

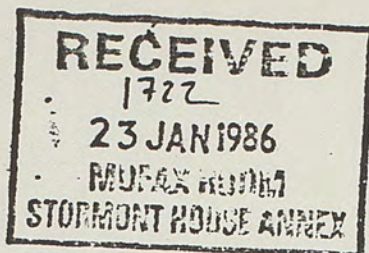
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cc PS/Dr Boyson (L&B) M  
 PS/PUS (L&B) M 24  
 PS/Mr Bloomfield M  
 Dr Quigley DFP M  
 Mr Fell DED M  
 Mr Brennan  
 Mr Drummond DED M  
 Mr Semple DFP M  
 Mr Chesterton  
 Mr Watkins DED M

H&W: CORPORATE PLAN AND 1986-87 FUNDING

- 1 Mr Fell's submission of 19 November 1985 set out a number of options for the way forward which were discussed by the Secretary of State, Dr Boyson and DED/DFP officials on 8 January.
- 2 I now attach a draft memorandum for the Secretary of State to place before his E(NI) colleagues as soon as can be arranged with the E(NI) Secretariat (but see para 6 below). This is on the lines discussed with the Secretary of State and has been agreed by NIO, DED and DFP officials.
- 3 The Secretary of State's memorandum will be supported by Notes by Officials analysing H&W's corporate plan and the small yard strategy. As the main Note is on a word processor in Belfast, DED will provide you with copies for the weekend box. Since these documents are fairly lengthy, I suggest that they should not be issued as formal E(NI) papers; instead, DED will provide you with a draft covering letter from you to PS/Prime Minister which should issue with both Notes when the memorandum itself is released to the Cabinet Office.
- 4 The main points of the Secretary of State's memorandum are:
  - brief description of the corporate plan, highlighting its undeniable weaknesses;
  - review of options discussed in Mr Fell's submission;
  - adoption of a new financial control regime;

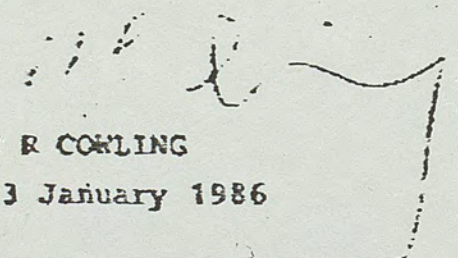


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recommendations for a 1986-87 EFL. For reasons made clear in the papers, Treasury Ministers may seek to impose cuts of some £3M, but those should be resisted. Likewise, colleagues may express concern at the range of EFL's forecast for 1987-88 (on realistic scenarios £43.5 - £49.6M). In response the Secretary of State should undertake to keep the squeeze on costs, in particular through an overheads reduction exercise to be undertaken by consultants.

5 Detailed briefing for the E(NI) discussion is being prepared.

6 The Secretary of State wishes to meet Mr Parker before the E(NI) meeting. I suggest that you should now make arrangements for the discussion: DED will provide a brief once the meeting with Mr Parker has been arranged.



R R COWLING

23 January 1986



DRAFT - 22/1/86

HARLAND AND WOLFF PLC

MEMORANDUM BY THE SECRETARY OF STATE FOR NORTHERN IRELAND

Introduction

1. I wish to seek colleagues' endorsement of my approach to Harland and Wolff PLC (H&W)'s 1985 Corporate Plan Update and Government subsidy for 1986/87.

Background

2. When E(NI) approved 1985/86 funding for H&W during July, colleagues agreed with my predecessor's proposal to insist on the preparation of a revised corporate plan on a more realistic basis and showing sound prospects for declining EFLs (taking account of repayment of certain sums which we directed the company to use from shipowners' advance deposits). We also agreed that when the new plan was presented to us we would consider an analysis of the option of significantly reducing EPL requirements by substantially reducing the size and capacity of the yard. We agreed further that officials should attempt to develop a revised financial control régime for the company. Finally we also insisted that H&W's bids for MOD orders should be unsubsidised and include a profit margin.

Key Parameters and Objectives

3. Before proceeding to the detailed proposals it would be helpful to identify the key parameters and Government objectives in relation to H&W. We all recognise that on straight economic grounds the yard would have ceased trading many years ago without substantial and continuing support from public funds.



