# NATIONAL ENTERPRISE BOARD

## A Case for Euthanasia

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&
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# Contents

The view that the markets and the financial institutions of the City of London had failed industry was a recurring theme of the early 1970s. There was a vague feeling that a gap existed in the market, in other words that worthwhile companies were not getting the finance they required, and that the alleged gap needed to be filled. It was a matter to which the Wilson Committee gave special and early attention.

Does the gap really exist? Did it ever exist? The City institutions provided a great deal of evidence to the Wilson Committee which showed convincingly that plenty of finance was available for worthwhile ventures. Perhaps more tellingly, the City's evidence was in general supported by industry itself. What had been lacking was not the supply of funds but the demand. Industry and commerce had been (and still are) put off by too many major economic uncertainties and political constraints. The alleged gap was a figment of political imagination.

Nationalisation has not been a success in Britain. Thank goodness we now appear to be understanding its failures and looking for ways of loosening the debilitating grip of the State.

The National Enterprise Board has, as the following pages suggest, been at best irrevelant to Britain's economic problems. It has tilted at symptoms and failed to attack the underlying disease. Indeed it has not had the powers to do the latter.

The NEB has found that no substantial financing gap exists. When the underlying economic problems of inflation and low profitability have been solved, and the potential rewards of industrial investment again begin to match the risks involved, finance will be readily available from the normal financial markets. No King or Minister ever solved a problem by indiscriminately throwing money at it. This lesson, when learned, will do us all a lot of good.

Nicholas Goodison

# I Origins

To the socialist mind a State holding company is both a natural and a necessary concept. Since individual acts of nationalisation need both a Parliamentary majority and Parliamentary time, it is the simpler route to control of the 'commanding heights' of the economy. Better still, once there is a State company it gathers its own momentum and supporters whichever party rules at Westminster.

This theory has yet to be proven wrong. The new Conservative government, one of whose senior members criticised Inmos as 'irrelevant' and 'subsidised competition' when in opposition, is finding it difficult to stop the NEB 'punting with taxpayers' money' in the field of high technology. The present NEB is a very different body from that planned during Labour's period in opposition from 1970 to 1974. The Labour Party's Public Sector Group, the 1973 Green Paper on the NEB and Labour's programme all envisaged it as an agency to control around one-sixth of the GNP: it would purchase a stake in some twenty-five of the top hundred companies, and use the majority holdings to direct investment, create employment and perform miracles.

The original plans envisaged wholesale nationalisation of leading companies, compulsory planning agreements with remaining private sector companies and the threat of an official trustee to take control. The NEB was too burdened with a galaxy of conflicting aims: from export promotion, new job creation in the regions, co-ordination of public sector purchasing — and it should make profits! Based on huge issues of Treasury bills, NEB companies would pay only half the usual Corporation Tax and, in addition, would receive liberal supplies of taxpayers' money. The I.R.I. in Italy, which had pioneered the disastrous southern investment programme for Alfa Romeo, was one of the NEB's main models. Only tactical errors by the Left and the 1973 Labour Party Conference, the strength of Harold Wilson's opposition and the eventual overruling and dismissal of Mr Wedgwood Benn as Industry Secretary diminished its role.

When it was born in 1975, the scope of the NEB was limited dramatically. In the last four years on the industrial stage, intervening at random, it has failed to establish a coherent strategy.

# II Themes

With Anthony Wedgwood Benn and Harold Wilson as parents, the NEB was bound to be a controversial child. At its birth, in 1975, Wedgwood Benn claimed the NEB would be 'the biggest step forward in industrial policy since the last war'. Four years later, Eric Varley, Secretary of State for Industry, made the equally modest claim that 'it was impossible to imagine British industry without the NEB'! That, surely, carried parental hyperbole a little far!

This pamphlet aims to be both a critique of the four year life of the NEB and a commentary on the case for and against a state holding company intervening in the free-enterprise market. The NEB companies comprise two categories. First, those such as British Leyland and Rolls Royce which were previously vested in the Secretary of State for Industry and subsequently transferred to the NEB. Secondly, those companies acquired from the private sector by the Board, on its own 'entrepreneurial' judgement; of these, some are wholly-owned subsidiaries, others are part-owned.

The NEB's intended functions are fourfold. First, as a holding company for Government shareholdings in a number of companies. Secondly, as a means of intervening in profitable industry. Thirdly, as an agency to fill the gap alleged to exist in the provision of finance for smaller high-risk companies. Lastly, as an agent to restructure selected parts of British industry.

We start with the Industrial Reorganisation Corporation, created in the late 1960s by the Wilson Government. Though it had a narrower remit than the NEB, it was intended as a government instrument for restructuring sections of industry — a role parallel to that of the NEB.

Was the 1970 Conservative Government right to wind it up or did it have successes which should have continued under Conservative administration?

The NEB's role as a holding company for a number of scattered government shareholdings has entailed commitments not always of the Board's making. We ask what function the NEB can have as an intermediary between the State, as industrial subsidiser, and the recipient company.

We examine the leading companies within the NEB, from British Leyland to the smallest newcomer and assess the impact the NEB has had on the companies under its influence. Has the NEB contributed anything, other than money, to companies who have tried every other source of finance and been turned down? We question the success the Board has enjoyed in its sector strategy and the stimulus it has given the entrepreneurial activity. We search in vain for the gap in financial provision alleged to exist for smaller companies or riskier ventures.

We consider the cohesion of the Board's policy. It is often difficult to perceive any industrial logic in many of the piecemeal acquisitions ranging from Thwaites and Reed, a small and poorly managed clock making company losing £300,000 a year and employing twenty-five people at St. Leonards-on-Sea, to the trouble Fairey Engineering Group with sixteen subsidiaries. One of these, Fairey Marine at Cowes, took a stand at the 1978 Boat Show selling luxury motor yachts costing £80,000 — no doubt one of socialism's commanding heights.

We examine the NEB as successor to the IRC as a re-structuring agency for British industry, looking in particular at the automobile and electronics industries where the NEB has been heavily involved.

In any judgement of the NEB one needs to examine what effect, if any, political pressures have had on its strategy. Did Parliamentary criticism restrain its activities? Or did it sometimes act with undue haste in order to put down roots and thus make it difficult for the incoming Conservative Government to curb its powers? Has political pressure to preserve jobs in individual politicians' constituencies had any effect on the NEB's decision making? The Board's establishment and terms of reference make political influences important when strategy is being formulated.

The review of the NEB includes a comment on the Board's finances, with an assessment of the return on the £1000m-plus of taxpayers' money committed to the Board since 1975.

In conclusion we ask what the present government should do with the NEB and its forty companies? Should it be pruned, cut down, or uprooted? If it were merely cut down might it be useful to a Conservative Secretary of State for Industry who might be forced into a Rolls Royce type rescue operation? Some think it would be, others are doubtful. We examine the case for rescue under the new Government, being undertaken by a "pruned" NEB, or by the Department of Industry through the mechanism of the 1972 Industry Act. Relative remoteness may have the advantage of keeping politicians at arms length, but equally it makes it more difficult for the House of Commons to watch over. We conclude that the NEB has no obvious role. If successful companies were sold off, overhead costs would be too high to maintain the rump; avoiding duplication between the NEB and the Department of Industry logically leads to abolition. There seems no case for maintaining the NEB as an investment trust with stakes in successful, as well as unsuccessful, companies.

# III Industrial Reorganisation Corporation

*It is interesting to record that the total cost of investments in equity shares which the IRC has made is £20.4m. The equity valuation of those investments last Friday was £16.4m. Stock market values have gone down, but there is no clear evidence that these restructuring have led to shiningly successful firm's . . .*

*30 October 1970*
*Nicholas Ridley*
*Hansard Col 630*

The Industrial Reorganisation Corporation was Labour's attempt in 1966 to establish a public body designed to intervene in industry. As such it was the father of the NEB, although a creation of a more responsible age. Where the NEB would immediately have recourse to public funds, the IRC looked for less costly solutions. Where the NEB would give priority to job preservation at almost any cost, the IRC was concerned with balance of payments considerations and with efficiency. Where the NEB would give money as Public Dividend Capital, the IRC was more likely to consider a loan package.

Nonetheless, by the time the IRC was wound up in 1970 by the incoming Conservative administration, its investments were not in good shape. The genuflection to commercial principles and the primacy of balance of payments arguments did not succeed in building a strong portfolio of profitable investments any more than the different criteria for the NEB have provided the background for success. The defence of the IRC, as propounded by one of its former members, Professor McClelland, has therefore centred upon other arguments. As he has written:

> The primary purpose of IRC's investments was not IRC's financial gain. That merely set a lower limit of rate of return, and an upper limit of risk, to what could be undertaken. The real test of IRC's success lies in the

> performance of the industries in which it has been involved, compared with what the performance would have otherwise been. Companies like GEC, BLMC, ICL, RHP, Clarke Chapman and George Kent, their profits, exports and productivity, these are what count . . .

The contrast and the similarities between the NEB and the IRC bear examination, in view of the controversy which surrounded the winding up of the IRC and the deductions that can be made by examining two attempts to provide a public sector stimulus to private enterprise. The stated aims of the IRC were to promote industrial efficiency and profitability through reorganisations, and the establishment or promotion of enterprise. This framework was wide but one which was interpreted, within the spirit of the times, as favouring merger promotion to increase the scale of British industry, thus helping to concentrate it in the hands of a few very large firms. These were thought better able to compete internationally as they could reap the economies of scale. The prime function and technique of the IRC was, therefore, in conflict with that of another government body set up to encourage efficiency in industry, the Monopolies and Merger Commission. It is a paradox that if a claim can be made out for the IRC at all, it centres upon its intervention in mergers acting as a constraint upon interference the other way from the Monopolies Commission. However, IRC was an expensive and elaborate mechanism if one of its aims was to negate another public body.

The companies which Professor McClelland mentions as prime examples of those assisted by the IRC are the principal ones within the seventy cases handled by the body during its four year life. They do not make a distinguished list. BLMC was subsequently reorganised and still lurched so far towards bankruptcy that it had to become a state pensioner under the IRC's successor in title, the National Enterprise Board. ICL fell into acute financial difficulties in the mid 1970s and had to be rescued again by the NEB. Clarke Chapman's performance has been constantly disrupted by the erratic order programme of the electricity industry and finally merged with Reyrolle Parsons, a merger which occurred in the market place with no public sector intervention. RHP has had a better performance since 1970 whereas George Kent collapsed and had to be taken over by a Swiss competitor. The one outstanding success has been the emergence of GEC from English Electric and AEI, yet in this case the IRC's involvement was scarcely crucial.

