THESIS

VICTOR EWART SHUTE

B.Sc., M.Sc., C.Eng., F.I.Prod.E., F.I.W.M., M.B.I.M.

PUBLIC OWNERSHIP AND CONTROL IN THE PRIVATE SECTOR

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SUMMARY

PUBLIC OWNERSHIP AND CONTROL IN THE PRIVATE SECTOR

VICTOR EWART SHUTE Ph.D. 1978-79

The thesis objectives were (a) to investigate and adduce the possible effects of contemporary public policies and instruments of intervention on management in private sector manufacturing industries and (b) to investigate the methodologies of corporate asset valuation with particular reference to expropriation of private sector corporate assets by the State and the bases of compensatory settlements.

Research methods and practice included the study of contemporary primary sources such as public policy indicators, current legislation and associated reports, statements, publications and statistical data; a statistical analysis of private sector takeovers; a survey of professional institutions in the fields of corporate valuation and transfer; study of cases of public sector acquisition with specific regard to the bases of expropriation; examination of the management connotations of public intervention policies and practice and a corporate analysis of a State acquisition.

Chapter 1 was concerned with statements of objectives, boundaries and scope of the thesis. Chapters 2 and 3 were designed to provide supportive economic and political studies to give perspective to the formative analyses carried out in the remaining eight chapters. Chapters 4, 5, 6 and 7 contain the specific investigative and conclusory work relating to the first objective (a) and Chapters 8, 9, 10 and 11 that of the second objective (b): conclusions have been detailed and summarised in Chapters 7, 10 and 11.

Because of the nature of the research it is impracticable adequately to summarise here the two main bodies of conclusions in their entirety. With regard to private sector management, it is concluded that fundamental changes in the structures and practice of management are likely to ensue as a consequence of current developments in public ownership and control and that these changes could be both favourable and adverse. The principal conclusions relating to the second objective are that the method of valuation based on stock market capitalisation is potentially inequitable to vendors because the property value of control is not adequately recognised; and that the unilateral fixing of an arbitrary datum period for the purpose of valuation by the State also constitutes a potentially inequitable practice in terms of the interests of vendor and/or purchaser.

STATE INTERVENTION - CONTROL - ACQUISITION - MANAGEMENT

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CONTENTS

Page

Page

LIST OF FIGURES AND TABLES

Page

CHAPTER 1

> Without principles one is in darkness and chaos;.....
> The principle is the lighthouse fixing the bearings but it can only serve those who already know the way into port.
>
> Henri Fayol : 1841 - 1925

OBJECTIVES AND BOUNDARIES

1. Introduction and Aims

State intervention has political, economic, legal, social and ethical significance but, fundamentally, it is based on the structures and applications of power. Power is based on the will and the ability to change the course of events and on the control of resources necessary to effect changes. For these reasons, the objectives of this research are to examine some aspects of the loci and machinery of power by

(a) an investigation and analysis of contemporary legislation, primary sources of information and associated contiguous data relating to public ownership and control in the private company sector, with particular reference to public policies affecting management in manufacturing industry.

(b) an investigation of corporate asset valuation methodology in the private and public sectors, relating to expropriation of private corporate assets by the State.

2. Scope and Range of Investigation

It is intended that the following studies should help to amplify existing knowledge of the factors of change in this controversial area and to provide further support for research in this field. An historical survey and study of nationalisation, per se, is excluded since the focus is on contemporary innovatory developments dating from the issue of the White Paper,[1] 'Industrial Reorganisation Corporation' in January, 1966,[1] which signalled the commencement of a new phase of intervention by the State. In terms of power, this question was settled in the cases of the nationalised industries on their respective vesting days, when decision-making power passed from their previous owners and managers to the State. Consequently, no attempt is to be made here at increasing the considerable amount of research on the founding and operations of the public sector industries.

Clearly, public policy has undergone significant changes since 1966 so far as industry in the private sector is concerned.[2] Different ways and means of achieving public ownership of and control in industry are being evolved, and the contemporary policy statements, Parliamentary papers, Bills and enactments associated with these changes reflect the influences of political and economic pressure groups. If it is accepted that the form of enactments and the powers inherent in legislation are, in effect, a record of compromise and consensual agreement at points in time, then analyses of such data should be constructive and productive of valid conclusions within the bounds of the above objectives.

The range of investigation extends from an examination of the White Paper of January, 1966, to the Industry Act, 1975, and the research includes such associated data as is germane to the main issues.

Questions of valuation of assets, in connection with acquisitions by the State in the private industrial sector, are of relevance in terms of equitable compensation to owners and shareholders particularly in view of the contentious bases of valuation which have given rise to adverse comment.[3.4.] Therefore the latter part of this work comprises a study of factors of valuation with particular reference to material differences in the private and public sector approaches.

Although an economic treatment has not been attempted, it was thought necessary to review some economic arguments for and against intervention by the State, in Chapter 2, so as to put the remaining work in perspective and, for the same reason, a survey of current political attitudes has been researched in Chapter 3.

3. The Areas of Investigation and Research

It is necessary also to delineate the area in which public ownership and control in the private sector was to be considered. The present work is concerned with the machinery, philosophies and ideologies of state intervention by contemporary means rather than with nationalisation per se; with proposed methods of exercising state control at the company level by means of the National Enterprise Board, Planning Agreements, the furtherance of Industrial Democracy and corporate information disclosures; with valuation criteria of corporate asset transfers from the private sector to public ownership.

The more general methods of control by central government agencies, such as legal regulation, fiscal and economic controls, grants, allowances, subsidies, State purchasing power, preferential treatment, state monopolistic and monopsonistic powers, prices and incomes policies, favourable loan treatments, investments policies and the like are only to be considered where they may be peripheral to the main research areas as outlined above.

In choosing to site the studies on currently developing events there is an obvious difficulty associated with the inevitable lack of published work of other researchers. Consequently, it has been found necessary to rely largely on current primary sources for much of the research material.

The inception of the National Enterprise Board has given rise to heated controversy. Analogies between this body's structure and that of its precursor, the former Industrial Reorganisation Corporation (I.R.C.) may be relevant if the former's activities lead it into the kind of controversial operation which marked the latter's entry to the private takeover arena.[5]

Planning Agreements, as proposed in the White Paper[6], have also given rise to dissent from representative bodies[7] and they have been a focus of resistance during Parliamentary proceedings on the Industry Bill[8]. These, and similar events, indicate the areas where political and economic influences invite analysis, a task which is attempted in the following studies of the relevant policy statements and legislation.

The growth of the concept of Industrial Democracy and the varied forms of its potential development, in terms of workers' co-operatives; worker directors; planning agreements with union participation; declared State policies for the National Enterprise Board[9]; joint management committees[10]; two-tier boards etc., also mark fundamental changes in traditional power structures in the U.K. private sector of industry.

A number of areas of contention is also indicated in the political and ideological struggles over the proposed extensions of public ownership and control, and the identification of these significant differences is among the aims of this work.

4. An Initial Basic Hypothesis

It is shown in Chapter 3 that both of the major political parties subscribe to the concept of a mixed economy in the United Kingdom. But the concept of a stable state mixed enterprise economy may not be tenable: a mixed economy may be a transitional stage between a developed capitalist system on the one hand and a state autocracy with full central direction and control on the other.

Taking a macro view for the purpose of the succeeding analyses, the mixed economy may be conceptualised as a bi-polar system in which the poles of power are represented by dissimilar structures of resource ownership, allocation and deployment. Namely, a structure comprising free market forces as one node and a structure comprising state regulation as the other.

One extreme of such a postulated spectrum would be a primitive society in which free consumption predominated, investment was virtually non-existent, the multi-lateral resource-allocative processes were at the level of the individual consumer/supplier, accumulated wealth was at a minimum, communal organisation was elementary, collectivism was absent and ownership of rudimentary economic resources was private.

The opposite extreme would be the converse, in that investment is significant vis-à-vis consumption, consumption is regulated, resource-allocative processes are centrally directed and controlled, accumulated wealth is maximal, communal organisation is complex, collectivism is total and ownership and control of economic resources is public.

The U.K. mixed economy can be considered to be located at a point on such a spectrum. Traverse along the spectrum, represented by successive stages of metamorphosis, could be a function of the balances of economic and political power. Observable states of transition would reflect the existence of velocity (denoting changes of state), acceleration (denoting the rate of change) and direction (indicating the polarity of metamorphosis).

Measurement of the velocity of change can be both quantitative and qualitative and may be expressed in relative terms on comparative bases with historical criteria. Rates of change may be similarly assessed; but since the direction of change is clearly a function, mainly, of political power, the construction of testable hypotheses becomes difficult in view of the conjectural nature of such assumptions as the political complexion, strength and probable terms of office of political entities in a democracy.

It would not be feasible to attempt a comprehensive study of all the perceived factors within the bounds, constraints and objectives of the present work. Consequently, the emphasis will be on the analysis of contemporaneous developments relating to the two objectives delineated in this chapter.

Chapters 2 and 3 contain outline studies of some economic and political aspects necessary to put the formative research of the thesis into perspective, with particular reference to the industrial wealth-producing sector of the U.K. economy.

CHAPTER 2

SOME ECONOMIC ASPECTS OF OWNERSHIP AND CONTROL

1. The Relevance of an Economic Survey

Economic power, represented by the ownership and control of resources in the private and public sectors, is a crucial factor in terms of equilibria or polarisations of forces in developing societal systems such as the U.K. mixed economy.

Comparative studies of economic power can be quantified in real terms by the physical measurement of resources owned and privately controlled by the wealth-producing sectors. But transfers of power from the private company sector to the public sector must be preceded not only by adequate political organisation and influence but also by a consensual climate of informed opinion that such changes are proper and based on acceptable premises of benefits to the community in the long run.

The formation of supportive climates of informed opinion depends on the gradual distillation of consensus arising from the evidence adduced by successive professional studies. Since economics is acknowledged to be an inexact science[1] it is evident that some qualitative factors are involved in arguments for and against increased ownership and control of resources by the public sector.

Consequently, it is thought to be necessary in this chapter to survey some aspects of economic theory and opinion so as to add perspective and supportive structure to the thesis. Unlike political power, which varies in intensity and direction by its nature, economic power - represented by the ownership and control of real resources - is relatively stable and certainly less reversible in the short term.

The following analyses and discussion in this chapter is an attempt to encapsulate the development of economic climates and criteria of judgement relating to the economic role of the State and to the compulsory transfer of corporate resources from private to public ownership and control.

Recognition of the difficulties inherent in relating economic studies to applications involving public policies and to producing mechanistic, quantitative prescriptions is clearly indicated by the following quotations.

> "Since the days of Adam Smith, when economics as a systematic discipline is said to have been born, economic theory has been used and misused as a guideline for public policies"2

This statement by an economist may be compared with that of another,[3]

> "The object of our analysis is not to provide a machine, or method of blind manipulation, which will furnish an infallible answer, but to provide ourselves with an organised and orderly method of thinking out particular problems;....."

Since the latter statement was published (1935) the tools available to economists for macro and micro economic analyses have become increasingly sophisticated, but the improvements in methodology have been accompanied by the growing complexity of highly developed societies. If one also considers the relative immaturity of behavioural sciences and the consequent imprecisions in explaining individual, group and societal reactions to environmental stimuli, it is not surprising that the ultimate economic models for perfect control of the economy have yet to be developed.

2. Economic and Political Relationships

Concurrence of authority for economic and political decision-making is symptomatic of the totalitarian state where the central government is not accountable to and replaceable by the people. Thus, the fact of public ownership and control, per se, may be considered as an economic argument in terms of public welfare only so long as the criteria of political accountability and replaceability remain valid in a democratic state.

Judgement of the economic efficiency of allocation of resources depends on the interpretation of 'efficiency'. If the maximisation of economic welfare is synonymous with that of social welfare then the problems are simplified. But social issues are increasingly being held to justify the economic misallocation of resources; for example, the maintenance of employment to produce goods that had no market.[4]

The difficulties of deriving universally acceptable quantitative values of social benefits are manifest since value judgements enter the calculations of such cost-benefit analyses. If social acceptability, political expediency and pressure group utility values, inter alia, are included in the decision-making processes leading to the allocation of resources by the State, then the resultant 'efficiency' of the outcome must be measured according to the criteria normative to the input influences. The need for such multi-faceted evaluation of results suggests that the facile tendency to blame 'economics' for the failures of public policy is, at best, inequitable and, at worst, malicious.

3. <u>Measurement of the Creation of Surplus Value</u>

A criterion of efficiency of the use of resources often used by economists[5] is the rate of return on capital, although problems of measurement are associated with this yardstick. One obvious advantage of such a measure is that, providing one can obtain a consensus on valuations of social issues, it is universally applicable. Even if social cost analyses results differ, it should still be possible to present a usable range of alternatives to guide choice in public policy.

However, a problem which may be thought to be intractable lies in the area of pricing policy. Rates of return on capital will clearly be affected by the criteria used in pricing output. Where public ownership is concerned, monopolistic power may offer a full range of policies; ranging from overt subsidisation on social grounds (e.g. redistribution of income policies) and consequent under-pricing, through to maximisation of rate of return on capital with what the market will bear in terms of over-pricing; particularly where price inelasticity is a marketing attribute of the output.

This suggests that evaluations of the efficiency of public ownership based purely on the rate of return on capital must be qualified in the light of political, social, legal, ethical, commercial and general public policy considerations associated with the economic decision-making relating to the allocation and deployment of resources.

A more subtle problem in using the rate of return on capital lies in measurements of productivity and, in a behavioural sense, motivation. Comparisons such as 'value added' may be made on an international basis where monopolistic outputs in public ownership are concerned, but the ethnic, cultural and social differences and the differing stages of technological development in terms of relative capital/labour intensity, may make the validity of such comparisons highly suspect.

The 'efficiency' of use of resources in the public sector may be questioned in view of the lack of commercial pressures to produce 'profits'. Other factors include the relative security of employment and promotional systems; the lack of the 'owner's eye'; the relative anonymity of bureaucratic structures and the strength of protection afforded by collective association in state-controlled organisations: also, not least, the relative transience of political policies and ideological influences and their effects on corporate policies in the long run.