The market outlook offers no prospect of return to profitability in the foreseeable future. However given the traditionally high levels of unemployment in Northern Ireland and the symbolic importance of the yard, none of my predecessors has felt able to precipitate the yard's closure; in the current political climate I must absolutely rule it out. In view of the growing pressures on the Northern Ireland Block I have the greatest possible incentive to limit the burden which H&W places on the Block. I therefore need more effective and credible controls than the current system based largely on the EPL. At the same time I wish to render the H&W Board and workforce more accountable and more responsible for the future performance and direction of the yard. Whilst easily stated these key points necessarily involve a continuing balancing act.

#### Corporate Plan Update

4. A full analysis of the Plan is at paragraphs 8-29 of the Note by Officials circulated with my Private Secretary's letter of 1            1. The most important aspects of the Plan are:-

- (i) its recognition that levels of capacity must be determined by availability of financial resources, and not vice-versa as has too often been the company's approach;
- (iii) the Plan puts forward 12 possible scenarios, each of which is designed broadly to keep the company within Government support levels of £36.5m, £34m and £29.5m in 1986/87 to 1988/89, and which are triggered by success/failure in obtaining certain critical new



contracts. Only the intermediate or pessimistic scenarios (identified in the Note by Officials) can be regarded as likely to materialise;

(iii) while the forecasts for Government support levels might show an acceptable trend when account is taken of the early draw-down of £5m from deposits at our discretion last summer, they need to be supplemented by (a) bank borrowing of up to £9m for trading purposes in the first two years to be repaid in the third year of the plan when there must be doubt about ability to repay, since a very substantial item (£7.5m) is payable only on successful and timely completion of the BP SWOPS contract; and (b) additional funds over 1986/87 and 1987/88 ranging in estimate from £3m to £13m to cover rationalisation and redundancy costs which might arise on the intermediate and pessimistic scenarios;

(iv) in the most credible scenarios gaps of 1-2 years arise in workload beginning early in 1987. The yard is currently engaged in serious negotiations with two shipowners and it is highly desirable that a merchant order emerges from these early this year. This will be necessary as a means of bridging the 1987 workload gap, even if H&W's bid to the MOD for the first two AOR orders is success-



ful. The Plan's thrust is nonetheless to move away from merchant-building and place more emphasis on quasi-naval and offshore work; colleagues will in particular wish to note the importance of the AOR orders to H&W (although they would not significantly affect H&W's financings until 1988/89);

(v) the Plan assumes on-schedule deliveries of orders within budgeted cost; the financial forecasts must therefore be regarded as tending towards optimism even though there are grounds for believing that productivity is improving in line with the Plan's aims; and

(vi) the Plan is unconvincing on how B&W's Engineering Division could break-even (as we have stipulated for both H&W and BS's engineering activities) and suggests that it could be hived off as a separate company and eventually privatised.

5. While the Plan illustrates that the company has made progress in a number of important areas and is adopting a vigorous approach to secure significant improvements in performance, I nevertheless have to say that I cannot endorse the Plan without qualification. I have therefore considered a number of options.

#### Options

6. Closure: In 1983 we considered a study of the costs and



economic implications of closing the yard. My officials have recently updated the study and have come to conclusions similar to those reached in 1983: that although continued support is more expensive in the long run and the national economy could fairly quickly absorb the job losses, adjustment within Northern Ireland would be much slower with little possibility of early replacement of the jobs lost (both direct and indirect). For the reasons given in paragraph 3, closure must be ruled out.

7. Small Yard Strategy: In 1984 H&W undertook, albeit reluctantly, a study to investigate whether significant savings could be obtained through a radical reduction in manpower and physical facilities. A synopsis of this study, which concludes that such an option would not yield major savings, was also circulated by my Private Secretary. Even if I were wholly to reject the study's conclusions, the current political and economic situation would provide quite the wrong climate for me to instruct the Board against its will to shed up to 2000 jobs. But, as colleagues will see, the option which I favour may well have a similar effect - but achieved by Board decision rather than by Government direction.

8. Endorse Plan and impose additional financial control system, etc

Our experience with attempts to control H&W through EFLs has been similar to that with British Shipbuilders: because of the nature of the industry, short-term decisions on EFLs are confronted with virtual faits accomplis arising from inescapable contract losses and the long lead-times for capacity reductions. As with BS we need a system, to supplement the EFL, which links losses with capacity reductions. Appendix 7 to the Note by



Officials outlines a proposed new financial control and contract approval system for H&W (the contract support limit (CSL)) to act in tandem with the EPL discipline. This has similar constraints to the system recently introduced for BS but is adjusted largely to suit the single yard status of H&W. The main effect would be that, as with BS, H&W itself would within defined limits decide on the level of subsidy for potential new orders. This degree of freedom however would be matched by the necessity for the company to do everything it can to minimise losses not forecast at time of taking contracts in order to permit sufficient subsidy for future orders. If the company fails in this, the EPL control will force contraction upon it. Since the operation of the system lies with the Board's control, it is the company rather than the Government which would be seen to be taking key decisions relating to the success and size of the yard. I believe that this is right in principle as well as preferable by far to direction of the Board against its will at the current stage of political development in Northern Ireland.