GEC's two large mergers were designed to create a diversified international company in the electrical and electronics industries. The aims were to bring together businesses which had previously been in competition with one another, to bring together compatible but not directly competitive businesses and to submit all of them to a similar management philosophy. The result was the creation of one of the UK's most successful large corporations. Any analysis of GEC and of Sir Arnold Weinstock, its principal architect, must conclude that the initiative came from within the companies and the main events took place in the stockmarket. Whilst the IRC endorsed the idea of the mergers it was unable to comment on the terms, which were properly a matter for the shareholders of the companies involved. The absence of Monopolies Commission intervention was definitely helpful, but there was no need for an IRC to achieve the end result.

The case of BLMC was far less felicitous and illustrates one of the prime features of a merger based strategy for industrial regeneration: management talent is essential to ensure success. The IRC could, and did, do nothing to increase the pool of management talent available in British industry, nor could it tackle the wider problem of the availability of skilled labour generally. Incomes policies and government taxation measures, in contrast, were busily squeezing differentials to make skills less valuable and therefore less desirable at the margin. In the case of BLMC the larger group was unable to find the common successful management style, so apparent in GEC, to bring together the right product with the right workforce in the right factories to sell to the right markets. The new British Motor Corporation certainly had greater scale than its predecessor car producers but it failed to exploit it. The preservation of a wide range of brand names, marques and differing specifications made parts standardisation impossible. Stock levels were consequently never reduced whilst production remained spreadeagled across the country in increasingly old fashioned plants. The new conglomerate proved incapable of designing attractive mass-market cars. The attempts to stretch the successful mini formula produced the less attractive maxi and midi vehicles, whilst new design only threw up the Princess range which was never able to match the competition from Ford, Renault and Fiat.

George Kent was the most contentious of the companies created by active IRC intervention and paradoxically, for all the effort and money expended, one of the least successful. The IRC's aim was to bring Kent and Cambridge Instruments together as a strong independent competitor of Rank, to leave two main UK instrument makers. Unfortunately, management skills were not available to carry the grand design through to a successful conclusion. The IRC was able through direct purchases of shares in the market to force a merger between the two but the record of the resulting company was desultory. From 1970 profits fell every year, reaching a loss of £104,000 in 1974 instead of profits of £2.064m to March 1970, the first year of the full merger after the 1968 activities. The dramatic decline in cash flow forced a takeover by Brown Boveri Kent, the UK subsidiary of the Swiss Brown Boveri Corporation. Thus within five years of the much heralded creation of a UK competitor to Rank, effective control of the company had passed to an overseas rival following a profits collapse. Since control changed, profits have risen from the 1974 loss to £6.3m.

RHP represented a merger between three companies: Ransome & Marles Bearing Company, Hoffman Manufacturing and Pollard Ball & Roller Bearing. The takeovers were handled in the usual way by the stockmarket with merchant banks advising the respective participants. However, the IRC was involved in the discussions and the IRC's endorsement of the revised scheme for the industry was always stressed to shareholders. The company created has maintained a UK presence in roller bearings although the profits record has been erratic in view of capital problems and Japanese competition. Whether the IRC was needed remains an open question. RHP, however, is not a disaster compared with George Kent where the IRC took a firmer stand.

The IRC's involvement with ICL was but a small part in a much longer and larger process. The UK computer industry, of its own momentum, was coming to reside in one company. In 1959, Power-Samas Accounting Machines was merged with British Tabulating Machines Company to form ICT. Computer Developments and Data Recording Instruments became ICT subsidiaries, EMI's data processing division and Ferranti's computer division were then transferred to ICT.

The IRC supported the merger of ICT with English Electric Computers, formed from mergers between Leo Computers and Marconi and Elliot Automation's Computers. However, the group formed was not strong enough to develop the 2900 series unaided and, in 1972 and 1973, £40m of government funds had to be provided. Pre-tax profits declined sharply in 1972 and the dividend had to be cut. The merger in 1968 was never properly consolidated in the aftermath, the company remained overstaffed and inherited two different and incompatible model lines. It was only in 1972 with the appointment of Mr T. Hudson as chairman and Mr G. Cross as managing director that action was taken to make the company a more useful competitive unit.

In the case of Clarke Chapman intervention was again unable to solve the fundamental difficulty of the business, although this was a somewhat different problem from that of Leyland's. In the case of power engineering the lack of continuity of domestic order books was the bedevilling feature which no IRC or NEB concern has ever been able to alter. With ICL the IRC did have, like the NEB, some better argument in so far as it was concerned with the provision of finance which the market may have been reluctant to supply.

The IRC did have money at its disposal from the National Loans Fund to assist its policy of intervention. To this extent, it acted as a means of taking money invested in fixed interest securities, primarily gilt-edged, and lending it to industrial users who might have found it difficult to borrow all they needed from traditional sources. The existence of such a role assumes, of course, either that the market is unable to perceive the prospect of reasonable returns on certain kinds of investment or, alternatively, that there are projects which are not likely to produce returns which, nevertheless, we should invest in. Both of these propositions are suspect.

The case of ICL implies that the market was right to be sceptical, as the company's requirement for funds has always greatly exceeded its cash generating potential and the shareholders' return has been extremely volatile. The question of whether there are businesses in which we should invest, for example, for balance of payments reasons so popular in the epoch of the IRC, is more difficult. It seems as though there are types of technology which advanced nations like to enjoy but which may not be commercially viable. Most states like Germany, the USA and France support them by using money levied from taxation, usually through the form of Research and Development related contracts. There is a similar tradition in the UK where much of advanced defence work is financed in this way. Such a procedure allows a government directly to determine which type of sophisticated research it wishes to back.

Judgements of governments are fallible, as the decisions on supersonic transportation demonstrated with the escalating cash demands of the Concorde programme. However, there is a good case for keeping decisions about the desirable technology which any government wishes to purchase firmly under the control of the House of Commons and forcing governments to accept that such decisions are not strictly commercial but are connected with defence, employment and other policies. All that an intermediary like the IRC can, and did, do is to distribute government money after having spent a little of it on the way. Any serious decision will involve the government, whatever the alleged autonomy of the intermediary authority, as no government wishes completely to surrender control over the distribution of subsidy and patronage.

All of the IRC case studies point to the conclusion that no such body can contribute anything to the available pool of entrepreneurship, finance or management. It can make no direct contribution to improving productivity, and where it actively furthered the amalgamation of firms it did so with success entirely related to the quality of management in the underlying businesses who had often initiated the merger in the first place. The much mourned loss of the IRC in 1970 was mourned mistakenly. If governments are to subsidise industry they have the mechanism they need through the Department of Industry where such decisions should properly be made and where they can be held responsible to Parliament.

# IV Is there a market gap for finance?

*There are plenty of agencies offering investors' funds to business. There is no evidence that in this capacity there is any need for the NEB.*
*10 April 1978*
*Sir Keith Joseph*
*Hansard Col 1022*

Critics of the market place delight in finding, or alleging they have found, glaring gaps in provision. But their research efforts tire at seeking out a particular size hose pipe or a particular colour of boiled sweet which manufacturers have been remiss in not producing. Financial markets, however, attract a veritable siege army of critics all asserting that the problems of British industry could be solved by one or another form of directed investment. Such assertions are usually made by those who have never worked in any competitive market in their lives.

The theory of the competitive market is simple and difficult to rebut. Those seeking to run competitive businesses will aim for the best available returns as they see them. Individually, they may be ill-informed, ill-advised or simply foolish; collectively the best investment projects will be financed down to the level of perspective return near the long term cost of capital. Collective wisdom or individual folly is best understood by those who have had to make large investment decisions.

Critics allege that whilst the theory sounds sensible, albeit amoral and therefore offensive, the practice is different: the collective behaviour of large institutions, they claim, ignores the smaller company, whilst the pursuit of rapid results prevents longer term investment. This chapter analyses these two propositions to see if there is a market gap or market myopia such as the critics of the competition theory suppose.

In 1975 to 1976 concern amongst politicians and the City that the market might be ignoring the needs of smaller companies in the £1m-40m capitalisation range led to the formation of Equity Capital for Industry. Established with a share capital of £25⅔m, ECI offered facilities to quoted companies where ordinary rights issues through the market or bank borrowings could not provide the necessary funds. The demand was so poor that during 1978-1979 ECI set about active marketing but even so, at its last year-end, investments in companies totalled only £5.9m against £19.4m in cash after allowing for current liabilities.

It would be unfair to criticise ECI for its early ventures in Bond Worth, which promptly went bankrupt, or for its misfortunes with Brittains Ltd. whose shares were suspended on 24 January 1979 and where the Receiver was appointed in December. For whilst it was born of difficult times in the stockmarket, which passed as rapidly as it emerged, ECI has shown flexibility, initiative and discretion in combing the lists of smaller quoted companies with a view to offering them tailor-made financing packages. The exercise proves one thing above all: the market is not missing many opportunities to finance the smaller quoted companies.

Beneath the target market for ECI lies another group of smaller companies that have not gone public although a few make the transition to a full stockmarket listing each year. Such cases are assisted by specialist houses particularly Gresham and Charterhouse, whilst some efforts have been made to provide less onerous requirements than a full listing to enable dealings in an "over the counter" market. The Stock Exchange, as a regulatory body, has long been concerned, on the one hand, about balancing the need to exercise caution and thoroughness before admitting companies to a public quotation and, on the other, to permit flourishing smaller companies direct access to financial markets. Gresham Trust provides cash for companies with net profits of over £20,000 per annum. The Trust is profitable and flexible in its approach to smaller company finance and would be able to raise additional money if needed by the demands of the market place. By March 1978 total investments in 115 unquoted companies had reached £6.5m. Similarly Charterhouse makes cash available for this sector of the market.

The inability of the market to provide longer term risk finance is a less serious argument than the delicate question of smaller companies. In one sense the market is always making long term risk capital available by agreeing to the reinvestment of retentions in ethylene crackers, nuts and bolts factories and new oil refineries. The market regularly provides rights money to companies for projects with an investment horizon of ten years and core shareholdings in growing portfolios are held for a similar period of time.

When critics pause to reflect on this they respond that, nonetheless, out-of-the-ordinary long term projects do not attract money. By this they must mean that, for example, the market will not provide £100m for re-equipping BL despite the perception of a strategic need to maintain a domestic car industry. Alternatively, the market will not supply "risk capital" for a new team to build a polypropylene plant or explore in the North Sea.

