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Defence
Acquisition

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Defence Acquisition

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Contents

Introduction	2
The Impact of the Strategic Defence Review	3
Essays : Smart Acquisition	4
The Defence Procurement Agency	6
The Defence Logistics Organisation	8
The Defence Estate	10
Public Private Partnerships	12
Key Components of Defence Acquisition	14
Value for Money	14
Outputs not Inputs	14
Whole-Life Approach	14
Clarification of Internal “Customers” and “Suppliers”	14
Best Practice	16
Teamwork with Industry	16
Prime Contracting – “Smart Construction”	20
Non-Project Procurement	21
E-Commerce	21
Wider Markets	22
People	22
Results	23
Future Challenges	25

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Defence Acquisition

INTRODUCTION

1. The Ministry of Defence is a major purchaser of goods and services. In Financial Year 2001/2, it is spending some £9.7 billion acquiring defence equipment; and a further £5 billion on construction and property management and miscellaneous stores and services. These figures highlight three important issues. First, as a large-scale public sector purchaser of goods and services, the MOD has a duty to apply best acquisition practice to ensure that it achieves best value for money for the taxpayer. Second, the scale of defence acquisition means that it can have a noticeable economic impact. While proportionally far less than in the past, defence expenditure still comprises a significant component of total Government expenditure (about 2.5% of Gross Domestic Product, compared with 11.1% of GDP on Social Security and 7.1% on Health). In particular regions where there are high concentrations of defence employees or manufacturers whose major business is defence related, this impact is magnified. Some 170,000 jobs in the United Kingdom (other than employees of the Ministry of Defence or the Services) depend directly or indirectly on domestic defence equipment expenditure. Third, because of the scale of its acquisition programme the MOD is a major customer for industry. In some areas, the MOD is effectively the sole purchaser of a particular good or service. This means its decisions about acquisition can have far reaching effects on industry. In short, defence expenditure, and defence acquisition expenditure in particular, are economically important. Thus the manner in which that expenditure is undertaken is important. The aim of this policy paper is to describe *how* the MOD goes about acquisition, including some of the key principles, processes and organisations involved, and to look ahead at how this approach might develop.

A note on terminology: the MOD uses the word "acquisition" to denote the totality of: setting the *requirement* for a new equipment, facility or service; *procuring* that equipment, facility or service; and *supporting* it through-life - all the way through to its disposal or decommissioning.

2. Recent years have witnessed significant changes in the way in which the MOD acquires goods and services – whether high technology fighting equipment, accommodation for military personnel, or basic commodities and consumables. These changes have been characterised by a number of terms: *Public Private Partnerships*, *Smart Procurement*, *Smart Acquisition*, *Prime Contracting* and so on. The different names signify that these different initiatives have distinct foci and centres of gravity; *Smart Procurement* is focused on improving the acquisition of fighting equipment; the *Prime Contracting* initiative of the Defence Estates agency is focused

on construction and building maintenance. The initiatives share a number of common principles. These include:

- ◆ Acquiring against output-based specifications, rather than the traditional input-based approach.
- ◆ A whole-life approach to achieving value for money, rather than considering only initial purchase costs.
- ◆ Clarification of the respective roles of internal “customer” and “supplier” organisations.
- ◆ Application of best practice from the civil and private sectors.

These common principles are explained in more depth later. In particular, the initiatives entail a more dynamic relationship between the MOD and its external suppliers in industry. The reader should note that this paper seeks to examine current or recent developments of particular note. It is not a wholly comprehensive statement of all acquisition activity undertaken by the Ministry of Defence and its agencies; there is much activity, at the level of local purchases or programmes being run by individual Top Level Budget (TLB) holders, for example, that is not directly addressed in this paper.

THE IMPACT OF THE STRATEGIC DEFENCE REVIEW

3. Defence acquisition has been subject to constant evolution over the years, reflecting changing ideas about the conduct of government business. In 1900 and in 2000 the proportions of the defence budget spent on personnel, equipment and works and other services were remarkably similar, despite patterns and methods of acquisition having changed enormously. However, no single event introduced as deep or as broad a change in defence acquisition as the Strategic Defence Review (SDR) of 1998.
4. The SDR introduced five key measures:
 - ◆ The launch of the *Smart Procurement Initiative* – a change programme designed to transform processes and organisational structures with the aim of making the procurement of defence equipment *faster, cheaper and better*. The Smart Procurement Initiative was renamed *Smart Acquisition* in October 2000 to stress the point that the MOD is concerned not only with buying equipment, but with acquiring the means to support it throughout its in-service life. This programme had an associated target of reducing acquisition costs by £2 billion over the period 1998 to 2008.

- ◆ The creation of an *Equipment Capability Customer (ECC)* organisation, responsible for determining future equipment capability requirements and priorities for procurement.
- ◆ The remodelling of the Procurement Executive as the *Defence Procurement Agency (DPA)*, an Executive Agency of the MOD.
- ◆ The amalgamation of the three single Service Logistics Commands to form the *Defence Logistics Organisation (DLO)*.
- ◆ A Defence Estate Strategy and the development of a new model for construction procurement as part of a wider government initiative to reform the construction industry.

In parallel, and in line with general government policy, the MOD combined its Private Finance Unit and Competing for Quality Team to form the Public Private Partnerships Unit as part of a more integrated approach to Public Private Partnerships.

5. Each of these programmes or organisations, and some of the relationships between them, are described in the following short essays.

Smart Acquisition

The aim of Smart Acquisition is “to enhance defence capability by acquiring and supporting equipment more effectively in terms of time, cost and performance.” Understanding this aim means understanding that the effective acquisition and support of defence equipment are not ends in themselves. They only have value if they enhance defence capability. This aim gives equal emphasis to initial procurement and support, as integral parts of the overall acquisition process.

A number of organisations are involved in Smart Acquisition. In the case of equipment acquisition, these are:

- ◆ The **Equipment Capability Customer (ECC)** which determines future capability requirements.
- ◆ The **Defence Procurement Agency (DPA)** which is responsible for procuring equipment capability to meet those requirements.
- ◆ The **Defence Logistics Organisation (DLO)** which is responsible for supporting equipment which has already entered service.
- ◆ The “**2nd Customers**” (or the users), namely the single Service staffs who advise the ECC on operational needs and the Front Line Commands who determine the availability and sustainability requirements for in-service equipment.

For Smart Acquisition to work, all of these organisations must work closely in concert.

The specific objectives of Smart Acquisition are:

- ◆ Delivering projects which meet or better the time, cost and performance targets which were set when the decision to proceed with the project was made.
- ◆ Acquiring capability progressively, at lower risk, and with the right balance between military effectiveness, time and whole-life costs.
- ◆ Cutting the time for key technologies to be introduced into the front-line, where needed to secure military and industrial advantage.

