


*Subject*  *cf Master*

## 10 DOWNING STREET

From the Private Secretary

8 April 1982

Dear Jonathan,

BRITISH AIRWAYS

Your Secretary of State was present this afternoon when Sir John King, accompanied by Mr. Dibbs, and by Mr. Wheatley of Price Waterhouse, called upon the Prime Minister.

Sir John King said that British Airways, as the Price Waterhouse report had made abundantly clear, was in a mess. It lacked a competent and businesslike management. He could deliver a successful airline to the Prime Minister, but it would take more than the two years which remained of his appointment as Chairman. When he recruited new people from outside he needed to be able to say that he would be Chairman for longer than two years; the same point applied so far as the establishment at British Airways was concerned, given that they had seen a succession of Chairmen and Secretaries of State come and go. He also needed freedom of action to recruit, and to pay at an appropriate level, three top managers: a managing director, a deputy managing director and a finance director. He intended to sell International Aeradio (IAL); and it was possible that an overseas potential buyer would come forward. He had already sold the College at Hamble. Finally, he asked that the progress in implementing the changes following the Price Waterhouse report would not be monitored in detail by the Department of Trade. It was for the BA Board to do this, and for the Chairman to report to the Secretary of State. If the Department attempted to monitor in detail, the Board's responsibility would be eroded.

Mr. Wheatley said that he had begun work on his report in October 1981, and concluded in March. His conclusion was that British Airways was in a mess, financially, managerially and operationally. Without a Government guarantee it would not be able to continue trading. Its debt/equity ratio was worse than Laker's. Yet it still had a £2 billion capital expenditure programme. British Airways was the most unproductive and overmanned of all international airlines. There was scarcely a businessman in the organisation. He had enquired of BA what plans they had for renegotiating - as other airlines had - the terms of their purchase of nineteen Boeing 757s. They had none; indeed, the idea had not occurred to them. Mr. Dibbs said that

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he had, similarly, discovered that no investment appraisal had been made at BA for the purchase of a Boeing 747 freighter which BA had subsequently sold at a large loss after eighteen months or so of unprofitable operation. It was true that BA had suffered over the years from the insistence of governments that it should purchase aircraft it did not want; it had also suffered from higher fuel costs, and from the effects of sterling depreciation. But he had been appalled at the amount of management effort which had been expended on devising various very short-term expedients to overcome BA's financial difficulties. He was not recommending, and BA were not requesting, that the Government should now take over £812 million of BA's debts. It was necessary first to rebuild BA's management (and, for example, to bring to an end a situation in which the only person in the airline who was profit-accountable was the Chief Executive). Above all it was necessary to create a viable business. Once this new situation had been created it would be time to consider how to deal with the airline's unsustainable debts.

Your Secretary of State said that British Airways were confronted by a very serious situation and that it would be a major task to turn round the losses of recent years. But he had doubts giving the British Airways Board an entirely free hand in the selection of three top managers. The level of their pay was bound to have repercussions elsewhere in the public sector. As to monitoring, he did not wish to set up a bureaucratic procedure, but some monitoring was inescapable, given that the Government was answerable to Parliament for British Airways' affairs.

The Prime Minister acknowledged the importance of recruiting sufficient new management strength to take on the existing establishment effectively; one man on his own, however able, could find this an impossible task. Sir John should go ahead and look for three people of the kind he had in mind. She believed that it would be very difficult to find people of the right kind; it was possible to pay £90,000 a year (Sir John had mentioned this figure), and still get somebody who was of little use. The repercussive effect elsewhere in the public sector of a high salary was not necessarily a decisive argument; Mr. MacGregor's appointment at BSC was a case in point. She was grateful for Sir John's undertaking to consult Lord Cockfield before coming to final conclusions on this matter. So far as the sale of IAL was concerned, a proposal to sell to an overseas buyer would need to be looked at very carefully, and treated with sensitivity. Present indications were that, given the degree of interest being shown by a number of UK potential purchasers, this question would not arise.

I am sending a copy of this letter to Terry Mathews (Chief Secretary's Office). I would be grateful if both you and he would give it a very narrow circulation within your Department.

*Yours sincerely,*

*Michael Scholar*

Jonathan Rees, Esq.,  
Department of Trade.



From the Secretary of State

Prime Minister

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*[Handwritten signature]*

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Michael Scholar Esq  
Private Secretary to the Prime Minister  
10 Downing Street  
London, SW1

16th April 1982

Dear Michael,

BRITISH AIRWAYS

Thank you for your letter of 8 April recording the outcome of the meeting between Sir John King and the Prime Minister.

The Secretary of State found the meeting an extremely useful introduction to the problems facing BA. He does not doubt the importance of the issue, and will be pursuing the range of questions raised by Sir John King and his colleagues.

In your note you record Mr Dibbs as saying that "no investment appraisal had been made at BA for the purchase of a Boeing 747 freighter which BA had subsequently sold at a large loss after 18 months or so of unprofitable operation". The Secretary of State recognises that Mr Dibbs' point was simply intended as an example of what he saw as BA's shortcomings. But whilst this purchase did in the event prove unnecessary, Mr Dibbs' assertion that there was no investment appraisal is incorrect. Such an appraisal was carried out early in 1979, and was submitted to the Department in the usual way. The Department subsequently communicated approval of the order in May 1979.

For obvious reasons, I am also copying this to Terry Matthews in the Treasury.

Yours Sincerely,  
*Jonathan Rees*

J N REES  
Private Secretary

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SIR JOHN KING

April 8<sup>th</sup> 1982

Dear Prime Minister

How very kind of  
you to see us this afternoon  
in view of all the major &  
pressing matters of state  
that you are dealing with.  
Your support & understanding  
is a massive help towards  
solving the British Airways  
problem. Again my thanks  
Yours sincerely  
John King