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SECRETARY OF STATE FOR NORTHERN IRELAND

BF with Treasury response.

Prime Minister

SHORTS - CORPORATE PLAN AND PRIVATISATION

As you know, I had hoped to be able to bring my proposals on Short Brothers to E(A) for discussion early next month, but I now understand that it is difficult to find a convenient time for the Committee to meet to discuss the paper. On reflection I think it may be possible to dispose of the immediate issues by way of correspondence.

.... 2. I enclose a copy of the paper I had intended to table for E(A). The decisions I had intended to seek from the Committee are set out in paragraph 14. These decisions are becoming urgent for the following reasons:-

(a) the delay in payments for missiles by the Nigerian authorities (paragraph 3 of the paper) is likely to mean that the Company will exceed its authorised EFL in the first week of March. Although the Company is confident that it will be paid by the Nigerians in due course the payment now seems likely to be made after the end of the financial year. If only for the sake of financial rectitude it is important to authorise Shorts to exceed their EFL on a temporary basis early in March;

(b) if we are, as I propose, to convert the Department of Economic Development's £25.6 million loan to the Company into equity, in order to pave the way for privatisation it is highly desirable to do it in time for it to show in the balance sheet that will be drawn up for 31 March 1984. Strictly speaking we should give the Company one month's notice of this decision, but while we can obviously agree with the Company a

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waiver/....

SECRETARY OF STATE FOR NORTHERN IRELAND

waiver of this requirement it is clearly desirable that we give the Company notice as early in March as possible;

(c) the Company's EFL for 1984/85 must be fixed at latest before the end of March, but preferably early in March so that the Company is able properly to gear itself to the cut in EFL that I am proposing.

3. I hope that colleagues will feel able to agree to the proposals I make in paragraph 14 of the paper. Although those proposals include a suggestion that we should take a firm decision to move towards privatising Shorts, I recognise that colleagues will want a full opportunity to discuss the way in which we should approach privatisation, and the strategy to be pursued in the interim period. I am not therefore seeking agreement at this stage to anything more than a decision in principle - but I think it would be helpful if a collective discussion on the way forward to privatisation could be arranged at a fairly early date.

4. I am copying this minute to colleagues of E(A) and to Sir Robert Armstrong.

J P

22 February 1984

MEMORANDUM BY THE SECRETARY OF STATE FOR NORTHERN IRELAND

SHORT BROS LTD : STRATEGY AND FUNDING

Introduction

I seek colleagues' agreement to future policy towards the Government-owned aerospace company, Short Bros Ltd. The attached Note by Officials prepared in conjunction with Touche Ross sets out the issues.

2. Shorts has three main activities: commuter aircraft, aero-structures and missiles. The company should achieve the £15m operating profit target we set for them in 1983-84 within an overall loss of £2m - the best result since 1974. Turnover has increased from £67m in 1978-79 to about £158m this year with similar manpower levels (currently 6,100). The company forecasts that from Spring 1984 it will require no net increase in external funding.

1983-84 Funding Requirement

3. Last year we agreed a cumulative external funding limit of £90m for the current year. The company has signalled the risk of an overrun of up to £5m which has arisen largely through the postponement of delivery of missiles to Nigeria. Following the recent change of government in Nigeria, Shorts have not been able, so far, to conclude satisfactory arrangements for the payment for the missiles and the consignment is still in Belfast. The uncertainty surrounding this order has compounded the difficulties which the company normally faces in matching aircraft receipts with the end of year EFL. I believe that this is a short term problem, and trust we can agree that, if necessary I should authorise Shorts to raise its temporary bank borrowings by up to £5m, with no public expenditure impact, to tide them over this difficulty.

1983 Corporate Plan Strategy

4. The overall strategy of the 1983 Plan (endorsed by consultants who advise my Department on Shorts) is to build upon the company's existing strengths and devote a substantial amount of its internally generated cash to new work opportunities. As reflected in the following table, it expects to move into overall profit in the year ending 31 March 1985, to reduce its external funding requirement from a cumulative peak of £90m in March 1984 to £87m a year later, and to increase employment:

Year to 31 March	1984	1985	1986	1987	1988	
Sales Turnover	158	205	221	205	230	(£m)
Operating Profit	13	23	28	28	30	(£m)
Consolidated Profit/(Loss) after tax	(2)	5	11	10	10	(£m)
External Funding Requirement (cumulative from 1.4.80)	90	87	90	87	84	(£m)
		-3	+3	-3	-3	
Employment	6200	7200	7100	7700	7900	

Assessment of Strategy

5. I fully endorse the conclusion of officials that the company's strategy is right in the short term. The SD 360 has shown that it can sell well and officials are confident that its sales forecasts for next year are realistic. Similarly officials believe that the company's aerostructures and missiles forecasts are reasonable for 1984-85. (There must of course be some risk to the financial forecasts in that aircraft sales, on which the forecasts are critically dependent, could be affected by the predatory sales packages offered by competitors, but the company is however developing a range of measures to combat

competitors' sales packages and if, following examination by officials, these can be put in place I am confident that Shorts' financial forecasts are realistic). On balance the forecasts are reasonable, and I believe we should authorise a cumulative EFL of £87m (this represents a negative EFL for the year of £3m) and an overall profit target of £5m. These figures include £6.5m in selective government grants, £3.2m of which will be SD360 launch aid approved last year. A suitable adjustment will be made in the EFL and profit figures if the company wins the United States Air Force contract for supply of an SD330 variant for the European Distribution System Aircraft programme (EDSA). At the same time I will require the company to keep a tight grip on its costs in the ways identified by officials (Note, paras 35,46).

6. The key question arises over the company's longer-term strategy. If Shorts win the EDSA contract - a decision is expected shortly - the SD330's life would be prolonged. But the company's main product the SD360, will on Shorts' own forecast reach peak deliveries in 1984/85 and the company has not produced hard plans for the post SD360 period. On aerostructures the nature of the business effectively prevents Shorts from initiating new work. Shorts' main missile product, as with aircraft, has recently been further developed, but the company will have to identify a new product in the not too distant future. While I believe that it would be premature for the company to decide now on its precise longer-term strategy (officials agree with the company that at present there is no penalty attached to deferring decisions) I am not satisfied that the company has focussed sharply enough on its future strategy, particularly on a product to follow the SD360. Therefore I intend to ask the company to present a range of costed options for its medium and longer-term development for my consideration in the autumn. The company has drawn attention to the fact that, in contrast to

most aerospace companies, the share of its turnover accounted for by defence work is low and it can be expected to press this point. I believe we shall need to respond sympathetically.