Central to Smart Acquisition are Integrated Project Teams (IPT), each formed to acquire and support a particular *capability*. Each IPT comprises personnel drawn from key specialisms, including requirement definition, technical, financial, contracts and logistics experts. IPT members may be civil servants, Service personnel or from industry. The breadth of expertise and multi-disciplinary nature of IPTs underline the commitment to a “whole life” approach, from procuring and supporting equipment to final disposal. To ensure continuity, the IPT remains in being throughout the life of a project, transferring from the DPA to the DLO (see below) when the equipment enters service. IPT Leaders are responsible for managing projects without day-to-day direction from a management hierarchy and, in consultation with customers, for making performance/time/cost trade-offs within approved parameters. IPT Leaders are selected on merit by competition, against criteria which include leadership as well as requisite core and functional skills. The MOD’s experience is that the new system is working well.

It has long been a criticism of the acquisition of defence equipment that the process simply takes too long and is too complex; the equipment is out of date or the requirement has changed by the time it has come into service. A key aspect of Smart Acquisition has thus been the MOD’s attempt to streamline the whole acquisition process. Central to this has been a rationalisation of the equipment approvals process. The number of points at which a major equipment programme is approved for continuance has been cut from four to two - at project initiation (Initial Gate), and prior to the main investment decision (Main Gate). The Initial Gate is a relatively low hurdle, designed specifically to encourage early and full exploration of a wide range of options and trade-offs for meeting a particular capability, and with emphasis on investment in early risk reduction work. This ensures that the widest possible set of options for meeting a capability requirement is considered. By the time Main Gate is reached, the IPT Leader must have a high level of confidence of being able to deliver the project to narrowly defined performance, cost and time parameters.

Of course, requirements may change during the course of a major project, owing to technological developments or as a result of lessons learned from recent experience. The risks associated with such changes can be reduced through ‘Incremental Acquisition’. This Smart Acquisition principle aims to develop systems which can be upgraded in a planned way, bringing an initial baseline capability into service early and then progressively incorporating evolving technology as it becomes available.

Two other important guiding principles characterise Smart Acquisition. The first is that there should be more investment during the early stages of a project, the aim being to reduce as

far as possible elements of risk before binding performance, cost and time parameters are set. Second is a greater willingness to identify, evaluate and implement effective trade-offs between system performance, costs and time. Both of these principles are in direct reaction to past procurement failures, where the right equipment has been delivered too late, or where the particular dynamics of defence equipment procurement have led to equipment that does not have the capability required.

The Defence Procurement Agency

By its very nature, Smart Acquisition required new or changed organisations to employ it. The Defence Procurement Agency (DPA) was formed in April 1999 with a mission to equip the Armed Forces. It is headed by the Chief of Defence Procurement (CDP), employs 4,600 staff and has an annual budget of £6 billion. It aims to provide value for money and to deliver equipment to the Services within the agreed parameters for time, cost and performance. The Agency's performance is first and foremost measured by achievement against its Key Targets:

- ◆ Four of these targets have a direct relationship to the service the Agency provides to its customers.
- ◆ Three key targets cover the principal project measures of performance, cost and time.
- ◆ The other customer-related target is a measure of customer satisfaction established through a comprehensive survey of DPA customers.
- ◆ The final key target requires the Agency to deliver equipment and services while remaining within agreed Resource Control Totals.

Over recent years, as the National Audit Office's annual Major Projects Reports have recognised, the DPA has been successful in containing project costs and meeting customers' requirements and the Agency has met its Key Targets on cost and equipment performance. The Agency is supplying major items of equipment that meet over 95% of the key requirements of its customer. On average, they are costing only about 5% more than the estimates made at the time when the main decision to invest in the project was taken – typically several years before the equipment is due to be delivered. Agency targets of customer satisfaction and internal operating costs have been met in its first two years.

The Agency has been less successful on timeliness. But, while on average major projects have entered service nearly two years later than planned, much of this delay occurred on projects that started their life before the introduction of Smart Acquisition and are now in service or close to being in service. Important reasons for delay include technical difficulties in industry (it should be remembered that defence equipment is typically at the very cutting edge of what is technically possible) and the deferment of projects in the MOD annual planning cycle: but more consistent excellence in project management should enable these

difficulties to be foreseen and managed. The DPA aims to improve performance in this area by improving accuracy in forecasting, developing smart techniques to improve the understanding and management of risk, and increasing risk reduction work in the early stages of projects. There is evidence that newer projects are managing time better and the Agency expects the average delay to in-service dates to drop significantly as Smart Acquisition techniques work through the acquisition cycle.

The DPA has set itself the goal of having 90% of its projects within the agreed parameters by 2005. The legacy of projects approved prior to Smart Acquisition makes this the highest figure practically achievable in the time period. The DPA's goal for the longer term is that more than 95% of projects at any time should be within the agreed parameters for performance, time and cost.

Organisation

The engine rooms driving excellence in project management in the Agency, and delivering smarter procurement, are the 80 or so Integrated Project Teams. Each IPT Leader is answerable to a Director of Equipment Capability in the ECC (see below), with whom outputs and working methods are agreed. IPT Leaders are accountable to CDP for the quality of their service to the customer, and their achievements on performance, cost and time. As a project develops, the focus of work passes from concept work led by the ECC, to the assessment, demonstration and manufacture phases led by the IPT within the DPA, to in-service support and ultimately disposal led by the Defence Logistics Organisation (DLO). At a suitable point, the IPT will transfer to the DLO, maintaining continuity of support for the equipment at a key point in its life.

Relationships with the ECC and the DLO are vital for the DPA. It should be clear from the Agency's targets that it is – and needs to be – a very customer focused organisation. Meeting the expectations and requirements of all Agency customers is vital, and the Agency has set itself a demanding level of increase in levels of customer satisfaction.

The DPA also supplies specialist acquisition-related services to customers elsewhere in the MOD, to Other Government Departments and to overseas Governments. These include commercial, legal, pricing, quality assurance services and professional training.

In May 2001, the DPA and DLO launched a major joint initiative to achieve total interoperability between the two organisations. The principal focus of the initiative is to examine the management processes and associated tools that need to be put in place to enable the DPA and the DLO to work more closely together. The joint development of interoperable processes between the two organisations is an essential enabler for improving the support the two organisations can provide to their customers. Pursuing interoperability opportunities is a logical follow-on from the adoption of the principles of Smart Acquisition and initial work will focus on financial processes, human resource management and business tools. It will also mean that the MOD will be better placed to engage with future acquisition-related challenges, such as industrial restructuring and e-commerce.

The Defence Logistics Organisation

Logistic support is crucial to the operational effectiveness of the Armed Forces. Equipment must be maintained at the right standard and consumable stores such as food and fuel must be delivered to the right place at the right time.

