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**CANADAIR LIMITED AND
THE de HAVILLAND AIRCRAFT OF CANADA LIMITED**

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M E M O R A N D U M

CONCERNING

CANADAIR LIMITED AND
THE de HAVILLAND AIRCRAFT OF CANADA LIMITED

PREPARED FOR

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I. FOREWORD

The attached memorandum concerning Canadair Limited and The de Havilland Aircraft of Canada, Limited was prepared by me in response to a request by the Minister of Industry, Trade and Commerce. It represents a personal assessment of the options open to the Government in connection with its ownership of these two aircraft companies, and their advantages and disadvantages.

I wish to record my appreciation for the cooperation which the Boards of Directors and Senior Management personnel of the two companies extended to me. I would also like to express my appreciation of the assistance which I received from officials in the Department of Industry, Trade and Commerce and from Mr. F.M. Steers of Telesat Canada. In addition, many experienced individuals both within and outside the aerospace industry gave me the benefit of their views.



D.A. Golden
July 10, 1978

II. INTRODUCTION

On March 1st, 1977, the then Minister of Industry, Trade and Commerce, The Honourable Jean Chrétien, asked me if I would undertake a study concerning the future of Canadair Limited and The de Havilland Aircraft of Canada, Limited.

The task definition included:

- "- consideration of the basis, if any, for rationalization of the DHC and CL operations;
- the definition of appropriate relationships between the two companies and the Government during the period when the companies are owned fully or partially by the Crown;
- definition of the need, timing and character of appropriate business links between the companies and foreign or domestic aerospace entities."

On March 2nd, I agreed to undertake this study and to do it "as expeditiously as possible, but bearing in mind at all times my primary responsibilities as President and Chief Executive Officer of Telesat Canada." As it happened, these responsibilities did in fact prevent me from working on the assignment for a number of months, with the results that the Memorandum was completed somewhat later than had been expected.

The options listed hereafter and the comments relating to them are as objective as I have been able to make them and are not listed in any order of preference. In addition, I thought it might be useful to make a few comments with respect to the role of Directors and the advisability of continuing to appoint Civil Servants to the Boards of the two companies.

III. SUMMARY OF THE OPTIONS AVAILABLE

- Return the companies to private ownership.
- Return the companies to the private sector under majority Canadian ownership, with a foreign company taking a minority interest.
- Sell a minority interest to the private sector in Canada, while the Government retains the majority interest.
- Sell a minority interest to a foreign aerospace company, while the Government retains the majority interest.
- Return one company to the private sector and the Government retain ownership of the other.
- Create a holding company which would own and operate the companies as two separate and distinct divisions.
- Retain the two companies as separate companies and make Crown corporations out of them.

IV. DETAILED CONSIDERATION OF OPTIONS

1. Return the companies to private ownership.

The first option which needs to be considered is the one involving the sale of the two companies and returning them to private ownership. This is so because when the Government acquired Canadair and de Havilland it expressed the intention of returning the companies to the private sector under majority Canadian ownership at the earliest opportunity.

Before considering the advantages and disadvantages associated with this option, and indeed before considering whether or not this option is available to the Government at this time, under any reasonable conditions, it is important to be clear what is meant by "purchase" and "sale" when used in this context. It is clear that the rights of ownership in any tangible object are usually regarded as all embracing and not subject to any restriction or inhibition. If I offer a pencil for sale and someone agrees to purchase it from me, neither of us are in any doubt that I have surrendered all my property rights in that pencil and complete ownership is transferred to the purchaser, the new owner. Presumably, no one will question his right to destroy the pencil, use it, give it away, or whatever. When one talks about "selling" Canadair and de Havilland, I doubt that any such untrammelled rights of ownership are contemplated. What is to be avoided at all costs is any misunderstanding between vendor and purchaser as to what is intended.

Over the years Government spokesmen have emphasized that the airframe industry has strategic importance to Canada because of its defence capabilities, and that it makes a unique contribution to the country because of its high technology, opportunities for skilled employment, and contribution to export earnings. If, then, there are National objectives which can only be met by keeping this industry strong, efficient and innovative, it follows that the new owner would not be permitted to exercise his rights of ownership in such a way as to either defeat these ends, or regard them as secondary to some other purposes of his own. We then find ourselves talking about ownership with strings attached, or ownership restricted in some material and significant respects. That is not to say that sale cannot include conditions -- on the contrary, but it does mean that we should not talk about one set of circumstances, when we really mean a quite different set.

