DEFENCE INDUSTRY EXPORT ENQUIRY

FERRA ENGINEERING PTY LTD SUBMISSION

SECTION 1 – INTRODUCTION

1.1. Ferra Background Information

Ferra Engineering Pty Ltd (Ferra) specialises in the design, development, production, maintenance and logistical support for defence equipment, release systems, and structural components as well as electromechanical subsystems for fixed and rotary wing aircraft.

Ferra is a supplier to international defence programs both directly and through primary defence manufacturers including Lockheed Martin, Boeing, EADS, Raytheon, Parker, BAE, Northrop Grumman, General Dynamics and Pratt & Whitney.

Our company has a long-term commitment to the defence and aerospace market and is dedicated to supporting customers throughout their systems' service life.

Ferra's goal is to continue be a 'Supplier of Choice' for high performance subsystems and components for leading systems manufacturers whilst growing to a position of long-term sustainability as a key strategic Australian defence industry capability.

1.2. The Inquiry

The Defence Sub-Committee will examine how Government can better facilitate export of Australian defence industry products and services. The inquiry will consider matters including barriers and impediments to growth in defence exports, and assess the export support given to defence industry by governments of comparable nations.

1.3. Terms of Reference

The Joint Standing Committee on Foreign Affairs, Defence and Trade shall inquire into and report on Government support for Australian Defence industry exports, having particular regard to:

1. identification of barriers and impediments to the growth of Australia's Defence exports;
2. how Government can better engage and assist Australian Defence industry to export its products;
3. the operations of the Defence Export Control Office;
4. assessment of the export support given to Defence industry by governments of comparable nations; and
5. any other related matters.

SECTION 2 – SUBMISSION

2.1. General

This section provides Ferra's responses to the Inquiry's 'areas of regard'. The opinions expressed here are informed by Ferra's experience as a supplier for Australian and international defence industry programs. The theme throughout the responses is the necessity for collaboration between Defence and Australian defence industry as a precondition for the development and maintenance of a sustainable defence industrial base (DIB) - a DIB that is able to concurrently compete internationally while providing dependability of supply and value for money for Australian Defence programs.

2.2. Barriers & Impediments to Growth of Australia's Defence Exports

Ferra's concerns can be divided into two main categories of domestic and foreign barriers. Domestic barriers include limited access to finance; foreign barriers include supply chain integration, particularly as relating to the burden of international transportation costs.

In the first category limited access to finance impacts, capital investment for growth and working capital requirements. Limited access to finance present key barriers and impediments for small to medium enterprises (SMEs) striving to build business and capacity as capital is needed to drive and deliver export sales.

The Australian Government has addressed domestic barriers in part by forming the Export Finance and Investment Corporation (EFIC). This has enabled SME's to seek funding for key projects by paying a margin to EFIC. However, an unwanted secondary effect has been the creation of a new barrier, as high cost of funding affects SME's ability to effectively bid and win contracts against competitors that can access much cheaper finance.

We recommend that the Joint Committee address methods for assisting companies to invest in capital equipment to boost export sales as part of their considerations.

We also recommended that the Joint Committee review and revise costs on exporters within the Government's control; for example the margin paid to EFIC by defence export companies. This will help to ensure that funding costs are more closely aligned with those paid by European and the US competitors

Ferra's secondary concerns relate to support for investment, including co-investment, in off-shore manufacturing and quality assurance facilities as a means of overcoming high freight cost in competition for foreign defence supply opportunities. This strategy at once offers one of the few means available to establish a competitive presence while still leveraging Australian managerial, design and engineering expertise.

2.3. How Government can better engage and assist Australian Defence industry to export its products

Ferra believes that the Australian Government can better assist defence industry exports primarily through optimising the Australian Defence Industry Policy (ADIP) outcomes for Australian industry participation in Australian Defence Organisation (ADO) programs.

