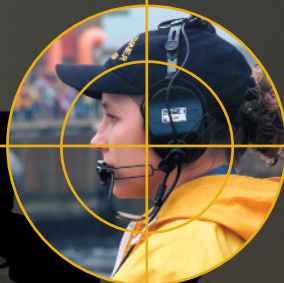




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SELLING TO THE UK MINISTRY OF DEFENCE A Practical Guide For Canadian Industry



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INTRODUCTION

The UK has one of the largest and most technology-rich defence markets in the world. Accounting for as much as 3 per cent of UK manufacturing output, the domestic defence industry employs some 345,000 people directly and indirectly in the UK. The Ministry of Defence (MoD) is the UK manufacturing industry's biggest customer, spending an average of £15 billion per year on everything from military equipment to food, stores and clothing.

The UK has led the way in encouraging an open and competitive defence market, increasing value for money for the taxpayer. This open competition policy resulted in defence equipment imports of some £1.7 billion in 2004 (against exports of £4.7 billion). In addition, the MoD's Industrial Participation policy encourages the transfer of work and technology between foreign suppliers and UK-based companies.

Procurement policies pursued by the MoD ensure that the UK defence market is truly open and accessible, allowing foreign defence companies an equal and fair opportunity to do business in the UK. Opportunities exist for companies of all sizes to tender for contracts of all values and involving a huge variety of goods and services. A vast number of subcontracting and supply opportunities also exist as a result of the many new contracts awarded.

What This Guide Offers

This guide has been developed to help Canadian defence and aerospace companies more easily pursue contracts offered by the UK Ministry of Defence. The guide will be of particular use to companies that are new to the UK; however, it will also serve as a useful summary for more experienced organisations.

Readers of the guide will find:

- an overview of how the MoD is organised, how it communicates its purchasing requirements and the purchasing procedures it employs;
- a review of current issues and procurement initiatives, such as the Smart Acquisition initiative, integrated project teams, public private partnerships and industrial participation;
- information on the latest developments associated with the Defence Industrial Strategy; and



- references to useful sources of information such as trade bodies, websites, publications and government departments, including the Canadian High Commission in London.

Overview of the UK Ministry of Defence

Every year, the Ministry of Defence spends around £15 billion on equipment, works and miscellaneous stores and services ranging from tanks to tools, and from clothing to window cleaning. Suppliers range from large multinational companies to the smallest limited companies.



The Secretary of State for Defence is the government minister responsible for the formulation and conduct of defence policy and for providing the means by which it is conducted. The Defence Secretary is supported by three ministers – Minister of State for the Armed Forces, Under Secretary of State and Minister for Defence Procurement, and Under Secretary of State for Defence and Minister for Veterans.

The Defence Secretary and the three ministers are accountable to Parliament, which votes public money to the MoD for defence purposes. Parliament exercises its oversight through a variety of means: parliamentary questions, themed defence debates in both houses of Parliament, the Defence Select Committee and the Public Accounts Committee.

Most defence procurement takes place outside the MoD head office and is managed through eleven 'top level budget (TLB) holders' and four 'trading funds'. The Permanent Secretary grants each TLB holder extensive delegated powers over their resources of cash, personnel and land.

The Equipment Procurement TLB is managed by the Defence Procurement Agency (DPA), which is responsible for the procurement of equipment to meet new requirements. The Chief Executive of the DPA is the MoD's Chief of Defence Procurement, and is personally accountable to the Minister for Defence Procurement for the Agency's management and performance against its targets.

The Defence Logistics Organisation (DLO) is another TLB holder. It provides logistics support to all frontline services, and typically purchases spares, consumables, fuels, and medical supplies, etc.

ROLE OF THE DEFENCE PROCUREMENT AGENCY

Based at Abbey Wood in north Bristol, the DPA was launched on 1 April 1999 as an executive agency of the Ministry of Defence, replacing the MoD Procurement Executive. As stated above, the DPA's task is to procure equipment for the UK Armed Forces.