7. Experience has shown that tenders for new aerostructures contracts often have to be submitted by Shorts very quickly. It is essential that these should receive proper but rapid assessment. The company must be encouraged to hunt aggressively for new business, the interdepartmental consideration (and collective Ministerial consideration in the exceptional cases where this is required) of cases submitted by Shorts will need to be swift.

Management

8. During the year the company has strengthened its financial and marketing teams and, as foreshadowed in our consideration of last year's plans, Sir Philip Foreman was appointed to the joint post of Chairman and Managing Director. I know that there was some apprehension at a combined appointment, but I am glad to report that Sir Philip has in Adam Butler's and my view brought a coherence and drive to the management that was lacking under the previous arrangements. It is also the case that no personality within the company has emerged capable of relieving Sir Philip of his executive duties immediately. I therefore propose that we should continue with the current arrangements until, or certainly nearer to the expiry of Sir Philip's appointment (March 1986).

9. In the meantime, however, following a long search, Shorts have identified Sir John Sparrow as a potential deputy chairman and I propose shortly to appoint him to the Board with a view to the probability of his assuming deputy chairmanship in due course. He will bring to the company invaluable experience of both Government and corporate finance.

Privatisation

10. In examining the 1983 Plan I have given particular attention to the possibility of privatising Shorts. Shorts' board sought advice from three merchant banks and I have also had the benefit of independent specialist opinion. Having taken account of this advice my view is that Shorts is a clear candidate for return to the private sector, but that disposal by public flotation would be unlikely before 1988. However it might be possible to privatise the company at an earlier date by disposing of a substantial proportion of our holding principally through placement.

11. In our handling of privatisation however we must take full account of the particular importance of Shorts to Northern Ireland. Shorts has an increasingly critical role in the regional economy representing not only the largest manufacturing employer, but also a centre of technical skill and excellence. It would be politically as well as economically disastrous for Northern Ireland if disposal of the company were to lead to its relocation outside Northern Ireland or a decision by new owners to pursue expansion elsewhere. Indeed we could face considerable opposition from both local politicians and the trade unions were this felt to be a possible outcome of privatisation. A stronger base of MOD work, particularly in aircraft and aerostructures, would not only make the company more attractive to new investors but also provide a partial safeguard against substantial relocation.

12. I propose that we should now confirm our intention to privatise Shorts and that I should retain merchant banking advisers to explore the possible means, cost/benefit and timing of a disposal, taking account of the Northern Ireland dimension. In particular I would ask advisers to examine, within a range of alternative courses to privatisation, the possibility of disposal, perhaps as early as 1986, of 51% of our holding through placement largely with financial institutions, particularly local ones, but including opportunities

for employees, with flotation of the balance of shares some 12-24 months thereafter. This would have the advantage of enabling the company to become more accustomed to the discipline of private ownership and the financial community to familiarise itself with the company. Bank advisers are unanimous that the company's balance sheet - there will be negative shareholders' funds at 31 March 1984 - will have to be restructured before disposal. Apart from the conversion of government loans, this could cost £55m - £60m. I could not fund such a large capital injection from the NI block unaided. If capital reconstruction occurred (in say 1986) in advance if final disposal, we would at least receive, in the proceeds of 51% sale, some offset for this injection of equity.

13. Whatever form privatisation takes, it will help in the meantime to improve the balance sheet in one way which is immediately open to us, and I therefore intend to convert the £25.7m of interest-free Government loans to equity. This will be in earnest of our intent to move to privatisation. If we do this now, the improvement in the company's structure will appear in the 31 March 1984 balance sheet.

<u>Recommendations</u>

14. I recommend we:-

(a) endorse the company's strategy in the short term but seek costed options for its longer-term development;

(b) agree that, if necessary, I may authorise the company to raise temporary bank borrowings of up to £5m to cope with short-term cash flunctuations at the end of the current financial year;

(c) authorise a cumulative EFL of £87m, including £6.5m in discretionary Government grants, and set a consolidated profit target of £5m in 1984-85;

SECRETARY OF STATE FOR NORTHERN IRELAND

(d) agree in principle to privatisation and confirm that merchant banking advisers should be retained to explore means; cost/benefits and timing of privatisation, bearing in mind the particular Northern Ireland dimension;

(e) agree that £25.7m of Government loans be converted to equity as a first step in progressively restructuring the balance sheet;

(f) continue with current senior management arrangements and note the likely appointment of a new deputy chairman;

(g) agree that the company may seek further aerostructures contracts and that these should be dealt with speedly by officials, or referred speedly to Ministers in the exceptional cases requiring collective consideration; and

(h) accept officials proposals for monitoring capital expenditure and investment in new work, their recommendations concerning efficiency, and their conclusion that the aid proposed for the company need not be notified to the European Commission.

February 1984

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NOTE BY OFFICIALS PREPARED IN CONJUNCTION WITH TOUCHE ROSS

SHORT BROTHERS LIMITED

REVIEW OF 1983 CORPORATE PLAN UPDATE

CONTENTS

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BACKGROUND

1. Short Brothers Limited is a company wholly owned by Government and operating in the aerospace industry. It has three areas of activity, namely :

Aircraft : small commuter aircraft;

Aerostructures : parts built on sub-contract basis for major aircraft manufacturers;

Missiles : Blowpipe,Javelin and other missiles.

Control of the company is the responsibility of the Secretary of State for Northern Ireland acting through the Department of Economic Development (DED), who hold 91 per cent of the issued shares, the balance being held by the Department of Trade and Industry. DED has retained management consultants Touche Ross (TR) to assist in the appraisal of Shorts' Corporate Plan.

2. Shorts is the largest manufacturing employer in Northern Ireland, with a current workforce of some 6,100, approximately six per cent of total manufacturing employment. Its turnover in the financial year to March 1984 is expected to be about £158 million, of which about £100 million will be exported.

PERFORMANCE IN RECENT YEARS

3. Shorts have not made an overall profit since 1974 and have received substantial amounts of cash. Summary statistics in recent years are :

	1978/79 £M	1979/80 £M	1980/81 £M	1981/82 £M	1982/83* £M	1983/84+ £M
Profitability						
Turnover	67	91	111	122	81	158
Profit After Tax	(8)	(9)	(13)	(15)	(4)	(2)
Cashflow						
External Funding Limit (cumulative)	n/a	6	33	74	78	90
External Funding Requirement (cumulative)	n/a	6	32	65	74	89 #

* Seven months to 31 March (previous years to 31 August)
\+ Projected
\# This total consists of £25 million in DED funding, £64 million in bank borrowings.

Footnote: monetary figures in this Note are expressed at outturn prices.