These examples bear examination. The market would naturally be reluctant to pay up if an established company had consistently failed to make profits and then sought major new funds to try again. The City would have to decide whether anything outside or within that company's control had changed sufficiently to warrant new money. More often than not, the required provision of further funds would not simply be for projects with a longer time horizon than normal but where there is no prospect of a realistic return ever being generated. Sometimes money is forthcoming; British Land's 15 per cent mortgage debenture provided funds after a period of cash difficulty for the group and assisted its recovery. Had more market money for Leyland, in contrast, been forthcoming in 1974-1975, no return would have shown in five years.

Two new companies, LASMO and SCOT, were formed to participate in North Sea licences; the consortium they joined was successful in locating the Ninian field. These two small private companies had to set about raising £100m with no prospect of any payback, or even any money to pay the interest on borrowings, for at least five years — possibly longer. A few weeks delay on platform construction would mean a year's delay on field development: the loss of a platform could mean three years delay. The companies had no other material assets.

Nonetheless, the money was raised in a unique package of loanstock and oil production shares; the companies subsequently merged and were publicly quoted. The success of this venture demonstrates that even in a market unused to a weekly flow of entrepreneurs seeking finance, longer term money for risk projects can be found if necessary.

The NEB's search for this gap had been no less onerous a task than anyone else's. The NEB has tried all routes to find the gap; advances to established companies unable to raise more from the market, sponsorship of new ventures and the support of smaller companies both quoted and unquoted. In the first category Herbert & British Tanners complement British Leyland and Rolls Royce. The problem of all four were such than no ordinary rights issue or further bank borrowing was possible and the results remain disappointing.

Competition ensures that most of the market's many functions are carried out. Long term risk capital can be found if the new venturers satisfy the City of their abilities. Smaller quoted companies can find money; investors find it more difficult to find good smaller quoted companies able to use cash productively. The management of decline and decay is more problematic but there must be occasions, as with British Leyland, where the market declines to make further donations. The normal handling of decline is to encourage merger and rationalisation, to allow good management to take over bad, and by continuing to concentrate the minds of management on the problems of financial success to stimulate productive investment and efficiency. In all this the market can proceed unaided by the NEB for the fountains of British enterprise remain, on the one hand, the entrepreneurs with the ideas and, on the other, the saver seeking a return for his risk. These are best brought together through a free market rather than via a bureaucracy.

# V The dangers of crowding out

The United Kingdom economy over the last decade has developed powerful mechanisms for aggregating savings, particularly from private individuals who, as a sector, are regularly in substantial surplus and therefore have a proportion of income available for other sectors to use. By far and away the most important force has been the development of privately funded pension schemes in both the public and private sectors of industry, as employees have sought security of future benefits for their retirement by encouraging the formation of funds separate from the employing company to provide a store of value. In addition the life offices have been successful in developing new products to be aimed at those who choose to save through the intermediary of a life assurance policy and take advantage of tax concessions. In particular, they have exploited the opportunities inherent in the provision of housing finance and have marketed unit linked contracts successfully to service those who require some personal involvement in stockmarket investment decisions.

The way in which savings have been aggregated has much to do with the tax system. Taxation rates paid by life funds make life assurance attractive to the higher rate taxpayer whilst the relief on premiums over the longer run of a policy should more than offset the costs of the policy and provides an inducement to all tax paying savers to choose this route. In addition the tax relief on mortgages has encouraged the development of the active house mortgage market, itself financed by the lure of building society deposits and the relative efficiency of the societies compared with banks which have to maintain an expensive clearing system for cheques. This in turn has fostered the sale of insurance to those taking out loans through the advice, or even at the command of the building societies.

The complete tax haven provided for funded pension schemes has been an even greater inducement for those making longer term provision for the future to agree to a funded scheme as a means of enforced savings. The only anomaly in the system has been the payment of 2 per cent contract stamp by gross funds on UK equities which acts as a constraint on turnover in portfolios. The combined forces of the life companies and the pension schemes, with the pressures which operate in favour of individuals saving through them, have meant that in the UK there has been a substantial and important increase in the supply of investible funds year by year channelled through experts who should have been able to ensure that the money was put to good uses. The table beneath illustrates the rapid growth in such forms of finance.

**TABLE 1**

| Year | Insurance Companies (Long Term and General Funds) | | Pension Funds | |
|---|---|---|---|---|
| | £m | % of 1974 | £m | % of 1974 |
| 1974 | 1,902 | | 1,445 | |
| 1975 | 2,509 | | 2,215 | |
| 1976 | 3,029 | | 2,970 | |
| 1977 | 3,326 | | 3,185 | |
| 1978 | 4,501* | 236% | 3,625* | 250% |
| *provisional estimates | | | | |

The institutions to whom the money passes are, however, prisoners of the system to the extent that they have no role as initiators of investment projects nor can they determine the prevailing investment climate. Their role is that of making a collective response to government, industrial and commercial companies and entrepreneurs as they come for funds to the various market places in the UK. Over the last five years the rapid increase in institutional money has been accompanied by heavy government spending, increased in part by subsidies to nationalised businesses and other concerns through the intermediation of such institutions as the National Enterprise Board, special assistance through regional grants, grants under the 1972 Industry Act and other such measures. In contrast, companies have not been active in seeking major funds from the institutions in the form of new equity: the debenture and loan stock market (as distinct from the Eurodollar market) has been moribund, and the rate of new public company formation has been disappointingly low.

This pattern has been worrying. It has meant that government has been by far and away the biggest user of private sector savings. Largely insensitive to the rate of interest it has to pay and always regarded as a good quality borrower in view of the powers of taxation it commands, government has rarely adjusted its policy to take account of the impact a very large borrowing requirement may be having on other potential users of money. The absence of corporate debenture issues illustrates that there are no company finance directors prepared to risk borrowing for ten years or so at 14-16 per cent, yet the government has continued to borrow on coupons of 13-15.5 per cent almost regardless of the implied deterioration in the economy that such borrowing requires to prevent it becoming, over its life, massively expensive as the rate of inflation falls. It also illustrates that the atmosphere as a whole has not been conducive to a spirit of risk taking and rigorous innovation which any industrial society requires for its survival.

There are those who blame the institutions, the channellers of money, for the lacklustre performance of investment in the UK. If only, they argue, the providers of long term finance were more prepared to venture cash for new entrepreneurs, if only they were prepared to take a long view, if only they were more helpful to industry and sympathetic to its problems. There is some force in the question of whether the development of the fund management industry has proceeded in the right direction, but there is little substance in the argument that nowhere in the very competitive market places are there people prepared to take risks. Whilst it is true that the pursuit of ever better quarterly performance analyses and ever better computer systems to tell whether a fund is under-performing this or that index does tend to concentrate individuals around the mean and tend to limit their innovative powers, the story of the main events in the market shows that there is still enough competitive life to overcome even these vexing trends.

Every new share issue in the last two years has been heavily oversubscribed. Very often banks and stockbrokers have been cautious in their valuation of companies only to see the few good small companies seeking a share quotation soon command a large premium to the original offer price. Anyone who charted the progress of Eurotherm International whose share price more than doubled in a year, will know there is plenty of support for small companies in the right growth areas for the 1980s; the success of the Ferranti sale and the speed with which the stock market placed the NEB's holding in ICL demonstrated that even for large companies with a chequered history there was money to welcome them back into the private sector; the success of recent retailing issues like Harris Queensway shows that even for conventional companies money is only too readily available to support a public quotation, whilst in the case of rights money, where there is a reasonable expectation that it will be well used, as with BTR, again there is a ready alacrity by fund managers to take up shares.

All this evidence illustrates that the market is plagued primarily by a marked absence of good propositions, a line of argument supported by much of the evidence to the Wilson Committee. Too many companies seeking rights money are large, well-established businesses in difficulties, finding competition from overseas too strong, needing to reduce manning and re-orient their product and marketing strategy. At time these problems become so large, as with British Leyland, that they have been taken on by the public sector as the market has called a halt to further funds.

The absence of good projects is the most terrifying part of the economic prospect. Relief of some of the burdens of personal taxation and, particularly, of the burdens placed by bureaucracy on small growing companies must provide some answer to the worrying low rate of company formation and development. It is essential to the future flexibility and well being of the economy that there is a flourishing small business sector, containing the GECs and Shells of future years as well as a new generation of medium size companies with established reputations in new product ranges. Lower marginal rates of taxation and some facility for successful businesses to be passed on to a new generation without complete disruption through Capital Transfer Tax must be tried. At the same time, government should make it easier for employers so that they do not feel from the time of filling in the first form that they are some kind of potential criminal under constant surveillance by a Kafkaesque bureaucracy.

There then need to be changes on the other side of the account. At the moment we have a cumbersome structure of company taxation and subsidy which in overall terms succeed both in lowering the total amount of investment made in British industry and in lowering its productivity. It lowers the overall total through inflating the government requirement for funds, thereby raising interest and inflation rates, and, thus, discouraging more marginal projects amongst efficient companies. Government replaces this in part by channelling new money into inefficient concerns that could not raise it from the market, whilst the market itself is probably supplying more money than it should to relatively inefficient firms through rights issues because better firms are discouraged from expansion or seeking new funds at all.

Analysis of the supply of funds for industry demonstrates that subsidy, corporation tax concessions for high stocks and leasing are now the principal sources. Leasing, which has mushroomed through an odd anomaly of the taxation system, is now having a considerable impact on the pattern of investment and is serving to distort it further. The only salvation from the imposition of controls has been that the more efficient companies have been constrained from paying rising dividends in real terms and this may have encouraged them to make some further investment of forced retentions. It does not seem an ideal mechanism to achieve this end.

A pattern of job preservation in less efficient firms, distortions from the pattern of corporation tax reliefs, and other impediments to new business formation all help to ossify the industrial structure at a time when there is a particular need for rapid responses to change, particularly from technology. Inefficiency is also encouraged by the reluctance of the institutions controlling the inflow of savings to make moves against less than adequate managements through fear of the business consequences. In addition, they have no obvious suggestions as to who should succeed unsuccessful boards, given the relative shortage of talent in industrial management which, in turn, reflects all types of social pressures.

The future must see reform of the plight of small businesses, a major reduction in government requirements for funds and a lower interest rate structure. In these circumstances the debenture and loanstock market place for funds could be revived. All this could occur without changes to the tax system which favours the institutionalisation of funds, although changes particularly in the area of life assurance reliefs could divert money from the institutions to individuals who could then invest direct. Changes in pension fund rules are not recommended in view of the long term nature of the liabilities and the tragic history of disruptive changes in pensions arrangements in recent years. The institutions themselves would respond to more industrial imagination and a higher rate of new company formation though their response to the need for change in some declining industries would continue to be sluggish. More private shareholders might, in some circumstances, feel less constrained in their criticism of bad management; it can do no harm to move the tax system in their favour to see if they are better at fulfilling the necessary role of owners of business as a prod to managerial efficiency.