4. The Economic Roles of the State

In reviewing general factors included in economic discussions about public ownership and control it may not be inappropriate to recall that central government was involved in economic activities (e.g. issue of currency and regulation of weights and measures) affecting society over a thousand years ago.[6] However, the rapidity of development of modern economic views on the role of the State may be indicated by the following statements:

> "The State feels it incumbent upon itself to intervene in trade and industry - its functions can no longer be summed up in the maintaining of law and order and in leaving the economic sphere alone. And, as if to emphasise the fact that in the matter of trade and industry we have consciously departed from laissez-faire, we have two new Government departments carrying out duties thought by the classic economists to be no part of government's province. These new Departments are the Ministry of Labour and National Service and the Ministry of Transport'. 7
>
> - "The argument on government ownership is based partly on political, social or ethical reasons and cannot be decided by economic theory, although economics can help to indicate the cost of alternative methods". 8 (1975)

Although a comparison of statements by different individuals at different times is not offered as evidential of general philosophies, the change in the economic ambience is noticeable.

As with other disciplines, economic theory is capable of supporting tendentious assertions if the researcher has strong a priori views or a partisan patron but even assuming no bias, professional interpretation of economic data can lead to the presentation of opposed conclusions.

Hence, one encounters economic research conclusions in favour of and against public ownership. An example is, on one hand, a claim that productivity in the nationalised industries has been increasing at a faster rate than that of the private sector[9], and, on the other hand, an assertion that the converse is the case.[10] The alternative conclusions stem from the differing treatment of fixed capital investment per unit of output and per unit of labour input and their effects on productivity.

The main reasons for government intervention in the private industrial sector have been well rehearsed by economists and the argument has become increasingly sophisticated and refined.[11] It would be inappropriate for the present author to attempt more than a general survey for the reason mentioned in Chapter 1.

Monopoly has been a central theme in these discussions. Meredith[12] discusses the parallel growth of scale and economic power leading to such monopolistic practices as uninhibited price regulation, the elimination of competition, restrictive control of output. He states[13],

> "The general course of economic history shows clearly that where economic conditions are such as to make it possible for individuals to manipulate production and sale arbitrarily to their own advantage, society re-acting to the attack develops institutions which purport to control and prevent these evils".

The record of legislation, culminating in the Fair Trading Act, 1973, marks the progress of public policy in control of monopolistic power in the private sector.

Allen surveys the development of public policy relating to monopoly[14] and maintains that a Monopolies Bill was drafted, although not proceeded with, in 1920. The works on monopolistic practices make it clear that, fundamentally, the question is one of use and misuse, even abuse of power.

Power founded on the untrammelled allocation and deployment of resources is beyond the control of individual consumers or consumer groups, however public-spirited.

Another important consideration is the economic concept of 'natural' monopoly, the case where competition would result in wasteful duplication and, thus, mis allocation of resources. More technically, the output which is characterised by economies of scale over a large range of outputs such that the long-run average cost declines up to the quantity which would be demanded by the entire available market; thus tending to establish a single producer when the production characteristics are coupled with restriction of entry to the industry owing to initial high average cost and/or prohibitive capital investment.

Superficial consideration of these economic relationships may lead to the conclusion that only accountable central government agencies should be entrusted with output of the goods or services constituting a 'natural' monopoly. In fact, alternatives have been proposed[15] which entail government intervention in the resource monopoly rather than in the firm which constitutes the operation of the monopoly, or the provision of capital by the State to new firms to overcome barriers to entry which tend to produce 'natural' monopolies.

5. Benefits and Penal ties of Externalities

External economies or diseconomies, generally known as 'externalities', give rise to further argument on government intervention. Brennan[16] differentiates between pecuniary and non-pecuniary externalities. An example of the former is the change in resource costs to an industry caused by output volume changes of particular producers; the entry of new producers; the exit of existing producers.

Examples of non-pecuniary externalities might be the intensification of road traffic in an area due to discontinuation of a railway freight-carrying facility, or the provision of alternative power services to a major producer, making possible the development of secondary industry. The Clean Air legislation has produced obvious externalities for which direct charges to all the beneficiaries are not possible for the firms having to bear the costs of re-equipping.

The diverse nature of externalities and the wide range and incidence of benefits to and penalties on individuals and differing sections of society make reasoned argument leading to prescriptive solutions very difficult. However, there seems to be acceptance in economic theory that externalities are, by their nature, outside the power of firms and thus incapable of regulation by them as corporate units. Alternative means of control in specific cases have been discussed by economists.[17]

Remedies have been proposed such as the creation of property rights and the auctioning of franchises; direct subsidies to equalise the private costs and benefits with optimal social requirements. The creation of charge systems for uncosted resource use which entails social penalties would be implementable, it is suggested, by the government in the indirect role of an agency of exchange rather than as a centrally-directing interventionist authority.

6. Redistributive Policies

Another factor exercising economists in the debate about public ownership and control is that of redistribution of income. This aspect is also heavily influenced by political and social overtones and the general arguments are not necessarily convergent to the economic criteria of judgement. Governments invariably implement policies that benefit the sectors of society which furnish and sustain their political power. The question of economic logic in the consequential re-allocation of resources is, ipso facto, secondary to political survival.

Questions of redistribution of income are not amenable to consideration only in purely economic terms for the debate inevitably returns to the questions of social choice. The demagogic appeal of the point that it is better that ten thousand consumers should be able to buy bread rather than that one consumer should buy a Rolls Royce depends on non-recognition of the possibility that the flow of resources released by the latter transaction might have enabled fifteen thousand to buy bread.

Where pricing policies are concerned, the social criteria may well lead to a rejection of economic marginal cost and revenue relationships by government policies overtly adopted as income discriminatory vehicles.

Bates and Parkinson discuss the complex relationships involved in the consideration of socio-economic factors and their effects on pricing policies in the public sector. They conclude that,

> "Price determination cannot be regarded independently of social and political objectives; for apart from being a device to promote the efficient use of resources, the pricing system determines the distribution of income and the economic (and sometimes)(sic) political power of individuals and corporations. It is not surprising that when such diverse considerations are brought into contact the economist cannot expect to have the last word and that one of the major issues of price policy - that of monopoly - should be a matter for the courts as much as for the economists." 19.

Consideration of redistribution of income policies is made even more difficult because of the ideological factors inherent in concepts of industrial democracy and profit-sharing. If policies are based on the politico-social/moralistic premise that labour is the sole fount of 'profit' and that distribution should be directed accordingly, then purely economic criteria become inapplicable - at least in the short term - and the argument migrates to more qualitative spheres.

Economic debates on public ownership and control in the 'national interest' or 'public interest' are generally sustainable only if qualitative social, ethical, moral and political issues are excluded. Since the argument becomes sterile without meaningful definitions of the national/public interest, around which the relevant evidence may be marshalled, this chapter is not the place to attempt a detailed analysis of this factor.

7. The Maintenance of Standards and Parities

Regulation or the 'maintenance of standards' constitutes a further field of economic debate in the public versus private sector arguments. Clearly, the aspects previously considered above may be included within these broad descriptions and the central points of significance are located within the powers to direct on the one hand and the motivations and objectives of the decision-makers on the other.

In discussion the competing claims of the maximisation of economic and social welfare, respectively, Brennan has pointed out that,

> "The consumer is the focal point of economic welfare theory. Since everyone (regardless of other functions performed) is a consumer, economic benefits flowing from policy actions are judged by their broadest social impact. If gains to all consumers as a group outweigh losses to any industry or other private interest, the losers can in principle be compensated for losses and a net gain prevails. Then the policy is judged to be sound. Logical and philosophical limitations of the theory prohibit iron-clad inferences, but the theory does contribute to enlightened policy formulation in areas where the economic effects are significant". 20

If gain to the consumer be taken as a fundamental criterion of the allocation and deployment of resources, it would appear that a common starting point exists to reconcile the views of the proponents of private enterprise and the agencies of market forces and the advocates for state regulation and the agencies of government planning and control. Unfortunately, this is not the case for in any system of scarce resources relative gains and losses between different classes of consumer may not be comparatively justifiable on purely economic grounds.

There are also debatable points in the resource allocation arguments arising in a mixed economy which is undergoing transition from a position of relatively unregulated private enterprise to an increasingly state-regulated and controlled society. For instance, if monopoly power is held to be undesirable in the hands of private enterprise but desirable when wielded by the State then the assumption that societal checks and constraints are ineffective to control the former sector suggests that such power might not be susceptible to control by the electorate when it is in the hands of central government. The inference is that a partisan government may abuse its monopoly power to promote sectional interests just as private entrepreneurs have been accused of doing in the past and present.[21]

Further, deliberate policy choices maximising social welfare at the expense of wasted resources must, in the long term, adversely affect all consumers whether or not they are the recipients of preferential benefits in the short term.

8. Pricing Policies and Market Distortions

Pricing systems, as determinants of consumer preference, demand and the consequent allocation of resources, may be regarded as unbiased economic indicators only in markets free from the inhibitions, restraints and choice influences imposed by central government in the furtherance of public policies. For this reason, the current economic controversies about the relative performance of state-controlled and private sector industries are, in the writer's opinion, merely polemic exercises. In the present climate of rigid controls by government, in both the private and public sectors, freedom of choice in the questions of margins, revenue distribution, retentions and, hence, investment is so severely curtailed as to make normal economic comparisons virtually meaningless.

A further complication is the recent and current coalescence of enterprises in the private corporate sector, tending toward the emergence and growth of multi-national companies and the relatively increased mobility of capital investment in overseas developments. Clearly, investment preferences stimulated by enhanced returns on capital projects overseas could lead to capital deprivation, even disinvestment, in the U.K., with a consequent lowering of performance of the private sector.

The inter-relationships between the private and public sectors in terms of exchanges of goods and services (and the related pricing distortions effected by public policies on the one hand and customer dependency, inter alia, on the other) are also affected by factors outside the bounds of economics and, thus, make comparisons difficult to sustain on equitable bases.

Consideration of the question of public ownership and control in the private sector must include factors other than those normal to economic debate. The writer has attempted to indicate the differing economic points of view in this chapter. Evidently, many of the points dealt with briefly require much more exhaustive treatment to do them justice. It is hoped that these peripheral studies will, at least, add to the perspective of the entire analysis.

9. Economic Aspects - Conclusions

Two conclusions may be drawn as a result of these observations. First, the development of an economic climate of opinion more favourable to the role of the State as an interventionist owner and controller of resources at one time thought to be the province solely of private enterprise. This qualitative transformation of attitudes over many years has created an environment in which the compulsory transfer of private sector economic resources to the State is regarded as a normal and unexceptionable occurrence.

Secondly, the growing complexity of modern society and the concomitant scale of resource allocation and deployment have resulted in economists' acquiescence, if not positive subscription, to the efficacy of central direction for reasons such as the control of monopoly power, the existence of 'natural' monopolies, the effective management of externalities, the need for redistributive policies, equitable pricing policies and, inter alia, the maintenance of standards and parities.

These economic factors relate generally to the questions of efficiency of resource allocation. It is necessary, for the purpose of this work, also to consider the related but differing political aspects and this has been attempted in the following chapter (3).

CHAPTER 3

SOME POLITICAL ASPECTS OF OWNERSHIP AND CONTROL

1. The Relevance of a Political Survey

Public ownership and control in the private sector is an economic fact. Some of the major economic premises on which public decision-making have been based were surveyed in the preceding chapter and it was seen that both the requisite economic climate and justification existed to explain the observed existence of a mixed enterprise economy in the U.K.

Power based on the ownership and control of economic resources is relatively stable and the inertial (and active) resistance to transfer of such resources from the private to the public sector, and vice versa, can be postulated as one reason for this stability.

A characteristic state of a mixed economy can be illustrated by the measures of economic resources controlled respectively by the State and by private enterprise. Economic power is, however, subservient to political power in the short term, and decision-making based purely on economic criteria is necessarily subject to modification by political desiderata in the arena of public policies.

But political power, unlike economic power, is relatively transient and often subject to diametrically opposed reversals of direction in terms of both objectives and policy. Political expediency may require fundamental changes in approach by central government whilst the elective processes can result in immediate transformations of public policy through a change of administration.

The outcome of electioneering is, by its nature, often conjectural and this thesis is not the vehicle to support an examination of politics, per se. Subjective judgements may have relevance but no value in such a work and it is not intended to conduct a political analysis as part of the structure of the present study. However, study of appropriate evidence to adduce the standpoints of the major political parties on the question of public ownership and control in the private sector is germane since it has been noted (Ch. 1, S.4) that direction of change in a mixed economy depends, inter alia, on political power and attitudes.

Therefore, it is necessary to establish these factors for the purpose of perspective and to make more meaningful the context of the analyses as a whole. The evidence to be considered in this chapter is derived largely from objective primary sources. Subjective value judgements are eschewed and the establishment of fundamental standpoints of the two major political parties on public intervention and acquisition is the goal of this part of the work.

2. Political Orientations : Ownership and Control

The relatively unequivocal position of the Labour Party is indicated by the following statement:[1]

> 'The traditional socialist critique of private enterprise is based upon our opposition to the concentration of ownership and control of the means of "production, distribution and exchange" in a few powerful private hands. For nearly a century the British Labour Movement has therefore called both for public ownership of large-scale industry and, in the wider sense, for the control of these industries to be vested in a more democratic fashion upon a wider social base'.

This may be compared with a recent policy declaration by the Conservative Party.[2]

'.....no government should pursue a policy of wholesale nationalisation for party ends nor seek to further the interests of only a section or class of the population. And certainly our economic condition is far too grave for our country to be subjected to a divisive and dogmatic attack upon the private sector of our economy.

.....we believe that the survival of a mixed economy is vital to national prosperity. If all economic power were in the hands of politicians and civil servants, if all economic and industrial decisions were taken in Whitehall, Britain would become a dictatorship. An all-powerful government is the end of freedom.

A mixed economy ensures the diffusion of power. That is the only way we can prevent the abuse of power. Hence, the destruction of the mixed economy would entail the destruction of our democratic liberties, and the end of our parliamentary democracy.'