PROGRESS SINCE LAST PLAN SUBMISSION

4. Ministers have endorsed Shorts' plans in recent years albeit with specific conditions on issues such as operational management and cost control. The strategy behind the 1982 Corporate Plan Update was to continue to develop strengths in aircraft and missiles markets and to seek relevant new aerostructures work as and when opportunities arose. This strategy was approved subject to the company :

- implementing an action programme recommended by consultants to maximise savings in stock, work in progress and non-recurring costs;

- appointing consultants to advise on overhead savings.

The company has taken steps to comply with these conditions and their progress in this regard is reported in Annexes I and II.

5. The 1982 Update approval also directed that the company achieve an operating profit of £15 million for the year to March 1984 and that overall losses for the year to March 1984 be limited to £2 million within a cumulative EFL of £90 million. The company's latest estimates indicate that these targets will be met, although a favourable variance on Missiles offsetting an adverse variance on Aircraft is an important factor :

	Budget £M	Estimated £M	Variance £M
Aircraft	7.7	4.1	(3.6)
Aerostructures	2.4	1.6	(0.8)
Missiles	13.8	18.0	4.2
Total Gross Margin	23.9	23.7	(0.2)
Overheads	(10.4)	(10.1)	0.3
Operating Profit*	13.5	13.6	0.1
Interest, etc.	(9.4)	(9.4)	0.0
Design and Development Written Off	(6.4)	(6.4)	0.0
Consolidated Profit/ (Loss)	(2.3)	(2.2)	0.1
Cashflow (cumulative)	(90.3)	(88.7)	1.6

* A change in accounting policy since the 1982 Update has the effect of decreasing the operating profit target from £15 million to £11.5 million.

It should be noted that achievement of these targets is highly sensitive to aircraft sales which, given the nature of the market, will remain uncertain until near year end.

INTRODUCTION TO 1983 CORPORATE PLAN UPDATE

6. The 1983 Update covers the period to 1987/88 and the overall strategy is to build upon existing strengths and to devote a substantial amount of cash to new, and largely unspecified, projects. The company anticipate a period of significant growth, with turnover rising by 46 per cent in four years, a compound rate of just under 10 per cent per annum in real terms. By 1988 £51 million, or 22 per cent of turnover, will have to come from new projects. The P332 project will account for £13 million of this increased turnover in 1987/88.

7. Profitability is also anticipated to improve substantially. If the 1983 Update's plan is achieved, 1983/84 will be the last loss making year and profits will increase steadily over the plan period to £13 million by 1987/88. These profits arise entirely from existing projects; the new work turnover produces little by way of profit in the plan period due to the high front end costs assumed for these new projects.

8. A small cash inflow in 1984/85 approximately balances an outflow in the following year and the last two years of the period are in surplus; overall, therefore, funding requirements fall slowly over the plan period.

9. The principal changes between the 1982 Update and the 1983 Update are :

	1984/85 £M	1985/86 £M	1986/87 £M	1987/88 £M
PROFIT/(LOSS)				
1983 Update	5	11	10	13
1982 Update	7	9		
CUMULATIVE FUNDING				
1983 Update	87	90	89	84
1982 Update	81	81		
EMPLOYMENT				
1983 Update	7,200	7,100	7,700	7,900
1982 Update	6,900	6,900		

The main reason for these differences are :

- lower forecast aircraft sales;

  Sales forecasts for the SD 360 in the period 1984/85 to 1985/86 totalled 85 in the 1982 Update, but only 66 in the 1983 Update. The reduction in profitability in these two years is £12 million.

- higher costs;

  Higher costs, particularly on the aircraft side, decrease profitability by £7 million in 1984/85 to 1985/86. Two important factors have been the need to increase marketing efforts and the greater expenditure on product development.

- greater missile profits;

  A higher level of more profitable overseas sales is an important factor in Missile profitability increasing by £9 million in 1984/85 to 1985/86.

- lower exchange rate;

  Although Shorts obtain a high measure of forward exchange cover, the assumption of lower average exchange rates improves profits by £12 million in 1984/85 to 1985/86.

- new work;

  The 1983 Update assumes a higher level of new work, costing an extra £5 million in cash between 1984/85 to 1985/86.

<u>ANALYSIS BY ACTIVITY</u>

<u>Aircraft</u>

10. There are three major products :

- Skyvan - a small military/freight aircraft;
- SD 330 - a 30 seater commuter aircraft;
- SD 360 - a 36 seater commuter aircraft which first entered service in 1982.

11. Skyvan sales have been falling for several years. This is due partly to age - the basic concept is a 1960s design - and partly due to effective competition from other aircraft, especially the CASA 212 (Spain). The plan assumes a further seven aircraft sold after the end of 1983/84; at present there are prospects for three sales. The company agreed that stocks, work in progress and purchase commitments provide for about seven aircraft and that this availability was at least as important as market assessments in establishing sales forecasts. There must be a distinct possibility that the Skyvan line will terminate within the plan period. If, despite the current prospects, no sales are made after March 1984, this will adversely affect cash requirements by up to £4 million over the plan period but with little effect on profitability.

12. The SD 330 commuter aircraft has sold in reasonable quantity in recent years. The company have delivered 93 aircraft and the most sold in any one year was 19 in both 1980/81 and 1981/82. Despite its sales success it has incurred a cumulative negative margin of some £50 million on a launch aid contract signed in 1974. Since the introduction of the SD 360, a stretched version of the SD 330 offering better fuel economy and lower cost per passenger/mile, SD 330 sales have been slipping. The company sees little future opportunity for the SD 330 in commuter markets given the inherent advantages of the SD 360. Opportunities are perceived, however, in military and freight variants. The shape of the tail section has allowed a rear loading door version to be introduced without major redesign. Shorts are very hopeful of winning a major contract with the United States Air Force (USAF) for a European Distribution System Aircraft (EDSA) for which they recently submitted a comprehensive bid; progress on this contract is given in more detail in Annex III.

Sales forecasts for SD 330, compared to last year's plan, are as follows :

	1983/84	1984/85	1985/86	1986/87	1987/88
SD 330 - 1983 Update	5	10	10	10	8
SD 330 - 1982 Update	6	6	6	-	-

13. TR's market analysis indicates that the company are correct in anticipating few further sales of SD 330s to commuter operators. The chances of military sales are likely to be critically affected by the outcome of the EDSA bid as acceptance by USAF, whose rigorous selection procedures are well-known, would significantly improve sales prospects in other military markets. Some freight sales are possible and to some extent Shorts see the SD 330 in this role replacing the CASA 212 in much the same way as the 212 replaced Skyvan. Officials believe that without EDSA the company's forecast for 330 sales is highly optimistic and if this proves correct there will be an adverse affect on cash requirements and profitability.

