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Joint Standing Committee on Foreign Affairs Defence and Trade

PO Box 6021

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Canberra ACT 2600

INQUIRY INTO THE DEPARTMENT OF DEFENCE ANNUAL REPORT 2023-24.

Dear Defence Subcommittee Chair, Hon. Brendan O'Connor MP

On behalf of the Australian Industry and Defence Network I thank you for the invitation to provide a written submission to the inquiry into the Department of Defence Annual Report 2023-24. AIDN sincerely appreciates the opportunity to participate in this important inquiry.

ABOUT AIDN

The Australian Industry & Defence Network Incorporated (AIDN) is the peak industry association for small-to-medium enterprises (SMEs) who support the Australian Defence Force (ADF) and the Department of Defence (DoD). AIDN represents almost 1000 Australian SMEs, who employ approximately 61,000 of Australian workers across the country.

At a time of national economic and geopolitical uncertainty, our hardworking middle Australians contribute more than \$10.6 billion to the Australian economy annually, through our sovereign supply chains; modern manufacturing practices; research and innovation; skills development; and regional and veteran employment.

AIDN's nationwide membership is agile and can pivot to support the Australian Government to deliver its urgent needs requirements.



Established in 1995, AIDN represents the interests of Australian SMEs in the Defence and security industry sectors through advocacy, representation and member services. AIDN is committed to supporting the Australian Government in delivering a self-reliant Australia through the development of a sovereign, onshore defence industrial capability, guided by what the ADF requires.

Sovereign Defence Industrial Priorities

AIDN accepts the right of governments to determine which areas of defence it defines as being essential for the defence of Australia and its national interests.

The seven Sovereign Defence Industrial Priorities (SDIPs) are:

- Maintenance, repair, overhaul and upgrade of ADF aircraft.
- Continuous naval shipbuilding and sustainment.
- Sustainment and enhancement of the combined arms land system.
- Domestic manufacture of guided weapons, explosive ordinance and munitions.
- Development and Integration of Autonomous systems.
- Integration and enhancement of battlespace awareness and management systems.
- Test and evaluation, certification and systems assurance.

AIDN welcomes the commitment by Defence Industry and Capability Development Minister Pat Conroy to boost investment in local industry in alignment with the Defence Industry Development Strategy (DIDS).

The Minister went on to say that the announcement in February last year would provide industry with certainty on the pipeline of upcoming projects and timelines to invest.

However, a year on from that announcement AIDN has fundamental concerns that persist about the current structure of defence industry and the government's approach to industry and delivery on the SDIPs.

AIDN continues to argue and has done before in parliamentary forums, that the current approach to industry policy will not secure a more self-sufficient sovereign industrial base.

There are many reasons why Australia must develop a strong indigenous sovereign defence capability. Clearly there is an economic benefit to Australia and there is the return on investment argument for the Australian taxpayer.

However, the most compelling argument is the need for national resilience and the ability to resupply and provide maintenance for the ADF which must now be considered strategic requirements.



The defence industrial sector involves hundreds of companies, ranging from large multinationals to small micro businesses that provide niche services, and all must play their part.

A seat at the table for the SME sector is vital or Australian industry could easily become an afterthought for its inclusion in to the supply chains for the multitude of projects Australia is undertaking. If Australian industry is not incorporated into the planning of all defence activities, we will simply be placing the fortunes of Australia into the hands of foreign governments and foreign companies. These companies will in a conflict, resupply their own defence forces, leaving Australia to sit in a queue waiting to be resupplied.

It is AIDN's view that the definition of Australian business as laid down in the DIDS falls short of securing the sovereign Australian defence industry the government seeks. The difficulty is that under the current definition, any foreign equipment manufacturer could set up a subsidiary in Australia and employ a local workforce and be considered Australian. What was missing and as applies in most other countries was any requirement for local ownership, or local board control of decisions.

AIDN knows from the experience of our own members that not enough contracts are flowing to the SME sector under the current industry settings. There is no doubt 2024 year was another challenging year for Defence industry.

To put it quite simply, while the release of key policy documents has provided some certainty for industry there is still a stark budget reality for many SME's.

Industry has been patient and has done a lot of waiting while the Defence Strategic Review and flow on strategy documents have held up procurement decision making.

This has seen orders slow down or be cancelled altogether, while Primes have held on to work to ensure there is sufficient work for their own employees in-house.

AIDN's chief concerns around the implementation of DIDS and the SDIPS are as follows:

Issue 1 The Prime SME Relationship:

Defence is increasingly utilising prime contracts, with AIDN members opportunities occurring mainly as sub-contractors to primes. The Australian Industry Capability (AIC) construct is intended to encourage primes to use Australian sub-contractors, but many countervailing factors undermine program effectiveness. AIDN understands that the Government in concert with Defence has embarked on a program to reform AIC plans to ensure Primes are held more accountable. However, this is a work in progress. AIDN recommends the current approach to AIC be amended from a "best endeavours" model to contractually binding levels of Australian content.