With an annual procurement budget of £6 billion, the DPA is the single biggest purchaser of manufactured goods in the UK. The Agency currently employs about 4,600 staff, of which some 3,750 are civil servants and about 750 serving members of the Armed Forces. It also employs secondees from industry, consultants and other temporary staff. These people manage more than 13,000 contracts, ranging from the purchase of submarines to small parts for field radios.

The DPA aims to deliver 'value for money' projects that are within forecast performance, time and cost limits.

Commercial Services Group

The Commercial Services Group (CSG) within the DPA, which consists of around 1,800 professional buyers, is responsible for purchasing high-quality goods and services that represent best value for money.

The CSG has laid down procedures designed to secure best value for money and to spread best commercial practice through the MoD and the defence industry. The Group has also produced acquisition conditions and other guidelines for industry to follow, including partnering arrangements



between the MoD and its suppliers. (See 'Useful References and Contacts' at the end of this guide)

Defence Suppliers Service

Canadian companies making their initial approach to the MoD will find the Defence Suppliers Service an extremely useful first port of call. Part of the CSG, the Defence Suppliers Service acts as a focal point across MoD to provide advice and assistance to companies interested in becoming defence suppliers.

On initial contact, the Defence Suppliers Service will ask new suppliers to provide a written description of their product or service (in Word or PDF format) and will send out a supplier pack full of relevant and detailed information. The Defence Suppliers Service will also advise prospective suppliers on which section of the DPA to contact, depending on their company's equipment or service.



Where appropriate, the Defence Suppliers Service can also provide a list of the MoD's Low Value Purchase (LVP) offices and a list of the major defence contractors. The LVP list indicates the type of products or services usually purchased by LVP offices along with office addresses. The list of major defence contractors provides details of the products or services supplied to the MoD together with company contact information.

Approval Requirements

Companies no longer need to be on an approved suppliers list to participate in tenders and win work from the DPA. Furthermore, foreign companies do not have to be security-cleared to bid for and undertake MoD work when the level of the work is classified at RESTRICTED or lower. However, work that has a security classification of CONFIDENTIAL or above requires companies to be security-cleared. Security clearance procedures are outlined in MoD booklet JSP440. Companies that are not security-cleared can be granted provisional clearance during the tendering stage.

MoD contracting procedures ensure that there is no competitive advantage in prior security clearance. Requests for security clearance, if needed, are made as part of the MoD's contracting process for any unclassified company that the MoD wishes to invite to tender.

To obtain security clearance, a company must first be sponsored. The sponsoring process takes place only when a company is engaged in a classified tender, or is under contract with the MoD to undertake work classified at CONFIDENTIAL or above. For prime contractors, the sponsor is an officer in the DPA or DLO. For subcontractors, the sponsor is the prime contractor.

Security clearance is issued only where there is a legitimate requirement for it, and the process of sponsorship ensures a level of assurance that the company is suitable to undertake work classified at CONFIDENTIAL or above. Security clearance is removed as soon as the company is no longer involved in work at this level. In the UK, the security levels above CONFIDENTIAL are SECRET and TOP SECRET.

MoD Defence Contracts Bulletin

The MoD Defence Contracts Bulletin (DCB) offers a useful and efficient means of identifying the MoD's larger value purchasing requirements. All MoD requirements (with the exception of fuel, food, toxic or nuclear requirements) over £500,000 (or £250,000 for consultancy, textile or clothing contracts) are advertised in the DCB.

The DCB provides contact details for appropriate commercial staff and includes sections covering possible future purchases, tenders invited, competitive contracts awarded and single-source contracts awarded. It also contains an advertising section for subcontractors, various announcements and information on MoD-related reports, and a section on prime contractors' requirements.



The DCB, which is published every two weeks, is available on subscription in paper format, on CD-ROM or on the Internet at www.contracts.mod.uk.