14. The SD 360 is the main product of the company's aircraft activity. It will sell around 30 aircraft in the current financial year. The full sales forecast over the plan period, including a comparison with last year's plan, is :

	1983/84	1984/85	1985/86	1986/87	1987/88
SD 360 - 1983 Update	30	36	30	28	25
SD 360 - 1982 Update	28	48	37	-	-

The reduction in forecast sales in the medium term is stated to be due to two factors :

- the company's less optimistic view of the marketplace;
- the company's compliance with Ministers' wishes to reduce inventory costs and minimise financial risks.

Both officials and TR believe that the forecast of 36 sales in 1984/85 is realistic. According to Shorts' plan this will be the highest sales level in any year, thus suggesting that the company's earlier high volume sales strategy has not succeeded. The company's contention that the reduction in sales forecast is partly due to Ministers' wishes to reduce investory costs and minimise financial risks is not correct. The revised forecast reflects market conditions and not Ministerial instructions.

The recent order situation is encouraging. In the 1982/83 financial year only nine new orders were achieved, although this was partly a reflection of the high initial level of orders obtained on launching the aircraft in the previous year. In 1983/84, however, a total of 22 orders had been obtained by mid-December and the company should be carrying a satisfactory number of firm orders into 1984/85. The 1983/84 orders included eight new customers.

15. The forecasts for subsequent years are more difficult to assess. At present the SD 360 is the only commuter aircraft of any consequence in the 30 to 40 seater market. Four directly competitive aircraft are all due to enter service in the next eighteen months. These aircraft tend to be described as "new generation" commuters and they are all pressurised and offer a better range. The SD 360 is unpressurised, but offers lower capital and operating costs on routes of up to 200 miles.

16. Views differ on the total market size in the period 1984 to 1989. Shorts estimate 650 aircraft sales, whereas the Department of Trade and Industry estimate 400 to 600 sales. Shorts then claim a 25 per cent share for themselves, whereas DTI feel 20 to 25 per cent is more appropriate. These figures give rise to the following sales estimates for the SD 360.

	SD 360 Sales 1983/84 to 1988/89
Shorts estimate	160 - 170
DTI estimate (calendar years)	100 - 120

17. The SD 360 has been the subject of a launch aid agreement and will receive £16.2 million of assistance by 1987. This will be repaid in the form of margin sharing and the company plans to repay up to £2 million in 1984/85. The forecast for SD 360 sales in the plan is consistent with full repayment in 1988.

18. A separate but related issue is that of sales financing. Due to the high capital cost of aircraft, manufacturers tend to include sales financing as part of their selling operation. Sales financing can cover :

- the credit risk in extending a loan to the purchaser;
- the granting of favourable credit terms.

19. Shorts have established arrangements with a group of banks which effectively removes any credit risk for the lender. These arrangements are currently limited to US $ sales and the company wishes to :

- extend the dollar loan facility;
- establish a sterling loan facility.

They feel that the latter is important in improving UK sales prospects. At present they are unable to offer credit facilities to UK customers, in contrast to their overseas competitors who export to the UK.

20. A problem arises from the credit terms offered. Shorts are limited to current ECGD terms. We are advised by the company that some of their competitors are quoting significantly better terms. The most favourable, from Embraer, can be as low as 7.5 per cent over 10 years. The effect of these terms can be to reduce the monthly repayment for such planes below the level repayable on a Shorts aircraft, despite the lower initial capital cost of the latter, as indicated in the following table.

Aircraft	Total Capital Cost	Cost Per Seat	Financing Terms	Effective Monthly Repayments	
				Total	Per Seat
	$000	$000		$	$
Shorts SD 360	4,000	111	12.25 % over 10 years	51,500	14.3
Embraer Brasilia	4,600	153	7.5% over 10 years	46,100	15.4
Casa/Nurtanio CN 235	4,900	129	9% over 10 years	52,300	13.8
De Havilland Dash 8	5,200	144	Not quoted		
Saab/Fairchild SF 340	5,500	162	12.50% over 10 years	64,000	18.8

21. The availability of favourable credit terms is only one of a number of factors which commuter operators will take into account when considering aircraft purchase although in some cases it will prove decisive. It is desirable that Shorts' sales packages should be improved as a contribution to achievement of production objectives subject to the risks in case of default being acceptable. Officials will be examining specific proposals shortly. It should be noted that, as Embraer's terms are beyond OECD agreed rates, ECGD are considering if they can match on a case by case basis any such terms offered by Embraer to prospective Shorts' customers. Such assistance would be a useful complement to rather than replacement of Shorts' own sales financing packages.

Aerostructures

22. The main aerostructures projects currently to hand are :

- RB 211-535 Engine Pods (for Boeing 757 aircraft);
- BAe 146 Engine Pods;

- Boeing 747 Undercarriage Doors;
- Boeing 757 Wing Flaps;
- Fokker F28 Wings.

Activity has been low in this Division recently as the world recession has hit sales of larger aircraft. The company is anticipating substantial recovery over the plan period for most of the above projects. Volumes on existing projects are anticipated to rise as follows :

Product	Unit	1983/84	1984/85	1985/86	1986/87	1987/88	Average % p.a. Increase
RB 211-535	Pods	35	60	60	84	84	24
BAe 146	Pods	40	52	52	52	52	7
Boeing 747 Under-carriage	Sets	12	12	14	16	24	19
Boeing 757 Wing Flaps	Sets	14	37	62	64	84	56
F28/P332	Sets	15	12	10	13	15	0

23. Current sales of large aircraft are at their lowest levels for some years and most observers feel that recovery is likely. Whilst some of the above increases seem high, this is due in large part to their being projected from a low base. TR and DTI both accept that the increases in sales forecasts shown above are feasible.

24. Shorts are hopeful of obtaining a number of new aero-structures contracts. Their bid for the P332 project, the successor to the existing F28 project, was approved by Ministers last December and Shorts have reached agreement with Fokker on commercial terms for participation in the project (which will be renamed F100). Other smaller bids are currently outstanding and more are anticipated in the forthcoming year.

Missile Systems

25. The main missiles product is the Blowpipe ground to air missile. Blowpipe has been purchased in considerable quantity by the MOD (PE) and overseas sales have been made to a number of countries.

