing concern. The primes themselves have an incentive to procure on the most cost-effective basis. So provided that we get the incentives and contracts right, they should only be making things where they are the lower cost producer and therefore they have a series of make-buy decisions. Most of our primes have substantial third-party content which is often coming from the SME community. There is something in that, behaviourally as much as anything else. The amount of time that the Department or the large companies put SMEs to, when they do not have large numbers of staff to be able to go through large bureaucratic processes, and then the kind of hurdles that industry and we have required them to clear historically are an issue.

If I might just offer one other observation about the way that the Government works which is unhelpful to them, cash flow is absolutely critical to SMEs. The amount of time it takes the Government to decide to do something can be the difference between success or failure. They simply cannot afford to try to pitch the shoe for 12 or 24 months in the hope of getting an order. So all of those things are real issues. They cannot ever be completely solved. It is like living in Holland and dealing with the sea. It is a constant work of Hercules but we definitely need to focus on it.

Peter Luff: But we are doing well with the engagement of SMEs. Now 43% by volume of our new contracts are going to SMEs. It is a much smaller percentage by value, as you would expect. We cannot get an SME to build a category A or a category B programme project because otherwise it obviously would not be an SME. That means that of the available equipment spend to SMEs, they are getting
Q138 Chair: The Centre for Defence Enterprise. On Thursday morning we were a bit surprised to hear that none of the witnesses from ADS, including the SME representative, had had any experience of it. Do you agree that there is work to be done?

Peter Luff: No. I think it is probably their problem and not mine. I am amazed by that. I heard a report of this. I was staggered that companies of that nature should not have been aware of the work of the Centre for Defence Enterprise. I want to pay tribute to one of my predecessors, Lord Drayson, whose brainchild this was. It is a first-rate organisation, doing a great job. Most of the primes are engaged with it. We are focusing its work more and more on SMEs because we think that is where they have a unique contribution to make. We are expanding modestly its role, not its staff. It is very unbureaucratic. It is very efficient. You, Chairman, I know attended the CDE’s showcase event at the Department for Business, Innovation and Skills only a few weeks ago and I think you were impressed by what you saw there.

Chair: I was.

Peter Luff: I am staggered that your witnesses did not know about the CDE.

Chair: Well, they didn’t and so maybe another letter might be in order.

Peter Luff: Well, next time I see Sir Brian and Mr Southwell I will remind them of an organisation which they should hold in very high regard and which their competitors are using very effectively.

Q139 Chair: A final question before we get on to the aircraft carriers. The White Paper suggests that the MoD will be more open with industry about its requirements. Do you think that it is open enough? How are you working with other Government Departments to take the interests of industry into account? Do you think they bring in industry early enough? Do you say to industry, “This is what we want,” or, “This is what we want to achieve.”?

Peter Luff: Again, a very big question, Chairman.

Chair: You don’t have to answer in a big way.

Peter Luff: I will try to be economical with my answer, but not the truth.

There is again some tension here. You have to recognise that at the end of the day we are the customer and they are the suppliers. There will always be a limit to the degree of openness we can have with them, for example, about our forward equipment programme. There will be things we want to conceal from them simply to make sure that we not put at a commercial disadvantage in our negotiations. That is the real world in which we live, but I do think we need to engage them in our requirement setting process much more thoughtfully than we have done up to now. I might invite the Air Marshal to say a few words—he has been silent for far too long. He will laugh when I say this, but again I highlight the Niteworks organisation at Farnborough. There is a debate about its value in the MoD. I personally attach great value to it. We are looking at its work again now. It provides an opportunity to engage with industry at an early stage of the acquisition process and say, “Here is what we want to achieve. How do we do it?” That kind of approach we do not do enough of, I think.

Similarly, CDE provides an opportunity for companies with innovative ideas to come and say, “Here is an idea you might not have thought of,” and we say, “Oh yes, that’s a good idea. We can actually use that.” We have done that in successful operations. So I think we are getting better at this. The new Defence Suppliers Forum, which replaced the old National Defence Industries Council, is more openly engaged in a less structured engagement. We have below it the old network of sub-committees that always met to debate particular issues of importance, and I think that still works very well. My door is open to as many defence contractors as I can manage, to engage them on particular problems.

I do find a problem with the defence industry. They are remarkably reluctant in public to express what they really think. It must be the fear of giving secrets away to their competitors. If I go to speak at a defence industry event—

Q140 Chair: Also, they do not want to offend their main customer.

Peter Luff: Well, they seem quite happy to do it behind our back. Doing it to our face occasionally would be quite welcome as well. There has to be a relationship of constructive tension between us and the industry. We must not be in their pockets or they in ours, but at the same time we want to have the maximum openness we can achieve to obtain the requirements we strive to seek.

Air Marshal Hillier: Perhaps I can give a couple of practical examples from my personal experience. In relation to operations in Afghanistan and prior to that in Iraq, one of my previous capability responsibilities was to do with platform protection. Very much as the Minister described, rather than us doing all the work and saying to industry, “Can you now go and build us one of these or manufacture one of these and put it on to our platforms?” we ran a number of sessions in which we just described the problem. We ran it at a suitable level of classification for the cleared contractors as I can manage, to engage them on particular issues of importance, and I think that still works very well. My door is open to as many defence contractors as I can manage, to engage them on particular problems.

Peter Luff: Well, next time I see Sir Brian and Mr Southwell I will remind them of an organisation which they should hold in very high regard and which their competitors are using very effectively.

Chair: I was.

Peter Luff: I am staggered that your witnesses did not know about the CDE.

Chair: Well, they didn’t and so maybe another letter might be in order.

Peter Luff: Well, next time I see Sir Brian and Mr Southwell I will remind them of an organisation which they should hold in very high regard and which their competitors are using very effectively.

Q141 Chair: So that is an example of it going well.

Air Marshal Hillier: It is. I am about to give you another example of it going well. This is more recent and it is in the information systems space. My
perception was that we were describing far too much
a long-term strategy on the basis that we would know
our information requirements many years in advance,
and the world is not like that. My sense was that we
would be much better describing a volume of money
that we ought to spend in this area and having a very
open dialogue about how well that money was spent.
I worked with one of the industry associations, the
Intelllect body, and we went through and had a
discussion about our requirements. How would we
actually balance that—trying to provide some
certainty so that we were not just completely in a sort
of ethereal space, but equally keeping ourselves so
that we could be reactive as information capabilities
evolved?
The consequence of all that work, which was a
number of sessions with the MoD, in fact, was the
construction of an information portfolio approach, and
that also allowed the MoD to realise significant
efficiencies, which was part of how we achieved
getting rid of the overspend in the defence
programme. So those for me are very positive
examples of how we can bring industry into our
requirement setting space.

Q142 Chair: Were you going to give us some
negative examples, or would you rather not?
Air Marshal Hillier: To be honest, I am sure there are
examples out there, but they do not immediately leap
to mind, because I am looking at it from a positive
perspective. I would just say that, in my mind, it
works when it is not strict. Bernard is clearly much
more in that space of the contract relationship, and
that is not my business. Constantly having a dialogue
with industry once we have decided to do something
leads to the frictional costs that we have talked about.
I want to be much more in that capability setting,
defining requirement space and involving industry. I
do not know if Bernard would perhaps—that was the
construction of an information portfolio approach, and
that also allowed the MoD to realise significant
efficiencies, which was part of how we achieved
getting rid of the overspend in the defence
programme. So those for me are very positive
examples of how we can bring industry into our
requirement setting space.

Peter Luff: I will hand on to Bernard, but I will just
say two things. I am sure that acquisition after
acquisition in the past has specified every bolt, screw,
dial and knob that you can think of at too great a level,
and then just delivered against that. I am sure that you
will find that in many acquisitions that process has
been followed, which is an inappropriate way to do it.
By the way, I think that we should not focus just on
equipment. The total support force concept, which we
are working very closely with industry to develop—
we discussed it at the Defence Suppliers Forum last
week—is not about equipment directly, but about the
support of the force and making the best possible use
of the military, the reservists, the civilians and the
contractors. We see a very heavy use of contractors
now in Afghanistan, for example. There are many
thousands of contractors engaged there supporting the
effort in Afghanistan. Making sure that that works still
better and better in the future is very important for
defence in terms of delivering the outputs we seek,
and Bernard will be procuring that through his
organisation. We are working very closely with the
industry to agree how that is best taken forward.

Bernard Gray: I have just a couple of observations
on it. First, I definitely think that a richer dialogue
between companies and the Department would be
helpful. However, it is constrained in a number of
ways. One of those ways is that the mechanics of the
procurement process means that there is a sort of
Caesar’s woman component—people have to be seen to
be very careful about what they say—which actually
works against the Government’s interest in
understanding the full richness of the picture that they
could perceive. That is a very real problem. In an
attempt, effectively in EU delegated legislation, to
ensure that public procurement happens on an entirely
appropriate basis, you lose some richness in that
dialogue, and that is a problem.
The second problem is that for my money, we do not
have enough people in the Department who understand
how these things work in industry. We
sometimes do not understand the key drivers of cost,
so we may inadvertently specify things in such a way
that drives cost or ineffectiveness into the system. We
need to get better at that.
Thirdly, I have been on the other side, trying to supply
the Government and thinking, “Why on earth are you
asking for this? It does not make any sense.” Trying
to talk to a Department—not this one, but another one—and say, “Listen, you could do what you are
trying to do in a completely different way”; you run
into a juggernaut that has decided it is going in this
direction and it is not for turning. Some supineness of
mind, agility and understanding of shortening that up
would be helpful. People in my organisation feel
really constrained out of being able to talk, for fear of
the accusation of bias.
My final observation is directed back at industry,
where, as Steve has pointed out, there are examples
which have led to reduced cost for us—he was talking
about the Intelllect proposition. Too often still, though,
the proposition is still something along the lines of,
“Do you realise that if you just spent another £500
million with us, this is what you could have?”. I am
not sure that the defence industry has fully absorbed
that the defence budget is fixed and we are looking to
deliver more capability for the same money. Too
often, it imagines that it is still in a version of what
the Department was in, of thinking, “Yes, but I can
compete for more money in this, that or the other
vertical,” etc.
There is definitely a cultural shift that starts to ask,
“How can we use innovation to cut the cost for us?”
In fairness to the RAF, on things such as Tornado
support, for example, which has been a theme for
some years, that has been done, but applying that to
new innovation to cut costs, rather than saying, “If
you came and spend more money with me as a
contractor, rather than someone else, you will have a
higher capability”, is not something that I think has
fully got across yet.

Chair: Thank you very much. Now, aircraft carriers.

Q143 Thomas Docherty: A nice easy one to begin.
How much was spent, including penalties, on the
conversion project and how many MoD personnel
work on it?
Peter Luff: I cannot answer the question on
numbers of personnel, and I doubt we will be able to
give you a sensible answer, because some people have had a hand
in the mangle on this one, but we will see what we can do about that. In terms of costs, it is very straightforward. It is just as the Secretary of State said on Thursday last week in the House. There are really three elements: the design work that was done to look at what needed to be done to the carriers to fit the change; some of the contractual work around the relation with the US suppliers and the equipment—the work on the foreign military sales relationship with the United States of America—and some limited actual physical changes to the carriers, which were of a modest nature. Those costs together come to the order of £100 million in total. That is roughly split 50:50 between the design and contractual issues—the FMS stuff—and the actual physical changes to the carriers. It is around £100 million.

I have seen another figure—a bigger figure—banded around. I think that is a misunderstanding, because there are additional things we now put on to the carriers, to cope with the STOVL capability, that were not required for a carrier variant capability, but the net costing of that is not additional cost. The actual policy changes might have cost as much as £100 million.

**Q144 Thomas Docherty:** Okay, that is helpful. That was easy, wasn’t it?
**Bernard Gray:** To have a stab at your personnel number—I am drawing from the depths of the goo at the back of my mind—about 100 people in my organisation have been working on it. There will have been other people involved.

**Q145 Thomas Docherty:** That was civilians at MoD?
**Bernard Gray:** That was a mixture of civilian and military personnel.

**Peter Luff:** It will have been people in Main Building, people in the Navy and people in the RAF.

**Bernard Gray:** Of the order of 100 DE&S staff have been working on this over the past 18 months, with an engagement with people in the Main Building and elsewhere through that process, but it is that kind of order.

**Q146 Thomas Docherty:** That is helpful. The Secretary of State told the House that the cost of cats and traps had risen from, I think, £900 million—that was the figure bandied about—to over £2 billion for one carrier, and the suggestion was that it would be a greater sum again for retrofitting. How did the Ministry of Defence get its estimates so spectacularly wrong?

**Peter Luff:** That is a very good question—one that I would like to know the answer to myself, in some respects. We did underestimate, it is true, the complexity of the conversion process. I want to make it quite clear that it is not an increase: there was some increase in the cost of the equipment, but that is not actually the total picture of the cost. The cost is also a reflection of various other issues, such as the FMS route for the equipment itself, but the cost of the conversion itself was the real issue.

Bernard has been following this very closely for a rather long time, and I think it is best to give him a detailed opportunity to explain the situation.

**Bernard Gray:** Let us leave aside the start and end point. On the component parts that build up the change, the cost—in particular of the catapult system—proved, on further dialogue with the US, to be significantly higher. I cannot remember the exact figure for that component, but it was of the order of 50% higher than the original estimate for that piece of equipment, largely because of the assumptions, made broadly at the time of the defence review, that we would be procuring half of a US system. The US system has four catapults on a Ford-class aircraft carrier; we would have two. Broadly speaking, therefore, the assumption was that the cost of the equipment would be about half.

In practice, there is a lot more common equipment that is required to drive the system overall, regardless—to a point—of the number of catapults that went into that. There was also a significant component of additional technical advice, which the contractors in the US were recommending was required. That was of the order of over £150 million. Additional aircraft launch and recovery equipment was required, on top of the cats and traps, which had not been included in the original estimate. The cost of going through the FMS purchasing route and some inflation adjustments were further components. The final component was the degree of invasiveness into the ship that was required to install the cats and traps. I think that we gave the numbers last week: it went from 80 to 280 major compartment changes, as we got into the detailed design. Those are the component parts of how you get from A to B.

To take on your second point about the conversion of the second carrier being even more expensive, that arises out of the fact that having built the Queen Elizabeth, you then have to take her back in, refit her, and take her apart again in order to put that in. Our estimate, which was very preliminary, suggested that it was between £2.5 billion and £3 billion to retrofit it to a fully built carrier, as opposed to just shy of £2 billion to insert it into the Prince of Wales in build. So that is the delta, if you like—the difference between the two.

As for why you get from one to the other, the team worked with and got initial estimates from the United States around EMALS, and had dialogue with people in the Aircraft Carrier Alliance, during the defence review, to come up with a feel for what that cost was. There had always been envisaged a development process that went on over two years, in order to determine exactly what those costs were going to be. Immediately after the defence review concluded, the people working in the Ships Operating Centre in Defence Equipment and Support started that work, and there was a set of approval processes to go through. It has become clear, over the course of that period, that some of the initial assumptions being made were too aggressive, which has led to some of these changes.

One of the reasons why we have effectively cut that two-year process short at 18 months is that we would have been required to commit ourselves to long-lead
items for the catapult system, and indeed to commit ourselves to the course of action on the aircraft over the next two or three months. We were looking at a situation where, had we decided to proceed, we would have bought over £100 million-worth of long-lead items for the catapults, for example. That forced us into a situation of evaluating all those data prior to making that choice, because clearly, we would not want to waste any more money.