The quotations have been selected to indicate the respective stances of the major parties on the status of the mixed economy and control and ownership of economic resources.

Since this thesis is concerned with both public ownership and control, it is appropriate here to amplify the Labour Party approach to control of resources. In a foreword to a Labour Party Green Paper, the General Secretary Mr. Ron Hayward, stated:[3]

'Some socialists may wonder why the Labour Party should devote its time to a consideration of a major reform of company law. The reason is that even when the whole of our current programme of nationalisation is carried through, there will still be a very substantial private sector in the economy.

Through a socialist reform of Company Law the private sector can be made responsible (sic) to employees and to the general public. It is with this end in view that our working parties.studied possible reforms of Company Law. The document they have produced outlines the most radical review of this subject ever undertaken and opens up a number of exciting possibilities for socialists'. (1974)

In the document referred to, control over the private sector is to be sought through the following channels.[4]

1. The establishment of a new structure for the relationship of the company and its workers - a formal machinery for industrial democracy.

2. The formation of a 'Companies Commission' to regulate companies and financial institutions.

3. An increase in disclosure of company operational data.

The relevance of such a programme in terms of control is that successful implementation could clearly result in trades unions sitting on both sides of board room tables, a public enforcement agency to facilitate public control in the private sector and an open system of information flows external to the undertaking.

Structures such as these could significantly change decision-making powers at corporate levels in the private sector.

An earlier Labour Party document (1973) advocated,[5]

> '.....a fundamental and irreversible shift in the balance of power and wealth in favour of working people and their families....To make power fully accountable to the community, to workers and the consumer.'

This is accompanied by a proposal,[6]

> '.....to provide, if this is necessary in the national interest, for reserve powers to remove directors in firms with which the Government has a planning agreement.'

A fundamental basis of the Labour Party's position on public ownership and control is established in its Constitution (Clause 1V(4)) and, in view of its importance, the relevant statement is quoted verbatim,[7] 'To secure for the workers by hand or by brain the full fruits of their industry and the most equitable distribution thereof that may be possible upon the basis of the common ownership of the means of production, distribution and exchange, and the best obtainable system of popular administration and control of each industry or service'.

These concepts are considered so fundamental that they are also quoted in constituency and branch rules.[8]

3. Political Reasons for Public Ownership and Control

Economic reasons for State control were discussed and outlined in Chapter 2 (10). It is a purpose of this thesis to analyse contemporary developments of interventionist policies and machinery, with particular reference to the private corporate sector in succeeding chapters. Although an historical treatment of nationalisation was eschewed at the outset it is relevant to survey political reasons for public ownership and control at this point in order to establish the politico-economic bases of such policies for the purpose of this work.

A major programme of nationalisation was carried out by a Labour Government between 1945 and 1951. The industries concerned were steel, gas, coal, electricity and rail and road transport. During this period public corporations were established to run civil aviation; atomic energy became a concern of the State; the Bank of England was transferred to public ownership and Cable and Wireless became 100% publicly owned.

In a subsequent review, published in July, 1957[9], the case put forward for these transfers to public ownership included the dependence of the U.K. economy on such basic industries, relative shortages of capital, poor industrial relations, inefficient management, wrong structure and the existence of monopolies warranting public control rather than dissolution.

Political justification adduced in the review[10] included higher rates of investment; restructuring to eliminate private ownership fragmentation and the consequent unification of control and benefits of scale economies; production and productivity increases in the coal industry; improvements in output quality; greater research and development facilities; rationalisation of wage structures and pricing policies. Advantages claimed for the electricity industry[11] included the elimination of shortages of generating plant; extension of supply capabilities; improvements in thermal efficiency and the standardisation of supply parameters.

A recent (1976), and possibly more disinterested, appraisal of the purposes of and reasons for nationalisation[12] included the evolvement of municipal utilities (stemming from natural monopolies or the regulation of competition to meet public service standards) to national status, economies of scale and the existence of heavy subsidisation: these causes being relevant in the late 19th and pre-1945 period of the 20th centuries.

Political viewpoints on public ownership and control in the last fifty years have included the following aspects[13],

a) An essential prerequisite of nationally orientated economic planning.

b) To facilitate equitable distribution of income.

c) Promotion of efficiency by affording access to industry - wide rationalisations for reasons such as economic efficiency; orderly contraction; protection of communities; to achieve import savings and/or export benefits; public investment where private risk-capital was unavailable.

d) For the economic reasons adduced in Chapter 2 (10).

e) A political sine qua non of trades unions' aspirations.

To these must be added;

a) The attainment of ideological objectives inherent in political parties' constitutions and causes.

b) The relative failure of Keynesian demand-management policies[14] and the adoption of positive interventionist methods in the 1960's.

c) Improvement of international competitiveness of U.K. industry.[15]

d) The maintenance of national security by the strategic support of high-technological research and development on other than commercial criteria of performance.

e) Social support and re-structuring.[16]

f) As a concomitant of political (electorally-vulnerable) sensitivity.

g) Supply and demand inefficiencies of market forces systems.[17]

h) The political pressures of large-scale unemployment.

A more recent political reason for public ownership and control is the advocated need to direct investment funds into industry.[18]

4. Political Reasons Against Public Ownership and Control

Notwithstanding the fact that all governments intervene[19] and that informed political opinion supports such policies, as indicated in the previous section, a number of reasons has been advanced as to why interventionist policies should be discontinued or abated so far as increased central regulation is concerned. Moreover, evidence of problems arising from nationalisation and state control has been adduced even by the proponents and supporters of such policies.

In the review of nationalisation cited in the previous section (9) many problems were identified[20]. Difficulties arose because of the differing structures and organisation of the nationalised industries and the lack of homogeneity of the public corporations by which they were established under public ownership. Problems of inadequate management were attributed to the low standards inherited from private ownership. Communication short-comings, particularly with domestic - as distinct from industrial - consumers, were admitted.

Labour relations had continued to pose problems in the fields of negotiations on such matters as wages and working conditions, and in terms of communication in consultative and participative decision-making relationships with management. Finally the important aspects of accountability and democratic control were recognised as problem centres, specifically in the distinctions between Parliamentary supervision of major policy matters and management accountability for the operational efficiency of the undertakings.[21]

As a comparison, it is appropriate to indicate some of the problems of the major nationalised industries, nearly twenty years later, nominated in the report to the Government (12) by the National Economic Development Office (NEDO). These include, inter alia, a lack of understanding within the machinery of government of industrial management problems[22]; the effects on efficiency of a lack of stability and continuity of objectives and policies; the effect of differing time scales of politicians and industrialists on long term planning and operational effectiveness; and the damage caused to morale and performance by government intervention based on short term political expediency.[23]

Despite nearly twenty years of experience since the former review of nationalised industries (9) the problems of the relationships between government and nationalised industries had still not been resolved. The advocated arm's-length relationship of the 1967 White Paper (Cmnd 3437) was claimed to be unsuccessful and confusion over the respective roles of Ministers, civil servants and management had vitiated the concept of accountability and had led to cynicism, resentment and loss of morale[24].

It is significant that both of the reports identified the problems of co-ordination between government and the publicly-owned industries at the strategic policy level, and the fragmentation of executive accountability at the operational level due to bureaucratic involvement in tactical decision-making (21)(24). The NEDO report advocated a Policy Council and a separate Corporation Board as a revised structure to obviate these problems.[25]

Specific problems at the interface between civil servants and board members and management of the major nationalised industries included lack of communication on policy issues and formulation; a scarcity of declared long term policies but an abundance of short term interventions; incompatibility of policies emanating from different departments, leading to conflicting priorities to be resolved at operational level; difficulties stemming from civil servants' role interpretations by the corporations, and the former's lack of awareness of the industrial consequences of policy changes.[25]

Increasingly frequent and ad hoc interventions by government, the lack of prior consultation, inconsistency with agreed guidelines and procedures and unwillingness to carry responsibility for the results of interventions have resulted in resentment at board level in the nationalised industries.

These problems are claimed to have led to delayed decisions, disruption of plans, invalidation of performance assessment criteria, financial deficits, lower corporate morale and an escalation of levels of decision making resulting in heavier loads at senior management level. Counter allegations imply that the results of interventions are over-emphasised by boards and management in order to obscure managerial short-comings.[27]

Other problems include, inter alia, non-statutory price interventions; pay negotiations interventions; investment programme interventions;

corporate strategy interventions; fundamental differences in attitude, experience and style between civil servants and public corporation management; dissimilarities of government and industrial organisation and structures; relative transience of public appointments; insufficient incentives, and negligible sanctions for failure; the ubiquitousness of political pressures; illogical capital structuring and deficient board appointment procedures.[28]

It is a measure of the gravity of these problems that despite thirty years of politico-industrial relationships, in the case of the earlier nationalisations, a state of symbiosis between government and publicly-owned industries has still to be achieved.

5. <u>Some Political Implications for Private Manufacturing Industry</u>

Conflicting views on the economic performance of the nationalised industries were discussed in Chapter 2 (S.4). Research has indicated[29] that the performance record of the nationalised industries has been inferior to that of private industry, that public ownership offers no evidence of inherent superiority and that there is no convincing case for the extension of public ownership on grounds of economic efficiency. However, it has been claimed[30] that judgement of the nationalised industries on purely economic criteria is not equitable in that social, political and governance factors are inseparable from balanced arguments on the subject.

The wider issues inherent in the consideration of these factors, although of pressing interest and contemporary relevance, are outside the declared objectives and scope of the present research. What is germane to this study are the political implications of existing relationships between government and publicly owned industry, with particular reference to the structures and machinery constructed, or to be constructed, by the State to control the private sector corporate assets transferred, or to be transferred, to public ownership.

In private sector undertakings there is, or ought to be, a continuum of management from the strategic to the tactical levels. The strategic management of the corporate entity is concerned with the establishment of corporate objectives, the development of corporate strategy and the specification of corporate policies through the media of corporate planning and periodic corporate reviews. Resource provisioning and allocation at the macro levels are managed by these board level activities and responsibilities.

Deployment of resources at the tactical (increasingly micro) levels is carried out at the operational strata where the boundaries and scope of decision-making become increasingly prescriptive, criteria of performance become increasingly tangible and definable, responsibilities become subject to detailed specification and accountability may be delineated in absolute, rather than relative, terms.

This continuum of management and managerial activities entails multi-directional flows of information within an organisational matrix of knowledge, experience and understanding of corporate relationships. The boundaries of tactical, operational levels of management are defined by the structure of the undertaking, resources are quantifiable, problems tend to be repetitive and largely programmable, decision-making data is more or less processed or processable.

At the strategic levels, the ambience is the resultant of the economic, political, social and cultural environment of the undertaking. Problems are largely unstructured, inputs are qualitative, decision-making is discretionary, the boundaries are amorphous, risk is endemic and the ultimate penalties for failure are draconian.

The integration of these differing components of management in the private sector is normally accomplished by the inclusion of executives as a majority of the board. These directors are, by definition, representative of an important fund of knowledge of the particular business stemming from years of experience at different levels, and in various capacities, of management and, not infrequently, from proprietorial connexions. Their corporate identities, as board members, reflect a totality of management experience which is often reinforced by non-executive directors of professional standing.

The immediacy and potential coherence of attachment of the corporate and functional systems of management are evident. Communication between the strategic and tactical levels of management is facilitated, informed and usually effective. Consensus at the interface between board and executive levels is a product of communication continuity; homogeneity of corporate, group and individual goals; corporate and personal commitment to success and survival; voluntary subscription to the demands of the undertaking; the likelihood of rewards for success and the certainty of penalties for failure.

The evidence adduced in the previous section (S.4) clearly indicates that the injection of politics and State intervention is inimical to the development of mutual confidence between the policy makers and operational management. Many of the indispensable conditions for managerial and operational success are transgressed. Crucial elements, such as motivation and involvement in primary corporate decision making appear to have been given insufficient attention.

These patent failures are an indictment of the methods, rather than the fact, of State intervention. But their prevalence and longevity indicate that State intervention in industry, particularly at the level of the firm, could have significant consequences for board and senior management echelons in their tasks of corporate and operational management .

6. Political Aspects - Conclusions

Study of the evidence adduced in Section 2 of this chapter indicates that both of the major political parties subscribe to the concept of a mixed enterprise economy and thus to the acceptance of public ownership and control. The major political differences appear to centre on the degree rather than the fact of State intervention. In these respects, the conclusions are similar in terms of both the political and the economic viewpoints. Namely, that the political climate is favourable to an active interventionist role on the part of government and that good and sufficient reasons exist for central direction policies.

The reasons for public ownership and control adduced in Section 3 are largely axiomatic and the passage of thirty years since the post-war first large scale nationalisation programme indicates that the political parties acquiesce to the existence of such measures.

Section 4 indicates that much opposition to extensions of State control derives from questions of efficiency of results and methods rather than from basic reasons for central direction.

Since this thesis is primarily concerned with the effects of extensions of public ownership and control with particular reference to manufacturing industry, the discussion of political aspects in Section 5 is of specific relevance. A conclusion that satisfactory methods and machinery of state intervention remain to be developed seems not to be unreasonable in view of the evidence adduced above.

The rationale for the economic and political surveys in Chapters 2 and 3 having been established, the intention is to carry out analyses and investigations of contemporary developments in the three succeeding chapters with specific aims of identifying the evolving structures and machineries of State intervention in the private corporate sector. In particular those innovative media or agencies likely to have a crucial bearing on the deficiencies discussed in Sections 4 and 5 of this chapter.

CHAPTER 4

LEGISLATION - A SURVEY : 1966 - 1973

1. Indicators of Current Ideologies and Public Policies

In view of the enactment of the Industry Bill, and the codifying effect of the resultant Industry Act, 1975, it is not considered necessary in this chapter to conduct an exhaustive investigation into the minutiae of the several Green and White Papers, Bills and Acts which were published during this period. However, perspective demands that a survey be carried out of the philosophies and machinery emanating from the two administrations in the furtherance or restriction of public ownership and control in the private sector, with particular reference to expressions of current industrial policies.

The publication of the White Paper in January, 1966, signalled a significant departure from traditional policies concerning public ownership and control. It was proposed to introduce a novel agency, the Industrial Reorganisation Corporation, with features, powers and methods of operation which were distinctive from the previous forms of State intervention and control.

