

Prime Minister (2)

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MCS

to see

12th July 1983

The Rt. Hon. Margaret Thatcher, M.P.,
Prime Minister,
10 Downing Street,
LONDON SW1.

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Has it - been
set up yet?
ms

Dear Margaret,

As a courtesy I am sending you a
copy of a submission being made to the House
of Commons Committee on Industry and Trade.
You will see that it is not quite in accord with
the post prandial speech you made in Tokyo!

The senior management now being dis-
missed, or side tracked, in such large numbers
by Sir John King are the people who pulled the
airline out of the slump. Credit is due in
particular to Roy Watts and Peter Herman; the
latter was one of the ablest Management Services
Directors that I have met in private or public
enterprise.

I have acknowledged
on your behalf

Please do not trouble to acknowledge.

Best wishes for the new session,
Yours ever,

Frank

Encl:

BRITISH AIRWAYS

British Airways has recently been the subject of critical comment, much of it couched in extravagant and emotive language. Being nebulous, these attacks are sometimes difficult to rebut. "Quagmire of privilege", "overmanning on a prodigious scale", "Conducted.... as though money grew on trees", and "recipe for disaster" are but a few of the phrases used to denigrate the airline. This, coupled with a Price Waterhouse report, which apparently ignores readily available evidence, has given the widespread impression that until the arrival of Sir John King, British Airways was an incompetently administered airline which had done nothing to improve its efficiency. This does such a grave injustice to many of my former colleagues - some of whom are now being forced to seek posts outside British Airways - that a few facts should be introduced to give a more balanced view of the airline's history.

British Airways was originally formed under the 1971 Civil Aviation Act to take over the activities of British Overseas Airways Corporation (BOAC), British European Airways (BEA) and various subsidiaries of these two corporations. The super-imposition of the British Airways Board was intended to co-ordinate activity, achieve economies of scale and create a common trading identity. Although in the early days of the merger there was some erosion of divisional operational integrity by the creation of single departments for engineering, sales and industrial relations for example, the mainstream airline business remained divided into three units - Overseas Division, European Division and Regional Division. All were relatively self-contained, the three divisions had their separate "boards", were situated at geographically different points and were inclined to become inward looking and defensive. The staff built up at Headquarters largely mirrored the three divisions and problems were often resolved in committees of equals. These tended to proliferate thus slowing down the decision-making process. The centralised industrial relations department of the personnel function filled a substantial part of the management vacuum which a structure of this type creates. Little took place in the way of inter-divisional standardisation of equipment, while planning tended to be a summation of divisional plans. This organisational structure also made it difficult to present a single face to the outside world. For example, no one person was in charge at Heathrow Airport, while the negotiation of a mail contract with the G.P.O. required the presence of three or four individuals not necessarily with an identity of interest.

The senior staff of British Airways were well aware of the defects of the organisation as it had evolved and two of them - Messrs. Herman and Wood - were deputed to seek the views of their colleagues as to the best way forward. Various alternatives were considered, including the liquidation of British Airways and the re-establishment of BOAC and BEA; maintaining the status quo with rationalisation of the U.K. services; breaking the airline down to mini groups with their own routes and dedicated aircraft; and a wholly functional organisation. There were arguments for and against each of the different proposals but the eventual recommendation, agreed by the Board and accepted by the Government, was the elimination of the three divisions and the substitution of a unified structure with three operating units:

Flight Operations
Engineering
Commercial Operations

and seven service departments:

Finance
Planning
Management Services
Personnel
Subsidiaries
Legal
Public Relations

The main feature of commercial operations was a structure of route groups, each responsible for British Airways in its territories and for the development of the markets. The new organisation came into effect in April 1977. In 1982 a three divisional structure was created but this in turn was liquidated in mid-1983 when British Airways underwent yet another re-organisation which bore some similarities to the one introduced in 1977 but downgraded certain activities such as Flight Operations and Planning. Anyone who has ever administered a large operation appreciates that there is no single structure that is perfect. Indeed if the will to make an enterprise succeed is present the objective can usually be achieved by several different forms of organisation. However, constant chopping and changing are destabilising.

