

First Review of the implementation of Defence Industrial Policy

Foreword

In October 2002, the Government launched its Defence Industrial Policy¹. This Policy is driven by the need to ensure that our Armed Forces get the equipment they require at the best value for money for the taxpayer, and at a price we can afford. It recognises the importance of the defence industry in achieving these goals and the important contribution that the sector makes to the economy of the UK. This Policy states that the Government will seek to maximise the economic benefit to the UK from the billions we invest in defence each year and that we will seek to enhance the global competitiveness and sustainability of the UK defence industry. It forms part of the Government's wider agenda on enhancing the competitiveness of the UK and improving productivity. It reaffirms open and fair competition as the bedrock of the Government's defence procurement policy (in line with other government acquisition) and confirms our willingness to use other approaches where they offer better long-term value for money. The publication of the Policy was a watershed in that for the first time we brought our ideas together into a single document whose conclusions are reproduced at Annex A.

At the launch of the Policy, the Defence and Trade & Industry Secretaries announced that the Government would formally review implementation after one year. Our assessment is set out in this paper. It is important to note that this is not in any sense a new or revised policy – we are conducting a review of the implementation of the Policy launched in 2002.

Government and industry have worked well together for many years on defence industrial issues, but the publication of the Policy galvanised both to adopt new ways of working together. Most obviously this has resulted in a joint approach to implementation and the development of a joint action plan. The Policy has been a significant driver in bringing together government and industry (one of the key objectives of our Smart Acquisition Initiative), giving both access to better information – one manifestation of this being work to develop a common database detailing the capabilities of the UK defence industry.

A joint senior level workshop on acquisition held in September further exemplified the commitment to work together. Both sides used the workshop to bring together ideas on topics of mutual interest, and agreed actions that will be implemented during the next two years.

Throughout the year procurement decisions have been taken within the framework of the Policy but it will naturally take some time for it to apply to projects from 'cradle to grave' given the long term nature of defence acquisition: the full effect will be seen more visibly as new programmes start to mature. We have made a good start but we need to keep pressing ahead – looking for quick improvements but concurrently working with equal diligence on those things that take longer.

Looking ahead, we remain committed to high-level engagement with industry through the National Defence Industries Council (NDIC) and to developing the regular

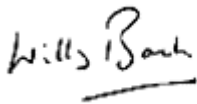
¹ Ministry of Defence Policy Paper No. 5 Defence Industrial Policy

dialogue that we have established on Defence Industrial Policy implementation. We will continue to monitor the effectiveness of the Policy and to develop best practice in this area among the MOD acquisition community. As more new programmes are conceived and progress through the acquisition cycle we will be able to assess the impact of the Policy more clearly.

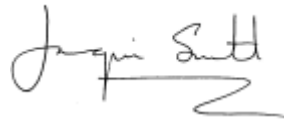
The work to improve the return on our investment in research and technology has resulted in significant changes to our approach to science and technology. Towers of Excellence and Defence Technology Centres are still in their early stages but the high level of support from industry and academia is very encouraging and promises high quality outputs.

We will seek to improve further our dialogue with industry to coordinate our efforts to improve access to overseas defence markets. We will continue to push hard for improvements in co-operation with our allies through better market access, and improved processes and regulation. This must extend beyond government-to-government co-operation and facilitate more effective industrial cooperation.

We thank industry for its responsiveness and commitment during the year, especially for its support during the conflict in Iraq; and we look forward to working together to meet challenges in the coming year. We intend to publish a further review of the implementation of Defence Industrial Policy in a year's time.



Lord Bach, Minister for
Defence Procurement



Rt. Hon. Jacqui Smith MP, Minister of State for
Industry & the Regions and deputy Minister for
Women & Equality

Defence Industrial Policy – One Year On

Introduction

We published the Defence Industrial Policy last year following extensive consultation with industry through the NDIC. Reactions to the Policy have been favourable, and since its launch government and industry have worked together closely on its implementation. Detailed guidance on the Policy has been developed for the MOD acquisition community, and is also available to industry. In parallel the Aerospace Innovation and Growth Team report in June 2003, made many recommendations that are complementary to Defence Industrial Policy.

