

Chapter 3

The DMO and industry

Industry is a vital component of defence capability. A combination of government policy and market pressures has brought significant improvement in the capability of Australian defence industry. In many areas, it is now highly cost-competitive. Major projects, when well managed, can introduce new technologies and skills into Australian industry. The Government's objective is to have a sustainable and competitive defence industry base, with efficient, innovative and durable industries, able to support a technologically advanced ADF...

Australian defence industry needs to be competitive on an international basis. ... The Government is committed to strengthening the defence industry base, without encouraging inefficiency or dependence.¹

3.1 The above extract from the White Paper *Defence 2000* describes the policy framework within which the Defence Materiel Organisation has sought to reform its engagement with industry. This engagement is taking place at a time when other significant developments are also being realized—for example the individual plans for discrete sectors of the Australian defence industry.

3.2 Another key document which helps to frame the debate about industry's role in defence is the 1998 Defence and Industry Strategic Policy Statement *Team Australia*. That document identified six strategies for change and improvement:

- Integrate industry into capability development.
- Enhance industry's contribution to the nation's capability edge.
- Reform procurement.
- Establish new ways to involve Australian industry in Defence business.
- Increase Australian exports and materiel cooperation.
- Commit to cultural change and improved communication.²

3.3 In the Committee's view, the current reform activity being pursued by the DMO is fully consistent with the 1998 *Team Australia* commitments. Indeed it is clear to the Committee that the DMO has been conscientious in tailoring its reform agenda to the requirements of both the 2000 White Paper and the 1998 Statement.

1 Commonwealth of Australia, Defence White Paper *Defence 2000—Our Future Defence Force* (December 2000), pp. xv, 101–102

2 Commonwealth of Australia, Defence and Industry Strategic Policy Statement *Team Australia* 1998, p. 1

3.4 The Committee's positive view of DMO's efforts to fulfill the requirements of the various policy statements is somewhat at odds with the assessment by the Australian Industry Group of the overall policy outcomes for industry.

Regrettably, Defence has a poor record of implementing policy which impacts Australian industry. While the 1998 Defence and Industry Strategic Policy Statement did not necessarily represent a fundamental shift in approach, it stands out from previous declarations because it was a detailed policy which was Cabinet endorsed. Additionally, it recognised that implementation was going to be the key to the policy's success. Unfortunately, its implementation was patchy at best.³

3.5 A third significant document affecting the levels of engagement between Defence and industry is the Defence Capability Plan, which has a 10 year planning horizon, and is reviewed annually.

The publication in December 2001 of a public version of the Defence Capability Plan (DCP 2001) was a significant reform in the relationship between Defence and industry. Covering Defence requirements for the next ten years, it involved a new level of openness with industry, with a view to achieving any mutually beneficial planning, innovation and strategic commitment. This and future DCPs provide the means to link Defence needs to a sustainable and competitive Australian defence industry.⁴

3.6 The Committee addresses hereunder a range of discrete issues and concerns raised by industry witnesses, and Defence's responses to those concerns. These matters range from the funding of policy implementation to the details of contracting templates and the handling of grievances.

3.7 The Committee situates its analysis firmly within the framework of current government policy and Defence practice. The Committee's perspective in this exercise draws on the overarching assessment by the Australian Industry Group Defence Council that:

a strategic, and positive, agenda for reform has been established by the Government and senior Defence executives. However, key delivery organisations within Defence continue to struggle with the existing reform framework and this is compounded by insufficient progress in cultural change.⁵

3.8 To use the word 'industry' as all-embracing is somewhat misleading in that there are effectively three different tiers of industry doing business with Defence.

Defence deals with many companies spread broadly across the three tiers of Australia's defence industry—with major local and foreign primes, their

3 *Submission 20*, p. 9 (Australian Industry Group Defence Council)

4 *Submission 10*, p. 15 (Department of Defence)

5 *Submission 20*, p. (i) (Australian Industry Group Defence Council)

subsidiaries and systems integrators in Tier 1; moderately sized overseas and Australian companies able to play a major subcontracting role in Tier 2; and small to medium enterprises (SMEs) comprised almost totally of Australian firms in Tier 3. Companies in each tier make a unique contribution to the nation's defence.⁶

3.9 The *Defence Materiel Guide* published in June 2002 outlines Defence's approach to 'acquiring and supporting specialist military equipment for the Australian Defence Force'. The *Guide* describes DMO's Australian Industry Involvement Program as one that:

Develops, sustains and enhances strategically important capabilities in Australian industry and focuses on developing and sustaining in-country capabilities needed to repair, maintain and adapt materiel capabilities.

Small to medium enterprises have a unique role in Australia's defence industry base and the DMO sources at least ten per cent of its purchases through small to medium Australian enterprises.⁷

3.10 The *Defence Materiel Guide* declares that the benefits of its reforms for industry include 'lower transition costs, certainty and continuity of work, better planning guidance and greater capacity for it to make a long-term investment in infrastructure, skills, training and research and development.'⁸

3.11 The *Guide* also outlines the various mechanisms by which the DMO seeks to keep in touch with industry, including:

- Close liaison with the Defence Industry Advisory Council (DIAC) and industry associations
- Supporting industry forums and a Recognised Supplier Scheme
- Administering a 360 degree Company Scorecard process
- Running an annual Defence+Industry Conference
- Operating a Defence and Industry Study Course for both Defence personnel and people from industry
- The one-stop-shop facility of the dispersed System Program Offices

3.12 In the course of its inquiry, which included site visits and inspections as well as public hearings and informal briefings, the Committee received a diversity of views from Australia's defence industry. One problematic feature of the Committee's consultation with industry was that there was frequently a reluctance by company managers to place their views 'on the record'. They tended to fear that any criticism

6 Commonwealth of Australia, *Team Australia* (1998), p. 33

7 Defence Materiel Organisation, *Defence Materiel Guide* 2002, p. 10

8 Defence Materiel Organisation, *Defence Materiel Guide* 2002, p. 11

they might make of Defence, or the articulation of any proposals that were not favoured by Defence, would somehow result in adverse consequences, including jeopardizing their company's success in future contract bids.

3.13 It has been very difficult for the Committee to assess whether such anxieties are simply the inevitable consequence of firms competing for business in a market where Defence is often the sole customer, or whether there is truth in the allegations about the attitudes and behaviours of some DMO personnel. The Committee explores these matters in more detail when it deals with issues of cultural change, and the handling of grievances associated with contracts and tendering processes.

3.14 The Committee has been most grateful for the public contribution of some of the defence industry's peak bodies and of individual CEOs. Their evidence has been valuable in assisting the Committee to test views put privately by others. But there remains an undercurrent of 'bad form', expressed or implied, in confidential submissions and other communications from industry than demands more than cursory examination.

Funding and budget issues

3.15 Any consideration of defence industry matters must first take into account the levels of funding that are available to pursue the strategies outlined in strategic and policy statements.

[C]apability priorities established by successive White Papers have been dependent on funding increases. While the Defence Organisation has continued to program capital expenditure on that basis, these funding increases have not been forthcoming and this has put immense pressure on the budget. And second, the short-term pressures applied by continually increasing personnel and operating costs have subsumed the long-term capital needs of the Defence Force. Clearly these are expenses that must be met and recently, for example, have resulted from largely unforeseen and extreme international developments. However, it is critical for long-term Australian Defence Force capability—of which in-country support and therefore industry sustainability are key components—that this situation does not become an ongoing feature within the Defence budget.⁹

Undoubtedly, compared to a decade ago, significant elements of defence capability are now provided by Australian industry, and this has shown to be more cost effective than before, not only in terms of capital expenditure per se but also in terms of the entire through-life support. Having said that, nonetheless when we look at actual dollars spent in Australian industry in the last 10 years, it has dropped from about 70 per cent of the capital expenditure budget to about 40 per cent. This is significantly due to a change in some of the capital expenditure programs, from shipbuilding to,

9 *Submission 20*, p. 2 (Australian Industry Group Defence Council)

say, aerospace and electronics, where there is not the same capability in Australia as overseas.¹⁰

3.16 The ministerial foreword to the 1998 *Team Australia* document contains several statements emphasizing *partnership* between Defence and industry. Such a partnership is to be ‘a means to achieving Australian Defence Force capability’. As a result ‘industry will be able to look to the defence market as one in which it can invest with confidence’.¹¹ These goals are substantially dependent upon the availability of funds. *Team Australia*’s affirmation of ‘smart’ companies will ring hollow if the Commonwealth is unable to make the necessary dollar investment.

In recent times Defence funding has been insufficient to make use of the capability that has been developed in Nautronix. While apparently important strategic capability has been established in Nautronix, funding to implement the capability in the ADF has been less readily available. Unfortunately the actions necessary to sustain the Defence capability in Nautronix require a braver act of charity than the company or its shareholders are able to provide. This issue is not a criticism of the Department or the Defence Materiel Organisation. It is recognition that the Defence budget is not adequate to meet to provide a coherent Defence industry strategy.¹²

3.17 In the Committee’s view, one of the significant determinants of Australia’s capacity to sustain a viable defence industry base is the scale of the exercise. Unlike the United States, for example, which has an enormous defence infrastructure and budget and an industrial capacity which is both broad and deep, Australia has relatively few major defence companies, with small to medium enterprises scattered across the country trying to optimize both defence-oriented and commercial opportunities. This constitutes a challenging environment in which to sustain even a moderate level of self-sufficiency in capability, or to maintain the continuity of work necessary to ensure the viability of firms.

