



Prime Minister

MS 25/7

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ROLLS ROYCE

1. It would be wrong to take a decision on this before the new Chairman's Corporate Strategic Plan is available in September. Until we have that plan, we do not know what the long term future of the Company is. That must surely be the condition precedent of any decision.
2. An earlier version of the Plan was presented last December by the previous Chairman but was withdrawn following the change in chairmanship.

The present Chairman, Sir William Duncan, may argue that he cannot finalise his Strategic Plan until he knows whether he will get launch aid. That argument is misconceived. If, as stated in the papers, Sir William Duncan regards the E4 as "an indispensable part of the strategy", his right course is to draw up his strategy on that basis. Unless he does so, Government has no means of telling, even if launch aid is given and the E4 goes ahead, whether or not the Company has an effective long term future. The figures given in paragraph 43 of the Note by Officials are not good enough for this purpose - particularly as it is admitted that they will "be superseded by Sir William Duncan's review".

3. Nowhere are the facts clearly set out. Nor is any attempt made anywhere to bring the figures together in a proper coherent manner. The position would appear to be as follows. In 1978 agreement was reached on the development of a C-type engine for which the Government provided launch aid of £211 m. The cost of development is not stated but appears to have been £394 m. These figures are all at 1981 prices. In 1980 because of competition from Pratt and Whitney it was decided to develop this engine further to form the E type. The cost of this was to be met wholly by the Company. In 1982 it was decided to develop the E type further and it is in respect of this further development that launch aid is now requested. The position is summarised below.

Original C type programme agreed in 1978

Cost £394 m. Launch Aid £211 m

First E type programme approved December 1980

Cost £65 m. No Launch Aid - Cost to be met by Company

Extended E type programme

Extra cost £111 m. Launch Aid requested £83 m

Total cost of fully developed E type ie C plus E £570 m.

Launch Aid agreed or requested £296 m

All at 1981 prices

4. There is a further problem about the figures, mainly that MoD estimate the total cost of "development of the improved E4 [as] likely to [be] £325 m compared with the Company's estimate of £298 m". It is not at all clear how or where these figures fit into those given above.
5. The C type was developed specifically to power the new Boeing 757. In late 1980, Pratt and Whitney announced the development of an engine of advanced design, frankly intended to push Rolls Royce out of the market. The first E type programme, approved in December 1980, was Rolls Royce's response. But the improvement was not sufficient and, in 1982 Rolls decided that further enhancement of the E type engine was necessary.

Some C type engines have been delivered. Further engines of this type will no doubt still be delivered. No figures are given. But it is highly unlikely that the C programme looked at in isolation will remotely have paid off. The E programme really has no separate existence: it has grown out of the C programme and could not have existed independently. From the point of view of judging commercial success, the whole programme needs to be looked at as an entity. On this basis the Treasury are right in putting the real rate of return at 5% or less, as opposed to the 7% to 10% given by the Department of Trade and Industry.

6. But this is not the end of the story. The simple truth is that a great deal of the money sunk into the C programme has been abortive. How much we do not know. Nevertheless, so much money has already been committed to the venture that the real issue now is whether we should dip our hand further into our pocket to save the benefit of what has already been spent. If one does a calculation on this basis, and if one assumes that the project will ultimately succeed, it is almost bound to show a profit - as indeed it does. This follows almost inevitably from the fact that one is taking the incremental cost and comparing it with the total yield from the project: and the assumption of success removes the element of risk.
7. My own view is that, without this engine, Rolls Royce faces a bleak and unpromising future. The engine is due to fly on test "this summer". This I would have thought is absolutely crucial. But if the test programme is successful and the new Corporate Strategic Plan is satisfactory, I would think we should then go ahead. But we are certainly in no position to take such a decision now.
8. On a more mundane level, I suspect also that Rolls Royce may be asking for too much. The £65 m cost for the original E type programme was to be found wholly by the Company. Despite this, the Company are now throwing this in with the extra £111 cost for the extended E type programme and claiming launch aid in respect of the total of £176 m. (The launch aid claimed is £85 m, which is about 50% of the £176 m: up rated to current prices, this then becomes £102 m.) The figure ought to - and no doubt could - be scaled down. This needs to be investigated.

A.C.

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25 July 1983