Logistics is also big business. The DLO employs 36,000 staff, has an annual budget of over £7 billion (which is on a par with British Airways) and has assets valued at around £20 billion (greater than BT). Like the DPA, the DLO delivers much of its output through IPTs (over 70 at present). In addition to the IPTs, however, who are responsible for supporting specific equipment through its life, there are a number of other organisations responsible for providing common services such as storage, distribution, transport, food, fuel etc. Significantly, DLO involvement with equipment now starts well before it enters service, as the DLO is increasingly involved with the decision making from the earliest stages of acquisition.

The Strategic Defence Review represented a watershed in the way that logistic support was to be delivered with the decision to create a single tri-Service organisation which could drive out duplication of effort, thereby reducing costs, while embracing opportunities such as those offered by the world of electronic business to increase the speed and quality of service delivered to the front line. Previously, logistic support had been provided on a single Service basis. Now it is the preserve of a fully joined-up, tri-Service organisation which is not only improving its internal processes, but also has the clout to negotiate with industry as a huge customer.

The DLO's central strategic objective is to reduce the cost of its outputs by 20% over the first five years of its existence – by 2005. To meet this goal, a series of business improvement initiatives across the entire range of DLO activities is now in progress. Most significant among these, and one which affects the whole of defence, is the introduction of Resource Accounting and Budgeting (RAB). This enables the MOD for the first time to understand the true costs of owning equipment, stocks and capital assets; this will be a vital aid to better management of defence resources and for identifying where true value for money lies.

With an asset base well in excess of £20 billion, reducing the volume and value of DLO stocks and ensuring that assets held are fully exploited is crucial to the success of the organisation. The DLO is bearing down on the £9 billion worth of capital spares that it holds for defence by making the newly formed Integrated Project Teams more directly responsible for the spares held on their behalf. The DLO has already reduced its stockholdings by 20% (by value), and there is more to come.

The DLO is also introducing the Defence Stores Management Solution (DSMS). DSMS will give full visibility of stock across the entire Defence supply chain. It will allow improved forecasting, provide better management information and offer a deployed capability for front-line operations.

The DLO has identified a number of other areas where it plans to make a significant step-

change in performance to achieve its strategic objective. Two of the most crucial areas are convergence and e-commerce. The Department's approach to e-commerce is detailed separately below.

Convergence

One of the key advantages of moving to a single logistics organisation is the opportunity to combine parts of the business involved in the same or similar tasks. Such combination, or convergence, offers substantial opportunities to streamline processes, spread best practice, improve performance and thus save money that can be invested in the front line. A number of significant organisational changes have already taken place. Examples include:

- ◆ An integrated military aviation support capability - Director General Equipment Support (Air) - provides one home for the in-service management of all Navy, Army and RAF aircraft support.
- ◆ The Defence Communications Services Agency (DCSA) has absorbed those parts of the RAF Signals Engineering Establishment previously engaged in similar activities.
- ◆ A new Warship Support Agency was formed on 2 April 2001, bringing together the Ship Support Agency and most of the functions previously carried out by the Naval Bases and Supply Agency. A single agency is now responsible for all aspects of supporting the Fleet.
- ◆ Other joint groupings formed in the DLO's first year that bring together similar activities previously spread over several areas of responsibility include:
 - ◆ The Defence Fuels Group.
 - ◆ The Defence Catering Group.
 - ◆ A Corporate Technical Services Centre.
 - ◆ A single Defence Munitions Group.

These are just some examples of the organisational changes underway in the DLO. Such changes have already saved around £20 million and are likely to save well in excess of a further £100 million over the next three years. The DLO will continue to examine all the activities it carries out with the aim of further combining processes and organisations where it is effective and efficient to do so.

Engineering Support

On 2 April 2001 the Defence Aviation Repair Agency (DARA), which provides a single home for all Navy, Army and RAF aircraft repair, became a Trading Fund. This move gives the agency substantial commercial freedom to market spare capacity, seek new trading relationships and thus reduce costs, while preserving an effective in-house repair capability. Closer partnerships between DARA and industry have provided the opportunity to focus on engineering support as a single process from the factory to the front line rather than separate efforts at each level. The lessons identified from such projects have reduced repair turn-around times radically and offer a signpost for future support strategies for new aircraft from the outset. In a similar fashion, the Army Base Repair Organisation (ABRO) has established a number of key partnerships with industry for the support of specific equipment, and it is planned that ABRO will become a Trading Fund in April 2002.

Support to Operations

While managing this major programme of change, the DLO continues to discharge its prime responsibility – which is to support front-line military operations. During its first year, the DLO has continued to provide support to operations in the Gulf, the Balkans, Sierra Leone and garrisons around the world. It has also supported the UK's largest overseas exercise for many years – Exercise Saif Sareea 2 – in Oman.

The Defence Estate

The Defence Estate is critical to the effectiveness of our Armed Forces. It is where they train, where they live and it provides a base from which their operations can be mounted. It is also an important national resource, comprising 1% of the UK mainland and some 40,000 buildings on 4,000 separate sites. Its existing use value is some £14 billion, and between £1 billion and £1.5 billion is spent directly on it every year.

Estate Strategy

The MOD's Estate Strategy, *"In Trust & On Trust: The Strategy for the Defence Estate"*, was launched on 7 June 2000, fulfilling a commitment made in the Strategic Defence Review. For the first time it provides a comprehensive framework for the long-term management of the estate. Developed across the Department and the Armed Forces, it recognises the MOD's wider role in society and reflects consultation with both the Government's Statutory Advisers and the voluntary sector, particularly in relation to the MOD's rural landholdings. It also takes account of the conclusions and recommendations of recent National Audit Office reports on the estate.

The MOD's vision for the future of its estate is *"to have an estate of the right size and quality to support the delivery of defence capability, that is managed and developed effectively and efficiently in line with acknowledged best practice, and is sensitive to social and environmental considerations"*. The MOD is now putting in place a specific performance framework within which the Defence Estate can be managed and developed to deliver this vision, and allow the effectiveness of its stewardship to be judged.

Over time the Estate Strategy will deliver a number of important benefits to the Department:

- ◆ To date, comparatively little attention has been paid to the corporate management of the Defence Estate and its contribution to defence capability as a whole. The Strategy will shape a new culture in which managers and users can focus clearly on these issues, particularly through a better understanding of the total costs of occupation and use. Increasingly challenging targets will be set to drive continuous improvement.
- ◆ By identifying opportunities to consolidate activities on to defined long-term core sites, the Strategy will deliver improved levels of utilisation, more widely spread overheads and lower running costs. It will also be possible to direct investment better. By 2002 the MOD intends to identify those core sites on which it seeks to focus activities and within five years to increase by 10% the proportion of staff employed on them.
- ◆ The Strategy will help the MOD to demonstrate to external stakeholders that their needs and expectations, particularly those relating to issues of access and sustainability, are being taken into account while pursuing the Armed Forces' operational requirements. By 2002 the MOD aims to have developed the means to measure its long-term need for rural training land and the means to manage this requirement in a sustainable way.
- ◆ Finally, the Strategy will provide for a greater level of openness and more information for the public about defence needs, and about management and use of the Defence Estate. A formal annual stewardship report will detail the MOD's performance against a range of measurable performance indicators and aspirational goals. The first such report will be published early in 2002.