3.18 The Committee acknowledges the inevitable tensions between what is desired in terms of ‘industry partnership for capability’, and what is possible in terms of whole-of-government budgets and the disbursement of the Defence budget across the full range of its responsibilities. There are also further debates that could be had about the place of defence industry policy in broader industry and regional development policy. This is not the place to engage with those broader debates, but the Committee explored the extent to which industry appreciated those tensions and debates.

We are not coming to this inquiry asking for some sympathetic support for Australian industry. We are talking about hard-nosed commercial benefits to the Australian economy, to the defence organisation and to the global competitiveness of very significant industries here... We are not here about sentiment. We are not putting our hand on our heart and saying, ‘Support

10 *Committee Hansard*, p. 301 (Mr Leigh Purnell)

11 Commonwealth of Australia, *Team Australia* (1998), p. (iii)

12 *Submission 9*, p. 2 (Nautronix Ltd)

the good old Aussie battler.’ We are talking about world-capable technology. The two studies that we have already done on the minehunter and the ANZAC projects, which I have detailed in our submission, show the real benefits to defence, to the Australian economy and to the people at large.¹³

3.19 The Committee has neither the capacity nor the authority to specify budgetary arrangements that will deliver to industry the resources necessary to achieve the vision of ‘a technologically advanced ADF... supported in close partnership by efficient and innovative industries’.¹⁴ It is a vision which the Committee endorses. The principle of partnership is explored in more detail in the section of this Report dealing with projects and project management.

3.20 The Committee is persuaded that the kinds of industry support and engagement envisaged in the 2000 Defence White Paper, in the 1998 *Team Australia* document, and captured in the Defence Capability Plan is entirely consistent with Australia’s best interests.

3.21 However, the Committee makes the point that a sound defence industry policy, and a forcefully stated commitment to it by government, will inevitably—and reasonably—raise expectations, especially within the ‘smart’ companies that possess the intellectual resources, the passion and the patriotism to take up the challenges and respond to the opportunities that are presented.

3.22 If there are insufficient grounds for those expectations, and inadequate government support and follow through—financial, procedural, promotional—then disillusionment and frustration will rapidly erode the momentum and good will achieved during the policy development phase. All the policy statements, structural reforms and revised procedural frameworks in the world remain impotent until put into practical effect.

Industry agrees that the processes do exist. However, for us, the real issue remains policy execution.¹⁵

While the new policy is a significant advance and has the potential to build an industry with real capability to influence the defence of Australia, it will fail unless the Government forces Defence to account for progress by measurement of outcomes.¹⁶

If you look at the defence and industry strategy paper that was brought down by the government a couple of years ago, if all of those objectives

13 *Committee Hansard*, p. 397 (Mr Leigh Purnell)

14 Commonwealth of Australia, *Team Australia* 1998, p. 7

15 *Submission 20*, p. 8 (Australian Industry Group Defence Council)

16 *Submission 11*, p. 5 (SAAB Systems Pty Ltd)

were able to be fully implemented, we would be pretty close to what we were wanting anyway.¹⁷

3.23 The Committee intends to closely monitor the implementation of Defence industry policy. The Committee is confident that the vision is right and is shared by industry. The bureaucratic structures and processes are being reformed along lines which appear to have the blessing and broad support of industry and of defence observers. If the policy fails in its implementation, accountability belongs with government. The failures will most likely be traceable to inadequate resourcing, either in terms of Defence dollars invested in locally produced capability, or to the effectiveness of managers, project leaders and those who sit on project governance boards. It is here that the Committee's scrutiny will be most searching.

How industry perceives DMO and the reform agenda

The first message we want to give to this inquiry this morning is that we [Australian Industry Group Defence Council] believe that we are doing things better now than we were a few years ago. The second message we want to give very strongly is that, while our submission is heavily focused on reforms to the DMO, there are reforms on both sides. There are a lot of things that industry is working on and believes it can do better... But I want to make the point very strongly that the defence contracting industry in Australia knows that all of the reform is not just within the DMO; it is also on industry's side.¹⁸

3.24 The Committee was pleased to have drawn to its attention by an industry peak body that the defence procurement reform agenda was not confined to the bureaucracy alone. The Committee notes also the strong endorsements of the DMO coming from Australian Business Ltd, an organisation that supports more than 250 defence related contractors, big and small, across all industry sectors.

At the outset we wish to make very clear the genuine support and cooperation provided by the Defence Materiel Organisation to Australian industry... Commencing in 2001, with the active support of the Under Secretary... ABL initiated a regular program of visits to defence firms by DMO executives. These tours have helped the communication process and demonstrated an active interest on the DMO's part in better understanding the concerns of Australian SMEs... ABL is regularly consulted by DMO project staff on issues relevant to industry. The DMO has ensured that industry is provided with every opportunity to exploit opportunities to tap global supply chains... ABL's Defence Industry Committee is of the view that recent DMO acquisition reforms are delivering positive outcomes.¹⁹

17 *Committee Hansard*, p. 310 (Mr Leigh Purnell)

18 *Committee Hansard*, p. 301 (Mr Leigh Purnell)

19 *Submission 23*, pp. 1–2 (Australian Business Limited)

3.25 It is important that industry accepts its responsibility to cooperate with the DMO in bedding down efficient project management practices. Companies, too, need to be diligent in their own analyses of risks and cost-drivers as they enter tender processes.

3.26 The Committee also exhorts industry to acknowledge the distinctive responsibilities of a government agency in matters of transparency, accountability and due process. Normal commercial practice is not the standard for organisations that are accountable to parliament for the expenditure of huge sums of public money. Industry has every right to expect efficiency, and that commercial practices will be accommodated as far as possible within the bounds of prudence and accountability expected of public servants bound by, among other things, the *Financial Management and Accountability Act 1997*. Industry personnel should remember that they are also citizens, along with their public sector counterparts, with a stake in the Commonwealth purse.

3.27 Strong representations were received from some industry representatives to the effect that a (wholly or partly) corporatised DMO would optimize its capacity to deal efficiently with industry. Their arguments were couched in terms of overcoming gaps between policy intent and implementation, reducing time between requests for tender and contractor selection, and promote a stronger commercial ethos amongst DMO personnel. The proposal was first put to the Committee by the managing director of SAAB Systems Ltd, Mr Nick Hammond.

While specific reform initiatives may be individually beneficial, the most productive approach to improvement of performance of the DMO would be to create an environment where delay and poor performance had real and evident outcomes. One way to achieve this would be to link the organisation's own administrative and salaries budget to its acquisition budget so that delays in letting contracts and in achieving expenditure on contracts already in place would translate directly into a reduction in the DMO's budget, engendering the same "time is money" attitude that motivates industry.²⁰

3.28 Mr Hammond also drew to the Committee's attention what he regarded as a serious problem for the DMO, namely the capacity to provide the salaries and other conditions necessary to attract the kind of high level experience and expertise that its tasks required.

[I]n terms of a structure that would allow it to compete in the marketplace, ... I referred to a corporatised organisation... [I]ntuitively it seems to me that that is a possibility. In other words, there would be a defence procurement agency which would be run under corporate lines and it would be freed from the constraints of public service salaries and things like that. Perhaps rolling in the two ideas together, its budget could be a percentage of the money it was spending on acquisition and so there would be then an

20 *Submission 11*, p. 2 (SAAB Systems Pty Ltd)

incentive to spend the full defence budget and to minimise its cost. It is an idea which I think is worth pursuing or at least exploring.²¹

3.29 Similar views were advanced by representatives of the Australian Industry Group Defence Council.

The Australian Industry Group Defence Council view is that the quasi corporatisation of the Defence Materiel Organisation would enable it to take a more commercial focus. It would be contracted by the Government for its activities and, therefore, must be in a position to accept or reject proposals emanating from capability development areas that are insufficiently developed or are unlikely to produce a value for money outcome... [W]e are of the view that while a strict corporatisation model is not fully applicable for the DMO, with some changes reflecting its unique agency role, many of the benefits flowing from a corporatisation process can be achieved with no significant hurdles—whether they be capability, legislative or processes—which would hinder this approach.

The Australian Industry Group...believes that the Defence Materiel Organisation's quasi corporatisation, with its increased capability of recruiting, retaining and developing the appropriate skills base to achieve its objectives outside normal public service processes and culture, would be a positive stimulus for the Defence Materiel Organisation. Additionally, it will be critical to ensure that further reform of Defence processes, particularly in relation to the development of capability proposals is achieved... [T]he result of this approach would be a more effective capability outcome for the Australian Defence Force, a more sustainable outcome for Australia's defence industry and a more cost-effective outcome for the Government and the Defence Organisation.²²

3.30 The Committee explored the corporatisation proposals on several occasions and in some depth. The Australian Industry and Defence Network was another peak Organisation that saw merit in the corporatisation proposal. But among Defence officials there was a general resistance to the idea, based on the conviction that the DMO should not become too far removed from its main customers—the three Services—and that the DMO's reform agenda would address many of the industry's concerns. The Under Secretary Defence Materiel expressed those views as follows:

I can see some attractions in terms of giving me some flexibility on the remuneration front, because I do have difficulties in attracting and retaining some key skills, particularly aerospace engineers and software engineers. I have two concerns about it. The first is that the most important relationship is between my customers—the three service chiefs and the vice chief, who is in charge of capability—and me, and I would not want to see any distance put into that relationship. The second is, if you want a really clear cut interface between us and the rest of Defence then you are starting to look at

21 *Committee Hansard*, p. 186 (Mr Nicholas Hammond)

22 *Submission 20*, p. 11 (Australian Industry Group Defence Council)

a degree of formality of that process that involves almost contractual obligations over that interface. All that does is shift the contractual specification requirement closer into the centre of Defence. On balance, the way we are structured at the moment is probably best but, if I could find a way through the attraction and retaining of key technical resources, I would be happy.²³

3.31 The Chief of Air Force, Air Marshal Houston, emphasized the key relationship between DMO and the three armed Services, and expressed concerns that a commercially discrete procurement agency would undermine key features of that relationship and weaken Defence's capacity to fulfill certain statutory responsibilities.