Progress on the implementation of the Defence Industrial Policy has been encouraging, especially through the deepening of government-industry dialogue. This has resulted in a close working relationship, with small joint industry / government teams being established to take forward the strands of a joint implementation plan, and a joint senior level workshop on defence acquisition taking place in September 2003. Having said that, implementation of the Policy is a major task and will continue to challenge us all in the coming years. We will focus particularly hard on addressing those areas where progress has been slow.

This work has, of course, been going on at a time when the Armed Forces have been involved in conflict in Iraq – an experience that has underlined the crucial role of the defence industry. A vital part of supporting our Armed Forces was the fulfilment of over 200 Urgent Operational Requirements. We are grateful for the high level of responsiveness and commitment demonstrated by UK and overseas industry in delivering the required capabilities.

As set out last year, Defence Industrial Policy brought together existing and new behaviours into a framework to deliver real and coherent benefits. In many ways we are still only at the beginning but government and industry have established a clear and agreed way forward to deliver our collective aims. Already there are examples of decisions taken and progress made which demonstrate the policy in action. They are highlighted in the following pages.

Overarching Themes

- *Provide required equipment at best value for money at a price we can afford*
- *Review policy and implementation*
- *Treat all defence suppliers that create value in the UK fairly, regardless of ownership*
- *Maximise economic benefit to the UK from defence expenditure*
- *Maintain close dialogue with industry*
- *Sustain an environment that enhances competitiveness of defence industry*

We made very clear in the Defence Industrial Policy that the Government considers UK defence industry to embrace all defence suppliers that create value, employment, technology or intellectual assets in the UK. That is reflected not just in our handling of individual projects but also in the way government and industry are working together on the implementation of the Policy.

We are committed to providing our Armed Forces with the equipment that they require, at the right time, and at best value for money for the taxpayer. Within the framework of Smart Acquisition we have focused our processes on delivering capabilities and supporting them efficiently and effectively throughout their lives. We will continue to acquire equipment and services from the most appropriate sources, including those with significant overseas content.

The wide range of activities that we are pursuing as part of our implementation of Defence Industrial Policy will contribute to creating and sustaining an environment that enhances the competitiveness of the UK defence industry. We have retained our open market, exposing companies to competitive pressures, while at the same time working to increase similar openness – and therefore competitive opportunities – in overseas markets. We are working to improve the return on our investment in research and technology by focusing our efforts and working with industry and academia to identify those areas where we can compete successfully in a global market. We are investing early in technology to enable us to network our capabilities and to position ourselves at the forefront of this emerging field.

Work to increase access to overseas markets, through co-operation / collaborative agreements and Industrial Participation arrangements, as well as by demonstrating to our allies the benefits of allowing competitive access to UK industry, has resulted in long-term investment in the UK and in industrial relationships that endure beyond individual defence programmes.

The Policy has been continuously tested throughout the year, not only by decisions on individual projects but also through our engagement with industry. Government Departments (Defence, Trade & Industry, HM Treasury and Foreign & Commonwealth Office) have met regularly with representatives of the Defence Industries Council, under the chairmanship of the Cabinet Office, first to develop and then to assess progress against a joint implementation plan. Within this framework, joint sub-groups are taking forward specific areas of work. These include:

- improving common understanding of, and access to information about, the capabilities of the UK defence industry;
- focusing research and technology resources, identifying areas for joint action and ensuring better co-ordination of industry positions on research and technology;
- developing the links between emerging military capability requirements and future industrial capabilities;
- developing strategies to improve industry's access to overseas markets;
- further developing acquisition processes in the light of defence industrial policy;
- examining the financial health of the UK defence industry;
- developing long-term plans to ensure that appropriate skills are available to the MoD and the defence industry.

