

CONFIDENTIAL

Prime Minister ②

RF 17/10

MR. TURNBULL

NATIONAL BUS COMPANY - PRIVATISATION

E(DL) is due to take Mr. King's paper of 11 October tomorrow. Since the Prime Minister does not chair E(DL) I am minuting you for information only; but you are welcome to make wider use of the minute if you so wish.

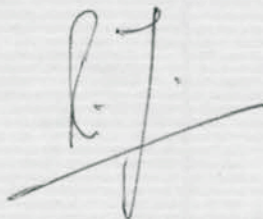
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Chairman
have this
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The proposals made in paper 83(5) are still at such a formative stage that they should not yet be approved, even in principle.

Mr. King wishes, rightly, to consider other methods of sale than management buy-out. Methods of sale are heavily influenced by what should be made available for sale and therefore by NBC's structure. That in turn is influenced by considerations of competition.

The DTp officials' paper is lightweight - even fatalistic - on all three topics. Its prescriptions would leave Government with a large shareholding in a de facto monopoly which would require heavy regulation and continuing subsidy - surely the worst of all worlds? Annex A reconsiders competition, structure and methods of sale. It raises questions, cogent responses to which might form the basis of firmer proposals for privatisation.

E(DL) would be well advised to note Mr. King's preliminary recommendations, but to make no public announcement yet and to call for substantive proposals before the Christmas recess. No violence would be done thereby to his own timetable.



ROBERT YOUNG

17 October 1983

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1. COMPETITION

National Bus Company (NBC) competes generally with rail transport and the private motorist, whether on inter city, inter urban or short distance (stage carriage) services. Within public road transport, however, NBC enjoys a monopoly in some areas and a dominant position in others. There is no reason in principle why competition should not be introduced where little or none now exists. After all, NBC itself benefited from a single Government measure (deregulation) which was intended, successfully, to promote competition between bus and rail transport.

The DTp officials' paper and the NBC published accounts make it clear that NBC's biggest financial problem resides in the provision of urban and rural stage carriage services, a large proportion of which are supported by subsidy. DTp appear to accept that this state of affairs must continue; therefore that NBC should be privatised whole in order to permit continuing cross subsidy (as well as ratepayer subsidy); and therefore that further deregulation must be prohibited for some years to come.

The allocation of local authority subsidy to each of NBCs operating subsidiaries is not revealed. But the NBC accounts show a huge variation of profitability among the subsidiaries, before and after the allocation of central government subsidy. Why should this be? Who is benefiting from the total/^{subsidy}of £138million? Does it support a genuine social need, or is it financing operating inefficiencies and/or fares calculated to hold competition at bay?

DTp should be asked to examine whether competition among stage carriage services could not permit subsidy to be reduced or eliminated; and at the same time to consider whether further deregulation would support this end. If NBC is privatised whole, before the subsidy issue is closely examined, Government will find great difficulty in containing the problem later.

2. STRUCTURE OF NBC FOR SALE

For management purposes, NBC is already divided into four geographical regions. On a historical cost counting basis, all are profitable after interest and tax:

(A) <u>Region</u>	(B) <u>Profits</u>	(C) <u>Nett Assets Employed</u>	<u>% B of C</u>
Midlands-West	£ 1.352m	£ 36.92m	3.66%
Northern	£13.31m	£101.98m	13.00%
South East	£ 6.17m	£ 54.92m	11.24%
Wales-Marches	£ 1.41m	£ 14.43m	9.73%

On the face of it, the Northern grouping looks attractive, and the South East and Wales and Marches only a little less so. (The relatively low profitability of the Midlands and West grouping warrants a closer look anyway).

If it is feasible to introduce competition into the stage carriage services in order to reduce regional dominance/monopoly, a good case emerges for selling the regional groups individually. That would permit geunine competition on inter-region travel, both long and medium distance.

There does not appear to be a strong countervailing case that NBC should be kept together because of vital economies of scale.

At very least, DTP should be asked to consider break up before sale, with the encouragement of competition and the minimum of regulation in mind.

3. METHODS OF SALE

It is curious that E(DL) should be asked to endorse proposals in which the Secretary of State disagrees with similar advice from two merchant banks. But he is right to be cautious: if Government retains nearly half the equity in an employee buy-out, its negotiating position is weak in the run-up to privatisation, but weaker still afterwards. Government's interest does not stop short at achieving a sale. It needs also to free itself from the costly and contentious issues of subsidy and regulation.

Achieving that end may well depress NBC's sale value. But NBC will almost certainly have to be sold at a discount from book value anyway - to achieve book value implies a price/earnings ratio of 14 plus, according to NBC's 1982 accounts. A larger discount may well be a small price to pay for Government to reduce its role very substantially.

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The question for DTp to examine is therefore what method of sale
will best secure the reduction of Government's involvement in
guaranteeing, regulating and subsidising bus and coach services?

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17 October 1983

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18 October 1983

NATIONAL BUS COMPANY PRIVATISATION

The meeting of E(DL) which was due to take Mr. King's paper on the privatisation of the National Bus Company was postponed in order to allow Mr. Ridley an opportunity to make up his own mind on this subject. I understand that the Treasury may have had a number of reservations about Mr. King's original proposals. These doubts were shared by the Policy Unit here and the Prime Minister has suggested that the Chancellor might like to see the note which they had prepared.

Andrew Turnbull

John Kerr, Esq.,
H.M. Treasury.



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10 DOWNING STREET

Prime Minister ⁽²⁾

To be aware of Policy Unit doubts about the wisdom of privatising NBC as a whole without tackling problem of competition

Political Office have reservations about privatising without settling bases of subsidies for rural services eg. danger that if NBC withdraws services, blame and/or cost of keeping them will fall on H.M.G.

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Prime Minister (4)

To note .

Mr King is keen to
privatise NBC but

- (i) he is exploring options
other than employee buy-out
- (ii) problem of achieving
greater competition still to
be solved as ~~there~~ are
- (iii) problems of subsidies and
rural services .

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10 DOWNING STREET

(4)

Prime Minister

Mr Younger first concludes against privatizing STG as a whole; then examines case for selling parts.

Concludes:- that Caledonian MacBrayne ferries are not saleable except by guaranteeing large subsidies

- that MacBrayne

Haulage should be privatized

- that Scottish Bus

Group should not be privatized,
at least until Scots have
seen experience with NBC

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10 DOWNING STREET

Prime Minister ②

This paper is on the agenda for the E(A) scheduled for Wednesday - subject to whether you attend NHS Debate.

There will be a Cabinet Office brief in due course. Meanwhile you might like to see Policy Unit paper.

WM attended
NHS debate -

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21/10