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Interesting

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GEC AND THE SUBSIDY MACHINE

GEC has lost its way and has become an arm of the UK public sector. For years it has under-invested and become too dependent on public sector markets. It is sitting on a £1.6 billion cash mountain, but has few ideas about how to spend it. Its purchase of its own shares is an admission of failure.

Turnover

GEC's largest, and most profitable, markets are in the public sector. Through its Marconi subsidiary, GEC is MoD's largest supplier, involved in every major programme. Its defence sales will be around £1,200 million in 1984-85, compared to Plessey (£510 million), Racal (£340 million), Ferranti (£220 million) and United Scientific (£140 million). GEC's order book with MoD stands at £2 billion. Defence has been GEC's fastest growing business. GEC's sales pattern overall is set out below.

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Table 1: GEC's Activities, 1984

Activity	Worldwide Turnover (£m)	Profits as % of Turnover (%)
Electronic Systems (Mostly Defence)	1580	12.7
Telecoms (Mostly BT)	735	12.8
Automation	450	11.7
Medical Equipment	435	5.6
Power Generation (CEGB)	620	8.4
Electrical Equipment (BR/CEGB)	755	6.6
Consumer Products	280	8.4
Distribution and Trading	200	7.2
	5050	10.1

Source: Company Accounts

Before it acquired GEC and AEI in the 1960s, GEC was primarily a consumer product company. The table above shows the extent to which GEC has withdrawn from competitive, private sector markets (consumer products and distribution), which together account for less than 10% of turnover, and positioned itself in the predominantly public sector capital equipment markets. GEC's sales to the public sector (defence, BT, local authorities, CEGB, British Rail) probably accounted for three-quarters of UK turnover last year, and over one-third of GEC's total turnover worldwide. These sales yielded comfortable profit margins, of around 10%.

But what has been good for GEC has not always been good for Britain. Two of GEC's major MoD projects have been disasters - the AEW Nimrod and the Tiger Fish Torpedo. A recent Panorama programme revealed that Britain's airborne early-warning system is "already 3 years late; it will cost £1,000 million and still doesn't work properly". The Shackleton, which currently performs the task, has already achieved a unique distinction - the first operational RAF plane to be in a museum. Nimrod was commissioned in 1977 on a cost-plus basis, so the overruns merely add to GEC's profits. GEC's Tiger Fish Torpedo entered service in 1980 but has proved inadequate (this may explain why Conqueror used a pre-War vintage Torpedo to sink the Belgrano). The Tiger Fish programme cost £250 million; another £170 million may be needed to make the Torpedo work.

Under-investment?

Compared to its competitors, GEC is investing little in new equipment and products. Only 21% of its cashflow (or £225 million) was invested last year. Whereas 39% (or £420 million) was added to its bank balances.

The pattern was the same in 1983. As in previous years, GEC has difficulty in investing its cash surpluses. In relation to its profits, GEC has been investing at less than half the rate of Plessey and Racal.

This approach is not new; it is entirely consistent with the history of the group. GEC was a product of an IRC merger between GEC, English Electric and AEI. English Electric had the technology, AEI the manufacturing capability. GEC had underfunded R&D, and had the necessary cash, the stock market rating and the aggression to make the acquisition. GEC itself brought little to the group, other than financial discipline. The only apparent business strategy was to milk established markets, preferably in the public sector, rather than develop new ones.

GEC closed down one of Britain's earliest micro-curcuit design teams in 1971 and recently pulled out of robotics. Profitability has been achieved partly by under-funding investment. The results of this policy are beginning to show through. GEC is increasingly uncompetitive, losing out to Plessey in defence and telecoms contracts. The recent success of GEC Avionics with the MoD contract for a remotely-piloted vehicle was its first victory over Ferranti for some time.

The Subsidy Machine

GEC has shown great skill in manipulating Whitehall. It is a regular visitor to the DTI cash dispenser. Leaving aside regional grants, which are automatic, GEC has secured offers totalling around £80 million in the last 5 years from DTI's discretionary support schemes. Around £20 million is likely to be paid over to GEC in both 1985 and 1986 - sums equivalent to around 10% of GEC's investment. Since GEC is sitting on a £1.6 billion cash mountain, it seems odd that GEC can get away with the argument that, without DTI support, GEC would not support "sound" investment projects. GEC is in effect saying to DTI: I won't invest unless you pay me to do it. We need to call GEC's bluff.

GEC is also well supported by fixed rate export credit. At July 1983, loans of £1.5 billion of fixed rate credit support were outstanding on support for GEC exports under the fixed rate credit scheme. This support amounts to a subsidy of 10-15%. GEC's share of the UK total (11%) was the largest of any company. The recent Guangdong power station negotiations revealed, among other things, GEC's presumptuous attitude to this support. When asked to share some of the profits which may materialise from this project with the taxpayer who is subsidising one quarter of the cost of the bid, GEC protested that this was "an unwarranted interference with commercial decisions".

Conclusions

GEC's approach reflects many of the ills of the modern, Government-dominated economy. It is easier to make money by influencing Government, both as buyer, supplier of credit, and supply of subsidy, than by fighting for new markets. GEC has developed its own form of "churning" - lending to Government the profits from Government contracts.

What can be done?

1. Encourage MoD to abandon cost-plus contracts (it is moving away from them) and to renegotiate existing ones which have overrun, eg AEW Nimrod.

2. Encourage DTI to end discretionary grants to large companies with adequate financial resources. Norman Tebbit will be writing to you shortly about his review of support for industrial R&D. This is an opportunity to make a start on ending grants to large grant-takers.

3. Tighten up on soft export credit.

4. Use competition policy to prevent GEC from acquiring major competitors and customers eg BAe.

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