



CONFIDENTIAL

B.06977

PRIME MINISTER

c Sir Robert Armstrong

Future of the Crown Agents  
(OD(84) 5)

BACKGROUND

FLAG A

1. The Committee previously considered the future of the Crown Agents on 16 December 1983 (OD(83) 9th Meeting). At that meeting the Foreign and Commonwealth Secretary proposed that the Crown Agents should continue in being as a public corporation with an extensive reorganisation and capital reconstruction programme aimed at improving efficiency. Privatisation in the sense of selling off was not considered to be an option for the Crown Agents in their present financial circumstances and closure was the alternative offered. The view taken by the Committee was that many of the Crown Agents' tasks were not appropriate to the public sector and that, if there were serious doubts about the ability of the Crown Agents under new management to achieve financial viability by 1986, it would be better to close them down at once rather than face the prospect of closure later. The Foreign and Commonwealth Secretary was accordingly invited, in consultation with the Chancellor of the Exchequer and other Ministerial colleagues, to bring forward a paper covering the full implications of a possible closure. It was also agreed at the meeting that Government Departments should not be required to accept on transfer certificated Crown Agents staff who would otherwise be redundant.

FLAG B

2. In his Memorandum (OD(84)5), the Foreign and Commonwealth Secretary, in addition to answering the OD remit of setting out the full implications of closure, has brought



CONFIDENTIAL

forward alternative proposals for reorganising the Crown Agents with a view to privatisation, with a final decision on the timing and modalities of privatisation to be taken later. These alternative proposals are based on advice from the Merchant Bankers, Morgan Grenfell.

3. While closure (involving the parcelling out of certain key functions) offers a quicker and more certain solution, it has serious disadvantages:

(a) the need for complex and controversial legislation for which no place has been found in the 1984-85 legislation programme;

(b) the addition of at least 200 more civil servants following the transfer of aid administration tasks to the Overseas Development Administration;

(c) the taking of the Crown Agents' procurement and related functions more closely into central Government by amalgamating these activities with those of Crown Suppliers, which is operated as a trading fund within the Department of the Environment. (The creation of a more overtly Governmental organisation for this purpose would be against the main stream of Government policy and might also discourage custom.)

4. The alternative proposals for reorganising the Crown Agents with a view to privatisation have been developed in the light of Morgan Grenfell's advice that there is a reasonable prospect of successful privatisation in the sense of establishing a majority holding by private investors in 1986 with eventual achievement of complete divestment depending on the strength which the private sector partners were able to contribute. Furthermore, Morgan Grenfell consider that the Crown Agents' short-term forecasts of income for 1984 are soundly based and achievable and that the longer-term (1985-86) forecasts have been prepared on a reasonable basis. The Foreign and Commonwealth Secretary favours this solution.



CONFIDENTIAL

5. Morgan Grenfell have, however, indicated in relation to the proposed privatisation that:

(a) the achievement of longer-term forecasts of costs would require a high degree of drive and determination from management and the continuing full support of the new Chairman. Present cost-cutting proposals are considered if anything to be insufficiently radical;

(b) a minority HMG shareholding would be necessary until the Crown Agents were sufficiently well established to cope with the adverse reaction which, in the Merchant Bankers' view, privatisation would be likely to provoke now from a number of customers. It was not possible for Morgan Grenfell to be specific about how long it would take HMG to divest itself entirely of its holding;

(c) the index-linked pension arrangements for Crown Agents staff would be a disadvantage but not an insuperable bar to privatisation and the adoption of a less rigid scheme would be desirable.

6. The figures in Annex C of the paper show that, if pensions remain funded, the differences between the three options of privatisation, reorganisation as a public corporation and breakup are small in public expenditure terms. For the reasons explained in paragraph 14 of the paper it has not been possible to produce an agreed comparison of costs on the alternative basis of HMG realising the Crown Agents pension investments, currently worth £70m., and meeting pension obligations on a pay-as-you-earn basis. Total closure would be more costly since it would involve a greater net write-off of Commencing Capital Debt and a short-term need for funds to finance redundancies, pending the sale of assets.



CONFIDENTIAL

7. The Chancellor of the Duchy of Lancaster is unable to attend because he is leading in a Debate in the House of Lords. The Secretary of State for Defence will be in Chesterfield at the time of the meeting and will be represented by the Minister of State for the Armed Forces (Mr Stanley). The Secretary of State for Trade and Industry has a prior engagement with a senior French Minister and will be represented by the Minister of State (Mr Lamont). The Secretary of State for the Environment, the Secretary of State for Scotland, who has an interest in some employees of the Crown Agents, the Minister of State, Privy Council Office and the Minister for Overseas Development have been invited to attend.

HANDLING

8. You will wish to invite the Foreign and Commonwealth Secretary to introduce the paper. You will also wish to invite the Chancellor of the Exchequer to comment. Issues which should be brought out in discussion are:

(a) Does the advice from Morgan Grenfell give adequate assurance that the privatisation proposals are viable? In particular, is there sufficient confidence in the new Chairman and the ability of his management team to produce the drive and determination needed to make a success of such a reorganisation in the longer term?

