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Prime Minister
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20 March 1985

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A NEW BASIC TRAINER FOR THE RAF

There ought to be no argument about Michael Heseltine's decision in favour of the Shorts Tucano. After a lively and successful competition, he proposes now to award the contract to the winner - the company which fully met the MoD specification at the lowest firm price. The two other advantages which flow from this decision - 650 (real) jobs in Belfast and the boost to Shorts' privatisation prospects - are bonuses.

Possible Arguments Against

1. The Tucano is an "untried aircraft". This is incorrect: the plane is flying in hundreds. There is a minimal developmental risk (borne by Shorts) in so far as the chosen engine has not been flown in the Tucano. The RAF technical experts judge this risk to be slight. Re-engineering is a standard operation; with known airframe and engine is poses no problem. The PC9's engine still has not fully satisfied RAF experts.
2. RAF preference for PC9's handling: the RAF naturally prefer a sportier aircraft if they can have it, but they don't need it for a basic trainer. That is why the specification laid down in the competition asked for a modest speed of 240 knots. The RAF will get nearly 30

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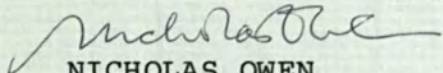
knots more than this. They haven't had a chance to fly the faster Tucano. Shorts were pushed by MoD to re-engine after meeting the original specification.

3. Might Shorts' competitive advantage be paid for by the taxpayer? Shorts are profitable (operating profit of £13 million on a turnover of £160 million in 1983-84). They are as profitable as BAe on a profit before interest and tax basis (around 3% on turnover). Their cheaper bid satisfies the Treasury's criterion (12% return in money terms); it has a genuine economic basis. Shorts are a leaner organisation than BAe, whose hourly labour costs are higher because of larger overheads, due to their failure to rationalise their rambling organisation of 22 plants. BAe is more likely to make a loss on this order, if it was awarded to them. Informed reliably on the bidding by their friends in MoD, BAe have reduced their price considerably to keep in touch with Shorts bids. Any loss which BAe might make could easily be loaded on to the many cost-plus contracts which MoD have awarded it.
4. Do we want more capacity? We want low-cost capacity, appropriate to the task. Shorts specialise in small, simple planes and airframe structures. It would be a mistake to top up BAe outside its main line of business in order to put off overdue rationalisation.

Recommendation

We recommend that you:

1. Endorse Michael Heseltine's decision. If we do otherwise, our new procurement philosophy - state the performance specifications we need and invite industry to provide the cheapest solution - will lose credibility. BAe have not behaved well in this competition (using their pull in MoD, putting in late bids after the whistle). It would be a disgrace to overturn the clear value for money verdict.
2. Press Douglas Hurd to name a date for privatising Shorts (in 1987 at the latest). Shorts have been winning commercial business. This MoD order will stabilise their order book and appeal to the City. There may be no better time to privatise.


NICHOLAS OWEN



10 DOWNING STREET

From the Private Secretary

Prime Minister

You will want to
note the Policy Unit's advice,
strongly in favour of the Tucans,
immediately behind the Cabinet
office brief.

Also the message received
from the President of Switzerland,
pressing the case for the PC9

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2073.

Also the latest minute from Mr. Hereltine -
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