It seems probable that at a minimum the Government would require a prospective purchaser to provide assurances that relate to:

- (a) Prior approval before closure of any facilities,
- (b) Relocation of facilities,
- (c) Maintenance of employment,
- (d) Rationalization of production,
- (e) Level of Research and Development effort,
- (f) Maintenance of facilities necessary to support DND requirements.

It also seems probable that any prospective purchaser faced with these conditions of sale, would require assurances relating to the amount of Research and Development funding to be made available from Government sources, assistance with regard to financing for export sales, level of Government procurement, protection against competition from offshore suppliers, etc. The sale price could be affected as well.

Advantages

Since both companies operate businesses, and are subject to a greater or lesser extent, to the rigours of the marketplace, they ought to be owned and operated in the private sector. The disciplines which such ownership would require ought to be beneficial. There should be rewards for success, and opportunities for the initiative and achievement-oriented approach which characterize the private sector at its best. If the companies can be sold, on any reasonable and equitable basis, then they should be sold, on the basis that Government should only own those companies which for one reason or another cannot be, or should not be, in the private sector. Those who advocate Government ownership, in other words, should be required to establish that such ownership is necessary, rather than the converse.

Disadvantages

Both companies operate businesses, but they are businesses of a unique kind. They are subject to control and direction by Government by virtue of their special importance for defence, advancement of the technological base, balance of payments, employment, etc. They require large Government funding, either by way of grants or loans, or both, for the development of new programs. Such being the case, is there an argument for taking this reasoning one step further, and saying that this is one industry which is particularly suited to Government ownership? Outside the United States of America, this appears now to be more the norm than the exception. Does U.S. experience have more to tell us than the European one, or less? If the Government, for reasons of regional development, employment, advancement of technology, defence support, balance of payments, etc., seeks to have greater power of direction over such companies than is normally compatible with private sector ownership, then perhaps public ownership is the answer.

If the motive force behind such companies cannot be solely or mainly profit, do they belong in the private sector?

Timing

In any consideration of sale of the two companies to the private sector, the question of timing could be of critical importance.

De Havilland's main program at the moment is the DHC-7. Although I make no assumption that this program will not be successful, any purchaser of that company at this time would presumably wish to be indemnified against losses which might be incurred on the program, or assisted if further expenditures are required to make the program viable.

Canadair's main program at the moment is the Challenger. Here too, I have no reason to assume that this program will not be successful. However, the aircraft is in the early stages of production, and is some months away from being certificated. It is reasonable to assume that any purchaser would want some assurances with regard to this program as well.

In addition, the Government has currently under assessment several proposals for the supply to the Armed Forces of an Advanced Fighter. These bids are believed to include certain offers or undertakings with respect to offsets in favour of Canadian industry. If these offset arrangements include either de Havilland or Canadair, or both, which is likely, then the viability or profitability of these companies could be materially affected. No decision is expected for some months, and far-reaching consequences could flow from some of the ideas being considered.

For these reasons, therefore, the question of returning ownership to the private sector could be deferred at this time without prejudging the ultimate decision, and then reviewed later in the light of circumstances prevailing at that time. In the meantime, the Government could address itself to consideration of this option as one of the various options open to it.

2. Return the companies to the private sector under majority Canadian ownership, with a foreign company taking a minority interest.

The second option which needs to be considered is that of returning the companies to the private sector under majority Canadian ownership, with a foreign company taking a minority interest.

Advantages

The companies owned by the Government -- Canadair and de Havilland -- are small by international standards, and, therefore, do not have, and cannot be expected to have, the depth of experience and talent in production, marketing, servicing, engineering, finance and over-all management possessed by the large companies abroad, and particularly those in the United States. To be big is not necessarily to be better, to be small not necessarily to be worse -- but there are advantages of size in the aerospace industry which it is perilous to overlook. Access by Canadair and de Havilland to these larger management and technical

pools could have a beneficial effect on their business prospects and could assist them in adjusting to changing technologies and new market opportunities.

