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PRIME MINISTER

ROLLS ROYCE

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As you are aware, we face heavy losses in Rolls Royce for current contracts taken on low exchange rate assumptions. Kenneth Keith has been an indefatigable salesman but does not pretend to have the necessary skills for the tough management cost-control job now necessary if losses are to be minimised. NEB have been straining at the leash to put in a replacement for Kenneth Keith, between whom and Leslie Murphy relations are bad.

I do not consider that the right course is to leave Rolls Royce under the control of the NEB. I think the present rift between Keith and Murphy in part reflects the unsuitability of the NEB for this role, and that difficulty is likely to become greater as the role of the NEB in other areas is reduced. My Department has therefore had discussions with Sir Arnold Weinstock about the possibility of GEC taking a dominant role in supervising the management.

Weinstock has proposed that GEC should buy the whole of Rolls Royce but sell back to the Government the aero-engine business assets. He would then have a management contract with the Government to supervise the aero-engine business with penalties and rewards dependent on performance. The remaining parts of

/Rolls ...



Rolls Royce - industrial and marine engines and nuclear work - would be integrated with GEC's heavy electrical and power engineering business, with the aeroengine business also being a part of this group. Ultimately the shares of this heavy electrical/gas turbine/aero-engine business might be put on the market as an independent company with GEC shareholders being given preference.

Weinstock would provide a Managing Director for the aero-engine business (he has suggested a man known to my Department as an able manager), as well as of course controlling the enlarged power engineering business. Weinstock would be content for Keith to remain as Chairman in a non-executive role both at the aero-engine business and in the power-engineering company, and indeed to join the main board of GEC. This should help to effect the change without a major row.

Timing would be a problem, because it will not be possible to remove Rolls Royce from the NEB without legislation. But I hope it would be possible to persuade the NEB to accept the new GEC management without delay if it were made clear that Rolls would cease to be an NEB responsibility as soon as legislation was passed.

There may be serious difficulties in what Weinstock proposes. Most difficult is likely to be the negotiation of satisfactory terms for the sale of the Rolls Royce company to GEC and the buying back of the aero-engine business assets; we would need to



use an arbitrator. For this reason I cannot at present be sure that the proposals will prove feasible. Before starting on the work necessary to clarify this, which will inevitably involve informing Sir Kenneth Keith and Sir Leslie Murphy of these plans, I should be glad to know that you are content to embark on this course. In my own view, it is the best chance we have of changing a situation which could become an intolerable financial burden to us. I should make clear that this approach will not eliminate the need for very large calls on public funds for Rolls Royce. Our predecessors had committed £192 million at 1977 prices in launch aid and provided for a further £100 million through the NEB during 1979-83, and the exchange rate appreciation means that much larger amounts would be needed to complete that programme. However, I have no doubt that the tight management for which GEC is known provides the best prospect of keeping a proper grip on this business and limiting the sums required.

I am sending copies of this letter to the Chancellor of the Exchequer, the Secretaries of State for Foreign and Commonwealth Affairs and for Defence and to Sir John Hunt.

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K J

13 July 1979

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