Among the points made in support of the new body by the Labour administration were,

a, need to improve the balance of payments,

b, necessary concentration and rationalisation of British industry to meet international competition,

c, the relative smallness of British production units compared with overseas companies and their consequent inability to take maximum advantage of economies of scale,

d, the inability of market forces alone to produce necessary rationalisation at the required pace,

e, belief that financially centralised diverse conglomerates with loosely-knit operational units were undesirable.

In support of these claims, it was asserted that no existing organisation had the special functions proposed for the Industrial Reorganisation Corporation (IRC) and that alternative agencies, such as the issuing houses and merchant banks, were client-orientated and thus insufficiently flexible in their approach to rationalisation schemes having national import.

The White Paper claimed that the new agency would work closely with industry and existing financial institutions and that its operations would be "...through the normal machinery of the market or in close collaboration with the market"[2]

Proposed powers of the IRC, relevant to intervention policies, were to include the ability to acquire a stake in the ownership of private sector undertakings although it was declared that such holdings would be relinquished, "...when the profits of rationalisation have been assured and it can do so to advantage".[3] The body would be advised by industry, the City, Government Departments and the Economic Development Committees. The intention was that it would act as a 'catalyst' and would be involved in the management needs of new groupings.

It would advance capital for expansion, new projects, investment in new plant, expansion of research, development and design and it would act as a prime leasing agency to facilitate fixed asset acquisitions. Initial drawings were to be fixed at £150 millions, and IRC schemes would be exempt from the (then) Monopolies Commission.

The attitude of the (Conservative) Opposition was summed up by the late Iain MacLeod in a Commons Debate, when he said,[4]

> "Our attitude towards the Industrial Reorganisation Corporation is that of the preacher about sin - we are against it."

The tenor of the White Paper was placatory in that the IRC was to be required to seek "..the fullest cooperation from industry and existing financial institutions.."[5], but the Confederation of British Industry (CBI) expressed misgiving about the government's real intentions in a statement which claimed,[6]

> "The CBI has not been consulted by the Government about its intention to set up an Industrial Reorganisation Corporation. The background against which the White Paper on this question is issued is coloured with suspicions regarding the Government's interventionist policies in industry."

2. <u>Public Ownership and Control in Practice - A New Agency</u>

In December, 1966, the IRC Act became effective and it provided for the establishment of a public corporation to be empowered to promote or assist the reorganisation or development of industries, sections of industries or industrial enterprise, including establishment of the latter.[7]

The Corporation was to comprise a chairman and between seven to fourteen other members whose qualifications were to be wide experience of and evidence of capacity in industry, technology, administration, the organisation of workers, commercial or financial matters. It was given the duty of selection of suitable projects and was to be largely autonomous in the exercise of its functions within the bounds of its declared objects.

It was empowered to acquire, hold and dispose of securities; to form corporate bodies; to make loans; to acquire and deploy premises, plant, machinery and other equipment; to give guarantees (subject to controls) on loans made to others.

The Secretary of State had the power of mandatory direction of the IRC and, virtually, control over its appointments to membership. He was enabled to fund its operations by payments not exceeding £50 million in the aggregate "...or such greater sum as he may from time to time by order specify."[8] The limit of loans, borrowings and direct payments was not to exceed £150 million, as proposed in the White Paper.

The IRC's operations, impact on the economy and general philosophies have been researched and analysed in detail.[9] Undoubtedly, its operations were, at times, controversial[10] particularly so in the Rank/Kent/Cambridge takeover battle. Comments made at different times during its life cycle indicate the marked changes in its approaches under different chairmen[11].

A measure of changed attitudes may be indicated by statements made about the IRC in the Commons by members of its sponsoring administration:-

> "The Corporation (IRC) competes with nobody. It threatens nobody. It compels nobody."12 (1/2/67)

> "Having reached that conclusion (the benefits of a Kent/Cambridge merger) the IRC first of all gave moral support to Kent, and then backed up its actions with public money. ...the intervention of the IRC was crucial. ...It was established to intervene and this was intervention."13 (8/7/68)

As a comment on the inferred omniscience of State agencies and their members, the retiring Chairman of the IRC, Mr. Ronald Grierson's reasons for leaving the organisation may be relevant.[14]

> 'Mr. Grierson said he had left IRC because he was unhappy about judgements it had to make.
> "One of the dangers is that you are bound to divide industrial organisation into goodies and baddies," he said. "This is something I noticed when I was with the IRC, that you have to judge people's efficiency. These judgements are entirely subjective." One could not always be correct; sometimes the "goodies" were not quite so good as expected and sometimes the "baddies" had great potential.'

The ambivalent stance of opponents of the IRC may be inferred from the wording of a Commons Motion[15] :-

> "That this House, while upholding the independence of the Industrial Reorganisation Corporation, deplores its action in intervening with public money on behalf of one bidder in a merger operation, and regards such action as a dangerous precedent for the future." (The motion was rejected by a majority of 74 : 307 to 233)

Whilst the IRC was seen to be acting as an independent body and its membership included supporters of free enterprise principles, the antagonists of State intervention were, at least, not totally opposed to its operation. But its potentiality, as an agency for "nationalisation by the back door"[16], when staffed by public control supporters gave rise to expressions of resistance typified by the quoted motion.

In a post-mortem final report[17] on the IRC, the views of the Board on the role of the Corporation were stated :-

> "Much has been said and written about IRC. The Board has deliberately and studiously avoided becoming involved in public debate. Its members would not have agreed to serve the Corporation if they had not considered it had an important role in promoting the efficiency of British Industry and of thus serving the national interest. Nothing has occurred to cause them to alter their opinion."

Of the initial £150 million authorised by Parliament, £43m. (50m total) of Public Dividend Capital, and £64.6m of borrowings from the National Loans Fund totalling £107,600,000, had been taken up by the IRC, effective at the closure date (30th April, 1971).[18]

The main projects with which the IRC were concerned included[19] the special steels industry; steel castings; heavy engineering; pressure vessels sector of the mechanical engineering industry; materials handling and construction equipment; pump manufacture; mining machinery, machine tool industry; ball and roller bearings industry; nuclear power industry; computer industry; industrial and control instrumentation; textile industry; aircraft industry; motor industry; shipbuilding. In addition to specific ventures in these fields, the IRC was also involved in studies of company law reform, the taxation system and in general appraisal procedures.

An evaluation of the work of the IRC has been carried out by Young and Lowe (ref. 9). But its early demise ended support operations which would have been, presumably, complementary to its role as an innovatory body. The complexity and severity of national and international economic pressures since the IRC ceased to operate have inevitably changed the development patterns and structures of the companies and industries which were the recipients of its attentions. But its major historical significance as an innovatory agency for potential public ownership and control in the private company sector remains undiminished, particularly as regards its powers of acquisition using public funds.

The final report included the sentence:-[20]

> "This (the overall review of IRC activities) indicates that the Corporation has been substantially involved in about 90 projects at least 75 of which are turning out as expected."

If the expectations were of measurable improvement it may be assumed that the Board were not dissatisfied with their achievements at the time of the dissolution of the IRC.

Young and Lowe suggest[21] that an important aspect of the Corporation was its use as a learning medium for policy-makers in the sphere of public policy implementation.

3. Policies of Disengagement - A Comparison

The coup de grâce of the IRC was signalled by the election of a Conservative government in 1970, and the following White Paper[22] on government reorganisation presaged State disengagement and the adoption of philosophies markedly different from those of their predecessors. An early result of the declared policies of the new administration was an announcement, shortly after the publication of the White Paper, that the IRC was to be wound up. An Order made by the Secretary of State for Trade and Industry, under the Industry Act, 1971, ended the life of the Corporation and dissolution took place on the 31st May, 1971. Another early casualty was the embryonic Industrial Expansion Act, 1968 which had given the Government direct powers to invest in industry.[23]

The new era of laissez-faire was relatively short-lived. Economic pressures which included inflation, growing unemployment and stagnant capital investment invoked a volte face in central government policy and expansionist aims ushered in a more positive interventionist role for the State.

Among the legislation was the passing of the Industry Act, 1972[24] which comprised four parts dealing with,

(I) Regional Development Grants

(II) Financial Assistance for Industry

(III) Credits and Grants for the Construction of Ships

(IV) Miscellaneous Provisions

For the purpose of this work the relevant area comprises Part II. Comparison of this part of the Act with that of the Industrial Reorganisation Corporation Act, 1966, shows that it is, virtually, a re-enactment of that legislation, with a number of significant similarites and differences. Section 7 of Part II deals with selective financial assistance to industry in assisted areas but Section 8, dealing with general powers, contains the machinery, structures and powers analogous to those initiated in the former IRC Act, 1966.[25]

The specific similarities comprise :-

1. The declared purposes of the Acts.
2. The scope given to the executive agencies under the Acts.
3. Breadth of potential application of the legislation.
4. Operational mechanisms for securing participation/control in the private sector.
5. Selective qualifications of Board members (with some field differences)
6. Sources of funds and destination of revenues.
7. Ultimate accountability to Commons or both Houses of Parliament.

Differences between the two Acts are of interest in indicating the differing ideologies and philosophies of the administrations sponsoring the legislation. They comprise, mainly :-

1. Under the IRC Act, the Board was an executive body: the Industrial Development Advisory Board (IDAB) of the 1972 Act is an advisory body.

2. The role of the Secretary of State was directorial under the former Act but directorial and executive under the latter.

3. The Board of the IRC had a primary role whilst that of the IDAB is secondary. Recent events suggest that IDAB's advisory role is now merely a facade.[26]

4. Operational control of accounting and reporting procedures (by Parliament under the IRC Act and by the Secretary of State under the later Act).

5. The IRC operated in competition with normal financial market forces, whilst the powers under the 1972 Act were extra-market.

6. The IRC could acquire controlling interests in private sector companies: there was a nominal prohibition of acquisition of controlling interest under the provisions of Section 8 (3b) of Part II of the Industry Act, 1972.

7. Autonomous operation was a feature of the IRC Board's activities : operations affecting ownership or control were on a basis of consultation and mutual consent under the later Act.

8. IRC Board had no statutory limitations on degree of control or ownership achieved in private sector companies; the 1972 Act provided for such limitations (later amended by the Industry Act, 1975 - see Chapter 6).

9. Since the IRC was established in perpetuity there were, effectively, no restrictions on the length of period of equity/loan stock holdings: the 1972 Act specifically enjoined that the period of such holdings be curtailed to the minimum possible to achieve its purpose; Sec. 8 (4)

10. Time limit of IRC's powers was indefinite: life of 'general' powers under Section 8 of the 1972 Act was limited to about five years.

11. Qualifications of IRC members could include 'technological' and 'organisation of workers' experience: these were replaced by 'banking' and 'accounting' in the later Act.

12. Post-hoc legislative controls of the IRC's activities contrasted with operational control of the IDAB by the Secretary of State.

13. Global sum (£150 million) was the only limit on IRC project expenditure: £5 million limit, subject to Parliamentary waiver, on any one project under the 1972 Act.

4. Intervention versus Participation

The listed similarities indicate that the Conservative administration eventually concurred with its predecessors in viewing the State as having a role in the management of the private corporate sector, albeit participatory rather than interventionist. Study of the mechanisms by which public intervention/participation was to be achieved shows that investment in the equity of companies and/or the provision of secured, unsecured or subordinated loans was possible under the two administrations. Also, the scope of application in the two Acts suggests consensus that an activist, positive role for the State in the private sector was not inappropriate.

Fundamental differences in Conservative and Labour policies are plainly indicated by the analysis of principal dissimilarities. The advisory role of the IDAB and the subsequent developments referred to above show a basic weakness of the legislation in assuming that the operating Secretary of State would be a champion of free enterprise. The intentions of the original legislators were turned upside down when a politician with opposing views held the reins and was able to operate the mechanisms of the Act with scant regard for the views and advice of the IDAB; a fact which is established later in this chapter.

The greater power of the Secretary of State under the later Act was doubtless regarded by the Conservative administration as a shield against overt State intervention; but this was clearly dependent on their retaining political power. As was shown, the political reversal and the subsequent appointment of Wedgwood Benn gave the executive role of the Secretary of State a new significance in terms of the power of central government to pursue more active interventionist policies in the private sector. If the inclusion of the IDAB was seen, initially, as a further safeguard against public activist control policies, this proved illusory in the crucial absence of real executive sanctions available to reinforce acceptance of its advice.

A crucial difference between the two Acts is that outlined above (6).

The later Act indicates the sensitivity of the supporters of free enterprise toward State intervention in providing that not more than half, by nominal value, of the equity share capital of any company may be acquired under Part II, section 8 (3b). Clearly, since effective control of many private sector companies may be secured by a holding of much less than 50% (where shareholdings are fragmented) this provision was decorative rather than significant. But it compares with the absence of any such provision in the IRC Act, thus giving the IRC obvious potentiality as an agency for the implementation of public interventionist policies.

The differing philosophies of the two administrations are also clearly indicated by the emphasis laid on the necessity for consultation with and agreement of the company in which the State was to take or relinquish an interest under the 1972 Act. This compares with a total absence of any such provision in the former Act and the IRC could act without having to observe the niceties of 'by your leave'.

Thus it appears that the two administrations were in agreement that the State had a role in active reorganisation of the private sector but their choice of effective machinery to implement public policies indicates their fundamental opposition on the degree of overt State ownership and control.

The Annual Report, for the year ending 31st March, 1975, on the Industry Act, 1972, carried evidence of philosophical and ideological differences stemming from the mechanisms and operation of the Act. A statement by the IDAB[27] asserts,

> "In five cases where the Board advised that the circumstances of the case did not appear to warrant assistance, the

Government concluded that assistance should be provided. The Board recognises that aspects of a particular case may be open to differences of emphasis, and that ultimately the Government are free, under the provisions of the Industry Act, to set aside the principles upon which we are called upon to consider proposals. In one case, however, the Board considered that the circumstances were such that it requested the Secretary of State to make a statement to Parliament in accordance with the procedure in Section 9(4). In the others the Board considered that the chances of viability, even over a considerable period, were remote. In three of these cases proposals were for the workforce to continue the business in the form of Co-operatives after it had collapsed. The Board sympathises with and respects the aspirations of those working in an enterprise to see it continue and shoulder greater responsibility for its operation. However, to attempt to introduce the Co-operative approach in concerns which have collapsed in a sharply competitive market and where the prospects of viability are remote is not, in the Board's view, a propitious way to support these aspirations."