# VI British Leyland

The conflict between the NEB's commercial and social raison d'être is nowhere more explicit than in its attitude towards British Leyland. Although most businesses have on average a target of a 20 per cent return on capital employed, the holding in BL is excluded from the general calculation and a separate target of 10 per cent was fixed for the motor manufacturer. In 1978 Leyland managed half that level of 5.1 per cent as defined in the *Financial Duty**.

The magnitude of the investment programme envisaged in the various BL corporate plans is huge. By the end of 1978 capital expenditure commitments totalling £391m were carried forward into the new year following investment of £221m during 1978. The 1979 report comments, in addition, that £900m of new capital commitments could be entered into in 1979. This compares with year-end 1977 total fixed assets, tools, dies and jigs valued at only £411m. Of the total finance for these ventures taxpayers money channelled via the NEB will have reached £975m.

The NEB has done little as an intermediary caught between Leyland's cash requirements on the one side and the government as subsidiser on the other. It has dutifully compiled reports and comments on BL's progress and has agreed to make equity capital available with no prospect of dividends before 1981. It has not asked the fundamental question whether it is best to treble the managed assets in the space of three years or whether an investment in a new company with a new automobile or parts products would have produced a better return. With the money now being spent a sizeable new motorworks could have been built with none of the inherited problems.

*Profit before interest and tax as a percentage of assets.

The main changes at British Leyland in the NEB era have been the new management team under Sir Michael Edwardes and the injection of massive investment funds. The former did not need the NEB to organise; the government was quite capable of making the substitution direct. The question of whether the direction of massive investment funds needs an intermediary is also dubious. Only if the NEB clearly has skills and powers as a result of its own constitution which distinguishes its approach to investment objectives and targets from that of the Department of Industry could it be said to be useful. There is nothing in the record or in the difficulty of its current relationship with BL to suggest that it has any special advantage.

The main problems centre around productivity, the model range and management skills. The adaption of the mini formula to produce a family of cars in the form of the Maxi and the 1100 turned out to be a bad decision which left the company without attractive products in the middle range. This coupled with underpricing of the Mini in its early years and a failure to develop the hatchback replacement fully in the early 1970s crucified cash flow and model strategy for the later 1970s. Superimposed on this has been the difficulty in recruiting good general and design engineers by successive wage policies which has made recovery more difficult. Finally, persistently bad labour relations have made achieving manning and productivity targets, even on brand new investment (as at the Rover factory), impossible thereby undermining the competitive position still further.

The case for the NEB's involvement in Leyland must centre upon its being able to contribute towards the solution of these problems. Yet its Board has done little other than review the Group's progress and channel public dividend capital in accordance with Parliament's wishes.

The crucial problem of model strategy is acute in volume cars. Rover has a relatively new product which is competitive and can be modified to extend its life into the 1980s. Jaguar-Daimler has an old design for its saloon but recent upgrading dealt with immediate difficulties there and the product is a tribute to the original design quality. However, in the Cortina-Cavalier sector of the market, Leyland is all too vulnerable and has witnessed a precipitate decline in volumes in recent years. The involvement of Honda recognises that it is a major manufacturer, rather than the

NEB, which can help, given the time constraints on the management to produce a new vehicle soon to encourage dealers and customers alike.

In the area of engineering skills the immediate need is for better remuneration to attract more talent. Too many of the limited supply of engineering graduates in the UK abandon their skills to go into different walks of life; a combination of better rewards and working conditions are necessary to keep them where their skills are needed. Here again the NEB itself, constrained by damaging pay policies, has been unable to help.

In the case of productivity all the NEB has been able to do is to stress the need for improvements. Whilst having every sympathy with the NEB's position vis a vis BL, observers can see that man for man, even on similar lines, British Leyland is lagging way behind whilst the average age and quality of machine tools still leaves much to be desired and exacerbates the comparative statistics. Yet only the management and workforce themselves can ultimately solve the problem, gradually and through hard work. The provision of too much money on easy terms can even hinder this process by relaxing the approach of all concerned to the problem of collective survival.

The NEB can be helpful only in the provision of funds and the changing of management. Yet the government could do both jobs equally well direct. No one is fooled into thinking that because the NEB is an intermediary standards will be any tougher or the government will find it any easier to stop grants to British Leyland thereby precipitating its early demise.

Commentators could have formed a better impression of the NEB's skills had it been given the brief of spending money on a UK motor industry and using Leyland and its subsidiaries only where this seemed appropriate. As it is, only Sir Michael Edwardes has perceived the need to reinforce some of the forgotten successes that otherwise will themselves be subject to competitive pressure. Range Rover and Land Rover are to receive some capital support, and the truck and bus divisions, which have been successful but now need more resources to survive, are receiving attention.

In the 10 April 1978 Parliamentary debate both Section 8 of the 1972 Industry Act and NEB money for Leyland were approved. It is difficult to see why both were needed. The public dividend capital routed via the NEB has helped some re-equipment and has dealt with the immediate cash flow problem. Sir Michael has fought the fires bravely but there are too many to douse successfully even with £2,000m. The NEB holds out the prospect of profits of up to 15 per cent on capital by the early 1980s and the return of British Leyland to the dividend lists. If this happens it will owe everything to the management and men of British Leyland and nothing to the NEB. Similarly, if British Leyland fails to meet these targets, as still seems most likely, it will be difficult to blame the NEB who were unhappy intermediaries in one of the biggest and costliest rescue operations ever mounted in UK industrial history. As Table 2 shows, investment is still heavily dependent on the NEB; Leyland has a long way to go to match the NEB £1 for £1 as intended. It is a future which can best be supervised directly by the government.

**TABLE 2**

GROWTH OF BRITISH LEYLAND'S BALANCE SHEET

| | 1975 | 1976 | 1977 | 1978 |
|---|---|---|---|---|
| **Total** | 252 | 513 | 622 | 1,066 |
| Of which: | | | | |
| Share Capital | 30 | 130 | 130 | 579 |
| Reserves | 109 | 250 | 198 | 156 |
| Net Loans | 0 | 10 | 160 | 160 |
| Others | 113 | 123 | 134 | 171 |
| NEB funds | 1975 + 200 | | +150 | +499 |
| BL's contribution to own financing | Scheme of Arrangements | + 44 | — 52 | — 42 |
| Others | | + 10 | + 10 | + 37 |
| % Increase in Total | | 103.6% | 21.2% | 71.4% |

# VII Rolls Royce Limited

The origins of Rolls Royce's collapse, in 1971, are to be found a year earlier when the Minister of Technology, Anthony Wedgwood Benn, approved government £47m to help Rolls Royce develop the RB211 engine for the Lockheed Tristar. The terms of that contract, overseen personally by the Minister, were to prove fatal. The then board of Rolls Royce and the government must bear responsibility for encumbering themselves with a liability subsequently found to be way beyond the company's net assets. If Rolls Royce had had better management and stronger cost control procedures, the problem would have been noticed earlier. Perhaps, if accountants instead of engineers had had greater power within the company, then such a contract would not have been signed in the first place. The failure to perceive the possible escalation of development expenditure was an expensive error. Mr Wedgwood Benn espoused the RB211 deal enthusiastically but without any personal experience of business. His role in the saga remains as a vivid warning to future ministers to beware of involvement in industrial contracts.

By mid-1970, Rolls Royce told the Heath government that the development costs would now be £135m and there would be losses on production engines. Mr John Davies, then Secretary of State for Trade and Industry, agreed to invest a further £42m, subject to a thorough investigation by accountants. Their report revealed an urgent — even desperate — need to re-negotiate the RB211 contract. But, even before the accountant's report reached the government, the directors, led by the chairman Lord Cole, told John Davies that losses on the contract would exceed the company's assets. Shortly afterwards a Receiver was appointed: under Company Law the directors had had no option.

With a good deal of courage, and some embarrassment, the

Conservative government stepped in. The assets were acquired by Act of Parliament from the Receiver. There were sound and compelling reasons for this rescue. First, Rolls Royce supplied aero-engines to the Royal Navy, the Royal Air Force and to many foreign defence forces. Secondly, in civil aviation Britain had had (except for the Viscount) greater success in engines than in air frames. The RB211 contract, although it had to be re-negotiated, appeared to be necessary if the company was to remain in the aero-engine business. Conservative MPs, with the exception of Mr Enoch Powell, accepted these arguments. The Minister of Aviation Supply, Sir Frederick Corfield, told the House on 11 February 1971 that the nationalisation was only temporary. The government intended to encourage maximum private participation in Rolls Royce as soon as possible.

Rolls Royce Motors, the car division, was separated from the nationalised aero-engines company which was called Rolls Royce (1971) Limited and floated on the market. Despite criticism from the left-wing of the Labour Party this move was successful and Rolls Royce Motors has prospered. Rolls Royce (1971) Limited was transferred into the NEB's ownership in 1976.

Since 1971 Rolls Royce has maintained its technical eminence. Permission was given in May 1978 for the RB211-535, the next generation of engines. British Airways and Eastern Airlines of the USA ordered the 535 for their Boeing 757s and further business should follow. The RB211-524 are in both Lockheed 1011 and Boeing 747s. A joint venture is planned with the Japanese for a new RB432 (18,000-20,000lb thrust) for the next generation of medium range aircraft. At the same time, the military aircraft side has good order books. Adour engines are supplied in Jaguars for India whilst the Sperry engine will power the next Italian military aircrafts.

Diversification includes manufacture of SK30 generating sets and industrial gas turbines, and a joint venture in nuclear power plants for ships. Such high technology consumed £75m in research and development in 1978: the company's Report forecasts that equally large sums of money will be needed over the next five years.

There is no doubt that as engineers Rolls Royce are excellent. The essential question that will be asked by many who know Rolls Royce, is whether they are any good at running the business efficiently. Significantly, the NEB's report on Rolls Royce, published as a Blue Book in January 1979, stated in its opening paragraph, 'The Company has its best year ever in terms of sales, signing deals which could be worth more than £2,000m.' Little is said about the profitability of these contracts.

There will be doubt on this crucial point whilst the company remains in the public sector. Being nationalised may appeal to the company because it enables it to obtain the money with the minimum of difficulty. At the same time, it may be that it removes the commercial pressures from management. The intended transfer from the NEB to the Department is an important first step.