Work is currently underway to bring the training and development of Defence Estates' IPTs under the Prime Contracting Initiative (see below) into line with those of Smart Acquisition elsewhere in the Department. This will bring the MOD's estate business into the mainstream of the Department's acquisition processes and will allow all staff to exploit wider career development opportunities.

Public Private Partnerships

Public Private Partnerships (PPPs) are a key part of the Government's approach to providing services in the public sector. The Ministry of Defence is using PPPs to develop better ways of supporting the Armed Forces. Defence PPPs have built upon several years' experience of contracting for support functions from the private sector. The Department's long-standing relationship with the defence industry also provided a solid foundation on which these new commercial relationships could be developed.

The MOD selects PPP projects on their merits. It employs PPP tools such as the Private Finance Initiative (PFI) and Partnering where they offer the potential to achieve greater value for money than could be achieved under more traditional ways of doing business, while improving or sustaining front-line capability. The MOD has no dogmatic preference for private over public, or vice versa.

Private Finance Initiative

PFI remains the cornerstone of the Department's PPP programme. Wherever the MOD needs substantial new capital investment, it considers whether or not it makes sense for that investment to come from the private sector rather than from public funds. In PFI, the Department contracts for services rather than assets, so the MOD first needs to decide whether it would be practical to meet its requirements by means of a contract under which services are provided rather than by the outright purchase of assets such as buildings and equipment. If so, the Department next considers whether such an approach has the potential to offer better value for money than if it bought assets directly. PFI aims to achieve this by allowing the MOD to focus on its core military tasks supported by a private sector partner, who can offer services more efficiently or at less cost because it is able to do things that the MOD cannot. For example, a contractor may be able to reduce the cost of providing a service if he is able to sell on spare capacity as an asset to other users.

But one of the most important features of PFI is that it offers the MOD the potential to transfer risks to the private sector where it is better placed to manage them. For example, where demand for a service can vary, it has been possible to specify minimum and maximum service requirements in contracts, so the MOD pays for the service it receives only when it needs it. It is essential, therefore, when designing a PFI contract, to understand the risks associated with it, to define them precisely, and to allocate each area of risk to the party best able to manage it.

Because payments are made to the partner only when satisfactory service is received, there is a strong incentive on the partner to deliver. This is underpinned by the partner's need to service the finance it has raised to buy the assets it is using under the contract. Under the process known as "due diligence", the providers of finance will test the assumptions behind the business plan of the partner in order to satisfy themselves that the question of risk has been properly addressed. This mix of mechanisms and incentives means that once a contract is signed, projects are much more likely to deliver the required level of service on time and, because there is no scope in the contract for additional payments, within the budget.

The MOD's PFI Programme

The Department has a very large and diverse PFI programme that includes service accommodation, housing, information systems, utilities, training facilities and equipment. Thirty-seven contracts have so far been signed, resulting in some £2 billion of private sector investment in defence. These include high profile projects such as the contract to refurbish the Department's Whitehall HQ and to provide serviced accommodation for a 30-year period, and the recently opened Joint Services Command and Staff College at Shrivenham.

Some 50 further projects are being developed which offer the possibility of a further £12 billion of private sector investment. These include Future Strategic Tanker Aircraft (FSTA), the Skynet 5 satellite, and Heavy Equipment (Tank) Transporters (HET) for the Army. FSTA and Skynet 5 should both benefit from the private sector's ability to market the assets acquired for each project to other customers when they are not required by the Armed Forces. In the case of FSTA, the number of aircraft required for large-scale operations is greater than those needed in peacetime for routine operations and training. This offers potential for a private sector partner to use tanker aircraft to carry cargo for commercial operators when they are not required for military purposes. Similarly for Skynet 5, a communications satellite designed along commercial lines need not be restricted to UK military use provided essential security needs can be protected. Both FSTA and HET also seek value for money by employing people flexibly. Both projects intend to use the Sponsored Reserve concept in which contractor personnel can carry out military and non-military work in peacetime, but can be deployed as members of the Armed Forces on operations.

Taking PPP Forward

The MOD has a rich PPP programme, exploiting the full variety of tools available under the Government's PPP policy. Amongst the different strands, however, there are some common themes and common lessons to be drawn. Much of Defence PPP is about closer, long-term relationships with private sector partners which require commitment and effort on both sides in order to achieve common goals. In so doing, it is necessary to understand the strengths and weaknesses of both public and private sector bodies. The MOD's aim is always to develop relationships that capitalise on the strengths, but in allocating responsibility for management, to take into account the weaknesses.

Such relationships are based on open, co-operative means of doing business with shared risks and rewards. This depends upon the clear identification of risks and who is best able to manage them. It is also essential that contractors are provided with commercial incentives to review and improve their performance throughout the length of the contract. It is with these principles in mind that the MOD continues to push forward the PPP agenda.

KEY COMPONENTS OF DEFENCE ACQUISITION

6. Defence Acquisition is a necessarily multifaceted activity. Encompassing everything from minor local purchases through to long-term equipment programmes worth billions of pounds, there cannot be a “one size fits all” solution. However, there are a number of key guiding principles and important components to the MOD’s approach.

Value for Money

7. In all areas of acquisition the MOD seeks to achieve best value for money. This does not mean that it simply acquires the cheapest available item or accepts the lowest bid in a competition. Best value for money denotes the solution that meets the requirement at the lowest through-life cost.

Outputs not Inputs

8. Traditionally, the MOD has tended to write into specifications a large number of detailed stipulations about the nature of the product it wished to acquire. These might be the number of layers of paint on a ship or the thickness of the walls of a building – or, put another way, *inputs*. This represented a concentration on stipulating *how* suppliers should go about providing what was required, rather than concentrating only on what it was that the MOD required in terms of the final capability. This has changed and the MOD now specifies the capability or *outputs* which it requires, leaving the supplier greater freedom to determine how best to *deliver* the desired outcome. This approach can be applied more widely, either as part of a PFI deal or in a conventionally funded contract.

