Prime Minister

BSC's assessment of their cash requirement for 1980/81 is £950 million - at least as bad as we had feared. Sir Keith is not asking for a decision on this now. But he does have to write to Sir Charles Villiers (see page 7) and I think you will want to discuss with Sir Keith and the Chancellor. Shall I set up a meeting? If so, shall we include Mr Prior and/or the Attorney General?

Yes please MT

Mr Hoskyns
Mr Wolfson

PRIME MINISTER

BSC FINANCES

My Private Secretary wrote to yours on 25 January saying that a critical situation was looming in connection with BSC finances in 1979/80 and 1980/81. BSC's revised estimates forecast a loss of £427 million in 1979/80, with a cash requirement of £888 million (£188 million over the EFL of £700 million), if the steel strike lasted 8 weeks, and a loss of £285 million in 1980/81 with a cash requirement of £715 million (£265 million over the EFL of £450 million) plus any spillover from 1979/80.

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After discussing this on 28 January, you set up a group of Ministers and officials under my Chairmanship to consider the options open to us. The report of this group, MISC 34(80)1, was then considered by a group under your Chairmanship on 30 January. We agreed to concentrate on the search for a new Chairman to succeed Sir Charles Villiers. We had no grounds on which seriously to doubt the validity of the estimates presented, which involved £300-500 million of cash requirements over the EFL, but considered that the settlement of the strike must take precdence; meanwhile, "every effort should be made to prevent the information about the financial position of BSC becoming known before a settlement had been reached in the pay dispute".

In the event, the strike lasted 13 weeks. As a result, the EFL for 1979/80 was underspent and not overspent. The settlement of many

1979/80 obligations was delayed by the strike and we allowed the unused £130 million of the 1979/80 EFL to be carried over into 1980/81 to cover this. Also, BSC have to cover, in 1980/81, the underlying overspend in 1979/80 attributable to the direct and indirect losses resulting from the strike. The provisional estimate of these losses is £150 million, which is a call on the 1980/81 EFL. So the latter has looked increasingly vulnerable. However, I have continued to press BSC to consider options which would enable them to stay within or close to the EFL and this pressure has been supported on the Board by the two Government directors.

PRESENT POSITION

Sir Charles Villiers has now, on behalf of the Board, formally notified me that all the efforts BSC have made on such matters as disposals, savings in stocks etc have only served to offset the further adverse movement in the market since the beginning of the year (with costs continuing to rise but prices remaining stagnant). The loss in 1979/80 is now estimated at £450 million from ordinary activities. The Accounts will show a further loss of £1,169 million from extraordinary items, including cash expenditure on redundancies and other closure costs of £330 million, and a large write-off of fixed assets; this does not involve cash expenditure but acknowledges that the book value of BSC's assets is overstated in the Accounts, in that they are not expected to be wholly recoverable out of future earnings (the write-off amounts in total to £1,058 million against which will be offset £300 million now in the reserves).

For 1980/81, BSC at present estimate a trading loss (after depreciation and interest but before the contingency item of £100 million for major disputes etc) of £350-375 million - some part-time Board Members consider it will be substantially worse than this - and a cash requirement on top of the EFL of over £400 million. The Corporation seek our consent to their covering this gap by the factoring of home debts (to yield about £200 million) and the sale and leaseback of major assets (to yield a further £200 million). Sir Charles Villiers claims that these expedients would enable him to stay within the EFL (though he knows the Government is opposed to them). Without this consent, the Board could not carry on trading and would recommend the liquidation of the business. They fear that they will be running out of cash by September though our guess is that they could last at least a month longer, possibly more.

CONSIDERATION

BSC have therefore concluded that they cannot manage without another £400 million in cash this year over and above the EFL. The fact that they are prepared to raise this cash outside Government sources - though by expedients they have been told are chargeable against the EFL under the rules - does not, in my view, excuse their failure to plan and propose options, for which I have repeatedly asked, which would have enabled them to stay close to the EFL. I acknowledge that external events have moved against them - the continued deterioration in the level of demand and the adverse effect on BSC's competitiveness of the high rate of sterling. However, despite Sir Charles' protestations, I am not satisfied that BSC have taken sufficient and energetic corrective action in areas that

/are ...

are within their control.

I am therefore considering whether we ought to signal our concern at this failure by seeking the resignation of the whole of the Board. There is much to be said for this if the credibility of the EFL system is to be sustained. It is what shareholders in the private secotr would do, leaving the new Chairman to reappoint those whom he considered could help him put matters right. On the other hand, we rejected this course in January because of the adverse impact it would have had on the strike and there are arguments against doing so now. Sir Charles is anyhow leaving at the end of this month and the wholesale "resignation" of the Board on the very eve of Mr MacGregor taking up office, could create the wrong climate for him publicly and within the Corporation - even if some of the part-time Members are then reappointed. I intend to discuss the issue with Mr MacGregor early next week, to see what he thinks would help him most; until then, I should prefer to leave my position on this open.

Meanwhile, our acceptance now of BSC's assessment and our agreement to their additional cash requirement would have a most harmful effect on our efforts to contain public expenditure and on our policy relating to EFLs. The Opposition would no doubt revert to attacking our stance on the strike and claim that our intervention then would have had a much less costly outcome. There are other reasons why I remain reluctant to accept at this stage that the EFL is as totally inadequate as BSC say. Their present estimates are still largely based on the forecasts made in January. Because of the disruption caused by the strike, the first informed assessment of the trading and financial prospects for 1980/81 will not be available until the end of this month; it may well be worse (as some part-time Board Members fear) or it may be better. So it is premature to fix a new financing limit or to agree to financial expedients as proposed by Sir Charles, to which I know Treasury Ministers remain opposed. Also, agreement to BSC's request would relax the pressure on management to try and bridge the gap from within their own resources; I still believe that more can be done here. Therefore, I would prefer Mr MacGregor, after taking up office, to examine the possibilities closely and report before we come to a considered view on BSC's cash needs.