By October of the same year (1975) at least one of the workers' co-operatives, the Scottish Daily News, referred to in the Board's adverse report, had to petition for a provisional liquidator to be appointed[28], and another company associated with a co-operative plant (NVT with Synova) had to appoint a Receiver.[29]

Doubtless, the Board restructuring referred to in the same Annual Report[30] will have been designed to avoid recurrences of such clashes. The possibility of such an outcome was to be expected in view of the status of the IDAB under the Act.[31] Its creators could hardly have foreseen that their legislation would be used to promote further disintegration of private control and ownership by the formation of workers' co-operatives based on public funds disbursed under its provisions, albeit controversially.

The global financial limit available under the terms of Part II, Section 8(7) of the Industry Act, 1972, was raised from £150 million to £250 million in March, 1975[32]. Payments and undertakings under this part of the act totalled £127 million at 31st March, 1975.[33] This compared with £212.8 million paid out as Regional Development Grants and £69.2 million for Regional Selective Assistance under Section 7 during the year ended 31st March, 1975.[34]

5. Development of Public Control Machinery

Although the Fair Trading Act, 1973, is not directly comparable to the previous legislation considered above, in terms of public policies of ownership in the private sector it is relevant to this part of the work under the terms of objective (a), Chapter 1, since powers given under the Act have a bearing on State intervention activities affecting ownership and control in the industrial and commercial sectors.

The Fair Trading Act is significant in that it codifies and amends previous legislation dealing with restrictive trade practices, monopolies and mergers, inter alia[35], and confers powers[36] of direction; which aligns it clearly as an instrument of public policy germane to this analysis. Consumer protection is an important part of the provisions of the Act, but, for reasons already mentioned, the principal investigation is concerned with Parts I, IV to VIII inclusive and the associated Schedules.

Part I of the Act deals with, inter alia, the role of the Director General of Fair Trading, the Consumer Protection Advisory Committee, the Monopolies and Mergers Commission, powers of the Secretary of State in relation to the functions of the Director General and definitions of monopolistic situations and practices. Part IV specifies the functions of the Director General and the Monopolies and Mergers Commission in terms of monopolies and uncompetitive practices.

Part V deals with newspaper and general merger definitions, whilst Part VI relates to references to the Commission other than on the grounds of monopoly or merger. That is, general references in protection of the 'public interest' or in respect of restrictive labour practices. Part VII outlines procedural and related matters concerning the carrying out of investigations and reporting to Parliament.

The Director General of Fair Trading is appointed by the Secretary of State for five-yearly terms of office. He is required to keep under review the production and supply of goods and services in the U.K. and to collect information thereon with a view to monitoring practices which may adversely affect the economic interests of consumers in the U.K., and to receive and collate evidence on practices affecting the economic, health, safety or other material interests of consumers. An important duty of the Director is the requirement that he be responsible for monitoring circumstances relating to monopoly situations and uncompetitive practices and for subsequent information, reports and recommendations to the Secretary of State.[37]

6. Regulation of Monopolies and Mergers

Formerly known as the Monopolies Commission, the regulating body constituted under previous legislation[38] is renamed the Monopolies and Mergers Commission and comprises between ten and twenty-five members appointed by the Secretary of State. The principal functions of the Commission are to investigate and report on any question which may be referred to it :-

(a) with respect to the existence or possible existence of a monopoly

(b) with respect to transfers of newspapers (ownership) or of newspaper assets.

(c) with respect to merger situations qualifying for investigations under the Act.[39]

An indication of the projected scale of operations is given by the definitions of monopoly under the provisions of the Act.[40] Unlike the traditional economic definition of a monopoly as constituting at least one third of a market for goods or services controlled unilaterally, the Act specifies one quarter as the appropriate criterion: this definition to hold also for exports from the U.K. Scale measurements may be in terms of value, cost price, capacity, quantity, number of workers employed or other suitable units or combinations. In general, the criteria used to judge the appropriateness of a reference to the Commission on the grounds of monopoly are matters for that body or the Minister making the reference.

In terms of the functions of the Director and the Commission in relation to monopoly situations and uncompetitive practices, wide powers are given by the Act to enable information to be obtained on relevant matters[41]. The scope of possible investigation may be judged by the diversity of scale measurement factors quoted in the preceding paragraph. A comment on the nature of the relationship between the Director and informants may be gleaned by the provision for fines up to £400 for refusal to supply information and for up to two years imprisonment and such a fine for the furnishing of false information[42].

The form in which a monopoly reference to the Commission is made is important since it controls the scope of investigation. A "monopoly reference limited to the facts"[43] requires the Commission only to investigate and report on whether or not a monopoly situation exists in relation to specific terms of reference set out in the Act (Section 47) whilst a reference in the form, "monopoly reference not limited to the facts"[44] may enable the investigation, and subsequent report and recommendation, to encompass facts found during the investigations. It is, however, possible for the former class of reference to be subsequently varied to the latter (but not vice versa).[45]

Reports of the Commission on a monopoly reference is required to be made to the Secretary of State if the reference was made by the Director General of Fair Trading; alternatively, to the Minister(s) by whom the reference was made. The report is expected to include definite conclusions with an account of the reasons for these conclusions and such supportive data as are necessary for adequate assimilation and understanding of the report. In addition, if the Commission's Report states that a monopoly situation exists which adversely affects the public interest, the expected effects must be specified: appropriate remedial action may be considered and the report may include recommendations on such action.[46]

Transfer of newspaper assets are given special treatment under the Act, presumably as a reflection of the importance of the media in formulating or tending to formulate public opinion. Mergers affecting newspaper interests are also featured in the provisions of the Act.[47] Transfers of such assets resulting in an output capacity of 500,000 copies per day are deemed to be unlawful and void unless the transfer is given consent in writing by the Secretary of State, normally preceded by a report from the Commission.

An interesting definition of a controlling interest as a newspaper proprietor rests on the ability to determine the manner in which one quarter of votes are cast at a general meeting, on matters which preclude the exercise or restriction of special voting rights.[48] If the newspaper in question has an average circulation of not more than 25,000 copies per day, the Secretary of State may assent to the transfer of assets without the formality of a report from the Commission unless there is an unresolved question of adverse effects on the 'public interest'.[49]

More general provisions as to mergers giving rise to monopolistic situations are dealt with in Part V of the Act. Mergers giving rise to possible monopolistic aggregations, as defined previously, are further defined by two main criteria[50] :-

(a) That a monopoly situation is, or may be, created by two or more enterprises ceasing to retain their separate identities by merger.

(b) That the value of the assets taken over exceeds £5 million (a lower limit which may be raised by Order of the Secretary of State).

Restructurings within these terms may result in references to the Commission. For the purpose of the Act, the value of assets criterion determining reference liability relates to the total value of the assets of the enterprise(s) which ceases to be distinct, except any enterprise which remains under the same ownership and control. If none of the enterprises remains under the same ownership and control then the determinant would be the one having the highest asset value. The actual value is determined on the book value of the assets less relevant provisions for renewals, depreciation or diminution in value.[51]

Procedure following merger references is substantially similar to that outlined for monopoly references, including the presentation of the Commission's report. In the case of merger references, the Secretary of State is given power to take interim action by Order whilst the Commission is investigating the reference subject. Such an order may prohibit or restrict certain merger activities: impose mandatory duties to carry on specified activities: safeguard assets: invoke certain powers under Schedule 8 (12) of the Act: all with a view to preventing prejudice to the reference or the objects of the Act.[52]

A merger reference may be made to the Commission in anticipation of a merger if it appears that the proposal invokes such action as would be taken in the case of an actual (qualifying) merger.[53] To this end, the Director is charged with a duty to keep himself informed about such material transactions and prospective mergers.[54]

7. Control Sanctions Available to the State

This analysis is concerned with public control in the private sector, and the parts of the Fair Trading Act, 1973 which are particularly relevant to the study relate to the powers of the State, which are exercisable in pursuit of the objectives of the legislation.

If a report by the Commission to Parliament states that a monopoly or merger situation has effects which are adverse to the 'public interest' the Secretary of State may, by statutory instrument, make an Order invoking powers under Schedule 8 (Parts I & II) of the Act.[55] The nature of these powers indicates the power of control of private sector restructuring vested in the State.[56] They include, inter alia, power to:

a, terminate agreements or make them unlawful,

b, curtail freedom to withhold, restrict or impose conditions on the supply of goods or services,

c, prohibit price discrimination,

d, ban preferential treatment in ordering or supplying goods or services,

e, regulate prices and ban recommended or suggested prices,

f, PROHIBIT OR RESTRICT, OR IMPOSE CONDITIONS UPON, TRANSFER OF ASSETS SUCH AS BUSINESSES OR PARTS OF UNDERTAKINGS.

In addition to the above sanctions, an Order may require the division of a business or of any corporate groups entailing, where appropriate, the transfer or vesting of rights, obligation, liabilities or property, contractual adjustments and the creation and deployment of shares, stock or securities. Other powers include the formation or winding up of a company or association; amendment of memorandum, articles or other regulatory instruments relating to enterprises; control of alterations affecting the financial structure or constitution of companies or associations and participation in legal proceedings.

8. Public Control and the Public Interest

References to the Commission may also be made for reasons other than for ab initio monopolistic situations or mergers,[57] specifically in terms of general effects on the public interest. Such references may relate to practices adopted for the purpose of preserving monopoly situations or which foster the continuance of uncompetitive activities. References concerned with restrictive labour practices may be considered by the Commission[58] provided the circumstances do not involve an industrial dispute.

Part VII of the Act is concerned primarily with procedural arrangements for the taking of evidence from competent bodies and the methods of conducting enquiries are laid down in these sections: questions of confidentiality, privilege attaching to reports and the laying of reports before Parliament are also dealt with in detail.[59]

In view of the frequent references to the 'public interest' in this Act and in other State publications, it is of interest to note the definitions associated with this term.[60] Aspects covered include:-

(1) maintenance and promotion of effective competition in the supply of goods and services,

(2) promoting cost reductions, development and use of new techniques and new products,

(3) facilitating entry of competitors into existing markets.

(4) the interests of users of goods and services in terms of prices charged, quality and available variety.

(5) promotion and maintenance of the balanced distribution of industry and employment in the U.K.

Analysis of the relevant provisions of the Fair Trading Act indicates that the emphasis is on the control aspects of State intervention rather than on acquisition of private sector corporate assets. But the measures and sanctions available to central government outlined in Section 7, constitute a potential inhibition of corporate decision making at the level of the private undertaking, particularly where structural growth strategies are intended to be adopted by its directors.

9. Public Policies and Private Interests

The significance of the developments analysed in this chapter, so far as private sector manufacturing undertakings are concerned, may be summarised as follows.

Incorporation of the Industrial Reorganisation Corporation constituted a novel instrument of interventionist policies. By this means, the passive phase of central government interest in private sector corporate management at the level of the industry was transformed into a positive activism at the level of the firm or undertaking. Corporate decision making, traditionally a function of the board of directors, became a potentially open system rather than the relatively closed system it had been hitherto, particularly in respect of acquisitive policies involving corporate restructuring.

The controversial use of public funds by the IRC in a private sector takeover contest (Chapter 1 : ref. 5) and the haste with which the Corporation was dismantled by a Conservative administration (ref.22) might not have been unconnected. But the similarities and dissimilarities between the structures and machineries of public intervention in the IRC Act, 1966, and the Industry Act, 1972, as analysed in Sections 3 and 4 of this chapter, indicate the respective stances of Conservative and Labour administrations. The differing nuances of public policy are seen to reflect the political attitudes examined in Chapter 2, Section 2.

Industrial management must accept the fact of State intervention irrespective of which of the two major political parties is in power. The philosophies of State interventionism were seen to alternate between positive activistic and participative policies (Sec. 4), and it was shown that machinery set up by one administration could be, and was, redirected with an entirely different effect by a successor with dissimilar political orientations.

The control sanctions available to central government, as analysed and identified in Section 7 of this chapter, constitute further potential constraints on directorial decision making in the fields of corporate objectives, strategies and planning, where the operational scope of the undertaking falls within the purview of the legislation.

In Chapter 5, it is intended further to develop the studies of these contemporary innovations of public policy; specifically of the events leading up to the passing of the Industry Act, 1975. This was an enactment of crucial importance to management in manufacturing industry because of the managerial implications of the problems inherent in public management, as discussed and identified in Chapter 3, Section 5.

CHAPTER 5

NEW APPROACHES : PRELUDE TO THE INDUSTRY ACT, 1975

1. New Machinery for Public Ownership and Control

In the interests of continuity and consolidation it is intended to study the renewal of positive interventionist policies by a newly elected Labour administration, with particular reference to those matters affecting or likely to affect the management of private sector manufacturing industry.

The views and attitudes of the supporters and opponents of increased State intervention in the private corporate sector during the Parliamentary processing of the Industry Bill (culminating in the Industry Act, 1975) serve to illustrate the political, philosophical and ideological differences between the two major political parties and, thus, the manner in which government is likely to intervene in pursuance of alternate public policies.

Although the Industry Act, 1975, is analysed in detail in Chapter 6, it is thought necessary to amplify study of the contentious areas revealed by the exchanges that took place during the passage of the Bill, both within and without Parliament. Consensus, represented by enactment in marginal conditions of Parliamentary supremacy, is reached by successive stages of bargaining and compromise which tend to establish tenable relationships between governors and governed. Extremist policies can only be sustained by sanctions and the degree of perceived extremity is dependent upon the schism between opposing ideologies.