26. A more advanced version of the missile known as Javelin has recently been developed. Javelin is due to go into volume production in 1984/85 and MOD (PE) confirm that they anticipate substantial orders for this new variant. Sales are also considered highly likely in overseas markets, given the relative success of Blowpipe in such markets and the fact that Javelin is easier to use. MOD (PE) regard Shorts' total forecasts are not unreasonable, although if anything, on the high side. Volumes for missile production are shown below :

	1983/84	1984/85	1985/86	1986/87	1987/88
Blowpipe/ Javelin	2,320	2,720	3,330	3,000	3,170
Seacat	165	130	130	200	200

Blowpipe/Javelin sales together with other smaller missile contracts for which Shorts are bidding should provide a reasonable basis, at least in the medium term, for its missile activities. Further developments will be necessary for longer term survival and the company is actively pursuing a number of alternatives.

MAJOR RISKS AND SENSITIVITIES

27. Aircraft

Market : As noted earlier, the overall forecasts made by Shorts for the SD 360 market are towards the top end of the range of likely outcomes. They are probably within reasonable bounds for 1984/85 and, to a more limited extent, 1985/86; it is in the subsequent years when the full impact of four competitive products is experienced that forecasts are uncertain. Accepting that the company can tailor its production to its sales prospects, within limits, the 1984/85 forecast can be allowed to stand. Forecasts for future years can be reassessed in next year's Update.

Sales forecasts for both Skyvan and SD 330 appear very optimistic although the EDSA contract would reverse this for the SD 330.

Capacity : If the EDSA order is obtained, output will rise to 60 aircraft by 1985/86. In addition, major new contracts such as P332 will require substantial capacity in areas such as tooling and design. TR have reported that Shorts will face capacity constraints in manufacturing and assembly. The company accept this view and state that they anticipate sub-contracting appropriate elements of the work programme.

28. Aerostructures

A substantial change in manufacturers' estimates for aircraft sales would have a knock-on effect on Shorts' output and new work prospects would also be affected.

29. Missile Systems

Assuming Shorts meet overseas sales targets and unless there is a major failure in the Javelin system, which is unlikely given that development is almost complete, short term prospects are good.

30. Costs :

TR report that the systems for cost control that they have seen at Shorts seem appropriate. Cost overruns may be experienced, however, in areas such as :

- the learning curve on new projects; Shorts use industry standards, but individual projects may prove difficult;

- productivity; Shorts set themselves a challenging 2.5 per cent per annum improvement, although they claim recent experience of the same order.

31. General

The company is sensitive to external factors such as exchange rates and growth in the American economy. A particular risk at present is the possibility of a substantial fall in the US $ which many forecasters feel is currently overvalued. For technical reasons relating to forward exchange cover, the company's results tend to lag behind exchange movements. This means that the potential benefits of the present rate of $1.40 - $1.50 will take some time to show through in trading margins. A substantial fall in the dollar would also take time to show through but would certainly damage medium-term prospects.

32. A table of key sensitivities is shown overleaf.

(Increase)/Decrease in Cumulative Funding Requirement as a result of :

		1984/85	1985/86	1986/87	1987/88
(i)	Exchange Rate (£/$)				
	Pessimistic (1.67→1.80)	(1)	(3)	(6)	(9)
	Optimistic (1.63→1.40)	1	3	6	9
(ii)	Inflation				
	Pessimistic (6% → 10%)	(4)	(9)	(18)	(32)
	Optimistic (4% → 6%)	3	7	15	29
(iii)	Aircraft				
	Pessimistic market assessment (30 aircraft 1984/85)	(10)	n/a	n/a	n/a
(iv)	Aerostructures				
	Pessimistic market assessment (20% decrease)	(4)	(4)	n/a	n/a
(v)	Missile Systems				
	Pessimistic market assessment (20% decrease)	2	(6)	n/a	n/a
(vi)	Selling prices increasing by 1% less than cost inflation in each year	(4)	(6)	(9)	(14)
(vii)	EDSA (first contract only)	8	7	1	1

Some if the above sensitivities are not shown for all four years. The company states that it faces difficulties in constructing full sensitivity tables as these require a number of fundamental policy choices to be made.

33. Officials have costed a worst case scenario for 1984/85 which assumes that the company does not obtain EDSA and experiences the pessimistic outcomes on all factors shown above. The cashflow consequences would be a deterioration in EFL of £21 million. It is most unlikely that all these factors would coincide and a pessimistic funding requirement might be some £10 million - £15 million above plan.

EXTERNAL FUNDING REQUIREMENT AND PUBLIC EXPENDITURE CONTRIBUTION

34. In the plan the cumulative external funding requirement for the year ending 31 March 1985 is £87 million compared to a requirement of £90 million for the current financial year. Whilst it is clear from the above tables that the requirement is sensitive to a number of risks, officials suggest that the company be encouraged to achieve the targets it has set in the plan. There are downside risks such as the optimism in sales forecasts for Skyvan and SD 330. Set against these are officials' reasonable confidence in 1984/85 SD 360 sales forecasts and the company's historic record of bettering planned missile performance. On balance officials consider that the plan proposals are challenging but attainable. Agreement will have to be reached with the company as to how the reduction in EFL from £90 million to £87 million should be monitored. Ministers should also note that in the last couple of years Shorts has cut back on its capital expenditure programme to ensure that the EFL was not breached and, while this is common commercial practice, this point should be subjected to rigorous monitoring by DED.

Nevertheless endorsement of the EFL and profit targets in the plan is recommended.

The appropriate limits for 1984/85 are then :

EFL*	£87 million cumulative
Profits	£ 5 million

The discretionary grant implied in these figures is £6.5 million. £3.2 million would be by way of SD 360 launch aid contract approved by Ministers last year and the balance would include R&D grant and assistance towards training programmes matched by complementary grants from the European Social Fund.

35. There are a number of detailed recommendations in Annexes I and II. These have public expenditure implications and officials make the following recommendations :

(i) stock ratios should be held at the 1984/85 level. The company is forecasting a decline in 1985/86 and subsequent years; maintaining stock ratios would give savings of up to £18M by 1987/88.

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* Officials are considering the composition of Shorts' EFL. It is recommended that Ministers review Shorts' funding requirements on the basis presented in the Corporate Plan and that officials be asked to make in due course any adjustments which may be necessary following the review of composition of EFL, or as a result of conversion of DED loans (paragraph 58 below) or if Shorts win EDSA (paragraph 12 above).

(ii) the level of non-recurring cost expenditure should be reviewed each year against the target levels set in previous plans;

(iii) proposals by consultants Binder, Hamlyn, Fry on overhead reduction should be implemented and progress monitored.

EC ASPECT

36. Ministers agreed last year that the launch aid element of the 1983/84 public expenditure contribution to Shorts need not be notified to the European Commission. Officials are agreed that there is no reason to modify this stance in respect of the launch aid to be provided as part of the 1984/85 public expenditure contribution to Shorts. The balance of the 1984/85 contribution, including assistance assumed in the Plan by way of standard capital grant, is also not notifiable to the European Commission on the grounds that it falls within the limit of aid under the Commission's Communication on Regional Aid Systems (February 1979) and as such is within the discretion of HMG.

