

Ai Group Answers to Questions on Notice – Senate Economics References Committee Inquiry into Australia’s Sovereign Naval Shipbuilding Capability

General questions to both AIDN and Ai Group

1. *What value do AIDN and the Ai Group place on early engagement of Australian firms with respect to the naval shipbuilding program?*

Answer: We place a high value on early engagement with Australian firms with respect to the naval shipbuilding program. Early engagement provides a range of benefits, including enhanced opportunities for the discovery of local capabilities; improved and early notice of the requirements to allow business investment; and assistance in the development of skills.

a. *Do you think that Defence has been adequately engaging Australian firms to date?*

Answer: Our view is that Defence has conducted engagement through a range of means, such as involvement in project briefings. However, we should aim for continuous improvement in this regard. In addition, publication of an updated Integrated Investment Program would assist firms to better understand the opportunities.

2. *Do you think that Australian firms/suppliers are unfairly disadvantaged in defence procurement?*

Answer: Ai Group advocates strongly for the development of a level playing field for Australian firms/suppliers. In our submission to the Senate Economics References Committee Inquiry into Australia’s sovereign naval shipbuilding capability (submission number 26), we noted that: “Australian industry is, in many cases, at or above world benchmark standard. In some instances, Australian companies are struggling to compete with overseas suppliers for a variety of reasons. The playing field is, in some cases, tilted against them.” (p3)

a. *How can local industry be given a better opportunity to participate in the naval shipbuilding program?*

Answer: Our submission to the Senate Economics References Committee Inquiry sets out our views on how these issues can be addressed – including through further development and consistent application of the Australian Industry Capability (AIC) policy, and prioritisation of the release of the proposed Shipbuilding Sovereign Industrial Capability Priority Implementation Plan. We also provided suggestions in our submission in relation to the industry programs to assist Australian companies participate in the naval shipbuilding programs – including through the Centre for Defence Industry Capability and the Defence innovation programs.

b. *Do you think Defence's approach to assessing technical risk of tendered offers is in the best interests of Australian Industry?*

Answer: We do not have detailed visibility of the way in which Defence approaches technical risk during individual tender evaluations. However, our submission sets out principles by which we think value for money should be assessed – including through evaluation of a broad range of factors such as:

- Sustainment costs;
- Sustainment time critical capability;
- Technical evolution capability versus creating technical orphans;
- Skills created which can benefit Australia's overall complex project needs beyond Defence;
- Development of advanced technology exports; and
- Facilitation of long-term investment by companies in the technology areas covered by the AIC and sovereign priorities.

3. *What steps would you like to see taken by the Government to ensure that a significant proportion of defence spending is occurring locally and with Australian companies?*

Answer: Our views are as per our submission and in accordance with Answer 2(a) above. In summary, there are a range of initiatives and policy developments we recommend that could assist in the development of local capabilities, including:

- Further development and consistent implementation of the AIC policy;
- Additional recognition of the importance of high value technology transfer and intellectual property to develop internationally competitive high tech and advanced manufacturing industries in the country;
- Bringing attention to the advantages of getting design activity into Australia for the development of enduring domestic capabilities and for leverage into the sustainment process; and
- Ensuring that the AIC is not stove-piped but looked at as a coherent whole with the Global Supply Chain program and related policies.

We note that since publication of our submission, the Government has undertaken initiatives that go towards meeting our recommendations. In particular, we look forward to the AIC independent audit program and the enhanced contractual framework. We are also pleased to see that the Government has released updated Commonwealth procurement guidelines and completed the review of the Centre for Defence Industry Capability.

4. *The Defence Industry Minister said in July that: "We're talking about a generation of Australian jobs, and a substantial level of Australian industry involvement in these major acquisitions". How and to what extent has the Government sought your organisation's*

involvement to ensure that Australian industry involvement is optimised and integrated in both the acquisition and sustainment phases of the naval shipbuilding plan?

Answer: At present, optimising Australian industry involvement in the shipbuilding projects is (appropriately) largely a responsibility for the shipbuilding projects with their Prime contractors, industry, Defence and broader Government (including the Centre for Defence Industry Capability). Ai Group has played an important role in helping to inform policy development through a range of means, as well as assisting in the provision of information and convening our Working Groups with Government and industry. We would welcome the opportunity to further support the shipbuilding projects as appropriate in the future.

a. What work has been undertaken to design Australian firms into the supply chain?

Answer: Our understanding is that each individual shipbuilding project is taking steps to design Australian firms into the supply chains. The approach and strategy depend on the individual project, and this question would be best answered by the companies involved and by Defence.

b. Can you provide examples of Australian companies that are in the process of qualifying to supply tier 1 and tier 2 level supplies at either of the Primes?

Answer: As we do not have visibility of the detail of individual supply chains, our view is that this question would be best answered by the companies involved and by Defence.

5. *The Government's rhetoric suggests support for home-grown growth, but accountability is crucial if this is to occur. How do you think this could be achieved?*

Answer: Ai Group strongly supports the development of local capabilities in the shipbuilding programs. Accountability across the shipbuilding enterprise stems from good governance, strong project management as well as the development and implementation of clear policies such as the AIC program. The AIC requirements need to be clearly detailed and enforceable in the build contracts.

Questions to Ai Group

6. *You express the view in your submission that the effectiveness of the AIC program needs to be improved to achieve the Government's vision as stated in the Naval Shipbuilding Plan and that there is a need for decisive action given the rapidly progressing nature of the projects.*

You say that: "in many cases AIC requirements lack clarity, are without clear measures, and are not supported by adequate monitoring and enforcement arrangements".

How should we be defining and measuring Australian Industry involvement and what sort of monitoring and enforcement arrangements would you advocate?

Answer: Ai Group welcomes the actions taken by Government and Defence since the publication of our submission to the Senate Economics References Committee Inquiry, in particular:

- Appointment of Mr Martin Halloran in the new position of Head of AIC;
- Announcement of the AIC independent audit program and enhanced AIC contractual framework; and
- Completion of the review of the Centre for Defence Industry Capability.

It is understood that the AIC independent audit program and enhanced AIC contractual framework will go towards addressing the issues that Ai Group raised in the submission to the Senate Economics References Committee Inquiry.

7. *What level of Australian Industry Content should we be aiming at across the programs within the naval shipbuilding plan?*

Answer: Ai Group is of the view that there are pitfalls in setting particular percentages of the AIC value targets too early in program design, and in setting one-size-fits-all targets. In the past, this has led to unforeseen outcomes and a focus on the percentage, rather than on developing competitive capabilities that will underpin the sustainable involvement of local producers. The focus should be on the quality of the AIC, specifically ensuring a high quality and high tech focus, including design capabilities, intellectual property and technology transfer. Once agreed, our view is that the AIC contractual percentages should be rigorously enforced and audited in a clear, consistent and transparent way.

8. *Your submission highlights the importance for industry of the visibility of Government's investment and capability plans and you point out that the Integrated Investment Program (IIP) was released in 2016. How often should the IIP be publicly updated and what are the dangers associated with the current level of transparency?*

Answer: Ai Group is a very strong advocate for the publication and annual updating of a clear and transparent Integrated Investment Program, which should cover all of the shipbuilding and related Defence programs. A good benchmark is the US Naval Shipbuilding Plan which sets out the long term (30 year) shipbuilding demand and is updated/authorised annually by US Congress. A high level of transparency of the Australian Government's investment plan is critical for allowing businesses, particularly small to medium enterprises, to invest and upskill their workforces in accordance with those plans.