Issue 2 Global Supply Chain limitations:

The Defence Department points to the success of the Global Supply Chain (GSC) program in securing \$1.9 billion dollars of work for 250 suppliers over many years and AIDN does not dispute this. However, the GSC program does not address commercial factors that constrain the nature of Australian businesses the foreign primes involve in their supply chains. The GSC may be effective in gaining workshare for Australian businesses in supplying commodity or manufacturing type work. However, it will not generally be effective in attaining workshare for Australian suppliers of IP rich technology and highly advanced manufacturing. AIDN believes Defence will need to use mechanisms other than the GSC scheme to gain export markets for Australian SME's offering IP rich technology or highly advanced manufacturing supplies. AIDN itself has been active in this space, holding direct talks with Foreign Governments to bring Australian industry and their overseas suppliers together to enhance the global supply chain, for the betterment of all countries. It is hoped that by doing this we will be improving contracting surety for defence SME's.

Issue 3 Defence Industry Development Grants:

AIDN considers that under the current definition these grants are too restrictive on what constitutes eligible expenditure. We have highlighted that none of the DIDS grant streams provides grant assistance for internal staff expenses for IP development or advanced manufacturing processes. Grants also only cover up to 50 percent of project costs and this may need to be increased to assist smaller entities. AIDN members have also expressed concern about application turnaround times with a truly responsive timeframe from submission to notification being no more than four weeks.

Issue 4 Development of Mid-Tier Australian businesses

AIDN offers the following approaches to foster growth conditions for SME's in order for them to emerge as genuine Tier 2 businesses. Defence needs to identify growth opportunities for SME's in upcoming major programs. Procurement strategies should be aligned to promote the likelihood of the identified SME gaining work on the program. Set the minimum viable capability (MVC) level for the program low enough to allow the SME to bid directly to Defence. Where a larger MVC level is unavoidable and Prime integrator is required than Defence must either mandate the relevant SME supplier or impose fully transparent and separate supplier evaluations on to the Prime to enable the SME to bid fairly for the opportunity.

SDIP4 – A brighter note. Though AIDN's industry policy requirements apply to all SDIPS the Global Weapons and Explosive Ordinance initiative deserves some praise in its own right. AIDN members report that the GWEO enterprise and the Defence



Department are making genuine attempts to engage SME's in this program. That goes beyond holding the occasional industry presentation and it is a credit to Air Marshal Leon Phillips OAM, the inaugural Chief of Guided Weapons and Explosive Ordnance, Raytheon and Lockheed Martin and perhaps offers a model for other SDIPs to emulate.

AUKUS

AIDN embraces the tri-lateral partnership which forms a foundation for Australia's security including the effort to acquire Virginia class submarines and then engage in the build of a fleet of SSN AUKUS nuclear powered submarines in Adelaide. AIDN also welcomes the intent to provide opportunities for Australian industry through Pillar Two initiatives focussing on cyber capabilities, artificial intelligence, quantum technologies, hypersonic and advanced undersea capabilities.

AUKUS Pillar 1

AIDN welcomes the decision of the Albanese government to commission a review of the Australian Submarine Agency (ASA) currently being conducted by former Defence Department Secretary Dennis Richardson.

AIDN sincerely hopes the Richardson review will lead to improvement in the functioning of the ASA as its shortcomings have become something of an "open secret" in industry.

The main criticism from the SME sector is that it was too difficult to engage with the ASA...as if it lacked the resources for industrial engagement on the program at scale.

Yet AIDN argues that some form of industrialisation program is essential if the AUKUS program is to succeed. We believe that if the US is not satisfied with Australia's AUKUS industrialisation program it would impact adversely on the program and possibly make it very difficult for the RAN to secure the Virginia class submarines from the United States. With regular rotations through SRF West formally beginning from 2027, time is of the essence.

A second but no less important concern of the SME sector has been the tendency of the AUKUS primes to poach talented engineers and other staff from SME businesses on inflated salaries.

AIDN believes any such poaching is counterproductive given the primes will want to engage SME's with capable and skilled workforces on the programs in future.



Again, the development of a broad workforce plan across the shipbuilding sector could alleviate talent poaching and see workers deployed to the tasks most needed at the appropriate times to succeed in the programs.

AUKUS Pillar Two

AIDN believes AUKUS Pillar Two is faring somewhat better. AIDN was invited to be a member of the AUKUS Capability Trade Forum or ACIF. The ACIF was established under a tri-partite arrangement between the three AUKUS governments. The aim of the ACIF is to ensure each country's respective industry is represented with the outcome to discuss both opportunities and barriers to trade. In a related move AIDN was also invited to be a member of the Ministerial Defence Industry Council. The aims of this council are to ensure all issues facing defence industry have a forum for discussion, direct with the Minister. These are both positive and welcome developments.

Conclusion

To return to the over-riding theme of this submission, AIDN believes Australia's Sovereign Defence Industrial Priorities can only be achieved if the procurement framework within the Department of Defence undergoes a transformative shift. That shift must guarantee genuinely local, Australian-owned small and medium-sized businesses are not merely benefitting, but truly thriving, by obtaining substantial work opportunities.

For Australia's defence industry to be self-sufficient and highly capable, it is imperative to build a robust local supply chain that can support the defence force in the event Australia must rely solely on local resources.

As Australians grapple with the escalating cost-of-living crises, it is crucial that the Department of Defence's procurement framework is tailored to favour and support local small to medium-sized enterprises.

AIDN welcomes any questions you may have about the discussion included in this submission. On behalf of AIDN's national membership, I thank you again for the opportunity to participate in this inquiry, we appreciate it and look forward to the opportunity to meet with the committee in due course.

Yours Sincerely

Mike Johnson

AIDN National CEO