The establishment of the Industrial Reorganisation Corporation had been the focus of controversy (Chapter 1, ref. 5) and its operations had not been free from controversy (Chapter 4, Sections 1,2 and 3). But its existence had created a precedent for such a novel approach to positive interventionism, and the manner in which it was dismantled by the Conservative government virtually guaranteed that the idea would not be abondoned by the incoming Labour administration. Consequently, it was not altogether unexpected that the former public policies of State ownership and control would be renewed notwithstanding the marginal Parliamentary majority.

Continuance of the former positive interventionist policies was indeed shown to be the case and the development of further novel instruments of intervention, together with the claims in justification and the rebuttals to maintain a status quo, form the study areas of Chapter 5. These preparatory analyses lead to a detailed investigation of the Industry Act, 1975, in Chapter 6.

If the White Paper,"Industrial Reorganisation Corporation", was notable in presaging a new instrument of State ownership and control, the White Paper[1] published by the Labour administration in August, 1974, was significant in proposing not only a virtual reconstitution of the defunct IRC but also novel methods and machinery further to advance the policy of intervention by central government agencies.

The opening statement in the White Paper, "The Regeneration of British Industry" appeared to seek integration of sectional interests. It stated[2],

> 'Britain's prosperity and welfare depend on the wealth generated by its industry and all those who work in it. It matters vitally to all of us that British industry should be strong and successful. We need both efficient

> publicly owned industries, and a vigorous, alert, responsible and profitable private sector, working together with the Government in a framework which brings together the interests of all concerned: those who work in industry, whether in management or on the shop floor, those who own its assets, and those who use its products and depend on its success'.

Among the reasons given[3], social, industrial and economic, for our relative failure to compete were low levels of investment in industry in the U.K., increased investment by British firms in overseas developments, unsatisfactory industrial relationships and poor managerial deployment of our resources; in particular, manufacturing equipment.

The Paper clearly stated[4] the view that regulatory relationships between Government and industry is not enough and that only partnership between the two will provide the positive relationships required to achieve the objectives of success for industry and prosperity for the country.

Among the proposals for increased State ownership and control[5] were community ownership of development land: establishment of the British National Oil Corporation: nationalisation of the shipbuilding and aircraft industries: extension of public ownership in the road haulage and construction industries; commercial ports and cargo handling facilities. A partnership based on nationalisation of assets at least assures the State of a measure of control.

The aims of the extension of the degree of control in the private sector by the Labour Party are too well established to justify further analysis here but the methods and machinery by which central government and associated agencies seek to control are of vital importance. Not least, because of the novel approaches suggested in the White Paper and the current restructurings of power within the capitalist industrial system from the owners and managers of resources to organised labour and its representative bodies.

Two new instruments were proposed[6] in this policy statement,

a. Planning Agreements, and

b. A National Enterprise Board (NEB).

2. Planning Agreements as Control Media

Planning Agreements are, initially, to be between the Government and major firms in key industrial sectors, whilst the function of the NEB is generally to reconstitute that of the defunct IRC as a central government agency for ownership and control in the private sector, albeit with extended objectives similar to and different from those of the latter body.

Proposals relating to Planning Agreements included the co-ordination of company plans with objectives of national status; the provision of firmer bases for controlling use of financial assistance by the State; enhanced co-operation; the provision of criteria for determining allocation of financial resources to the private sector; reciprocal benefits in joint formulation of private and public sector plans, and the exchange of policy information to stimulate and support long run planning.[7]

Methodology involves the provision of corporate information; agreements given statutory but not legally enforceable recognition; reserve powers of the State to require companies to provide information to itself and to "workers in the firm". Bilateral consultations leading to agreements for three years - to be reviewed and rolled forward on an annual basis - and the guaranteed maintenance of regional assistance levels during the currency of Agreements were also to be featured.[8]

Although the proposals related specifically to large companies, the Government proposed to review the problems of small businesses and to suggest separate means to help overcome them.[9]

Areas of discussion were stated to be primarily strategic and principally in the areas of pricing policies, investment, (timing and location), regional balance of employment, productivity, product development, balance of trade, industrial relations - including negotiation and consultation arrangements - and the interests of consumers and the community. In announcing these fields of concern, regard was to be had to the need for flexibility and for freedom of participating companies to respond to market changes.[10]

The scope of the proposals were, as stated, directly to include "major and strategic firms"[11], a definition which covered both the U.K. holdings of multi-nationals and the major nationalised industries and publicly-owned firms.[12]

A significant objective was the extension of involvement of employees and employee representative bodies. Management and unions are intended to be in jointly participative relationships in furtherance of industrial democracy.[13] To this end, information relating to corporate planning is to be made available to the Government and, ipso facto, to the unions in certain cases.[14]

3. <u>A Phoenix - The National Enterprise Board</u>

Echoes of the Industrial Reorganisation Corporation were to be noticed in the proposals relating to the establishment of the NEB. The agency is intended to be an instrument,

> 'to secure where necessary large-scale sustained investment to offset the effects of the short-term pull of market forces.' 15

Its functions are to assume and add to the activities formerly related to the IRC. Namely, to act as an industrial holding company; to be an active interventionist agency, a source of investment funds, a holder of equity capital, a promoter of industrial efficiency and profitability, an adviser, an entrepreneur, a manager of resources and a channel for State assistance in terms of funds or management.

The NEB was to be an instrument for the execution of public policies relating to regional employment, a source of information to government, industry and the public sector, an agency for nationalisation of profitable firms and an innovatory body with involvement in new ventures.[16]

An important proposal indicated that the NEB will be expected both to compete with the private sector and to operate as a maximiser of returns on investment.[17] However, where goals of social benefits are inimical to commercial viability the NEB would administer resources deployed, in such cases, on a separate basis.[18]

The magnitude of these objectives, perceived duties and responsibilities suggests that such an institution, if successful in performing the functions, would quickly assume the status of a government department, notwithstanding initial intentions of agency status.

Industrial democracy was seen as having a major role in public policy. The White Paper, to this end, proposed that the NEB would provide for employees at all levels to be involved in decision-making in the enterprises under its control.[19]

In accomplishing its objectives within the framework of State control, the NEB was to be granted scope similar to that of the IRC in terms of sources and uses of funds.[20] Proposals for acquisitions of holdings by the NEB included the intention that "agreement" should be a feature, but a statement in the same part of the Paper claimed:[21]

> "But to act decisively in its role of creating employment and creating new industrial capacity, the Board will need a number of companies where it holds 100 per cent of the equity capital, in order to avoid conflict between its objectives and the interests of private shareholders'.

No indication is given as to the means to secure "agreement" of minorities to the necessary transfer of ownership entailed in 100 per cent share holdings by the NEB. But provisions for compulsory acquisition by an Act of Parliament, if necessary, are proposed and an assurance is given that such takeovers would be "subject to prompt and fair compensation to existing shareholders".[22] The basis of fair compensation is not revealed.

Despite an earlier statement suggesting only indirect relationships between the government and the NEB, the reality of control is spelled out in the proposal that Government would need power to give general and specific directions to the NEB.[23]

A comment on the legislation passed by the previous Conservative administration is contained in the reference to Sections 7 and 8 of the Industry Act, 1972.[24] This states, inter alia, that the "powers of agreed share purchase will be widened and made permanent".

4. Reactions to the New Approaches

The publication of "The Regeneration of British Industry" provoked a hostile response which was to develop into an intensive campaign against the following Industry Bill by champions of market forces and free enterprise. An example of the reaction to the White Paper was the special letter sent out by the then Chairman, Sir Jack Callard, of Imperial Chemical Industries.[25] It claimed that there were great dangers in Government intervention in management and operation of the business and in public ownership of part or whole of the company, and ended by saying:-

> 'I am convinced however that State control or ownership would be detrimental not only to the performance of the company and to your own personal interest, but also to the national economy'.

A similar tone was adopted in a statement by Mr. Ralph Bateman, president of the Confederation of British Industry (CBI)[26], who was quoted as having said that the proposals would be greeted with dismay by the whole industrial community and that the "outlook is raging inflation, jobs at risk and no growth". The CBI followed this by issuing a joint statement with the Association of British Chambers of Commerce[27] condemning Government proposals for extension of public ownership.

The paper published by the CBI in defence of free enterprise[28], 'Industry and Government' was followed by a discussion paper which summarised this body's reactions[29] to the proposals set out in "The Regeneration of British Industry". Among the points made were, in regard to the need for restructured relationships between Government and Industry, a charge that the State paper (Cmnd 5710) had entirely ignored the contribution made to this end by "Industry and Government". The lack of consideration of the effectiveness of existing machinery for State/Industry consultation (such as NEDO and the EDC's). The constraints on industrial investment imposed by, inter alia, State fiscal policies, price controls, distribution restrictions; and the contention that Government's record of control of investment in the nationalised industries had indicated an absence of expertise in the field of profitable capital allocation.

The concept of Planning Agreements was also criticised on the grounds that assurances of freedom from compulsion gave no comfort, that the practicability of the system had not been demonstrated, that the system would be unworkable and that no information had been given on the use of State powers to compel firms to give the necessary information.

Itwas also suggested that public policies could lead to conditions in which the private sector had neither the funds nor the incentives to invest, so leading to the position in which the choice was insolvency or takeover by the National Enterprise Board (NEB).

A claim was made that the NEB was specifically designed to acquire and retain an increasing share of British industry, thus being an agency to enlarge the scope of public ownership and control.

The Government's proposals were also challenged on the grounds that no quantification had been given of the costs of such programmes to taxpayers anywhere in the White Paper, and another significant area of criticism concerned the availability of managerial competence. It was suggested that public policies for increases in control by the State inferred that central government was capable of doing better than private enterprise in the allocation and management of resources:

but the CBI document declared that the State had no access to "secret" supplies of managerial competence and that there was no evidence to suggest that the Government had either the competence or prescriptive formulae to "improve industrial management".[30] The record of political interference in the nationalised sector was quoted as an example of the results of State intervention in practice.

The final paragraph of the CBI paper summarised the position of that body. It stated:[31]

> 'CBI has set out fully the arguments for reinforcing free enterprise, encouraging market forces and redefining constructively the proper functions of Government. These arguments have been totally ignored. CBI therefore concludes that the basic aim of the Government's programme is a steady and continuous extension of state control over Industry in order to concentrate economic power in political hands. Taken together with the Government's other anti-industry policies the result of these proposals can only be to steadily undermine the free enterprise system by which British living standards have been built and are maintained.'

'Industry and Government' also contains an explicit statement of policy[32] which is, in some respects, complementary to the above quotation.

> 'We (CBI) believe that the relationship between Industry and Government must continue to evolve as a concept in which the economic democracy of consumer choice, and resource allocation by market forces, parallels and sustains the political democracy of our parliamentary system.
>
> Of course, Government would continue to lay down the legal frameworks, and this would respond in future, as in the past, to changing social, economic, technological and environmental conditions. And of course Industry would continue to recognise that it has responsibilities as well as rights and seek to fulfil them. But above all such a policy should aim to provide the continuity, stability and incentives by which Free Enterprise can go on increasing the nation's wealth and income and improve its quality of life'.

5. Structures of Public Ownership and Control - the Bill

If the publication of "The Regeneration of British Industry" created flutterings in the dovecotes of free enterprise, the publication of the Industry Bill[33] did nothing to dissipate the apprehensions which had caused them. Michael Heseltine, an Opposition champion of free enterprise, wrote to the Chairman of Britain's 1,000 largest companies to state the Conservative Party's reaction to the Bill[34] (in his capacity as Opposition Spokesman for Industry).

Among the factors which were discussed as the bases for their resistance to the Bill were the following. The NEB's overt function as an agency for nationalisation of profitable manufacturing industrial companies. The need of the private sector to compete with public companies, which were backed by the (largely unspecified) financial power of the public purse. The power of the Secretary for Industry vis-a-vis the NEB; lack of parliamentary accountability; removal of some provisions in the Industry Act, 1972, relating to control of the State's powers of equity acquisition and retention. A claim that power was being transferred from a wide base in the private sector to a narrow plinth in central government. Dangers to confidentiality and corporate flexibility inherent in Planning Agreements. Invidious positions directors would find themselves in as a result of compulsory provision of information affecting, or tending to affect, corporate decision-making, to the possible detriment of the company and its shareholders. The possible use of corporate strategic plans as deterministic platforms for trades union negotiations despite their innately stochastic characteristics. Finally, the distortion of multi-national development competition by the constraints of unilateral Trades Union participation in the U.K., which would be unparalleled so far as overseas competition were concerned.[35]

Another early response to the Industry Bill was the publication of a guide to the Bill by the Industrial Society.[36] It purported to be a neutralist examination of the proposed legislation aimed at both management and union representatives, inter alia, but all its quotations in amplification of the provisions of the Bill were from government publications or politicians in office. The effect is of unquestioning acceptance but, even so, several references are made to the imprecision of the parts of the Bill and to its susceptibility to the effects of political decision-making in practice.[37]

It is not the aim here to conduct an exhaustive investigation into the provisions of the Industry Bill since the main significance lies in the intentions (the White Paper) and in the realisations (the machinery, structures and conferred powers of the resultant Industry Act, 1975). However, some points of deviation or modification from the original proposals are indicated from a study of the Industry Bill.

With some additions, the establishment of the NEB and the scope of its functions are similar to that of the former IRC. The relationship of the Secretary of State to the formation of the NEB is more direct than the parallel situation which obtained under the IRC Act, 1966, and the structuring of the new board is different in detail,[38] but the power locus is unaltered in any material respect. Functions proposed for the NEB follow those outlined in the White Paper (Cmnd 5710)[39].