The rationale for this position is that participation in Australian programs is an enabler for achievement of the following effects:

- a ‘base-load’ of Australian demand provides the opportunity to demonstrate capability, quality and consistency of supply which assists gaining access to international tender competitions; and
- Subsequent to growth in international demand, the increased production rate of effort contributes to achievement of sustainable levels of production, which in turn contributes to ADO objectives of *supply dependability* and *value for money.*[1]

Examples of actions the Australian Government could undertake to assist with this strategy are listed in brief in the following paragraphs.

- Establish a coordination system to link capital equipment acquisition and through life support (TLS) across individual projects/programs sharing similar technologies with common components.
- Improve promulgation of ADO supplies requirements via a network of Defence industry stakeholders including ADO Systems Program Offices (SPOs), ADO Capability Managers and Australian defence industry suppliers.
- Improve promulgation of Defence/Industry policies in a consolidated accessible publication for Defence and industry personnel (essentially, updated details on procedures and practices to realise policy guidance published in DIPS 2010);[2]
- Reinvigorate attitudinal surveys in Defence and industry in order to identify Defence/Industry relationship (*health*) issues, and develop, implement and monitor remedial measures.
- Sponsor combined Defence and Industry delegations to leading international defence exhibitions to enhance international understanding of Australian defence industry capabilities and the contribution of local industry to Defence capability outcomes.
- Reinvigorate Defence/Industry joint system development and co-investment activities, particularly where the ADO has a specialised requirement that can be produced locally but requires international sales to achieve economy of scale to meet value for money objectives.

2.3. The operations of the Defence Export Control Office

Ferra does not have any significant issues with the Defence Export Control Office.

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[1] Markowski, Hall and Wylie (2010, p.162)

[2] Department of Defence, 2010, ‘Building Defence Capability: A Policy for Smarter and More Agile Defence Industry Base’ (DIPS 2010).

2.4. Assessment of the export support given to Defence industry by governments of comparable nations

2.4.1. Canadian Defence Procurement

The Canadian Defence Procurement Agency (DPA)[3] is in effect a group of interacting Government of Canada (GofC) departments. The Department of National Defence (DND) is the lead agency. The DND acts as the 'civilian' support system for the Canadian Armed Forces (CAF). The National Defence Headquarters (NDHQ) integrates the DND and the CAF.[4] The DND includes a 'Materiel Group', which '*…is the single, central service provider and program authority for materiel for the Canadian Armed Forces (CAF) and the Department'.*[5]

The DND though is not the 'procurement-contracting' agency. The Department of Public Works and Government Services Canada (PWGSC) is an all-of-government procurement contracting agency. Subsequently, when analysing the Canadian DPA the PWGSC must be included in the considerations.

The third significant party with a role in the Canadian DPA is 'Industry Canada' (IC). The mission of IC *'...is to foster a growing, competitive and knowledge-based Canadian economy'.*[6]**.** IC's primary impact on Defence procurement is via the implementation of the Industrial and Regional Benefits (IRB) policy[7] that effectively mandates 'off-sets'. The IRB requires: *'…the winners of major defence contracts to spend the equivalent of the dollar value of contracts (which are often awarded to foreign firms) in support of Canadian industry."* [8]

The '*Canada First Defence Strategy*' (CFDS) [9] was released by the GofC in 2008. In February 2013, the PWGSC released *'Canada First: Leveraging Defence Procurement Through Key Industrial Capabilities'*[10] (the PWGSC Report). The focus of the Report is to recommend procurement strategies that *'…leverage the economic opportunities for Canadians as a result of planned defence procurement.*[11]

The Canadian Defence Industrial Base (DIB) is primarily composed of high performance small to medium enterprises (SMEs) who *'…generally operate in various "tiers" of the global value chains (GVC) of large, mainly U.S., prime contractors.'* [12]

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[3] Author's term – not in official Government of Canada usage. Used here as a generic term for the collective of agencies making providing the Defence Procurement function in the Canadian context.

