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PRIME MINISTER

ROLLS-ROYCE CORPORATE PLAN

Following your suggestion, Adam Butler and I had a discussion with Frank McFadzean about the Rolls-Royce Corporate Plan on Friday 12 September. In advance of the meeting, I had written setting out the main points of the Government's preliminary view on the Plan as set out in my minute of 6 August.

In the discussion, I re-iterated that so far as the Company's Civil Aero-engine business was concerned, I accepted that - on the basis of the improved financial projections shown in the Plan - continued exploitation of the RB211 should be the cornerstone of the Company's commercial strategy. There was certainly no other obvious alternative. For this strategy to be effective, however, Rolls-Royce would have to remain competitive and at the same ^{time} improve profitability. It was clear, moreover, that both would be dependent on the Company's plans to improve its productivity. I also emphasised the importance the Government attached to the Company's objective of breaking-even in cash flow terms by 1983.

Frank McFadzean accepted the Government position, but pointed out that the forecast of break-even by 1983 was made on the basis of an exchange rate of \$2.20 : £ rather than the current rate of \$2.40 : £. Moreover, differential inflation rates between the UK and US affected Rolls-Royce and their anticipated cash requirements for 1981 and 1982 were now looking much higher. He nonetheless accepted that he had,

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P. C. A. Dugard

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Sir Keith's report -
back on his
discussion, with

Frank McFadzean :
reasonably satisfactory.

B.
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somehow, to manage the Company back to the level of profitability laid down in the Plan. He also agreed that the Company had to eliminate waste and flabbiness and, at the same time, to keep tight control on suppliers and sub-contractors whose contribution to Rolls' business was considerable. Indeed increased efficiency among suppliers, who contribute over 70% of Rolls' manufacturing stocks, is as crucial to Rolls' success as improvements in Rolls' own productivity.

We discussed the Company's proposed joint venture with a group of Japanese firms to manufacture and market a new engine (RJ500) for medium-sized medium-haul jets. Although we have allowed the Company to go ahead and to explore a collaborative arrangement with Japan, I expressed the Government's doubts about the viability of the prospect and invited Rolls to consider whether it would not be wiser to examine a link with Pratt and Whitney. Lord McFadzean was not in favour; he thought it was most unlikely that Pratt and Whitney themselves would be in competition with the RJ500 or the GE SNECMA engine, which is also being developed. Discussions were, moreover, so far advanced with the Japanese that they were unlikely to be willing to extend the partnership. In any event, the timescale would not allow a round of discussions with P & W if the launch timetable were to be met. I am not inclined to interfere with Frank McFadzean's own judgment of RR's commercial strategy. The Government will, of course, have the opportunity to consider the project as a whole when RR seek approval to enter into a launch commitment or additional funding is required.

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