The powers conferred under sections 7 and 8 of the Industry Act, 1972 would be exerciseable by the NEB, but the financial accountability provisions are markedly less stringent, potentially, than in the case of the IRC.[40]

A nominal restriction on the acquisition of equity of 30 per cent of a company and a consideration limit of £10 million would be dependent only on a decision of the Secretary of State and, thus, appears to be window-dressing.[41]

Provisions relating to ownership transfers should be of particular interest to multi-national companies in that their global strategies could be affected materially by the powers of prohibition and/or vestment of assets in public ownership contained in the Bill.[42]

The Bill links the fact of a planning agreement between Government and a corporate undertaking with the availability of financial assistance under the provisions of the Industry Act, 1972, and with guarantees of grant stability during the term of such agreements.[43]

Selective financial assistance constraints in the 1972 Industry Act are intended to be swept away, thus giving the Secretary for Industry a freer hand. The limitations as to the existence of alternatives preventing State aid, for example, are to be repealed, as are the requirements to dispose of stocks or shares as soon as possible, and the limitations on the proportion of equity (not more than half) acquirable by the State in any company. Provisions relating to the need for consultation and time limits (powers ending on the 31st December 1977) are also to be repealed.[44]

Other controversial provisions in the Bill were those relating to the compulsory giving of information concerning capital expenditure, output, sales, employees, productivity, fixed assets, capital disposals and charges, capital acquisitions, changes in fixed asset formation and exports[45]. Resistance was focused not only on the types of information sought but also on the proposed fields of use (e.g. trades unions negotiations).[46]

Not unnaturally, the TUC indicated their intention to make full use of the intended Industry Act and the CBI's criticism of the Bill was attacked by the Economic Committee of the TUC.[47]

The CBI Director General, Campbell Adamson, indicated that industrialists were concerned about the arbitrary powers for intervention, the major aggregation of power in the hands of the Secretary of State, proposed extensions of public ownership in profitable manufacturing industry, erosion of the private sector, information disclosures and the resultant threats to security.[48]

Evidence of ideological differences between the two main political parties was manifest during the second reading of the Industry Bill and the battles in the Commons were accompanied by the strife of protagonist groups outside Parliament. A leader in the Financial Times[49] indicated support for the views that industrial investment needed to be encouraged, that planning agreements need be no more than an extension of existing public and private sector relationships, that industrial democracy as typified by worker participation was bound to develop and that acquisition by the State of private company equity was a reasonable corollary of the provision of special financial assistance.

The editorial expressed misgivings, quoting widespread objection in industry, Westminster and Whitehall, regarding certain provisions of the Bill. Among the points made in this respect were the Treasury's lack of control over the financial investments and returns on assets of the NEB; the virtually autonomous power of the Secretary for Industry over the NEB and his consequent ability to direct it to carry out activities allotted to it as he pleased; the compulsory disclosure of information not linked to machinery of planning agreements; the destination and use of such information (trade unions); the weakness of appeals procedures and the likelihood of conflict between the Government, trade unions and private sector firms as a result.

Lord Watkinson, (then) chairman of the Confederation of British Industries' companies committee, also attacked the provisions of the Bill relating to disclosure of information.[50] He claimed that the measures would damage existing initiatives in this respect and said,

> 'To bring in by law elaborate machinery for legal enforcement and for mandatory disclosure to trade unions, but not to employees as a whole or to shareholders, is to put the cart very firmly before the horse'.

He went on to claim that it was impossible and improper to deal with the management of industry on policies laid down by the TUC and doctrinaire politicians and that such agencies did not know how to manage businesses nor how to secure participation on the correct basis. Companies in the private sector were urged to provide a standard of participation for their employees superior to that achievable by State mandatory interference.[51]

Both the CBI and the Association of British Chambers of Commerce (ABCC) renewed their attack on the Industry Bill during its Committee stage.[52] In a joint statement they criticised the powers of the Secretary for Industry and the NEB to extend public ownership with minimal accountability to Parliament, and compulsory information disclosure. They claimed that enactment of provisions of the Bill would damage relations between industry and commerce and the Government, impair investment confidence and reverse trends of improved consultation between management and workers.

A further attack on information disclosure provisions was made by the City Capital Markets Committee, which had been established under the auspices of the Bank of England in 1974. It criticised powers to force disclosure of commercial secrets without adequate safeguards and the provision of disclosures to trades unions.[53] It was claimed that inhibitions of planning and free discussion of corporate plans would result and the Committee regretted the abandonment of the voluntary principle embodied in the White Paper (Cmnd 5710). They pointed out the highly changeable nature of corporate projections, which were subject to major modifications and amendments, and that such matters were valuable assets to companies.

Ralph Bateman, president of the CBI, continued his attack on the Industry Bill when he exhorted the City and industry to join forces in the fight to preserve the market economy and the private sector.[54] He claimed that industry had become a pawn in power politics and that current legislative and fiscal proposals had nothing to do with industrial efficiency,

> "They are about the ownership and control of industry - they are about power...." 55

He blamed crippling price, profit and dividend controls, high taxation, unabated inflation, industrial unrest and undisguised Government hostility to industry for the resultant poor returns on investment in real terms. He claimed that, with the position of 60% of U.K. companies working below capacity, the climate for major new investment was not favourable.

The instability of political balance was indicated when changes in the Industry Bill were announced, after Anthony Wedgwood Benn had been replaced by Eric Varley as Secretary for Industry, by the (then) Prime Minister, Harold Wilson. These changes in the Bill pleased neither the CBI, on the grounds that they were not sufficiently extensive, nor the Left (represented by Miss Joan Maynard, M.P. for Sheffield, Brightside), on the basis that the Bill was without teeth.[56]

Changes to the Bill were, in essence, discretionary power to the Secretary for Industry to decide what information from companies should be made available to trades unions (instead of mandatory transfer of all disclosures). The setting up of an independent advisory committee on information disclosure requirements. Restrictions on the NEB's powers to take interests in newspapers and to establish new newspapers; and a requirement that the NEB should dispose of minority interests in newspapers, if acquired with other business interests, as soon as possible.[57]

The stormy passage of the Industry Bill through the Commons was repeated in the Lords; a number of major amendments were passed during the Committee, Report and Third Reading Stages, but these were dropped when the Bill returned to the Commons and the amendments were reversed.[58] The Bill was enacted and became law in November, 1975.

6. Managerial Significance of the New Approaches

The policy approaches indicated by the above studies have two major elements of significance for private sector industrial management in manufacturing industry. First, the proposed establishment of the National Enterprise Board, in the terms to be delineated in Chapter 6 could have direct and indirect consequences for corporate and functional managers.

Boards of directors could be directly affected by acquisitive policies involving the transfer of selected corporate assets in the industries subjected to NEB operations: not only in the primary sense of possible loss of office but also from possible secondary effects caused by structural industry changes brought about by public enterprise activities.

Functional managers at operational levels could also be affected in terms of marketing (competitive changes), production (relative capital/labour intensity levels), personnel (industrial democracy structures), general management (corporate strategy, objectives and planning influences), to state the more obvious corollaries of publicly owned competition in the private manufacturing sector.

Secondly, implementation of instruments of public intervention at the level of the firm, or undertaking (e.g. planning agreements) could precipitate the dichotomy between corporate and operational levels of management discussed in Chapter 3, Sections 4 and 5, with similar results. Namely, inefficiency of deployment of resources, low morale, loss of managerial confidence, decreased motivation, poor communication, inadequate integration of decision making processes and the other traumatic results noted in the sections referred to above.

The studies in Chapter 5, Sections 4 and 5, indicate the qualms and misgivings of informed observers, eminent management practitioners and authoritative representative bodies in the private sector about the proposed implementation of direct intervention at management levels; extensions of public ownership; planning agreements (on a compulsory basis); the acquisitive role of the NEB; compulsory company information disclosures and distribution of commercially-sensitive corporate data. Not least, the danger of seriously impaired relationships between government, industry, management and workers.

Allowing for the natural reaction in protection of special interests and of the status quo, the evidence adduced in Chapter 3 indicating serious management problems at the interfaces between politicians, civil servants and managers cannot be ignored. The pressures resulting from resistance to some features of these interventionist proposals caused modifications to be adopted, as indicated in Section 5 above, and the final outcome of the struggle is on public record in the form of the Industry Act, 1975.

Since this Act is a major contemporary development central to the public control objective of this thesis, Chapter 6, is devoted to a detailed analysis of the provisions of this important legislation. This will also serve the purpose of identifying the public instruments of relevance to management in manufacturing industry and of preparing for the concluding studies of objective (a) of this thesis (as nominated in Chapter 1, Section 1) in Chapter 7.

CHAPTER 6

THE INDUSTRY ACT 1975

1. Statutory Consolidation of Public Structures and Machinery

The preamble to the 1975 Industry Act states that its provisions establish a National Enterprise Board; confer powers on the Secretary of State to control (by prohibition) the transfer of ownership of undertakings in manufacturing industry outside the U.K. and to acquire compulsorily the capital or assets of such undertakings if control has passed, or is likely to pass, to persons not resident in the U.K; amend the 1972 Industry Act and the 1967 Development of Inventions Act; provide for disclosure of information relating to manufacturing undertakings to government and the trade unions; and relate to connected purposes.[1]

2. The National Enterprise Board

Part 1 of the Act deals with the establishment of the National Enterprise Board (N.E.B.), which comprises a chairman and between eight and sixteen members to be appointed by the Secretary of State. The structure of the N.E.B. may include deputy Chairman and a chief executive. Schedules 1 and 2 of the Act control the conditions of appointment and tenure, remuneration, etc., of the members and the proceedings, incorporation, financial and administrative provisions and reporting procedures of the N.E.B.[2]

General purposes of the N.E.B. are to promote the U.K. economy, industrial efficiency and international competitiveness and to attend to the provision, maintenance or safeguarding of productive employment in the U.K.

These purposes are to be achieved through the exercise of the N.E.B's functions, which are extensive. They include the establishment, development, promotion or assistance of any industrial undertaking, or of an industry. Extension of public ownership into profitable areas of manufacturing industry. Promotion of industrial democracy within undertakings in the control of the N.E.B: the takeover of publicly owned securities and properties and their subsequent management. The N.E.B. is given virtual carte blanche in the exercise of these functions.[3]

In addition to the wide brief given to the N.E.B., it is specifically empowered to create corporate undertakings; to enter partnerships; to make loans; to deal in securities; to hold securities (without constraints as to time limits); to act as guarantor; to deal in property, land, plant, equipment, premises and machinery; to act as a provider of these latter for use by others, and to provide financial, administration, management and organisational services.[4]

The N.E.B. also has power to exercise the provisions for selective financial assistance under sections 7 and 8 of the 1972 Industry Act, if directed to do so by the Secretary of State, subject to consent of the Treasury. In such action, the N.E.B. is not required to seek Treasury consent and is obliged to carry out directions (but must be consulted before a direction is given by the Secretary of State). In view of the obligatory nature of these duties, the N.E.B. would be acting as an agency since a direction may specify the amount of financial assistance, purposes for which assistance is to be given, the terms and conditions and the manner in which the powers are to be exercised.[5]

3. Public Policy Changes in Acquisition Powers

Examination of repeals of parts of sections 7 and 8 of the 1972 Industry Act reveals the final outcome of the relevant political battles during the passage of the Industry Bill.[6] Section 7 of the 1972 Industry Act (which relates to financial assistance for industry in assisted areas) has been truncated to remove the inhibitions requiring the Secretary of State not to give financial assistance, if alternatives exist, by way of acquisition of loan or share capital in any company, and to dispose of stock or shareholdings as soon as it is practicable to do so, after consultation with the company.

In Section 8 of the 1972 Industry Act (general powers to give financial assistance) the removals comprise the following requirements. That alternatives to State assistance are a contrary indication to the providing of financial assistance. That assistance by way of acquisition of share or loan capital may not be given if alternatives exist; that not more than half, by nominal value, of the equity share capital of any company may be acquired. The requirements that shares or stock acquired by the provision of financial assistance have to be disposed of after consultation with the company as soon as possible, and the subsection (5) containing the date of expiry of the powers conferred under Part II (31st December, 1977), are also repealed.[7]

Thus it is seen that these mechanisms, provided in the 1972 Industry Act by the Conservative administration to constrain public ownership and control in the private sector ("nationalisation by the back door"), have been swept away. The provision in the 1972 Act which required the consent of a company to acquisition of its shares or stock has been made the responsibility of the Secretary of State and not that of the N.E.B.[8]

Where a direction has been given to the N.E.B. by the Secretary of State under the provision of Section 3(1) of the 1975 Industry Act, the latter is required to lay statements before Parliament retrospectively, giving details of the transaction: the N.E.B. is also required to provide similar information in its annual report.[9] The N.E.B. is required to make an annual report of its operations to the Secretary of State which must then be laid before both Houses of Parliament.[10]

The status of the N.E.B. as a managing agency for publicly-owned property and securities is established in the 1975 Industry Act; the Secretary of State's role is directorial in this respect and entails a Parliamentary statement of the details of the transfer of such assets to the N.E.B. if the consideration for the transfer exceeds £1 million.[11]

4. Financial and Accountability Constraints

Among the requirements specifying the financial accountabilities and responsibilities of the Secretary of State and the N.E.B. is the following[12]:-

'It shall be the duty of the Secretary of State and the Treasury, before making a determination (of the financial duties of the Board), to satisfy themselves that the duties to be imposed on the Board (N.E.B.) are likely, taken together, to result in an adequate return on capital employed by the Board'.

The term "adequate return" is not delineated but the flexible treatment of interest payments on loans, returns on public dividend capital and structure of the N.E.B's capital [13] suggests that precise quantification is likely to be elusive, particularly if the effects of social-benefit analysis are also to be considered.

Directions given to the N.E.B. by the Secretary of State, whether general or specific, are mandatory although the Act requires that the former be consulted about proposed directions: it does not require that the N.E.B's recommendations, if any, be acted upon.[14]

An aggregate limit on funding, excluding outstanding interest, is fixed at £700 million with provision for an increase to an ultimate limit of £1,000 million. In fixing the limits, 'general external borrowing' specifically excludes internal borrowing from a N.E.B's wholly owned subsidiary, non-repayable Treasury guarantee payments incurred by the N.E.B., "financial assistance" borrowings under the provisions of Sections 7 or 8 of the 1972 Industry Act and existing borrowings by subsidiaries other than from the N.E.B.or other N.E.B. subsidiaries. Debts incurred by the N.E.B. in respect of acquiring Crown assets and under a vesting order (Section 13) are also excluded from the aggregate limit.[15]

5. Protection of Media Interests

The power and influence of controllers of the media are reflected in the provisions of the 1975 Industry Act relating to the N.E.B's functions in that field. In general, the Board is not permitted to set up as a publisher of newspapers, periodicals or magazines nor to enter into a contractual relationship with the Independent Broadcasting Authority for the provision of programmes; although the production of periodicals mainly connected with the activities of the N.E.B. or of its subsidiaries is not proscribed.

