

UNCORRECTED TRANSCRIPT OF ORAL EVIDENCE

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TAKEN BEFORE THE

DEFENCE COMMITTEE

STRATEGIC DEFENCE & SECURITY REVIEW

WEDNESDAY 8 SEPTEMBER 2010

IAN KING, RICHARD MARTIN, REAR ADMIRAL REES WARD and DR SANDY WILSON

Evidence heard in Public Questions 1 - 82

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Oral Evidence

Taken before the Defence Committee

on Wednesday 8 September 2010

Members present:

Mr James Arbuthnot (Chair)

Mr Julian Brazier

John Glen

Mr David Hamilton

Mrs Madeleine Moon

Alison Seabeck

Bob Stewart

Ms Gisela Stuart

John Woodcock

Examination of Witnesses

*Witnesses:* Ian King, Chief Executive Officer, BAE Systems and Chair of the Defence Industries Council, Richard Martin, Chairman, Kembrey Wiring Systems Ltd, and SME Representative on Defence Industries Council, Rear Admiral Rees Ward, Chief Executive Officer, ADS Group Ltd, and Secretary, Defence Industries Council, and Dr Sandy Wilson, President and Managing Director, General Dynamics UK, and VP-Defence, ADS Group Ltd gave evidence.

*Chair:* Welcome to the Defence Committee and thank you very much for agreeing to give evidence to us about the strategic defence and security review. I wonder whether you would be kind enough to introduce yourselves, not that you are unknown to the Committee, but nevertheless it would be helpful to have all these things on the record. Shall we start with you, Dr Wilson?

*Dr Sandy Wilson:* My name is Sandy Wilson. I'm managing director of General Dynamics UK and vice-president of defence for the trade association, ADS.

*Ian King:* I'm Ian King, CEO of BAE Systems and chairman of the Defence Industries Council.

*Rear Admiral Rees Ward:* I'm Rees Ward. I'm the chief executive officer of ADS, the trade association.

*Richard Martin:* I'm Dick Martin, chairman and chief executive of Kembrey Wiring Systems and SME lead on the DIC.

*Q1 Chair:* I will start with a Mandy Rice-Davies comment, which is not intended to be insulting, but there will be some who watch, listen to or read what you say and come to the conclusion, "They would say that, wouldn't

they?" So if during this evidence session we can do our utmost-obviously, we won't be able to avoid the risk entirely that that will happen-to avoid talking about individual programmes that would help your particular industries, I'm sure you will be extremely helpful on that.

This strategic defence and security review seems to be being conducted at a bit of a pace. Is it going too quickly? Who would like to begin?

*Ian King:* When we last gave evidence, or quite a few of us gave evidence, in December 2009-I think it was on 8 December-we said that we would be very uncomfortable if the process was driven purely by budgetary constraints and that we recognised the challenges on Government, but we really wanted the process to be taken right the way through to the conclusion of looking at foreign policy and looking at the vision for the force structure, which then could determine what a set of programmes would be and what the impact on the defence industrial strategy would be. There should be a defence industrial strategy out of this, because otherwise we in the defence community wouldn't know how to react to the requirements of the defence capabilities.

We understand the need for pace. We were uncomfortable with it at the start, but it was on the basis that following the SDSR, there would be a defence industrial strategy, which I know informs the defence industries technology policy. That's the basis that we're working on-that at the end of this process there will be something that industry can react to in terms of its resources, the capabilities and the programmes. We do need granularity on this, and you can see the impact on share prices with the uncertainty that exists out there in the marketplace.

*Rear Admiral Rees Ward:* When we started off, as Mr King has described, there was a hope that the SDSR would be running in echelon, very close up with a defence industrial policy of some sort, so that when the decisions were taken within the SDSR, they would be taken with the industrial implications fully understood. As you took policy down into capabilities, down into actual programmes and plans, towards the end of the SDSR there would be a linking in of industry, so that as the SDSR reached fruition and the key decisions were starting to become visible, the industrial input and strategy could start to form, so you had a fully informed set of decisions. I'm talking about the SDSR and, as it is now called, the defence industrial technology policy running in echelon, so that you had a fully informed discussion and decision set.

Q2 Chair: Do you think this is a fully informed discussion at the moment?

*Rear Admiral Rees Ward:* I don't think so. It is purely because the SDSR has to go at pace, because it has to mesh in, as we understand it, with the

comprehensive spending review. Our concern in industry is the potential for a detachment between the SDSR process and the DITP.

*Ian King:* We said previously that we recognised and wanted there to be a balanced budget, and so the concept of tying it in with the comprehensive spending review-once and for all there would be a balanced programme which we could respond to. That is something we wanted. We take it as read that there will follow on from that the equivalent of the defence industrial strategy, because without that we would not and will not know how to respond. We are making decisions today in isolation from that. We are having to make pretty hard decisions on resources, capabilities and sites in the UK structure.

Q3 Chair: Would anyone else like to add anything? Or has it been covered?

*Dr Sandy Wilson:* There has been quite a bit of input from industry to the overarching process. The ADS has put in information on how it would expect small and medium-sized enterprises to be engaged on R and T, on exports, on acquisition reform and on some of the underlying principles that might underpin the DIS-for example, an emphasis on systems integration as one of the core skills.

In one sense, the officials within the Ministry should have all that to hand when they come to make decisions. What we haven't had is much follow-up, caused by the speed at which the process is going on. But significant inputs have been made.

*Ian King:* And there are a lot of inputs going on at programme level-sector level is probably a better way of putting it.

Q4 Chair: This being a defence and security review, it is not run by the Ministry of Defence but by the National Security Council, from the Cabinet Office. Do you think that there is a sufficient degree of understanding within the National Security Council to conduct this process?

*Ian King:* Our inputs are into the Ministry of Defence. Our engagement is with the MOD. We do not have any official engagement with the National Security Council.

Chair: So really your answer would be that you don't know.

*Ian King:* I don't know. I don't know the structure of the final reports against the SDSR are going to be.

Q5 Chair: Is it of concern to you that a body which did not exist three months ago is running the defence and security review of the country?

*Ian King:* Yes, because we don't have any engagement with that body. We know that representation on that body is through the Secretary of State for Defence.

Q6 Alison Seabeck: You mentioned the disconnect between yourselves in the SDSR on the defence industrial strategy. Are you confident that by aligning the CSR, and therefore the Departments, with the process, the Treasury will take account of and understand the need that you and industry have for colleges and universities to be able to continue running training and apprenticeship courses, which support the skills that you want for your industries?

*Ian King:* It is a very good question. We have to ensure that, when we give inputs to BIS or anyone else, they understand the significance of the defence sector. There are 300,000 people in the defence sector. At any given time we have, even within my company, 1,200 people in training. So it is a fairly fundamental part of the education system. We are getting alignment and understanding of the importance of it. For you to ask me if I believe whether this is a fact that the Treasury would take into account, I don't know, because I don't know the criteria by which the National Security Council will put the SDSR into play.

Q7 Alison Seabeck: Are you confident that other Departments understand your needs and, therefore, will be lobbying indirectly and by speaking to Ministry of Defence officials?

*Ian King:* The Departments that we speak to understand the importance of defence to the economy and to the education system if we are going to create a more balanced economy and be less exposed to just the finance sector; I think that they do have a level of understanding now of the importance of defence.