From that perspective, the decision that was made at the time worked on the best data at the time, which had been discussed with industry. However, when you do all the additional work, it turns out that this job was substantially more difficult than was originally thought, and therefore, changing that decision seems to me to be entirely the appropriate thing to do.

Q147 Thomas Docherty: I have the transcript here, Mr Gray, of when you gave evidence to us on 22 June last year. I raised the very issue of price-gouging by General Atomics and the figure that the then Defence Secretary had given the previous month to the press gallery, and I quoted to you a figure of £2 billion. That was for two carriers—that was what Liam Fox had said.

Bernard Gray: I do not understand what that means.

Q148 Thomas Docherty: Liam had gone to the press gallery lunch in Moncreiff’s the previous month and had said—I was certainly there, and I think, Mr Chairman, that you might have been there, as was Mr Stewart—that the cost was £2 billion to convert both of the carriers. You said in your evidence, when I challenged you—

Chair: I was never clear that the £2 billion was for two carriers.

Bernard Gray: He said £1.2 billion to £2 billion.

Bernard Gray: It could never have been £1.2 billion to do two.

Q149 Thomas Docherty: You said that you did not recognise the figure.

Bernard Gray: It still don’t.

Q150 Thomas Docherty: But you have gone from £900 million to £2 billion.

Bernard Gray: I haven’t, but it has.

Q151 Thomas Docherty: You haven’t, but the figure has.

Bernard Gray: I am not sure what the question is.

Q152 Thomas Docherty: How did you not see this coming? Even I, a year ago, could see this coming, and I am not as bright as you are.

Bernard Gray: Forgive me, but I am not clear what numbers you are quoting there. You are talking about a lunch at which I was not, and a statement by Dr Fox—I do not know what he said.

Peter Luff: And on a decision to which you were not party, either.

Bernard Gray: There appears to be a lack of clarity about whether we are talking about one or two, which makes a significant difference. I, at the time, last year, had people working on this issue. I did not have any additional number subsequent to the defence review number. To go into the rather more tedious detail of it, we refined the defence review number over the course of the month or two afterwards, which had been in a range from £750 million to £1 billion, to come up with an initial estimate of £951 million by December 2010, which was prior to my arrival in the Department. That was the number we were working on through the first part of last year.

A lot of detailed work to nail down that final number was going on through last year but was not due to complete until December 2012. If you knew more then, you knew more than the people working on the team did. We did not get updated prices from General Atomics until February 2012 to start to plug into the total map, so we did not have any numbers of the type that you suggest. People can go around speculating whatever they like, and they may be right and they may be wrong—I do not know—but what I am telling you is that we did not have those data at that point.

We were doing modelling with CAAS, which the Minister referred to earlier, and there was a long debate going on through the back end of last year about what the appropriate price should be. It was not until we got numbers from General Atomics in February that we were in any kind of position to be clear about that.

Q153 Thomas Docherty: The concern is that a vastly significant decision was taken, before your time, to change the carrier—not just the carrier itself, but the things that rolled on from it, which I will not list because of the time—without, it appears to me and perhaps the Committee, firm, solid numbers. Please tell me that you are never doing that again.

Peter Luff: I think we had access to the best possible information at the time we took the decision. On the basis of the facts available to us, I think we took the right decision. Do not forget that it is not just about money; it is also about timing. It became apparent that it would take three years longer to generate the capability using the carrier variant and the STOVL variant. I think a 10-year gap in carrier capability is the maximum that I am prepared to tolerate. To take it up to 13 would be unacceptable.

If I am honest with the Committee, and I must be, I think the fundamental misunderstanding that many of us had was that these carriers would be relatively easy to convert and had been designed for conversion and for adaptability. That is what we were told. It was not true. They were not. They were physically big enough to accommodate conversion, but it came at a higher price than was apparent at the time when the decision was taken.

Thomas Docherty: I agree.

Q154 Chair: Having been "designed for conversion", and conversion having proved far more expensive than we expected, do we have any comeback against those companies that did the design?

Peter Luff: It is not my belief that they were genuinely designed for conversion, or that the contract allowed them to be designed for conversion. It was an assertion that was probably unfounded. That is my view.
**Bernard Gray**:
They had the physical space. They are, as we all know, very large. However, because the decision to go STOVL was taken in, from memory, 2002, no serious work had been done. It had been noodled in 2005, but no serious work had been done on it. It was not a contract-quality offer; it was a simple assertion that that could be done, but nobody said, “It can be done at this price”, and certainly nobody put that in a contract.

Q155 **Thomas Docherty**:
On the F-35s, the SDSR foreword stated that there would be interoperability with the French. When did you know that was not the case? In procuring the F-35s—Lockheed Martin has a very limited manufacturing ability, and it is scoping to do 47 B variants for the US Marine Corps this decade—have you had it in writing from Lockheed Martin that they can deliver you an operational squadron in 2018?

**Peter Luff**:
I think everyone wants to answer that question, but I will start by saying that our understanding of what we require from interoperability has changed. It is a fact that has changed. We now realise that what really matters is having the carrier groups to put to sea—a French carrier group and a British carrier group are available at any one time—so you can guarantee continuous Anglo-French—

Q156 **Thomas Docherty**:
When did you learn that?

**Peter Luff**:
I cannot give you a precise date for when that thinking emerged. The Air Marshal may be able to help with some chronology. We now put greater emphasis in our thinking on the ability to put carrier groups out to sea—a French carrier group and a British carrier group are available at any one time—so you can guarantee continuous Anglo-French—

**Air Marshal Hillier**:
It is just a maturing of thinking. From my own operational experience, it is exactly as the Minister said: the most important thing at that strategic level of interoperability, if you like, is that you can complement each other’s carrier aviation capabilities, cover commitments and synchronise your refits, or whatever. At the operational level, the question is: when you are both there, can you speak to each other and can you exchange data between nations? That is key. At the tactical level, the question of whether you can fly off each other’s decks has real practical limitations, in terms of weights of the aircraft, weapons fits, refuelling and so on. It is not something that is the key to interoperability; it is those higher-level parts.

Q157 **Thomas Docherty**:
It is cited in the foreword. The SDSR specifically cites the ability to land on each other’s carriers. It cites it.

**Air Marshal Hillier**:
If I might point to another example, we have the statement of intent, agreed with the US and signed by the Secretary of State in January this year. If you go through that document, which is very comprehensive, the actual physical ability to cross-deck aircraft is covered in about three lines of a potential option. The rest of the document focuses on all the other areas that I mentioned, so in the decision that we made, we checked very carefully that we were completely consistent with that statement of intent with the US. It is in that context.

**Bernard Gray**:
May I briefly answer the question about industrial capacity? There is plenty of industrial capacity at Fort Worth for Lockheed Martin, not least because the US has dropped its buy over the course of the next five years by 180 aircraft. Lockheed Martin is completely indifferent to whether it builds Bs or Cs for us. We have had that confirmed not only by Lockheed, but by the joint programme office, which is completely relaxed about it. The key issue for us is not the building, but the training, for which we will need assistance from the US Navy and the US Marine Corps. We have had those discussions with them, and they have guaranteed us that coverage.

Finally, we did not suffer any damage to our place in the F-35 programme. As we made this decision in time, our three test and evaluation aircraft will be STOVL aircraft. We did not change any of them, and our ability to fit UK requirements into the block 5 upgrades has been maintained, so our position in the programme is unaffected by this.

**Chair**:
In a marathon session, I think we have all ground each other into the ground.

**Peter Luff**:
We are up for another hour, Chairman.

**Chair**:
You are very kind, but we are not. You have been very helpful. Thank you very much indeed.
Tuesday 13 November 2012

Members present:
Mr James Arbuthnot (Chair)
Mr Julian Brazier
Mr Jeffrey M. Donaldson
Mr Dai Havard
Sandra Osborne
Sir Bob Russell
Bob Stewart
Ms Gisela Stuart

Examination of Witnesses


Q158 Chair: Good morning, gentlemen. Thank you very much for coming to give evidence today. Minister, welcome to your first Defence Committee meeting—the first of several, I have no doubt. I do not think that it is necessary today for us to ask you to introduce yourselves, because we have had Air Marshal Hillier, Mr Dunne and Mr Gray in front of us before, and you are welcome, Minister, as we said. Let us begin straight away with the format. We have lots of questions, I am afraid. We shall finish at 12 o’clock. That will mean that a lot of our questions go unasked and unanswered, so we will be writing to you at the end to say, “Can we have answers to the following questions, please?”

Let us begin with the first general question. You have just come into your job, how do you find it?

Mr Dunne: Good morning, Chairman. Thank you very much for inviting me to join you today. It is a pleasure to be here.

I came into the job, as you said, just over two months ago. I was not expecting a role in the Ministry of Defence, as I have no previous military background other than school and university cadets.

Sir Bob Russell: Ideal man for the job.

Mr Dunne: I think, as Sir Bob says, the reason for my being offered the procurement role, which I accepted with alacrity, was because it is of some benefit to come to the role afresh. It is an extraordinarily large, diverse and interesting job, which I am finding utterly fascinating. I have to say that much of the hard work has been done, and I am fortunate to be coming into it when I am following the good efforts of my predecessor Peter Luff and of the current and previous Secretaries of State in putting together the SDSR 10 and the follow-up work. The legacy challenges that this Government inherited in defence, with an overblown, aspirational equipment plan that was unfunded, have been put right and put into an envelope that is clear. My task now is to ensure that the Department, as far as the equipment side is concerned, lives within that envelope and delivers the equipment that the military forces need, on time and on budget. That is a big enough challenge in itself, but we do not now have to start by paring back the aspirational wish list that existed when we came into government.

Q159 Chair: You have paid tribute to your predecessor, and I think that many of us on this Committee would wish to do the same. May I put one thing to you that your predecessor agreed with at his last visit to the Committee? We suggested that a defence research budget of 1.2% of Government spending on defence was really far too low, and he said immediately that he entirely agreed. Do you agree that it was too low?

Mr Dunne: I would slightly take issue with the number that you have quoted. That 1.2% relates to the science and technology element of the research budget. The Ministry of course spends much more than that on research and development of programmes, so the figure, when you take the two combined, is much closer to £2 billion.1 Approximately £400 million is spent on the Science and Technology Programme, within the approximately £500 million total on research and approximately £1 billion on programmes in development. So the overall research and development effort funded by the MoD is roughly double the figure that you mentioned.

Q160 Chair: Even so, would you like it to be higher?

Mr Dunne: I think the good news is that we have committed to the 1.2% for science and technology representing a floor. Over the years, it has been marked down in successive years, but we have now said that that is as low as it should go. I have asked for some work to be done in looking at how we spend the resulting science and technology budget of £500 million2 and whether we can do more to ensure that we are marrying up the spend in science and technology through the DSTL with the military requirements going forward, to ensure that there is proper joined-up connectivity between the two. It is very important that we maintain investment in future capability through the science efforts of DSTL and our industrial base, because we are sponsoring through research contracts in industry considerable research there as well—we want to make sure that the two are well married up.

Q161 Chair: So it sounds as though you think it is one of your priorities to maintain our defence industrial base.

Mr Dunne: I would say that we are determined to ensure that we maintain capability. The defence industry is very important to this country. The Prime

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1 Note by witness: £1.5 billion
2 Note by witness: £400 million
Minister has made that very clear. He has been out flying the flag very impressively in recent days. He made a speech last night, as you will have read, emphasising the significance of the defence industry to this country. With 300,000 people employed in the defence industry, we are the fourth largest nation exporting in defence. One of the differences between my role and that of my predecessor is that the responsibility for defence exports within the Ministry of Defence has come back to me as well. So that, I would say, is a very important priority.

Q162 Chair: But in order to have those defence exports, we need to have a strong and sound defence industrial base, do we not?

Mr Dunne: We do, but that does not conflict with the principle of introducing competition in much of our procurement, because that helps to ensure that our defence industry is fit for purpose, is lean and can compete internationally.

Chair: You may find that that is one of the conflicts inherent in your role throughout your time as a Defence Minister.

Q163 Bob Stewart: Good morning, Minister. Congratulations on your new appointment. When we saw your predecessor in May, there were certain pieces of work that he suggested were still awaited. I hope you do not mind if I do a little bit of a checklist to see where we are on each of them. First, the tenure of equipment plan—where are we on that and when might we see it?

Mr Dunne: The equipment plan is currently with the National Audit Office. I think my predecessor pointed out that we were asking the NAO to review the plan, and that we would publish it once its review could also be published. It is with the NAO. We are expecting it soon, and as soon as it is available, it will be published.

Q164 Bob Stewart: The next bullet point is the priorities for military science and technology. Do you have an idea on what is happening there?

Mr Dunne: There is a meeting next month to review where that work has got to. I have had meetings with the Chief Scientific Adviser and the chief executive of the Defence Science and Technology Laboratory— I know that the Chairman does not like us to use acronyms, and it is quite useful for me to seek to spell out acronyms—to check that I have got them right. I met Jonathan Lyle and Vernon Gibson last week, and I have regular briefings. I chair the Defence Research Board, which is meeting before the end of the month, so there is work going on. I do not have a precise timetable for when we will produce the output from that work, but it is ongoing.

Q165 Bob Stewart: I am sorry that this is a checklist. Where are we on Lord Currie’s review?

Mr Dunne: We have made good progress in looking at Lord Currie’s recommendations. We have had meetings with industry. The Secretary of State chaired the Defence Suppliers Forum last month, at which I was present, and took them through where we are with our views on reform of the Yellow Book and single-source procurement.

It is our intention to accept most of Lord Currie’s recommendations to proceed with a fundamental overhaul of the Yellow Book. As you will know, Bob, it was set up in 1968. There have been countless attempts since then to improve aspects of single-source procurement, and they have tended to take a long time. In the most extreme case, I am told that trying to change one clause in a contract has taken over 10 years and still has not been completed. That was for something apparently as mundane as timber products; this is not at the cutting edge of technology. That is clearly unacceptable, and we have told the industry that. They are up for change. I would say that they do not entirely agree with everything that we have put forward, but in some areas we have agreed to disagree. But we intend to put this forward on a statutory basis.

Q166 Bob Stewart: My last chart item is the open procurement principle, and its openness for us and the public to examine it. Where are we on that?

Mr Dunne: The Chairman has already indicated that this is likely to be a running discussion. We are determined to allow open competition for as many projects as we possibly can, recognising that there are certain capabilities where single-source procurement is the logical and appropriate way to go. We are seeking to open up the defence budget to participation by SMEs as much as possible. I know that my predecessor made that one of his top priorities. It is a very important priority for me. I have chaired my first SME forum. I have visited SMEs around the country to learn from them some of the challenges that they face in seeking to participate in procurement. We have done a number of things. We now have a website to provide access to all contracts over £10,000, so they are well publicised. We draw on the Centre for Defence Enterprise, which is going to showcase, to prime contractors and others interested in defence, innovative ideas coming out of our small and medium-sized companies. The first showcase is on 3 December. Members of the Committee would be very welcome to come and attend that. I think we have a dozen companies—I may have got that number wrong, but I think it is a dozen—coming to demonstrate their particular products, and we have invited all the main prime contractors to come and see what is on offer, so we are doing quite a lot to raise the profile. There is also a Government commitment to seek to ensure that SMEs share in procurement to a greater extent than they have in the past. We have a challenge in meeting any aspiration of Government because so much of our procurement spend is skewed towards the very big contracts, which of course by definition could not be given to SMEs. So it is a challenge for us to be the exemplar in terms of the proportion of business that goes to SMEs, but having said that, we have made it clear to our prime contractors that we want to get more information out of them as to how much they use SMEs in the chain, and the recent evidence
suggestions that it is rather more than we had thought. The analysis that I have seen so far says that of the approximately £20 billion spent in 2011–12—we have managed to analyse about half of that, of which 5% is direct purchase from SMEs and about 8% is contracted through the top 27 prime contractors sub-contracting down to SMEs. That gets us to 13% out of 50, if you like, so we are well on our way. There is a challenge—you might ask me why we have not looked at the other £10 billion. That is something that we are looking into.

