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DEPARTMENT OF INDUSTRY

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PS/Secretary of State for Industry

5 November 1979

Tim Lankester Esq
Private Secretary to the Prime Minister
10 Downing Street
London SW1

Dear Tim

... I enclose a brief for the Prime Minister's talk with Sir Kenneth Keith on Tuesday 6 November. My Secretary of State is seeing Sir Kenneth Keith, Sir Frank McFadzean and Sir Leslie Murphy in the course of the morning and I will send you supplementary briefing early in the afternoon.

Yours ever
Ian

I K C ELLISON
Private Secretary



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PRIME MINISTER'S TALK WITH SIR KENNETH KEITH ON TUESDAY 6 NOVEMBER 1979

Purpose

- i to respond to Sir Kenneth Keith's wish to have a talk with the Prime Minister;
- ii to secure his resignation from the Chairmanship of Rolls Royce by agreement and with honour.

Background

Sir Kenneth Keith told Sir Keith Joseph last Wednesday at Derby that in a sense he had "shot his bolt", that he had never pretended to be an expert in manufacture and that if he could think of someone who knows that side he would make way for him and accept an international sales consultancy role. But he is a mercurial person, subject to changes of mood, and there is always a possibility that he will have changed his mind, particularly if he sees a future ahead without the encumbrance of the NEB.

Points to bear in mind

- i Sir Kenneth Keith has the strongest antipathy to Sir Leslie Murphy in particular and to the NEB in general. This means that his resignation will only be achieved if it is clearly seen by him to be none of Murphy's doing, and if this is clear to the world at large too. It also means that to tell him in confidence of the Government's decision to take RR out of the NEB will be some compensation for his loss of the Chairmanship.
- ii Sir Kenneth Keith is a proud man who will respond to visible signs of recognition. For example, a dinner given by the Prime Minister to mark his departure from Rolls Royce would help;
- iii Sir Keith Joseph will have seen him on the morning of the Prime Minister's talk, to prepare the way, and further briefing will be given in the light of that discussion;



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- iv it will be best to concentrate on Sir Kenneth Keith's own personal position, but if he introduces discussion on candidates for the succession it could be useful to mention that the Government has in mind Sir Frank McFadzean.

✓ Sir Keith Joseph will mention this if it seems opportune in the morning. ✓

Conduct of the meeting

Depending on how the morning's discussion with Sir Keith Joseph has gone, it might be best to begin by inviting Sir Kenneth Keith to give the Prime Minister his assessment of the company's present position and the way ahead. He might also be invited to give his views on the NEB.

Subject to the risk of changes of mood mentioned above, there is a good chance that Sir Kenneth Keith will respond by indicating his willingness to go and, if so, that makes the discussion correspondingly easier.

Facts and Figures

A short note is annexed (Annex 1) summarising some of the facts on Rolls Royce with which the Prime Minister is already broadly familiar.

Collaboration with Japan

Sir Kenneth Keith wishes to raise this. A note is enclosed at Annex II.

Points to make in discussion

- i warm recognition of what Sir Kenneth Keith has achieved since, at the request of Lord Carrington, he took over the Chairmanship of Rolls Royce following the collapse in 1971; no-one could have devoted himself more wholeheartedly to the task and the nation recognises this;
- ii acknowledge that the company has not been helped in its task by the Labour Government's decision to transfer the Government's ownership of the company to the NEB and tell



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Sir Kenneth Keith in strict confidence, for his own information only and not that of any of his colleagues, that the Government intends to announce shortly its decision to take Rolls Royce out of the NEB - the only alternative would be to secure the resignation of Sir Leslie Murphy;

[It may be necessary to say something broadly indicative of the Government's thinking during the Industry Bill Debate on Tuesday, but the Government must control the handling of this delicate matter.]

- iii returning to Rolls Royce, congratulate Sir Kenneth Keith on achieving the launch order position for the new 535 engine in the new Boeing 757 medium range, medium size, passenger airliner. This was very much a personal achievement of Sir Kenneth Keith;
- iv while welcoming this, express the Government's concern about the scale of the company's financial problems. In the normal way a shareholder accepts the need to finance the cost of increased inventory when business expands, but unfortunately, with movements in the exchange rate, the past effects of inflation, and the difficulty of improving productivity, Rolls is facing some heavy losses in the period immediately ahead;
- v we know that Sir Kenneth Keith sees the critical issue facing the company, now that he has re-established it in the market place, as the successful management of a huge expansion in the production of the RB211 family of engines without increasing the labour force and with a major reduction in costs;
- vi the Government thinks this analysis is absolutely right and the Prime Minister has had a report from Sir Keith Joseph of the private talk he had with Sir Kenneth Keith last Wednesday at Derby;



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- vii the Government accepts the wisdom of Sir Kenneth Keith's view that the skills required for this new stage in the company's progress might best come from a new Chairman;
- viii naturally the Government would want to mark the change in the Chairmanship by some public recognition of Sir Kenneth Keith's contribution; [The Prime Minister might sound him about a dinner in his honour at No 10]
- ix end with recognition that Sir Kenneth Keith has been motivated throughout by a sense of public duty and the Government will remember this.