(b) Is there a real risk that the Crown Agents' performance will not be attractive enough to achieve a majority private shareholding by 1986 with the accompanying prospect that the case for closure might have to be reviewed again in 2-3 years' time when the proposed legislation would be particularly unattractive?

(c) How dependent is the viability of the scheme on the co-operation of the trade unions in facilitating the proposed move to Sutton and the changes of conditions of service involved?



CONFIDENTIAL

(d) Can a firm plan be developed now for privatisation with target dates being set for initial flotation and a full divestment of HMG's holding with clear financial targets for the Crown Agents to achieve?

CONCLUSION

9. Subject to the discussion you might guide the Committee to agree that:

(a) in accordance with the Foreign and Commonwealth Secretary's recommendation, a decision should be taken in favour of reorganising the Crown Agents on the lines proposed with a view to privatisation;

(b) the Foreign and Commonwealth Secretary and the Chancellor of the Exchequer should draw up a firm plan for privatisation, including target dates for initial flotation and eventual full divestment, with clear financial targets for the Crown Agents to achieve;

(c) in announcing this decision, Ministers should make it clear that the Board of Crown Agents accept that their long-term future depends on their ability to achieve financial success.

*David Goodall*

A D S Goodall

21 February 1984

CONFIDENTIAL

21 February 1984  
Policy Unit

PRIME MINISTER

CROWN AGENTS

The Foreign Secretary has set out two possible courses of action. His preferred course, to reorganise and to await privatisation, is more hazardous than his note implies, whilst the relative costs have been rigged unfairly in favour of holding on rather than breaking up the Crown Agents as it stands. This hinges on success being achieved where before we have witnessed failure: David Hobson and I are sceptical.

Break-Up

The paper alleges difficulties in pursuing this course. The legislation could be included in the 1984-85 Legislative Programme, which still contains a large number of marginal Bills. The recruitment of additional civil servants would be compensated for by a run-down in the staff at the Crown Agents who are currently entirely within the public sector. There would be more redundancies than with reorganisation, but this is merely a measure of the level of over-staffing in the organisation at the moment. The Crown Agents' presence abroad in a wide variety of functions is overstated: the bulk of their overseas work is procurement, as the numbers make clear.

The paper is less satisfactory when considering the future of each individual part of the Crown Agents' activities. We suggest the best treatment below:

1. Procurement. The best thing would be to leave this as a separate business in a limited company (Crown Agents Limited) under the ODA, not Crown Suppliers, with a view to potential privatisation in due course.
2. Inspection and quality assurance. This could be put with the procurement function.
3. Price certification. The potential contract should be grouped with procurement or handed to the private sector.
4. Supply advisory and supply-related training services. This to be grouped with procurement.

CONFIDENTIAL

5. Investment management. This work to be handled by the private sector.
6. Engineering and project management. This work to be handled by the private sector or closed down. It is currently unprofitable.
7. Security printing stamps and coins. This work to be handled by the private sector: De La Rue and Bradbury & Wilkinson are world leaders anyway in this field.
8. General payment services. This should be taken over by the ODA.
9. Pension payment services. This should also be taken over by the ODA, in view of the £750,000 saving they estimate they could make by handling it themselves.
10. Recruitment. This could be done by the private sector or the ODA.

#### Privatisation

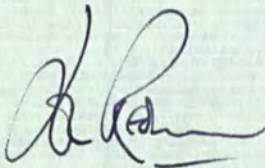
The Morgan Grenfell report is disappointing, and riddled with ifs and buts. Morgan's cannot guarantee the revenue forecast (even though it shows no growth) for the second and third years, which are the crucial years in the restoration of profit. Cost-cutting, as they suggest, is less vigorous than might be expected given the enormous cost base. The Brunei Contract shows just how vulnerable some of the business was, and there is nothing to prevent loss of further contracts occurring over the next 3 years. In a competitive international business like the Crown Agents, you have to pedal fast to stand still. Some of the possible benefits occurring in the P&L take place because they are predicting developments of new business activities which are uncertain and are forecast in ODA aid assisted territories. The report correctly illustrates the deficiencies of the current management, who have been responsible for many of the difficulties of recent years. They will have to recruit new managers to make any inroads into the cost problem, and for the aggressive new business drive which they do need if they are to succeed.

Morgan Grenfell undermine their own case by stressing that it would not be attractive to portfolio investors. This is code for saying that it may not be a free-standing competitive profitable business

in which people will naturally want to invest. Their idea of selling control of it in 2 years' time to a consortium of interested parties who are also involved in business with the Crown Agents in other ways, means that they are looking for people to buy the group who might buy it for other motives - perhaps to gain access to the word "crown" in the title. You should be suspicious of this approach. The whole Morgan Grenfell review reads like a paper assembled as a brief to privatise and salvage the whole, in which they themselves have little confidence or belief. The Government will remain on risk for a long time.

Conclusion

ODA should recommend early legislation to wind up the Crown Agents. The legislation should take the necessary powers for transfer of pensions and general payment services to the ODA and for the separate establishment of the procurement functions. These should be sold as soon as possible to private shareholders or allowed to wither away. The rest should be closed. The Crown Agents have gone on for too long whilst the empire has withered.



JOHN REDWOOD