[4] Ugurham Berkok, 210, in Markowski, M., Hall P., and Wylie R., (Eds) – Defence Procurement and Industry Policy: A small country perspective. (2010) Routledge, London.

[5] See http://www.forces.gc.ca/en/about-org-structure/assistant-deputy-minister-materiel.page

[6] See < http://www.ic.gc.ca/eic/site/icgc.nsf/eng/h_07017.html >

[7] See also the Industrial & Regional Development Act at: < http://laws-lois.justice.gc.ca/eng/acts/I-8/index.html >

The GoC's IRB is administered in the IRB Directorate within the Aerospace, Defence & Marine Branch of IC.

[8] Public Works and Government Services Canada (PWSGC) (2013), 'Canada First: Leveraging Defence Procurement Through Key Industrial Capabilities', xii – 'the PWGSC Report'

[9] See < http://www.forces.gc.ca/en/about/canada-first-defence-strategy-summary.page >

[10] See PWGSC, above n8.

[11] ibid, xviii

[12] ibid, 17

Strategies that are designed to enhance the Canadian DIB must consider the international nature and relationships of the SMEs that make up the DIB. The scope for procurement of purely indigenous solutions for Defence capabilities is limited. Therefore most Defence related Major Crown Projects[13] (MCPs) include international suppliers who often act as the prime.

The integration of the Canadian DIB with U.S. industry is '... *reinforced by longstanding bilateral defence production sharing agreements'* [14] and many Canadian manufacturers have been able to grow as a result of this relationship.

MCPs are all reviewed by an IC-led IRB Evaluation Team. The *'…IC may intervene in the validation of procurement strategy selection, project approval, source selection, negotiation and contract award phases…'*.[15] It is apparent that international contracts for supply of Defence equipment should not only meet capability objectives, but equally, must provide direct socio-political and Canadian DIB benefits.

This approach at once ensures that there is adequate consideration of Canadian DIB participation in MCPs and provides a very significant 'spring-board' for Canadian DIB participation in international defence programs.

2.4.2 Application for Australia

While the Canadian model is not presented as an exemplar, the Canadian approach is highly relevant to Australia due to similarities in terms of the scale and nature of Defence requirements, industrial capacities and socio-political circumstances. Some key points from the Canadian model include:

- The Government of Canada actively intervenes in the Defence programs in order to realise social and national industry outcomes including the employment of off-sets to enhance the sustainability of the Canadian DIB and though this comes at a cost, significant national social and industry benefits are being achieved, and the strategy is recognised as providing reasonable cost/benefit.
- The pursuit of national Defence industry objectives provides significant assistance to the Canadian DIB in gaining access to international defence programs that in turn enhances the sustainability and capacity of the Canadian DIB.
- Australian SMEs have similar challenges with 'economy of scale issues' as their Canadian counterparts in so far as they cannot survive on local business alone, though need a base-load of local demand, as local demand is key to managing the peaks and troughs of overall demand.
- Australia's geographic position creates greater challenges for SMEs than their Canadian counterparts, though the rapidly improving capacities of information technologies enables Australian businesses to leverage their managerial, engineering and design advantages when combined with in-country manufacturing facilities in markets such as India and China. The relative high cost of Australian labour is also driving the shift in focus to service 'intellectual products' and high-end systems and solutions, rather than commodity supplies.

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[13] Major Crown Projects (MCPs) e.g. acquisitions of Can$100m or more.

[14] PWGSC, above n8, 17.