**TABLE 3**

Rolls Royce

| Year | Turnover £m | Before Tax £m | After Tax £m |
|---|---|---|---|
| 1971 | 184.9 | | 3.48 |
| 1972 | 374.9 | NA | 10.68 |
| 1973 | 432 | 22.8 | 8.69 |
| 1974 | 469 | 16.7 | 12.2 |
| 1975 | 602 | 4.5 | NK |
| 1976 | 620 | 21.9 loss | |
| 1977 | 703.9 | 20.3 | 18.6 |
| 1978 | 765 | 11.7 | 10.0 |

The time, therefore, has come to return some or all of the NEB's holding in Rolls Royce to the market in accordance with the original 1971 plan for the rescue. No doubt there will be a need for launching aid for new engines, but funds for this can be provided under Section 8 of the Industry Act 1972. For several decades the government gave financial backing to the then privately owned Hawker Siddeley and British Aircraft Corporation for their aircraft projects. At no time did government feel a need to own shares in these companies, nor is there any evidence that the companies would have benefited from any government shareholding. The fact that a Labour government subsequently did nationalise them and used launching aid as an excuse (rather than a practical reason) in no way invalidates the 'keep away from equity' argument. Current profitability is not adequate but it would be possible to arrange an offer for sale if management produced credible forecasts of future cash flow and profits and if the government laid down guidelines for aid to launch new products.

# VIII Ferranti

In 1974, Ferranti, a privately owned company with a fine reputation in the field of high technology, found itself in serious financial difficulties. Its transformer division faced a collapse of the UK transformer market, and its semi-conductor (microchips) division was at the stage of development which required substantial financing. Ferranti's bankers, the National Westminster, felt unable to provide further finance and insisted that the company should approach the government. The then Prime Minister, Harold Wilson, had just appointed Sir Don Ryder (now Lord Ryder) to be the Government's industrial adviser. Ferranti, an important defence contractor, was Ryder's first major problem. Anthony Wedgwood Benn, then Industry Secretary, did not wish a private sector solution for Ferranti. Potential rescuers, almost certain to be in the high technology field and, therefore, subject to Government arm-twisting, took the hint and fled the field. Ryder drove a hard bargain with the Ferranti brothers on behalf of the Department of Industry. Sebastian and Basil de Ferranti might easily have seen their industrial inheritance all but totally nationalised had they not, with Lord Goodman, fought back. Lord Goodman stood up to Ryder, who was no match for the former's talents as a negotiator. As a result, the Department of Industry holding was agreed at 62.5 per cent (£8.7m of new equity and a £6.3m loan). The "key" Goodman clause in the contract placed an obligation on the Department of Industry to reduce its shareholding to 50 per cent by way of an offer to existing shareholders if the company obtained a listing for its stock, before 1 October 1978.

With the benefit of hindsight, this appears to have been a reasonable contract. Both the Ferranti brothers and the NEB (to whom the Government's 62.5 per cent shareholding was compulsorily transferred in 1976) have benefited from Ferranti's recovery from its 1974 crisis. It is, therefore, a travesty of the facts for the NEB to claim (as it frequently does) that Ferranti is an NEB triumph. Originally, the rescue was by the Department of Industry and not by the NEB. The shares were transferred to the Board on the instructions of the then Secretary of State for Industry, Eric Varley. Indeed, the recovery followed so swiftly on the deal that the inherent strength of the company, built up over many years, must have been considerable.

Can we learn a lesson from the Ferranti rescue? There is strong evidence that there could have been a private sector rescue mounted by the City in conjunction with an industrial group. Ferranti had attractions, with its defence contracts through the Scottish and Computer Systems Groups. It had had a considerable lead in avionics, including gyrotechnology, moving displays, computer control systems and microchips — which the NEB likes to give the impression it discovered! Ferranti had had to work without the benefit of the huge home market available to its competitors, mainly in the USA. Of course, it had problems of which a shortage of capital was one: there had been no major injection of new equity capital between 1908 and 1974. Inflation, combined with this urgent need for more working capital and losses in the transformer business, all brought the crisis to a head. Management, overwhelmingly dedicated to technological progress, appeared unable to cope with these problems. The Ferranti brothers were understandably reluctant to close down the transformer business as a thousand long-service employees were affected. Loyalty, normally an admirable quality, was probably misplaced in the face of the decline in home and export orders for transformers.

Looking back over the five years since the Ryder rescue, nothing seems to have been done by the Department of Industry or the NEB that could not have been done by a private sector rescue. First, capital was provided. Secondly, a Chief Executive, Derek Alun Jones, was appointed by the company. The Transformer Division has subsequently been rationalised and may soon be run down completely, for losses are still running at little short of £500,000 a year.

However, one can criticise the NEB for refusing to face up to closures during the time it held the government shares; it seems the NEB pushed Ferranti into new engineering activities to absorb spare space capacity which resulted from rationalisation of the Transformer Division. This move into areas in which Ferranti had little management strength owed more to "job saving" than to hard-headed commercialism.

**TABLE 4**

Ferranti

| | | | |
|---|---|---|---|
| **Scottish Group**<br>35% of business | Defence Electronics and Avionics. Military & Civil. Offshore systems (systems for underwater development and survey). Lasers and instruments. | | |
| Record & Forecasts: | Year ended 31st March | Sales (£000) | Profit before Interest (£000) |
| | 1976 | 29,417 | 1,941 |
| | 1977 | 39,429 | 2,889 |
| | 1978 | 49,207 | 3,917 |
| | 1979F | 64,000 | 5,300 |
| | 1980F | 85,000 | 7,100 |
| **Computer Systems Group**<br>27% of business | Real-time on-line computer systems for specialised application. RN very important customer. Industrial Process control systems. Police and Fire control systems. Manufacture of Cathode Ray Tubes and Plasma display. | | |
| Record & Forecasts:— | Year ended 31st March | Sales (£000) | Profit before Interest (£000) |
| | 1976 | 32,343 | 2,094 |
| | 1977 | 39,546 | 2,673 |
| | 1978 | 47,668 | 2,931 |
| | 1979F | 57,000 | 3,500 |
| | 1980 | 66,000 | 4,100 |
| **Instrumentation Group**<br>10% of business | Domestic and Industrial meters.<br>Industrial Instruments.<br>Aircraft Equipment.<br>Weapon Firing Equipment. | | |
| Record & Forecasts:— | Year 31st March | Sales (£000) | Profit before Interest (£000) |
| | 1976 | 12,442 | 283 |
| | 1977 | 13,113 | 748 |
| | 1978 | 15,258 | 1,054 |
| | 1979F | 16,500 | 1,250 |
| | 1980F | 20,500 | 1,600 |

The NEB can be heavily criticised for pushing Ferranti into such "investments". If, as it appears, little benefit accrues to Ferranti shareholders, as a result of the NEB's 50 per cent holding, then the sooner the Conservative Secretary of State for Industry (Sir Keith Joseph) issues a direction for the shares to be returned to the private sector, under Section 7 of the Industry Act 1975, the better. If Ferranti is to be secure in the future it probably needs to be less dependent on UK Government defence contracts, which represent about half of present turnover. A severing of the NEB's umbilical cord should spur the Ferranti management into greater efforts to seek more civil and defence business overseas.

# IX ICL

By 1972 International Computers Limited was experiencing considerable difficulty in amalgamating the various companies grouped by the IRC and its own merger activity in the 1960s; money to finance its new computer development programme was short. After a public debate about the desirability of supporting the industry a decision was made to make public funds available to develop a new generation of British computers.

This decision was made because ICL was the only British-owned computer company and in an important and rapidly growing sector of the electronics industry. Although ICL's failure to consolidate the mergers of the 1960s was principally one of management in the 1968/71 period, a shortage of money was exacerbated by the UK government's less generous approach compared with that of many international governments for their indigenous computer industries. The government was swayed by the all pervasive nature of the applications of computer technology particularly in government departments where, it was argued, computers would make great inroads in to clerical functions and make departments of state more efficient. The importance of computer technology across a wide range of industrial activity was an equally important consideration whilst it was also felt that the rapid growth of the industry and its high value-added content should, in the medium term, produce a good return on any investment.

Perhaps the most important event in 1972 was the appointment of new management which was able to deal with the inherited problems, to make the group more efficient, to rationalise the product range of the merged companies and to make the costs reasonable in relation to revenue. The favourable impact of their action coupled with the assistance given in the research and development programme through government intervention meant that good progress was made. ICL became a profitable and successful company whose share performance reflected investor confidence in the broader base of the new group. The relatively modest investment has, therefore been one of the most successful of those made by government in its overall industrial strategy and, given that many international competitors have enjoyed similar assistance, a case can be made for such grants.

However, the story also illustrates the consumate importance of there being good management able to respond to cash made available from government sources. One good way of supporting a domestic computer industry is to make research money available through public sector development contracts which then have spin-off benefits in developing the product range for sales to the private sector.

ICL has pursued the policy of reducing its dependence upon the UK public sector business although its market share in this area is still above average. The Singer acquisition has assisted the policy of diversification from major dependence on the domestic market and is a sign of management's wish to have more independence. By late 1979 there appeared to be no reason for the NEB to retain its stake in the company and its 25 per cent holding was sold on the Stock Exchange, producing a good profit to the Exchequer and helping to reduce the public sector borrowing requirement by asset sales. The worry concerning ICL is how the company will choose to finance the major capital expenses of the development programme necessary for it to remain an important and independent computer company in the market in the 1980s. Its cash requirement is estimated at £500m in the next three years and although not all of this will be available from internal sources, it should now be possible to raise finance through loans and even through a rights issue.

If there is a case for modest government assistance to ICL it should not be done through the equity route. Discussions with the company illustrated that the NEB was in no way committed to developing an equity strategy for the company. The main decision to support the group was taken in 1972, before the NEB was conceived, and reflected management weakness from 1968 to 1971. Subsequent purchase of additional shares by the NEB was an investment decision which did not buy them a say in board policy in ICL. If, in future, there should be any question of government assistance to the computer industry it could be undertaken by support for research and development work in conjunction with universities' programmes of research, which the government has financed anyway. There should not be a renewed case for the government equity stake in the computer industry as the government and its agencies have no special skills in running or developing the computer business which are not already present in the management and employees of ICL.