9. I am attracted to the CSL system as a means of demonstrating our resolve to see a turn-round in the yard's performance and of removing at least some of the Board's insulation against market pressure in formulating its decisions. Armed with the system I think that we can endorse the company's Plan. We should therefore notify provisional/CSL amounts of £14m and £13m for 1986/87 and 1987/88. These are subject to variation however in the light of order intake in early-1986 and my and Treasury officials should be instructed to make any necessary adjustments in the light of the position in March 1986.



10. We should also, I believe, seek a clear way forward for the Engineering Division. We have set break-even targets for it and Clark Kincaid; H&W will be fortunate to achieve this by 1988/89. I do not think that there is an equitable case for closure at present. But building on the Board's own suggestion, I propose that we should ask the company (a) to establish break-even by 1988/89 at the latest as the Division's overriding operational objective; (b) to appoint merchant bankers or accountants now to assess the prospects for complete disposal to a third party; and (c) to plan for closure if by March 1987 neither break-even by 1988/89 or disposal looks realistic. Again the future of the Division would be put more clearly in the hands of the Board.

11. I also support officials' recommendation that the company should appoint consultants to examine the scope for further overhead savings. A similar exercise achieved major savings in 1982; it is time for a repeat exercise. I shall also be examining the scope for further improvements in working practices.

1986/87 EFL

12. The most realistic scenarios foresee a total cash requirement (covering Intervention payments, Government loans and bank borrowings) of some £38.5m in 1986/87. In nominal terms, this may not appear to square with the policy of declining EFLs, although it does so - as stipulated by my predecessor in his letter of 2 August to the then Chief Secretary - if account is taken of early use of deposits, at our instruction, in 1985/86. Of course I am disappointed that the EFL for 1986/87 cannot be lower but I believe that, since the yard is all but fully committed for 1986/87, the only sensible response is the introduction of the CSL system I have described. Savings of



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£3M would be required to bring the 1986/87 below that for 1985/86, and I have examined how such savings could be achieved: a cut of £1M in capital expenditure would stop all but the lowest maintenance level when our aim is to boost productivity inter alia through capital investment; and the saving of £2M through a wages freeze is something I am not prepared to impose - we will of course be seeking a low settlement but a freeze at our direction would almost certainly be counterproductive both in company terms and in wider political terms. I must advise strongly against imposing these reductions. Instead, I recommend that we set an EFL of £38.5M, consisting of £37M in direct support from DED and £1.5M in bank borrowings. £2.3M of this should be ring-fenced for capital expenditure in order to boost productivity.

13. I am concerned too at the range of forecasts for 1987-88 (Appendix 6 of the Official note). I shall be telling the company to plan as many savings as possible; the overheads reduction exercise should also contribute.

#### Product Strategy

14. H&W's lesser emphasis on merchant building is doubtless right, given the depressed state of the merchant market: and we have insisted on fair competition for MOD orders. H&W's plan to enter the offshore market in a gradualist manner is sensible in principle and I do not wish to block it as a possible way of reducing EFLs. But their assessment that initial prices will be less than cost - even though this is common for new entrants to business - is worrying because of its effects on private-sector competitors. I suggest that we should seek a full market analysis from H&W and tell them that in the meantime they should not take orders over £0.5M without referral to my Department; I would put before colleagues orders over £5M which arise before the offshore market plan has been endorsed. But we should in any event insist that any cost/price gap be funded from the CSL as an effective discipline on the company.



Recommendations

15. I recommend as follows:-

- (1) we put in place an adjusted CSL system, as described by officials, to complement the EFL discipline on the company; and that provisional amounts of £14m and £13m be notified to the company, subject to ratification by officials in March 1986 in the light of order intake by that time;
- (2) we set an EFL of £38.5m, consisting of £37m in direct DED support, £1.5m in bank borrowings, if advantageous under Government guarantee;
- (3) within this EFL, £2.3m be ring-fenced for capital expenditure alone;
- (4) the company be instructed to prepare a full analysis of offshore market prospects; any orders in the meantime should be handled on the basis described above;
- (5) the company be instructed to plan for its Engineering Division as described above;
- (6) the company retain consultants to examine the scope for further overhead savings.