SMART PROCUREMENT – SMART ACQUISITION

Smart Acquisition

Originally known as the Smart Procurement Initiative, Smart Acquisition is aimed squarely at making MoD procurement 'faster, cheaper and better'. Launched in 1999, the Smart Procurement Initiative quickly identified several measures to improve value for money. These included:

- partnering arrangements with industry to involve industry more closely in developing operational requirements and, subsequently, equipment designs;
- integrated project teams consisting of all those with a stake in the success of the project, including operational, scientific, procurement, contracts, finance and logistics staffs. Industry would be involved 'when competition permitted';
- a 'through life' systems approach, taking a broader view of the equipment life cycle and making trade-offs between military requirements, costs and time scales; and



- incremental acquisition to allow fielding of equipment of a less ambitious initial capability, which would then be upgraded in several, lower-risk stages.

More detail on partnering and integrated project teams is provided later in this guide.

Competition Policy

Over the years, competition has assumed an increasingly larger role in acquisitions by the MoD and is intended to deliver value for money for the defence budget. The growing emphasis on competition is reflected in the proportion of competitive contracts placed, which rose from 40 per cent in the 1970s and 1980s to more than 70 per cent in 2005. Today, competition is at the heart of the MoD's Smart Acquisition strategy.

The MoD has an open competition policy that enables domestic and foreign companies alike to tender for the supply of products and services at both prime and subcontract level. However, competition does not mean simply accepting the lowest price tender. The recently unveiled Defence Industrial Strategy places greater emphasis on 'through life' cost aspects such as the performance of the equipment and timeliness of its delivery, the risk involved in achieving the required performance, and the sustainability and support costs of the equipment.

PARTNERING

Partnering between the Ministry of Defence and industry is a key aspect of the Smart Acquisition initiative and is widely used in relation to the acquisition of equipment and services. Partnering with the MoD takes several forms, including integrated project teams and public private partnerships, both of which are described below.

The recent Defence Industrial Strategy stresses the importance of building and sustaining effective relationships. The MoD has issued a booklet (CPG Guide No. 9) on collaborative working, which outlines the following objectives:

- achieve consistency in the approach to relationships;
- employ more effective risk management;
- avoid disputes and, if a dispute arises, reach an early resolution;



- reduce waste;
- improve mutual understanding and confidence; and
- engender the right behaviours, attitudes and culture.

Partnering is essentially the development of new, more cooperative long-term relationships between the MoD and industry. Partnering differs from conventional contractual relationships in that it stresses effective communication strategies among partners to build trust, provide for better and earlier identification and management of project risks, and increase value for money in large-scale, complex projects.

It should be noted, however, that partnering is not the same as a legal partnership, as defined by law. Partnering is best viewed as a means of managing a relationship between the MoD and its suppliers.

Integrated Project Teams

The Defence Procurement Agency's equipment projects are organised into some 60 integrated project teams (IPTs), which form the core of the Agency. An IPT is responsible for managing an equipment project from concept to disposal. It brings together all stakeholders and involves industry at an early stage (except during competition phases) to balance trade-offs between performance, whole-life costs and time within boundaries set by



the approving authority. IPTs use a range of advanced project, risk and commercial management techniques to carry out their work.

An important objective of the IPTs is to encourage a joint approach to risk reduction, which should help ensure that the later project stages proceed more quickly and that targets are met.

Many IPTs include foreign nationals employed by foreign defence companies.

IPTs are grouped into six clusters under the DPA's operations directors. The number of major projects managed by each cluster and the total estimated procurement cost of these and smaller projects is shown on the chart opposite.

A public private partnership (PPP) is a form of long-term partnering that occurs when a public sector organisation (such as the MoD) commissions a private contractor to provide a service for an agreed period of time. The service provided could be the building of a facility such as a training facility. PPP differs from more conventional forms of contracting in that the private contractor takes responsibility for the required capital investment and is paid by the public sector organisation over the entire period of the contract. In effect, the public sector organisation leases the service from the contractor.

Typically, but not necessarily, the contractor in a PPP arrangement borrows capital from a third-party financial institution. MoD policy demands that all projects considering PPPs develop a 'public sector comparator', to show the cost of meeting the requirement by non-PPP means.