Q167 Chair: We would like to come to the showcase on 3 December, or at least some of us would, so if you could make sure a formal invitation—

Mr Dunne: You would be very welcome.

Q168 Bob Stewart: My final question is this. When I was a little staff officer wheel in the Ministry of Defence and the CDM was even then a big wheel, we were talking about the new acquisition and all that sort of thing and changing the system. How can we be sure—we cannot of course, so that is the answer, but what are your views on the fact that we have tried so many times over so many years to change the system, with experts such as Bernard Gray at the centre of it? How can we be as sure as we can be that this time we might have finally cracked it and sorted out procurement?

Mr Dunne: The proof of the pudding is in the eating. This Government have tried to tackle the root causes of the problem, so the first thing that we have done to improve procurement is to seek to eliminate the regular annual paring back of projects in order to fit the spend within that year’s budget. From the work that you will have read that Bernard did in his report of 2009, that accounts for close to half the frictional cost, the extra cost, the waste that is inherent in the procurement system because of the way we do it. That was a major step and a good mark of our intent to get a grip on this. The second mark of intent—you are also seeing this happen—is the decision to support Lord Levene’s recommendations and undertake the defence transformation programme. That is a major shake-up of the way the MOD does its business. That will have implications for procurement, but in order to give you confidence that we are determined to get a grip on this, those two actions speak louder than our intent.

As far as where we are in looking at the materiel strategy and as far as DE&S transformation itself is concerned, we are coming to a decision point fairly soon. We have been undertaking a value-for-money exercise, which was announced in a statement by the Secretary of State in July, to compare the Government-owned contractor-operated—GoCo—route with—

Chair: We will be coming on to that in just a moment.

Mr Dunne: Okay. The conclusions of that work will come out fairly soon, and we will then be able to move towards the next stage of a decision, but as you have mentioned Bernard, I would like Bernard to come in and give you an indication of why he thinks—

Q169 Bob Stewart: May I ask a supplementary question of Bernard? Is there anything else you think you could have done to make the system better?

Bernard Gray: We’re not done yet. In fact, we are—

Q170 Bob Stewart: A wish list then.

Bernard Gray: It is somewhere between “not done” and a wish list—there is a plan. It is always a good thing to agree with the questioner: we cannot be certain of the future; we can only plan as best we can. As well as the specific measures, what really determines whether or not there is change is a relentless application of principles and focus over time. There is a slight sense sometimes that one comes along with a magic wand, dings something and everything changes. Actually, the underlying drivers, incentives, and so on, are very deep-rooted, and changing those is a significant challenge.

I have had conversations in a number of areas of the Department over the past few years where it was as if everything that had been written and said on the subject had never happened, because plenty of people will sit there and assert things that we showed were demonstrably untrue three years ago. There is no substitute in that sense for a managerial approach that goes through all of the issues relentlessly and changes the incentives, the information systems and the people such that you get into a situation where they are eliminated and something different becomes business as usual. Too often we have taken a short-term run at something, made some changes and moved on. It just takes the application of effort over time.

Q171 Mr Donaldson: Minister, in terms of procurement around the country, what steps are you taking to outreach to SMEs in the further regions of the UK and to work with the devolved Administrations in each of those regions to increase the level of procurement?

Mr Dunne: Well, Jeffrey, it is early days in my role, so I think it is fair to say that, initially, my focus is to get out and about to visit military installations to see the Services in action using the equipment that we are procuring for them. I intend to spend more time next year getting out and about to see facilities where equipment is being manufactured, although I have already done a little bit of that.

As for what the Department is doing, we do not draw a distinction between where a facility or company is located and its ability to provide equipment to the Armed Forces. Companies from right across the country are invited to showcase their wares in the ways that I described to Mr Stewart. I am aware that there are some significant operations in Northern Ireland—which is the area you will be most interested in—particularly the Thales facilities. I am due to meet the Thales chief executive shortly for a formal visit. I have met him on two or three occasions at defence supplier events, and he is part of the engagement that Bernard is organising at Abbey Wood to keep them informed of what we are doing on materiel strategy. It is important that, where companies have an interesting, innovative product to offer, they make it available to us, and we will buy it if we think it is the
right piece of equipment. We are not geographically focused in where we direct our orders.

**Q172 Chair:** Minister, over the next 10 years we are due to spend £160 billion on defence equipment, with £4 billion of headroom for cost overruns and £8 billion of headroom for stuff that is not in the core budget but that we might find we need. How much of that headroom, of either the £4 billion or the £8 billion, has already been allocated?

**Mr Dunne:** As you say, there are two aspects. We refer to the £8 billion as “unallocated,” rather than “headroom.” The unallocated applies from SDSR 15 onwards, so none of the £8 billion has yet been allocated, and it is relatively unlikely to be allocated this side of the next SDSR. There might be a reason for that to be brought forward, but it seems unlikely.

We are looking at the remaining £4 billion, which is a contingency to allow for cost overruns, if they occur, on existing programmes. Again, that is more evenly spread across the 10 years. There is a small amount in the current year which allows us—we are just over half way through the current fiscal year. You will be aware that we have been able, through setting up these quarterly decision points, to look at where we are going and the spend each quarter. We have had two of those so far, and in each we have been able to make some relatively modest increments to the programme to use up budget that has become available.

The important point, to start with, is to say that this is a good news issue. For the very first time, at this time of the year, we have not been sitting around working out what we are going to have to cut to fit within this year’s budget constraint. We built prudence into the system which allows us some flexibility to meet additional requirements. There are always additional pressures—each Service, as you can imagine, is coming up with things that they would like to buy regularly and putting forward requests—so it is good to be in a position where, from time to time, we will be able to meet some of those requests.

**Bernard Gray:** We have not yet touched any of the £8 billion, as the Minister said, or any of the £4 billion. The additional money that Steve has been able to allocate in the course of the last year has come through the management of the Department’s total cash resources; in other areas, as well as in equipment, we have constrained the budget so that it is not overrunning. That has meant that we have been able to release some in-year money for specific projects.

**Air Marshal Hillier:** Can I just add that, in relation to the £8 billion, as the Minister said, it does not come into our financial profiles until around 2015 or 2016, but, with the front-line commands, we are actively planning the sort of projects which we anticipate may need to come into that headroom space—we are not just waiting until that point before we take any action.

To the left hand side of that, we are also doing the early assessment and concept phase work to make sure that, once that headroom comes in, we have an idea of what we would like to spend it on so it is prioritised. Then, we can initiate the projects when we need to.

**Q173 Chair:** Let me put to you a risk. That risk is that the Treasury will try to take this money back. Do they realise how short-sighted that would be and how that might lead to all the bad behaviour and misaligned incentives that we have seen in the Ministry of Defence for decades past?

**Mr Dunne:** We have a good relationship with the Treasury.

**Chair:** Of course. They are our greatest friend.

**Mr Dunne:** As you heard from my predecessor when he gave evidence, the Chancellor has indicated that the equipment plan could look forward to a 1% real-terms increase from 2015, so we are—

**Q174 Chair:** That remains in place, does it?

**Mr Dunne:** That remains in our planning assumption.

**Q175 Chair:** Right. That is good to hear. Carry on.

**Mr Dunne:** As far as relations with the Treasury are concerned, it is also fair to say that one of the issues that surprised me, and others who are less used to Government accounting, is the extent to which major capital projects—we and, perhaps, the Department for Transport are probably the two Departments that have the largest individual items in procurement, which last over many years—are subject, still, to the same in-year accounting rules, which mean that funds need to be deployed within the fiscal year if they have been allocated. We have started a discussion as to whether it would be appropriate to consider an accruals system of accounting under which other enterprises operate very successfully. It seems peculiar that we are potentially forced into a tight box for reasons that lead us to make decisions that are not, in other respects, logical.

**Q176 Chair:** How is that discussion going?

**Mr Dunne:** It is early days.

**Q177 Chair:** Badly, from the sound of things, then?

**Mr Dunne:** We have started discussions.

**Q178 Mr Havard:** The Committee has made similar observations to those that you have made about a better process for longer term planning, whether that is for 10 years or whatever the forward process is. Can I just be clear, because your predecessor said that, as progress is made on what he described as reducing the overheating in the equipment system, there may be money available, not to give back to the Treasury, but to do other things with. He may have had aspirations to spend some of it on science and technology. However, in his speech to RUSI on 1 November—this is where we need to be clear about the £8 billion, the £4 billion and what is coming out of what or whether it is a cash saving within the year—the Secretary of State said: “For instance, since the beginning of this financial year, the new discipline in our budgetary regime has allowed us to give the go ahead for a series of equipment projects for the air environment over and above the committed equipment programme.” Then he itemised “targeting pods for fast jets, better protection systems for Tornado GR4, and enhancements to MERLIN Helicopters.” Can I be clear that that money is not out of this £4 billion or
the £8 billion? It is from this other rigour that has been introduced into the financial process that you described. Is that correct?

**Air Marshal Hillier:** That is absolutely correct. The philosophy that we wanted to introduce is having a stable, affordable core programme with layers of, if you like, contingency shock absorbers to protect us against cost increases. That still remains in place. As we go through that stable programme, our aim is to add to the programme according to financial opportunity and emerging operational requirements. What we have been able to do, because we have the balanced budget, is on the quarterly basis review the financial performance of the Department, sit that alongside our emerging operational requirements, which continually evolve, and make these decisions about adding to the programme. This is absolutely what we set out to do, and the amount of money we have been spending has not been the £4 billion or the £8 billion. It has been from other efficiencies within the overall core programme. It is important to underline—

**Q179 Mr Havard:** Sorry, within the core programme?

**Air Marshal Hillier:** Yes, efficiencies within the core programme. The Chairman mentioned that we were spending £160 billion on equipment and equipment support over the next 10 years: £8 billion of that is unallocated headroom and £4 billion is realism contingency. The vast majority of money therefore is sitting in the core programme, and we are absolutely focused on trying to generate efficiencies within that core programme. As those efficiencies are realised, we can then reinvest it in additional capability, and that is exactly what you are seeing with those additional targeting pods and the protection for aircraft. I would underline that it is not just for the air environment; we have also done it for the land environment. Mr Luff announced in the summer additional Foxhound protected mobility for the Army, for example, so there is a whole range of projects across the joint environment. It takes us into a fundamentally different place where we can respond quickly to the operational need and add to the programme from where we were previously.

**Q180 Chair:** Could you give us an example of one or more of the efficiencies that have given rise to this extra equipment?

**Air Marshal Hillier:** Well, as part of the overall activity we have been looking at in the equipment programme and the equipment support, we have been ensuring that all those individual projects are realistically costed and individually have the right level of risk contingency. In the way of risk, some of those risks materialise, in which case we deploy the money, and some of those risks do not materialise, in which case we then have that money available to recycle and buy new equipment. That activity is not just in the equipment programme. It goes across the whole of Defence in all the top-level budgets.

**Q181 Mr Brazier:** Minister, could I ask why the Government is focused on the GoCo option? Just to flesh that question out a little, in Mr Gray’s writings—in his original report and in briefings to the Committee—he set out a number of very clear reasons why the current structure does not work at the working level: the civil service pay and conditions; the immense difficulties in taking on someone new; and lack of access to various kinds of expertise and so on. The hybrid model, which was in the frame and has now been dropped, as far as I could see tackled almost all those issues. It has proved extremely successful in the case of the Olympics. Why are we now focused on a much more risky and complex option, and why have we dropped the halfway house?

**Mr Dunne:** The first thing to say is that we have not completely dropped the halfway house at this point. What is going on at the moment is an analysis to ensure that the GoCo route, if pursued, represents value for money compared with the halfway house non-Departmental body alternative. That work has not completely concluded yet. If it concludes that there is a value-for-money case, we would then be looking at comparing the GoCo route against a baseline that would be an improved DE&S—we are calling it DE&S plus. That would be work that we would take forward if we decided to proceed down the GoCo route, which would involve an investment appraisal and starting a tendering process for potential contractors. That would lead to a point where there would be proposals that would be concrete offers from contractors. We would compare the best of those offers against the parallel work that we would be doing of an improved DE&S–DE&S plus.

To get to the nub of your question, the challenge of improving the flaws as we see them in the way in which DE&S is organised, which get to being able to recruit individuals to work within the environment who have the requisite commercial business skills to be able to negotiate against some of the leading commercial companies in this country, is the fundamental part of the problem. We believe, from the work that we have done thus far, that any entity that remains in a non-departmental body construct would not have the same freedoms to recruit the best people in order to establish the right kind of interface with the customer—the MOD and its commands—if it was in that form, rather than in a GoCo route.

**Q182 Mr Brazier:** Forgive me, but can I press you on the detail there, because that is absolutely at the heart of it, before we come on to the tendering process, which I will ask about in a second? I find it very difficult to understand your last answer. Just to recapitulate, clearly, DE&S plus cannot overcome civil service pay and conditions or ignore the extremely clumsy arrangements for recruiting people and so on, because, as you say, you are still inside the civil service model. But the Olympic games did not have any problems with the hybrid model. They got the people they wanted in the arrangement they wanted. If you compare GoCo against the manifestly flawed baseline, you are not really doing a fair comparison. What I do not understand is why you aren’t looking at the hybrid model. Certainly, for the Olympics, they were able to get away from those
problems, and they have not taken on all those extra risks of the GoCo model.

Mr Dunne: I shall ask Bernard to answer, but before I do, one of the big contrasts between the Olympics and what we are talking about is that the Olympics benefited from having an end date. There was a clear date by which everything had to happen, or else we would be in a terrible mess. That provided a discipline throughout the chain of command, which does not apply in anything else—in this case, where we do not have such a finite end to any of our projects; in fact, the projects last for much longer than the Olympics. They had to build them by a date and then it was all over two months later. Here, we are building equipment that will last 25 to 40 years, depending on what it is. I think the timeline has a big influence on behaviour. I am going to ask Bernard to answer.

Bernard Gray: If I may slightly contest the premise of the question, we have looked in detail at the option. It is not as though we were not looking at it. We have looked at it for the last 18 months. To expose a bit more of our thinking about it, we were attracted to it for a long time for the very reasons that you are talking about. It is by any means that we have disregarded it. The issues with it are several-fold. We were attracted to it because of the Olympics example specifically, but as the Minister said, there are some specific factors about the Olympics that, if you ask Sir John Armitt and the other senior people involved in the Olympics, made it unique. For the people managing the Olympics, it was much more like, in our terms, a UOR process, where you are able to say, as the managing group of that entity, if someone wanted to turn it from an oval stadium into a square one, which would be the equivalent of some of our requirement changes that we impose on ourselves from time to time, such as, “Do we want catapults on an aircraft carrier or not?” people would be able to turn around, in the Olympics case, and say, “That’s a very exciting idea. If you don’t mind holding the Olympics in 2014 or busting the budget, we can make that change.” We don’t have that same forcing discipline from most of the activities that we conduct because the timelines have proved flexible. So a key difference—it was both in the explicit pushback and the self-censorship—was that people tended not to come to the Olympics and attempt to change the self-censorship. I am going to ask Bernard to answer. Bernard Gray: Let me come to that as a different issue. We absolutely agree that the performance of the Olympics was excellent. We spent a lot of time talking to the ODA, John Armitt and others and we wanted to learn from them for this very reason. What we are saying is that there is not a direct read across in terms of project control because we do not have the same forcing function of that deadline, which John himself would say was extremely important.