Whole-Life Approach

9. It is often the case that the initial purchase cost of a system or building is only a fraction of the cost of operating or maintaining it throughout its life. The figures can be particularly startling for defence equipment because, typically, it will have a long service life – 25 years is not uncommon. The whole-life approach is therefore a key principle of Smart Acquisition and the other initiatives. Using sophisticated techniques and modelling, project teams seek to establish the Whole-Life Costs (WLC) and annual Cost Of Ownership (COO) of the solutions under consideration for meeting a capability requirement, so that investment decisions are not founded on just initial purchase cost. Under PFI deals, the supplier is responsible for making the initial capital investment and then operating and maintaining the equipment or facility for several years: whole-life cost considerations are therefore an essential part of the bidding and subsequent contract negotiation processes.

Clarification of Internal “Customers” and “Suppliers”

10. To bring rigour and discipline into the acquisition process, it should be clear who within the Department requires a particular capability (and who is therefore accountable for clearly

defining what is required) and who is responsible for delivering it (and who is therefore accountable for the efficiency with which this is done). Smart Acquisition has placed particular weight on the establishment of clear customer/supplier relationships. This has led to the creation of the Equipment Capability Customer (ECC) organisation (see separate box) which is responsible for defining the equipment capability required, both across the board and for individual projects.

Equipment Capability Customer

The Equipment Capability Customer (ECC) organisation is responsible for determining future equipment capability requirements, and producing an annual Equipment Plan programming future investment to meet the current and future needs of the Armed Forces. ECC staff act as customers for the IPTs, primarily in the DPA, who procure equipment as required by the ECC. The ECC's tasks are to define the requirement; prioritise and balance investment between and within equipment capabilities; seek and obtain approval for the capability; and finally, authorise acceptance by confirming that the capability has been met by the systems supplied.

The Equipment Plan is built up from over 1,000 present or future equipment programme lines. But the ECC focuses on a capability approach. This means:

- ◆ Framing future requirements in terms of mission needs, not assumed equipment solutions. Directors of Equipment Capability are responsible for generic capability areas such as Theatre Mobility, or Command, Control and Information Infrastructure, which cut across single Service boundaries. The IPTs are responsible for developing equipment solutions to meet the capability need, and then delivering them within agreed performance/time/cost envelopes.
- ◆ Adopting a more rigorous approach to determining the optimum balance of investment in the Forward Plan. The ECC is developing a process for auditing its forward plans against the capabilities needed to achieve successful campaign outcomes, underpinned by operational analysis of a range of representative scenarios.
- ◆ Adopting a through-life approach to capability management. This involves ensuring that whole-life cost implications (including manpower and equipment support) are fully factored into all investment decisions; and ensuring that all stakeholders have a voice in the ECC's decisions.

11. It has also led to the emergence of the Second Customer function. Essentially, these are the users of the equipment among the single Service staffs and Front Line Commands. They provide a user's perspective during the procurement stages of the acquisition process and, for equipment already in service, stipulate the levels of availability (eg for a ship, days at sea) which the relevant IPT must aim to deliver.
12. In the Defence Estate environment, the prime contracting procurement strategy also has clearly defined customer (demand) and supplier roles. Each prime contract will be managed by an Integrated Project Team, which will work with the prime contractor and his supply chain once

they are appointed. In June 2001, the Defence Management Board endorsed a new model for the overall management of the Departmental estate that will clarify the distinction between the demand and supply roles. This envisages up to six new estate requirement organisations embedded in TLBs, and a single new 'purple' body responsible for working with PFI and prime contractors in industry to put together estate solutions that it will then be accountable for delivering through its IPTs.

Best Practice

13. The MOD organisations involved are all concerned to achieve excellence in defence acquisition. The DPA, DLO, Defence Estates (DE) and the ECC have all adopted the European Foundation for Quality Management's Excellence Model, which provides a comprehensive framework for improvement and change by providing the opportunity for continuous monitoring of organisational performance. Smart Acquisition also advocates the use of techniques such as incremental acquisition and trading-off between performance, cost and timescale parameters.

Teamwork with Industry

14. Bringing about a profound change in the nature of the relationship between the MOD and its suppliers is a key feature of Smart Acquisition and a key aim of the DPA, the DLO and DE. The optimisation of relationships within the supply chain can offer benefits to all concerned: to the MOD, by reducing costs and enabling the Department to generate the savings necessary to fund the improvements in front-line capability emerging from the SDR; and to its *suppliers* by giving them a clearer understanding of their customer and requirement, and the prospect of more stable, longer term business with attractive earnings potential.

The Partnering Ethos

15. In this new environment, the specific contractual arrangements between the MOD and its suppliers need to be underpinned by the right set of broader relationships between them. This is often described as the partnering ethos. Its key features include:
 - ◆ A shared commitment to excellence. The partnering ethos underpins a number of the MOD's initiatives. These include Smart Acquisition, PFI, Outsourcing, Wider Markets, Lean Logistics, PPPs, Partnering Arrangements, and Prime Contracting. Increasingly, the conventional acquisition of equipment requires the establishment of long-term contractual arrangements with a private sector partner. In order to make these arrangements work, the MOD needs to establish a good relationship with the partner. MOD aims to promote effective communication between the public and private sectors leading to openness and trust, better mutual understanding and earlier identification of problem areas in projects, and increased value for money in complex procurement projects. MOD believes industry shares these objectives. All this requires:
 - ◆ A commitment to achieve excellence in the timely supply of high quality products and services and an attitude of mind that builds on the Department's acquisition policies.

- ◆ A shared commitment to securing best long-term value for money.

- ◆ Transparency and honesty between the Department and its suppliers.

16. To support the development of this partnering ethos, the MOD and its supply base are engaged in active dialogue at all levels. Beneath the National Defence Industries Council – which is chaired by the Secretary of State or the Minister for Defence Procurement and comprises the top acquisition officials and leading defence industrialists – are a number of joint working groups (see box). These address matters of common concern and develop jointly practical guidance on specific issues.

MOD/Industry Joint Working Groups

Commercial Policy Group

The Commercial Policy Group (CPG) is a joint MOD/Industry Group which deals with commercial policy in defence procurement. Its purpose is to promote improvements in defence procurement and, in particular, to provide guidance to both sides on Smart Acquisition. The group aims to agree ways in which ideas for improvements in defence procurement, and in particular the principles of Smart Acquisition, can be put into effect, and to publish these as agreed policy statements to those involved in the business.

Human Resources Group

The Human Resources Group (HRG) was formed to enable MOD and industry to share their experiences and learning in the Human Resources (HR) field; to address HR issues raised by Smart Acquisition and to share best practice. The HRG has set up two sub-groups to focus on:

- ◆ Improving MOD/industry interchange
- ◆ Joint Learning

Partnering Implementation Working Group

The Partnering Implementation Working Group was formed to collect, discuss and promulgate best practice on Partnering Arrangements between the MOD and industry. It is chaired by the MOD with the CBI leading for industry, with support from a number of Trade Associations.