# X INMOS & NEXOS

*Small Business Creation*
*Most of the giants of the semi conductor revolution in America have grown from back shed to $100m turnover in under a decade. At that point they have been bought out by established concerns, turned respectable, or gone broke. The pattern is familiar to any student of the English Industrial Revolution., It is a better formula for wealth creation than the NEB: merchant bankers and businessmen, who failed to adopt new technology when privately funded, trying again with the taxpayers' money.*
P. Virgo
*Cashing in on the Chips* p.17

The NEB's sector strategy has centred upon electronics; the all-pervasive silicon chip and futurised office equipment became the two ruling themes, involvement in computer software marketing the method of executing the strategy.

The choice of sector was understandable. In the next ten years the two most likely and obvious developments will be growing leisure time and increasing use of sophisticated electronics to improve industrial and commercial productivity. It was in the latter that the NEB decided to stake out its territory.

The underlying assumption behind the NEB's involvement was that British industry was ill-equipped and slow to respond to the challenges of new electronics when compared with the development of the US industry, in particular in the field of silicon chip technology.

The NEB's approach involves three separate lines of development. INMOS is designed as a basic producer of silicon chips to compete against the major US corporations, NEXOS is designed to assemble a strategy for the 'office of the future' market, whilst INSAC and its related companies attempts to sell UK software technology in the computer business.

The investment in INMOS was the boldest and perhaps the least interesting of all the three avenues. Major UK electronics companies already have captive capacity and development plans for chip production where appropriate but most industry experts are agreed that the skill lies in applying commodity chips to a wide range of products. The physical task of manufacturing the chips is arduous and not particularly rewarding.

In the first place the pace of technical change is so rapid that to keep abreast of the market requires the application of regular and increasing amounts of capital. In the second place the rapid decline in price of the finished product limits profitability and intensifies the quest for volume and technical lead. In the third place there is difficulty, especially in the UK, in finding sufficient high quality electronics personnel.

The typical profile of the US industry is of heavy cash requirements, little use of labour other than highly skilled personnel and tremendous competition. INMOS's £25m is not a large investment by industry standards and is unlikely to produce a worthwhile return. The intensity of competitive and technological pressures is illustrated by the fact that between 1963 and 1977 the price per function fell from $1 to 0.1 cents and is still falling. A typical financial profile is given below:—

| | | | £m | | |
|---|---|---|---|---|---|
| Turnover | 9 | 14 | 22 | 33 | 50 |
| Working Capital | 3 | 4 | 6 | 8 | 13 |
| Fixed Capital | 8 | 9 | 10 | 12 | 13 |
| Total Capital | 11 | 13 | 16 | 20 | 26 |
| Capital Turn | 0.8 | 0.9 | 1.4 | 1.7 | 1.9 |
| Cash Flow | —15 | —4 | —2 | —2 | —2 |
| Cumulative Cash Flow | —15 | —19 | —21 | —23 | —25 |
| Profit | —4 | —2 | 1 | 1 | 4 |

As this illustrates it is a cash hungry and unrewarding business where the competition is already most intense.

In the case of the "office of the future" activities, other groups are better placed to exploit the opportunities than the NEB. Major corporations on both sides of the Atlantic — Exxon, Rank, GEC, Plessey, Olivetti and others — have all recognised the potential in this particular market and are actively seeking a product range to satisfy it. To succeed a company needs experience of computers, telephones, data communications, word processing and xerography which the NEB does not have and, in comparison with the groups chasing this market, it has little cash either. The very phenomenon of so many major groups chasing this market indicates that there is no need for public sector involvement. Indeed, UK companies such as Thorn, with no previous experience in this market, are so persuaded that they are seeking acquisitions to take them into it.

In the third area, computers, the NEB have moved more swiftly, establishing a range of small interests in software operations. Although INSAC and its affiliated companies are not profitable overall, they do form a small grouping which could be attractive to the private sector. Sale of an equity stake would probably assist the companies in giving them easier access to private sector funds and disciplines. INSAC's record is disappointing with a loss of £1.3m in the year to 31 December 1978 and the promise of more losses to come. The encouraging improvement in profits at Systime and Computer Analysts and Programmers could form the basis of an equity issue. Although parts of the grouping like Logica have been dependent on large private company ventures in the field (Unilever), and the NEB has not been well informed about all the detail, they are nonetheless enterprising and could be of interest in the private sector.

There is no denying that the main problem of the UK electronic industry is the chronic lack of good suitably trained people. There is no absence of investor support and enthusiasm for the area; the phenomenal success of Eurotherm as a new issue and the high ratings of all the good companies in the sector (Racal, GEC and the component distributors) proves this. Nothing the NEB has done can deal with this underlying shortage of skills which owes more to the tax and education system than to anything else. Shuffling the few people in the industry around does not deal with the underlying problem, whilst intervening in highly competitive areas of new business is an unnecessary luxury we can live without. Analysis suggests that INMOS is undesirable as a use of public funds, NEXOS unnecessary and INSAC a venture which would benefit from private sector involvement.

# XI British Tanners

In 1977, the Barrow Hepburn Group (BHG), a public company owning tanneries as well as chemical interests, turned to the NEB for assistance for its tannery interests. They were seriously in debt to the parent company and were making trading losses.

As the NEB, then under Lord Ryder, was desperately searching for new investments, their approach, proposing the hiving-off of their loss-making companies into a joint NEB-BHG company, fell on fertile ground. To its discredit the NEB made scant enquiries into the trading conditions prevailing in the tanning industry.

The independent tanners were surprised to learn of the NEB's deal with the BHG. Only six weeks earlier, an Under-Secretary at the Department of Industry had chaired a meeting with the British Leather Foundation to discuss a leather industry scheme for which financial assistance might be available under Section 8 of the 1972 Industry Act. But, the right hand of the NEB had no idea what the left hand of the Department of Industry was doing. Had its officials done their homework by consulting with the tanning industry and with the Department of Industry, they would have learnt that there was bound to be a contraction in the tanning industry and it would have been clear that the BGH tanneries were among the least efficient and should, therefore, have been allowed to close down.

Barrow Hepburn's initiative had paid off. A new company, 50 per cent owned by the NEB and BHG was formed, called British Tanners Products (BTP). The participants had created a loss-making enterprise that was to be the NEB's most controversial and criticised venture.

Knowing the very uncertain state of the tanning industry, a group of leading independent tanners met in an attempt to stop the deal or, at least, to minimise possible damage to their own companies. The Barrow Hepburn tanneries comprised 35 per cent of the UK tanning industry. There is little doubt that, but for the NEB's lifeline, they would have been closed. As well as ceding to BHG the entire executive management of BTP, Barrow Hepburn was placed in the position of having a 50 per cent interest, through BTP, in any expansion or acquisition by BTP (with NEB money!) of other tanneries. As Richard Odey, the chief executive of Barrow Hepburn, said in *The Times* in May 1977, 'If some smaller tanneries were forced to close because of pressures, BTP would be able to take over their business'. The intention, as the independent tanners always feared, was increasing government control of their industry — by stealth. Only the vigorous opposition of the highly alarmed independent tanners created the public and political pressures to stop the NEB allowing BTP to proceed in such a way.

The independent tanners' case was that, by this intervention, the NEB had contravened its statutory Guidelines. Paragraph 12 of the Guidelines state: '. . . the NEB . . . shall look for an appropriate discounted rate, or rates of return on the proposed investment . . .'. Paragraph 13 says: '. . . the NEB shall make acquisitions on their own account only when they see the prospect of an adequate rate of return within a reasonable period . . .' Lastly, the tanners claimed the NEB failed to follow paragraph 14 of the Guidelines '. . . the NEB shall avoid undue preference in their trading relationships and shall use any power they may possess to ensure subsidiaries avoid this.'

The tanners claimed, with considerable justification, that there was never any hope of an adequate return within a reasonable period and that no reasonable body of men sitting on a Board could have seen any such prospect. The claimed that the BTP/BHG agreement to grant the sole buying rights for BTP to a subsidiary of BGH — Stubbs — and the sole selling rights to three companies controlled by Barrow Hepburn, contravened Para. 14 and undoubtedly did show 'undue preference'. The pressure of the legal action drove the NEB into making BTP end the Stubbs sole agreement. For the independent tanners, so ably led by Fred Lang of W. J. & W. Lang Ltd., and John Pittard of Pittard Group, the expensive legal action was paying off.

It may be asked why private firms should be driven into such

# XII Odds and Ends

Apart from investments such as INMOS and BTP, which attracted much publicity and comment, the NEB has put money into a motley collection of smallish companies. A few have prospered. One, Reed and Smith paper makers, did so well that the giant St. Regis Corporation of the United States took over the Board's shareholding. The success of Reed and Smith owed little to the NEB intervention, although it was one of the Board's better "deals" from a financial point of view. It is worth saying, however, that Reed and Smith were amazed at the ease with which the NEB put up £792,000. Apparently, there was little or no checking by NEB officials of Reed and Smith's figures.

Another company in which the NEB put money was a small clock manufacturers called Thwaites and Reed. The record of this company, employing less than a dozen people, had been disastrous, and it had the worst possible reputation in the clock trade. When the NEB investment became known, the Chairman of the British Clock & Watch Manufacturers Association, Mr. F. W. Elliot, wrote to Lord Ryder on 24 March 1977:—

> The NEB have announced the investment of £240,000 in Messrs. Thwaites & Reed Ltd. of Hastings.
>
> I wish to place before you the following facts:—
>
> 1. There is already one UK company in the field of Bracket clocks complete with tooling and good sales in Germany, America and Japan. *Ours.*
> 2. I was indirectly offered the opportunity to purchase Thwaites & Reed Ltd. just before Christmas and refused it because it was bankrupt with no assets. Its management has no record of profitability or technical expertise in manufacture at all. Any previous activities have been subcontracted.
> 3. As Chairman of the British Clock and Watch Manufacturers Association and immediate past Chairman of the British Horological Institute I know that there was no trade examination of Thwaites & Reed Ltd. by the NEB.
> 4. The Germans have suffered a 40 to 50 per cent drop in manufactured volume

on sales to America because of reduction in market. Our Company has benefited because of the value of Sterling and we show growth and expansion.

5. It means your Board has invested money to enter into competition with a well-established UK Company in the field. You can only lose that money unless you have placed a Director who knows the trade both Technical and Market.
6. If you have £240,000 to spare it should have been offered to us which would have allowed us to make an immediate export impact.

I regret I must place these facts before my Member of Parliament.

On 28th March, Mr. J. H. Murray of the NEB replied:

Thank you for your letter of March 24 which Lord Ryder passed to me as head of the Division of NEB concerned.

It might help to your fifth and sixth points if I explained that we deal with propositions put to us and that had you decided to come to us we would have been delighted to discuss a proposition with you.