Q8 Mrs Moon: This seems an appropriate place to bring in the question of whether or not they also understand the long-term viability for the defence and security of this country, and maintaining individual skill sets and capacity. The capacity to build a nuclear submarine is not something that can be picked off the shelf after popping down to the job exchange. Is there an understanding of the need to maintain capacity within the work force, and to maintain the independence of our own capacity by having a work force that can produce the defence equipment that we need?

*Ian King:* You have come to the nub of the matter. This is one sector where there are many lessons to be learned-they are hard for both customers and the industrial sector-when there are discontinuities in capability. If we look at the current nuclear submarine programmes that are going through, we learned

hard lessons on the Astute programme when there is a discontinuity between the end of one programme and the start of another. A number of sectors today also have major potential for discontinuities. I can give a couple of examples, and perhaps you will excuse me for going into areas of my business, but I will try to keep them to the sector.

On the carrier programme today, BAE Systems entered into a terms of business agreement with the Government to protect the key industrial capabilities for that sector which allowed you to sustain a warship capability, characterised by activity on the carrier, but leading then to what is called the future surface combatant and other programmes. If you terminate the carrier programme or other programmes without balancing that with an equivalent programme, you will lose that capability and you cannot reconstitute it at a later date.

We also face such potential issues in the air sector where it is probable, I suspect, that the SDSR will conclude that you will come down from a fleet capability of, say, four fast jets to two fast jets. In order to keep the capabilities required to ensure that the Typhoon, for example, can be kept alive and current in terms of capability and meet operational needs, you will need to have another development programme going on. That will not be a manned jet; it will be an unmanned capability, so there needs to be an unmanned combat air vehicle programme to sustain those core capabilities. Otherwise, you will not then be able to upgrade what will be the front-line jet for the UK's armed forces.

We are making sure, as best we can, that those issues are full and frontal in the decision process, because you cannot reconstitute that capability and you cannot take a capability holiday-I think that was the term used-and then come back to it. You are absolutely right that to leave the sector-there are enough lessons out there which show this-is both unaffordable and unachievable in terms of that factor.

Our concern is that as we head towards the SDSR-the comprehensive spending review-decisions will be made on force structure that could, although they may not be directly attributable to individual programmes, almost be made in the absence of a defence industrial strategy.

*Dr Sandy Wilson:* A point that I have made to this Committee previously is that the skills that might be divested of a reducing defence industry do not just sit there waiting to come back. They will be mopped up by other industries that need such skills. We are talking about high-level systems engineering skills, which are often described as hen's teeth. It is an area in which the country generally needs to invest more. You can think of the

upsurge in nuclear and alternative energy as being two areas that would mop up those people almost immediately. Then the question would be not of choice, but of them just not being there.

Q9 Bob Stewart: Forgive me if this naive, but aren't you international companies, and haven't you got rather large arms-for example, in the United States? So when you talk about a loss of capability, can't you pull the capability from your international arms? For example, if you lose a capability, British Aerospace has quite a large business in the United States, and I am sure that you all have. When you say that a loss of capability will never be recovered, I ask the rather naïve question, why not?

*Ian King:* If this were an open marketplace, you are right. But it is not an open marketplace; there are security restrictions.

Q10 Bob Stewart: Forgive me, but you have secrets that you can't translate across all companies-I know that.

*Ian King:* In the US, we operate under what is called the special security agreement. We are American in terms of technology and capability. Only if the State Department believes that that technology can be releasable to the UK-or any other country-would it be releasable.

Q11 Bob Stewart: I thought it was a naive question, but I am just asking because assuming that our greatest allies are the United States, and assuming that we didn't have the capability and the United States was our best ally, surely there would be some kind of-

*Ian King:* That is quite a big political move to take.

Bob Stewart: I know. That's why I'm asking it.

*Ian King:* Which is why at the time of the strategic defence and security review, we said that we need to start with the foreign and defence policy that the UK wants to undertake. What does it want its position in the world to be? What risk is it going to take about the capabilities it wants onshore? Those that it will accept may be at the vagaries of the open market or the restrictions of other countries in transferring them to the UK.

Q12 John Woodcock: First, I have a question for you, Mr King. You talked about the carrier programme. Are you being pressed to reduce the carrier programme to one or to zero? Where are you?

*Ian King:* The carrier programme is committed against two vessels. That's the current contractual commitment and that's what we're working against. We have been asked to look at a number of options. We were recently asked over

the past couple of weeks-probably in the past week or so-to look at a number of options. Contractually, the programme is for two vessels and that is what we are working on.

Q13 John Woodcock: Can you say what those options are?

*Ian King:* They range from having one carrier to having no carriers but with an equivalent other programme to look at the skills. There is quite a range of options so that decisions can be made.

Q14 John Woodcock: Presumably, from your starting point you will be working through this, but I am intrigued as to what kind of equivalent programme there would be to maintain that skills base.

*Ian King:* That's a debate that the teams are going through.

Q15 Mr Hamilton: Before I ask a question, it sounds to me like the old phrase of putting the cart before the horse. We need to get the strategy right and determine where we want to be in the world before we start talking about cuts. The cuts will take us to a place where we might not want to be. They are doing it the wrong way round. That's what is coming through and that's what many of us feel. With that in mind, what direct discussions has industry had with the Treasury in relation to this proposal?

*Ian King:* I will pass that to my colleagues, but to the best of my knowledge we have not had any direct involvement with the Treasury.

*Rear Admiral Rees Ward:* I can confirm that from a trade association point of view we have had no direct contact with the Treasury.

Q16 Mr Hamilton: Do you think that you should have a direct link to the Treasury given the circumstances and that this is being led by the Treasury?

*Ian King:* When we started this process we were told that it was about achieving a balanced budget. We were told that it would start from, as you said, being policy-led, which would then lead to what was coined as the 2020 vision where the force structure needed to be, and then it would start to look at the funding implications of that.

*Rear Admiral Rees Ward:* In fact, what has happened, we hope, is that it is policy led and resource informed. I suspect that the resource informed part is a hard line in terms of the way that this is being taken forward.

Q17 John Glen: Do you have any impression in the course of what is obviously a process that there has been a change in the nature of the conversation? Has there been some involvement of the Treasury in terms of what the MOD has been asked and what has been asked of you? It is one

thing not to have direct contact with the Treasury, but given the ongoing and detailed conversations that you have been having, can you detect or do you have a view about whether the Treasury has been more involved in recent weeks?

*Rear Admiral Rees Ward:* May I correct what I think might have been a misapprehension? I don't think that we've had ongoing and detailed conversations. I think that there have been bilaterals, as Mr King has explained, and Dr Wilson made the point that we have given a lot of evidence to the Ministry of Defence on how we think that industry feels about a number of issues that we will probably discuss later, such as research and exports and things like that. But the discussions have been sparse because the NSC has held the process very tightly. It's been held at that sort of level, and it is only now that we're detecting that the discussions and decisions of the NSC are starting to come down into the MOD's area, and we're starting to see capabilities and programmes being questioned. It is at that sort of stage at the moment.

Q18 John Glen: So you can't honestly say that you detect an evolving role behind the scenes at the Treasury, in terms of how it affects you?

*Rear Admiral Rees Ward:* No. I suspect that the Treasury has been involved from the outset.

Q19 Chair: None of you, as far as I am aware, was involved in the 1998 review. Were you, Admiral Ward, in a different capacity?