Disadvantages

Since, as a business proposition, taking a minority position in the Canadian airframe industry is unlikely to be attractive, the foreign company presumably must have some other reason to make the investment. This reason is likely to be the hope, or the assurance, that the products of its foreign factories will be granted special status in the Canadian market. This could be a large price to pay, for it might inhibit teaming arrangements from time to time which are more attractive from the point of view of Canadian interests.

Also, the partner smaller in size even though larger in terms of share ownership might tend to be pushed around somewhat by the one larger in size though smaller in terms of share ownership and this could be detrimental to Canadian interests.

As well, having a larger and more powerful company always at hand would tend to mitigate against the further development of indigenous resources in management, marketing, production, engineering, finance, etc.

In addition, the responsiveness of the companies to Canadian national interests, as delineated by the Government, could be lessened.

3. Sell a minority interest to the private sector in Canada, while the Government retains the majority interest.

The third option which needs to be considered is that of selling a minority interest to the private sector in Canada, while the Government retains the majority interest, thus creating a "mixed" corporation.

One reason sometimes advanced in support of this option is that it would bring the private sector approach to management into the companies, but it is hard to see why this could not equally be achieved by having private sector directors on the Board, which is now the case. Majority Government ownership of a company in an industry so highly dependent on, and responsive to, Government policies, does not leave very much room for the private sector minority interest to influence policies. Such a relationship could prove uncomfortable to both parties, and could generate tensions and misunderstandings which would mitigate against efficient operations.

In addition, the value which the private sector would place on such an investment would be likely to be substantially discounted below its intrinsic worth. Governments often have objectives other than, or in priority to, the maximization of profit.

4. Sell a minority interest to a foreign aerospace company, while the Government retains the majority interest.

The fourth option which needs to be considered is that of selling a minority interest to a foreign aerospace company, while the Government retains the majority interest. This usually is taken to mean having a U.S. company become a minority shareholder, but there is no reason why such an option could not apply to a company outside the U.S. as well.

The problem here is not necessarily what the Government would hope to achieve by such an arrangement, but what advantages the foreign company would perceive as accruing to it. No one is going to become a minority partner with a foreign government, which is the perspective from which the foreign aerospace company will look at the proposal, without some considerable benefits to outweigh the obvious and very considerable hazards. As well, these benefits are likely to be bargained for, and agreed to, before the investment is made, thus putting constraints on the Government's policy options. If any such arrangement were to be contemplated, it is absolutely essential that all of the conditions associated with it be firmly agreed to in advance.

Most of the propositions discussed under option 2, need to be considered under this option.

5. Return one company to the private sector and the Government retain ownership of the other.

The fifth option which needs to be considered is that of returning one company to the private sector, and the Government retaining ownership of the other.

It is difficult to deal with this option without knowing the specific circumstances which are likely to prevail at any given time. The two companies are different in their product mix and the markets which they seek to serve. They are currently at a different stage with respect to their new programs. At one point of time, de Havilland might be more readily saleable, at another, Canadair.

This option is more likely to be a response to conditions in the marketplace, rather than a considered policy. In other words, if the policy judgment were made to return the companies to the private sector, the circumstances at the time might in fact permit sale of one and not the other.

6. Create a holding company which would own and operate the companies as two separate and distinct divisions.

Another option which has to be considered is that of creating a holding company which would own and operate Canadair and de Havilland as two separate and distinct divisions. This company would have a strong Board with a small staff headed by a Chairman and consisting mainly of people with financial and strategic planning backgrounds. The Board would include among its members, the President and Chief Executive Officer of both Canadair and de Havilland, thereby ensuring that the views of the operating divisions are put forward at all times. As far as possible, the Minister of Industry, Trade and Commerce would deal with the Chairman of the holding company when it is necessary or desirable for the views of the owner to be made known. Policy guidelines and definitions of Government objectives would be addressed to the holding company. In turn, the holding company would ensure compliance by the operating divisions, and monitor their performance. If any rationalization of facilities appears to be necessary or desirable, this ought to be the responsibility of the holding company. If thought to be desirable, consideration could be given to having other companies which report to the Minister of Industry, Trade and Commerce transferred to the holding company.

Advantages

The advantages are that this would permit a coordinated management approach to operation of the two companies without prejudging whether any closer relationship is appropriate. It could provide a medium to prevent unnecessary duplication of both facilities and scarce management talent and at the same time provide for appropriate help and assistance by one division to the other.