[15] Berkok, above n4, 213

2.5. Related Matters

2.5.1. Governance of Australian Industry Involvement/Capability Programs

The Australian Industry Involvement (AII) Program and related initiatives have been key element of Australia's Defence Industry Policy. The Australian National Audit Office (ANAO) audit of the AII Program[16] in 2003 was conducted to assess the extent that the Program had achieved the objectives of:

- *Develop(ing) and sustain(ing) strategically important capabilities in Australian industry to support ADF operations and Defence capability development; and*
- *Maximise Australian industry involvement in Defence's procurement of goods and services, (while) achieving best value for money to the Commonwealth.*[17]

The report focused on:

- implementation measures;
- cost-effectiveness;
- administrative processes; and
- performance assessment and reporting.[18]

The Audit found agreement amongst Defence and Industry on the utility and desirability of the AII Program framework for ensuring industry considerations were addressed in procurement; and further, that the AII was an important element of the ADIP framework. The Audit also found that the AII Program was not supported by clearly defined strategic objectives nor adequate program governance and management. [19]

While it is evident that there has been some progress in the AII and related programs (AIC, PICs, SICs) since 2003, there remain deficiencies in at least two key components; a coherent overarching performance management framework and a coordinated approach to industry effort across projects/programs.

Recommendations for remediation of these deficiencies include the introduction measures to encourage SME participation through risk mitigation and the development of a performance management framework that enables improved (NDIP) outcomes including those AII/AIC aspects that underpin SMEs ability to survive and subsequently to thrive.

Australia's Defence Industry Policy has a solid foundation of philosophy, policy and procedures. Perhaps its greatest weakness though is its vulnerability to the vagaries of the political cycle. These vagaries can be mitigated to an extent through a performance management framework that carries over from one cycle to the next.

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[16] Australian National Audit Office. (2003), The Auditor General Audit Report No.46 2002-03 Performance Audit: Australian Industry Involvement Program Department of Defence. Upgrade. Australian National Audit Office, Canberra

[17] Ibid, 11.

[18] Ibid, 29.

[19] ANAO, 2003, 11.

2.5.2. Defence Industry Policy Challenges

The Executive Summary to DIPS 2010 notes the main challenge for Australia's Defence Industry Policy is to:

> *'…set clearly communicated goals, develop the framework and processes to implement those goals and to customise these programs to assist industry across the entire capability development life-cycle, with programs complementing each other.*[20]

Below the overarching requirement for the performance management framework, there are a myriad challenges for all stakeholders; not the least for SMEs who often not only have to deal with the complexities and machinations of Defence but also with the concurrent complexities of working for Defence through a Prime Contractor.

Encouraging Primes to positively engage in the 'welfare' of their supporting SMEs presents a challenge.[21] Government must find a balance in how to assist and protect SMEs without compromising Defence Industry Policy objectives and the 'market' generally.

Further challenges for SMEs include:

- Intellectual Property (IP) issues;[22]
- the need for development of innovation skills to boost productivity;[23] and
- the requirement for workforce resource levelling brought about by changing demand and competition for skills.[24]

The reality of defence industry in Australia is that the majority of Australian owned firms are SMEs. It follows that the Defence Industry Policy should support SMEs in the development of globally competitive local technological and industrial capabilities.

The intent then, is to provide local defence industry with enablers to aid their competitiveness in providing Defence with *value for money* options and for meeting strategic *supply* objectives. Indeed, Australia's Defence Industry Policy must satisfy the primary objectives of *supply dependability* and *value for money.*[25]

Both value for money and supply dependability should be enhanced if a local manufacturer/supplier is able to use local involvement as a 'launch pad' for international contracts.

It follows then, that a sound Defence Industry Policy that includes a robust performance management framework that provides proper governance of schemes like the AII/AIC, will provide a return on investment to the Government both in terms of value for money and supply dependability.

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[20] *(DoD, 2010, p.11)*

[21] (DoD, 2010, p 84; Jacopino & Cummins, 2012, p.55)

[22] (DoD, 2010, p.22)

[23] (DoD, 2010, p.65; Jacopino & Cummins, 2012, p.42)

[24] (DoD, 2010, p.66; Jacopino & Cummins, 2012, p.23)

[25] Markowski, Hall and Wylie (2010), p.162

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