One strand of this work is to improve our joint understanding of the capabilities of the UK defence industry to meet the needs of the UK Armed Forces, particularly in relation to the supply chain and SMEs. This will facilitate the consideration of UK industrial capabilities (research, manufacturing and support) during the acquisition process. With strong leadership from industry this work has made rapid progress, and a pilot database has been developed and demonstrated. A strategy is now being developed to achieve full-scale implementation.

We are jointly looking at the financial health of the defence industry and how defence procurements, and related policy and structural developments in MoD, affect company profitability and industry's ability to raise capital. This has proved to be a particularly challenging subject where we have made relatively slow progress. We will focus on defining the scope of, and carrying out, this activity during the coming year.

A key factor in the future success of the industry is the availability of suitably skilled labour. This is an area that is being addressed as part of the joint implementation plan. We are seeking to encourage a more cohesive and joined-up approach to planning the requirements for future skills across industry sectors. The issue of skills is, of course, one that was also highlighted in the Aerospace Innovation and Growth Team report, and we will ensure that the various lines of action are brought together.

Acquisition

- *Open and fair competition remains the bedrock. We will use other approaches where they offer better long-term value for money*
- *Assess the aggregate impact of decisions on the defence industrial and technological base*
- *Be more transparent and inclusive from early stages of procurements and where relevant, declare and*
- *explain wider factors to potential bidders at the outset*
- *Seek to provide a more appropriate risk/reward ratio*
- *Review MoD/Industry Code of Practice*
- *Follow EU procurement law for all non-warlike equipment*

MOD has a responsibility to achieve the best value for money from its equipment programme and the assessment of the cost, affordability and operational effectiveness of different procurement options remains the principal focus of decision making. Competition continues to be the principal procurement method to deliver value for money for the defence budget. We recognise, however, that competition is not always suitable and that alternative procurement strategies might need to be adopted, as exemplified by our recent decision to select the BAE SYSTEMS Hawk 128, without competition, as the Advanced Jet Trainer for our Military Flying Training System (MFTS) project. This decision has removed uncertainty for the MFTS bidders as they now know which airframe will need to be integrated into the overall solution.

The Government continues to pursue Public Private Partnership solutions where these are best value for money. A current example is Skynet 5, the UK's next generation of Military Satellite Communication System.

Our Defence Industrial Policy sets out the wider factors which we will take into account in deciding how best to take projects forward. We have made good progress in this area and MoD has now published guidance, primarily for its own equipment acquisition staff, on how to consider wider factors in the context of individual programmes. The guidance is centred upon considering each case on its own merits and engaging the assistance of specialists in relevant areas. This is an important first step, and we are committed to ensuring its full dissemination (we have published the guidance on the MoD acquisition website – www.ams.mod.uk) and utilisation. To achieve fully the aims of the Policy the Government needs to consider these wider factors from the outset of each programme. This is starting to happen, although clearly projects where the Policy is being applied from the outset will not come to fruition for several years, and this means that in practice some aspects of the Policy will take time to become evident.

The policy is also encouraging the culture of openness with industry established under our Smart Acquisition Initiative, allowing project teams to be more confident when engaging with industry and explaining the factors that will be taken into account when reaching programme decisions. We expect that this will lead to a greater confidence in industry that competitions are fair. The MoD/Industry Code of Best Practice (Guideline no. 5) that sets out processes and standards of behaviour expected from MoD and industry is currently being reviewed by a joint industry / government working group.

Following a lot of detailed work over the last year, Government and industry decided to hold a joint senior level workshop on acquisition in September to bring together our ideas and set the agenda for the next two years. It examined three major issues affecting the success of our acquisition system:

- military/industrial capability requirements;
- effective joint management of projects;
- through life management.

A number of specific actions were identified at the workshop and are being taken forward in conjunction with other implementation work. As part of increased openness and transparency we will be talking to industry in rather more detail than hitherto about the MOD's future equipment capability plans, indicating both priorities and constraints. This should facilitate a much better understanding between the MoD and industry of future investment plans and thus a stronger link than in the past between the future requirements of the Armed Forces, and the evolving capability available from the industry based in the UK. Government is aware that industry attaches particular importance to this aspect of policy. Our actions to address technical risk and increase project maturity at the main investment decision point will be piloted on a number of large projects. We are also investigating the skills required within government and industry teams, and considering the merits of providing common training for our project managers.