I do not think that a commercial agency operating outside the department would necessarily work as well as the current arrangement. One of the advantages of the current arrangement is that we have a nice blend between military and civilian people who provide a great service to the services. The main customers are obviously Army, Air Force and Navy. It is important that people within that materiel organisation have an understanding of what is done at the sharp end. If you had a commercial agency that, essentially, worked outside the department, there is no guarantee that we would have that sort of operational appreciation and that sort of operational understanding. Another thing that is probably important for you to realise is that I have airworthiness responsibilities. I am the ADF airworthiness authority. I have to exercise that responsibility through military, aeronautical and other specialist engineers within Air Force. I think a function like that would be much harder to perform if you had a commercial organisation basically doing all the work.²⁴

3.32 The Committee explored possible models for corporatisation with representatives of the Australian Industry Group.

I guess the ABC could be seen as one particular organisation. It is a very different organisation, but it could be seen as something similar...

Australia Post is a good example. It is a very efficient operation. It remains in government hands but it has been given the corporate governance arrangements that allow it to operate as efficiently and as effectively as it possibly can. The DMO is a good example of an organisation that could have similar achievements. It is certainly heading down that path already. I think it could be helped along and progressed further by putting appropriate governance arrangements in place.²⁵

3.33 The Committee does not object in principle to a quasi-corporatised model for the DMO, but is reluctant to advocate for such a model to be applied to the DMO. The Committee notes the difficulties raised by the Chief of Air Force regarding his

23 *Committee Hansard*, p. 374 (Mr Michael Roche)

24 *Committee Hansard*, p. 219 (Air Marshal Angus Houston)

25 *Committee Hansard*, pp. 309–310 (Mr Lucio Di Bartolomeo)

statutory responsibilities for airworthiness, for example. The Committee is also taking into account the more streamlined tendering and contract procedures that have been introduced by the DMO, and is aware of the improved engagement at senior levels between the DMO and industry. In short, the promise of benefits to industry from the DMO reforms is sufficient to restrain the Committee from pressing for corporatisation at this stage.

3.34 The Committee gives particular weight to the requirement that DMO must relate intimately with the Services and the VCDF, especially given the crucial nexus between capability development and acquisition, and between the procurement of a platform by the DMO and its acceptance into service. This is fundamental to the achievement of operational capability, and there should be no artificial boundaries created between the DMO, Capability Systems and the three Services which might impede that relationship.

3.35 On balance, a move to a corporatised DMO is not regarded as appropriate to the Defence mission. Moreover, the Committee feels that it could be severely destabilizing to attempt a radical restructure at this time.

The relationship of SMEs to DMO

3.36 The Committee has already referred to encouraging evidence from industry representatives about DMO's understanding of the nature and role of Small to Medium Enterprises (SMEs) in contributing to Australia's defence capability.

3.37 However, there still appears to be a gap between the current and potential contribution that could be made by SMEs, and their current and potential level of engagement with the DMO. A fairly comprehensive account of the SMEs situation was provided by the President of the Australian Industry and Defence Network, which represents around 1,300 SMEs.

These SMEs individually display a degree of agility and responsiveness as well as an entrepreneurial spirit that is ideal to meet the demands of transformational warfare that, with international events today, I fear we are in the process of moving towards....

One of the things with SMEs is that they are primarily under-recognised as being a strategic Defence resource, primarily due to their ability to meet what we call surge demands. Surge demand is generally obtained when something like Timor arises and there is an immediate requirement for assistance to Defence in order to resolve issues or problems... Because of the experience that SMEs have with trends and with responding to orders both nationally and internationally, the SMEs are very well placed to meet these surge demands. From a Defence point of view, this is most worthwhile. With the majority of SMEs in Australia, Defence business is currently only a small proportion of their business. They often find it very frustrating due to the itinerant nature of Defence's purchasing—the long-term nature of Defence's ordering but with time frame demands that are usually greater than those which are acceptable or are currently

commercially accepted practice. So there are some issues that SMEs would have with Defence.²⁶

3.38 The Committee undertook several site visits to SMEs, and a frequent theme emerging in discussions with them was that the SME often felt that it did not have the opportunity to contribute early enough to projects. SMEs often felt that they had ideas, innovations and products that would enhance capability, but their involvement came much later in the acquisition phase, preventing them from having input into the capability requirement/definition phase. This appears to be attributable largely to where SMEs sit in the defence industry hierarchy.

There are two ways in which SMEs meet Defence. One is via the linking of the SME underneath prime contractors to Defence, where the prime contractor is awarded a tender or a contract from Defence and the SME then supports that prime contractor with the supply of materials and/or components and/or technology to enable that prime contractor. Alternative to that is the methodology whereby the SME has a capability or a product or a service which is stand-alone sought by Defence. Because the SMEs have only a portion of their business with Defence, they are not in a position to be able to survive entirely on Defence work. It is therefore incumbent upon that SME to ensure that they have a good foundation with respect to civilian market orientation both in national and export markets and support those commercial orientations.²⁷

3.39 The Committee encourages SPO Directors to seek a deeper familiarity with the SMEs that operate in their areas of interest. While SMEs will continue to contribute to capability largely through their role as sub-contractors to larger defence companies, consolidated relationships between SMEs and SPOs are bound to enhance the opportunities for SMEs to bring their ideas and capacities to bear upon defence acquisition and logistics.

3.40 The Committee has been impressed with the intellectual and technological capacity of many of the SMEs it encountered. It is possible that some SMEs have a slightly inflated view of their capacity for innovation, but to the Committee it appears that the quality and potential of SME contributions remains somewhat opaque to Defence. No doubt this is largely due to the ‘tiered’ industry structure where Tier 3 (SME) firms are usually engaged by the Tier 1 primes who have won major Defence contracts.

3.41 As discussed elsewhere in the Report, there is a generally favourable view of System Program Offices (SPOs) amongst industry personnel, including SMEs. Except where an SME has a direct involvement with DMO on a project, the links between SMEs and SPOs are usually constrained by the commercial/contractual relationship between the SME and the prime contractor who has been contracted to undertake the

26 *Committee Hansard*, pp. 222–223 (Mr Michael Turner)

27 *Committee Hansard*, p. 223 (Mr Michael Turner)

project concerned. The Committee explored this issue with some of the System Program Offices.

The reality is that we [in a SPO] are not in a position to go in and take all the risk of contracting with every SME direct and then be responsible for the pulling together and the risk of the integration et cetera. That would be unacceptable risk. The minute something goes wrong, the prime would say, ‘Well, you picked them.’ So it is important that we recognise that there will be a lot of the larger projects where the SMEs will need to come in [under a prime]. I would have to say my impression is that some of the primes do play it fairly rough, but there is a limit to what we can do...

Again, in the land case, there are some things where we go direct to a range of companies—for boots, uniforms, webbings, sandbags, you name it. A lot of things we get are very low scale and we do go direct into the companies. If you are asking with something like an M113 or a Bushranger—something of that size—would I want to go and dictate who the SMEs will be and what the conditions are between them and the primes, no, I would not, because I would bear the risk. To some extent, we had some of those tensions in the M113 project with Tenix in dealing with potential subcontractors. The subcontractors would come to us and want us to direct and whatever. There is no way that we are going to dictate who will team with whom. We would then bear the full risk. So I think on the big projects we need to be careful.²⁸

3.42 The Committee pursued the apparent contradiction of having the SPOs in place to promote closer relationships with industry, when many SMEs cannot do anything other than go through the prime contractor to the SPO. By the time it gets through from the SME to the SPO, the message is lost. How does one overcome that problem?

From one point of view, we certainly have very regular dialogue with the companies. They come through regularly and, if they have concerns, they raise them and we will, where we can and where there is a genuine issue and a concern, address them. But at the end of the day, it is difficult.²⁹

I will give you an example. We [SPO] had a relationship with a subbie. The prime and the subbie were having a problem. We became aware of it because we have dialogue with all of these people. We said to the prime, ‘You have a problem in this area. We understand there is a problem. We won’t tell you where we got the information but there is a problem. We would like you to fix it.’ It went on. They said they would fix it but not too much happened. We set up a meeting in Canberra between the prime, the subbie and us. We sat in the same room and said, ‘There is a problem here. We want you to sort it out.’ They said, ‘Yeah, all right.’ And then we sorted it out that way.³⁰

28 *Committee Hansard*, pp. 113–114 (Dr Ian Williams)

29 *Committee Hansard*, p. 114 (Dr Ian Williams)

30 *Committee Hansard*, p. 114 (Colonel Peter Acutt)

3.43 The Committee became aware that research and development is another area in which the SMEs are less visible than perhaps they should be.

