

PRIME MINISTER

15 May 1985

REVIEW OF BR'S PERFORMANCE AND 1984 CORPORATE PLAN

On the basis of heroic assumptions, BR's 1984 Corporate Plan foresaw that the target 20% real terms reduction of the Public Service Obligation (PSO) grant would just be achieved by 1986/7. The return to profitability of the Inter City sector (target 1988/9) and the Freight Sector (target 1988) were in sight, but delayed a year or two. This year's Corporate Plan is currently under preparation, presumably still based on optimistic assumptions. Even so, Bob Reid is more than £60 million short of getting the PSO grant down to £710 million by 1986/7. His managers have been told to go back and look for more savings, whilst BR's commitment to the target has been re-affirmed.

Are Bob Reid and Nicholas Ridley whistling in the dark?

The 1984 Corporate Plan projected:

1. a 5% increase of passenger-miles (9% Inter City, 3% London and SE, 7% Provincial) over 5 years;
2. average unit receipts constant in real terms;
3. reduction of loaded train miles by 3-4% over 5 years.

This would be better than the long-term trend of a constant volume of business, constant real receipts and rising real costs.

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Moreover, the competitive outlook for BR is not promising. The number of cars in use is expected to increase by as much as 40% over the next 15 years. From 1950 to the early 1980s, the share of freight traffic taken by road increased from 40% to 85% and continues to rise, stimulated by the steady improvement of our network of trunk roads, the growing containerised and roll-on-roll-off lorry trade with Europe, and not least the recent coal dispute.

Express coaches have leapt in popularity since being deregulated in the 1980 Transport Act. National Express, for example, have gained over 40% more passengers, following a trend of steady decline prior to 1980. The average cost per seat mile by express coach is about half that by rail - and today's coaches offer video, toilet, refreshments and a hostess service. Coaches are even making inroads into BR's most robust market, London commuter services. At the top end of the Inter City market, BR is additionally exposed to competition from deregulated domestic air services; Department of Transport expect these to capture roughly 100% more business over the next 15 years.

Whereas BR's 1984 Corporate Plan projects a 4-5% real increase of income over 5 years, the competitive environment is such that BR will be doing extremely well to maintain the long-term trend of constant real income. Hence, the only scope for reducing the PSO Grant lies in tackling the cost side of the equation. This is dominated by the £1.3 billion paybill (excluding BREL) - 5 times this year's level of

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capital expenditure. BR is so manpower-intensive that staff costs account for well over 50% of the total, including depreciation. Small wonder that so much emphasis has been placed on industrial relations, increased productivity and manpower reduction - so far with limited success.

Nicholas Ridley refers to Bob Reid's adroit handling of this year's pay negotiations (4.85%) and speaks hopefully of the decision to decouple productivity initiatives, pursued mainly at local level, from the annual wage round. Can this achieve substantially more than was foreseen in the 1984 Corporate Plan?

Despite low increases of basic pay scales, average staff earnings have increased by 14% in real terms over 1979-84, compared with the national average of 12.3%. In shedding staff, and introducing productivity initiatives, BR have moved towards a richer mixture of staff, paid them for working more efficiently, reduced the standard working week and increased the annual leave entitlement. BR see this trend continuing in line with the national average - so that the planned 8% further reduction of staff would do no more than offset the real increase of average earnings over 5 years!

The E(NI) Meeting

1. We suggest that you major on paybill, productivity and the scope for manpower reductions. We need more than the 8% in 5 years which forms the basis of the 1984 Corporate

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Plan. Many in BR would regard that target as boldly optimistic. But they are long-serving railmen who have grown up with the rigidities and inefficiencies of established custom and practice, and who have few, if any, external benchmarks of performance. They need to be challenged to break out of that mould.

The coal dispute starkly exposed the inefficiency of BR's 12,000 waggons normally delivering 60 million tonnes of coal pa to power stations under the merry-go-round (MGR) system. When it was introduced 20 years ago, this system was regarded as a breakthrough in productivity. Yet we now learn (CEGB writing in Railway Gazette), that BR's MGR waggons average only 3 trips a week, whereas tipper lorries make 3 trips a day. On the face of it, a fleet of 40 lorries is no match in cost-effectiveness for 1 locomotive and 30 waggons of equivalent capacity. The rub is that the lorries have 5 times the productivity for a tenth of the capital outlay. Not surprisingly, the CEGB are looking with fresh eyes at their contract with BR.

A similar pointer is provided by James Sherwood, the new owner of Sealink. He is hoping to operate ferries on the short Channel crossing with 3 crews instead of 5. You might ask Nicholas Ridley why BR's remaining productivity aims are centred around operational train crews, when such staff account for less than a quarter of the total.

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2. BR's Provincial Sector - its equivalent of uneconomic pits - is perhaps the next most important topic for discussion. BR anticipate having to reduce fares in real terms, yet already costs exceed revenue by 4 times, and cumulative losses of some £1.8 billion are foreseen over the next 4 years.

The last Manifesto rightly precluded a substantial closure programme and has laid to rest for the time being the spectre of a Beeching axe. Nonetheless, big savings can be achieved on the margin. For example, Serpell estimated savings approaching £200 million pa through a marginal 4% reduction of passenger miles in the Provincial network. Now we are much closer to having a credible, low-cost alternative in the form of deregulated buses, coaches (already a great success), or licensed taxis.

What is happening about sensitive closures of the worst lines and bus substitution? BR should see bus substitution as an opportunity as well as a threat.

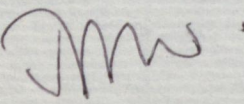
3. BR see limited scope for further achievement in disposing of property or generating non-rail income from their operational assets. As with productivity and the further scope for manpower reductions, they are probably conditioned by a narrow, pessimistic view of the rewards for imagination and initiative. The MMC report underlines this. BR should be urged to draw on private-

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sector expertise and ideas in return for a share in the
proceeds from property development; franchising and new
business development.

4. Even some favourable recasting of the figures for Inter City cannot conceal the softness of a market where income growth relies on traffic growth in an increasingly competitive business environment. BR's newfound emphasis on consumer-orientated marketing will have to be pushed harder. Further cost reductions cannot be shirked.
5. Nicholas Ridley will not want to be drawn into discussing BREL's future, until Bob Reid has reported and specific proposals prepared for consideration by colleagues. You could remind Nicholas Ridley of the Government's enthusiasm for privatisation as a means of releasing BREL's 24,000 staff into the private sector, simplifying the management of BR, and encouraging BREL to develop new business opportunities.
6. You might like to conclude by reinforcing Nicholas Ridley's intention not to relax BR's current objectives. If that discipline is not maintained, the taxpayer will end up footing the bill for the Government's achievements in improving roads, and liberalising buses, coaches and domestic air services.


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