The workshop also considered how MoD and industry can work more effectively together in the management of projects, adopting best management practice and looking across all phases of the acquisition cycle to encourage a through life approach. There was agreement to take a number of actions to improve the ways in which technical risk is addressed in major projects, and to examine the possibilities for adopting a more flexible, incremental approach to acquisition in such projects. One of the actions will be the selection of small number of pilot projects in which technical de-risking and deconstruction will be trialled, with a view to applying these techniques more widely if they prove successful. There will also be an investigation of the skills needed within government and industry to sustain major projects, including the opportunities for common training of our project managers.

Consolidation of industry has meant that individual project decisions can have a major influence on the future shape of an industrial sector and can result in companies viewing some programmes as "must win" business. The aggregate impact of decisions can be even more pronounced. We need to do more work to understand these pressures and their implications.

The naval shipbuilding industry is tackling our largest warship programme for many years – which brings its own challenges. UK shipyards will need to undertake work in parallel on programmes such as Type 45 and the future aircraft carrier (CVF) to meet demanding in-service dates, while other programmes such as Military Afloat Reach and Sustainability (MARS) may require new skills to meet commercial and legal standards not seen before in military vessels. These issues of capacity and skills are complex. To help us consider the aggregate impact of our decisions we have engaged the RAND Corporation to compare available skills and capacity with that which will be required. Potential problems could be solved by reconsidering the rate at which we require capabilities to be delivered, or perhaps the inward investment of skills and resources into UK shipyards from overseas. We do not have the answers yet, but we recognise that the decisions that we take on these programmes could have a profound effect upon the future of our shipbuilding

industry. In similar vein we are beginning to look in more detail at the aggregate impact of our programmes in other sectors of UK defence industry.

We have taken steps to increase our understanding of programme risks and share this information amongst stakeholders. It is in our interests for our suppliers to have as complete an understanding as possible of the challenges that they face before committing to contracts. We are seeking to address risk in the earliest stages of programmes to maximise programme maturity by the time the main investment decision is made at Main Gate. A joint industry / government group has examined how to involve industry effectively in the Concept phases of programmes, and this is being piloted by the Future Surface Combatant programme.

Investing more resources in the early stages of programmes to increase maturity allows the level of risk to be reduced and also better understood. By the time major investment decisions need to be made, normally under firm-price arrangements, our suppliers are better able to cost and manage the remaining risks, resulting in a more clearly bounded risk/reward ratio. In the CVF programme MoD has adopted a strategy where we are part of the Alliance with BAE Systems and Thales UK. We consider this to be the best way of delivering capability, exploiting the strengths of both companies. We will be more involved in the programme as it develops.

Research & Technology

- *Work with industry/academia to maximise benefit of R&T spend by identifying priorities through NDASP; target investment where we can be global leaders*
- *MoD to compete majority of research programme (where appropriate)*
- *Improve pull through of technology*
- *Exploit civil technology*
- *Improve access to foreign technology; increase proportion of research collaboration*
- *Make UK attractive to technology investment – domestic and from overseas*
- *Earlier technology de-risking in projects*

The Government's approach to science and technology is in the midst of radical reform. The MoD is re-orientating itself to deliver specific fundamental science and technology outputs by focussing resources in specific areas. Under its 'Innovation Review', the DTI has been developing, in close consultation with a variety of stakeholders, a new forward looking and focused strategy for increasing innovation in the UK. The joint industry / government priority is to link more closely research and technology to future military capabilities. There are many government initiatives in this area that are being drawn together into a coherent strategy.