Support Policy Group

The Support Policy Group (SPG) is a joint MOD/Industry group whose aim is to facilitate the delivery of improved, coherent, cost-effective and affordable defence capability support.

Involving our suppliers

17. Smart Acquisition places particular emphasis on actively involving suppliers in all aspects of a project and during all stages of its life cycle. This involvement can take forms such as:
 - ◆ Companies being encouraged to contribute their ideas at the “front end” of a project.
 - ◆ Contractors being given the opportunity to provide members of Integrated Project Teams.
18. As part of the multi-disciplinary approach adopted in IPTs, and as a way of building understanding between the MOD and its suppliers, industry is also given the opportunity to put forward candidates to be IPT Leaders. Propriety of the acquisition process is maintained when necessary by restricting IPT membership, such as during periods of tender competition. Currently, there are two IPT Leaders (one in the DPA and one in the DLO) who have been seconded from industry and one IPT Leader (in the DPA) who has been recruited from industry by open competition. A recent survey identified that approximately twenty companies have placed nearly 170 members of their staff with IPTs.

Sharing the benefits

19. Awarding contracts on the basis of open competitive tendering remains the MOD's preferred approach and obtaining the greatest advantage from competitive leverage, at prime and sub-contract level, remains a major tool in defence procurement. The aim, therefore, is to continue, wherever it provides best value for money, to select contractors by competition.
20. However a contractor is selected, it is in the interest of both the MOD and its suppliers to structure – and, where appropriate, restructure – contracts to ensure that they continue to deliver best value for money over time. Two key approaches are:
 - ◆ *Incentivisation.* Incentivisation for new contracts may be positive (rewards for good performance) or negative (sanctions in the event of failure to perform contractual obligations). Positive incentives may include paying bonuses where value is added beyond the baseline contractual requirement, and more flexible use of interim payment arrangements by which any retention against the contract price is adjusted to reflect good or poor performance.
 - ◆ *Gainshare.* Gainshare is where the reopening and examining of existing contracts may bring benefit to both the MOD and industry and is central to Smart Acquisition. Benefits of gainshare opportunities can include accelerated delivery of the product or service, performance improvements and reduced costs - in other words faster, better, cheaper. Technology advances, changes to trials programmes, innovative support arrangements, and income stream opportunities from the transfer of assets are examples of gainshare that may develop while a contract is in action.
21. The implementation of these approaches is subject to continuing joint monitoring by the MOD and industry representatives.

Partnering Arrangements and Agreements

22. Partnering may be formalised in a number of ways – strategic partnering agreements between the MOD and its key suppliers; Partnering Principles documents; Partnering Arrangements; and so on. This section will illustrate these approaches by reference to current business priorities.
23. A Partnering Arrangement is a form of long-term contract that establishes a framework within which the Department's relationship with a contractor can grow over time. Unlike a PFI contract, where the MOD has to be very clear of the long-term requirement (as the contractor generally has to finance a substantial initial capital investment and raise money for it), a Partnering Arrangement does not require the Department to be so clear about final outcomes. Generally, such arrangements promote a developing relationship with a private sector partner over a range of possible activities. The partner is given opportunities to innovate and seek value for money. If he is successful, the MOD is likely to expand its business with him, as he demonstrates he can meet the Department's needs efficiently and cost-effectively.
24. A key objective of the Defence Logistics Organisation is to deliver better value for money by making more intelligent use of industry's wealth of expertise and experience in supply chain management. Measured by value, most of the DLO's business is conducted with a few key suppliers with whom new strategic partnering agreements are being forged. These set out formally the principles that will govern the joint approach to business. They will commit the DLO and industry to working together in agreed ways to introduce improvements in cost and performance, and to share the benefits of mutual success. They will set targets and incorporate a spread of indicators that will provide visibility of companies' efficiency and effectiveness in how they conduct their business and deliver against the MOD's requirements.
25. These partnering arrangements will foster an environment in which both sides will be comfortable sharing views and information. Working relationships will be closer but still professional at all times. The DLO will work to identify initiatives that offer success to both parties – improved performance and lower cost to the Department, higher shareholder value to the industrial partner. By taking a more strategic overview of the span of its business, the DLO will be able to identify ways of achieving greater utilisation of resources and expertise. And it will be receptive throughout the life of a contract to opportunities for further improvement using the gainshare process developed as part of Smart Acquisition.
26. The DLO is not the only part of the MOD to embrace partnering. Elsewhere, for example, as in the case of the Naval Recruitment and Training Agency's (NRTA) partnering arrangement with Flagship Training Ltd, the partnering arrangement leads to individual PFI projects within the partnering umbrella. For example, NRTA has a PFI contract for its Fire Fighting Training Unit.
27. Partnering Arrangements normally take the form of a Partnering Principles document defining the principal agreements between partners, and a Framework Agreement within which separate tasking orders define each element of the service to be provided. An example of how this works in practice is the Army Training Estate Strategic Partnering Project (ATE SPP), through which the Army is seeking to appoint a private sector partner to help develop, maintain, and manage its training estate. The partner will play a central role in helping to ensure that informed strategic decisions are made about the estate in the light of judgements about commercial, social, and land management issues.

28. The partner will be expected to **share** responsibility with the military and Defence Estates for the planning and development of the ATE, the provision of range operations and the selling of spare capacity to third parties such as other military or police forces and civilian users. He will be expected to **take** responsibility for the management and provision of the built and rural estate, its administration, and other services such as catering. The partner will provide management information on his own performance and that of the DE and the ATE, to enable the training estate to be managed, developed and used effectively. The aim is to achieve value for money through combining best private sector practice with military expertise, allowing the military to focus on the development of training infrastructure on the ATE, and on providing military advice to units engaged in training on the ATE.
29. Military users of the training estate will be provided with a single point of contact through which they can arrange everything they need to support their exercise, for example domestic and training accommodation, catering, practice targets and stores.

