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From the Private Secretary

16 October 1979

The Prime Minister held a meeting this morning at 0830 hours to consider the current situation and prospects of Rolls Royce. The following were present: your Secretary of State, Sir Peter Carey, Mr. R. Dearing, Mr. K. Farrow (all from your Department), Sir John Hunt and Mr. P. le Cheminant (Cabinet Office) and Sir Kenneth Berrill.

The meeting took the form of a presentation mainly by Sir Kenneth Berrill and Mr. Dearing. This followed closely the text which Mr. Dearing left after the meeting and which will be circulated to MISC 22 along with other background material on the company. The presentation was aided by a number of charts, which will also be circulated to MISC 22.

The following points came up in discussion which were additional to the text referred to above:

(i) In response to a question from the Prime Minister about the losses on the RB211, it was explained that there were no production losses as such. The point was that production profits were not large enough to cover the heavy R and D expenditure with the result that overall profitability was totally inadequate. There was certainly scope for improved productivity, which was only about half that of the US aero engine manufacturers. Productivity at Rolls Royce in the 1970s had fallen because they had been unwilling to shed skilled labour at a time when demand was flat. Rolls Royce's latest Plan assumed a 25% productivity improvement for blue collar workers. This was not enough, especially if it was necessary to pay for the productivity increases in higher wages. The purpose of bringing in new management, as the Secretary of State proposed, was to achieve much better productivity and thereby bring the company into profitability earlier and on a more substantial scale. Although it was clear that the company were making inadequate profits on their production overall, it was less clear which production centres were the relatively good and bad performers. The Department of Industry would try to obtain further information on this.

(ii) In relation to the strategic alternatives, the Prime Minister asked whether there was scope for an immediate sale of the aero engine business to GEC. It was explained that GEC would only

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take over the business at the present time if it were handed over as a gift and in addition if they were given full compensation for the prospective losses. However, Sir Arnold Weinstock had indicated that GEC might be interested in purchasing the aero engine business at a later date after GEC management had come into the company and after they had been able to make their own assessment from inside.

(iii) The Prime Minister said that if the Government were to put additional funds into Rolls Royce, there was a case for asking the trade unions to put in their own funds as well.

(iv) Sir Keith Joseph said that a decision on his proposal to bring in GEC to manage Rolls Royce was now urgent. Sir Leslie Murphy was likely to be commenting on the position of the company in the near future, and the longer that a decision was delayed on measures to turn the company around, the worse this would be for customer confidence in Rolls Royce. Maintaining this confidence was absolutely crucial to the future of the company.

Summing up the discussion, the Prime Minister said that she herself was persuaded that the only real option was for the company to carry on with its existing strategy, but to bring about major improvements in performance. Compared with other industries, it was clear that the United Kingdom had a comparative advantage in aero engine building; and the alternative of withdrawing from the RB211 would be extremely costly. But even if Rolls Royce did manage to improve its performance, it would still absorb large amounts of public funds; consequently, there would need to be less spent on industries which did not have a future. A decision on Sir Keith Joseph's proposal to bring in GEC to manage Rolls Royce would need to be taken by Ministers collectively, and she would arrange for MISC 22 to be reconvened shortly.

I am sending a copy of this letter to Martin Vile, Cabinet Office.

Ian Ellison, Esq.,
Department of Industry