*Rear Admiral Rees Ward:* In a different place, Mr Chairman.

Q20 Chair: So, there's nothing you can compare it with in terms of discussions?

*Dr Sandy Wilson:* No.

Q21 Mr Hamilton: Chair, could I follow up on that point? The question in relation to the security industries has already been answered, about whether they have been involved and consulted as part of the SDR. I'm an ex-miner, with 20 years in the pits, and the coal industry reached a critical position when you reduced the capacity by so much you that ended up in the position that it was unaffordable. So, would I be right in saying that the real issue is that if we don't get this right, if we don't continue to look at this and all the discussions, leaks and debates that are taking place in the press about one carrier, two carriers or part-time carriers, whether it's French one half-week and ours the other, as Ian Davidson said today-it's got to be done very speedily-we're not going to have the capacity for a future defence of this realm? Is that the real danger that we are facing?

*Ian King:* Yes, that is exactly it. If you look at some of the capabilities in the programmes, you are at that critical point where if you cut back on them you will not be able to reconstitute the capability, and it will be lost to the UK. That will have an impact on the economy, because of the high-end skills that we have in the sector. Also, if you think of defence exports, an area in which the UK, I think, punches way above its weight, you will not be able to sustain that going forward.

*Dr Sandy Wilson:* Could I come back to Bob Stewart's point, which I will then relate to the last point that Ian King made? That is not a naive view if you could actually drag resource from other parts of our multinational corporations, but if you do that from the USA you end up with a very specific problem. Everything that you then do with US resource becomes ITAR contaminated. ITAR stands for International Traffic in Arms Regulations, and what it actually means is that if you subsequently wanted to export that equipment you would be under the auspices of the State Department. It would be a much more difficult process to export; it would not be just HMG that was deciding whether it was acceptable—the USA would be deciding.

If you think about where export sits within our defence industry, last year we won orders of about £7 billion, and £5 billion the year before. This is a very significant part, so anything that damages our ability to export is going to have a knock-on, double-whammy effect on our ability to meet UK needs five or 10 years from now. I think that is something that one must keep in mind. There is a real need for indigenous capability in the UK. In my case, I can bring people in from Canada and from Europe without the problems of ITAR contamination, but if I bring them in from the States, where a large part of my parent company is based, I have a problem. So I tend not to want to do that.

Bob Stewart: Forgive me, Mr Chairman, I wanted that on the record. It wasn't entirely naive.

Q22 Chair: No one would dream of accusing you of that, Bob.

It is not the purpose of the Ministry of Defence to preserve your export capability. It is the purpose of the Ministry of Defence to defend the country.

*Dr Sandy Wilson:* Absolutely. But the fact that most companies are heavily involved in the export market actually enables an industrial capability to exist in the UK that the Ministry of Defence could not afford to sustain.

Q23 Mrs Moon: Is it not also true, Dr Wilson, that part of your capacity to export, having demonstrated a desire by the Ministry of Defence to buy your products, use them for the safety and security of this realm, and to

demonstrate their effectiveness through our own armed forces, is also a key component in any export that you are able to achieve?

*Dr Sandy Wilson:* Yes. Having the imprimatur of UK armed forces on it helps.

Q24 Mrs Moon: They can't be seen as separate entities?

*Dr Sandy Wilson:* No, they're not.

Mrs Moon: There is a crossover.

Q25 Chair: That gives you significant value, which means that it ought to reduce the prices that you charge to the Ministry of Defence dramatically.

*Dr Sandy Wilson:* And there are levies that recompense UK MOD for any exports made of stuff it paid for the development thereof.

*Ian King:* And where you have volumes in manufacturing going on at the same time, you get the benefit of the volume scale.

*Rear Admiral Rees Ward:* And our exports sustain about 55,000 jobs and generate a larger research and development base, which generates better equipment for our own armed forces and for our exports, so I think there is a synergy there, and I particularly pick up your point about battle proven with a stamp on it, used by the UK armed forces. That is a huge positive when industry is going around the world.

Q26 John Woodcock: I'm interested in drawing out further the effect on our actual front line of losing this kind of capability. What is your sense of urgent operational requirements and how they might function differently if you lost the UK-based capability in the areas in which it was being asked for?

*Ian King:* That is an exceedingly good question, because the industry is proven in the current conflicts-its responsiveness and agility for putting urgent operational requirements in. If you lose that capability, you will not be able to respond in the same way in terms of inserting capability. The nature of conflicts is changing so rapidly that it is going to be in the nature of taking a current platform and being able to upgrade it through either urgent operational requirements or spiral upgrade of capability. You will not be able to do that so easily. If you take Sandy's point, if you're doing it on a platform that is developed overseas, you are at the behest of the other Government as to whether you're going to get the release of the technology upgrade.

Q27 John Woodcock: So at the very least you are probably looking at equipment getting to the front line later, or not at all.

*Ian King:* Or not at all.

Q28 Mr Hamilton: I'll move on because we'll come back to this. A previous Committee reported that the defence equipment industry welcomed the commitment to regular defence reviews taking place. The last review was held in 1998. How will regular reviews affect industry's adaptation and capability to plan for longer term use? Will that be of benefit to you when we start to have a regular review taking place? Will that be helpful to you or will it be a hindrance?

*Ian King:* It will be helpful to us if we get a more up-to-date view of the capabilities that the Government want from the industry, because it informs our planning rounds and the strategic reviews that we do of our businesses.

Q29 Mr Hamilton: How often would you see that review taking place, which would be helpful? Five years?

*Ian King:* Five years. There is a five-year cycle that takes place in the US.

*Rear Admiral Rees Ward:* Could I add another word to that? When reviews are spaced so far apart, there is a propensity for equipment programmes to become overheated, because they are not reviewed on a regular basis. I suspect part of the issue around the current defence equipment programme being overheated is that there has not been a fundamental review for 12 years. If that review was done on a regular basis-say, every five years-that programme is less likely to become over-programmed. That is hugely important for industry as well as the Ministry of Defence: to keep a firm grip on a balanced and affordable programme. When it becomes unbalanced, the nature of rebalancing that within annual cash limits is to defer programmes. When programmes are deferred, they cost a lot more. The carrier was a classic example, where the carrier costs went up by 20% for a two-year deferral. Stop those deferrals and you will get capability at the cost, at the price, you originally wanted, rather than these sorts of inflated prices when those sorts of things go on.

*Richard Martin:* From an SME perspective, a more regular review would bring more certainty for SMEs. It would certainly help them to fund new projects, because there would be more certainty within the marketplace. At the moment, sadly, we are seeing many insolvencies in our industry and I fear that this will increase, largely as a result of the uncertainty of what we are doing at the moment; and it has been like this for some considerable time-a year, I guess now. Going forward into the future with, I am sure, a reduced defence spend, it will at least provide some security for keeping the skills and technology within the SME community in the UK.

Q30 Chair: Why, though, does throwing the whole thing up in the air every five years create more security?

*Richard Martin:* I don't think it would throw it all up in the air. I can't see that a strategic defence review would throw everything up in the air, as you put it. I think it would be a tailoring and more closely followed line from before. Of course, there may be changes but I am sure that if we have got the strategic defence review right in the first place, this would, by a series of iterations, continue rather than reinvent the wheel again.