It was appreciated that the 1977 organisation would not obtain its objectives in terms of efficiency and profitability overnight. The airline had to continue operating during the period of reorganisation and elimination of duplication and overlap. A contribution audit was started with the aim of determining the personnel establishment necessary to operate the airline under its new organisation.

British Airways had already carried out several studies on its productivity relative to its main competitors. Comparisons of this type, particularly across national frontiers, are notoriously difficult to make with any degree of accuracy. Published information is rarely

adequate; airlines vary widely in equipment, the nature and density of their route structures, complexity of operations and the extent to which services are purchased from outside, or work performed for others. In an endeavour to eliminate these differences British Airways participated with ten other scheduled airlines in providing sufficient information to a firm of management consultants - McKinsey and Company - to enable them to make meaningful comparisons both of overall productivity and the relative performance of specific functions. The total airline operation was broken down into more than one hundred personnel categories. A detailed study, copies of which can no doubt be obtained from British Airways, was produced in 1977. It showed that, compared with its major competitors, British Airways was overmanned by 15,000, or approximately 25% of total personnel. In functional terms engineering and maintenance, ground handling and stations, and flight operations, accounted for about 80% of the total. The study also showed that approximately 60% of the overmanning was in direct personnel, while overhead categories were just below 30%. One of the most noticeable productivity gaps was in the supervisory category where overmanning amounted to 2,300 staff, or 35% of total supervisory personnel.

An interesting feature of the report was that in spite of the productivity difference of 15,000 personnel the lower British wages and salaries resulted in personnel costs per available ton mile of 12.6 U.S. cents for British Airways which put it marginally below the 12.9 cents for the North American carriers and substantially below the 18.4 cents of the European airlines in the survey. In other words, British Airways was a low productivity and low wage airline and in this respect was not markedly different from many other businesses in the U.K. in both the private and public sectors. It was, however, different from several other British industries insofar as the low wages and salaries offset the low productivity and left the airline competitive at the rates of exchange then prevailing.

The fact that British Airways, in spite of its overmanning, was competitive with other major airlines was reflected in the financial results of the Company. In the 1978-79 financial year, Mr. (now Sir) Ross Stainton was able to report a profit (before tax and cost of capital borrowings) of £110m., which showed a £13m. improvement on the previous year. After interest, taxation and a dividend payment to the British Government, as shareholders, the Company was able to plough back £62 million. The return on net assets was 14.7% against 12.4% in the previous year which had suffered serious disruptions as a result of strikes by ground engineers and air traffic control assistants and the need to repair the cracks which had been discovered on the wings of the Trident 3s. In the ten years to 1978-79 British Airways achieved a return on net assets of 9.1% and an overall self-financing ratio of 71.5%, or 81.4% if Concorde is excluded. In common

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with other members of the industry, the airline was looking to a continuing expansion of business although at a slower rate than the historical trend.

Against this background there was no case for wholesale dismissal of personnel. Indeed any attempt to have done so would have been unacceptable to the Labour government and the Unions and would almost certainly have grounded the airline. The general industrial relations atmosphere of the late seventies seems too easily forgotten. Official strikes were the least of British Airways' problems; it was the almost interminable unofficial strikes, normally in breach of agreed procedures, that delayed aeroplanes, disrupted the planning of schedules, earned the Company the ill-will of its travellers and put an almost intolerable burden on the staff who formed the inter face between the airline and the travelling public. In addition, British Airways suffered from a "blacking syndrome". The practice of blacking union members who worked during disputes was extended to "blacking" aeroplanes, specific engines and equipment and, in one case, part of a hanger. The constant guerilla warfare, sometimes pursued with almost total contempt for the interests of passengers, was sharply diminished when travel privileges were withdrawn from unofficial strikers and individuals were directed to work on "blacked" equipment or face suspension without pay.