The second thing is that the passage of time has meant that many of the freedoms enjoyed by ENDPBs have been curtailed. So it is possible within a Department for the accounting officer to disestablish an ENDPB under a memo. So therefore you don’t have the same degree of independence as you would do by being outside the Department. One of the key things is not just about your ability to recruit and retain, which is significantly curtailed compared with five or six years ago when the ODA was recruiting, but that your freedom of action to speak truth to power, as it were, as a procuring organisation, is subject to being removed at a moment’s notice. So what degree of independence do you really have under those circumstances?

Reports that we had of conversations between the ODA and other ENDPBs effectively said that the other ENDPBs were increasingly like being in the civil service. They are public servants but increasingly treated with less independence. People looked rather jealously at the independence that the ODA had but recognised it was a one-off. We don’t believe that we would either get the recruiting freedoms, the salary freedoms or the management freedoms that the ODA got. That is the first proposition.

The second issue is that it was the value-for-money work, which is ongoing at the moment, is what we are trying to compare is how much additional freedom and expertise you would get moving from what is the best that a public service can be in a D&E&S plus to the ENDPB model. So how much additional benefit would you get for the amount of money you would have to put into it?

The ODA, as you know, is composed of two parts. It had the ENDPB itself and then it had its consortium partners, the strategy partner led by CH2M Hill, the contracting engineers. They worked as a team. There was a significant bill associated with the hiring of the strategy partner. So it was many tens of millions a year. The question would be what would that bill for a similar strategic partner be for us? How much additional benefit would it gain you in the ability to control the programme? That is the evaluation that is going on at the moment. The indication that we were talking about in July was the prima facie case that said, “We are not sure that the ENDPB takes you sufficiently far on from the best that the public sector can be, sufficient to justify the additional cost.”

Mr Dunne: The other thing, which is completely different from the ODA, is that the ODA started with no employees. We start today with 17,500 employees.

Q184 Mr Brazier: Forgive me for pressing you, but did they ever come up against the problems of civil service terms and conditions of service?

Bernard Gray: Let me come to that as a different issue. We absolutely agree that the performance of the Olympics was excellent. We spent a lot of time talking to the ODA, John Armitt and others and we wanted to learn from them for this very reason. What we are saying is that there is not a direct read across in terms of project control because we do not have the same forcing function of that deadline, which John himself would say was extremely important.

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has been a tendency to try to move, wherever possible, from the most basic cost-type contract into competitive contracts, and where it is not possible, incentive contracts, and so on. What sort of contractual structure do you envisage on the interface between Government and this new GoCo entity, were you to do it?

Mr Dunne: What we need to be clear about is that a new entity would be incentivised by way of fee. The risk for the asset stays with the Department, and the structure of the fee is something that Bernard can touch on in a moment. One issue that came up last time you were discussing this was whether the risk passed to the contractor—the project manager. The analogy is that the GoCo operator would essentially be a project manager, delivering the projects for a fee.

Bernard Gray: Can I just pick up your last point? Nothing would please me more, Mr Brazier, than if we had the freedom to be able to do, within the public sector, the things we need to do. I just do not have it, and I have had a number of conversations that imply that if I apply for a derogation in relation to all that, I would not get it. So while I appreciate that I would like a lot of things to be available and true, in reality, they are not.

Q185 Mr Brazier: And primary legislation to create that kind of freedom has been ruled out.

Bernard Gray: That assumes that there is a unity of will for such a thing to happen in that frame, and that other people do not say “Yes, but the issue is that in solving this problem over here in relation to this piece, you are creating inequalities or dissatisfactions over here.” A potential argument might be, “Well, if you allow DE&F all these freedoms within the civil service structure, what is to stop you arguing that the following 10 other examples should have equivalent freedoms to go out and hire people?” What happens to comparabilities within the civil service structure and terms and conditions for pay across all those different bodies?” The Treasury might then say, “This will turn into a free-for-all in public sector pay”—for example. Other people have, in a sense, legitimate concerns about the system as a whole, which unfortunately means that we are a particular specialist sport within the civil service. Most people in the civil service do very well. They would be output cuts, so we must be clear about this. The other half would not be efficient, but suggests that the other half will not be efficient, but

Q186 Mr Brazier: And the tendering process?

Bernard Gray: We are currently going through a second round of soft market testing, as we called it, discussing with a variety of companies the kind of structure that we want. I am having meetings over the next few weeks with our internal team to decide how a competition would be structured, if Ministers decide that they wish to pursue one. We are discussing with the companies the kind of things that they think they could sensibly bid on, in a pre-competitive phase, so that we are not prejudicing any outcome, but we are making sure that we ask the most sensible set of questions that we can. Broadly speaking, we then have two or three procurement routes that we can go down in technical terms and we will settle on which of those we think is the most sensible that leads to the right answer. Broadly speaking, there is a trade-off between ones that offer dialogue and which allow competitors to offer innovation, which is in principle a good thing for them in the process, versus the difficulty of potentially deciding between apples and oranges when you get to the end of that process, because different bidders have produced different answers. That is versus a boilerplate model that says, “Here are the answers and you must come up with something that is completely compliant with this and no other thing will do.” That makes it easier to compare, but potentially less supple for implementation. If we do decide to go forward with a competition, we would hope to launch that some time in the first quarter of next year.

Q187 Chair: Is legislation needed?

Bernard Gray: We are consulting on that, I think. Mr Dunne: We are consulting on that matter.

Q188 Chair: And what about the possibility of trialling a GoCo arrangement for, say, one or perhaps a clutch of large projects. Is that being considered?

Bernard Gray: It is certainly being discussed. The difficulty with it as an approach is twofold. First, it takes a long time to get results, because you have to run a competition and run a GoCo. How much evidence do you need over what period of time to conclude whether it is a success? The second problem is that those who do not love such ideas do their best to smother them. It is, therefore, unclear to me whether the results of such a trial would lead to a genuine answer.

My third proposition in relation to it is that we have already conducted it, because we have had AWE running as a GoCo for 20 years. We have the results of an extensive trial that has been run that absorbs more than £1 billion a year of the Department’s money in the shape of Aldermaston, which is working very well.

Q189 Sir Bob Russell: Following on from that series of questions, I wonder whether I can ask Mr Gray to reflect on what he told the Committee on 12 May when he referred to the headcount reductions of 28% from around 20,000 to 14,500. You went on to say that “we can achieve about half of that reduction through what I call genuine efficiency gains.” That suggests that the other half will not be efficient, but the opposite.

Bernard Gray: They would be output cuts, so we could do fewer things. That remains broadly true. In fact, the final proposals that we put into the Department will generate efficiency gains of about 18% of the 28%. The final 10% could either be achieved by outsourcing or reduced output. Depending on what the Department chooses to do, there are a set of tasks within—particularly logistics, distribution and storage—where it is possible to tender for the
outsourcing of those to logistics companies. That would take something over 2,000 people from the DE&S budget and put them into a contractor.

Q190 Sir Bob Russell: So we are just juggling people and titles, because outsourcing does not necessarily mean efficiencies and improvements, does it?

Mr Dunne: There has been a very significant reduction in the headcount within DE&S already and the second wave of that concluded in September. There have been 2,267 civilian heads cut in two phases, in March 2012 and September 2012. Some 150 Service personnel have been cut.

Q191 Sir Bob Russell: Minister, I understand and acknowledge the driving force that wants to cut costs—of course I understand and acknowledge that—but my main concern is the efficiency and competence of Her Majesty’s Armed Forces. I am concerned, to put it mildly, that the drive for efficiency savings and reducing the headcount of skilled personnel may not be in the best interests of Her Majesty’s Armed Forces.

Bernard Gray: Can I comment on that? During the first half of this year, we have gone through an extensive period working with the management team within DE&S to look at what we could achieve through efficiency savings. We pulled together the plan that you are referring to by around the end of June, when all the operating centres that work for me had, in fact, a management plan that allowed a reduction from something over 20,000 to a little under 17,000, on an agreed basis. That has been discussed not only with the management team but with our trade union. Effectively, that portion of the plan is agreed and, as the Minister says, is largely in the process of being enacted.

The question arises around what we do about the last 10%. I absolutely agree with you; I am very conscious of the safety and support of the Armed Forces in this. I know Charles Haddon-Cave, and I discussed with him his report when it was in preparation more or less simultaneous with my own. So I am clear that some of the mistakes that were made at the beginning of the 2000s, where we reduced cost and lost sight of, in this case, some safety issues, must not be replicated. I have ensured within the 17,000 population that, for example, all safety and safety-related posts are starred, which means that they must not be left vacant.

We are then saying, “Okay, in relation to the balance of the reduction of about 2,000 to 2,500 people, the question is how to achieve it.” It depends what the Department wants to achieve. Broadly speaking, if it is a nominal headcount, it can do what the Department and many others have done over many years, which is to say that you can transfer that service to a private contractor. You might do that for efficiency reasons anyway. That does save some of the cash, but not most of the cash, because those people keep working and you therefore maintain your output. You have the same amount of output available.

If, however, you want to reduce by that amount of cash, what we are being clear about, unlike previously, is that I am not saying that I can maintain my output to the Armed Forces on that basis. I am saying that I have to give, particularly to Steve and his organisations, less output. I can give you fewer services, because I do not have enough people to supply the total range of services.

Q192 Sir Bob Russell: Minister, Mr Gray said in May “we slim things down and so on.” It is the “slim things down and so on” that concerns me and I think, Chair, we will have to revisit this one in a few months’ time. Does “we slim things down and so on” mean site disposals? You have fewer sites, so you get a nice capital sum by flogging off land. The efficiencies and the annual revenue go up and you get a capital receipt. Are we talking about fewer sites where vehicles are maintained, for example?

Mr Dunne: There are certain asset disposals within our programme. The Defence Support Group is one that we have discussed, which does include, as you say, maintenance of vehicles for land systems. That is a programme that is at very early stages but is expected during the course of the SDSR. Over and above that, within DE&S itself we are not talking about site disposals that I am aware of. What we are talking about is the balance that Bernard has identified between cutting programme teams and, therefore, not delivering a programme, or not. That is a delicate balance, and discussions are going on within the Department about what the appropriate balance is between those two competing demands.

Bernard Gray: To be clear, the Defence Support Group does not sit within DE&S. The people who work there do not work for me, and whether or not there is a capital receipt from the disposal of that has absolutely no impact on what they do.

Mr Dunne: But they do work for me.

Sir Bob Russell: You are all one big happy family.

Bernard Gray: But not one big happy budget.

Mr Dunne: There are certain asset disposals outwith DE&S, but within the general responsibilities that I have.

Q193 Ms Stuart: Minister, can I take you back almost to your opening statement? You bemoaned the inheritance of an overblown budget and overblown aspirations, and everything outside the envelope and all over the place. But then, with great joy, you announced that now we are well back on board, the budget is balanced and we are inside the envelope. When your predecessor came to talk to us, he expressed his surprise that he could not only say, within the UK, that the budget is balanced but believe it when he said it. What makes you think that will still be the case in 2020?

Mr Dunne: As I said earlier, this is the first year where the Department is not running around desperately looking for programmes to cut or defer, because we are living within our budget. As the Air Marshal has said, that is allowing us to meet some aspirations that the commands have. We have a plan, which goes out for 10 years; it has within it—and, as we said earlier, we will be publishing the equipment plan to provide a little more meat around it—all the major programmes that we are already committed to.
As Bernard Gray has said before, 95% of the £160 billion is already committed. We know the programmes on which that will be spent, and our task is, therefore, as much keeping within that envelope. The remaining 5% is the £8 billion of unallocated, plus the £4 billion of head room. There will be demands on both of those, and we will be pleased to meet demands for unallocated where we have new programmes to introduce. But the challenge is now on the existing programmes, and keeping them within budget and on time. One of the great advantages for industry is being so clear about which programmes we are supporting, rather than it being the whole panoply of programmes; many of those were unsupportable, but industry did not know that. Now they are going to know that the programmes that are in the equipment plan are supportable and are funded until we reach the individual milestones for each individual project. That will make it much easier to ensure that we do not get into the same challenges as the previous Administration.

Q194 Ms Stuart: Presumably it is not just the previous Administration; it is every Administration before that.

Mr Dunne: Previous Administrations, I should say.

Q195 Ms Stuart: They would not have gone into it saying, “Let’s blow the defence budget beyond recognition and spend more than we have.” What precisely has changed now that makes you say that you will still be okay in eight years’ time, not just by next year? What was so different in all the previous generations that you have now mended?

Mr Dunne: There are two things. First of all, I would point you to the letter that the Secretary of State wrote on 13 August setting out what we had done and the chronology of how we had brought the budget into balance.\(^5\) Secondly, I am afraid I do take issue with the way in which the previous Administration treated the defence budget. I have every expectation that what happened was that the forces chiefs said, “This is what we want,” the Ministers at the time said, “We’re not sure that we can afford this,” they went to the Treasury and said, “We’d like to make these commitments” and the Treasury said, “Okay,” knowing full well that they would be adding to the national debt and it would be outwith the budget. But there were political imperatives to order military capability, for reasons that are understandable given our commitments in Iraq and Afghanistan at the time, which overrode budgetary rigour. This is a different environment: we are seeking to get a grip on the deficit at a national level and we are seeking to get a grip on the budget at a departmental level.

Bernard Gray: Can I add something that might help, as a person observing both sides of the divide? The Department historically has focused on the next year or two’s budget, and one of the problems with defence procurement is that it is a set of post-dated cheques. You stand up on a given day and announce a piece of equipment or a programme, but you don’t have to pay for it for three or four years. There are little bits of money at the beginning, but it does not build up to its main cash outflows until you start manufacturing, which can be two, three or five years down the road. So it is very easy to announce a new programme without the money, with the bill arriving significantly later. The departmental processes had always focused on the first couple of years, or, at most, a CSR spending period. One of the significant changes that has happened over the last two or three years is a real focus on the 10-year programme, to say that the 10-year programme as a whole has to be affordable. That is the first thing. The second thing is a measure of realism being applied to what a programme will really cost, as opposed to what people hope it might cost on its best day. Those two things together, forcing people to recognise the real cost of programmes at the beginning and looking at the long term, make a significant difference to the way that the budget will pan.

Chair: Talking of rigour, I note that there are 20 minutes left, so if we could all bear that in mind as we ask and answer questions I would be grateful.

Q196 Ms Stuart: Would you anticipate that within your 10-year plan the spending would still be within 2% of GDP?

Mr Dunne: For the current SDSR ‘10, we expect to achieve spending of 2% of GDP as that has been set out there. I cannot speak in advance for what the next SDSR 2015 will say, but we are currently meeting our NATO commitments, and that is our expectation.

Q197 Ms Stuart: But I would expect that you would want to continue to meet your NATO commitments and spend 2%?

Mr Dunne: Whether I will be in a position to have any bearing on that, we will have to see. I don’t have a crystal ball.

Q198 Ms Stuart: Can I change the subject completely? I want to take you back to not long ago when there were some Sunday Times reports about what were deemed or perceived to be inappropriately close relationships between recently retired senior military figures and the MOD. Would you like to give your view on that?