SPECIFIC MAJOR ISSUES

37. A number of major issues are addressed in the 1983 Update. The most important of these are :

- successor to SD 360;
- defence work;
- new work;
- strategic options.

Successor to SD 360

38. When reviewing last year's plan, Ministers anticipated that the 1983 plan would include proposals for a production successor to the SD 360. The 1983 Update does not give details of such a successor. Given the fall off in SD 360 sales which the plan predicts, it is important that a decision on the future development of Shorts' business is made as soon as possible so as to offset the SD 360 decline. Shorts recognise these arguments, but point out that the market is likely to be particularly unstable and turbulent in the short term with the entry of four new competitors. They therefore feel it premature at this stage to specify the next major aircraft project after the SD 360.

39. Officials accept the logic of these arguments. Whilst in planning terms it would be desirable to begin development of the successor as soon as possible, the risks of making the wrong choice during the turbulent stage of the market seem high. Deferral by one year of development of a successor will not be detrimental and officials therefore support the stance taken by Shorts. Officials are concerned nonetheless that the company's attention should be focussed very sharply and soon on its strategy post SD 360 if the company is to remain in airframe production. It is therefore suggested that the company be asked to provide by early Summer 1984 costed options for the post SD 360 period.

Defence Work

40. Shorts present a detailed analysis of their limited involvement in defence projects. Their only significant business in this sector is in missiles and in comparison with other major UK aerospace companies the proportion of such work is very low (around 80 per cent of total turnover at Westland and BAe, 60 per cent at Rolls Royce and 40 per cent at Shorts). Shorts would therefore like to have the opportunity to bid for aerostructures defence work as well as expanding on the missile front.

41. The company argue that such work is usually profitable and carries low risk. They point out the importance of BAe's defence contracts in the context of privatisation and suggest that their own forecasts and prospects would be more soundly based if they had a similar proportion of such work. They also feel that defence-funded projects in areas such as materials, system design and manufacturing techniques may have profitable spin offs to their civil business.

42. The general argument that a company such as Shorts engaged in relatively high risk markets should seek an underpinning of defence work is sound (although it must also be valid for a large number of other companies). In particular, if Shorts is to be privatised (now or later), it would doubtless be desirable for more of such work to be won by the company. Major aircraft defence contracts are however too large for Shorts to undertake on their own and they have therefore requested in the plan that the Government consider offering elements of such work on a sub-contract basis. Where possible defence procurement at both prime and sub-contractor level is done through competition. While a greater volume of defence work is important Shorts will have to be sufficiently competitive to obtain such work. This is not a point therefore on which Ministerial decisions are required.

New Work

43. The 1983 Update assumes that a large amount of resources will be devoted to new work - this is defined as projects additional to those already on hand. Thus an increase in the number of 757 flaps produced by the Aerostructures Division does not count as new work, whereas the new P332 project would count.

44. The table overleaf shows the provision in the plan for existing projects and new work, with the P332 element of new work shown separately :

	1984/85 £M	1985/86 £M	1986/87 £M	1987/88 £M	TOTAL £M
TURNOVER					
Existing Projects	199	212	181	179	771
P332	0	0	10	13	23
Other New Projects	6	9	14	38	67
TOTAL	205	221	205	230	861
PROFIT (GROSS MARGIN)					
Existing Projects	34	37	36	39	146
P332	(2)	(1)	3	4	4
Other New Projects	0	2	(2)	(4)	(4)
TOTAL	32	38	37	39	146
CASHFLOW (NET)					
Existing Projects	14	8	13	18	53
P332	(8)	(5)	(3)	(1)	(17)
Other New Projects	(4)	(6)	(9)	(12)	(31)
TOTAL	2	(3)	1	5	5
EMPLOYMENT					
Existing Projects	6,465	5,845	5,715	5,600	
P332	660	715	760	740	
Other New Projects	75	540	1,225	1,560	
TOTAL	7,200	7,100	7,700	7,900	

45. The cash consequences of this policy are particularly important. If the current year is excluded, then existing work in hand at Shorts will generate net cash inflows of £53 million over the next four years. The funding for new work consumes £48 million in the same period, leaving a net inflow of just £5 million. However of the £48 million, £17 million relates to P332 work and of the remaining £31 million some will be spent on implementing the strategy in the plan (i.e. design work etc.) with the balance being spent only if the strategy is successful.

46. As noted in the review of strategy, the broad principles of this approach are accepted in terms of increasing the product base and producing a sound basis for sustainable growth. There is a problem, however, in the analysis and control of this expenditure. The sums involved could be used, if the company so desired, to fund losses elsewhere in the business. This situation is not satisfactory and approval of the plan should be made contingent upon an acceptable system for ensuring that the large amounts of money designated for new work actually get spent on that item. These procedures are discussed in Annex IV.

47. Annex IV also considers the methods by which new projects are subjected to approval by Government. The problems of achieving Government approval for major bids are noted, particularly in circumstances where the company has to meet tight deadlines. Officials recommend that this problem should be further examined so that the Government's response to proposals may be accelerated while taking account of the need for full evaluation, as proposed in option (iii) of Annex IV.

48. The 1983 Update excludes two major potential projects which are likely to require substantial amounts of cash, the Boeing 7-7 and the successor to the SD 360. Expenditure in both projects could arise within the plan period and if so would have to be treated by way of a major change to existing plans.

STRATEGIC OPTIONS

49. A strategic problem for Shorts is its small size and narrow product range in high risk markets. Thus, there is only one major project each in the aircraft and missile activities, the SD 360 and Blowpipe/Javelin respectively, and aerostructures is a highly competitive sector. The lives of the aircraft and missile products are limited and successors are not obvious or assured as explained in paragraph 38 above re SD 360; they are also likely to require high initial development funding. New aerostructure contracts are difficult to win and existing products rely on the ability of Shorts' clients to sell their aircraft in depressed world markets.

50. To expand its base, the company is proposing in its 1983 Update to embark upon a period of substantial growth. This growth comes from a number of components :

- major increases in the turnover and profits of Missiles Division, as Javelin comes on stream and development of projects such as the High Speed Missile (S14) with the aim of widening the product base;

- increases in turnover from existing aerostructures contracts;

- major investments in new work opportunities absorbing £48 million of internally generated cash over the next four years;

- extension of the life of the SD 330/360 and expansion of their markets through the development of variants.