It is true that we are financing a competitor to you. However, it is a fact of life that any investment we make is in someone's competitor and we cannot accept the argument that we should let companies decline until the survivor had a monopoly, since it is our aim to strengthen manufacturing industry in the UK.

It may interest you to know that we take a fairly optimistic view of the export potential over the medium term for UK companies and I trust that market will be big enough for both of us.

I have noted your remarks about the need for technical and marketing strength at Thwaites & Reed and assure you we are conscious of it.

Lord Ryder subsequently wrote to Mr. du Cann and said:—

'We do not accept that the NEB invested in "a company which is bankrupt and has no assets". We accept that the company had some problems in the past but we consider that it has good future prospects which fully justify the NEB's decision to invest in it.' (9 June 1977)

Despite this optimism, Thwaites & Reed lost £170,000 during 1977, under the NEB's aegis. The Board then had to put in a further £180,000. Lord Ryder's statement to the Parliamentary Accounts Committee said that under the Thwaites & Reed 5 year Corporate Plan, devised by the NEB, turnover would rise to £3.4m.

The Board's investment in Sinclair Radionics, came after the company had unsuccessfully gone the rounds of the City institutions. It was reported at the time that Sir Arnold Weinstock of GEC had turned down the opportunity of taking over Sinclair. To date, the record of Sinclair (a loss of £1.29m in the three

# XIII Accountability

Since it was founded, MPs from all parties have been deeply concerned about the Board's lack of accountability to Parliament.

The NEB Guidelines laid down by the Labour Government (in paragraph 9) allow the NEB to 'make loans, provide guarantees, engage in joint ventures or make any other form of financial commitment within a limit of £25m for each project.' All they have to do is give the Secretary of State 'reasonable notice of their intention'. This amounts to a blank cheque within the overall block of money voted to the NEB by Parliament: and that vote has always been generous.

Though the Secretary of State and the Department of Industry's Accounting Officer, Sir Peter Carey, have a certain measure of control over the Board's activities, the House of Commons effectively has none. Parliamentary Questions often produce the stone-walling reply, 'That is a matter for the Board'. The All-Party Public Accounts Committee can question the Chairman of the NEB, but it has no right to look at the books or send for papers. As a result, the PAC's confrontations with the chairman are one-sided and generally unproductive.

During the Parliamentary Session 1976/77, the PAC asked the Department of Industry and the NEB if they would mind the Comptroller and Auditor General having access to the Board's books and records. The Department and the Board dodged the argument when they replied that the accounts were audited commercially. The bureaucrats were unable to reassure all the parliamentarians that taxpayers' money was being monitored conscientiously by Parliament. However, the NEB felt that such access by the C & AG would adversely affect the Board's relationship with its customers. In contrast to this reaction from the NEB, the PAC recorded in a Report that the Scottish Development Agency disagreed with this view. The Agency does allow the C & AG access to its books, and it is clear that its experience contradicts directly with the NEB fear of allowing such access by the C & AG.

The Public Accounts Committee enquiry of May 1978 illustrates the problems facing a Parliamentary group questioning what is meant to be in part an entrepreneurial body. Because the Board is invested in so many different ventures and can always argue that the future will be better than the past it is difficult for the Committee to handle the detail. Efforts to discuss general principles usually give rise to vagueness on the other side combined with guarantees of good faith which may or may not be reasonable.

On 8 May 1978 Mr. Crouch led a line of questioning:

'You like the working of the NEB so far, and you say "Give it the chance to go on working as it is structured and as it is statutorily set up"?'

Sir Leslie replied: 'I believe it is working in the way that we intended'.

Similar questions and uninteresting answers followed. The defendants then turned to arguing that the type of Parliamentary control envisaged would require a large increase in NEB and Auditor General's staffs. Mr. Crouch summarised it all excellently when he observed that the entrepreneurial role assumed by the NEB was the stumbling block between the NEB and the PAC.

In addition once the PAC did manage to gain reassurances events often turned out differently. On 10 May it emerged that whereas in April 1977 the PAC had been told that £100m for BL was going to fund capital expenditure, some half of it had been used to finance working capital. In response to Sir Peter Carey, Sir Leslie Murphy argued that it was irrelevant how the money was spent; the question was one of total funds for the business.

The PAC reports illustrates how dire is the need for more precision by those answering questions and how important independent information is to the successful functioning of the Committee. The Public Accounts Committee itself also believes that accountability should be improved (Eighth report, 1976/77):

> We remain convinced that arrangements for the Board's accountability to Parliament should be strengthened. Without free access to the Board's records by the C & AG we have no independent source of advice on the way in which the Board has discharged its duty, or on matters of interest or concern arising thereon: nor, therefore, are we in any position to report in any cogent fashion to Parliament. It is for this reason, which goes to the heart of effective accountability of public bodies such as the NEB, that we have laid such stress on the the need for full access by the C & AG.

The Comptroller and Auditor General, the PAC's investigatory arm, must be given complete access to the NEB's books and papers. To quote the PAC:

> We recognise that if the C & AG were given such access to an important public corporation, substantial extra responsibility would be placed on him and that he would need to be assured of adequate staff resources. We would need to be assured of adequate staff resources. We believe that he would exercise it with care and discretion and without attempting to second-guess properly considered commercial judgments. We have carefully weighed the arguments put before us and have concluded that in the case of BNOC and NEB such access is an essential step towards securing the measure of accountability which we believe to be necessary and justified. We recommend accordingly that appropriate arrangements should be made.

That clear and unequivocal request from the PAC, endorsed by both Labour and Conservative MPs on the Committee, has so far been ignored totally. Mr Edward du Cann, the then Chairman, spoke eloquently on several occasions in the House of Commons of his frustration and annoyance at the Government's refusal to meet the PAC's wishes.

When pressed in Parliament ministers in the Labour Government could only lamely suggest a 'general enquiry into the Comptroller and Auditor General's activities'. Such an excuse for dodging this important issue of the NEB's accountability to MPs must not be used by future governments. Even a truncated NEB would need watching.

An example of the need for the C & AG to have access to the NEB's books is well illustrated by one incident. In May 1978, when questioned by the PAC, Sir Leslie Murphy was asked for facts about the Board's investment in British Tanners Products. He gave an incorrect answer about the transaction between BTP and the Barrow Hepburn Group which had a 50 per cent stake in BTP. This incorrect information was not picked up by the PAC, but by the joint-author. The Chairman of the PAC then tackled Sir Leslie Murphy and the latter, in a letter of 2 June 1978, apologised and submitted the correct details.

Of course, mistakes can happen. However the PAC must have the ability to check on all data sent to it. Without the C & AG it has no method of doing any such checking.

The whole is adequately summarised by the Secretary of State for Industry, Sir Keith Joseph, who said in Parliament on 10 April 1978:—

> When the Government seeks such vast additional sums from the taxpayer, it at least behoves them to lay before the taxpayer and his representatives in the House some decent record of achievement, some decent programme of intentions such as Government supporters would rightly expect any bank or stockbroker in the City to lay before the investing public when seeking money.

# XIV Conclusion

Judged on its results so far the NEB has not been an outstanding success. Armed with effectively limitless supplies of capital, some in the form of non-dividend paying equity and some in the form of loan capital at prime rates, the NEB has not been able to find productive uses for its cash. The search for a market gap amongst smaller companies denied access to funds in the marketplace has been a search for a will o' the wisp. Where companies can be found, the results of investment often vindicate the market's view that money should not be advanced. The sector strategy has been no more successful although the NEB chose one of the most promising areas for its excursion.

In the year to December 1978 the NEB reported profits of £102.9m at the operating level. Yet although over £1 billion of the £1.4 billion of capital invested by the taxpayer is given interest free, at the post interest level the NEB could only manage a profit of £30.7m. Even this was optimistically stated for exceptional costs brought that figure down to a loss after extraordinary items of £40.3m. This was not a handsome return on £1.4 billion.

To view the figures unadjusted is, however, unfair to the NEB who could rightly point out the investment in British Leyland and Rolls Royce was not of their choosing — although they pursued a policy of approving further investments in those companies. If we, therefore, remove those two the operating profit becomes £8.84m and the pre-tax profit £5.63m against exceptional items of £11.9m or a net loss of £5.27m. The return of a loss on capital employed of over £300m in businesses where the NEB does claim some autonomy is somewhat disappointing. Finally if we exclude Ferranti which became an associate during the year but was still included in the Profit and Loss account as a subsidiary, the result becomes a loss of £3.96m pre-tax or almost £15.0m after extraordinaries.

Supporters of the NEB can of course make two comments: first, that hospital case businesses are likely to be loss making during their stay if they are sold on returning to profits and, secondly, that entrepreneurial activities will take longer to come to fruition. The first point is a reasonable one, although commentators should see just how much of the profit of the NEB comes from the revived Ferranti and ICL, the second point is reminiscent of Professor McClelland's heroic remarks about the IRC which proved ill judged as events unfolded.

If we examine the plight of the two major industries in which the NEB has come to be or chose to be involved, electronics and motor assembly, it is difficult to make out any better case than that of the bare current profits figures themselves. In the case of several sections of the electronics industry there is still need for substantial reorganisation and tighter management but the NEB could not do and has done nothing to foster this. The destiny of the sector will be determined by the market in good times as the future direction of Plessey and Decca becomes clearer. The main achievements in the sector continue to be those of GEC and Racal with some smaller companies now growing rapidly through the provision of various specialist goods and services. The NEB's gaggle of software companies should be at least in part floated off and the INMOS and NEXOS businesses quietly discontinued allowing the staff to move to major companies better able to use their talents.

In the case of motor assembly the NEB has done nothing to arrest the inexorable decline of Leyland's market share, done nothing to lift its productivity and done nothing to arrest the concomitant rapid rise in the numbers of imported vehicles. It may have been better to have built a new motor industry from scratch or it may even have been better to specialise in areas other than mass saloon cars, in specialist vehicles and perhaps in components. Yet none of these options was ever evaluated properly; the mix was the same as before, subsidy to the failing business, often too late to change the progress and process of decline. We are handling our motor industry, in consequence, in the same way that we handled shipbuilding and steel.