Mr Dunne: Indeed. Clearly we took that very seriously, and the Secretary of State tasked the permanent secretary to review not only the arrangements that we had with the individuals concerned but also our policies. The permanent secretary has undertaken a review and has confirmed that we are not aware of any inappropriate conduct by the individuals. The most important thing to say is that there is no influence borne on the current procurement programme by retired senior officers. We accept that there are a large number of retired officers who take positions in the important defence companies in this country, and they have an important part to play in providing advice in their new roles, but it is absolutely vital that we maintain transparency about relationships and abide by the rules of the ACoBA, to use one acronym.

\(^5\) ???
Q199 Ms Stuart: Just as an observation before we move on, I think you are right, and that there is a danger that we might end that by barring people from talking to anyone else simply because they actually know what they are talking about.

Bernard Gray: Can I add one comment, since I was a person named in those articles? I have never had lunch, breakfast or dinner with any of the generals, admirals or air marshals mentioned in that article. Nor, so far as I am aware, have I ever been approached by any of them to have lunch, breakfast or dinner with them, or, indeed, any other meeting. Were they to approach me to have lunch with them, I don’t have time for lunch, and if I did I would probably have it with my wife rather than them. Other than that, their claims of influence were entertaining if nothing else.

Q200 Mr Havard: So lunch is for wimps, Bernard? We all know that. What is this thing called lunch? Anyway, back to head office of the Ministry of Defence and its relationship with you—it is supposed to become an intelligent customer. In order to create that situation there are the Levene reforms and so on. The single Services are able to bring that expertise into that customer organisation and that makes remain in the best interests of defence overall, as opposed to just the single Services. There is very much a coherence and co-ordination function there.

Bernard Gray: Through the decision-making process, because you can explained some of that earlier on. I am trying to get to work closely with the finance people. Perhaps you retain some responsibilities for the coherence of joint services, the Joint Command and so on. There is all that new structure, and there is also something written here that says “current capability planning and delivery responsibilities of DCDS MilCap”. God help me. Somebody help me.

Air Marshal Hillier: That’s me.

Q201 Mr Havard: Thank you very much. You will retain some responsibilities for the coherence of joint activity, as I understand it, but you are going to have to work closely with the finance people. Perhaps you explained some of that earlier on. I am trying to get through the decision-making process, because you can have GoCo, but if you put garbage in, you get garbage out—GIGO. Can you give examples of how these new arrangements are working in practice?

Mr Dunne: I will just start off, but I think that the Air Marshal is best placed to get into the detail. We have accepted Lord Levene’s proposals.

Q202 Mr Havard: Is he becoming more intelligent, your intelligent customer?

Mr Dunne: Improving the ability of DE&S and the Service commands to be able to procure intelligently is much of what we are about in both defence transformation and transformation of DE&S. We are going through the process of devolving much responsibility for procurement down to the commands. That process has been under way for some time, and formal responsibility takes over with effect from 1 April next year, so we are retaining within the main building an overall strategic capability and responsibility for certain strategic procurement, such as the deterrent. That will continue to be run by Air Marshal Hillier, who is also responsible for the devolution process, which I think he would like to describe.

Air Marshal Hillier: The Levene report said we should delegate the capability planning and delivery responsibilities that I currently hold to the single Services. The reason is that ultimately the single Service chiefs and the commander JFC are responsible for the military output of their organisations, so it is sensible to make sure they have responsibility for the equipment they require in future. That is why we are doing that, and that model has many potential efficiencies and advantages.

As the Minister says, we are right in the middle of the devolution process at the moment, and from 1 April next year the single Services will have that capability planning and delivery responsibility. In head office, I will then make sure that we give the appropriate direction, and make the appropriate balance and investment decisions across the Services, and that we make sure that the individual planning and decisions that the single Services makes remain in the best interests of defence overall, as opposed to just the single Services. There is very much a coherence and co-ordination function there.

Part of the model is also about making sure that I sit alongside the finance director, because one of the weaknesses of our previous system was that our military capability planning was over-optimistic in relation to the amount of money that was going to be available. The finance director and I now have a conjoined organisation to make sure that does not happen in future. That process is currently running. How do those future front-line commands interface with the DE&S, particularly as we work through the process of getting a DE&S, which is a much higher performing organisation? As you touched on, there is no point in having a high-performing acquisition organisation if you do not have a high-performing customer organisation. It has to be the totality. So in addition to the work we are doing at the moment, which is devolving my responsibilities from head office to the commands, we are also building up a related piece of work that we are calling the intelligent customer work, which is to make sure that the single Services, individually and together, have sufficient qualified and experienced people to be able to match up to the DE&S in future, and make sure we have that complete through-life defence acquisition organisation.

Q203 Mr Havard: There has been some concern about MilCap, your military capability organisation, and its capacity in the sense of whether you have enough numbers—there have been significant reductions in numbers—and the right grade mix for you to be a strong customer. What is happening? How much have they reduced? Do you have the capacity? Air Marshal Hillier: My organisation has had its proportional reduction, and we have reduced our overall head count by something around 25% or 28%, which is the same for everyone in head office. The parts of my organisation that are going to the single Services were then split five ways—three single Services, joint forces command, and what I retain. There is the potential, as you take it down into smaller lumps, of reduced capacity and knowledge base. The front-line commands very much recognise that, but they already have many experts in the capability areas, and the single Services are able to bring that expertise into that customer organisation and that
long-term planning function. We have also provided the front-line commands with additional people with skills that they do not currently have in areas such as approval and scrutiny of projects to make sure they have the skills there.

As part of the intelligent customer work, we also need to look into the DE&S, which has a range of people who are doing stuff which is in the customer function—we have requirements managers and programme support offices—and say, "How do they fit into this overall picture, and should they be redeployed within the overall customer organisation?"

Overall in defence, yes, there are fewer people in the customer organisation, but we are making sure that we marshal it in the right places to get the best out of what we have, that we have the right number of people with the right skills and that we have, as we already do, a strong training and education programme to make sure that people can bring their full customer skills to bear.

Q204 Mr Havard: Can I return to the business about relationships with the Treasury? To what extent will it be involved in questions about individual procurement decisions? There was a question earlier about what the previous relationship was and the ability to plan forward, but there is also the business of our concerns about money being clawed back; perhaps you cannot spend efficiencies. Can you say something about how that will work and what the new relationship will be in terms of individual procurement, so that they understand?

Mr Dunne: It is fair to say that the Department’s relationship with the Treasury is on an improving trend.

Q205 Mr Havard: From a low base, unfortunately.

Mr Dunne: Well, that was before my time. We have authorisation to spend up to £100 million on an individual contract, unless it is a PFI, in which case it is up to £50 million. The Treasury takes an interest in most of our significant programmes, because they are typically larger than that.

Q206 Mr Havard: We do not have time for it today, but one thing that we will be interested in is that there were a lot of Urgent Operational Requirements. There has to be a reconciliation. This relationship will have a legacy issue attached to it as well as a view of the world going forward. We will have to come back to the whole question of what your relationship is on individual procurements, both past and projected.

Air Marshal Hillier: I would add that there is nothing in the devolved model which changes our approvals process and the relationship with the Treasury. In my organisation at the moment, significant approvals have to go through the Minister to the Treasury for approval. That same process will apply, but be initiated in the front-line commands through the Minister and into the Treasury. There is no difference in that respect in terms of approvals.

Mr Havard: Speed of repayment is quite an important issue as well, we believe, but there we are.

Q207 Sandra Osborne: Can I ask you about your responsibilities in relation to defence exports? In reply to a recent parliamentary question, it is clear that the numbers of defence attachés and defence sections have declined over the past six years. What impact do you believe that has on the UK export drive?

Mr Dunne: What I would say is that there is a completely new attitude towards defence exports, which came in with the new Government. I have responsibility for the MOD’s involvement with exports, but there are many other facets of Government engaged in promoting exports for our defence industry. You referred to the defence attachés out in mission, I do not have figures in my head for six years ago, but compared with two and a half years ago when the Administration came in, we have gone through a rejuvenation of enthusiasm for ambassadors, commercial attachés and defence personnel as to the relevance of defence exports as part of their role.

It is fair to say that we adopt a responsible attitude towards exporting defence equipment. We have some of the strongest export licensing regimes of any defence exporting nation. We take it very seriously. Once we have decided that we are prepared to sell equipment to a country, the individuals in post have a refreshed vigour in their step when it comes to speaking up for defence contractors and seeking to help them secure contracts overseas. That does not just for the civil servants and military personnel engaged, but for the politicians. You will have seen, as I mentioned earlier, the Prime Minister making a virtue of the role our defence exports can play in encouraging growth back into our economy domestically.

Q208 Sandra Osborne: You referred to other Departments. How does the MOD work with other Departments, such as the Treasury and BIS? UKTI, for example, has also suffered from cutbacks.

Mr Dunne: You are right to highlight UKTI because it now has responsibility for the Defence Support Organisation that has people in the UK and in posts around the world promoting defence exports. We work very closely with them. I have a regular meeting with the leader of that organisation. There is a piece of work being done at the moment to improve cross-Government co-ordination of efforts on exports that should report before the end of the year. I think we will be looking at a slightly better co-ordinated role across Government for defence exports. It does involve the Foreign Office and BIS, and the Treasury get involved from time to time. Senior Government Ministers take a big interest in what is going on. It would be fair to say that we could perhaps co-ordinate some of our activities a bit better than we have.

Chair: Relationships between the UK and France: a quick burst on that.

Q209 Mr Havard: We are partly involved in scrutinising the treaty, as you know. We had meetings recently. There are questions about certain projects and things that are happening underneath it. The high-level group meets. We have asked that you try to keep us up to date in relation to some of those things,
because we see already coming through it questions about potential works share in the future and so on. There is the Livre Blanc, to which we are apparently offering some assistance, given our experience with the SDSR. Will you please say something about where that currently sits so that we can track it?

Mr Dunne: I am glad you have raised that. I must apologise to the Committee and your French counterparts for not being available on the day they visited. There are two particular aspects to this relationship that I would highlight. One is that, operationally, strong, close and effective working has started to take place. I was present with the Secretary of State and the Minister for the Armed Forces at operation Corsican Lion, which was the first major maritime exercise. It was the largest joint maritime exercise between the French and British navies in recent times. It took place in the Mediterranean at the end of last month.

There is a continuous series of meetings at official and ministerial level with the French to follow up on different aspects of the treaty. I am the British co-chair of the high-level working group and was in Paris a week ago yesterday, for meetings with my counterpart to review progress on the procurement side. We have identified 20 projects on procurement that are at various different stages of germination. Some are more advanced than others; some involve procurement of equipment from British manufacturers, some from French. At the moment there is a good balance there. Part of your question suggested that there might be a preponderance towards France and that is not our experience at the moment. We think it is a well-balanced procurement. It is early days and we will have to see how that develops.

Q210 Mr Havard: I have regularly played rugby against the French, so I have just got my eyes open, that's all. The letters of intent on the projects are the things that we need regular information about.

Mr Dunne: We would be happy to talk about that. On the Livre Blanc briefly, Sir Peter Ricketts, who is our ambassador and former national security adviser, is a formal participant in the Livre Blanc exercise. That is colouring decision-making out of France at the moment, because until that is concluded they are not in a position to advance new proposals. That is due to report in February. I was with Peter Ricketts last week and he says it is going very well and they are appreciative of his contribution.

Chair: We have one minute left. I think it would be pointless to ask you questions about BAE, EADS or about the advance decisions on Trident submarines that have recently been taken, or about the follow-up to the White Paper. We will ask you questions in writing about those things. I would like to say thank you to all three for coming to give evidence in a clear and helpful way. It will enable us to wind up our defence acquisition report. We hope to produce that, in MOD speak, in the autumn, which will probably mean some time around summer next year. We will do it as soon as we can. Thank you.
Written evidence

Written evidence from the Ministry of Defence

DEFENCE REFORM & THE MATIERIEL STRATEGY

Transforming Defence will deliver the Future Force 2020 structure set out in the Strategic Defence and Security Review (SDSR), supported by a smaller, capable and more flexible Department, within the resources available for defence. It is the MOD’s highest priority after operations and the programme is personally overseen by the Secretary of State for Defence (SoS). Transforming Defence comprises of 40 separate projects and programmes that include Defence Reform, which is based on the report published by Lord Levene in June 2011, and The Materiel Strategy, which builds on the Gray Report of 2009.

The recommendations made in the Gray and Levene reports are mutually supportive. Both reports identify the key issues around needing to strengthen financial and performance management; decision making and accountability (including clarifying roles and responsibilities); improving the delivery of enabling services; and getting the best out of our people.

The Blueprint for the Department sets out the new operating model for Defence, in response to the Levene report. This recognises fully the ongoing work in a number of areas, such as consideration of the best business model for Defence Equipment and Support (DE&S—The Materiel Strategy) and the need for future development of the operating model to take account of this work.

Progress has been made. The Chief of Defence Materiel (CDM) is a member of the new Defence Board, established in September 2011 and has the lead for commercial and industrial policy across Defence. The independent costing capability provided by the Cost and Assurance Analysis Service is mandated in the Deputy Chief of Defence Staff (DCDS) Capability (Cap) area and work is underway to extend this across the Front Line Commands (FLC) as part of the wider process of financial management reform.

At its essence, the organisational reform of the Department aims to enable us to deliver our outputs more effectively so that we can deliver what is required for the front line, within the available resources (both financial and human), in a way that is sustainable.

The Materiel Strategy, led by Bernard Gray, CDM, was launched in May 2011. Its aim is to consider how DE&S, the organisation that equips and supports the Armed Forces for current and future operations, can operate differently to become more effective and more efficient. Building on the Gray Report of 2009, the Materiel Strategy work complements Lord Levene’s wider Defence Reform activity and is one of the main elements of Defence Transformation. From its outset, The Materiel Strategy has had three desired outcomes:

- best value in Defence Materiel;
- a balanced Equipment and Support programme; and
- creating a more capable DE&S with engaged and motivated staff and the behaviours, accountabilities, skills and processes required to do the job.

Within the last 15 years there have been numerous major initiatives to reform Defence acquisition, including Smart Procurement, Smart Acquisition, the Defence Acquisition Change Programme and the Defence Acquisition Reform Programme. While each made progress in addressing key issues, serious problems remain. The Gray Report of 2009 highlighted major cost and schedule overruns in Defence acquisition; that, on average, equipment procurement projects cost 40% more, and take 80% longer, to be delivered than the Department forecasts at Initial Gate. The largest, most complex, projects overrun the most. Cost increases on projects must be found from elsewhere within the programme, project teams must be sustained for longer, and time delays mean running on elderly, often unsuitable equipment longer than planned. The factors that cause this are complex and inter-related, and the underlying reasons varied. But Materiel Strategy analysis has identified three root causes:

- the overheated programme;
- the weak interface between DE&S and the wider MOD that results in poor discipline and change control; and
- insufficient levels of business capability in DE&S for the size and complexity of the programme it is asked to deliver.

In order to address these problems, The Materiel Strategy has considered a range of organisational design options intended to break current organisational constructs that have in the past hindered improvement in DE&S’s performance. Three options were presented to Ministers in December 2011, these being:

- a Trading Fund;
- an Executive Non-Departmental Public Body with a Strategic Partner; and
- a Government Owned Contractor Operated entity.

3 Defence Reform—Blueprint for the Future Department dated December 2011.
The ability to achieve a step change in the delivery of equipment procurement, support and logistics rests on two key principles: greater support from the private sector to help transform skills, tools and processes; and
the ability to introduce a firmer interface between the wider MOD, with robust change control around budgetary and specification changes. As announced to the House on 1 March 2012, SoS has asked CDM to conduct further investigations into those options that increase the role of the private sector. This analysis is still underway. DE&S has now begun a soft market testing exercise to obtain the market’s view and explore the potential roles for the private sector.