Q31 Mr Hamilton: I spoke to one of my colleagues last week and said to him, "You know the price of everything and the value of nothing." Is it a possibility-and would it be helpful-if industry itself sought a meeting with the Treasury and with the MOD, to sit down and invite them to try to understand the critical position that industry is in at the present time, notwithstanding the decision we have to take about where the role of the British armed forces is to be in the future? Our decision on that role might be made for us if we don't resolve the issue before we get to that point. I am saying this as a lay person, as someone who worked in big industry: is it not the case that you really need to get yourselves together and meet the Treasury-demand a meeting with them-because they may not understand the critical position that industry is in?

*Ian King:* It would help and we have tried across the piece to get more access to the Treasury. It absolutely would help.

Q32 Mr Brazier: With your permission, Chairman, I would like to pursue a bit of a tangent. I found interesting something Admiral Ward said. How much of this loss of the overall process do you think is due to the factor that Bernard Gray pointed to in his report-the breakdown of the customer relationship between the OR staffs, as they used to be called, and the procurement process? If that is a big factor, why do you think it has happened? He is not at all clear in his report why it has happened, although I think he is right that it has.

Chair: OR being operational requirements.

*Rear Admiral Rees Ward:* You'll forgive me, I am not in good place to answer that, apart from at an industry point of view, observing what might be going on inside the Ministry of Defence. There is the broad point on the Bernard Gray report: I think industry welcomed the report. It got to the heart of some issues. It got to the heart of the notion of a balanced and affordable programme. It got to the heart of an acquisition process that, when you measure it against other processes around the world, was considered to be a reasonable process, but there was lots of room for improvement.

In terms of a breakdown between the operational staffs-the capability staffs-and the DNS-the procurement staffs-one could look at it and say that the

geographical separation doesn't help communication. They are at either end of the M4. You could take a view that the operational staffs, in forming the requirements, tended in the past to gold-plate those requirements-if that term is common knowledge. That is, the single services would be encouraging the 120% solution, if you will, because they will get one bite at that particular cherry. They then take those requirements to the DNS and the DNS has a lot of difficulty trying to get that into a funding line that makes sense. Hence you have a programme with a lot of inbuilt inflationary elements to it.

What Bernard Gray put his finger on was that there is another way of doing this: the incremental acquisition spiral development piece, which says, "Yes, armed forces, I know what you would like but what we would probably do better to do is go for an interim capability." So not the full capability from the off, which is hugely risky to programme, to understand the scope of the programme and to cost, because those programmes normally last 10 years, for big equipment programmes. Why don't we go for an interim operation and capability? It will be delivered into the hands of our armed forces much quicker, at less risk, with less of a risk price attached to it.

That is something that, as we go forward in acquisition reform, is a real prize: delivering capability quicker, in bite-sized chunks. If the need for the additional, the next tranche of that equipment, is proven, then they can take that forward, but it is something that industry can get their hands round and deliver at less risk and less cost. That would be a key gain as we go forward.

Q33 Mrs Moon: The Chairman started the session saying that there was a risk of people saying, "You would say that, wouldn't you?"

*Ian King:* We're trying not to.

Q34 Mrs Moon: But people might also say that there is a risk in terms of industry's involvement with the review that you are likely to lobby on behalf of your specific service that you work with closely, or the programmes that you're working with, and that that may well lead to a disjunction in the impression of the impacts that we need. Can I ask you the three things each of you fear most as the negative outcome for industry, and what are the three positives you are aspiring to see come out of the strategic defence review?

Chair: That's 24 things you have just asked for.

Mrs Moon: No, just three positives and three negatives.

Chair: Each.

Mrs Moon: No, sorry. Admiral Ward and perhaps Ian King. I assume there should be some coherence across industry.

*Ian King:* What will you go for, Rees, negatives or positives?

*Rear Admiral Rees Ward:* I am an entirely positive person. What would be really good to get out of this-and I think we have alluded to some of it-is a balanced and affordable programme, fundamentally well-structured, with industry's input so that it is not done in a vacuum: industry involved through a defence strategy so that capabilities can be preserved on the ground that will be able to deliver that programme, so that it is viable in terms of delivery.

I would like to see that supported by a sufficient research and technology budget, because these things are not just pulled off the shelf. This is high technology, advanced engineering, which is what this country does extremely well and what this industry does extremely well, as evinced by our ability to sell the stuff round the world. We are the second best defence exporter in the world, second only to the US. In all of that, a solid, well-founded research and technology budget that underpins all of this will deliver the right sort of equipment, the battle-winning equipment to our armed forces. It will also deliver that research and development capability, which will then allow us to develop the intellectual property that will give us the exports that will allow us to export around the world and therefore be of value to the UK economy, as we are at the moment. Those are the real keys, from my point of view.

*Ian King:* If you look at the negatives, they all relate to the points that Rees made. If we end up with an opaque set of decisions and an SDSR that isn't clean and doesn't have a defined industrial strategy around it, that is the worst of all worlds for us. I don't mind making decisions on capability, as long as they are proper decisions that everyone has made and as long as we can all look at ourselves in the mirror. But I worry that if we fudge any more of these programmes we will lose the capabilities by default. We'll all be sitting there when someone says, "This is really what we need to do with the Astute class submarine or the successor programme or UCAVs," and we'll say, "Well, we'd love to, but that capability no longer lives in the UK."

Q35 Mrs Moon: Rear Admiral Ward, you have said that you're always a very positive person, but you did say recently that one thing that you feared was the cutting of UK defence spending to the bone. What does that mean? Can you give us examples of what you mean by "cutting to the bone"? What would be kept? What types of budgets would have to go, and what's your great fear there?

*Rear Admiral Rees Ward:* I was trying to make the point that as we go through this cost-cutting exercise-let's be really clear that in a pragmatic sense it is a bit of a cost-cutting exercise; the Government have to get the country's finances back in kilter, and everyone understands that. The point I was making is that

defence has made a contribution to savings over the past 20 years. We have come from something like 4.4% of GDP down to 2.2%. We have been asking our armed forces to do more, I would opine, in the past five or 10 years. I don't think that two major conflicts, one in Iraq and one in Afghanistan, was envisaged in the planning assumptions that have underpinned the defence budgets of the past five or 10 years. At the moment we are in a situation in which defence has made a contribution and we are asking our armed forces to do more, and by common consent we have a defence programme that is overheated, and has been so for the past two or three years. So, as we go through this exercise, there may be a headline figure-defence must come down by say 10 or 20%-but underneath all of that is the figure of £37 billion over 10 years of programming that Bernard Gray identified. This is downsizing over downsizing over downsizing. The point I was making is that when you start to aggregate all that, defence is at risk of being cut to the bone. That was the point that I was making.

I'm afraid that I don't have knowledge of particular programmes. That is entirely the Ministry of Defence's decision, and it will act with respect to the money that the Treasury is prepared to put in this direction.

Q36 Mrs Moon: Mr King, you said that losing capability was something that you really feared.

*Ian King:* Yes.

Q37 Mrs Moon: But, in terms of the carrier programme, you were saying that you were having to put forward a number of options.

*Ian King:* Yes.

Q38 Mrs Moon: One of the things that my colleague, Mr Hamilton, asked was whether we were putting the cart before the horse, in terms of considering where we want to be in the world and then looking at the defence review. We are looking at the defence review and from that we will decide where we want to be in the world. Will you, as part of the programme options that you are going to submit, also be saying, "And in our view this will be the impact"? One of the things that worry me is that I am wondering who is talking to the Ministry of Defence about the impact of the reduction of the carrier strike capability on the UK's world role and where we need to be. Are you going to be making those sorts of comments in response as part of your options programme?