A surprising number of Australian SMEs do not bother to register their research and development projects with AusIndustry. The disappointing thing about that is that the ABS then does not pick up the correct statistics with respect to SME research and development because the SMEs perceive that there is a plethora of paperwork attached to it. Therefore, because they do not have the time to do that, they miss out on the 175 per cent taxation benefit available through AusIndustry and/or the possibility or the opportunity of working with AusIndustry for research and development grants under R&D Start when it comes back on stream, ostensibly next year.³¹

3.44 The Committee notes that some attempts have been made to link SME research and development efforts with the activities of the DSTO. These efforts are to be applauded and encouraged in a more systematic fashion.

Recommendation

3.45 **The Committee recommends that**

(a) AusIndustry undertake a specific promotional initiative to encourage and assist Small to Medium Enterprises (SMEs) to properly register their R&D activities with AusIndustry; and

(b) the DSTO develop a special program to nurture partnerships between the DSTO, the CSIRO and SMEs with respect to research and development in areas of mutual interest, and to expand existing mechanisms by which SMEs can seek R&D and technology advice.

Industry—DMO feedback mechanisms

To provide an objective basis on which to assess company performance, DMO has introduced a commercial-in-confidence company scorecard system. The company scorecard enables DMO to collect, assess and monitor contractor performance using an objective set of measures. This gives contractors an unprecedented insight into DMO's view of their performance, while identifying areas for discussion and improvement and providing a basis for considering past performance in source selection. For companies without a scorecard, techniques such as reference sites, demonstrated domain expertise and company capability assessments based on international models are being used.³²

31 *Committee Hansard*, p. 224 (Mr Michael Turner)

32 *Submission 10*, p. 10 (Department of Defence)

3.46 The Committee regards effective, formal feedback mechanisms to be fundamental to the development and maintenance of good relations between the DMO and industry, and to the promotion of best practice. The Committee was pleased to note that provision is also being made for industry to prepare an assessment of DMO's performance.

[P]erformance evaluation is not just one-way. DMO is piloting the 360 degree view scorecard, intended to measure DMO's performance from an industry perspective. It should highlight systemic and project-specific shortfalls, so that policies, practices, and new training may be introduced. It complements the continuing industry survey program.³³

3.47 Despite the occasional criticism of the scorecard system from individuals, the evidence coming to the Committee from industry representatives was overwhelmingly positive.

This process is taken very seriously within industry—with some companies linking performance bonuses to improvements in their company ScoreCard—and it is understood that some significant improvements in project performance have been seen.

Equally... it is important that industry has the opportunity to assess Defence's performance. The Australian Industry Group Defence Council has been working with the Defence Materiel Organisation to develop a '360 degree ScoreCard' process... This is a very positive development and needs to be seen as indicative of a mature relationship. This approach is currently being trialled and the Australian Industry Group Defence Council will be working to ensure that a short-term focus in reporting is balanced by a long-term, strategic view of the relationship.³⁴

3.48 During one of its site visits to a major facility the Committee observed the details of the company's scorecard being prominently displayed on the shop floor, along with a comprehensive commentary on the company's progress. The Committee is encouraged by the extent to which firms are incorporating scorecards seriously into their assessments of their own, as well as the DMO's, performance.

[C]ompany scorecards ...[record a]... company's performance over about 10 items, and we [DMO] have now found that we are getting visibility at board level within companies which have problems. One of the things that struck me was that, in companies where we had problems, very frequently the board level people were not aware of it. Possibly people down the line would sit on the problem.

The scorecards are going to the board and most companies are dealing with them at board level. If there are poor outcomes then we generally get a very high-level response. We have moved to a 360-degree scorecard, where we

33 *Submission 10*, p. 10 (Department of Defence)

34 *Submission 20*, p. 7 (Australian Industry Group Defence Council)

have invited industry to report on our performance as a contracting authority. There are a few home truths shared with us in that process. It is starting to work.

We are having difficulties getting industry to divorce views about budget issues and so on from their views about us as a contracting authority but we are working on that.³⁵

3.49 The Committee commends the DMO on the development of the 360 degree scorecard arrangement, and as part of its ongoing scrutiny of DMO's performance the Committee will seek from DMO summaries of industry's scorecard feedback to it.

Recommendation

3.50 The Committee recommends that during Budget Estimates the DMO table before the Senate Foreign Affairs, Defence and Trade Legislation Committee an audited summary of the feedback provided by industry to the DMO via the 360 degree scorecard process.

Requirements for cultural change

3.51 The concept of 'cultural change' emerged on several occasions throughout the Committee's inquiry, and in a variety of contexts. When industry people spoke about the need for 'cultural change' they tended to refer to both 'organisational culture' and the behaviours and attitudes of individuals inhabiting that organisation.

3.52 The Australian Industry Group Defence Council regarded cultural change as the *sine qua non* of policy effectiveness.

Defence has a poor record in implementing policy which impacts on Australian industry and it is the Australian Industry Group Defence Council's view that the cultural change required can only be achieved through a paradigm shift...

Key delivery organisations within Defence continue to struggle with the existing reform framework and this is compounded by insufficient progress in cultural change. Ultimately, this will be to the detriment of Australian Defence Force capability.

3.53 It is clear to the Committee that questions of cultural change are also prominent in the minds of those leading the reform agenda in Defence. Witnesses from Defence emphasized the cultural changes that they believed had already been achieved, while acknowledging that there was still much more to be done.

We have put an awful lot of effort into cultural change. I think one of the great achievements in the last three years—and, to be fair, to give Dr Hawke his credit—is that we now have got a leadership, values based culture within

35 *Committee Hansard*, p. 146 (Mr Michael Roche)

Defence that was never there before. If I go back 20 years, the whole environment in Defence was one of tribal infighting, a lack of cooperation, hidden agendas and so on... I have not seen any service rivalry like we used to have, say, back in the mid-eighties when we were fighting over scarce resources. We now recognise that resources are scarce and we work very well together. At the highest level, we take collegiate decisions and decisions that are in the national interest, not in the interests of individual services or individual groups within the organisation. So we have ... moved to a much more positive culture of leadership, cooperation and a focus on people and on results, and I think it is a huge step in the right direction. ...[W]e need to give the DMO time to bed in. It is working very well at the highest level, and it is working wonderfully well down at the force element group level.³⁶

We are doing a lot with our people. We are trying to change the culture in the organisation... We are now trying to get people to use more judgment but still within an overall accountability framework. We are putting major efforts into training, both on the leadership front and on the technical and professional front... We have introduced a range of performance measures—plan on a page—and so on. We are at the early stages of work force planning, to ensure that we have the right number of people to do the task.³⁷

There has been a lot of organisational change, there has been a lot of operational change and there has been a lot of cultural change. The effect of all that change is that we now have more capability than we had 13 years ago.³⁸

3.54 Notwithstanding the claims of these senior Defence witnesses—and the Committee does not doubt the genuineness of those claims—the message coming to the Committee from industry emphasised cultural gaps, and how considerable progress still needed to be made in Defence culture if reform was to prove efficacious.

In the Australian Industry Group Defence Council's view, [the Organisational Renewal (or "Results through People") initiatives of the Secretary and the Chief of the Defence Force] is a most welcome move and recognises the critical contribution that people make to the delivery of the Defence function and establish a basis for cultural change within the organisation. This cultural change must be evidenced across the full procurement and in-service life cycle.

It is these changes in culture and practice which are at the heart of improving the relationship between Defence and industry and, consequently,

36 *Committee Hansard*, p. 216 (Air Marshal Angus Houston)

37 *Committee Hansard*, p. 148 (Mr Michael Roche)

38 *Committee Hansard*, p. 214 (Air Marshal Angus Houston)

enhancing the outcome for the Defence Force. It is our view that a radical change is required to progress this cultural change.³⁹

3.55 It has been difficult for the Committee to gain a clear picture of the current culture of the DMO as an Organisation in its own right or as one half of the much vaunted ‘Defence–industry partnership’. With respect to the latter, the Committee notes the reported results of the New Focus Research Defence Purchaser and Supplier Attitudinal Survey of 2001 which show:

...dramatically lower levels levels of agreement [between the 1999 and 2001 surveys] amongst the Defence Materiel Organisation’s key large industry clients that Defence is meeting twelve [out of 27] performance criteria (NFR 2001: 7).

According to the Report, the most frequently cited barriers to the relationship were:

- lack of trust of both parties/poor communication/lack of open discussion;
- lack of understanding of industry;
- lack of commitment by Defence to contract schedules; and
- favouring large, often foreign owned corporations. (NFR 2001: 11).

This lack of trust is mirrored in responses to the survey from the Defence Materiel Organisation personnel where close to 40% of respondents agreed or strongly agreed with the statement that “industry is out to ‘get what they can’ at the expense of Defence” (NFR 2001: 24).⁴⁰

3.56 The Committee explored with DMO officials the extent to which they felt that a more concentrated and effective engagement with industry was ameliorating cultural differences between bureaucracy and industry. The Committee had received some quite positive comment from industry about improved access to Defence and more efficient processes.

3.57 Is there a sense in which the Defence–industry relationship is shedding mistrust and building mutual confidence? The USDM and Head of DMO’s Industry Division were both strongly of the view that such was the case.