Notes for Supplementaries

A Continuing Role for Sir Kenneth Keith

Sir Frank McFadzean does not want any future involvement in the company for Sir Kenneth Keith. But he would be prepared to offer him a retainer for a consultancy on the sales side, although he has indicated in strict confidence to us that little if any use would be made of Sir Kenneth.

Candidates for the Chairmanship

Sir Kenneth Keith may have ideas of his own on the Chairmanship. He thinks highly of John King of Babcock & Wilcox and also of Sir Arthur Knight, until recently Chairman of Courtaulds, and also until recently on the board of Rolls Royce. If he mentioned them the Prime Minister might warmly recognise their abilities but indicate that King is not really a production specialist while Sir Arthur Knight is too much of an intellectual in manner for the aircraft industry. The Prime Minister might, however, say that both will be considered for public appointments.

The American Version of the Harrier - AV8B

Sir Kenneth Keith is very keen for the RAF to adopt the advanced version of the Harrier (the AV8B), developed by the Americans. This is to help persuade the Americans to adopt the aircraft.



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Rolls have a lot to gain from this because the engine would be manufactured here. For British Aerospace the issue is not so clear-cut because a substantial part - yet to be defined - of the airframe would be made in America.

If Sir Kenneth Keith raises this the Prime Minister need only take note.

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ANNEX 1

KEY FACTS AND FIGURES

Employees number 59,400 (56,600 in the UK), most of whom work in the Aeroengine Division, whose main locations are Derby (civil engines, especially RB211), and Bristol (mainly military engines). Other locations include Coventry (industrial and marine engines), Glasgow and Leavesden (helicopter engines).

Turnover in 1978 was £760 million, of which £660 million was from the sale of aeroengines (53% military, 47% civil).

Exports accounted for 45% (£340 million) of turnover. The company showed a profit of £11.7 million (before tax, after interest) on capital employed of £364 million. The company's latest forecast cash requirement is £765 million for the years 1979/83; £139 million in 1979, £216 million in 1980). These figures are after allowing for £250 million launch aid on RB211-535 and RB211-524.

The company forecast a loss of £34 million this year; this is likely to be worse as a result of the engineering strike. The forecast loss next year is £45 million.

Rolls Royce Board

Chairman: Sir Kenneth Keith

Vice-Chairmen: Donald Pepper
Ashley Raeburn CBE

Directors: Sir George Burton
Sir St John Elstob CBE
Dennis Head CBE
Samuel Higginbottom (resident in USA)
Sir Frank McFadzean
Peter Moloney
Marshal of the Royal Air Force Sir Denis Spotswood GCB
CBE DSO DFC
Sir Peter Thornton KCB
Air Chief Marshal Sir Neil Wheeler GCB CBE DSO DFC AFC
Raymond Whitfield



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ANNEX 2

RB432 AND JAPAN

Sir Kenneth Keith may refer to the proposed development, in collaboration with Japan of the RB432.

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This engine, of about 20,000lbs thrust is aimed at the market for 100-130/aircraft, a market in which RR has achieved a reasonable share in the past with the successful Spey engine. Possible applications of the engine are the Fokker F29, a re-engined Boeing 737 and a Japanese project. None of these is yet certain.

Current RR estimates of the cost of the RB432 development is £300m over a 5-6 year period.

Because of the heavy financial commitments on development of the RB211 -524 and -535, RR have for some time recognised that new projects could only be launched in collaboration - a trend which is now widespread throughout the aerospace industry. Since the Japanese Government has a clear commitment to build up its aero-engine industry with the help of foreign technology, RR see advantage in harnessing Japanese funds to their project, assuring a secure market for the engine in Japan and possibly in a number of Far East countries, and pre-empting Japanese collaboration with RR's main competitors.

The company have, however, recognised the main danger of such collaboration in the permanent transfer of technology to Japan. They have, therefore, extracted in the proposed collaboration agreement, a commitment from the Japanese to involve RR in any further aero-engine projects based on the technology of the RB432. The terms of this are such as to exclude Japan from development of any aero-engines other than the large high by-pass engines such as the RB211 (which it is most unlikely they would want to do) without RR having the option to participate.

The proposed agreement between RR and Japan envisages two stages; initial launch in which the two sides further define the engine and establish the market, and full launch at which stage both sides would need their Governments' approval and must have established a source of funding.



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The Japanese are anxious to get RR's signature to the proposed agreement before the end of the month, because the Japanese request for funding goes before the Diet in December.

The company have been told, however, that in present circumstances Ministers are anxious to have more time to consider the implications of collaboration with Japan.

Line to Take (If subject raised)

- 1 The proposed agreement is of considerable importance for the long term strategy of the company. It would be helpful to have more time to study the implications.
- 2 Ask Sir Kenneth Keith to explain the reasons for the urgency of signature. Is it essential for the Japanese to have signature before the matter goes to the Diet?

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