The National Defence and Aerospace Systems Panel (NDASP) is currently working on updating industry's list of technology requirements, the National Defence Industry Technology Strategy. In harmony with this work the MoD is updating its Technology Strategy. Through this co-operation, technology areas of mutual benefit will be identified and will become focus areas for investment. In each focus area we aim for the UK to become a world-class source of technological excellence. MoD's partnership with industry and academia has moved forward through its implementation of Defence Technology Centres (DTC) and technology Towers of Excellence (TOE). Building on the same principles, the Missile Defence Centre (MDC) has been established to act as the UK interface with the US missile defence programme. This 'virtual' Centre will act as a showcase for the specialist expertise and equipment which UK industry has to offer to the US, and will also generate technical advice for policy makers considering future options for the defence of the UK and Europe.

MoD launched three Defence Technology Centres during the early part of 2003. The consortia are working on the following technologies:

- electromagnetic remote sensing, led by BAE Systems;
- data and information fusion, led by General Dynamics;
- human factors integration, led by Aerosystems International.

Defence Technology Centres bring together industry and academic experts to generate specific basic level technologies vital to the delivery of future capability. Each Centre is jointly funded by the participants and the MoD; the MoD will benefit from a source of expertise in specific vital areas of science and technology whilst industry will see a return

on their investment through exploitation in future equipment and academia will have greater opportunities to develop their ideas.

The first Tower of Excellence, Guided Weapons, was launched in the summer of 2002. MoD plans to launch four further Towers during 2003 covering synthetic environments, underwater sensors, electro-optic sensors and human-machine interface software. Towers are collaborative ventures between industry, academia and the MoD. Each Tower is aimed at developing sub-system technology to support high-priority military capabilities. Working Groups will ensure that coherence is maintained between Defence Technology Centres and Towers of Excellence.

MoD is progressively putting more research out to competition. It is the MoD's intention that this year some 15% of the non-DSTL² part of the Corporate & Applied Research programmes will be placed by competition, by 2007 we envisage this figure to be nearer 70%. MoD will continue this trend to maximise the benefits of competitive research. It will routinely make the results of competitively let research available to our suppliers to raise the overall level of the UK's defence technological capability. The alignment of MoD's fundamental and applied research programmes will enable it to improve the pull-through of technology into applications. The closer collaboration between MoD, DTI, industry and academia, will enable us to take greater cognisance of potential defence applications arising from technology developed in the civil sector.

Encouraging investment in technology research requires a stable environment that provides assurance that developments can be exploited. The changes that the Government has made to the science and technology research effort provide a clear set of priorities for investment that companies can consider when determining their own investment strategies. The emphasis on directing research at capabilities provides a clear exploitation path to deliver returns on investment within a reasonable timescale.

Earlier this year the MoD inaugurated the NITeworks programme to take Network Enabled Capability from ideas into capability. NITeworks is focused on allowing the full spectrum of interested industrial participants to engage in early experimentation in an environment that allows them full flexibility while enabling their intellectual property to be safeguarded. This facilitates modelling, rapid prototyping and cost effective trials.

² Defence Science and Technology Laboratory

Market Access

- *Secure freer access to overseas markets*
- *Establish a Defence Exports and Market Access Forum with industry*
- *Improve the flow of defence information and technology across borders*

Our overall aim is to secure freer access to overseas 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.

Progress in delivering increased market access inevitably takes time. Nonetheless we have made progress during the year. A high level joint industry/government Defence Exports and Market Access Forum has been established at the beginning of the year. Progress is being made to identify and focus upon the priority issues. One of the key themes of the Forum is increasing access to the US market, and we have established a joint government/industry US Strategy Working Group to assist in this.

We have continued to work with the US under the framework of the US/UK “Declaration of Principles”. We have improved cooperation on developing and harmonising military requirements and agreed measures to give confidence in the security of supply of defence equipment and services. We have also reached agreement with the US Administration on the terms of a waiver of the US International Traffic in Arms Regulations. Subject to confirmatory action in Congress this will enable certain unclassified defence items and technical data to be shared with the Government and qualified companies in the UK without the need for US export licences. It will enhance defence industrial co-operation and strengthen mutual defence through more efficient equipment acquisition and improved interoperability of our forces.