Mr Roche—...[M]y instinct was that we are starting to get some pretty good results back from industry and industry were making some pretty positive comments about the way that Industry Division was supporting them. That certainly came out with the joint strike fighter project. It has come out with our industry days, our industry trade missions and so on. My instinct was that they actually thought we were getting on and doing it. We have certainly been putting considerable effort into improving our knowledge of Australian industry. We have been out doing regional visits.

39 *Submission 20*, p. 2 (Australian Industry Group Defence Council)

40 *Submission 20*, p. 9 (Australian Industry Group Defence Council)

We have been out there with small to medium enterprises. All of that has had very positive responses.

Mr Learmonth—If I can amplify that, I would say that I spend quite a lot of time talking to senior industry leaders and others and the pretty uniform message I get out of all of them is that what they have experienced in the last couple of years has been, to this point, unprecedented levels of access and unprecedented levels of support, influence and communication on industry policy and other issues. They have not experienced before the level of support they are getting in relation to trade missions and export facilitation, not just in relation to the joint strike fighter but in other initiatives we have, such as the littoral combat ship, Team Australia and others. A number of proactive steps were taken in areas that do not get quite so much publicity at this point, for example in relation to sonar buoys. I confess I hear nothing but very positive messages out of industry and messages which suggest we are actually getting something right.⁴¹

3.58 The Committee sought additional information from the DMO about the results of Defence's own staff attitudinal surveys. The 2001 results revealed that at that time DMO scored second lowest on good leadership, beaten only by DSTO. As well, the DMO had the least confidence in the senior Defence leadership. At its final hearing of the inquiry, the Committee was advised that:

... the latest survey results [July 2002] indicated that there was improvement in the DMO results. This survey is conducted across Defence. My notes tell me that the two areas of improvement were in the sense of job satisfaction for personnel in DMO, and that they have greater clarity about what is expected in their jobs.⁴²

3.59 While the Committee takes some encouragement from the more positive survey results, it is aware that at least some individuals remain highly critical of DMO workplace behaviours and ethics, and the attitudes of some DMO personnel towards contractors who are considered 'difficult' or 'disgruntled'. It is extremely difficult for the Committee to adequately assess the merits of these claims and counter-claims. The Committee has formed no judgments about those claims that have been conveyed to it in confidential submissions and other communications.

3.60 However, the Committee considers it important to place before the readers of this Report the kinds of matters that have come to the Committee's attention, to indicate the nature of the Committee's concerns in relation to them, and to suggest how those concerns might be addressed.

3.61 One example which received explicit attention in the final public hearing related to the contents of a paper presented in October 2002 to SETE 2002—a Conference of the Systems Engineering Society of Australia and the Southern Cross

41 *Committee Hansard*, p. 361 (Mr Michael Roche, Mr David Learmonth)

42 *Committee Hansard*, p. 373 (Ms Kim Isaacs)

Chapter of the International Test and Evaluation Society. The Committee Chair (Senator Cook) sought a response from the DMO to the trenchant criticism contained in the following extracts from the paper:

Parts of the DMO are now dominated by a culture of bullying and rule by fear, where no-one is safe to suggest that decisions or initiatives may be wrong, or to make constructive suggestions. For DMO employees, 'stepping out of line' is likely to damage their careers within Defence. ... There is also a great fear of whistle-blowing..... One supposes that, in a climate that suppresses criticism and has a tendency to shoot the messenger, those who can see the problems are expected to grit their teeth and continue on regardless.

.Don't blame the workers... I've generally found DMO staff, both uniformed and civilian, to be at least on a par with their industry counterparts... I've also found their work ethic to be well above average, particularly with regard to their honesty, dedication to their tasks and loyalty to their employer. They deserve better.

Perhaps the saddest reflection on Defence's attitudes to acquisition reform is the fact that I could not have expressed these opinions in public unless I had retired from this sort of work. I could just not have afforded to take the risk in the current atmosphere of DMO.⁴³

3.62 The Under Secretary Defence Materiel responded as follows:

It is disappointing. That person obviously felt that... From my getting out and about in the organisation, I believe it is a pretty open organisation. Certainly people feel pretty free to say things to me and to put their views forward. We are trying to create a culture: we want people to argue with us and debate the issue. In an engineering based organisation, the last thing you want is people who are not game to say when they think they have a problem. If people think there is a better way of doing the job, then we are keen—we are all ears—to hear about it. I am sorry about the individual, but it is not consistent with the culture of the organisation we are trying to build. I do not think that a single one of my senior executives here would say that there is any culture within their part of the organisation that is consistent with what that person complains about.⁴⁴

Last year for the first time we brought together all the executive level 1s who were 'direct reports' to one stars and a certain number of others. There would have been I think nearly 300 of these people at the National Press Club. Basically it was about 'me and them'. The opportunity was there—through syndicate work, people could be de-identified—to put forward any number of suggestions. I have to say that none of the flavour of what that person complained about came through in that meeting. There were a hell of a lot of suggestions and a hell of a lot of proposals about doing things better

43 Extracts from paper prepared by Mr A Gabb and presented at *SETE 2002* Conference

44 *Committee Hansard*, p. 369 (Mr Michael Roche)

and differently. But there was certainly none of that feeling that this was an organisation ruled by fear. It was a very open and interactive session.⁴⁵

3.63 The Committee notes the Under Secretary's observation that the complainant was 'one person in 8½ thousand.', and also acknowledges his remark that: It is really a 'Have you stopped beating your wife?' sort of allegation.⁴⁶

3.64 However, the Committee cannot ignore the fact that the criticisms were strongly made in a public forum, and that the criticisms resonate with other claims made to the Committee in some confidential submissions and private communications. The Committee's concerns are reflected in the comments by Senator Johnston at a public hearing.

We have some anonymous submissions that border on that sort of commentary, obviously from people who want to intimate the sort of flavour that this particular person has enunciated. I have a lot of sympathy for your position on this, because an organisation of your size is bound to run into the odd bod who wants to take ... issue. But it strikes me that we are seeing more than just the odd bod. I am not overly concerned, but... [w]hen, early in the piece, we get these submissions both at this table and in writing—we are talking about something between half a dozen and a dozen submissions, comments and informal meetings with industry—that have an air of disquiet about the flavour of the relationship both internally and across contractual lines, it is something that we have to raise with you.⁴⁷

3.65 The Committee acknowledges that the criticisms of the DMO may be the random claims of the disaffected who have seized the opportunity of a Senate inquiry to make their point.

3.66 But when the flavour of the critical commentary seems to coalesce with the results for the DMO coming out of the Staff Attitude Survey; when its tone is set alongside that conveyed in the reported remarks of LtGen Des Mueller in his farewell speech to Defence personnel; when industry people are reluctant to speak in public and express fear of 'pay back' for criticism, articulating their views privately with considerable passion—then the Committee cannot lightly dismiss what has been placed before it.

3.67 Clearly the Committee is not in a position to form solid judgments on these matters, and has no power to enter the fray as mediator or arbiter. However, given that 'cultural change' has been a concept raised frequently by both Defence officials and industry representatives in the course of this inquiry, and that terms such as 'culture of blame', 'group think' and similar have found their way to the Committee's ears, the Committee wishes to address these matters if only in a preliminary way.

45 *Committee Hansard*, p. 370 (Mr Michael Roche)

46 *Committee Hansard*, p. 371 (Mr Michael Roche)

47 *Committee Hansard*, p. 371 (Senator David Johnston)

3.68 ‘Culture’ is a notoriously slippery word to define. In this context, the Committee regards the ‘culture’ of an organisation to be the sum total of workplace behaviours, attitudes, values and assumptions as these are manifested in the management style, decision making processes, client treatment and interpersonal dynamics of those who serve the organisation.

3.69 Dealing with an organisation’s ‘culture’ goes to questions of how people do things and how things get done; how things are communicated within the organisation and to those outside; how people are rewarded; how leaders model the values and behaviours they wish to inculcate in others; how the organisation and its people adapt and innovate in response to changes in their environment.

3.70 The Committee regards these matters as best addressed through an ‘auditing’ of the existing culture in order to identify suitable strategies for effecting cultural change, and urges the DMO to devote substantial effort to such a task.

3.71 The following remarks are adapted from advice posted by a British company specializing in cultural change.⁴⁸ The Committee regards them as having a serendipitous relevance to the DMO’s present circumstances:

- When a new organisation is born, there is a burst of energy among its members. A corporate culture seems to form rather quickly. The policies and work procedures that are formally documented articulate what kinds of behaviour and attitudes are considered important for success. The corporate culture may be very functional at first, but over time the culture becomes distinct from the formal strategy, structure and systems that sought to shape it. The DMO is not a new-born organisation. Its reformed ‘culture’ is probably still largely embodied in its ‘strategy, structure and systems’ rather than fully embedded in people’s actual workplace behaviours and attitudes. In reality, DMO’s ‘new and improved’ culture is probably still a blend of old and new attitudes, processes and values, all being acted upon, and in turn reacting to, the functional/structural reforms.
- Achieving cultural change means probing below what is visible, in flowcharts, rule books, manuals and manifestos, into the world of people’s actual feelings, beliefs, perceptions, attitudes, and behaviours. The DMO, and Defence generally, seems eminently skilled at devising and documenting processes. Getting the good practice out of the manuals and into the mindsets is where the challenge really lies. The Committee will monitor DMO’s response to this challenge over the next few years, using information from staff surveys and industry scorecards as well as careful scrutiny of the efficiency of project management.
- Situational forces, while important in shaping culture, cannot compete with actions of key individuals. For example, the managers’ objectives,

48 Available at <http://www.organisationalchange.co.uk>

principles, values and especially behaviour provide important clues as to what is really wanted from all employees. Employees take note of all critical incidents that stem from management action. These become an enduring part of the organisation's folklore, indicating what the organisation really wants, what really counts in getting ahead or, alternatively, how to stay out of trouble. They are the unwritten rules of the game.