Disadvantages

Unnecessary proliferation of management layers is always to be avoided and care would have to be taken that this would not occur in this case. This could impede or derogate from the management responsibilities of the Chief Executive Officers of each of the two companies. Lines of responsibility might be blurred rather than clarified. Since the two companies are very different, it may be that each should have direct access to, and liaison with, the Government, and that each Board Chairman or Chief Executive Officer should receive policy guidelines and Government objectives.

7. Retain the two companies as separate companies and make Crown corporations out of them.

A further option which needs to be considered is that of retaining the two companies as separate companies and making Crown corporations out of them pursuant to the provisions of the Financial Administration Act. This option would recognize in an institutional way, or in a formal way, the present realities of ownership. If the Government of Canada's proposals with regard to the control, direction and accountability of Crown corporations, contained in the paper issued by the President of the Privy Council, August 18th, 1977,

should be implemented in accordance with the draft legislative proposals contained in that document, then the observations with respect to this option are not very germane. On the other hand, no such legislation has yet been introduced, nor can it be said with certainty, at this time, that the Bill, if, as and when ultimately passed, will be in exactly the same form as the draft proposals. As the President of the Privy Council pointed out, the paper was published at that time "... to provide time for the Crown corporations, the Auditor General, and the Royal Commission on Financial Management and Accountability, and other interested individuals and groups to consider and react to the proposals before a Bill is introduced." These comments, therefore, are directed to the situation as it exists today, and not as it may be altered in the future.

Advantages

Since there are arguments which can reasonably be made to support a decision to have these companies remain in the public sector, it would be neat and tidy to go all the way and formalize their status as Crown corporations. The substance would not vary very much from what is now the case, since the Government, as shareholder, clearly has all the rights now of an owner, but the forms would be somewhat different.

Disadvantages

There are a number of apparent disadvantages to this course of action, and the strength and importance attached to each is more likely to be subjective than objective. Such a decision might inhibit the Government's flexibility with respect to sale or disposition, since it might be taken as a signal to the private sector that there is no intention ever to sell these companies. It might discourage initiative on the part of present employees who hope eventually that the company they work for will be returned to the private sector. It might hurt recruitment since some of the skills which companies of this type require are very often found to a very large degree in people who prefer not to work for a Crown corporation. It might impede production sharing and offset arrangements with the United States, since in some cases there are inhibitions against Crown corporations being eligible for United States Government contracts. It would be difficult, although not impossible, to reverse quickly if the circumstances so require it.

V. DIRECTORS

Much has been written lately, and no doubt more will follow, about the role of Directors of Corporations in the private sector. As well, the special responsibilities borne by Directors of Crown companies, or companies owned or controlled by the Crown, have come in for increasing attention.

It is natural that this should be so. Even in the private sector, it is now fully acknowledged that Directors may have responsibilities other than operating the company to earn maximum profit. This is even more so in the public sector, where national objectives or governmental policies were the reason why the company became Government owned in the first place.

What role should be played by the Directors of de Havilland and Canadair, vis-à-vis the owners, the people of Canada, acting through and represented by the Government of Canada, and vis-à-vis the management?

Take management first. The Board is the means through which ownership exerts its influence on and control over management. Although the Board has many functions, its overriding responsibilities are to monitor and audit management's performance, replace inadequate management, assist management where appropriate and ensure that there are policies for replacement and succession.

Now what about the Shareholders, the owners. If the owners want a change in management personnel, policies or performance, those wishes have to be effected through the Board. If the Board is not properly responsive to the owner's wishes, then the owner should change the Board. No Board can exercise its authority or retain its credibility if anyone interferes with its authority to deal with management. Equally, a Board must be willing to challenge the owners on matters of principle, and be prepared to resign or be removed if the owners decide that their views must prevail.

VI. CIVIL SERVANTS AS DIRECTORS

Both Canadair and de Havilland have Civil Servants on their Boards. In one case the Civil Servants are present officials of the Department of Industry, Trade and Commerce, in the other, one is from the Department and one is from a Crown corporation.

This practice has both advantages and disadvantages.

