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15th March 1984

COMPETITION POLICY

Thank you for your letter of 17th February. As you know, I strongly believe in the need for a drive to promote competition by all possible means. This programme has my wholehearted support and I have initiated action across the Department to further our objectives.

/ Answers to your questions are attached. I place particular emphasis on the need to achieve the maximum competition across the range of defence procurement, logistics and supply services. While competition is not new to the MOD, I have in the last few months launched a major initiative so that competition in equipment procurement is used to the maximum extent compatible with good sense and practicality. The reasons for not using competition need to be approved at appropriately senior level within MOD, and all cases involving over £10M will be considered by Ministers.

There are, of course, some major constraints on how far we can go along this road, arising from the nature of defence equipment and the structure of the UK's defence industrial base. Even in the USA, with its vastly wider industrial base and greater ability to afford competitive front-end financing, only 40% by value of defence contracts are placed competitively. To help secure an increase in the comparable



UK figure - 21% - I have decided to alter the terms on which we commit ourselves to production in our contracts with industry. As John Butcher is well aware from his attendance at the recent meeting of the National Defence Industries Council, industry is less than enthusiastic. But the changes we are carrying through are necessary to remove an unhealthy degree of automaticity that had developed in our affairs.

Competition in the defence industries is also being encouraged by removal of some 'preferred source' policies originally introduced to encourage the establishment of centres of expertise and the transfer to industry of some in-house R and D capabilities. Most have already gone and when the ROFs lose their preferred source status on incorporation under the Companies Acts later this year, we shall have seen the last of the formal inhibitions to competition of this kind. Some positive measures to the same end can be seen in the action we have taken to widen the opportunities of smaller suppliers to gain defence business both at the direct and sub-contract level.

A very significant recent example of the new policy is the decision on the production arrangements for the MCV80 armoured personnel carrier - a programme worth some £900M. This vehicle has been very successfully developed by GKN Sankey and the original intention had been to proceed on the basis of single source supply from GKN. However it has now been agreed that, although the firm will receive an initial production order, further orders will be open to competitive tendering by all interested and qualified manufacturers and these competitive arrangements will reflect back on the price which GKN will receive for the initial production batch. We are sure that the arrangements applied more generally will lead to lower costs, tighter timetables and sound products.

Outside the area of procurement, the other main contribution MOD can make to your programme is in moving in-house supply and support activities to the private sector. Apart from the privatisation programme for the ROFs, to which I have already referred, the MOD has been



progressively divesting itself of direct involvement in a wide variety of support activities, ranging from insurance, to office cleaning to aircraft servicing, by placing them with private organisations, almost invariably after competition. More can be done. I am determined that only those functions which it is necessary to carry out inside Government should remain in MOD if there are cost effective alternatives available in the private sector. In that way, we not only get better value for money but also, subject to the availability of alternative firms with appropriate capability, increase competition.

I am nominating Geoffrey Pattie as the Minister with whom Alex Fletcher should discuss the information given in this letter and its attachments in the first instance, though John Stanley leads on the activities outside the procurement field. John Miles, Head of IP1 (Tel: 218 6158) will be the contact point at official level.

I am send a copy of this letter to the Prime Minister and to Sir Robert Armstrong.

Yours truly

Michael Heseltine



QUESTION 1 What actions has the Government taken in your field since 1979 to promote competition?

PROCUREMENT EXECUTIVE

Procurement Procedures

1. The use of competition to obtain value for money is a fundamental principle of MOD contract practice. Since 1979 emphasis has been put on the need to maximise the proportion of defence procurement subject to competition, within the limits imposed by the specialised nature of defence equipment and the structure of the UK defence industrial base. This is an integral part of MOD's programme of action to obtain increased long term value for money and to help our defence industries to compete in the international market as has been outlined in the Open Government Document DOGD 1/83 "Value for Money in Defence Equipment Procurement". An indication of the effect of this programme is that the proportion by value of MOD contracts placed by competitive tender in 1979/80 was 14%; by 1982/83 this had risen to 21%.

Preferred Source Policies

2. A number of arrangements limiting the procurement of certain ranges of defence equipment to particular suppliers or groups of suppliers, have been discontinued. For example the "Leitch" policy which restricted procurement of fuzes to 5 contractors was formally discontinued in 1983 and two hitherto preferred contractors - Plessey for sonars and BAe/Sperry for mine counter-measures - are now required to compete for defence contracts in these fields.

Small Firms

3. A number of steps have been taken to widen the opportunities for small firms to compete for defence contracts. The booklet 'Selling to the MOD' produced last September gives information about MOD procurement and contracting procedures. It is designed especially for firms who are newcomers to this area. It contains a list of contact points to which they can turn for help and advice. The requirements for assessing firms for the Defence Contractors list are being harmonised with those of other Government Departments and assessment dispensed with for the large number of contracts which are under £5000 in value or placed under local purchase arrangements.