This pamphlet has argued that the evidence of the IRC made it unlikely that the NEB could find a satisfactory role. Its performance so far underlines this, whilst theoretical and practical considerations imply that many of the NEB's roles are unnecessary. We are left with one area and one area alone where there is a bigger question, that of saving large public companies in trouble. ICL and Ferranti, two major companies, have recovered their poise at least temporarily. The market place, often slow to intervene when a company is taking the wrong course, often too willing in the early stages of decay to lend money, becomes parsimonious once the catastrophe is apparent. Ideally banks and investing institutions would develop their lines of contact with companies more successfully, and clearing banks in particular would become less concerned to write another overdraft in order to exercise better control, but this is more likely to be pious hope than commercial reality. In some circumstances state money may be needed for rescues, but these should be closely monitored and should be parallel with a change of management or a change of management plan. In these cases we cannot see why the Department of Industry cannot perform the role of hospital board to ailing corporations direct, this means encouraging proper and close Parliamentary scrutiny of any such transaction and avoiding the complications of a separate body trying to build a profit into its own accounts at the risk of retaining a patient too long in its recovery ward. As we have shown, in several cases in recent years rescues were initiated by the Department of Industry anyway.

The NEB in its state holding role for companies like British Leyland and in its recovery role is duplicating or transplanting work that could properly be done in the Department of Industry. In its entrepreneurial and sector roles it is attempting to do something that the marketplace can do perfectly well for itself. In all of these cases the NEB cannot add one new manager to the supply of talent, cannot provide any expertise not present in the marketplace and cannot add to the sum total of savings in the economy which one way or another are channelled into productive investment. The record of the NEB like its predecessor shows that the projects left by the market for finance by a state body are far from remunerative, whilst their significance in any other sense has been greatly exaggerated. The NEB does not offer us a solution to our industrial malaise: it is not even a good investment trust in smaller and riskier situations. *Si NEB n'existe pas, il ne faut pas l'inventer.*

# Future Action

Sir Keith Joseph's statement in July 1979 gave a welcome commitment to beginning the disposal of some of the NEB's companies. The successful placing of its holding in ICL was an excellent start. Understandably, as Secretary of State, he has refused to be drawn on which companies were to be returned to the market. We feel no such inhibitions and, therefore, propose a rational programme for the future of the NEB.

In the appendix we have distinguished between four categories of NEB investment.

The first group represents quoted companies where there are NEB holdings that could be sold to other investors relatively easily and quickly. In each case there is every reason to proceed with all reasonable speed. In addition although Fairey has no public quotation we believe the company could be sold in a similar fashion. Rolls Royce is the most difficult as Chapter VII has argued, but with the right attention to profitability and indications concerning government policy on launching aid this too could be sold.

The second group represents hospital cases where treatment is not yet complete. Here transfer to the D.O.I. is recommended with more careful monitoring of progress. Public money would only be spent with full agreement of ministers answerable direct to Parliament.

The third group should become the centre of NEB activity for a six month period. The smaller companies in the NEB portfolio should be sifted and a trust offered to the market to allow private investors to take over the whole portfolio. If necessary some of the least successful should be written off to ensure success of the offer for sale.

Finally, INMOS and NEXOS should be terminated quickly and all assets and personnel offered to major public companies pursuing their own strategies in these fields. If it is claimed that the contract with INMOS commits the NEB to continue, it might be cheaper to pay compensation rather than to allow INMOS to become the ground-nuts scheme of the 1980s.

*Summary*

1. The holdings of the NEB are divided into four categories:

(a) Ferranti, Twinlock, Barrow Hepburn, Brown Boveri Kent, Negretti and Zambra: all these have share quotations. NEB holdings should be sold in the usual way through city institutions as soon as possible.

Fairey and Rolls Royce could also be sold although the latter needs more careful treatment.

(b) Herbert and Cambridge Instruments should be transferred to the Department of Industry for further hospital treatment.

(c) INMOS & NEXOS should be terminated as quickly as possible to avoid major losses. Ferranti Resin Limited should be offered to Ferranti. Wholesale Vehicle Finance should be sold to a financial institution or institutions.

(d) The remaining holdings in small companies represent the investments chosen by the NEB as (i) the most interesting available and (ii) the opportunities missed by the private sector.

The NEB should be given six months to decide how many of these companies can be placed in a smaller companies/venture capital trust suitable for public quotation and how many should be written off. The NEB in conjunction with advisers if it wishes should then prepare the trust for quotation and public subscription, stressing in the prospectus the future profits and growth it foresees in these investments it has chosen.

The personnel of the NEB should be run down with perhaps four or five executives transferring to manage the venture capital trust and the rest being given time to find other suitable jobs. Premises should then be sold, eventually saving around £3m per annum in NEB overhead expenses.

2. Chapters IV & V on the market gap and crowding out argue that the problems in financing industry have been created by general economic policies and the priority accorded to public sector borrowing rather than any failure of financial markets. The poor performance of NEB investments illustrates the difficulty in establishing the existence of a market gap.
3. The chapter on IRC counters the argument that winding up the IRC was a mistake by showing that most of the IRC companies subsequently performed badly. The only possible need for government intervention is in the case where it is needed to prevent the Monopolies Commission blocking a useful merger.
4. The Chapter on BL concludes that Department of Industry aid should continue to be awarded under the terms of the Edwardes' plan but that all decisions should be taken within the Department of Industry through the Secretary of State responsible to Parliament. The chapter demonstrates the major commitment to Leyland and argues that the NEB did not perceive the disadvantages of the original Ryder plan. Neither did the NEB suggest alternative ways of investing money in the motor industry which might have been more successful.
5. The chapter concerning Rolls Royce argues that Rolls Royce should be returned to the private sector. The disposal will need careful planning and may have to be coupled with a statement concerning the government attitude to future assistance which should take the form of launching aid and research and development assistance.
6. Chapter VIII concludes that the NEB made no contribution to the recovery of Ferranti and that the company should be sold back to the private sector. It is well known that companies like GEC and Racal may be interested in bidding for the whole group whilst institutional investors are also interested in increasing their investment positions.
7. INMOS and NEXOS. Both these ventures should be terminated at least cost as soon as possible, the modest assets and personnel available being offered back to the private sector companies already prominent in these fields — GEC, Rank Xerox, Plessey, etc.
8. British Tanners. This chapter catalogues the sorry tale of British Tanners. However, finally, after massive pressure from industry and Parliament, the NEB put in a Receiver.

9. The diversified portfolio has been dealt with above in suggested action; chapter calls into doubt the claims of former Secretary of State for Industry and the Chairman of the NEB that this carefully selected portfolio would be producing a return on capital in excess of 20% in 1981.

10. The chapter concerning the Public Accounts Committee illustrates the way in which it has been extremely difficult for the committee to obtain any realistic figures of the NEB's assumptions and the way in which the NEB managed to exploit its position to avoid public scrutiny of its affairs. The chapter concludes that one of the main reasons for removing the NEB is the lack of appropriate parliamentary control over the money it is dispersing coupled with the inability of the PAC by its nature to be a good portfolio investor on behalf of the tax payer.

11. The conclusion of the future action passage provides general and speculative propositions along the lines of those items in suggested action above.

# Appendix 1

*Recommended sales of successful companies — £264.84m*

| | | Cost £m | Market Value £m |
|---|---|---|---|
| Ferranti | | 6.93 | 53.0 |
| Rolls Royce | | 234.0 | |
| Twinlock | | 1.0 | 1.4 |
| Fairey | | 18.0 | |
| Barrow Hepburn | | 0.45 | 0.3 |
| Brown Boveri Kent | | 3.3 | 4.3 |
| Negretti & Zambra Ltd | Equity | 0.7 | 0.56 |
| | Pref | 0.461 | |

*Recommended transfer to Department of Industry — £889.5m*

| | |
|---|---|
| BL Ltd | 845.5 |
| A. Herbert Ltd | 44.47 |

*Recommended sale through a smaller companies trust flotation — £66.961m*

| | Cost £'000s |
|---|---|
| Insac Group | 7,100 |
| Agemaspark | 250 |
| Aqualisa | 69 |
| ASR Sevotron Ltd | 318 |
| Automation and Technical Services (Holdings) Ltd | 150 |
| British Tanners Products Ltd | 2,000 |
| BTB (Engineering) Ltd | 30 |
| Bull Motors Ltd | 1,220 |

| | |
|---|---|
| CAP-CPP Group Ltd | 549 |
| RR Chapman (Sub Sea Surveys) Ltd | 50 |
| CIC Investment Holdings Ltd | 15,016 |
| Computer & Systems Engineering Ltd | 930 |
| Data Recording Instrument Co Ltd | 11,844 |
| Doyce Electronics Ltd | 80 |
| The Energy Equipment Co | 500 |
| Exelarc Engineering Company Ltd | 70 |
| Hemmings Plastics Ltd | 100 |
| Hird Brown Ltd | 250 |
| James Howorth & Co (Holdings) Ltd | 116 |
| Hydraroll Ltd | 65 |
| Burndept Electronics Ltd | 510 |
| George P Brown (Holdings) Ltd | 575 |
| Duo Rubber and Engineering Co Ltd | 160 |
| Innotron Ltd | 95 |
| J & P Engineering Ltd | 100 |
| Keland Electric Ltd | 100 |
| Logica Holdings Ltd | 1,196 |
| Logica Securities Ltd | 1,000 |
| Logica VTS Ltd | 1,805 |
| Mayflower Packaging Ltd | 120 |
| Mollart Engineering Co Ltd | 382 |
| Monotype Holdings Ltd | 250 |
| Momex (UK) Ltd | 0 |
| Muirhead Office Systems Ltd | 210 |
| Newtown Securities (Northern) Ltd | 125 |
| North East Audio Ltd | 439 |
| Pakmet International Ltd | 200 |
| Powerdrive PSR Ltd | 245 |
| QI (Europe) Ltd | 2,000 |
| Sandiacre Electrics Ltd | 165 |
| Francis Shaw & Co Ltd | 546 |
| Sinclair Radionics Ltd | 5,350 |
| Sonicaid Ltd | 297 |
| Systems Designers International Ltd | 184 |
| Systems Programming Holdings Ltd | 600 |
| Systime Ltd | 623 |
| United Medical Enterprises Ltd | 5,774 |
| Vicort of London Ltd | 140 |

| | |
|---|---|
| Legibus Twelve Ltd | 137 |
| Middle East Building Services Ltd | 38 |
| Microform Communications International | 475 |
| Rigby Electronics Ltd | 75 |
| Sapling Enterprises Ltd | 1 |
| Technical Resources (Equipment) Ltd | 237 |
| Thermax Ltd | 350 |
| Yates Duxbury Ltd | 1,750 |

*Recommended other disposals — £25.026m*

| | *Cost £m* |
|---|---|
| Inmos Ltd | 11.093 |
| Ferranti Resin Ltd | 0.294 |
| Nexos Office Systems Ltd | 6.393 |
| Wholesale Vehicle Finance Ltd | 7.246 |