Advantages

The Boards find it useful to have the input of senior members of the Department, to the Minister of which they are responsible, in the course of their regular meetings. Such officials are usually well-informed and knowledgeable about Government policies and are able to reflect the owner's wishes on policy issues. Since the Department is also a granting body, it is useful to have access to the grantors or representatives of the grantors. The airframe industry is a major user of Government funds administered by the Aerospace Branch of the Department, and familiarity with its policies, priorities, and procedures is bound to be useful.

Disadvantages

Civil Servants sitting on these Boards could find themselves voting on a matter at a Board meeting, which subsequently entails an application to the Minister, which in turn requires them to advise the Minister wearing their Departmental, not their Corporate, hats. It takes no very vivid imagination to conceive of programs which might commend themselves very strongly to the Corporate Board, which might for excellent reasons be imprudent for the Minister to accept.

In addition, some institutional and administrative complexities can occur. Applications for grants, requests for assistance of one kind or another, don't just automatically get approved or disapproved. They proceed, through a hierarchical chain, in the course of which a number of independent judgments are in theory applied. For the system to work properly, everyone concerned must be free to express an honest and unbiased opinion. If, in the course of this review, it is apparent that senior officers of the Department, in their capacity as Board Directors, have already approved the program in question, will this, even if only subconsciously, weigh in favour of its approval and influence the views of subordinates? Is it possible, then, as a corollary of this, that companies in a similar position of seeking grants, but where no Civil Servants of the Department are on the Board, are less likely to succeed? Even if in practice no such distinctions are drawn, should the perception that there are such possibilities be removed?

The converse could be true as well. Although the Civil Servant ought to be thinking of his responsibility to the company when he is attending a Board meeting, he may in fact be influenced by his responsibilities as a senior official of the Department. In some subtle way, the company may be prejudiced by his determination not to be influenced by the views of his Board colleagues, or of management.

VII. FACILITIES

The operations of de Havilland are centered in facilities situated at Downsview in Toronto. Those of Canadair are centered at Cartierville Airport in Montreal. There is a third major company in the airframe sector in Canada, namely Douglas Aircraft of Canada, whose operations are centered at the Malton Airport.

As far as Canadair and de Havilland are concerned, I am not aware of any current proposal to require either of them to cease using the Cartierville and Downsview airports. However, this situation could change in the medium term and is likely to change in the long term. It would seem desirable, therefore, that a study should now be instituted, or previous studies updated, so that if the Government proposes to make changes in the availability of these airports, such decisions could be based on an up-to-date assessment of alternative options. It is not unusual for manufacturing and flight operations to be separated and, therefore, it does not necessarily follow that just because the airport cannot be used for flight testing, or that the airport has ceased to exist, that the plants have to be moved as well. However, there could be other reasons why a move of the manufacturing plants as well would be desirable. Any study of the airframe industry and its airport requirements ought to include Douglas as well.

At the same time, it would be useful to study how much of the Government-owned plant is likely to be usefully employed in the medium and long-term, and whether any facilities ought to be closed, renovated, expanded or the like.

VIII. RATIONALIZATION OF OPERATIONS

Before any useful discussion of the basis for rationalization of operations of the two companies can take place, certain facts about the fundamental differences between the two companies have to be made clear.

Each company has markedly different products, markets, business systems, organizational structures, facilities, and personnel arrangements. In fact, they are in different businesses to all intents and purposes. That need not remain so, but it is so now. For historical and other reasons their development proceeded on different paths, one reflecting the management style of a British company, the other that of an American one.

It is also true that although the ultimate results of rationalization, in an appropriate case and under appropriate conditions, may be not only beneficial, but even essential for healthy development and even survival, the process of rationalization can be injurious to employee morale, detrimental to production norms, extremely onerous with respect to management time and effort, and counter-productive in its general effect.

Is the present instance one in which rationalization has greater advantages than disadvantages, and if so in what areas? The case for general rationalization seems weak, since the basis for rationalization should be either to eliminate duplication or to combine for greater strength. The duplication, although present, does not hold out promise of large savings if eliminated, and the strength to be gained by combining disparate elements is likely to be illusory.

The case for greater coordination, rather than rationalization, seems more convincing, and the sharing of scarce resources of management and experience likely to be more rewarding. These ideas are addressed under another heading, that dealing with the option of creating a holding company.