Moreover, while the McKinsey study represented a considerable advance on those made previously, the authors were the first to emphasise that it would be "imprudent and naive" to use the 15,000 figure as a precise measure of productivity improvement. They recognised, for example, that, compared with other airlines, British Airways probably had greater problems of "peaking" in arrivals and departures and also had specific problems such as the need to staff three terminals at Heathrow. As a follow-up to the McKinsey exercise an analysis was made by British Airways' staff of how personnel numbers were likely to develop over the following five years, taking account of expected wastage, known retirements and the growth estimates then assumed in the forward plan, with the aim of reaching the McKinsey productivity levels by the end of the five-year period. Although the occupational distribution would change, the broad objective was not to reduce numbers dramatically but to increase productivity in terms of Available Ton Kilometres per man from 145,400 to 200,500. This represented an increase of $8\frac{1}{2}\%$ per annum or 55% over the period. To implement this scheme the broad McKinsey conclusions were translated into detailed plans of action and personnel establishments for every aspect of the airline's operations. The most difficult and time consuming task was convincing employees that it was in their interests to give up a massive range of restrictive practices in order to move from a low productivity, low wage, operation to a high productivity, high wage venture. This involved trying to change what were often deep rooted social attitudes and the renegotiation with Unions of a multitude of agreements.

To give but a few examples, the then current rosters did not match the operational requirements nor produce what the airline was paying for under national agreements on working hours; supervisory staff would not permit qualified tradesmen to sign out aircraft because it would have resulted in substantial reductions in supervisory numbers which was one area of over-manning highlighted by the McKinsey study; in ground services, cargo, ramp and catering, high overtime earnings had reached epidemic proportions and was protected by restrictive practices, overtime built into shift rosters and guaranteed overtime, whether worked or not, and the high level of payments became a major cause of unrest among skilled tradesmen who found their differentials virtually eliminated.

Given the industrial relations atmosphere prevailing in the late seventies, this mass of complex problems could not have been solved by any "stroke of the pen" approach. As a shrewd observer of the British industrial scene perceived: "Institutions and habits of mind, once firmly rooted, are not easy to displace in the absence of calamity or upheaval".* It required patient discussion, negotiation, persuasion and management firmness in the face of an over-elaborate consultative and negotiating machinery which only too easily resulted in the passive sabotage of time. At this particular juncture British Airways had 17 Trade Unions each with its own shop steward structure; there were approximately 700 shop stewards in the Engineering Department, 350 in the Ground Services Department, 125 in the Flight Operations Department and 150 representing clerical and administrative staff. There were 11 national sectional panels and over 150 local panels - involving more than 800 people - under the National Joint Council. It was not until August 1979 that the massive effort involved started to produce the reductions in numbers. By March 1980 numbers were down by 1,000 from the peak reached in 1978/79 and a year later the total was reduced by a further 4,288. Both Sir John King and Price Waterhouse choose to ignore the work which was done by British Airways career staff to achieve a solution of this complicated issue.

Another major problem for British Airways was the structure of its aircraft fleet. For a variety of reasons - some of the most important ones imposed on the airline - British Airways found itself in the latter half of the seventies with a more complex fleet than any of its major competitors. Leaving aside helicopters it had, in a fleet of under 200 aircraft, 12 basic types against 3 for Panam and 5 for T.W.A. It had 8 types of engines against 3 for Panam and 5 for T.W.A. In the McKinsey study British Airways had a fleet diversity, measured by the weighted number of types of aircraft and engines, of just under 16 compared with under 11 for Air France and under 6 for Eastern Airlines and Qantas. This, plus some

* G.C. Allen "The British Disease": I.E.A.

of the sub-divisions of the basic types, resulted in greater inflexibility in crewing, higher training expenses, a higher number of employees and a higher value of spares, all of which put the airline at a competitive disadvantage. Moreover, the fleet had 80 aircraft (31 Tridents 1 and 2; 25 Trident 3s; 9 Boeing 707s and 15 V.C.10s) that would be unable to meet the 1986 noise regulations set out by the Government in its White Paper on airport policy. In addition, a further 25 aircraft (Viscounts and Merchantmen) had to be withdrawn for technical reasons before 1986.