Contracting out of R&D Support

4. A significant proportion of the support work in R&D Establishments including the running of some major facilities and ranges, has been contracted out, in most cases competitively, since the Strathcona Report. This programme is continuing.



SERVICE DEPARTMENTS

5. The extension of competition into a range of support activities and services has been encouraged by audits and reviews under the Rayner programme as well as by introducing it as a theme in conferences and training courses. Pressure on civilian manpower numbers has also encouraged the services to examine their support area for tasks which can be contracted out. As a result a range of activities has been opened to competitive tender. Examples include:

- a. Cleaning; contract cleaning has been progressively introduced across all three service departments since 1979. Contracts now cover 83% of the MOD cleaning task and almost all are let competitively. 5,800 posts and £12M pa has been saved.
- b. Insurance; from April 1982 contracts were let with brokerage firms (for a 3 year experiment) for insurance against traffic accident and employers' liability claims;
- c. Supply arrangements for non-warlike stores have been examined and as a result of a competitive tendering exercise the defence accommodation stores depot at RAF Quedgeley and the Air Publications and Forms Store, Woolwich are to be managed by contractors with effect from 1st September and 1st October this year respectively. The former will save 370 posts and the latter 66.
- d. Aircraft Servicing is subject to a continuing process of scrutiny. The servicing of army flying training aircraft at Middle Wallop has been contracted out for some years and steps are now being taken to promote competition for the tender covering this and other services which is to be re-let in July this year. It was decided in 1983 to transfer major servicing and refurbishment of Canberras and Hunters to industry; tenders are being sought for contract support of University Air Squadrons and Air Experience Flights and a trial contract is to be let this year for the support of one Basic Flying Training School.
- e. The refit of Royal Fleet Auxiliaries and of the majority of Army vessels is now put to competitive tender with British industry.
- f. An increasing amount of army driver training has been put out to contract, and the RAF propose to expand the use of civilian driving schools for Group A ordinary licence training later this year leading to savings of about £½M and 55 posts.
- g. Contract catering has been introduced at some service establishments on a competitive basis.
- h. A substantial proportion of office equipment, supplies and services has been opened to competitive tender.



QUESTION 2 What actions are already in train in your field to promote competition?

PROCUREMENT EXECUTIVE

Procurement Procedures

1. A major drive to exploit any further scope which exists for the application of competition whenever sensible and practicable has been put into operation. Ministers have issued instructions, the main features of which are as follows: Staff have been instructed:

a. to secure maximum competition-having regard to value for money - at the early stages of projects in order to ensure the best available choice of concepts and to stimulate innovation.

b. at the development and production stages to secure a competitive situation wherever possible. Arguments for awarding the first tranche of production to the development contractor are to be carefully scrutinised. For later production orders the presumption will be that these will be the subject of competition. The necessary re-negotiation of some of the conditions used in defence contracts is in progress with industry but meanwhile the policy is already being implemented case by case.

c. that for proprietary items, competition should not be dispensed with until staff have satisfied themselves that there are no competing equipments which would satisfy the requirements.

d. to obtain authorisation at the appropriate level for any decision to dispense with competition. Cases over £10M or which are controversial are to be referred to Ministers.

e. to make clear to prime contractors that they are expected to exercise effective competition to the maximum possible extent in negotiating sub-contracts and in determining whether work should be done in-house by themselves, or by an outside contractor. Prime contractors are expected as a matter of course to set out the steps which they have taken to secure competitive prices for sub-contracts. A code of practice for prime contractors relevant to competition at the sub-contract level is being developed.

f. to set up a monthly statistical return for Ministers to monitor progress in increasing the use of competition.

Civil Exploitation of Defence Industrial R&D

2. The means by which innovations made in industry in the course of MOD funded R&D programmes can most effectively find application in the wider civil market are under discussion between MOD and industry. Possibilities include:



- a. a change of ownership of Intellectual Property Rights from (as now) the contractor to MOD, to facilitate licencing to other companies (including small, innovative firms) who may be better able to exploit them.
- b. an alternative arrangement set up by industry to achieve the same result.