PPPs are an increasingly popular method of developing infrastructure and modernising services based upon a partnership between the public and private sectors. The attraction of such partnerships lies in their ability to mobilise more capital than that held in the public account and to use private sector expertise to help manage project expenditure more efficiently.

For a PPP project, the MoD should specify its needs in output terms, based on the required capability (e.g. number of students to be trained) rather than a pre-determined technical solution. Bidders then have maximum flexibility to adopt innovative approaches or introduce practices from other sectors of industry. The procurement process for a PPP project can be a resource-intensive task for both the MoD and bidders. However, PPPs have realised savings of up to 40 per cent of forecast costs compared with



other forms of procurement.

The following are broad indicators of the scope for PPP in a project:

- the requirement entails significant capital investment now or in the future;
- a substantial element in the requirement can be configured as a service;
- there is room for innovation in the delivery of the service;
- MoD risks could be better managed in the private sector; and
- there is a possibility of long-term contracts.

Cluster	Projects less than £20M	Total value of projects at less than £20M*	Total value of projects at more than £20M*
Communications Network	22	10,200	1,000
Information Systems	20	3,800	400
Land Systems	18	6,000	1,200
Maritime and shipbuilding	12	22,500	700
Aircraft	12	20,100	100
Weapons	25	8,700	100
Total	109	71,300	3,500

*Approximate total value of projects

Projects with scope for third-party revenue or for transferring demand risk to the private sector are particularly suitable for PPP, but these features are not mandatory requirements for a PPP deal. PPP contracts are typically long-term arrangements (20 years or more), which means that further competition for that particular requirement is effectively neutralised over that period. However, companies in the supply chain that provide equipment or services into a PPP still have opportunities to secure contracts.

MoD currently has 17 PPP projects worth £7 to £8 billion.

UK INDUSTRIAL PARTICIPATION POLICY

Background

Over the past 15 years, industrial participation (IP) – sometimes known as ‘offset’ – has grown in popularity among countries that buy defence equipment. In many countries, the general purpose of IP is to ensure that domestic industry does not suffer at the expense of overseas purchases.

As indicated earlier, the UK Ministry of Defence has an active and open competition policy that enables certain defence contracts to go to foreign suppliers. However, UK companies seeking defence contracts in foreign markets can face barriers to competition in the form of protectionist measures or offset regimes. To correct this imbalance, the MoD has an IP policy that aims to secure opportunities for UK companies to compete for work overseas. In particular, this policy is designed to facilitate the involvement of UK defence companies as subcontractors or suppliers of the products and services required by the MoD.

(Note: The Canadian government also has IP policies that apply to the import of defence equipment to Canada.)

The UK IP programme is managed by the MoD’s Defence Export Services Organisation (DESO).

Threshold Value

The threshold value for IP is contracts of £10 million or higher. For tenders in excess of this threshold, DESO will invite IP proposals from foreign companies that indicate an intention to place reciprocal work in the UK. This procedure is undertaken in parallel with the main procurement activity, and IP proposals are judged and assessed alongside the adjudication of the main equipment tender. Successful bidders are required to submit detailed plans to DESO, which oversees progress.

The value of IP to be provided by foreign companies is 100 per cent of the offshore content. In practical terms, this means that on a contract of £10 million or more, the foreign supplier is required to place an equivalent amount of work with UK industry over an agreed period of time. This work can be directly related to the MoD contract in question or to any other defence work the foreign supplier is engaged in.

Canadian companies that have no experience in the UK may find it difficult to meet the IP obligation, and the costs and risks associated with IP should



be understood and evaluated well in advance of the contract. Failure to meet the IP requirements can lead to a foreign supplier being 'marked down' on future MoD tenders. DESO ensures that offshore companies fulfil their IP agreements by contacting UK companies for verification.

