MR BARCLAY

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ENERGY AND EXPENDITURE SAVINGS

In our note of 1 November to the Prime Minister, we drew attention to the scope for savings from BGC's working capital (forecast to increase by £900 million over the next 3 years) and capital expenditure running at around £1 billion per year. John Redwood suggested that we should amplify our concerns in this area.

Stemming from the major oil prices increase in the late 1970s, energy demand (including gas) has been depressed, whereas long-term supply arrangements have gone ahead. As for other fuels throughout the industrial world, UK gas supplies now exceed market requirements. Recent studies demonstrate that BGC will have a surplus of supply capacity - both average and peak - at least for the remainder of the 1980s. This has a cost, including the need for additional working capital. For example, BGC is likely to have to pay for £200 million more gas over the next 3 years than it can sell.

In our view, BGC are not confronting this situation with the right priorities. Instead of vigorously tackling the problem with a view of containing the increase of working capital and the cost of their operations, they are trying to dispose of their surplus supply capacity into additional low-grade industrial outlets; not usually, as it happens, displacing coal but heavy fuel oil. This represents the uneconomic use of a premium fuel. Why not negotiate with the producers for some relaxation of the take-or-pay provisions, using as a counter, a favourable price for incremental supplies when needed? Better save the gas for premium markets than squander it now in low-grade outlets only to be replaced later with very expensive Sleipner gas.

On capital expenditure, we would firstly question how much of it is justified by normal commercial criteria. The indications are that in testing the commercial benefit of capital expenditure proposals, BGC are less rigorous than the private sector. This reflects their inclination to place more emphasis on expanding markets than on making a commercial return on the assets. Secondly, we note that the Deloitte Haskins and Sells Report criticised the project management planning and control of the major Rough Storage and Morecambe Bay development projects. These were big prestigious projects tackled by dedicated teams. No doubt the scope for improvement is at least as great for the bulk of small capital projects.

JW

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