In effecting the replacement programme, one of the basic objectives of British Airways was to rationalise its fleet. On the long haul side the decision had been taken in the late sixties and early seventies to build up the Boeing 747 fleet for the dense routes and use the Lockheed Tri-Star 200/500 for the less dense routes. As these aeroplanes came into the fleet, the V.C.10s would be phased out and the number of 707s would be reduced before being completely withdrawn in the latter part of the eighties.

In the short haul operation, the main strategic decisions were made in the late seventies. At the thinner end of the range the Boeing 737 was assessed as the best aeroplane available and the decision was taken to introduce it in 1980 and progressively replace the Tridents 1 and 2. In the plus/minus 180-seater range, the Board of British Airways opted in favour of the Rolls-Royce engined Boeing 757, while on the densest short haul routes the decision was made to employ either the Tri-Star 1 or, a later member of the Tri-Star family, the 200, which could be employed in either short haul or long haul according to the demand.

All of these decisions were reached on the basis of operational cost assessments made in considerable detail by the career staff of British Airways. The reasoning was accepted by the Government and during the course of 1978 orders were placed for 19 757s and 28 737s, with 9 of the latter being for British Airtours. Since the orders fell short of the number of aeroplanes that had to be replaced by the mid-eighties concern was expressed that British Airways was putting its main effort behind the long haul operation. This was not so. One of the many advantages of rationalising the fleet in the manner proposed was the flexibility it afforded the airline. Forward estimates of route densities and profitabilities had been made but in the changing market circumstances these estimates were subject to a considerable margin of error. If the market proved more buoyant than current estimates showed the additional aircraft requirements would be in the 757/Tri-Star category. If, on the other hand, the passenger and cargo potential had been over-estimated, the emphasis would be more on the 737. It was the desire to retain flexibility as long as possible between different types of aircraft, and not any change in direction, that was responsible for the number of new aircraft ordered falling short of the number which required replacement. Giving an impression of financial laxity, the Price Waterhouse Report apparently

refers to a British Airways' commitment of £2 billion for future aircraft purchases. No such commitment was made, nor, given the budgetary controls in force, could it have been made without the approval of H.M.G.

During the negotiations that resulted in the steps to rationalise the fleet, Mr. Callaghan, the then Prime Minister, accepted the principle that the Board of British Airways should be permitted to buy the aeroplanes which, in its judgement, were regarded as the most suitable for the airline's current and projected route structure. He realised that this was an essential ingredient in clarifying accountability, although it was equally accepted that it would take many years for the full results of the policy to be achieved.

As a corollary to this return to business sanity it was accepted that British Airways should be free of extraneous costs in its operations. It was not at all clear to the management why the return on capital, or the wages and salaries it could afford to pay, or the amount it could plough back into the business, should be reduced by carrying the high costs of Concorde, an aeroplane which could not be expected to show a profit on any normal accounting basis. The Government accepted the reasoning and Concorde was written down to nil in 1978-79 with an associated reduction of £160m. in public dividend capital.

The turn of the decade saw an abrupt change in the outlook for British Airways. The sharp downturn in the world economy coincided with a greater degree of de-regulation and freedom of entry into the airline business, while the appreciation of sterling made companies based in the United Kingdom that less competitive in the international market. These factors were compounded by the prolonged Air Traffic Control strike in the U.K. and subsequently the U.S.A. Although the detailed work done on manning levels post McKinsey was an essential ingredient in the accelerated staff reductions, the target of partially growing into American cost levels over a five-year period was no longer appropriate in the changed market circumstances. For British Airways the traffic decline started at the beginning of the fiscal year 1980-81. Surplus capacity became common in the industry, competition increased and the discounting of fares by various devices became endemic. In that financial year revenue fell short of budget by £400m. and the loss before cost of capital borrowings and taxation was £70m. After interest and taxation the loss became £145m.

As the recession deepened and the much heralded economic turnaround receded into the future, more drastic measures were required. In September 1981 Mr. Roy Watts announced the details of a "survival plan" drawn up by himself and his Executive Board of Management.* It involved reductions in routes, stations, bases, staff and air-

*British Airways Bulletin of 10th September 1981.

craft. It was sufficiently dramatic, both in content and presentation, to provide "the calamity and upheaval" which, as the late Professor Allen observed, are often necessary to displace firmly rooted attitudes and habits of mind. The measures taken resulted in an improved operating performance in the financial year 1981-82. Profit before cost of capital borrowings and taxation was £11m. (against a loss of £70m. in the previous year, while the loss before taxation was £114m. (against £145m.)). However, after taxation and extraordinary charges of £426m., the loss was £544m. against a loss of £145m.