Essential Features of IP

Work must be defence or defence-related and carried out in the UK. Standard commercial equipment provided as part of a defence system may be admissible for IP purposes. Civil work is not admissible for IP purposes except where it is deemed defence-related. The work should involve equipment and technology that is at least equivalent to that required under the MoD procurement contract to which the IP obligation relates.



Opportunities for Canadian Industry Through IP Programmes

The value of the IP policy is that it promotes the initial introduction of Canadian companies that hold IP obligations to UK companies that have the relevant skills and technologies.

Under direct IP, UK companies are encouraged to register their interest in becoming a supplier to an offshore company bidding for an MoD requirement. Opportunities can be found in the MoD Defence Contracts Bulletin.

Under indirect IP – which can be generated through defence work on the range of programmes performed by offshore companies – the would-be UK supplier must establish whether there are areas of common interest with the IP obligation holders. This requires some research on the offshore companies through such means as websites and annual reports. In some instances, the offshore company's UK representative may be able to offer some guidance.

DEALING DIRECTLY WITH THE UK DEFENCE INDUSTRY

Although the emphasis of this guide is on selling to the UK Ministry of Defence, there is tremendous scope for Canadian companies to do business directly with UK industry, either in relation to MoD work or for exports outside the UK.

Over the last five years, the multi-billion pound UK defence industry has achieved a global export market share of 21 per cent, second only to the US defence industry. Moreover, the UK is the principal overseas supplier to the US, and represents a major potential customer for foreign defence goods and services.

The UK defence industry consists of various major defence contractors such as BAE Systems, Rolls-Royce, Smiths, Thales and Augusta Westlands, and a vast number of Tier 1, 2 and 3 suppliers that provide systems, subsystems, components and consultancy services. Canadian companies marketing to the UK industry should be aware of this depth in the supply chain, and determine the entry point or tier level most appropriate to their product or service.

LATEST DEVELOPMENTS

Defence Industrial Strategy

The Defence industrial Strategy (DIS) is an MoD initiative to address its relationship with industry in the context of the changing needs of the Armed Forces and its desire to demonstrate value-for-money contracting.

The DIS stresses the importance of adopting procurement strategies that take account of the 'through life' aspects of defence projects, and takes a fresh look at the relationship between the MoD and suppliers, in particular through partnering.

The DIS welcomes overseas investment where this creates value, employment, technology or intellectual assets in the UK. It currently



consists of a number of policy statements and objectives, and we can expect to see its measures being rolled out in contracts during 2006-07.

E-Purchasing

The MoD is an energetic user of e-purchasing, particularly for consumables and spares procured by the Defence Logistics Organisation. Current utilisation statistics show that there are presently some 58,000 inventory requirements, which translates into £1.145 billion of orders placed across 600 suppliers (or trading partners) and 1,135 live users connected.

The DLO also has e-catalogues, which contain over 16,000 items, and is implementing improvements to its e-purchasing systems to improve efficiency and speed of processing and to avoid wastage.

More Effective Contracting

More Effective Contracting is a further initiative to come from the Defence Industrial Strategy. Its aim is to improve contracting methods in order to reduce project risk and increase the likelihood of delivering products and services that meet performance, cost and time requirements. Other features of the initiative include:

- flexibility in the contracting process;
- entry/exit points and clearly defined acceptance criteria;



- use of new or improved technology;
- staged contracting;
- consideration of partnering arrangements; and
- use of improved project management tools such as earned value management and anchor milestones.

We can expect these initiatives to translate into new or amended purchasing conditions over the next 12 months.

USEFUL REFERENCES AND CONTACTS

Canadian High Commission (London)

ldn-td@international.gc.ca

www.infoexport.gc.ca

Offsets 2000

a specialist service provider in all aspects of offset and industrial participation.

info@offsets2000.net

www.offsets2000.net

MoD Defence Suppliers Service

www.contracts.mod.uk/dc/public/selling_mod/introduction.htm

MoD Defence Export Services Organisation

www.deso.mod.uk

Defence Manufacturers Association

www.the-dma.org.uk

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