We have recognised in The Materiel Strategy that a substantial increase in skills and capability is central to the future success of DE&S. That is why we are exploring ways of increasing private sector involvement, and the ability to increase and sustain levels of capability will be a key factor in the choice of future construct for the organisation. As part of The Materiel Strategy work we have assessed, with external help, the levels of capability we have at the moment and the key areas of gap which the strategy is designed to address.

In parallel to Materiel Strategy analysis, work has commenced on the organisation’s Interim Structure. The Interim Structure project is examining how the DE&S can continue to run effectively until the broader changes associated with The Materiel Strategy take effect. The overriding aim is to ensure that DE&S continues to meet its outputs in a safe and professional manner whilst delivering the reductions announced in the SDSR. The work is currently in its analysis phase and the intention is to agree plans for the new structure through the course of Summer 2012. In the analysis phase we have developed the DE&S resource baseline by project team and functional activity. Using this baseline we have then developed an understanding of the drivers of workload and team sizes using benchmarking, we have validated and risk-adjusted existing Operating Centre plans and we have developed a set of efficiency opportunities including, for example, increased centralisation of some functions, removal of duplicative processes, better demand management and outsourcing. We are now working with Operating Centres to assess our ability to take forward the potential efficiencies identified. We have used the Department’s initial Voluntary Early Release scheme to achieve the first phase of reductions in civilian numbers that we will need to make. In doing so, we have been very careful to assess the skills level and value of the skills to the business of every applicant before deciding whether to accept their applications, to ensure that we retain those whose skills we most need. Whilst we have not got a complete picture of our future skills requirement when making those judgments, we have sufficient understanding of the skills that are most important to our business to be confident that we are not taking undue risk by pressing ahead in tandem with design of our new operating model.

Within DE&S we have key designated posts within each of the five key skills areas (Commercial, Programme and Project Management, Engineering, Finance and Logistics) which require to be filled by suitably qualified and experienced professionals. We now also expect Project Team Leaders, both military and civilian, to have tour lengths of at least four years to ensure greater continuity through the project lifecycle. As our Interim Structure is finalised in the coming months we will have a more detailed picture of our forward skills requirement to inform our further decisions on exits. We will also look, where there is a justified business need, to continue with a certain amount of recruitment of more specialised staff so that we refresh key areas of skill at the same time. This more detailed understanding of our skills requirements will also inform the Department’s workforce planning, helping both DE&S and the Department more widely to decide where to focus its future investment.

THE IDENTIFICATION AND DELIVERY OF CAPABILITY

Deputy Chief of Defence Staff (Military Capability)

DCDS(MilCap) reports through the Vice Chief of the Defence Staff to the Chief of the Defence Staff. He is the military capability adviser to the Defence Board, the Armed Forces Committee and Ministers. DCDS(MilCap) currently oversees the delivery of new equipment, in particular, the coherence of all supporting Defence Lines of Development (DLoDs).

As part of Defence Transformation, the majority of DCDS(MilCap)’s current capability planning and delivery responsibilities will be delegated to the Front Line Commands (FLC). DCDS(MilCap) will, however, retain responsibility for joint capability coherence in the future. He will also be part of the Head Office Top Level Budget Holding to Account process, working alongside Director General Finance.

Identification of Required Capabilities

The MOD translates government policy and strategy objectives into tangible defence outputs through a comprehensive planning process.

Within the overall framework of cross-cutting National Security Tasks and the SDSR, the contribution of the Department to National Security, in terms of capabilities required, is identified through the following steps:
— The National Security Strategy (NSS) and the SDSR set a policy baseline, from which the MOD defines the Military Tasks which the Armed Forces should conduct. On the basis of an analysis of the strategic global context and an assessment of the UK’s place in the world, the NSS sets out the UK’s core security objectives—ensuring a secure and resilient UK and shaping a stable world—and also identifies, analyses and prioritises the key security risks the UK is likely to face in the future. The quinquennial SDSR sets out the ways and means (or resources) across Government to deliver the ends set out in the NSS.

— Within the overall framework of the eight cross-cutting National Security Tasks, the contribution of the Armed Forces is further defined through seven Military Tasks, which describe what the Government may ask the Armed Forces to undertake. Guidance on how to achieve Military Tasks is developed and articulated in Defence Strategic Direction (DSD).

— Defence Strategic Direction therefore sets out to the Department the Defence Board’s direction on implementation of the NSS and SDSR. It has a particular focus on a planning horizon 10 years out from the SDSR, but gives the timelines in Defence also looks out 20 years or more where necessary. The Strategy for Defence is the first element of DSD. This sets out what Defence plans to achieve over the next 20 years and how it intends to deliver that outcome, whilst remaining affordable. DSD also incorporates the Defence and Financial Planning Assumptions as well as a detailed planning guidance out to the Department (Top Level Budget areas or “Commands”). DSD therefore forms the basis for generation of the Command and TLB plans which set out how each of TLBs will deliver the outputs and activities for which they are responsible.

— The Strategic Force Development (SFD) and Strategic Balance of Investment processes are then conducted to determine the capabilities which Defence needs to meet the policy baseline. This is an iterative process, balancing potential policy aspirations with the available resource envelope. This work includes the development of a set of illustrative planning scenarios, set in projections of our World, covering an appropriate range of plausible threat and topographical environmental combinations in regions of Defence and Security policy interest. Strategic Balance of Investment (BoI) will consider the key drivers and constraints on the Defence programme, across all Defence Lines of Development, and seek to match (and as far as possible optimise) options for expenditure against benefits. The BoI will address options for delivering Defence Outputs (such as the Military Tasks defined in DSD) alongside other factors, such as Defence Industry capability and capacity, the relationships with and dependencies on Allies and partners and other important criteria and prioritise big Defence programme choices and profile of investments to derive the best fit and value for money against a Single Integrated Joint Capability Priority List. Risk judgements and the consideration of risk appetite will be a key factor in the process, which will inevitably be a combination of auditable structured judgement and evidence derived from a variety of sources.

— The task based conditions and effects identified by the SFD process are translated into pan-defence capability goals and requirements with indicative financial envelopes. The responsibility for the delivery against these capability requirements is delegated to the FLC through the Defence Plan (DP).

— Analysis is conducted with scientific support, to determine the means to address identified capability gaps, from short to long-term: new equipment requirements may emerge from this analysis and enter the Equipment Programme subject to joint priorities and affordability.

— The process from joint SFD to new equipment requirements and a balanced and affordable equipment programme is the responsibility of DCDS(MilCap), but is a co-operative venture involving the Front-Line User, Dstl, DE&S and where appropriate, industry.

Project Initiation

The Gray Report and the subsequent Strategy for Acquisition Reform (SiAR) highlighted the need to implement more effective controls over the initiation of activity within the Equipment Plan (EP). Consequently, the MOD has developed a process for Project Start Up—Project Foundation (PSPF), which controls the entry of new projects into the EP.

PSPF is the mechanism that controls all Category A and B projects entering the Equipment Programme and their subsequent foundation across all contributing Delivery Organisations and DLoDs. PSPF builds confidence in the overall viability, affordability and priority of projects as they enter the Concept Phase. PSPF

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4 The categorisation of an equipment project, including Technology Demonstrator Programmes, is mainly determined by its total expected procurement cost (ie the cost of the Concept, Assessment, Demonstration and Manufacture phases), including all non-recoverable VAT, at 50% confidence. Total costs through life, the risks associated with a project, any novel or contentious features or significant policy issues will also be taken into account. Category A projects comprise: Equipment projects/Support/Service provision above £400 million; In-service support projects and inventory purchase above £500 million; and Estates and IS Enabled business change projects above £100 million. All are approved by the MOD Investment Approvals Committee (IAC) and Minister. Category B projects comprise: Equipment projects from £100 million to £400 million (IAC approved); Support/Service provision from £200 million to £400 million (IAC approved); Estates and IS Enabled business change from £50 million to £100 million (IAC approved); and in-service support and inventory purchase from £200 million to £400 million (approved by the Chief of Defence Material).
was established as a key Defence Acquisition Reform Programme DARP work stream—jointly sponsored by Deputy Chief of Defence Staff DCDS (Cap) and DE&S Chief Operating Officer following reviews in 2009. Initial work produced the overall model which was then fully defined within guidance issued on the Acquisition Operating Framework. Work is now progressing to incorporate PSPF as a fundamental building block of Defence Reform and the DE&S Materiel Strategy.

Progress towards the Target Operating Model

Following publication of the Future Blueprint for Defence, extensive work has been underway to define the high level operating model for the future Finance and Military Capability organisation to be retained in the MOD Head Office. This model depicts the high level functions, inputs and outputs of the new organisation and its interfaces with the Front Line Commands (FLC), the Joint Forces Command and other key parts of the MOD (DE&S and the Defence Infrastructure Organisation in particular). Work on the high level operating model is due to complete over the next few months. After this, a period of detailed design will commence leading to the new structures being in place by April 2013 and embedded by April 2014. So, whilst by April 2013 we aim to have changed the structures in Head Office and prepared the Front Line Commands to take on delegations for capability, we anticipate that in the following year further work will be required to make further improvements or to make adjustments in light of experience.

Approvals Process

Scrutiny is an independent, non-advocate, expert and critical analysis of an investment proposal. It aims to determine whether the evidence presented supports the recommendation made over other options. Building on the output of assurance activity where appropriate, it tests the strength of the proposal, the soundness of future planning and the validity of assertions in the case, and assesses whether they adequately underpin the recommendation. Every project is independently scrutinised at least once before the main investment decision. The degree of scrutiny required will vary according to a number of factors, including the value of potential investment, the level of risk and the quality of the project management applied. Those scrutinising on behalf of the Investment Approvals Committee (IAC) Approving Authority members are independent of the line management chains of the project. This will continue to enable the IAC to decide between alternative solutions.

The team of scrutineers contribute to a Scrutiny Team Leader’s report which is submitted to the IAC or other Approving Authority in parallel with the Business Case. In order to maintain the current independence of the scrutiny process and the central point of contact for Treasury, the Department is intending to retain Head Office teams which can deliver the process for Category A and B projects, (except Category B In-Service Support, which will rest with FLC Directors of Resources), and the scrutiny functions currently undertaken by Secretariat (Equipment Capability) (requirement and affordability scrutiny), Operational Analysis and Technical Scrutiny, Commercial Assurance & Due Diligence (commercial scrutiny), Defence Analytical Services and Advice (value for money scrutiny) and Central Legal Services (legal scrutiny). As final approval of Urgent Operational Requirements (UOR) is held by Treasury there is no intention to delegate these approvals to the FLCs; UOR approvals will remain the responsibility of the central staff.

The Scrutiny Process will continue to examine projects in terms of whole life costs and ensure that projects have considered the implications of all DLoDs (which includes support such as training and infrastructure) as well as reflecting industrial and commercial issues, including the information gained from Subject Matter Experts via independent reports and operational analysis and other inputs provided from industry. The greater involvement of FLC under the new model should increase the input from the end military user.

Monitoring and Control of Projects

The Major Projects Review Board (MPRB) established in June 2011 and chaired by SoS, reviews the most significant projects for the Department, both pre and post Main Gate, using the Sentinel scoring system as the basis for considering projects under three categories of Monitor, Review or Project of Concern. Identification of projects for consideration at each MPRB meeting is based on a combination of the reported performance, the Sentinel score and senior management judgement. The agenda is provided by CDM, following consultation with Minister (Defence Equipment Support & Technology (Min(DEST))).

The MPRB responsibilities are to ensure that key investment decisions for the largest projects in MOD are soundly based, that projects are closely monitored and cross-cutting themes or issues that could affect project, departmental or industrial performance are addressed. The MPRB may recommend that a project should be cancelled, subject to formal approval. No projects reviewed by the MPRB to date have been cancelled or recommended for cancellation.

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6 A tool used to record standing project data, which is not expected to change during major phases of the projects lifecycle, and a set of project metrics (grouped into four key project elements of Performance, Personnel, Project Reviews and External Factors) against which teams report current projects status; the data captured is used to provide a quantifiable Red/Amber/Green score for the project.
Since its inception, following the 22 February 2011 Civitas speech by SoS Defence and Security Needs where he announced his intention to form this Board, the MPRB has met four times. In these meetings a total of seven projects have been considered and one project, Valiant Jetty, has been named as a Project of Concern. In considering a project the MPRB members judge whether slippage or cost growth is due to poor performance by the project team, poor performance by industry, or factors outside the control of either, such as adverse foreign exchange movements or deliberate Planning Round decisions, or a combination of these factors. For the projects reviewed, direction provided by the MPRB has been fed back to project teams and the appropriate company CEO for consideration and where appropriate action. This has led to measurable improvements in overall project delivery performance. Specifically, on an important new communications project the MOD and industry teams agreed an incentivised action plan to successfully resolve a technical problem that has led to success in deployment trials; on another project, industry agreed to cover the leasing costs to extend a capability on operations following delay of its replacement; and on the Valiant Jetty, which was publicly listed as a “project of concern”, the project is now moving forward under a MOD and industry agreed plan of work which will see it commissioned later this year. Senior Responsible Officers (SROs) are appointed for all of the Department’s capability programmes rather than for specific projects. The primary responsibility of the SRO is to realise the expected benefits from delivery of a programme. The Department accepts that SROs in the MOD have a different role from SROs in other Departments. The delivery of military capability requires the co-ordination of equipment, doctrine, training and a range of other DLoDs. No single individual could take responsibility for delivery of all these DLoDs. The Department recognises the need to provide greater clarity about the relationship between SRO accountabilities and accountability for delivery of individual project strands and is committed to ensuring that the issue of SROs authority, span of control and tenure is addressed in line with establishing the new Future Blueprint for Defence. As we develop this new operating model we are continually considering ways to meet the concerns raised by the Public Accounts Committee on the roles and responsibilities of SROs in the MOD. However, for military capability programmes it should be noted that changes brought about under Defence Reform will see further turnover of SRO responsibilities in the short-term. A project’s history is maintained as a “Project Record”, ensuring a consistency in scope and content, the promotion and completion of which is outlined in formal guidance within the Acquisition Operating Framework structure. The revised guidance now means the Project Record is included in the MoD-wide Project Management Methodology and a check of the Project Record is recommended as part of Health Check, Advice and Support Reviews. In this way assurance is now provided that Project Managers are maintaining a Project Record detailing all major decisions.

Research and Development

The White Paper National Security Through Technology announced the Government’s intention to sustain investment in the MOD’s Science and Technology Programme at a minimum of 1.2% of the Defence budget; over £400 million in cash terms per year. The MOD’s Research and Development Board is chaired by Min(DEST) and provides strategic direction and priorities for Science and Technology investment and is responsible for ensuring that robust management processes are in place to plan, fund and oversee a coherent programme. The presumption is that work should be conducted by external suppliers (e.g. industry, universities and other research organisations) unless there is a clear reason for it to be done or led by the MOD. However, there remains significant bridging between civil and national security science and technology, particularly in the Defence and aerospace industrial sectors.

We remain committed to the Centre for Defence Enterprise (CDE), as the first point of contact for new science and technology providers and anyone who wishes to submit an idea to the MOD. The role of the CDE is also being enhanced, with increased focus on Small and Medium Enterprises (SMEs). CDE will act as a bridge linking SMEs with the main Defence suppliers, mentor SMEs to guide their approach and maximise opportunities for exploitation, and promote SMEs through providing the opportunity to present their innovations to leading Defence suppliers and users. Additional funding has also been secured through the Technology Strategy Board’s Small Business Research Initiative, to progress successful projects which show the most potential for Defence purposes.