- Effecting cultural change requires accurate information (from all areas), commitment (from top to bottom), and multi-levelled and functional groups actively participating in cultural change management techniques to promote new norms. Just as old cultures can become out-of-date and dysfunctional, the same can happen with new ones. If the cultural change is not managed explicitly, it may be just a matter of time before the organisation is once again disrupted. But, if cultural change in the DMO is managed explicitly, it can expect significant improvements in both morale and performance.

3.72 These remarks are intended both as guidance and encouragement to the DMO. The Committee invites the organisation to reflect on its own practices in the light of the principles that they express.

Recommendation

3.73 The Committee recommends that

(a) the Senate request the Auditor General to direct that the proposed 2003–04 audit of DMO by the Australian National Audit Office include a cultural audit that will assess:

- **DMO's espoused corporate values and standards and staff compliance with these;**
- **management and staff values, behaviours and competencies measured against the capability requirement;**
- **employee attitudes, morale, beliefs, motivation;**
- **employee understanding of, for example, the DMO's customers, industry partners, strategies, business plans, roles and contributions to the overall mission of Defence;**
- **communication processes;**
- **the effectiveness of change management programs, employee commitment to them and the extent of the benefits materialising; and**
- **compliance with health and safety regulations; and**

(b) on the basis of that cultural audit the Under Secretary Defence Materiel shall engage a suitably qualified change management specialist to assist the DMO to respond to the findings and recommendations of the audit.

Complaint handling and disputes

3.74 Before it departs from the realm of ‘cultural change’, the Committee wishes to address the phenomenon of the so-called ‘disgruntled’ Defence supplier. It embraces both the apparent reluctance of Australian industry suppliers—disgruntled or otherwise—to publicly criticise Defence, and also the manner in which their complaints are dealt with by the DMO. This phenomenon has revealed itself to the Committee in various guises:

- The witness who says: “I did seek counsel from a colleague who runs a defence manufacturing business far greater than mine. His advice to me was not to appear at this hearing... I am sure that if [DMO] people wanted to make it hard for me they could”.
- The submitter who writes: “The Defence community is a network of contacts... We hear many disturbing stories of challenges to those who try and buck an inappropriate procurement system, including threats to serving personnel who are related to those civilians creating waves... As long as the culture of threat and fear presides within the defence supplier’s area, procurement will not be effective”.
- The reluctance of people in industry, including those approached directly by the Committee, to give evidence in public.
- The confidential emails and letters to the Committee that claim: “Before entering any discussions with Admiral ‘X’ we were warned not to upset him as he would walk out”; “...other cultures pervade Defence, namely the culture of blame, the culture of arrogance, the culture of denial, the culture of perception-is-reality. ... These issues are not only process related but also people related...”

3.75 The Committee is disturbed by all of the above. It cannot test the claims, nor can it remain totally unresponsive to them. The Committee cited the case of a particular complainant and asked the Under Secretary Defence Materiel how he felt about claims that to publicly criticise Defence would have adverse consequences. Mr Roche replied:

I have to say that I find it offensive to have it even suggested by those people. I think that we are big enough and ugly enough to take criticism... I do fear sometimes that some people confuse the loss, for good and valid reasons, of a tender in competition with a drought or being...victimised. In the time that I have been in the DMO, I have had a number of criticisms made to me by people who are concerned that they have been victimised. I have yet to find a case that I believe stood up... Any complaint along these lines concerns me. I certainly look at them in considerable detail and my staff will tell you that we certainly put them through their paces in testing this. I quite commonly appoint an independent person to look at complaints. We use the inspector-general. There are a variety of ways we test these things. To date, as I said, I have yet to see one case stand up. I have seen cases where we perhaps have not explained ourselves as well as we might

and cases where the process has not been as robust as you would like, but I have not seen cases where people have been victimised.

3.76 The Committee accepts Mr Roche's evidence in good faith, appreciates the requirements for due process that are mandated in public service codes, and does not question Mr Roche's commitment to, or the sincerity of his actions in seeking to honour, those codes.

3.77 But the Committee has no way of actually assessing the adequacy or effectiveness of the processes undertaken within the DMO to deal with complaints when they arise. For example, how commonly *are* independent persons used to deal with complaints? Does that occur in a *timely* way? Are complaint handling procedures *systematic and transparent*?

3.78 In one instance, the Committee has had the benefit of reading the report of an independent assessor brought in to deal with a complaint. It is not appropriate to expose its full detail, but some of the assessor's conclusions and recommendations are germane to several of the issues explored above. These are a *selection* only.

- There was no evidence that the complainant had been 'sent to Coventry' by Defence, nor was there any conspiracy involved.
- There was evidence that rumours spread by individuals within Defence had adversely affected the complainant. Attempts to deal with rumours had had limited effect.
- Documentation in one contract was confused, did not meet standards and was a major factor in the contract's failure.
- In proceeding to a decision to terminate the contract insufficient weight was given to the part played by defective administration by Defence.
- There was no evidence of any duress or unconscionable conduct by Defence in terminating the contract.
- Communication failures played a major part in fomenting the problems between the complainant and Defence.
- There is a view within some enterprises that DMO lacks the understanding and skills to work effectively with industry.
- A case management approach should be adopted to dispute resolution, involving the appointment of a suitably qualified person at an appropriate level and with a clear understanding of their role and authority and with access to senior management.

3.79 At this stage the Committee merely notes—neither endorses nor rejects—these findings, but considers the extracts helpful in forming the Committee’s views about the handling within the DMO of complaints from industry, especially from the so-called ‘disgruntled supplier’.

3.80 Because the focus here is on complaints from industry, the Committee is inclined to seek a solution to these kinds of problems through the auspices of the DMO’s Industry Division. That Division has an express responsibility to liaise and consult with industry, to translate its advice and interpret its needs to other sections of the DMO. To that extent, Industry Division is the suppliers’ friend at court, the home of those Defence officials whose job includes advocating on industry’s behalf and who would facilitate, promote and monitor internally the DMO’s engagement with industry.

3.81 The Committee is supportive of a case management approach to dispute resolution—but would not see every complaint automatically referred to a case manager. The Committee imagines that, in most instances, complaints from a contractor or supplier are made in the first instance to their usual contact in, say, a DMO Project Team or SPO.

3.82 It is only after a failure in genuine attempts to resolve the complaint at the level of the two parties most immediately concerned, or possibly after further referral to a section head, that a case management process should be instituted. Australian Business Ltd submitted firm views about their preferred approach to industry grievances.

[W]e do see the need for more effective and reliable consideration and handling of the concerns of industry resulting from the acquisition process. Our view is that the Industry Division and the Contracting Policy Branch of Land Systems Division ... are well suited to ensure... that grievances with the tendering process are properly investigated.

3.83 The Committee concludes that case managers should be drawn from a panel of appropriately qualified and experienced officers from Industry Division whose appointment to the panel has been endorsed by the Defence Industry Advisory Council or by other relevant defence industry peak bodies. Case managers should be given suitable training and be granted considerable licence to deal with whomever they deem appropriate within the Defence Organisation in the course of resolving a dispute. Their report and recommendations should go direct to the USDM, with copies to the relevant Project Governance Board (where applicable) and the VCDF.

3.84 The Committee is alert to the risks of a dispute process impacting adversely on the progress of business—for example, on the timeliness of a tender process. The fact that a dispute has arisen should not, in the normal course of events, mean that a tender process is placed on hold pending the dispute’s resolution. But the Committee believes that the case manager should have the power to recommend to the USDM an immediate pause in tender proceedings if the case manager regards the problem as sufficiently serious to warrant that course of action.

3.85 The Committee notes that the Defence Service Charter sets out in general terms what people can expect if they contact Defence with a question or complaint. It is not clear, however, whether a systematic complaint handling process has been specified for the DMO. When asked whether DMO has a formal complaints mechanism or complaints officer, DMO officials replied:

Complaints can come into the organisation at any stage. People use everyone from the minister onwards. It is really up to the individual. I do not know that we actually have a formal place... But as I said to you earlier, anything significant about a process or whatever will land on my [USDM's] desk. At the very least it will be on a two-star's desk, and I would expect them to consult with me if there is any significance in it at all. Then, generally, I will make the judgment as to whether we appoint an independent person, either somebody within the organisation who has not had contact with it before or somebody from outside the organisation to follow it through.

Ms McKinnie—Indeed, the process that usually operates, although it is not written down as a formal process, is that if an industry player has a complaint associated with a particular contract manager, they will usually escalate it to the next level. If it is dealt with there, then the complaint is finished. If they are not satisfied, then they will go to the next level. That is a fairly established process, and it generally works.⁴⁹

3.86 There is an element here of 'Caesar judging Caesar' and the Committee believes that it would be extremely helpful if the DMO developed a systematic approach to complaint handling and published a clear account of the process so that potential complainants would know exactly what to expect in terms of how their concerns will be dealt with.

3.87 The outcome of any dispute resolution process—that is, a decision on the matter by the USDM—would not preclude the complainant appealing against such a decision to the Minister for Defence. The Committee believes that in the event of such an appeal, each case would have to be determined by the Minister on its merits.

