



Prime Minister (2)

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Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Lord Cockfield  
Secretary of State  
Department of Trade  
1 Victoria Street  
London SW1H 0ET

5 May 1982

BRITISH AIRWAYS

John Biffen wrote to me on 5 April about the Price Waterhouse report, and I have now had an opportunity to consider it.

The Price Waterhouse analysis of British Airways deficiencies makes disturbing reading. One must accept that the airline industry as a whole faced a sharp deterioration in their trading situation from 1979 onwards. What emerges clearly from the report is that BA management, secure in the knowledge of Government backing, in no way measured or even tried to measure up to the challenge; through unfounded optimism and other devices, the real problems were glossed over.

I am particularly struck by two conclusions:

- (a) That it is inconceivable that an effective management would have allowed the growth strategy of 1979 to proceed unchanged in the way that the BA Board did (paragraph 12 on page 118 of the report);
- (b) That BA would not have embarked on and maintained such an ambitious capital expenditure programme had they not been a nationalised industry with the backing of Government guarantees on past and projected bank borrowings (paragraph 39, page 11).

I am worried by the fact that even now, in May 1982, no considered options or proposals have yet been put to Ministers on the key issues of business strategy.

You are I know giving a great deal of thought to this. The return of BA to adequate profitability must be the first priority. Scarcely less important is the need to construct an effective framework of sponsorship and financial control so as to ensure that the recovery measures eventually agreed are implemented and that the impact on BA of any new adverse developments is not allowed to fester, unacted upon, as in the past.

As regards profitability there is the difficulty that no financial target has yet been set for BA for this or future years. I alluded to this in my letter of 16 March to John Biffen but he was inclined to the view that it would not be possible to make a final determination until the Summer when the figures had emerged from BA's Corporate Plan. I am prepared to accept this subject to two stipulations.

First if we are to reach sound decisions on the basis of the Corporate Plan then it must address itself specifically to the implications of achieving alternative rates of return and should set these out fully and realistically, with a firm indication of the relevant timetables involved.

The Corporate Plan will of course need to cover a great deal else. In particular you have no doubt already told Sir John King that you will expect it to set out the BA's proposals for action on the crucial recommendations of Price Waterhouse on capital expenditure, route structure, aircraft utilisation and manning. There is clearly a range of options on some, if not all of these. The Plan should set these out and relate them to different possible overall returns over the next two or three years. It should also include a proper analysis of the vulnerability of the projections to the key factors in the competitive environment to which Price Waterhouse drew attention.

Secondly, BA must be persuaded of the extreme importance which we attach to this work being done quickly now. The present budgetary projections for 1982-83 are far from satisfactory, nor are those for the later years acceptable. Further delay in producing proposals for improving the situation would be intolerable. If E(NI) is to discuss British Airways in June as at present scheduled, then BA's Plan must be ready by the beginning of the month.

Turning to the question of future control, I see from the press and also from elsewhere that Sir John King is already addressing some of the recommendations in the report on divisional structure and senior management. Provided that the inevitable disruption caused by organisational and managerial changes does not lead to further delays in the production of the proposals for substantive measures, these changes seem to be generally in the

right direction. But implicitly, (and on occasion explicitly), the report has also revealed deviciencies in our own machinery of sponsorship which I believe must be put right. It may well be, as the report suggests, that it will be sensible to revert to the possibility of privatisation during the first part of 1983, but we cannot be sure. Moreover, there must be adequate monitoring of progress between now and then, if we are to reduce the risk of being once again sprung with a nasty surprise. My officials are discussing with yours a tightening of our arrangements for linking BA's future recourse to external finance to satisfactory reports of progress against plan during the year, drawing on the analogy of those which have been instituted for other nationalised industries in a similar position. I propose that you and I should receive regular reports based on this monitoring and should take any necessary action with British Airways as the year goes forward. I regard this as being of crucial importance.

I hope you will have no difficulty in agreeing to these points and would be grateful to know how, in the light of your discussions with Sir John King, you now see the prospects for making early progress. If you would find a discussion helpful, I would be happy to arrange one.

I am sending a copy of this letter to the Prime Minister, John Sparrow and Sir Robert Armstrong.

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Prime Minister (4)

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From the Secretary of State

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The Rt Hon Leon Brittan QC MP  
Chief Secretary  
HM Treasury  
Treasury Chambers  
Parliament Street  
London  
SW1P 3AG

20 May 1982

BRITISH AIRWAYS

Thank you for your letter of 5 May.

I fully agree with you that the Price Waterhouse analysis of British Airways makes disturbing reading. Although airlines all over the world are continuing to face grave financial difficulties - Braniff's bankruptcy is the most recent reminder - there is no doubt that British Airways' management must bear the prime responsibility for the failure of the growth strategy of 1979. Equally, however, I hope you can agree that there are now encouraging signs that Sir John King is taking the necessary remedial steps to turn British Airways round. The action taken last September to reduce over-manning and to cut costs, and the more recent decision to establish clear lines of profit-centred accountability, are important steps, and I am sure that we should continue to support the further remedial measures, as well as the plans for strengthening British Airways' management which Sir John has in mind. Our aim must remain to launch British Airways as a prosperous, efficient private sector company standing in high repute with its customers, its staff and its shareholders.

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*From the Secretary of State*

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To this end, the return to profitability and privatisation are inextricably linked. I therefore very much share, as I am sure you do, Sir John's hopes that it will be possible successfully to float British Airways during the lifetime of this Parliament.

Turning now to the specific points you raise, I of course agree on the importance of constructing an effective framework of sponsorship and financial control. Sir John, too, is seized of this point, and has initiated steps to improve the financial information which his own Board receives. He has also agreed that my Department, and of course the Treasury, will be given prompt, regular, and more importantly reliable, reports enabling us to monitor British Airways' performance. On the details of such improvements, I think your officials are already in touch with mine.

As for the Corporate Plan, Sir John is already well aware of the importance which we attach to receiving this by early June. We have also asked British Airways to ensure that the Plan addresses itself to the strategic options available, and to an analysis of the key sensitivities which might cause it to deviate. Again, your officials have already been involved in discussions on this point. In this context, I am glad to see that you recognise that we cannot realistically determine BA's financial target until after we have received their Corporate Plan.

Finally, I should emphasise that one of the crucial determinants of the success of British Airways' future will be the quality of their top management - which has clearly been deficient in the past. This in turn will require adequate remuneration to attract candidates of the right calibre. I shall be writing separately about this in due course.



*From the Secretary of State*

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I am copying this letter to the Prime Minister, John Sparrow and to Sir Robert Armstrong.

*Yours,  
Arthur*

LORD COCKFIELD

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20 MAY 1982