I know that Mr MacGregor already shares some of my misgivings. He told me on 14 May that investments which did not represent an outlet for BSC's steel, for example the South African engineering assets, "should be lopped off as soon as possible" - BSC management have been dragging their feet on this disposal. And he proposes to set up a small group to pursue more actively all that can be sold off in practice. On the other hand, he was attracted by the possibility of sale and leaseback of some assets to alleviate BSC's cash problems although he knows that the Chancellor said last year that sale and leaseback by the Post Office outside the EFL should not be repeated. He is extremely concerned by the lack of financial control and the poor financial reporting system within BSC and has already asked outside consultants to carry out urgent enquiries

/into ...

into BSC's organisation, into market prospects and into BSC's system of financial reporting. He is, of course, still only part-time and is in an awkward position vis-vis Sir Charles until he takes over on 1 July. He has told us privately that he will make every effort to give us his own assessment of the financial and trading prospects for 1980/81 by the end of July at the latest. He clearly feels that there is no hope of BSC becoming a viable operation unless capacity is further reduced below the present 15 million tonne target, so that manned operating capacity is brought more into line with demand; this may mean more plant closures (and also more redundancy payments). Otherwise, managers and workforce will continue to struggle unsuccessfully with plants that cannot be properly loaded and efficiently operated.

Sir Charles Villiers told me on 9 June that, in the light of their present financial forecasts, the BSC Board were reluctant to make any additional financial commitments. I told him that I would need to consult my colleagues before I could give a considered reply to his proposals. I added that, under the terms of Sir Peter Carey's letter to him of 27 February (on which both you and the Chancellor were consulted), BSC should meanwhile continue to negotiate local productivity agreements due to be completed by 2 July and to negotiate for the closure of Consett, due to be announced on 12 June, although they should make every effort to keep redundancy payments down to a minimum and if possible phase payments over more than 1 year. Secondly, they should for the time being continue with commitments already undertaken within the heavily reduced £178 million capital programme for 1980/81 (against the £435 million estimate

/when ...

when the EFL was first fixed in June 1979) but should make no new starts.

ACTION PROPOSED

I need to give Sir Charles our considered response in good time before the next meeting of the BSC Finance Committee on 26 June (his last meeting as Chairman). For the reasons set out above, I propose, subject to your views and those of other recipients - and to my discussion with Mr MacGregor about the future of the Board - to reply on the following lines:

a the Government have received and considered the conclusion reached by the BSC Board that their cash requirements for 1980/81 are some £400 million in excess of the EFL;

b the Government are not satisfied that the Board have taken or adequately explored all the corrective action open to them to help reduce their cash requirement in 1980/81; /possible addition: their failure to do so and to prepare options, however unpalatable, which would have enabled BSC to keep close to the EFL, has lost them my confidence and I should therefore be grateful if they would agree collectively to resign/;

c because of this dissatisfaction, we cannot agree now either to reconsider the level of the EFL or to consider whether money raised from factoring of debts or sale and leaseback could be outside the EFL;

d we recognise there is now very little time before Sir Charles Villiers' term of office expires. Accordingly, I propose to discuss with Mr MacGregor how long it will take him to produce new proposals for corrective action;

e meanwhile, the Government acknowledge the concern of Board Members about the Corporation taking on fresh financial commitments as an on-going concern, given their present forecasts and the expected cash availability. After considering the information Sir Charles has given me, I confirm that the position remains as set out in Sir Peter Carey's letter of 27 February, in particular, "that the Corporation is continuing to trade with the acquiescence of HMG" ... who would "in the last resort have to ensure that creditors of the Corporation had their claims fully met". BSC should continue to trade until the Government comes to a different view;

f however, I expect management to press on vigorously with the measures to save cash outlined by Sir Charles, particularly stock reductions and the disposal of assets, but also more effort to limit redundancy payments and to phase them over a period.

If you and the Chancellor agree to the above, we shall need to consider what should be said to Parliament. It is very important, in my view, that the position should be made public in a way that puts the blame fairly and squarely on the present management and the strike. My intention would be to inform Parliament, when Mr MacGregor takes over, ie on 30 June or 1 July, of Sir Charles' intimation to me of BSC's estimated loss in 1980/81 and greatly increased cash requirements. I would go on to say that the Government were not satisfied that everything had been done to keep the cash requirement much closer to the EFL. We could not therefore agree to the financial expedients proposed by the Board to cover their cash deficiency /possible addition: Our resulting loss of confidence in the Board has led them to offer their collective resignation./ Any revised cash provision (which would require a winter supplementary vote) would have to await consultation with the new Chairman after he had had time to take stock. Meanwhile, we had authorised the BSC management to continue trading as an on-going concern subject to the measures at (f) above.

We shall then, in August or early September, need to consider the proposals that will be made by Mr MacGregor following his own review, in particular the need for an additional cash provision in 1980/81 (with a possible reversion to expedients such as sale and leaseback provided we are satisfied on other counts) and measures to bring capacity more into line with demand. This consideration could then serve as basis for legislation early in 1981 on the financial reconstruction of the Corporation, when their present borrowing power will run out and new legislation will anyhow be required.

KJ

I am copying this to the Chancellor, the Secretary of State for Employment, the Attorney General and Sir Robert Armstrong.

Department of Industry
Ashdown House
123 Victoria Street

13 K J
June 1980