SERVICE DEPARTMENTS

3. The pressure described in the response to question 1 has been intensified and has featured in MINIS. Firm plans for the promotion of competition include the following:

- a. the refit of two warships is to be placed to contract with British industry to establish comparability with the Royal Dockyards.
- b. it is intended to contract out more than 30% of army equipment repair in the UK. Competitive tenders in this area will be an integral part of the developing strategy on the Army's workshops which currently handle £76M of REME repair work (86% of the total). Territorial and isolated regular units are to be given budgets for contracting out more vehicle repair and servicing to local garages.
- c. in the Royal Navy tenders are being sought to test the cost-effectiveness of contracting out sample support activities, currently done in-house, eg, marine services at Falmouth. It is likely that tenders will be sought for other activities later in the year.
- d. contract catering and gardening are being extended in Service establishments and progress is to be regularly reviewed by Ministers.
- e. the costs of all in-house services in the reprographic, printing and office machinery areas are being compared with the private sector resulting in an increase in the ranges of work subjected to competitive tender.
- f. Service training is under study by a group chaired by the Parliamentary Under Secretary of State (Armed Forces). The scope for competition is being examined particularly in ADP and driver training. An increasing proportion of basic driver training is now subject to competitive tender; tenders for a trial of contracting out HGV driver training to commence later this year are currently being assessed and more ADP training is likely to be put out to contract. A trial of contracting out guard dog training has been unsuccessful.



g. following a report on machinery maintenance at RN shore establishments plans are being developed for a significant part of this £40M task to go to contract.

h. recent experience in putting a helicopter refinishing task to competitive tender has encouraged the RN to put more of this work out to tender.

i. a trial of contracting out the provision of dental technician services is to commence next month.

j. The £33M annual buy of Royal Navy general stores currently placed with single source/proprietary suppliers is being thoroughly examined with a view to extending the range of items which can be subject to competitive tendering.

k. as a continuation of the policy of contracting out more aircraft servicing and repair, Ministers have decided that deep servicing of Nimrods is to be opened to competition.

l. Movement. All air charter contracts which can be are now subject to competitive tender. Action is in hand to put the Army's movement of freight (currently done by British Rail and the National Freight Corporation) to competitive tender next year.



QUESTION 3 What firm plans do you have to promote competition in your field in the next 3 years?

PROCUREMENT EXECUTIVE

Procurement Procedures

1. Implementation of the policy initiative outlined under question two.

Preferred source policies

2. The Royal Ordnance Factories are a preferred source for ammunition, explosives, guns and heavy armoured vehicles. This policy is already being phased out in the light of their forthcoming change of status and will be formally cancelled when the ROFs are vested as an organisation operating under the Companies Acts. This is planned for October. It has been decided to discontinue the policy of limiting procurement of Special Microcircuits to three contractors.

Civil Exploitation of scientific innovations at Defence R and D Establishments

3. Plans are being worked up for a group of entrepreneurs with access to venture capital to sponsor individuals to work up a portfolio of ideas exploitable in the civil field, based on work at a number of MOD R and D Establishments. It is expected that the results will often be exploited by the smaller innovative firms, increasing competition in high technology industry.

SERVICE DEPARTMENTS

4. a. It is intended to solicit competitive tenders for a range of support tasks normally carried out in-house or by single tender action. Many of these have been mentioned already; they include vehicle and machinery maintenance, catering, engine repair, aircraft servicing and the production of training films.
- b. It is hoped to increase commercial interest in tendering and sharpen the competitive edge by reducing the complexity of MOD requirements whilst imposing tighter delivery schedules.
- c. A management audit of the Royal Marine Auxiliary Service is to take place this year. The scope for providing these harbour and sea range services, currently costed at £102M, by competitive tender will be included in the study.
- d. The scope for introducing competition into the whole area of production, storage, management and distribution of printed matter will be examined.



e. Contractualisation of more storage depots will be examined. Scope at warlike stores depots may be limited, but examples of areas which are being examined are the RN helicopter repository at Wroughton and the supply and storage of gases to the RAF from Cardington.

f. MOD will be endeavouring to take advantage of the entry of Mercury into the telecommunications market.



QUESTIONS 4 AND 5

SERVICE DEPARTMENTS AND PROCUREMENT EXECUTIVE

- a. Continuation of the themes in 1, 2 and 3.
- b. Subject to revision of MPO guidelines it may be possible to put more security guarding tasks to competitive tender.
- c. The Army is conducting a study of its supporting Corps which may result in more tasks being contracted out. The other services have similar work in hand and will be considering, for example, the scope for competition in bird control at airfields and repair and maintenance of simulators.
- d. Lifting of the embargo on selling ships for scrap abroad may be considered.
- e. The scope for increased use of the private sector will be a consideration in a major study into the Defence Medical Services.
- f. Ministers hope to see a considerable increase in the quantity of repair and maintenance work in the RAF training, communications and support aircraft fleet put out to contract and will be paying particular attention to the prospects for contract servicing if a decision is taken to order a new basic trainer.
- g. Army districts are due to report next month on the scope for widening the use of the private sector for administrative transport in peace and transition to war.

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