3.88 The Committee suggests that the '15 working days' rule specified in the Defence Service Charter for responding to written correspondence is also an appropriate time for a complaint to be resolved by the DMO, with provision for referral of the matter to more senior levels as follows: The official most directly involved with the complaint, and who presumably is the first to receive it, has ten working days to effect a resolution. If the matter is not resolved at that level, the matter shall be referred to the next level (section head or above). If after 5 working days the matter referred is not resolved, a case manager should be appointed. The case manager has 15 working days to conduct an investigation and make recommendations to the USDM. If it is not possible for the USDM to make a decision on the recommendations within 5 working days, the complainant shall be so advised in

49 *Committee Hansard*, pp. 362–363 (Mr Michael Roche, Ms Shireane McKinnie)

writing, and a time specified by which a decision shall be forthcoming. That specified time shall be no later than 10 working days from the date at which the written advice is dispatched to the complainant.

Recommendation

3.89 **The Committee recommends that:**

- (a) a panel of suitably qualified case managers, endorsed by industry, be established within the Industry Division of the DMO to handle complaints or disputes that have not been resolved in a timely way between the two parties immediately concerned;**
- (b) the case managers be trained, and given broad powers to explore issues across all levels and divisions within DMO and the relevant Service arm;**
- (c) case managers shall report their findings and recommendations to the Under Secretary Defence Materiel, with copies to the Vice Chief of the Defence Force and the Project Governance Board (where applicable);**
- (d) the DMO publish an account of its complaint handling and dispute resolution method which sets out the timelines to be observed, the role and powers of case managers, and specifying the USDM as the ultimate decision maker in respect of a dispute.**

Other issues raised by industry

Unsolicited proposals

3.90 The context for the pursuit by Defence of unsolicited proposals from industry seems to lie in the Defence and Industry Strategic Policy Statement *Team Australia* of 1998. Among other things, the Statement declares:

- Defence will establish new ways to involve Australian industry in Defence business (p. 1)
- Industry is fundamental to the *development* of new capabilities (p. 5)
- Defence needs capabilities customized to its unique environment. (p. 6)
- Defence looks to Australian enterprise... particularly to sharpen the knowledge edge (p. 6)

3.91 The Statement provides quite explicitly for industry to take the initiative in bringing its innovations and ideas to Defence's attention.

Firms that offer a constructive flow of *information to Defence* will have the opportunity to influence decision-making and receive recognition as 'key players'. Industry advice can assist Defence to face the challenges of the future in innovative and efficient ways. Defence will benefit from industry advice on issues such as technology trends and trade-offs between cost and

capability. This information is a key input to its long term planning for capability development...⁵⁰

3.92 *Team Australia* also states that ‘Defence will expand the CTD (Capability and Technology Demonstrator) program to provide much greater scope for industry initiated R&D proposals’.⁵¹ The CTD program aims to show ADF users how leading edge technology can be integrated quickly into existing, new, enhanced or replacement high-priority capabilities. Proposals for the CTDs focus on activities in which the risk element relates to the application to Defence’s priorities rather than the underlying basic science.

3.93 The DSTO is essentially responsible for the CTD program through its CTD Program Office in Canberra. The Committee notes that some of the features of the CTD policy include:

- CTD proposals compete against each other to determine the best proposals for that financial year.
- CTDs can be proposed by any interested party.
- CTD proposals must have an ADF sponsor.

The final area where [DSTO and DMO] cooperate is in our CTD program. The thing that distinguishes the CTD program from a normal project in the end is that you generate intellectual property. That is effectively what the CTD program does. I have embarked on a program, as the CTD program has matured, to improve the way that we manage our intellectual property in the CTD program, but that is another strand to the intellectual property issue in DSTO... The CTD program is now starting to mature and [USDM] is very interested in how that is developing. I would like to see that continue.⁵²

3.94 The Committee understands that the CTD program is a discrete program, distinguishable from ‘unsolicited proposals’. However the Committee has been unable to establish any clear account of the success or otherwise of ‘unsolicited proposals’ to date.

3.95 The Committee notes that the June 2002 edition of the booklet *Doing Business with Defence* contains brief directions on submitting ‘unsolicited proposals’. There is, however, no mention of ‘unsolicited proposals’ in the Australian Industry Involvement Manual, and a search of DMO’s website revealed only that policy and guidelines on UPs would be ‘released in 2003’. UPs are not mentioned in the June 2002 edition of the Defence Materiel Guide, nor the Defence Annual Report.

50 *Team Australia* (1998), p. 12

51 *Team Australia* (1998), p. 18

52 *Committee Hansard*, pp. 171–172 (Dr Timothy McKenna)

3.96 There is, however, a reasonably detailed account in the *Capability Systems Life Cycle Management Manual* setting out how unsolicited proposals are to be handled. The *Manual* declares that ‘a web based information tool will be established that will provide the necessary information for a potential proponent to prepare and submit a UP to Defence. The tool will incorporate detail on the handling of confidential information and Intellectual Policy.’⁵³ This appears still to be unavailable at the time of this Report.

3.97 A significant reference to ‘unsolicited proposals’ appears in a ministerial speech to the Defence National Procurement Conference in June 2001.

I am pleased to announce that cabinet has agreed to consider proposals for private financing if they provide value for money. Government has recognised the potential benefits of accessing private capital to bring forward major infrastructure proposals and in allowing access to efficiencies through private sector expertise and management structures... I have recently had discussions with the DIAC about the criteria that might identify projects as suitable for private financing.

In addition, noting that an increasing percentage of the unsolicited proposals that Defence receives from industry have a private financing element, it is time that Defence had a structured process for dealing with such proposals. Accordingly, a review also has been initiated at my direction this subject and will report to DIAC in due course.⁵⁴

3.98 The Committee is aware that several firms have submitted unsolicited proposals to Defence, but the general feedback from industry is that they are frustrated by the lack of progress.

Additionally, 12 months ago, I was involved in working with Defence policy in regard to the handling of unsolicited proposals. One of the main issues in research and development for SMEs is the ability for that SME to ascertain whether the project or the technology which they have identified as being a possible research and development project has any future value to Defence. We were looking to instigate with Defence a methodology or a pathway for unsolicited proposals whereby Defence could say, ‘Yes, that has potential’ or, ‘No, it doesn’t’ prior to the SME expending considerable funds and assets in researching the capabilities for that unit.

It is now some 12 months since Defence flagged the unsolicited proposals capability. They have now been through three different Defence officers in that period and they are still deliberating on the non-finalisation of IP issues over that. From this hearing, we would like to see acceleration given by Defence to the finalisation of that and the opening up of a pathway for unsolicited proposals. Certainly from the other side of it, and talking to

53 *Capability Systems Life Cycle Management Manual*, para 4.57

54 Minister for Defence (Hon P Reith, MP) *Australia Needs a Strategic Approach to Defence Industry Policy* Presented at The Defence National Procurement Conference, 26 June 2001

Defence, there is a great deal of deliberation on the quality of unsolicited proposals that fall to them. That can be overcome by the promulgation of a formatted requirement for the submission, as well as the submission being required to include certain technical explanations to ensure that it has potential viability from a commercial point of view.⁵⁵

3.99 The Committee notes that the confidential report of an independent assessor dealing with a firm that had concerns about the handling of an unsolicited proposal concluded that there were ‘growing perceptions’ within industry that the current arrangements for unsolicited proposals are ‘not working effectively and are becoming counterproductive in terms of relations with Defence.’

3.100 The Committee has had the benefit of inspecting the laboratories and workshops of several SMEs, including some who are very much at the ‘knowledge edge’. It is clear to the Committee that the potential benefits of providing for these firms to bring their ideas and innovations before Defence in a systematic way are considerable.

Recommendation

3.101 The Committee recommends that the Defence Industry Advisory Council commission the development of an efficient formal mechanism for the promotion and handling of unsolicited proposals from SMEs. That mechanism should be applied at the level of the System Program Offices and be coordinated by the DMO’s Industry Division. Receipt of unsolicited proposals should be promptly acknowledged, and a time frame specified within which follow-up should occur.

Private financing initiatives

3.102 Along with representations concerning unsolicited proposals, the Committee received similar concerns with respect to shortcomings in the government’s commitment to the so-called ‘private financing initiative’ or ‘public private partnerships’ (PPPs).

3.103 A submission from ABN.AMRO Australia Pty Ltd set out for the Committee a detailed argument for, and a documented account of, public private partnerships.⁵⁶ The company describes PPPs as ‘a partnership which leverages respective skills of public and private sectors’, which is eminently suitable for ‘the delivery of infrastructure and other capital assets’ where the ‘government is responsible for core services’, and where risk is allocated ‘to the party best able to manage it.’ The submission presses the benefits of a PPP over traditional procurement arrangements in terms of both cost and time, and claims a greater value-for-money outcome for government.

55 *Committee Hansard*, pp 225–226 (Mr Michael Turner)

56 *Submission 6* (ABN.AMRO Australia Limited)

3.104 The Committee was impressed by the examples of existing successful PPPs across various enterprises and services from hospitals and waste management to vehicle fleets and court buildings.

3.105 Australian Business Ltd, which represents over 250 defence contractors of various sizes, was similarly emphatic about the need to activate opportunities based on private financing initiatives.