The White Paper is our high level policy on how we procure technology, equipment and support for the UK’s defence and security needs. Together with work on the EP and Materiel Strategy, it displays a new
realism about the equipment budget, programme costs and how best to deliver defence capabilities. These initiatives will allow the MOD to give industry a clear, comprehensive and credible view of its ability to meet the specified requirements, as well as to plan more effectively and invest more confidently in the development of new technologies.

The MOD's Relationship with Industry

The major conduit for MOD-industry relationships is the Defence Suppliers Forum (DSF), chaired by SofS and which includes representatives from Prime Contractors, international companies and SMEs. This allows for a broad, representative and productive focus for interaction between the MOD and industry. This is complemented by a dedicated SME Forum, chaired by Min(DEST) which has proved successful at establishing a dialogue with these important suppliers. In March 2012, Min(DEST) also launched a new Defence & Security Industrial Engagement Policy with overseas based defence and security suppliers. The aim of this is to build upon the long and successful relationships that the MOD has with such companies, by encouraging investment in the defence and security sectors in the UK.

Procurement Processes

The White Paper identifies the different approaches to procurement the MOD may have to take to ensure we meet the objective of providing our Armed Forces with the best capabilities we can afford; and in doing so, to provide the best possible value for money. Underpinning the White Paper, the MOD’s Acquisition Operating Framework sets out policy, process and good practice for MOD staff, and our industry partners concerned with Defence acquisition. It defines how we conduct, govern and control our defence acquisition processes.

Lord Currie’s review of the pricing regulations used by the MOD in single source (non-competitive) procurement, with the focus on increasing supplier efficiency and value for money, and the aims of benefitting SMEs and exports, is an important element to help achieve the delivery of best capabilities, for best possible value for money.

The delivery of Centralised Procurement through an integrated Government Procurement Service (GPS) is working to deliver a 25% reduction in central government spend in the CSR period across a number of common commodities including: energy; office solutions; print and print management; professional services; travel; fleet; learning and development; information and communications technology; and advertising and media. The MOD is fully committed to the Centralised Commodity Procurement (CCP) initiative and to working closely with the GPS to reduce commodities costs. The MOD has signed a Customer Services Agreement with GPS and continues to make good progress toward transitioning commodity volumes to GPS arrangements. GPS figures for February 2012 show that MOD spend (excluding our Arms Length Bodies) through GPS has reached £675 million in 2011–12. This figure will increase to in excess of £1 Billion during 2012–13 as key commodity areas including travel, energy and technical services are fully transitioned to GPS arrangements.

The Relationship between Principles of Open Competition and Technological Advantage

The principle of open competition is qualified by the principle of technological advantage in that we will take action to protect our operational advantages, and freedom of action, where this is essential for national security.

We will usually seek to fulfil the UK’s defence and security requirements through open competition on the domestic and global market. We judge that this approach maximises the likelihood of finding a solution to our needs at an affordable cost and at best value-for-money. We also believe this offers the best catalyst for UK-based industry to be efficient and competitive, which is essential for both its long-term viability and for UK growth. Open procurement cannot, however, be the whole answer because the Defence and security sectors are, in two fundamental respects, different from other fields. That is, to defeat our adversaries and to protect ourselves at times when we most need to do so:

— we often need superior technology and other forms of battle-winning edge (operational advantage); and
— we must be able to operate, maintain, and refresh certain capabilities effectively, without being dependent on others (freedom of action).

As with all acquisition choices, this is subject to affordability and value-for-money. The extent to which we choose to protect our operational advantages and freedom of action always involves a balance of risk and opportunity cost.

Maintenance of the UK Military Industrial Base

The long-term prosperity of UK industry depends on being competitive and market sensitive, in order to offer value-for-money to the British taxpayer and compete successfully in foreign markets. Our policy is designed to provide the catalyst for making UK industry competitive and therefore able to win a large proportion of additional orders within the global market. We are doing our utmost to assist UK-based suppliers to obtain export orders and increase opportunities for small- and medium-sized enterprises to fulfil their
potential. A healthy and competitive industry in the UK, making world class products such as the Sea Ceptor missiles is able to sustain many UK jobs and contributes to growth and a re-balanced economy.

We will take action to protect our operational advantages and freedom of action, but only where this is essential for national security. In doing so, we will sustain the necessary people, skills, infrastructure, and intellectual property that allow us to build and maintain our national security. In some instances, to preserve the UK’s operational advantages and freedom of action we have entered into some long-term partnering arrangements with industry. We will maintain these agreements as long as they are delivering the necessary capabilities and continue to provide value-for-money.

Additionally, we are prioritising investment in science & technology and it is our intention to sustain this investment at a minimum of 1.2% of the defence budget; this means over £400 million per year. A small rise in cash terms in defence science and technology spending is planned over the period of the Comprehensive Spending Review.

Support for Exports and Compatibility with Off-The-Shelf Procurement

Support to exports is not inconsistent with buying off the shelf. By challenging domestic suppliers to be lean and competitive, we will drive up their competitiveness in international markets; and we will also support them in those markets. At a time of declining defence budgets, the key to UK-based industry’s success lies not in dependency on the MOD, but in winning new business overseas. So our support for exports and our encouragement to new and innovative UK SMEs will help create competitive UK businesses.

We are taking measures to assist companies seeking to operate in a competitive global market. First and foremost, UK Ministers are now more personally involved in supporting defence and security exports. It is a principle of this Government that, when travelling abroad, Ministers from all departments are there in part to promote the UK and what it has to offer and will be briefed to raise important export prospects with their interlocutors. The Department has recently announced the appointment of a Director with overall responsibility for export issues within MOD. Susanna Mason will act as a single point of contact to lead and coordinate the support MOD provides to export campaigns. The MOD will also consider exportability issues early in the acquisition cycle and are taking steps to ensure that training alongside the UK Armed Forces can be made available at a competitive cost for major export prospects, providing it also delivers value-for-money.

Moreover, while we will look first to procure off-the-shelf we recognise that this is not appropriate in all circumstances. Off-the-shelf procurements may either not be available, or may still require modification before being brought into use.

Bi- and Multi-Lateral Procurement

There are two main reasons for working with other countries on defence and security procurement. First, we may wish to take the economies of scale that become possible when working with another nation, as well as the opportunity to harmonise requirements, pool resources, share facilities and overhead costs, and benefit from longer production runs. This also allows us to spread the cost and risk of research and acquisition, as well as to secure better value from our respective investments in defence and security. Second, working with another nation may allow us to maximise our capabilities, by sharing technologies and aspects of capability that would not otherwise be available to the UK. This may involve fostering cooperation in research and technology, as well as developing cooperative or collaborative equipment programmes that increase interoperability.

There are also broader benefits to working with other countries, including increasing participant nations’ military interoperability, capability, and effectiveness, as well as strengthening bilateral relations and helping deliver the UK’s wider national security objectives. Working with another state in these ways is not detrimental to our national sovereignty, provided that we retain the operational advantages and freedom of action that we judge to be essential to our national security. An example of this is the recent implementation of the US/UK Defence Trade Cooperation Treaty. This will provide for licence free trade of US Defence Articles under certain conditions and will provide an opportunity for UK and US governments and industry to share information and expertise in order to maintain existing and/or develop new capabilities. It also provides opportunities for UK industry, provided they are part of the approved UK community, to solicit for US contracts that have been declared as within scope of the Treaty and removes the need for individual US export licences for certain defence and security exports to the UK.

We will generally favour bilateral collaboration on technology, equipment, and support issues, as we believe this offers the best balance of advantages and disadvantages. We will, however, continue to work multilaterally, for example through NATO or the EU, where this offers a clear benefit to the UK.

April 2012
Further written evidence from the Ministry of Defence

This note is the response by the Ministry of Defence (MOD) to the letter received from the HCDC dated 5 July 2012 and on which the MOD was asked to provide comment.10

INTRODUCTION

The Department welcomes the discussion initiated in the Clerk’s letter, concerning the changing backdrop to equipment acquisition over the post-war era. The note does however posit an unorthodox intellectual framework for consideration of acquisition reform. First, it adopts unfamiliar coinage: for example, the terms “Strategic Concept”, “Acquisition Concept” and “Standing Force”, which are not fully explained in the note. Second, it promotes a positive view of acquisition during the Cold War which contrasts with much of the historical evidence, including the succession of significant studies (Gibb-Zuckerman (1961), Downey (1966), Rayner (1971) and Jordan-Lee-Cawsey (Learning from Experience (1988)) that recent problems in acquisition necessitated; the Committee’s own Eighth report of Session 1997–98, particularly the section on “Equipping the Forces”, is very clear in this regard. Third, it inaccurately portrays past and present approaches to force planning and provision of equipment for operations. It was therefore helpful to meet the Clerk to discuss the principles underlying the note, better to provide a basis for the productive dialogue on future acquisition models that we are keen to have with the Committee.

The note touches on the conceptual basis for current Defence policy, and our approach to acquisition within it. This is provided by the 2010 National Security Strategy (NSS) and the Strategic Defence and Security Review (SDSR), which were driven by a reappraisal of our foreign policy and security objectives and the role we wish our country to play in the world, set within the economic context which governs the amount that the Government is able to spend on defence and security. The NSS and SDSR concluded that we should assume an adaptable strategic posture, reflecting our expectation that the geopolitical context will continue to evolve rapidly and in ways that are hard to predict, and that this will create both opportunities and risks to which we will need to respond. Both the NSS and the SDSR stressed the need for affordable, sustainable capabilities in order to underpin our posture long-term, while making a contribution to rebuilding the economic stability upon which our national security depends. These fundamental assumptions—the recognition of uncertainty, and the budgetary position—informed the development of Future Force 2020. In consequence, we are investing in programmes that provide flexibility and advanced capabilities, and reducing legacy capabilities less suited to the future operational context. Our thinking on force structure and capabilities has developed since SDSR, including in the Army 2020 study, announced by the Secretary of State on 5 July 2012, setting out how the Army will transform to a smaller, integrated and more adaptable Army better able to meet the security challenges of the 2020s and beyond.

ACQUISITION OWNERSHIP—PRINCIPLES, STRATEGY & REFORM

We have a coherent approach to the governance of acquisition: we identify our capabilities, we have a balanced programme and a plan for delivery—and we will do this better by end to end reform.

Based on the outcome of SDSR, the MOD’s acquisition process is designed to provide the necessary equipment and support, to enable the Armed Forces to deliver the capabilities that are assessed as being required to support the adaptable posture, and as promulgated through the Department’s internal planning documentation to Commands and other Top Level Budget holders. As announced by the Secretary of State in May this year, we now have a balanced, affordable and fully funded core Equipment Plan that supports the major force elements and priorities for enabling the capability set out in the SDSR. It includes our current project commitments, the major equipment programmes announced in the SDSR and subsequently, investment in the current and future deterrent, and the support costs for all our current and new equipment. It also includes project commitments, the major equipment programmes announced in the SDSR and subsequently, investment in the current and future deterrent, and the support costs for all our current and new equipment. It also includes a significant contingency provision which gives us greater confidence that we can deliver within our budget. The reforms recommended by Lord Levene were in part about ensuring that we never again get into the financial difficulties we have experienced in the recent past. Achieving a balanced budget represents an important milestone in Transforming Defence. There is, therefore, coherence between the overarching NSS and SDSR, military capabilities required to implement their policy direction, resource allocation and acquisition strategy.

A core element of the wider process of Transforming Defence is reforming the acquisition system which we are continuing to develop through the Materiel Strategy work being led by Bernard Gray, Chief of Defence Materiel. Having now balanced the defence budget, this will drive better value from this budget in the future, delivering battle-winning equipment and support to the Armed Forces and value for money for the taxpayer.

Our planned and identified capabilities, and associated Equipment Plan, are supplemented, where necessary, by an effective Urgent Operational Requirements (UOR) system which enables rapid procurement to address any capability shortfalls that arise as a result of current or imminent operations. Rigorous planning procedures

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10 The response has been informed by a meeting between the HCDC Clerk and the MOD on 24 July at which clarification on the issues raised in Ev 551 was sought.

are in place to generate the specific capability packages required, and to identify and manage the risks that are faced. These procedures are informed by lessons learned from pervious operations. This has been highly successful in support of current operations in Afghanistan including the provision of additional Improvised Explosive Device detection equipment, and new and upgraded vehicles. It demonstrates our continued effort to ensure our forces are provided with the best possible equipment for the enormously difficult tasks we ask of them. The UOR system includes a review process which will determine whether each specific UOR will be brought into the core equipment programme at the end of the operation for which it was procured, or be disposed of if no enduring capability requirement is identified.

**Acquisition Infrastructure—Supporting the Armed Forces and Sustaining the Defence Industry**

We provide the required capability to support agile and adaptable Armed Forces sized for the tasks we require from them: from a defence industry that is innovative, competitive and sustained, where necessary, to provide operational advantage and freedom of action.

We do not use the concept of “critical mass” for our Armed Forces as a concept in Defence planning; the institutional and structural size and shape of our Armed Forces are functions of the requirements placed upon them. Rather, we seek to identify, through a process of force testing based on high level operational analysis informed by recent operational experience, how the force structure and its capabilities might need to change in order to best meet the requirements.

As set out in our previous memorandum to the Committee, the White Paper National Security Through Technology sets out our high level policy on how we procure technology, equipment and support for the UK’s defence and security needs. We will provide the required capability to support agile and adaptable Armed Forces, sized for the tasks we require from them, from a defence industry that is innovative, competitive and sustained, where necessary, to provide operational advantage and freedom of action. Equipment acquisition will therefore usually be undertaken through open competition on the domestic and global market, except where operational advantage and freedom of action determine that we need to take a different approach to protect our National interests. Our Equipment Plan sets out the programmes we intend to procure over the next thirty years. A summary of that plan will be published later this year, alongside the results of a National Audit Office affordability assessment which will provide industry with information on our capability requirements over the next 10 years and will enable them to be better placed to manage and sustain their businesses. We also intend to sustain investment in science and technology at a minimum of 1.2% of the defence budget, and will share our investment priorities with our supplier base early on.

We do acknowledge that, as the regular Armed Forces and the Department grow smaller in the next few years, we will need to understand better the full base on which military capability depends, both within and outside Defence. This is one element of the Whole Force Concept work endorsed by Lord Levene’s Defence Reform report, which seeks to ensure that Defence is supported by the most cost-effective balance of regular military personnel, reservists, MOD civilians and contractors.

As a further statement of the MOD’s policy in relation to the defence industrial base, the Committee may find the speech delivered by Peter Luff MP, Minister for Defence Equipment, Support and Technology at RUSI’s Defence, Industries and Society Conference on 28 June 2012 to be of interest.

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**Further written evidence from the Ministry of Defence**

**MINISTRY OF DEFENCE RESPONSE TO ADDITIONAL QUESTIONS FROM THE DEFENCE COMMITTEE**

**Question 1**

[Email from HCDC Clerk dated 31 July 2012 asking for the Ministry of Defence’s response to RUSI’s critique of the GOCO proposal.]

**Summary Response**

— The RUSI paper poses a number of questions about the merits of the proposal to convert Defence Equipment & Support (DE&S) to a Government Owned Contractor Operated (GOCO) organisation.

