

Case Study for Chapter 2

Aircraft carriers

In January 2003 the UK Government announced that the £2.8bn contract to build two new aircraft carriers for the Royal Navy would be split between British company BAE Systems and Thales, its French arch-rival. When maintenance work and upgrades are considered, the deal is worth approximately £9.2bn over the lifetime of the vessels.

Celebrations were, however, somewhat muted at BAE. The company will be getting two-thirds of the business, but will (under the terms of the deal) have to build the ships to Thales' designs. In other words, BAE are taking the lion's share of the risk, since they will be responsible for any cost overruns and design corrections, but will not have the power to vary the designs. Even though the UK taxpayer will pick up 10% of cost overruns, this still leaves BAE vulnerable in some respects. The situation is worsened by the fact that the companies who were involved in the bidding process were told that the outcome would be a "winner takes all" contract. On the other hand, BAE may be lucky to have been offered anything at all. In December 2002 the company's shares dropped dramatically after it announced cost overruns on other Ministry of Defence deals, then on January 15th Geoff Hoon, the Defence Secretary, announced that he thought BAE was "no longer British." Then as late as January 21st the national organiser of the Transport and General Worker's Union, Jack Dromey, revealed that senior civil servants were recommending that the contract should be awarded to Thales in its entirety.

Final details need to be worked out, and it is fairly certain that BAE will be pressing for a better deal on the overruns, since the company is already in dispute with the Ministry of Defence about cost overruns of up to £1bn on the Nimrod aircraft and Astute submarine deals. Industry reaction to the deal was one of astonishment – one senior defence executive said "Thales won this on design and price, but BAE got the prime contractor role because of politics."

The political issues are by no means simple. Under European Union rules, contractors throughout the EU must be given the opportunity to bid on Government contracts within any of the member states – in other words, national governments are not allowed to play favourites by awarding contracts to their own suppliers. The problem is that this law is more honoured in the breach than in the observance - although Thales have apparently come in with a lower price and a better design, it would be impossible for a UK government to award the contract entirely to the French, knowing that there is no possibility of the French allowing British companies to compete on an equal footing in France.

Defence secretary Geoff Hoon dismissed such allegations as being "the kind of anti-European, anti-French rhetoric that's come to characterise the modern Conservative party.... It's a disgrace." Meanwhile Lord Bach, the procurement minister, and Sir Robert Walmsley, chief of defence procurement, were examining the extent to which the taxpayer would carry the risk in terms of cost overruns. Government policy has been to move these risks away from the taxpayer and towards the contractor, but of course the higher the risk the contractor is expected to take, the higher the overall cost of the contract, so the Government will almost certainly need to compromise.

City analysts believe that the contract represents a Pyrrhic victory for BAE. Although the contract will contribute £30m to annual profits, this is a relatively small amount of money – the total contract only represents 2% of sales for BAE. In exchange for this, the company has given Thales a stronger foothold in the UK, building on its acquisitions of defence companies such as Racal, Pilkington Optronics, and Shorts Missile Systems. Some City analysts believe that BAE would have been better off if the company had lost the prime contract to Thales and had instead concentrated on low-risk subcontracting work at its shipyards.

Meanwhile, the Royal Navy eagerly awaits delivery of the ships. Captain Simon Williams, assistant director of strategy at the naval staff, says that the current carrier fleet is designed primarily for protecting the Navy from attacks while at sea. The new carriers will have the capability to attack shore installations. "If you put one of these carriers in international waters off another country it becomes a very flexible tool and it focuses the mind of the people we are trying to influence," he said. The ships will be equipped with the new F-35 fighters, the replacement for the Harrier Jumpjet, now nearing the end of its useful service life.

Whatever the outcome, the Unions are pleased. Bill Morris, general secretary of the Transport and General Workers' Union, said, "I believe our quality British workforce will deliver a quality British product. The challenge is now for BAE Systems to deliver on time and on budget."

Case study questions

1. How has the political environment affected the purchasing process? *The political environment has influenced the decision-making in three main ways. Firstly, the UK Government has been forced by EU rules and politics to award the contract (in part) to Thales. Secondly, the Labour Party (in power at the time of the decision) needed to ensure that part of the work went to a British company, even though the French company offered a better design and price. Thirdly, the Government knew that the French would not be as accommodating in awarding any of their contracts to a British firm – so a clear message needed to be sent to the French Government.*
2. Who were the influencers, deciders, buyers, gatekeepers and users in the DMU? *The influencers were the other political parties and the EU, and also the senior civil servants: the decider was Geoff Hoon: the buyers were the Ministry of Defence: the gatekeepers were (in part) the European Union, since they ruled that all companies in the EU must be allowed to bid: and the users are the Navy and (to an extent) the Ministry of Defence.*
3. What effect does the UK government's previous experience of the suppliers have? *The Government were apparently doubtful of BAE's qualifications, on the basis of the Nimrod and Astute overruns. Geoff Hoon was also doubtful of the company's British credentials.*
4. If the potential profits on the deal are so low, why would BAE be interested in bidding for the contract? *BAE need to bid for the contract because other work will follow on. The initial build contract is only £2.8bn, but the total expected income stream over the life of the ships is £9.2bn – much of which BAE might expect to win. Also, other contracts will undoubtedly materialise in the future, and the company needs to live down the problems it has had with the UK government in the past.*
5. What effects might the deal have on the long-term relationship between BAE and Thales? *BAE and Thales should have an opportunity to build a relationship rooted in their specific expertise. This should help when other contracts come up with Governments elsewhere in the world. The opportunity for joint bidding, rather than competitive bidding, means that both companies increase their ability to compete on the world stage.*