*Ian King:* It's not for us to make comments on operational capability-we can have opinions on operational capability-but we will be very clear about the impact on the defence industrial capability and the future ability, if you like,

to continually upgrade and perform in the defence arena. It's not for us to determine what operational capability the UK needs. I agree with you entirely that it should be informed by the foreign and defence policy of the UK. If the UK decides that its primary role is to defend the nation, one might argue that at that point in time you probably don't need two very effective carriers, because it's not going to be about force projection in foreign policy. But that's for Government to decide.

Q39 Alison Seabeck: My colleague has covered the macro, I'd like to come down to the micro issues within the carriers and come back to the options from two to zero. Within those discussions, have the capital savings that would be made been looked at, if the carriers were kept in Scotland and not brought down to Portsmouth, with all the additional works required in Portsmouth?

*Ian King:* You could take a view as to which is the most cost-effective solution.

Mr Hamilton: Scotland.

*Ian King:* And yes, we are informing that debate. We're obviously focusing a lot on the big primes and the big companies, but if you think of the challenge that we have in my company about defining defence capability-let's be very clear-we have a huge dependence on the SMEs in terms of accessing that capability for all these programmes. It's not Government or the MOD who access the SMEs in the main. It's the big primes that have the system contracts. If I'm finding difficulty in planning my resources, the SMEs have real issues now. So when I talk about the downside of having a very opaque settlement or opaque SDSR, these guys will be out of business and we absolutely will not be able to access that capability.

*Richard Martin:* I certainly support that argument. It's been the situation for quite a long time that less and less direct contact from SMEs to the MOD has been the normal business. More and more we're seeing all our work-we're probably 95% dependent on the large OEMs in this country. It's very important that they see a particularly clear view so that they can give us a clear message: we can give that for our training requirements and to our bankers and so on to make sure that they are happy, and we know exactly what we're going to be doing for the next couple of years.

Chair: One of the issues that has come up this afternoon, and which this Committee has always been interested in, is the issue of research and technology.

Q40 Mrs Moon: You said that research and development budgets were one of the things that you were hoping were not going to be impacted on, and

possibly even improved upon. Are there areas the MOD should prioritise in this area? Are there priority areas for research and development that you feel the MOD should look to first?

*Rear Admiral Rees Ward:* I am not sure that I could pull out particular priority areas, although I draw on what Sandy Wilson said earlier, that there are areas where we need to maintain capability-system engineering, integration. If we lose the ability to design, develop and integrate technologically advanced platforms, we will lose a great deal in this country. We will be dependent on other nations and our export capability will drop. The point I would make about research and development is that it has dropped within the Ministry of Defence by something like 23% over the past three years. That is a huge reduction in our ability to retain the skill sets that I have mentioned and to create the products that will support our armed forces and our exports. It is an extraordinary drop in many ways. When you look at other advanced nations around the world, certainly in recession, they are increasing their research and technology budgets, so that they are well positioned to come out of that recession, indeed fight their way out of recessions by exporting and producing. I find it curious that we have a situation of a loss of 25% of that budget; it just doesn't make sense.

Q41 John Glen: On that theme, in terms of partnership and recognising that you just said that you need clarity going forward. Often your programmes in industry are generally about long-term relationships and lots of investment. Is there anything that you think that industry could do more in these difficult times to contribute more in terms of shared projects and partnerships? It is one thing to criticise the Government, but given the long-term benefits that you will have potentially from exports as well, it would seem a sensible time for you to put up some proposals on that.

*Dr Sandy Wilson:* I think that industry has been putting forward proposals in partnership and partnering agreements for quite some time. The problem of committing to a long-term partnership is that MOD often thinks that that narrows opportunity for competition in future. That is something that I don't think MOD has quite got its mind round properly. A number of partnership opportunities, I think, have gone begging, simply washed up on that rock a number of times. With a new paradigm, a new way of thinking about defence and new financial constraints, there is the opportunity to reconsider partnership and partnering arrangements as a way forward, of reducing costs and providing that long-term commitment from both sides to delivering a particular type of capability. There are examples of partnering already extant but I think we have missed a number of excellent opportunities to do that over quite a period of time.

Q42 Chair: Do you think that the Ministry of Defence has made best use of the partnership and partnering agreements that exist?

*Ian King:* There are a number of very good examples of benefits that have been gained from partnering arrangements, and it is fully committed to working with. Looking at air support, there are long-term partnering agreements that are giving real cost benefits. The terms of business agreement around the maritime sector was the same. We are now investigating very hard how we can enter into an arrangement around the nuclear sector, which is slightly more complicated as there are three or four industrial players in it, but we are all fully committed to making that work. So the MOD has been quite proactive in driving those.

One concern-and we come back to the issue of the Treasury-is that the Treasury has always been to a certain extent quite anti these partnering arrangements, because by their nature they require long-term commitments to make the partnering agreements work. It views that as a reduction in flexibility on the purse, but you can't gain one without the other. As you go into the debate on carriers-bearing in mind the scrutiny that the original carrier programme went through, the terms of business agreement support, why we in BAE Systems bought VT in order to consolidate the industry and create savings-you are testing the boundaries of how you can drive value and essential capability into the defence sector.

Q43 Ms Stuart: Just a small follow-up question, sparked by Rear Admiral Ward's comments about how other countries invest in order to get out of recessions. If you were to look for one country that you think gets it right in terms of investment, partnerships and central Government, which country would you suggest we go and talk to?

*Rear Admiral Rees Ward:* Let me answer that partially in the broad sense: what are the criteria that I would look for in another nation as a partner? I would start with a nation that does similar things to those that we do in a defence sense, that has budgets of similar size as us, and research and development technology budgets of a similar size. Politically, the two nations would have to be looking in the same direction.

Ms Stuart: So you don't have far to go.

*Rear Admiral Rees Ward:* You are ahead of me. I am not being exclusive here, but I am saying that partnering is best done with equals. If you start dancing with elephants and you are the size of a mouse, you are liable to get squashed unless you have a very key element of that partnership, some extraordinary piece of technology that cannot be done without you.

*Ian King:* But if you look at pure partnering with industry, then the UK is way ahead of any other nation. The specific country which decided at a point in time that it was going to cut back on defence expenditure, but was going to spend more on R and D, was Germany in its latest budget. It was about protection of the core technologies and exporting in that sector.

Q44 Mr Brazier: But Germany was starting from quite a low base, wasn't it, for such a large country?

*Ian King:* Not in terms of R and D.

Mr Brazier: But a low base percentage wise. It has a bigger economy than us, but it was starting at a lower base percentage wise.

*Ian King:* But it was an interesting trend, that at a point in time when it wanted restraint on public expenditure, it should spend more on R and D to protect the essence of the sector.

Q45 Mr Brazier: Point taken. My question was almost the same as Gisela's. Do you look at all at arrangements abroad for ideas that you could put to MOD? I give just one example-the partnership which I think still exists between the Dutch Government and Royal Schelde, which seems to produce very cheap, affordable and good quality warships.