The main ingredients in the extraordinary charges were £199m. for redundancy payments and £208m. special write down of certain aircraft and related specialised buildings. The redundancy provision included £98m. of expenditure anticipated to be incurred in the following year. The fleet write down included, inter alia, reducing the book value of the Trident fleet to zero at 31st March 1982, although the 2s and 3s are still flying fare paying passengers and are likely to do so for a few years more. Only a State-owned industry could afford the luxury of such a performance and survive with the distorted Balance Sheet it produced. There are many private airlines, as well as shipping, refining, chemical and engineering companies, which wish it were possible to behave with such cavalier opulence. From now on it will be extremely difficult to make any very meaningful comparisons about the performance of British Airways over a reasonable time span, or how its efficiency measures up to the competition.

Various other accusations have been levelled at British Airways and its career staff. Thus Messrs. Dunlop and Dibbs gave great publicity to an alleged deficiency of £600m. in the Airways Pension Scheme; yet as the Accounts for 1981-82 recorded, the last actuarial valuation showed a deficit of only £20m. on estimated current, deferred and prospective liabilities of £1,980m., while the 1982-83 Accounts record that British Airways could reduce its pension contributions without impairing the solvency of the Scheme. Again security of airline tickets is a major problem. Accusations of widespread theft and the supposed calling in of Scotland Yard received considerable publicity but this too has gone silent. Overmanning in British Airways has been highlighted as if it alone suffered from the British disease, whereas historically it was a better performer than many other industries in both the private and public sectors*. There has been a tendency to attribute as particular to British Airways problems which are in fact common to the airline industry as a whole. British Airways was far from being the only airline company which had its forward estimates wrong and airlines were not alone in failing to foresee the depths of the slump - there are currently around 100 million dead weight tons of shipping laid up, primary distillation in refineries is averaging about 60% of capacity and ethylene plants are heavily under-loaded.