In July the Prime Minister and US President agreed measures to improve the flow of military information between our governments. They also agreed to establish a bilateral committee to develop increased co-operation in acquisition and more effective industrial relationships. We are working closely with our US colleagues to take this forward and to focus the bilateral committee on cutting through remaining barriers to co-operation. This will have benefits in many areas, and it will continue to receive high level of support.

The Government also wish to facilitate the development of a more open market for defence equipment in Europe and is maintains a dialogue with industry on how best to push forward this objective.

On European defence industrial business we continue to work with our partners under the Letter of Intent Framework Agreement, although progress can be slow. However, dramatic improvements have been achieved in the system for arranging classified visits and we are now allowing the use of commercial encryption products by industry. In addition a Global Project Licence system has been introduced permitting a single export licence to cover all aspects and phases of a programme.

In the context of the debate on the new EU constitution the Government has strongly supported the establishment of an agency to support, and increase the coherence of European defence capability development. On 19 June the European Council agreed to create an agency that will 'aim at developing defence capabilities in the field of crisis management, promoting and enhancing European armaments co-operation, strengthening the European defence industrial and technological base and creating a competitive European defence equipment market, as well as promoting, in liaison with the Community's research activities where appropriate, research aimed at leadership in strategic technologies for future defence and security capabilities, thereby strengthening Europe's industrial potential in this domain'.

Date : October 2003

Defence Industrial Policy - Key Conclusions

(Reproduced from MOD Policy Paper No 5 – Defence Industrial Policy)

The Government's defence industrial policy is driven by the need to provide the **Armed Forces with the equipment which they require**, on time, and at **best value for money for the taxpayer**.

We seek to maximise the economic benefit to the UK from our defence expenditure, a **healthy and globally competitive defence industry** and the development of a high value technologically-skilled industrial base, consistent with the Government's wider manufacturing strategy.

The UK defence industry **embraces all defence suppliers that create value, employment, technology or intellectual assets in the UK**. This includes both UK and foreign-owned companies.

Restructuring of the defence industry brings increasing commercial opportunities for UK companies, and economic and technological benefits through inward investment into the UK. The UK industry cannot grow by meeting domestic requirements alone, nor can all the technologies required by the Armed Forces be sourced solely from the UK. **We will not constrain UK companies** from expanding into new markets, except where national security clearly requires otherwise.

We will be **more transparent and inclusive, from the early stages of a procurement project**, about the factors that affect acquisition decisions. As far as possible, we will declare them to potential bidders at the outset to enable them to frame their bids accordingly. We will assess the aggregate impact of decisions on the defence industrial and technological base.

Open and fair competition remains the bedrock of our procurement policy. It is the most effective means of achieving value for money and of developing an efficient and innovative defence industry. But we will not use the competitive process beyond the point where it can offer long-term advantage, and we will use other approaches where these offer better long-term value for money. We will **seek to provide a more appropriate risk/reward ratio** for programmes with high technological risk; and we are committed to **public/private partnerships** to deliver benefits in the provision of defence services.

Protectionism is not a viable way forward, but we recognise that not all governments approach acquisition with similar openness. We will continue to press for **freer access to overseas markets**. We aim to **improve the flow of defence information and technology across borders**, and to enable the UK defence industry to compete on merit in other markets. We will continue strongly to support defence exports, and we have agreed to set up a new **defence exports and market access forum** to address export promotion and improved access for UK industry into foreign markets.

Investment in **research and technology** is crucial to the future prosperity of the defence industrial base and the capability of the Armed Forces. We will work with industry and academia to co-ordinate our joint resources, to maximise exploitation of civil technology, and to target our investment into areas of military importance in which UK industry can be

global leaders. This investment must then be pulled through into early technology de-risking of specific projects. We will also seek to avoid duplication of effort with our allies, improve access by industry to foreign technology, and increase the proportion of research collaboration.

We will review our defence industrial policy continuously as the strategic environment evolves, in consultation with industry through the National Defence Industries Council. We are committed to maintaining **a close dialogue with industry** in maintaining a comprehensive view of UK defence industrial capabilities, and to work together with industry to monitor progress and deliver results.