51. Officials believe that the general strategy proposed by Shorts is sound in the short term in that it seeks to expand and achieve steady growth in a manner designed to limit risks. A key feature is the lack of any calls for further cash even though some £48 million is devoted to developing new opportunities; this amount is funded entirely from internal resources.

52. Realistic alternative strategies in the short term are difficult to identify. One possibility, complete withdrawal from airframe production, would have the following consequences in the plan period :

- rundown of aerostructures business due to the integrated nature of manufacturing, including design, machining and fabrication;

- undue dependence on missile manufacture which would need to be substantially widened to provide a robust base;

- employment falling from 6,100 to 4,300;

- losses increasing to £10 million per year;

- cash requirements slightly reduced.

53. Officials would not recommend such a strategy but rather believe that Shorts should continue to seek to maximise SD 360 sales in what is likely to be the peak year for deliveries before competitors' aircraft come on stream. Although the company may also have to cope with the EDSA order, nevertheless it will have to prepare itself for key decisions on the long-term future in the post SD 360 period. These decisions may be influenced by prospects for participation on the new Boeing 150-seater aircraft and the V2500 engine. The recommendation by officials (paragraph 39) that Shorts be asked to provide by early summer 1984 costed options for the post SD 360 period is designed to ensure that the company does focus attention on these matters.

CAPITAL STRUCTURE

54. Past losses have been funded by way of loan and the capital structure now shows an insolvent company, which only avoids a going concern qualification by virtue of the guarantee of continued Government support last reiterated in Parliament on 23 December 1981. Shorts have discusssed their capital structure with merchant banks and, based upon the advice they have received, feel that their equity to debt ratio should be no worse than 3 to 1 (it is presently incalculable, since accumulated losses are more than share capital) and their interest cover should be five times (it is presently less than one). To achieve these statistics immediately, they are seeking :

- conversion of all current DED zero-interest loans, £25.7 million, to equity;

- injection of a further £55 million of new equity to be used to repay loans.

55. If this level of funds were made available, Shorts would immediately achieve an equity to debt ratio of over 4 to 1 and interest cover of five times. If their plan profits were then to be achieved, however, and assuming a modest level of dividend by 1987/88, the ratio would be over 40 to 1, and the cover over 20 times. Shorts defend these projections by arguing that they allow room for substantial loan funding of a successor to the SD 360 and the potential 7-7 project, neither of which are presently included in their plan.

56. Officials agree that the present capital structure is unfavourable and may limit business prospects, but do not believe that an immediate conversion on the scale requested by Shorts is required. The only rationale for such a conversion would be a swift ensuing privatisation.

57. If the company is to continue in public ownership for the foreseeable future, the need to inject equity is not so pressing. Whilst Shorts may face some difficulties with certain overseas customers, it is difficult to believe that a balance sheet unsuitable for a private sector company would actually cause them to lose business, particularly in the light of the Government's overt commitments to Northern Ireland generally and Shorts in particular. The main objective of any restructuring would be to remove current negative reserves and provide some headroom to avoid the same problem in the future.

58. The £25.7 million of zero-interest DED loans are due for repayment in 1989 and 1991. The Corporate Plan does not envisage generating substantial cash up to 1987/88, the end of the plan period, and whilst figures are not available for subsequent years, it is almost inevitable that the company would seek to recycle the above loans from Government. In these circumstances officials suggest that such loans be converted to equity, especially as they are not interest-bearing. This then allows a more respectable balance sheet at no direct cost to Government.

CONCLUSIONS

59. Officials believe that the general strategy is sound in the short term but subject to considerable uncertainty in each segment of the business. The aircraft segment merits further examination in terms of both maximising SD 360 sales in the medium term (by sales financing mechanisms) and a future without EDSA or a 360 successor. The company should focus sharply on the future of its aircraft activities.

60. In whatever direction Shorts' decide to pursue growth HMG should exercise firm but flexible control on new projects. The capital structure is inappropriate today, whatever the new and long term prospects for privatisation and should be improved over the next one to two years.

61. Ministers will wish to consider if they can endorse Shorts 1983 Corporate Plan and in particular to decide whether :

(i) to authorise Shorts cumulative external funding requirement of £87 million for the year ending 31 March 1985 and the provision by the Government of £6.5 million by way of launch aid (£3.2 million) and other discretionary assistance during 1984/85; (paragraph 34);

(ii) to set a consolidated profit target of £5 million (paragraph 34);

(iii) to defer immediate decisions on the company's post SD 360 development, but to ask Shorts to provide costed options by early summer; (paragraph 39);

(iv) to authorise Shorts to seek new aerostructures and missile work with more streamlined approval arrangements; (para 47).

(v) to agree proposals for monitoring :

- capital expenditure
- investment in new work (paragraphs 34 and 46);

(vi) to endorse officials' recommendations regarding :

- stock ratios
- non-recurring costs
- overhead reductions (paragraph 35).

(vii) to improve the capital structure of Shorts' balance sheet; (paragraph 58);

and also if the assistance proposed at (i) above need be notified to the European Commission (paragraph 36).

ANNEX I (i)

STOCKS, WORK-IN-PROGRESS AND NON-RECURRING COSTS

STOCK AND WORK-IN-PROGRESS

In accordance with conditions attached to Government approval of the 1981 Corporate Plan, Shorts engaged consultants to advise them on methods of reducing stock levels. The report from the consultants was submitted late in 1981 and Government approval of the 1982 Update required Shorts to implement the consultants' recommendations. Those recommendations included :

- the use of stock ratios to measure performance;
- an action programme to control Work-in-Progress.

Stock Ratios

A traditional measure of stock levels is the ratio of Sales to Stock. The higher the ratio, the lower the stock necessary to support a particular level of sales. Increases in the ratio are therefore generally desirable, as they imply a reduction in the level of working capital required. Too low a level of stocks, however, can cause sales to be lost due to temporary stockouts so a suitable balance must be struck. Industries often use standard measures against which they assess performance on stock control. The consultants advised that a general standard in the aerospace industry is a sales to stock ratio of 2.0:1. Shorts had a figure of around 1.0:1 at the time of the consultants report and agreed to work towards a 2.0:1 target.

Figures for stock ratios quoted in both the 1982 Update and the 1983 Update are misleading. Those given in the 1982 Update were based on August year ends and those in the 1983 Update are simply erroneous. The correct March year end stock ratios in the two plans are :

Shorts Stock Ratio of Sales to Inventory

	Year Ending March				
	1984	1985	1986	1987	1988
1983 Update	1.6	2.0	1.9	1.7	1.7
1982 Update	1.1	1.7	1.6		

The stock position at the end of 1983/84 will be significantly better than forecast in the 1982 Update. The main reasons for this improvement are :

- lower than anticipated inflation;
- higher sales turnover;

- lower stock levels in Aircraft Division (both finished goods and work-in-progress).

