

Prime Minister

AT 15/6

MR TURNBULL

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GEC AND BAe

John Redwood asked me to write on the competition problem with a GEC/BAe merger.

The absorption of BAe into a larger grouping is an unmissable opportunity for Government to dispose of its entire shareholding in BAe.

There are industrial pros and cons:

On the credit side:

- a. The creation of a large, very nearly all-can-do corporation in civil and military aerospace, should improve the ability of the enlarged company to fight its corner in overseas markets.
- b. There is little product or technology overlap between GEC and BAe which would result in the elimination of competing products. The only substantive area here is underwater weapons, which I believe could be dealt with by divestment.
- c. Under GEC ownership BAe might be less likely to undertake daffy projects such as the A320 which command heavy subvention by the taxpayer.

The debit side is weighty:

- a. The creation of a larger aerospace grouping which can compete internationally is of no use to the taxpayer: the MOD is disinclined to source by international competitive tender.
- b. The grouping of an end product maker with a major sub-systems maker does give cause for concern. GEC's Marconi operations now have a spread of product activity which spans large parts of Plessey, Ferranti, and Racal and smaller parts of Dowty, Smiths and STC. These latter companies would fear the effective elimination of competition for major sub-systems on military aircraft; and by extension would feel that GEC had acquired even more muscle to negotiate non-airborne systems such as ground surveillance or secure communications. I believe we could almost guarantee that the "offended" companies, backed by the Defence Industries Council, would press for a reference.

The potential problem of reduced competition among sub-systems competitors might require an MMC reference. But

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we should not get the scale of the problem out of proportion. It is easy to say that GEC and BAe together would be twice as big as the six main sub-systems suppliers. The more relevant issue is to determine how much bigger Marconi is than its direct product competitors. Accounts conceal this in detail, but in sales and profit terms, my guess is that Marconi is about as big as Ferranti, Racal and Plessey put together - a very strong position but not a killer.

I am driven to the conclusion that the bid should be referred and dealt with very quickly. We could only pray it was then given the green light.

*Linda Ferrell*

RP ROBERT YOUNG