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11 HCDC Inquiry: Defence Acquisition—Memorandum from the Ministry of Defence dated April 2012.
— On 17 July the Defence Secretary announced that MOD will focus its efforts over the summer on developing and testing the GOCO model further. This is not a down-select of the GOCO option as value for money analysis to underpin this assessment is not yet complete. But it follows a considerable body of analytic work in which the pros and cons of the different options have been thoroughly explored.

— The decision to focus on GOCO while the value for money work progresses recognises that we need to concentrate our own limited resources—and those of the market—on a single option in order to make progress.

— The questions posed by the RUSI paper are among those MOD is already considering. The Defence Secretary’s announcement represents the beginning of detailed work to mature the GOCO proposal and ensure careful consideration is given to all the issues. MOD will continue to engage with a wide range of stakeholders in this work. It is undoubtedly challenging. But the deep-rooted problems of defence acquisition have defied previous reform and radical action is needed to address them. Doing nothing is not an option.

— We expect to take a decision at the turn of the year on whether to approach the market and proceed with a launch of a competition for a private sector management company to run the organisation. This would be followed by an Investment Appraisal comparing the GOCO option against a robust Value for Money Benchmark based on an improved version of the status quo (a “DE&S plus”), with a final investment decision expected to be in 2014.

— Our goal is to create a more capable DE&S, where our staff are more empowered and have the necessary freedoms to meet the challenges we pose. Ultimately this will allow us to better support the Armed Forces and to better deliver value for money for the taxpayer.

**Questions from the RUSI Paper**

1. *How would assessment in any competition for the selection of a DE&S lead company be arranged?*

   A Procurement and Contracting Strategy is currently being developed for a competitive procurement. DE&S is seeking advice and assistance from specialist areas within MOD and Government, and engaging more broadly with other sectors to ensure we learn from wider experience. This strategy will set out how we expect to contract for a GOCO, the requirements of the Department and how potential contractors will be assessed.

2. *What restrictions would be placed on a DE&S lead company with regard to that firm’s other business dealings worldwide?*

   A future company engaged in the management of DE&S would have to demonstrate to the satisfaction of the MOD that it is free from conflicts of interest. Although the details of our policy on conflicts of interest are still being developed, we consider it unlikely that any potential partner would also be able to operate as a tier 1 defence supplier to the MOD.

3. *For what period would a DE&S lead company be appointed?*

   We are still in the process of developing our procurement and contracting strategy but we currently envisage a contract duration of between 5 to 10 years, with break points and options to extend.

4. *Would a DE&S lead company be responsible for decisions, or simply for advice?*

   We expect that a GOCO would manage the delivery of defence equipment procurement, support and logistics. This would involve the provision of accurate information to MOD to enable the Department to construct a robust and affordable Equipment Plan, and the focused delivery of outputs once agreed. The Capability Programmers of the MOD would remain responsible (as now) for deciding what should be bought and when; the GOCO would be free to make appropriate management decisions about how best to deliver its outputs.

5. *What would be the limits of ministerial, Treasury and Cabinet powers and the extent of the company’s legal responsibilities?*

   The Secretary of State for Defence would continue to be accountable to Parliament for DE&S business under any GOCO arrangement, with PUS acting as the Accounting Officer for the associated expenditure.

   The accountabilities, limits of responsibility and associated governance of the GOCO would be defined in the contract. Government would retain the right to make changes or provide direction on specific projects, although this would be subject to a formal change control process to ensure that accountability is clear.

6. *In legal contractual terms would the company have the status of principal or would it be an agent of the MoD?*

   We currently envisage that the GOCO would, in the majority cases, act as an “agent” of the Secretary of State when letting contracts for the Department’s programme.
7. How would a private sector firm conduct a Foreign Military Sales transaction? How would a DE&S lead company handle UK involvement in existing and prospective international projects?

International projects form a significant part of the DE&S portfolio and, as an agent of MOD, it will be important that international partners recognise the role of the new organisation and are comfortable with providing the necessary access to information. It may no longer be appropriate for some roles, such as the National Armament Director, to be discharged by DE&S and any such roles will be re-assigned to other parts of the MOD. We are working with the business and international partners to understand the best split of roles noting that we already use contractors (eg QinetiQ) as MOD’s agent in some international meetings.

8. Would the company take responsibility for a programme only after the prime contractor for its delivery had been chosen by the government as a whole?

The role of DE&S and the level of responsibility varies over the project life-cycle with early phases of the acquisition process currently being led by the customer. Any future GOCO would be expected to support all phases of the acquisition cycle with its responsibilities being defined within the contract. For example, DE&S’ current role of conducting “due diligence” on industrial proposals during the assessment phase and providing independent estimates would continue.

9. What financial risks would any DE&S lead company be asked to take on board?

The commercial allocation of risk between defence suppliers, a GOCO and the Department is something which we will be developing as the structure of any deal matures. Soft Market Testing has demonstrated that potential partners are willing to accept linking their reward to delivery performance risk providing they have sufficient management control over the delivery activity.

10. Could the weight of causes of cost increase be measured sufficiently, accurately and reliably to enable the allocation of the extra costs to the government and a DE&S lead company—if necessary, in court?

Significant analytic effort has been applied over recent months to understand the root causes of under-performance as part of the case for change. MOD needs, however, to build the management processes and information to be able to do this in a systematic way going forward. Our engagement with potential partners has indicated that this would be an early area which would be tackled under transformation contracts.

11. If the GOCO were to take on multidimensional financial risk, which clearly could run into billions of pounds, how much would it charge the MoD for its commitment?

We presently envisage that a GOCO would be contracted as MOD’s “agent” to deliver the equipment and support programme. The GOCO would be expected to take on a level of risk appropriate to its role, but will not be expected to accept significant levels of defence acquisition delivery risk where such risks are best managed by industry or MOD. We would expect a GOCO’s fee to reflect the level of risk it carries and its delivery performance.

12. How would any DE&S lead company make money and the MOD at the same time save money?

At present, hundreds of millions of pounds are lost to the defence budget each year because of the weak interface between DE&S and the wider MOD, and the insufficient levels of business capability at DE&S for the complexity of the portfolio it is asked to deliver. The costs of properly rewarding and incentivising a GOCO are expected to be greatly exceeded by the overall savings to the defence budget from robust and focused delivery of equipment and support.

13. Would, or rather should a government in practice hand over decisions on spending about £16 billion a year to a private company, especially when those decisions have the potential to put in place long-term dependences of UK armed forces on foreign sources of supply, or present employment threats and opportunities to specific regions in the UK?

Investment decisions on spending for defence capability will be retained by the MOD, either in the Front Line Commands or the MOD Head Office. The GOCO would be tasked to deliver products and services which inform these decisions and then subsequently take responsibility for their delivery. The GOCO, as an agent of MOD, would not be asked to make significant defence capability investment decisions in its own right.

14. How would a GOCO be held to account by Parliament, especially the Public Accounts Committee and the House of Commons Defence Committee?

The Secretary of State for Defence would continue to be accountable to Parliament for DE&S business under any GOCO arrangement, with PUS acting as the Accounting Officer for the associated expenditure. The GOCO would be held to account against its contract by MOD, and would be obliged to support MOD in discharging its wider accountabilities to Parliament.
15. **Who would have the power to dismiss the chief executive of the GOCO or to terminate its contract?**

The GOCO contract will be overseen and managed by a Governor function within MOD Head Office, which will represent the Secretary of State for Defence. The Contract will have appropriate voluntary exit points giving the MOD the right to terminate the GOCO Contract or revert to “in-house” MOD provision, alongside other rights to exit in the event of contractor failure.

16. **Would a DE&S lead company have responsibility for safety and environmental impact?**

Detailed functional analysis is being done to determine the precise split of responsibilities between a GOCO and MOD. We presently envisage, however, that a GOCO would have similar responsibilities to DE&S today in terms of providing safety and environmental evidence to support the entry of equipment and support capabilities into service, and for providing safety and environmental advice during in-service life. Duty Holders in the Front Line Commands will need to own and approve the safety evidence and ensure the equipment (or service) is safely operated.

17. **How would the MOD define, oversee and monitor the performance of any DE&S lead company, and how many staff and how much money would this entail?**

Key Performance Indicators (KPIs) would be defined in the GOCO contract covering the full spectrum of delivery—procurement, support, logistics and other services. The MOD Governor function would monitor performance against the contract, conducting audits as necessary to provide assurance that defence needs are being met. While further work is still being done, we presently estimate that this function could require at steady state some 40–50 staff.

18. **What provision would be made with any DE&S lead company for in-year, unexpected, demands on defence spending deemed essential by the government?**

Responding to new or urgent requirements would be a key user requirement for a GOCO. The responsibility for requesting and funding these requirements will come from either the Front Line Command or MOD Head Office Requester. The GOCO, as DE&S does today, would have to respond to such requests through the use of new or existing delivery resources, prioritised as the need dictates.

19. **How would a changed DE&S respond to the novel priorities associated with military operations?**

Delivering defence equipment and support would be at the core of what the GOCO does. It would be paid and incentivised to deliver this requirement. The majority of the GOCO’s staff would be existing DE&S employees, transferred under TUPE arrangements. They will therefore have a unique and in depth knowledge of delivering such defence capability requirements, supplemented by the additional skills and expertise brought to bear by the GOCO company consortia members.

20. **Would the DE&S be entrusted to one overarching prime contractor, albeit one with a number of specialised partners, or would different aspects of the DE&S’s work be entrusted to different corporate leaders?**

The recent Soft Market Testing exercise confirmed that a GOCO Management Company is likely to be a consortium of companies with a mix of skills and competences required to deliver against the requirement.

**QUESTION 2**

[Email from HCDC Clerk dated 2 August 2012 referring to Q98 and asking for a report of progress on an interim reorganisation of DE&S.]

**What progress has been made on this?**

Response

[The conclusions of the work are currently planned to be submitted to the Defence Board around the end of October 2012.]

**QUESTION 3**

[Email from the HCDC Clerk dated 21 August 2012 asking for progress on the Currie inquiry.]

Response

Detailed work on how the MOD is planning to implement Lord Currie’s recommendations is now substantially complete. The Single Source Regulations Office was given Ministerial approval by Minister (Defence Equipment Support and Technology) in August 2012. Collective policy agreement will be sought in October 2012 for inclusion in the Defence Reform Bill. The MOD is working towards an April 2013 implementation date for the new framework.
The 40% figure referred to the proportion of contracts placed without competition by value, which equates to £8.7 billion per annum. This was an average figure over five years as reported in the UK Defence Statistics 2010. The latest figures as published in the UK Defence Statistics 2011 are 43%, equating to £6.6 billion per annum.

**Question 4**

[Email from HCDC Clerk dated 23 August 2012 asking for any comparative information about the extent to which competitor countries, in particular France and the USA, open their defence markets to outside competition.]

**European Competitor Countries**

All European Union (EU) Member States, including France, are required to follow both the Defence and Security Directive and to the Intra-Community Transfer Directive (which covers internal EU transfer of defence products). The Defence and Security Directive was required to be transposed into national legislation by August 2011, while the Intra-Community Transfers Directive was required to be applied by June 2012. France has achieved both these deadlines. Both these Directives are aimed at increasing the openness of the European Defence Market. The Defence and Security Directive, in particular, should open up much more of the EU defence market to intra EU competition than has previously been the case, as it provides a set of procurement rules more suited to defence procurement than has previously been the case. While all EU nations have to comply with the relevant EU Directives and ensure that these have been fully transposed into national legislation there is the risk that this will not be uniformly implemented through out the EU nations.

As these Directives have only recently been implemented it would be impractical to undertake a comparative exercise at this stage. The European Commission have committed to producing a report on their impact to the European Parliament by 2016.

In addition, the European Commission has established a Taskforce for Defence Industry and Markets. The remit of the Taskforce is to assess potential ways in which the European Union may improve the openness of the European Defence Industrial Bases, potentially through further legislation. As part of this analysis, they will also review the implementation of the Defence Directive and the Intra-Communities Transfers (ICT) Directive, and we would expect them to report their findings in due course.

**US**

There are a number of US laws that serve to protect US industry, and some bilateral devices that mitigate them. The most significant restriction are the Buy America Act, the Trade Agreements act and the Berry Amendment and Specialty Metals restrictions. Other restrictions include Small and Medium-Sized Enterprise (SME) provisions which requires 23% of value of procurements to go to US SMEs.

The US International Traffic in Arms Regulations (ITAR) can also restrict the ability of UK firms to receive bid information in a timely fashion, though the Defence Trade Cooperation Treaty should provide some mitigation here. There is also the Committee for Foreign Investment in US (CFIUS). This Committee is intended to look at which nations are investing in significant US technologies. This can be another barrier through which the non-US importer may have to go through that a US competitor supplying the same programme may not, which may in turn make it more likely that the contractor will look to “Buy American”.

On the mitigation side we have the Reciprocal Defence Procurement Memorandum of Understanding (MoU) and where appropriate, other co-operative MoU.

*October 2012*

**Further written evidence from the Ministry of Defence**

The Committee requested further information on Currie and the potential GoCo bidders for the Material Strategy.

**Single Source Pricing Regulations**

You asked for further information on the reforms this Government intends to make on our regulations on single-source pricing (otherwise known as the “Yellow Book”), which have not been amended since first introduced in 1968. In particular, you have asked why we intend to put changes to the regulations into statute, and whether this will be primary or secondary legislation. Our proposed reforms reflect the Government’s response to the recommendations set out by Lord Currie in his report published in October 2011.

Single source procurement is usually undertaken if only a single supplier is able to provide the capability we require. The absence of an alternative supplier means that the MOD cannot walk away from a contract without losing important military capability, a situation which limits our commercial leverage. This has proven costly and time consuming when amendments in contracts have been sought to reflect evolving requirements.
These changes are inevitable in many multi-year single source procurements. In the absence of strong commercial leverage suppliers can refuse to provide us with the value for money protections that are inherent in the new framework. The proposed reforms, which introduce greater transparency and openness about industry costs and standardised reporting, are important to us, but we would find it difficult to walk away from an important capability if industry refused to provide this information. Legislation is the only way we can impose these small but important changes on an enduring basis on a budget worth circa £7 billion per annum.

Legislation also ensures a fair and consistent application of the new approach across our single-source portfolio. In its absence, a contract-by-contract approach would lead some suppliers to adopt the new approach voluntarily, while others would not. This would make it difficult for MOD to understand the full range of costs across our single-source portfolio, limiting the benefits that arise from the changes, whilst also being unfair to single source suppliers, who wish for a level playing field.

The legislation is likely to consist of combination of primary and secondary legislation. The appropriate split is yet to be finalised, and will be determined based on advice from Parliamentary Counsel and other relevant parties.

Material Strategy

You also asked whether there was anything publicly known about which companies are interested in bidding for the GoCo.

We have not yet decided to launch a competition for private sector partners to run DE&S as a GOCO. If we take this option forward, we hope to attract a wide variety of bidders, but at this stage the MOD is not in a position to comment on which companies might choose to bid.

You may be aware of the soft market testing which the Materiel Strategy team has conducted over the past year. The second phase of this involved six companies which are the type of organisation that we think may be interested in running a GOCO. However, their involvement does not mean that they should be regarded as bidders.

The soft market testing exercises were developed to help us understand marketplace views on how best to run a strong GOCO procurement process, should the decision be made to do so. We took steps to ensure that the companies’ involvement in this work does not give them an unfair advantage if we come to launch such a competition, and are actively taking steps (such as opening up the soft market testing closeout event) to ensure that other potential partners who have not been involved to date are aware of the Materiel Strategy.

January 2013