*Ian King:* We have looked at all the arrangements. I can assure you that before we signed up to the terms of the business agreement in naval shipbuilding, we benchmarked it against lots of other arrangements and looked at the costs that you got out of the UK industrial base relative to those complex warships, and the UK is pretty efficient. A lot of people look to the UK in terms of the arrangements it has in place. We should not be sat there almost inwardly destroying ourselves about whether we have a model that is completely perfect. What we are talking about here is the amount of money that should go to defence and whether it should be policy led. We need a balanced budget-absolutely, industry wants a balanced budget; we cannot cope with this feast or famine and re-scheduling of programmes. It destroys the sector and creates inefficiencies.

Q46 Mrs Moon: A very quick question. In terms of areas to prioritise, none of you have mentioned cyber security. Are we falling behind, or are we at risk of falling behind, in IT in that area?

*Ian King:* The UK is strong on cyber security. Relative to the amounts of budgets that are spent by the US, the spend is little. But in a funny sort of way it is relatively akin to defence in that we punch massively above our weight in terms of that sector for what we spend. The relationships in that sector between industry and the various agencies are quite fragmented, so you

haven't got a single entity. I doubt that you will ever have a single entity which procures all the things in the cyber security sector. There are some similarities and we have been looking at partnering arrangements in those sectors, because you want people to invest in technologies. If you think that the SME message in defence is strong, I can assure you that in cyber security it is even stronger, because there is a fragmented supply base and a very fragmented customer base.

Q47 Bob Stewart: Admiral Rees Ward, I might have misheard what you said, but I thought I heard you say that the procurement budget had been overheated in the last two or three years. My understanding is that it has been overheated for ever-much longer than two or three years. Would you please enlighten me about whether I am wrong?

*Rear Admiral Rees Ward:* It depends what you call overheated.

Q48 Bob Stewart: How about balancing what is paid and what is received?

*Rear Admiral Rees Ward:* Yes, the definitions are very clear. What we have seen over the past two or three years is excessive overheating-overheating that cannot be dealt with by shuffling things around and smoke-and-mirrors type of activity such as taking a bit more risk here, taking a bit less risk there and just trying to manage it. I am sure you are right that, in previous years, the budget over the 10-year period has been overheated, in that towards the end of the period, it is always much larger than the projected cash available, but I think that the Ministry has manoeuvred it in that way so that those large excesses are reduced so, when you get to the point of spend-that is, the current year-broadly speaking, it is in balance. Over the past two or three years, that has not been achieved, and that has been very clear from an industrial point of view purely through the mechanisms of deferrals of programmes.

Q49 Bob Stewart: So the jiggery-pokery could not be disguised over the past two or three years but, beforehand, it could?

*Rear Admiral Rees Ward:* I suspect that careful balancing of the programmes was the wording, but I take your point.

Q50 Chair: Can I ask a quick question about R and T? Is research and technology largely funded by larger companies or proportionately are smaller companies contributing their share according to their size as well? I do not know the answer to that.

*Richard Martin:* The Centre for Defence Enterprise at Harwell has recently opened up great opportunities for small to medium enterprises and to receive research funding of a proportionate nature, of course. From what we can see

so far, it has been quite successful. One of the big issues with small to medium enterprises is ensuring that they retain their IPR. From what I gather from colleagues who have used that facility, the issue of IPR is cleared immediately-whether it is a shared IPR or whether IPR is going into the research project that is already owned by the SME. These issues are cleared up pretty quickly and, from what I have heard, within two or three weeks of reopening the file on a particular project. One of the things that SMEs would like to see is a development of that. It certainly aids the OEMs. We can feed into that as feedstock.

Q51 Chair: Can I ask about the separation of the defence industrial strategy, whatever it was that Mr King told us?

*Rear Admiral Rees Ward:* The DITP. The defence industrial technology policy, as I understand it.

Q52 Chair: From the SDSR? Is that a disappointment to you? What will be the consequences of that separation? How could those consequences be ameliorated?

*Ian King:* It is a disappointment because we have been aware that that is the process for some time. The MOD was very clear that it could not do it in parallel, but would commit to doing it serially so that there was enough direction. The risk is that there are decisions made on the key programme so, as the 20/20 vision is stated and it determines the force structures, in certain instances you may be making decisions on the big programmes. That is why we are making sure that, as part of the current process-whether there are big issues on carriers or unmanned technologies or the ability to upgrade Typhoon if that is to be the primary part of the force structure-we can interpret the consequences for those we think may be affected by it. The employment and capability issues are known now. The risk is that, as you define that, you could be making decisions by default on the major programmes.

Q53 Chair: Certainly that is a risk. What is your view of the key elements that should be part of the UK's defence industrial capacity?

*Dr Sandy Wilson:* Can I start? When DIS was published in 2005, it started with a really useful exposition on systems engineering as the basis of all defence technology and all programmes. We fully endorsed that, liked it and thought it was a sound basis. What it didn't do was go into some of the sub-level aspects, such as systems integration, and that has become more important over the last five years. As we look to go to this 80% initial acquisition approach with incremental upgrades and probably the use of more COTS-based equipment-

Chair: COTS means commercial off the shelf?

*Dr Sandy Wilson:* Commercial off the shelf. Many activities now deal with open systems that will make integration of these, if you like, capability components rather easier than before, but you will still need systems integration as a fundamental. Once you've got that, you can integrate almost anything. Now, the question then becomes what level of knowledge you need in the UK at the level below, where you come down to specific disciplines and, therefore, specific technologies and specific types of product, such as radios, radars, thermal imagers and whatever else one would need in a system-propulsion systems, etc. Fundamentally, the system integration aspect would provide a very solid foundation for a defence-industrial capability moving forward. Then, it's going to be a very detailed debate about exactly what areas need to be invested in and supported. But there needs to be some solid base. In 2005, DIS had systems engineering. I think DITP should have systems integration as its fundamental, and then all the other technical aspects can build on top of that. It's important to get the basics right.

Q54 Chair: Any other comment on that?

*All Witnesses:* No.

Q55 John Woodcock: The ADS chairman wrote to the Prime Minister last week expressing concern about the Chancellor's decision to break the previous Administration's agreement that the capital costs of Trident would be borne centrally, rather than from the MOD pot. Do you know whether he has got a response to that letter yet?

*Ian King:* I don't think he's got a response to that letter.

Q56 John Woodcock: No, I haven't had a response to mine either. Can you spell out in broad terms the effect on the defence industries and the capabilities of our armed forces if, all things being equal, and with no commensurate increase in the MOD budget, the MOD had to bear the cost of Trident as well?

*Ian King:* When we talk about Trident, we're talking about the successor programme-the replacement of Trident-and the truth is we don't the cost yet, because people are going through the costings of the enterprise at the moment, and we're still working out the specific timing of when that cost would be spent.

Q57 John Woodcock: What options have you been asked to consider?

*Ian King:* There are two options. One is that we need to look at how industry-ourselves, Babcock and Rolls-Royce, the primary players in this-can look at

the overall enterprise and through-life to see what more cost-effective solution we can put in place. We are committed to working on that. The second thing is to look at the precise timing of expenditure on the successor programme, and that's what we're considering at the moment.

Q58 John Woodcock: So you're being asked to come up with options to shift it to the right?

*Ian King:* It's not options. We're actually being asked to look at the programme, because it isn't an existing programme.

Q59 John Woodcock: Look at whether to go ahead?