Prime Contracting – “Smart Construction”

30. For the acquisition of defence equipment, the MOD has for many years looked to a prime contractor in industry to deliver a complete solution which meets the Department's requirements. The SDR concluded that the same model should be applied to the Defence Estate. As a result of the SDR, DE (the MOD agency charged with managing its estate) has been driving forward a change project to improve radically the management of the £1.5 billion a year the MOD spends on the estate. The Department has set a target to demonstrate value for money improvements of 30% over the life of projects, where prime contracting is adopted, by 2005. The Prime Contracting Initiative for the Defence Estate – known as “Smart Construction” - is the application of the principles and methods of Smart Acquisition to property maintenance and construction projects. It centres upon the introduction of the well-proven process of prime contracting and supply chain management to the construction industry and has placed the MOD at the forefront of the Government's ‘Rethinking Construction’ initiative to reform the industry. Prime contracting is fully consistent with the principles of Public Private Partnerships (PPP) and was endorsed by the Defence Council in December 2000 as the MOD's method of choice when the Public Finance Initiative is not a suitable solution to a particular need.
31. Prime contracting for the Defence Estate covers both a series of large long-term regional arrangements with industry, and a programme of stand-alone contracts for substantial capital works projects (such as the major new initiative to improve single Servicemen and women's accommodation). Many projects are already underway and the transition to the new arrangements should be complete in 2004. The MOD expects to obtain significant improvements in the through-life value for money obtained from the money spent on the estate. Following the roll-out of the Defence Estates prime contract model, emphasis has shifted to implementation. The process of competition for the first of the regional prime contracts, which covers the provision of both new capital works and maintenance of the existing estate in Scotland, began in January 2001 and a contract is expected to be let in 2002. The other four regional prime contracts in Great Britain will be rolled out progressively and completed by 2004/05. These contracts will be 7 to 10 years in duration and worth between £400 million and £750 million each. Thus they are very challenging for the estates staff in the new Integrated Project Teams. In addition to the regional prime contracts, there are already more than 20 stand-alone estate prime contracts of various sizes in the procurement process.

Non-Project Procurement

32. The DLO spends over £120 million each year on common range items such as tyres, hammers, paint and packaging. Because of the way in which contracts have previously been placed, in separate and fragmented ways, defence has not been able to use its full weight in the marketplace. The DLO has therefore formed a single organisation - the Non-Project Procurement Office (NPPO) - which is applying economies of scale, reducing lead times, eliminating unnecessary stock-holdings and exploiting the advantages of e-business processes.
33. Through grouping general stores into specific product areas, the DLO aims to reduce the current 5,500 logistics contracts into about 25 arrangements with industrial prime vendors. This reflects the DLO's target to establish long-term, incentivised partnering arrangements with industry to reduce total support chain costs for both parties by reducing the number of steps in the chain. This in turn will reduce the price paid. It is estimated that this approach will yield around £120 million of savings over four years.

E-Commerce

34. The Ministry of Defence has the largest e-business programme in Government. The Defence Electronic Commerce System (DECS) will, over time, become the single and modern electronic face that the DLO – and the MOD – presents to industry. The contract for DECS was signed in July 2000 with Cap Gemini Ernst & Young, with whom the Department has formed a strategic partnership to enable it to exploit e-business opportunities designed to transform its business. A secure electronic messaging hub that joins up the MOD and industry so that orders can be placed electronically has been achieved; the MOD expects its trading partners to begin to use the facility progressively.
35. The DLO is at the forefront of the Government's drive to exploit the opportunities offered by the revolution in e-business. At present, three million defence transactions a year continue to be managed by completion and circulation of a 5-part paper form that soaks up an enormous amount of resources. There can also be the frustration of not being able to identify the location of a high demand spares item, perhaps critical to a current operation, from within a fragmented supply chain.
36. E-business offers a huge opportunity to take a decisive step forwards, allowing a single view of the defence inventory, the ability to track assets to and from the front line and the ability to place orders electronically – accurately and swiftly. An initial electronic purchasing capability has now been launched. This is the precursor to a full electronic "Purchase to Payment" system which is to be introduced. The DLO is now planning to develop collaborative e-business trading with more and more commercial suppliers, so its in-house parts catalogues and engineering configuration data can be accessed, and so that the DLO is able to track items as they progress around the industrial repair loop.
37. With new tools such as these, the DLO will be able to drive down costs significantly by reducing stock levels, managing expensive repairable assets better and cutting down on the number of suppliers it does business with. Greater visibility of the stocks and spares it holds, or has access to within the commercial sector, will allow the DLO to maintain and then improve its support to the front line

Wider Markets

38. The MOD is committed to the disposal of surplus capacity wherever practicable. But the nature of defence business means that some irreducible spare capacity is always likely to remain; for example the spare capacity that has to be held in peacetime so that the Armed Forces are able to meet an increased training requirement in times of crisis or war. Therefore, to make the best use of the MOD's extensive physical (equipment, land, premises) and non-physical (intellectual property, data, skills) asset base, the MOD budget holders are encouraged to market assets for which the Services have no immediate need, but which cannot be disposed of in order to secure extra income. Income from this 'Wider Markets' activity can be used by business areas either to support core MOD objectives, or to contribute to local 'quality of life' improvements for military and civilian personnel.
39. Depending on the scale and nature of the project, the MOD may decide either to undertake the commercial activity on its own, or through partnering or joint venture arrangements with the private sector. A private sector partner can often provide the commercial and marketing expertise and, sometimes, additional capital investment required to enter new markets and attract third party business more effectively. The range of Wider Markets activity within the MOD includes the sale of meteorological services, charts and maps by the Meteorological Office, the Hydrographic Office and the Defence Geographic Centre respectively; the use of MOD locations for film and television productions; and the marketing of spare training capacity by the Naval Recruiting and Training Agency, the Army Training and Recruiting Agency, and RAF Ground Training.

People

40. Applying the principles of Smart Acquisition and related initiatives requires a greater availability across the Department of skilled and experienced acquisition staff. A number of schemes are underway to meet this demand:
- ◆ The **Acquisition Stream**. Launched in February 2001 by the Secretary of State for Defence, the Acquisition Stream aims to create a highly committed, well-trained and skilled body of professional people in acquisition and to provide military and civilian acquisition staff with a common set of values and a framework within which to develop their skills and competences. The focus is on self-development with the individual deciding how, when and at what pace they want to develop in the various areas that make up the acquisition organisation. Over 1,000 people have already joined the Acquisition Stream. Members are provided with a number of development tools to help them identify the skills and competences they already have and those they need to develop further.
 - ◆ The Acquisition Stream complements the **Acquisition Leadership Development Scheme (ALDS)**. This is focused on developing existing and future IPT Leaders - to prepare them to take on the most challenging leadership roles across the acquisition organisations. Membership currently stands at 200 and is set to rise to 400 early next year. Empowered and responsible leaders are vital to the delivery of equipment

capability to the Front Line and the ALDS is expected to produce high quality candidates for leadership posts across the acquisition community. Both schemes are open to Service personnel, as well as to MOD civilians and secondees from industry.

- ◆ **Commercial Function training.** Commercial staff within the MOD are being encouraged to gain professionally recognised qualifications. MOD training courses now enable trainees to sit the Office of Government Commerce's (OGC) Certificate of Competence and greater membership of the Chartered Institute for Purchasing and Supply is encouraged (CIPS). A new suite of courses known as the Commercial Foundation Programme has been aligned to the OGC sponsored Certificate of Competence in Purchase and Supply qualification.

- ◆ **Joint training with industry.** The MOD/industry **Joint Acquisition Learning Group** is working together to develop training courses for staff from both the MOD and industry and is developing best practice guidelines for joint training events and promoting these events.