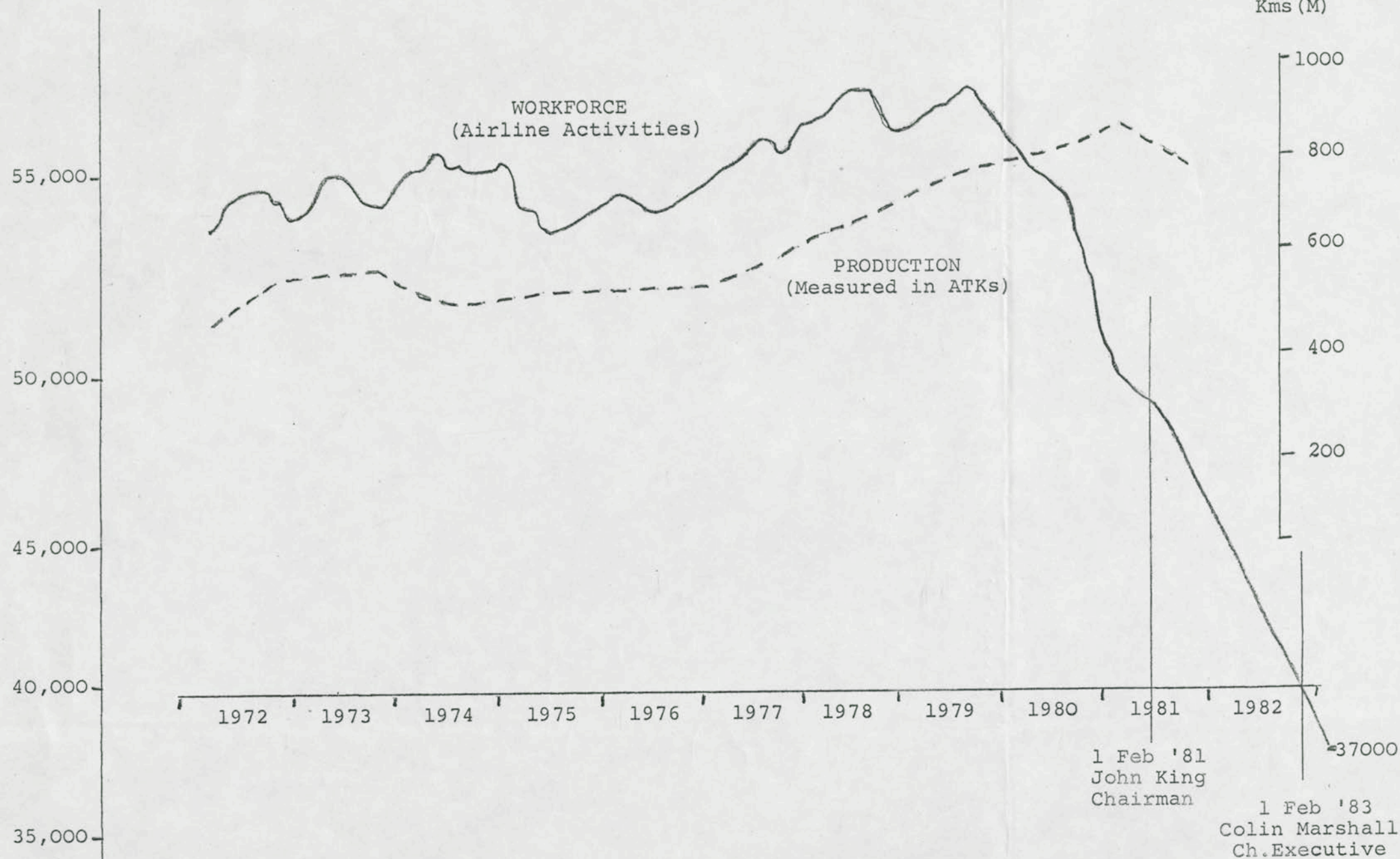
*Graham Hutton "Whatever Happened to Productivity?": I.E.A.

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The Government must carry a certain amount of responsibility for the generally hostile atmosphere against British Airways' staff. When he was a junior minister, Mr. Ian Sproat was almost hysterical on the subject but it runs much deeper. Distaste of nationalisation as an institution has too readily slopped over to scarcely veiled distaste of individuals who have sought their careers in the industries concerned. Too ready an ear is given to criticisms and too little to ascertaining whether they are soundly based or not. The Price Waterhouse Report on British Airways apparently went to the Prime Minister, raw and unprocessed by anyone with a knowledge of the airline industry or the history of the Company. I have spoken to two people who have read the report - one who used to be inside the airline and one from outside. Both were highly critical. Apart from the points made above, the document seems to contain the usual statements that can be made about any organisation - the need to improve management information, make better use of assets, provide greater clarity on management relationships, sharpen up financial procedures and so forth - and does not acknowledge how many of the apparently over thirty proposals originated from inside the airline. There is a case for publishing the Report, particularly as the secrecy surrounding it has fuelled rumours about its contents.

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Many criticisms can fairly be levelled at British Airways as, indeed, they can at much of British industry. However, the extraordinary provisions in the 1981-82 Accounts apart, there can be no doubt that the airline in the last few years has tackled its problems with vigour. A study of the dates shows that the main strategic decisions were taken and personnel numbers were being reduced before the arrival of Sir John King.* The survival plan was constructed and implemented by Mr. Roy Watts and other career employees of British Airways, several of whom now find themselves out of the airline or shunted into a siding. No doubt Sir John King ratified some of the major parts of the programme; he cannot claim, as is common belief, to have originated them.

*See Appendix

BRITISH AIRWAYS MANPOWER AND PRODUCTIONAvailable Tonne
Kms (M)



10 DOWNING STREET

(2)

Prime Minister

You asked if the Trade
and Industry Committee has
been set up yet. The answer
is no. It won't be until after
the recess when the Labour party
have sorted themselves out.

MLS 18/7

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