*Ian King:* No, we're looking at the timing of what you have to do to commit around a series of programmes. You know, probably better than I do, about some of the complexities about the real lifetime of the power plant that would drive the programme time scales, etc.

Q60 John Woodcock: Dr Wilson, you mentioned the competition that, at the high end, the skills sector faces with other industries. Presumably, the fact that we are looking at renewing Trident and building a successor programme at the same time as a renewal of our civil nuclear programme creates particular pressures that perhaps were not even there when we built the original.

*Ian King:* In that specific sector, you are absolutely right. It's a thing that concerns all of us, that the skills are all going to be dragged away from us if we cannot find what a programme is going to be. Absolutely right.

Q61 Alison Seabeck: Are you confident that the timelines that you're working to in the different elements of this programme fit in with the timelines for the American elements that will have to be put into this programme at some point? Is that something that you understand the review has been able to consider fully?

*Ian King:* The teams that are working on it understand all that information. I wouldn't like you to think that there's an industry team and an MOD team on this. There is one team looking at this, and the complexity of timelines around the American system, which relates probably to the missile replacement, is different from the replacement of the boat itself. But all those criteria are well understood by the teams that are looking at this.

Q62 Alison Seabeck: Would any slippage in the American programme necessarily encourage people who might want to defer the programme-the boat or platform element?

*Ian King:* No, because the platform element is driven around a specific safety case around the power plant.

Q63 Chair: Can we get on to Bernard Gray? Admiral Ward, you have said that the defence programme has become overheated in the past two or three years, although my memory, like Bob Stewart's, is that it was always overheated. Is this all the fault of the Ministry of Defence or does the defence industry share some of the blame for this? You purse your lips.

*Rear Admiral Rees Ward:* I'm thinking very deeply. I am just about to avoid the trap of, "He would say that, wouldn't he?" I think apportioning blame is probably not a good place to go. When industry and the MOD are working together, it is a sort of symbiotic relationship, which we take forward together. We have successes and we have failures, but they happen together.

In terms of this particular area-the overheating-I think Bernard Gray pointed out that the key areas were around this unaffordable programme and the necessity of deferrals, which put the cost of particular programmes up, and you get into a sort of downward spiral if you have that sort of thing going on regularly and you're not taking things out of the programme. The only people who can take things out of the programme are the Ministry of Defence. That's their business in managing it. To say that there were not technological difficulties that industry ran into that changed time scales would be fatuous. Of course there were. But I don't think apportioning blame is a fruitful way of going forward.

Q64 Chair: One of the many lessons that I took from the Bernard Gray report was that the average programme overruns by 80%, or about five years, from the time specified at initial approval through to in-service days. The average increase in cost of these programmes is 40% or around £300 million. I took mostly from his report that one of the key issues was the perverse incentive system within the Ministry of Defence. Is there anything similar within the defence industry that could be looked at now to reduce the defence industry cost base? That is surely the key issue, which is most of the defence costs for the Ministry of Defence as well.

*Rear Admiral Rees Ward:* I can give you a broad answer, but I look to my industry colleagues for specifics. I think that you will find that the defence industry in the United Kingdom is under a lot of competitive pressure anyway; this is one of the most open defence markets in the world-I think that is generally accepted. Because of those pressures and because we export a great deal of our product, the pressure in getting the cost base down goes on continuously. The only side to that would be in terms of what capacity UK industry would wish to preserve, and utilise at the moment, in looking

forward to what contracts it might aspire to acquire down the line. In every other way, the pressures on getting the cost base down are enormous. That is my broad comment.

Q65 Chair: We have seen the Type 45 ship, which is huge, unbelievably capable and totally unexportable because of its cost, which is £1 billion or so a throw.

*Ian King:* Yes, but I'm not sure that it's not exportable necessarily because of its cost; its exportability is limited because of the capability of other naval nations to take on board that sort of capital vessel. If the UK decides, from an operational set of requirements, that it requires a capable vessel such as that, that is what it is about.

Q66 Chair: So lessons will be learnt in relation to the Type 26, will they?

*Ian King:* Absolutely. We need to turn that class of vessel, which is a frigate replacement, into an exportable ship.

Q67 Chair: And should the Ministry of Defence itself be lowering its sights and developing a programme that is much less sophisticated than it has been trying to do?

*Ian King:* Absolutely, and it is industry's job also to keep pointing out, if requirement creep comes in, what impact that will have on the exportability of the vessel.

Q68 Chair: But if an industry sees that a profit margin may go up as a result of requirement creep-

*Ian King:* How does profit margin go up? Generally we have fixed-price programmes or target-cost incentivised programmes, so we are not incentivised to let this just creep up, because there are fixed budgets.

Q69 Chair: Is it a problem that one of the key things that the Ministry of Defence now has to concentrate on is investment in invisible things, such as information, training and stuff like that, rather than investment in platforms, which are big and everybody can support because they may bring obvious jobs to a particular area? Is there a problem selling this to the public of this country?

*Ian King:* It's always more difficult to describe things such as cyber technologies and information management systems than it is when you go up to Barrow or one of the big sites and see a major platform. In terms of how you explain the defence threat and then the policy to the public, yes, that

obviously is a challenge. If that is the nature of what we're dealing with, that's what we've got to do.

Q70 Mr Brazier: I asked a question earlier on the Gray report. Quite understandably, I don't think that anyone wanted to answer a question on the relationships between what are sometimes called capabilities and sometimes called operational requirements staff, whom you're dealing with in the early stages, and the procurement process itself. Does anyone have any views on that? It's very clear from the Gray report that that relationship isn't working very well. I have some views of my own on why it isn't working well, but I'd be interested if anyone had any views on the structure.

*Ian King:* It is for the MOD to decide how it wants to organise itself to deliver its strategy. Generally, you define what your policy and strategy is and then how you organise to deliver the strategy. Any view that the Gray report has must be relative to what will end up as the policy under the SDSR, and to do it any other way would be wrong.

Q71 Chair: Because my expectation is that we may be moving to a vote fairly soon, we just have one more area to cover, but at the end I would like to ask you if there is anything you wish to tell us that we haven't covered that you feel we need to be aware of in relation to the SDSR. The area that we still have to cover is the restructuring of the Ministry of Defence.

Q72 John Glen: Obviously, there have been several proposals and debate about the restructuring of the MOD and the need to reduce costs by perhaps 25%. Do you have a view on what the impact of that will be in some of the personnel changes that are going on as well; how it affects the relationship with industry and what the proposed structural changes mean for you—are they a good or bad thing?

*Ian King:* Any organisation has to go through a design change relative to what the strategy is. I think that they can sustain the relationships with industry as well as cutting the infrastructure in the MOD.

Q73 John Glen: With respect, that wasn't quite what I was saying. The issue is how the changes in the MOD affect your relationship, not hypothetically.

*Ian King:* You mean the specific leaders?

John Glen: Yes, and the restructured MOD. You must have a view about how that would affect the way in which you relate to them.

*Ian King:* I think that we can cope with the change in the structure of the MOD relative to the changes at the top of the MOD. That is a natural thing that they

are going to have to manage. Would you ideally do that at this time of great change? Probably not, but we are where we are.