RESULTS

41. Smart Acquisition and related initiatives are already delivering results. The challenging target of reducing acquisition costs by £2 billion over the period 1998 to 2008 (identified as a target of the Strategic Defence Review), in order to create headroom for new purchases, and investment in other areas, such as people, has been achieved. In the three successive annual planning rounds since the launch of the Smart Procurement Initiative, cost reductions equivalent to that amount attributable to Smart Procurement/Acquisition have been identified across more than 100 projects, including:

- ◆ The Attack Helicopter project expects to save £30 million each year in support costs by investing around £100 million to procure support test equipment to gain potential downstream savings of at least £700 million over the life of the aircraft. This represents 20% of the Attack Helicopter's support costs.
- ◆ The Ground Based Air Defence programme has achieved reductions of £60 million against original estimates. Its follow-on buy of new and refurbished missiles for the Rapier short-range air defence missile system has demonstrated the benefits of working closely with the supply chain.

In addition, further savings of over £200 million were made in the DPA's Equipment Plan drawn up in 2000/01 as a result of projects becoming faster, cheaper and better.

42. But Smart Acquisition has always been about more than achieving savings. The MOD is seeking significant improvements in timeliness and performance. For those large projects which make up the Major Projects Report, the Department is confident of meeting the challenging Public Service Agreement targets by March 2002; targets that include no average increase cost in-year, and no more than about a week's slippage on new projects.

43. Other cost and time savings have been achieved through Smart Acquisition by:

- ◆ The C-17 Short Term Strategic Lift IPT which reduced its programme costs by over 30% and took delivery of the first aircraft three months early.
- ◆ The Air-to-Air Refuelling IPT which has increased VC10 availability as well as cost savings of some 20%.
- ◆ The Flight Simulation and Synthetic Trainers IPT has delivered the Hawk Synthetic Trainer on budget, on time and 20% cheaper by adopting the PFI route.
- ◆ Engineer Tank Systems. The IPT has used Smart Acquisition techniques for the Trojan and Titan engineering tank projects programme achieving early Main Gate approval and subsequently awarding Vickers Defence Systems the contract for demonstration and manufacture one year ahead of schedule.
- ◆ Advanced-Cycle Low-Powered Gas Turbine Alternator. The Marine Propulsion Systems IPT recently conducted a competition on behalf of the Future Surface Combatant IPT for the development of a gas turbine alternator demonstrating enhanced capability and lower whole-life costs when compared to current technology diesel generators.
- ◆ Survey Vessels. The project has adopted a partnering approach involving the DPA, its customers and suppliers, and the DLO, working with a novel whole-life Contractor Logistic Support contract involving partnering and gainshare arrangements.
- ◆ The Air Launched Munitions IPT, working closely with Matra BAE Dynamics (MBD), has combined 26 separate contractual arrangements that existed to support four missile types.

44. The MOD's PFI programme is also delivering real results. For example, in October 1997, the MOD awarded a 20-year contract to CVS Aircrew Training plc for the delivery of training support to the aircrew of Puma, Chinook and Merlin Helicopters. The contract includes provision of a much more capable simulator system than had previously been available, backed up with computer based training to reduce flying hours, and hence both the cost and environmental impact of aircrew training. The Joint Helicopter Command is delighted with the new system's performance and feedback from trainees is very positive. When the simulators are not required for British military use, they are being used by the PFI partner to train aircrew from British industry and from overseas. The additional revenue from this is shared with the MOD.

45. In a similar arrangement, BAE Systems are providing a comprehensive training service at RAF Valley for RN, RAF, and overseas personnel, under a 17-year contract awarded in December 1997. The delivery of this service started on schedule in December 1998. The contract comprised the design, build, operation and maintenance of the simulator facility. The simulators include the Hawk Weapons and Tactics Simulators, and the Hawk Instrument Flight Simulator. Individual simulators can be networked together for team training. The simulator facility is now fully up and running and operating well with availability levels at very nearly 100% and very high usage rates, owing to the popularity and capability of the system.

46. The development of the Defence Estates' prime contracting model has been informed by experience of the application of supply chain management principles to two trial projects

involving Army Physical and Recreational Training centres at Aldershot and Wattisham. These have demonstrated improvements in design, labour efficiency, material wastage, construction time and working culture which, together, have delivered projected savings in whole life costs of 10 – 14%.

47. Although prime contracting has now been adopted by the Treasury as the preferred public sector construction procurement model after PFI, the benefits will only be measurable over the life of the projects concerned. More than twenty major capital prime contracts are now at various stages of the procurement process with the first to be placed - for a £38 million combined workshop, office and accommodation development at Andover - reporting that it is within both budget and programme. This project, and another to deliver submarine berthing facilities at Faslane, are also demonstrating the value of a fully integrated approach to procurement involving close collaborative working between the IPT, the end user and the supply chain. The first of five regional "one stop shop" contracts for property management and small and medium scale capital works in Scotland has attracted strong interest from industry.

FUTURE CHALLENGES

48. Smart Acquisition places the emphasis on acquiring *capability*, not equipment *per se*. This requires new ways of thinking – specifying outputs rather than inputs in contracts. A capability approach to defence acquisition is already being followed throughout the MOD and both PPP projects and Defence Estates, through their prime contracting programme, are good examples of this.
49. Principles such as taking a whole-life perspective, defining clearly the roles of customers and suppliers, and establishing Integrated Project Teams represent best practice which can be applied to any complex acquisition undertaking. Although originally developed for the equipment programme, the MOD is extending the key principles of Smart Acquisition to other forms of acquisition, to Smart Construction and to PPP service delivery projects.
50. The principles of best practice are being applied more generally across the MOD, learning from the Department's experience with Smart Acquisition. These include the need for clear objectives, smart targets which drive and encourage the right behaviour, and agile project-based team working.
51. While Smart Acquisition was in part a response to changes in the defence industry, the pace of globalisation and consolidation of the defence sector will continue to challenge the way in which the MOD conducts its business. The world's major defence industrial players have recently integrated and consolidated to the point where there are now only a handful of global prime contractors and the recent pattern of nationally based companies engaged in international programmes is being replaced by the emergence of real multi-national aerospace and defence companies. This, when combined with the shrinkage of defence business as a percentage of some prime contractors' overall business, will prove to be a challenge to the MOD in the way it secures military capability while securing Value for Money.
52. One of the drivers of globalisation is the increasingly international transparency in communication afforded by the Internet. E-business is becoming far more than an 'add-on'; it is

becoming fundamental to the overall culture of business, the way in which customers and suppliers interact, customer expectations and delivery of value for money. The MOD's suppliers are already adjusting to the new environment that e-business brings. The MOD will have to adapt too.