Since it was first identified [in 2000] as offering genuine potential to help address defence funding challenges... the Private Finance Initiative (PFI) has left industry frustrated and searching for a way forward. We believe that progress can be achieved on two fronts: earlier consultation of industry by government in terms of selecting those projects most suited to PFI and secondly a more informed and whole-of-government approach to the policy pertaining to PFI and the manner in which PFI bids are addressed.⁵⁷

3.106 The Committee did not explore the extent to which Defence has already been involved in discussions with potential private financing partners, but notes that in December 1998 the Department commenced a review of options for the greater use of Private Financing as a procurement method. The report provided a framework of guiding principles and a series of recommendations to ensure a more comprehensive use of Private Financing in Defence. In addition to the departmental review, the Defence and Industry Advisory Council (DIAC) was commissioned to consult industry to examine opportunities and constraints.

3.107 Private financing also receives attention in the *Capability Systems Life Cycle Management Manual*. According to the *Manual* Defence's interest in private financing turns on the question of Value for Money (VFM), and the potential to transfer some risks normally managed by Defence to the private sector. Consideration of private financing initiatives is best undertaken during the Requirements Phase.

3.108 The Committee notes that the Defence website includes a specific link to Private Financing Initiatives, which reports:

The Directorate of Private Financing and Commercial Support (PFCS) assists the effective implementation of Private Financing across the Defence Organisation. PFCS's role is primarily based on coordination and advice, ensuring that opportunities for Private Financing are brought to the attention of senior Defence personnel, and that group Managers and their staff use PFCS to validate the suitability or otherwise of proposals for Private Financing.

The key point is that PFCS provides advice and assistance - it is not a decision-making body. Group managers and their staff must, at least initially until processes are more mature, consult with PFCS on the feasibility of proposals for Private Financing. Ultimately, accountability for decision-making resides with existing approval authorities.

57 *Submission 23*, p. 2 (Australian Business Limited)

PFCS is located in Group Performance Branch in Business Strategy Division of the Chief Finance Officer's Group.⁵⁸

3.109 The Committee appreciates that private financing initiatives—especially in the form of public-private partnerships—tend to appear in infrastructure projects for which state governments are responsible. To date, the Commonwealth has not entered into a privately financed project.⁵⁹

3.110 Perhaps the clearest statement of the government's present position is to be found in a speech by the Minister for Revenue and Assistant Treasurer (Senator the Hon Helen Coonan) to the Australian Financial Review Infrastructure Summit in August 2002:

The Minister for Finance and Administration recently indicated that there currently appear to be limited opportunities for the use of private financing at the Commonwealth level. However, in saying that, it is important to emphasise that individual proposals will continue to be evaluated on the basis of their ability to offer value for money to the Commonwealth.⁶⁰

3.111 The Committee received no evidence concerning the outcome of the DIAC consultations with industry about public private partnerships. It appears, though, that any real progress with private financing initiatives will only be achieved through a whole-of-government approach.

3.112 The Committee notes that in June 2002 the Minister for Finance and Administration issued the Commonwealth Policy Principles for the Use of Private Financing. This builds on the Commonwealth's resource management framework and budgeting processes. It establishes policy principles and processes for the use of private financing by Commonwealth departments and agencies who are subject to the *Financial Management and Accountability Act 1997*.

3.113 A Private Financing Branch has been established within DOFA to assist Commonwealth agencies considering private financing proposals. The Branch has several roles: it provides advice to Government and agencies on the use of private financing arrangements, it assesses specific proposals, and it will oversee, on behalf of Government, the application and development of the Private Financing Principles.

Defence—industry partnerships

3.114 The language of 'partnership' has been prominent in Defence industry policy for many years and received particular emphasis in the 1998 Strategic Policy Statement *Team Australia*. Defence–industry partnership continues to be stressed

58 <http://www.defence.gov.au/cfo/privfin/>

59 Dept of the Parliamentary Library Research Paper No. 1, 2002–03, *Public Private Partnerships: An Introduction*, p. 14

60 Cited in Research Paper No. 1 2002–03, *Public Private Partnerships: An Introduction*, p. 15

throughout recent key documents, the 2000 *White Paper*, and the Defence Capability Plan.

3.115 The Committee will address the nature of specific partnerships between firms and Defence in the chapter dealing with contracts and projects. At this stage the Committee is focusing on the principles and policies of partnership as a strategic concept.

3.116 The Committee notes the strong statements on Defence–industry partnerships made by the government in 2001.

The unclassified Defence Capability Plan... has 21 different cost bands, compared with only 8 cost bands in the previous paper. It now covers a ten-year forward period rather than the previous five years and it has doubled in size to almost 300 pages. This means that those of you who are in the defence industry have a solid and more predictable base for your long term corporate planning. The government recognises—as we said in the Defence White Paper—that it has an important role to play in setting out clear long term directions for the development of the ADF to provide a more predictable and sustainable basis on which industry can plan...

The Defence White Paper... enables Australian defence industry, for the first time in peacetime, to plan ahead in the knowledge that there is sustainable defence business in Australia.

We must now think about how we can link defence acquisition projects together strategically so that we can create an environment that will lead to a sustainable defence industry in Australia. ... but I recognise that Defence's military requirements of industry, and its monopsony purchasing power, give rise to some peculiar characteristics that make it different from normal commercial business.⁶¹

3.117 These views seem to resonate strongly in the advice which has come to the Committee from industry during this inquiry. The Australian Industry Group, for example, identified among its three main goals:

to ensure that Australian industry capabilities are integral to Defence requirements on the basis of a genuine partnership between Defence and industry.⁶²

3.118 The AIG also reported its close involvement in the development of the 2000 *White Paper* in which the Group called for:

- recognition that a strong defence industry is an inseparable component of national Defence capability;

61 Minister for Defence (Hon P Reith, MP) *Australia Needs a Strategic Approach to Defence Industry Policy* Presented at The Defence National Procurement Conference, 26 June 2001

62 *Submission 20*, p. 1 (Australian Industry Group Defence Council)

- a clear understanding that, as opposed to 15 years ago, significant elements of defence capability are now provided by Australian industry;
- recognition of, and belief in, the long-term benefits of involving Australian industry in capability development, acquisition and through-life support;
- the Government’s articulation of its strategies to sustain and enhance Australian industry’s contribution to defence capability;
- adoption across all levels of the Defence Organisation of these strategies and commensurate changes in culture and practice; and,
- the Government’s articulation of its expectations of industry.⁶³

3.119 The Committee is strongly of the view that a strategic approach to Defence–industry partnerships is critical to the nation’s capability development and to enabling Australian firms to consolidate their business and become significant contributors to the global export chain.

3.120 The Australian Industry Group Defence Council expressed support for the 2001 ministerial statements regarding the problematic nature of project–by–project procurement when what is required is a strategic approach to capability development. They argued that :

...the sectoral plans should result in true alliances being developed with sustainability of Australian Defence Force capability, and therefore, appropriate in–country development and support being their goals. Regardless of their final structure, the Australian Industry Group Defence Council would expect that the key elements of the plans would be consistent with:

- a more strategic relationship between Defence and industry;
- the adoption of a whole-of-life approach to the development and management of capability for the ADF; and
- a clearer view of the industry outcome required as well as a long-term view of how that is to be achieved.

The Australian Industry Group Defence Council would expect, also, that underpinning this approach would be a strong focus on targeted exports, a commitment to maximising the use of Australian industry and the involvement of local small and medium enterprises, and a stronger commitment to indigenous research and development—not only within government and tertiary institutions but also facilitating this research in industry.

63 *Submission 20*, pp. 1–2 (Australian Industry Group Defence Council)

The Australian Industry Group Defence Council's view is that a sustainable defence industry base will be achieved through this combination of Defence, the industry champions and their supporting network of contractors and suppliers throughout all the tiers working together, rather than through the establishment of arbitrary targets in single project stovepipes.⁶⁴

3.121 The Committee understands that the Australian Industry Involvement (AII) program has been revised 'to cement the involvement of a sustainable local industry in the nation's defence.'⁶⁵ In particular, the AII Program now aims to 'link more clearly to Defence's strategic priorities' and 'target strategic priorities more clearly'.⁶⁶

3.122 In June 2003 it will be five years since the launch of the 1998 Defence and Industry Strategic Policy Statement *Team Australia*. The Committee believes that it is time to capture a snapshot of the extent to which that policy has been successful.

Recommendation

3.123 The Committee recommends that:

(a) in the latter half of 2003, the Defence Materiel Organisation convene a major seminar involving relevant Defence and industry representatives to assess the effectiveness of the 1998 *Team Australia* policy and to shape recommendations accordingly; and

(b) the proceedings of the seminar be tabled in the parliament along with a response from the Minister for Defence to the recommendations emerging from the seminar.

3.124 The Committee will monitor closely all aspects of the relationship between industry and Defence, paying particular attention to the strategic dimensions of Defence industry policy. It will be guided in this monitoring task not only by the *2000 White Paper* and the Defence Capability Plan, but also by the document *Defence Needs of Australian Industry*. This last document describes the key capabilities identified by Defence and Australian companies that are strategically important and commercially realistic for the defence of Australia, and is used to inform priority settings in areas such as export facilitation and capability and technology demonstrators.

64 *Submission 20*, p. 3 (Australian Industry Group Defence Council)

65 Defence Materiel Organisation, *Australian Industry Involvement Manual 2001*, p. (i)

66 Defence Materiel Organisation, *Australian Industry Involvement Manual 2001*, Chapter 2, point 8