Mr. Wicks
No need to trouble
PM on Airbus.
CDP. 17/3.

LCDP

Copy also filed on INDUSTRIAL POLICY: Rover pt 15

MR. GRAY

**BRITISH AEROSPACE (BAe), ROVER AND AIRBUS**

Sir Jeffrey Sterling came to see me on 14 March, at his own request, to brief me about British Aerospace's interest in Airbus and the company's proposed takeover of Rover.

His main point was that BAe would, if they took over Rover, face two massive management and financial problems - Airbus and Rover - either of which could, if things went wrong, bring the company down. The danger period for BAe would be some three years hence, just around the time of the next election.

AIRBUS

Sir Jeffrey is, as you may know, the UK representative on the four-man team studying the Airbus organisation. He said that their report is likely to make the following points.

1. Airbus technology is good.

2. The "management by committee" system needs to be changed. There needs to be "direct management" with someone in charge, and with management decisions taken in the normal way.

3. BAe are most strongly in favour of such a change, perhaps because they are the only private sector company in the operation. The Germans would accept this change, as would the Spanish partner. Aerospatiale would be most difficult, though those concerned in Toulouse desperately want a more efficient management structure.

4. No-one, not even the manufacturers in Toulouse, knew the true cost of the Airbus project. The partners did not pass true cost information to the centre. Sir Jeffrey stressed that he was not saying Airbus would not make a commercial profit. Information was not available to come to conclusions at this stage. There needed to be proper transparency of costs.

5. The aim should be to see whether it was possible to convert Airbus into a proper "PLC" by 1992. The first step would be to give it an orthodox management structure.

Sir Jeffrey was just off to see, with the other three team members, Herr Strauss, who was Chairman of the Supervisory Board of the German Airbus partner. He believed that Strauss wanted to see the changes described above. Strauss had a major political problem in that the German partner had a DM10b exposure on its balance sheet as a result of the project. This caused many people in Bonn to look askance at the project, particularly since the exposure could inhibit the privatisation of the German company, MBB. Sir Jeffrey thought that Strauss would have to resign the Chairmanship of the Supervisory Board; it caused all manner of complications and suspicions to have a serving politician so closely associated with the project.

The four Governments would need to decide whether to publish their report. There were arguments both ways. It could be advantageous to publish it quickly if there was clear agreement on the way ahead. This would demonstrate that the Airbus was a good product, and that there was a will to settle the project's management problems and so give it a good prospect of commercial success. This would help demonstrate that one of BAe's massive problems - Airbus - was on the way to a successful solution, and so could help the market accept BAe's bid for Rover. Of course, matters would look very different if the four Governments declined to accept the report's main recommendation for establishing a proper management structure. HMG would need to be ready to put pressure on partners, particularly Aerospatiale, if that looked likely. If there was no progress in introducing the required management structure, there could come a point when HMG would have to refuse further support for the project.

ROVER

Turning to BAe's bid for Rover, Sir Jeffrey said that BAe, as a capital intensive business, needed to strengthen its capital base. The Rover acquisition certainly did not do that. He was not certain that BAe would in the event proceed with the Rover bid. There was a possibility that, even if they reached agreement with the Department, BAe shareholders might turn the bid down. If that happened, Ford might well show an interest. That would be no bad thing if it concentrated Honda's mind. Sir Jeffrey believed that Honda held the key to Rover's future. They needed to put in management and finance which would take the company to its next stage of development.

I rather doubt whether it is worth troubling the Prime Minister with any of this at this stage. But if you or Charles Powell, to whom I am copying this minute, think so, please let me know. Jeffrey Sterling told me that he would be briefing Lord Young in a similar vein when he returns from Japan.

NLW

15 March, 1988.