The company anticipate continuing this improvement through to 1985/86. Beyond then, the ratio worsens as the anticipated aircraft sales decline is not marked by a corresponding decline in stocks.

Control of Work-In-Progress

The company have introduced improved controls on Work-in-Progress. Major changes include :

- renegotiation of existing supply contracts to increase flexibility by reducing purchase commitments;

- replanning aircraft assembly so that a number of major items are fitted later in the assembly sequence, hence reducing work-in-progress requirements;

- introduction of monitoring and expediting procedures to cover major bought-in and long lead made-in-works items. The object of this programme is to minimise expenditure on such items.

The company are presently extending their new stock control procedures to lower value items.

In summary, although the company has begun implementation of the consultants' recommendations, much of the recent improvement has come from factors such as lower inflation and higher aircraft sales. The company anticipate that the benefits of the new procedures will allow them to maintain stock ratios at around 2.0:1 from 1984/85 onwards. In this context, the decline in the ratio anticipated in the later years of the Plan is not satisfactory and officials suggest that the company be requested to maintain the ratio at 2.0:1 or thereabouts even if aircraft sales do diminish. If this were to be achieved, cash requirements to 1987/88 would be reduced by £18 million.

NON-RECURRING COSTS

Consultants recommended a number of steps that the company should take to reduce Non-Recurring Costs (NRC). In the 1983 Update, the company list those actions that they state have been taken in accordance with the consultants recommendations. In subsequent discussions, they also pointed out that the cost reduction programme is designed to allocate costs more precisely to specific projects and hence increase individual accountability. This is felt to offer better prospects for containing such costs within budget than a general attack on NRC expenditure. To achieve these objectives, they have appointed an accountant to work directly with their project engineers.

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Annex I (iii)

The company appear to have implemented the principal recommendations put forward by the consultants. Officials suggest that the level of NRC expenditure be reviewed each year against the target levels set in previous plans.

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ANNEX II (i)

OVERHEADS

Approval of the 1982 Update was contingent upon Shorts retaining consultants to consider the level and extent of overheads and to identify any areas for potential savings. The company appointed Binder, Hamlyn, Fry (BHF) to carry out this task, working to terms of reference agreed between Shorts and DED. Shorts report BHF's conclusions and recommendations in the 1983 Update.

EXISTING SYSTEM

The company's present practice is to add 225 per cent to direct costs to recover 'variable' overheads. This is intended to cover items such as :

- indirect labour, materials and expenses;
- stores;
- energy costs.

A further 125 per cent of direct labour is added to cover other overheads, which includes :

- accounting and administration;
- head office costs.

Shorts state that the BHF report endorsed this approach, but noted that rates in practice varied from area to area.

PROPOSED SAVINGS

The 1983 Update lists a number of areas which BHF indicated offer scope for overhead savings. It is understood that the savings shown are net, i.e. that they include allowances for the appropriate costs involved; also that any capital requirements were also included in the capital expenditure figures in the Update.

The company intend to begin implementation of BHF's proposals in the following sequence :

ANNEX II (ii)

	1983/84 £000	1984/85 £000	1985/86 £000	1986/87 £000
1. Computer Aided Planning				
Cost	(400)			
Savings		400	450	500
2. Capital Re Equipment				
Cost	n/a			
Savings		400	500	600
3. Systems Improvement - Stores Reorganisation				
Cost	(500)	(750)	(750)	
Savings		700	800	900

There are also plans to implement a number of more minor BHF proposals in the near future.

These implementation plans seem reasonable. Officials suggest that they are approved and that progress is monitored via the quarterly capital expenditure return, supplemented as necessary by enquiry at monthly monitoring meetings. The implementation plans should be reviewed once DED have had sight of the BHF report.

ANNEX III

THE EUROPEAN DISTRIBUTION SYSTEM AIRCRAFT

When reviewing Shorts 1982 Corporate Plan, E(EA) Ministers authorised Northern Ireland Ministers to approve Shorts' bid for the EDSA contract from the US Air Force, subject to the contract having at worst a neutral impact on Shorts' profit and loss and EFL. The contract required the supply of up to 66 cargo aircraft for servicing USAF bases in Europe and Shorts' bid was based on a modified SD 330 with a rear loading door.

Shorts' bid was reviewed at official level by interested Departments, including the Treasury, and in November last, Northern Ireland Ministers authorised a 'worst case' scenario which the bid would have to meet. This 'worst case' scenario met the terms of the collective Ministerial delegation.

Due to pressure on the US Defence Budget a decision by the USAF has been delayed and is unlikely to be made until March. If Shorts' are successful there would be the following affect on figures for 1984/85 in the Note by Officials :

	Note by Officials	EDSA	Revised Figures Incorporating EDSA
Turnover (£M)	205	31	236
Consolidated Profit (£M)	5	3	8
Cumulative EFL (£M)	(87)	8	(79)
Manpower	7,200	565	7,765

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ANNEX IV

NEW WORK AND PROJECT APPROVALS

NEW WORK

The 1983 Update envisages substantial expenditure on new work, £48 million over the next four years. TR suggest that the scale of such expenditure requires it to be monitored and controlled. In particular, it is important to ensure that those funds within the EFL designated for new work are not reallocated elsewhere.

In Section 12 of the 1983 Update the company list new work as a separate item in several tables, notably those showing Gross Margin and Cashflow. DED see little difficulty in carrying this separation through to the relevant tables in the monthly monitoring returns and suggest that this approach be adopted and that monthly monitoring of performance should include progress on new work. In addition, the company should continue to notify Government of all new projects so that a cumulative list can be maintained.

PROJECT APPROVALS

Shorts report problems in the present system by which they obtain Government approval for new projects. In particular they note the length of time necessary to obtain sanction in the light of the tight commercial deadlines that they often have to meet in bid situations. There is no doubt that the company do face difficulties on occasions in advising Government of their final bid well in advance of the relevant date for submission of tenders.

There are a number of options which can be considered :

(i) To continue the present system, acknowledging that it is likely to cause severe difficulties on occasion. To do so runs the risk of Shorts claiming publicly that a particular bid for a profitable project was not submitted because Government approval could not be obtained in the time required.

(ii) To continue the present system, but to have a speeded-up procedure to be used if appropriate. Whilst such a procedure could be devised, the drawback is that Shorts are likely to claim that virtually all bids should be subjected to it.

(iii) To devise swifter procedures. The simplest approach would be to agree that where wider consideration within Government is necessary it should as far as possible be handled at official level but with rapid reference of exceptional cases to Ministers where collective consideration is required.

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