*Dr Sandy Wilson:* A 25% reduction in, say, staffing levels would be quite significant. No one would expect them to maintain the same processes that they do today, not unless the volume of business that they were transacting had fallen by that same amount or a greater amount. I think that this is really an area where there would have to be a different way for MOD to do business. We talked about partnering earlier, and we have talked about joint delivery teams in certain areas. There are lots of ways in which if you look at industry and MOD having two sets of people doing broadly the same thing with two sets of overheads, there are undoubtedly ways in which better joint working would help them to achieve that significant manpower reduction.

Q74 John Glen: Not so much just in terms of rationalisation and reducing numbers, but in terms of the skills that the MOD has in dealing with you guys. What do you see as the gaps in the new capabilities that need to be found if the review is going to be a success?

*Dr Sandy Wilson:* One of the skills issues has always been in the commercial area. That is not to say that MOD does not have the commercial skills, but it applies the same process to, shall we say, small commercial items as it does to big commercial issues. There really needs to be some restructuring of that, and that would make the simpler commercial transactions almost routine, which I don't think they are today. That would then free up people to concentrate on the really meaty things, which enable major projects to move forward. I think that there is a fundamental dilemma in an environment where the Treasury demands more and more value for money and there are constraints on what can be spent because the scrutiny level goes up and up and up. So, instead of having two levels of scrutiny, there might be many levels there. Of course that takes up more and more manpower. It is a strange situation. A normal reaction to fiscal providence is to put in more scrutiny, but the way to solve the problem within the MOD is to loosen that up a little so that people have a delegation of authority, can make decisions and don't have to go through five levels of scrutiny to get something approved.

Q75 John Glen: Just to be clear, Dr Wilson, you are saying that the commercial acumen exists within the MOD, but the processes are too cumbersome to do it effectively?

*Dr Sandy Wilson:* I think the processes need to change, especially within the environment of reducing headcount. If they don't, we will get bogged down.

*Ian King:* I think what Sandy was saying is that the MOD recognised-I think that it was recognised in the Gray report-that it needed to upskill in

commercial and programme management. You can upskill in that, but if you don't change the basis, delegated authorities and some of the processes behind it, you will get the same inertia in the organisation, so you have to do both things at the same time.

*Dr Sandy Wilson:* So you are trying to use the existing skills more effectively.

Q76 Chair: Do you think that the Ministry of Defence recognises that?

*Dr Sandy Wilson:* Yes.

Q77 Chair: Do they need the help of industry in changing those systems?

*Dr Sandy Wilson:* I think industry can do a lot to help them because most of industry has spent a lot of time doing what we call lean six sigma activity, which is about looking at the efficiency of our processes so that we reduce, for example, the cost of carrying out a transaction. A lot could be done there.

Chair: Bob Stewart, do you want to ask something on this particular point?

Q78 Bob Stewart: I do. Following up Dr Wilson's and Mr King's point. The MOD isn't a commercial organisation but, say, you applied commercial practice to it; say you were given carte blanche to reorganise it-what would you do and what would you cut? Let's just say, could you cut it by 25% and make it more effective, so that it actually does its job better, if you put a commercial head into it? If that is the case, it would be jolly good if you did.

*Dr Sandy Wilson:* If you put a commercial head into it, in the absence of having a strategic defence and security review a policy and a set programme for change, forget it.

Bob Stewart: I take that point.

*Dr Sandy Wilson:* You would achieve nothing. It is quite right to say, "We need to focus on the SDSR, set the policies, and where we are trying to get the whole structure to. Then we can look at acquisition reform to support that strategy and the organisation." Do we think that they can take people out of the organisation? Yes, by reprocess engineering it. Do I think they are actively addressing it? Yes, I do.

Q79 Mr Brazier: Directly following the point from Dr Wilson on the importance of delegation-delegating powers to project managers and so on, so that they can make decisions, particularly with small and medium-sized funds, so that we are not going further and further up. There clearly is a problem at the MOD. How much of the problem is also the Treasury's micro-managing the process? One hears unbelievable stories. In one case-I won't divulge the project-a trial went extremely well but was very expensive, and

the Treasury insisted on cancelling the rest, because it was so obviously a success. In fact the piece of kit didn't work and it was a complete fluke that the trial had gone so well. That was some time ago. Is that the kind of experience that one still gets?

*Dr Sandy Wilson:* Let me try to answer in a different way. When you are in the private sector, you will go to the board with your strategy and the board will give the resources to deliver on that strategy, and will agree that you can then get on and do what you've got to do. If the MOD doesn't get that-and it is always being second-guessed by the Treasury, or whoever is that higher body-you are always going to get inertia because it will not be able to make decisions.

Q80 John Glen: I want to ask Mr Martin, do you agree with all of this? Or is there an SME perspective that is different on what is about to happen with the changes in the MOD? What would you like to see different?

*Richard Martin:* I would like to come at that question from the angle that, as a small-to-medium enterprise, we have to review our processes every couple of years. What we find is that, because we are supplying to a number of different customers, companies and clients, more and more processes are piled on top of each other each year. It becomes like an onion. Every couple of years we have to peel the processes back to see whether they really are adding value to our business. Generally, we find that 40% of the activity that is undertaken within our business is not adding value. That could be for all sorts of very good reasons but, nevertheless, we have to do that review every couple of years. That is all part of lean processes. I can't imagine that the MOD would be any different from that. I would suggest that you could possibly find-just by reviewing processes and whether they add value-that they give value.

Q81 John Glen: But 40% cuts?

*Richard Martin:* No. I didn't say 40% cuts. I said that you could probably reduce the processes by 40%.

Q82 Chair: To avoid everybody getting cut off by the Division bell, can we run quickly along the line and ask what is the key point that you would like to make to us this afternoon, that you feel you haven't really had the opportunity to make?

*Richard Martin:* This point has been made, but I would like to reinforce it one more time: delay is the absolute enemy of the small-to-medium enterprise. It doesn't have the strength in its balance sheet to be able to withstand long-drawn-out decision processes. Although we have said that the SDSR appears to be moving at a pace and a little out of step with the defence industrial

strategy, or the DITP, we nevertheless welcome the fact that we are going to get to a decision rather quickly.

Considering the type of situation that we are in, I will refer to an article in the *Telegraph* from about two weeks ago. It mentioned that there had been a 50% increase in businesses dealing with the public sector. I admit that that is in health, social services, education and defence, but it is a significant increase in the number of insolvencies. That is generally brought about not by bad practice by the SMEs, but by a failure to reach a point where a decision is made that investment can be made and work can be started on projects.

*Rear Admiral Rees Ward:* I think that most of my points have already been made. Getting industry involved as quickly as possible before major decisions are made that may well affect the industrial base in this country is the real key point. Don't allow the S and T budget to dwindle away through neglect. It needs to be supported and brought forward. If we are going to get ourselves out of the recession, we need to develop the IP in industry, which will give us our exports. Those are three key points.

*Ian King:* I think that most of the points have been made. My view is don't circumvent the process: we want the industrial implications to be taken into account in these early stages. If they are not, the DITP will be a rather academic exercise, because we will have already made the decisions.

*Dr Sandy Wilson:* Go hard on acquisition reform. I think it has the potential to save quite a lot of the defence budget. If financial considerations are coming into the thinking on SDSR, at least take into account the benefits that you will then get in future years from that acquisition reform and the cost reductions that will flow from it.

Chair: To all of you and to others from the defence industry who are here listening to this, thank you very much indeed for coming and thank you for a very helpful evidence session. It has been most interesting.

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