Further, save for exceptions under the provisions of giving selective financial assistance under the relevant parts of the 1972 Industry Act, the N.E.B. is not permitted to acquire share capital of such undertakings. It is specifically required to divest itself of such interests or ownership should this type of business form part of an acquired subsidiary, subject to the terms of directions by the Secretary of State. The tone of this part of the Act is unmistakeably protective of existing power structures and obviously framed to negate the possibility of charges of State control of the media or of undue central government influence on communication and public information sources.[17]

Part 1 of the Act ends with further curtailments of the N.E.B's powers. The consent of the Secretary of State is required before the acquisition of 30 percent or more of unrestricted voting power may be obtained by the Board in any corporate undertaking and if the N.E.B's holding of share capital were to exceed a consideration value of £10 million in a corporate body.[18] Presumably the consent would be forthcoming with degrees of readiness associated with the ideologies and political allegiance of the holder of that important office.

6. Powers Affecting Multinational Strategies

Interests of multinational groups in U.K. manufacturing industries or companies may prove to be abortive if the undertakings are deemed to be of special importance to the U.K. and the interest entails change of control to non-residents.[19] The change of control may be deemed to be the result of the following events.

Cessation of residence in the U.K. of a person in full or part control of such an undertaking. Acquisition of whole or part of a relevant undertaking by a non-resident of the U.K. Effective control passes via a company to a non-resident of the U.K. The acquisition of control of voting power of 30%, 40% or 50% by a non-resident directly in such a company or through a controlling company. Changes of residence from the U.K. which have the effect of expatriating control.[20]

The action which may be taken by the Secretary of State in anticipation or contemplation of such a change of control includes prohibition, restriction or vesting of control and assets in the N.E.B., N.E.B. nominees or in himself or his nominees, should the change be deemed to be contrary to the interests of the U.K. or of any part of the U.K. The stated sanctions, prohibition, restriction or vesting, are exercisable by order. Where 30% or more of the share capital of a company is vested, as the result of an order, in the Secretary of State or the N.E.B. the remaining shareholders must be given a notice of the vesting.[21] Vesting orders, however, must not be made unless drafts have been laid before and approved by Commons and Lords: such orders may follow prohibition orders but must be so laid normally within three months of the making of the latter.[22]

Vesting procedures include provisions for dealing with rights, liabilities or incumbrances of vested assets. These may be extinguished by payment of compensation, transferred to the Secretary of State or the N.E.B. or charged on compensation payable for the capital or assets. Rights in or transfer of vested assets may be prohibited or set aside by the vesting order and the latter may include safeguarding provisions relating to vested capital and assets. Rights to recovery of transferred assets and of compensation for such assets are also dealt with in the provisions of this part of the Act.[23]

Contraventions of prohibition orders may be dealt with only by civil proceedings since criminal proceedings in this connexion are not included under the Act.[24] The territorial limitations of such orders are confined to the U.K. operations of persons or companies but, in such cases, acts or omissions outside the U.K. may fall within the scope of prohibition orders.[25]

Compensation rights and procedures in connexion with vesting orders are dealt with in the last two sections of Part II of the 1975 Industry Act. A necessary precursor to a vesting order is the obligatory laying of a "compensation order" before both

Houses of Parliament.[26] Compensation orders include identification of the recipients of compensation, their rights and duties in relation to payable compensation; manner of such payments; compensatory interest payments. The orders may differentiate compensatory payments in respect of different classes of capital, assets, rights, liabilities or incumbrances.[27]

The form of compensation may be either money provided by Parliament or the issue of government stock, or both of these means.[28]

Disputes arising from vesting or compensation orders are dealt with in Section 20 and schedule 3 of the Act. Provided the initiating party has the status of a corporate body, the whole or part of whose share capital has been vested, or the Secretary of State, N.E.B. or their nominees, arbitration procedures to settle disputes by tribunal constituted under the Act are provided.[29]

7. Planning Agreements - An Extension of Control Potential

Planning agreements, the subject of much controversy during the Parliamentary stages of the Industry Bill and preceding White Paper, are dealt with in Part III of the Act. Guarantees relating to the stability of grants or financial assistance, provided under the 1972 Industry Act (sections 7 and 8), for the duration of such payments are made contingent upon the existence of a planning agreement between a company and the State.[30]

In view of the important part planning agreements are expected to play in government/industry future relationships it may be appropriate here to quote verbatim the definition given in the Act:-[31]

> 'In this Act "planning agreement" means a voluntary arrangement as to the strategic plans of a body corporate for the future development in the United Kingdom over a specified period of an undertaking of the body corporate or of one or more of that body's subsidiaries, or a joint undertaking of the body corporate and one or more of its subsidiaries, being an arrangement entered into by the body corporate and any Minister of the Crown which in the opinion of that Minister is likely over the specified period to contribute significantly to national needs and objectives.'

Since an operative phrase in the definition is "in the opinion of that Minister", the exercise of value judgements in which ideological and political influences may be present suggests that planning agreements objectives and structures need not necessarily be designed to secure efficient allocation of and returns on resources in purely economic terms.

Although the Act itself does not provide details of proposed planning agreements, the preceding White Paper[32] and a discussion document published by the Department of Industry[33] do give such information as is necessary to form a framework of intent of government aims. The latter source amplifies the areas of planning agreements discussed generally, earlier in this work (Ch.5.).

8. Disclosure of Corporate Information - the Scope and Procedures

Another aspect of the legislation which precipitated heated controversy and misgivings (referred to in Chapter 5) was the disclosure of information, dealt with in Part IV of the Act. As a quid pro quo for the requirements laid on the private sector, the government has accepted the need to provide information from central sources to reinforce realistic assumptions on which private sector corporate planning must, necessarily, be based.

The Treasury is required to build and maintain a macro-economic model in order to demonstrate alternative economic outcomes resulting from changes in input parameters and variables, to enable forecasts to be made and to relate such forecasts to participant companies in joint planning agreements. The use of a computer is obligatory and, presumably to offset expenses, it is required that the model shall be available to members of the public.[34]

The manner in which the Act deals with disclosure of information from the private sector to the State is evocative of the Parliamentary battles which preceded the enactment. In designating the sector to which disclosure provisions are applicable, the Act specifies undertakings wholly or mainly engaged in manufacturing industry which are operated by companies or groups of companies and which are deemed (by Ministers) to be making an economically significant contribution to a part or the whole of the U.K. The purpose of obtaining corporate information from the private sector is stated as being the furtherance of national economic policies or to facilitate consultation between the government, employers or workers.[35]

Although information relating to "know-how" (as defined in section 386(7), Income and Corporation Taxes Act, 1970) and research or development programmes is specifically excluded[36] the scope given to Ministers under the Act is wide. Subject to the issuing of preliminary notice and subsequent order[37] information may be sought on the following:-[38]

(a) the persons employed in the undertaking, or persons normally so employed (but not specifically as to individuals);

(b) the undertaking's capital expenditure;

(c) fixed capital assets used in the undertaking;

(d) any disposal or intended disposal of such assets;

(e) any acquisition or intended acquisition of fixed capital assets for use in the undertaking;

(f) the productive capacity and capacity utilisation of the undertaking;

(g) the undertaking's output and productivity;

(h) sales of the undertaking's products;

(i) exports of those products by the undertaking;

(j) sales of industrial or intellectual property* owned or used in connection with the undertaking, grants of rights in respect of such property, and contracts for any such sales or grants; and

(k) expenditure on any research or development programme.

*defined in the Act[39] as including, "without prejudice to its generality" such assets as patents, trade marks, designs, copyrights and know-how.

The nature of much of the information to be supplied to the government is of a highly sensitive kind in strategic terms, both as regards the participating company or group and its competitors, and the chances of significant leaks must be greatly increased as a result of the wider dissemination sought by the State. However, it is possible that the dangers of over-capacity, produced by parallel corporate strategies in oligopolistic market structures responding to identical demand forecasts, may be lessened as a result of freer availability of information about capital disposition intentions.

Corporate information relating to past and present periods may be required and such information relating to future periods is to be sought and regarded as forecasts.[46]

9. Information Disclosure and the Trade Unions

Trade unions and their authorised representatives are nominated as participants in the disclosure provisions of the Act. They are to receive copies of notices issued to companies or groups[41] and the information or part of the information supplied to Government may, by order and subsequent notice, also be required to be supplied to them.[42] Compulsory disclosure by order and notice to the company or group of companies may be imposed if the Minister is not satisfied that relevant information will be given voluntarily.[43] The practical effect is that the donor of such information has little choice but to acquiesce notwithstanding provisions for representations to be made to the Secretary of State.[44]

Information disclosed to the State may not be compulsorily disclosed also to trade unions if such disclosure would be prejudicial to the national interest or if contravention of a prohibitory enactment would result. Special reasons may also be a reason for withholding information from the unions. These are that such information was subject to constraints of confidence imposed on the company, or that disclosure would cause substantial injury to the company or a substantial number of its employees.[45]

The Minister may be required to refer matters of disclosure to an advisory committee, set up under the Act[46], in certain circumstances. If the donor of information considers that special reasons apply or the authorised representative of a trade union considers that information withheld for special reasons should be disclosed then the advisory committee procedure may be invoked. The Minister may make use of such a procedure in consideration of what information may not be disclosed to trade unions.[47]

Since the committee is to be advisory, its recommendations may influence but are unlikely to change decisions committed on firm ideological or political grounds. The Act does, however, provide a Parliamentary mechanism to revoke orders made for disclosure to trade unions.[48]

Duties of confidentiality on government use and transmission of relevant information not disclosed to trade unions are required under the Act[49] and penalties are prescribed in connexion with the passing of information (fines) and for breaches of confidentiality (fines, imprisonment or both).[50]

The provisions of the Act relating to disclosure apply to manufacturing companies, as stated previously, and further definitions of activities are given in connexion with the classification of 'manufacturing'. These are:-[51]

"research,
transport,
distribution,
repair and maintenance of machinery,
sales and marketing,
storage,
mining and quarrying,
production and distribution of energy and heating,
administration,
training of staff,
packaging".

10. Parliamentary Controversies - the Differing Philosophies

Comparison of the 1975 Industry Act with the White Paper which preceded it[52] indicates the areas in which Parliamentary controversy was relatively intensive. The diametrically opposed views of protagonists may be indicated by the following statements made during the Second Reading of the Industry Bill.

> "The reforms contained in the Bill have three prime objectives. The first is to reverse the long decline in British manufacturing industry by providing a new and important source of public investment which in its turn will help to sustain and expand employment. The second is to inject both the national and the regional interest, and the interest of working people, into the strategic decisions made by major industrial firms, and to improve our use of existing plant and equipment. The third objective is to expand industrial democracy in those firms to make them more accountable and thus help to bring about the shift in the balance of power towards working people which we see as a prime necessity if our underlying problems are to be overcome." 53
>
> Anthony Wedgwood Benn: Secretary of State for Industry.

"The purpose of the Bill was to achieve three principal functions for the National Enterprise Board and the Government. First, there was the unfettered freedom to nationalise individual companies. Secondly, there was power to direct those companies to obey the political will of the Government. Thirdly, there were the compulsory powers to force companies into Planning Agreements ... The Bill achieves all three objectives which have been persistently sought by the Secretary of State and his Left-wing colleagues. The Bill has emerged with the maximum powers for the Secretary of State and the minimum of Parliamentary scrutiny."[54]

Michael Heseltine, M.P. Opposition Spokesman for Industry.

The concepts, structures and objectives of the National Enterprise Board, Planning Agreements and corporate information disclosures provided grounds for fierce Parliamentary controversy during the stages of the Industry Bill[55] in both Houses. A measure of the differences is indicated by the number of amendments (180) up to Report Stage[56], although it was claimed that most of these were not controversial, consisting largely of technical, drafting, consequential and textu al amendments.[57]

Examination of the closing stages of the Parliamentary procedures leading to the eventual enactment of the Industry Bill reveals the areas which were the loci of substantial disagreement despite the refining influence of more than 142 hours of debate in the Commons and over 50 hours of debate in the House of Lords.[58]

A Lords amendment to remove the N.E.B's power to establish industrial enterprises[59] became a focus of argument about the merits and demerits of public ownership. It was held that removal of this function would result in emasculation of the declared policies of the government[60] whilst the Opposition view was that inter alia, the concepts of a mixed economy would be untenable without a prosperous and thriving private sector free from the shackles imposed by the possibility or actuality of public control.[41]

Other Lords amendments included opposition to the N.E.B's powers to extend public ownership into profitable areas of manufacturing industry[62] and to its promotion of "industrial democracy".[63] Limitation of its equity acquisition powers.[64] Changes in the definitions of trade unions, T.U.officers and workers representatives as recipients of corporate information.[65] Extension of disclosure requirements to members of companies,[66] and the status and functions of the advisory committee on information disclosures.[67]

11. State Regulation versus the Market Economy

During the recurrent Parliamentary battle about public ownership and control versus free enterprise and a market economy, the reasons for inadequate investment in U.K. manufacturing industries were rehearsed by Michael Heseltine, the Opposition Spokesman for Industry.[68] A key point was the inadequacy of returns on investment and another was the record of publicly owned industries in this respect.[69]

The reasons for inadequacy of creation of surplus value in the private sector could also include; the growing proportion of the gross domestic product appropriated by the public sector and the concomitant fiscal policies associated with the transfers; the prudency of directorial distribution and retention policies; transfer pricing mechanisms of multinationals; growing obsolescence of U.K. productive fixed assets in terms of international competition;

excessively high ratio factor costs such as energy and transport, in comparison with overseas competition; low labour productivity; inadequate capital-intensification owing to restrictive union practices on manning levels; inhibitive interest rates (curtailment of productive investment) and, of course, high inflation rates.

Other important factors leading to relatively low investment in private sector manufacturing industries could include the following. Restrictive effects on margins of public pricing policies. Attractive alternative investment in commodities, gilts, property, land, fine arts, gold, foreign exchange transactions, and alternative overseas investment by U.K.-based multinationals.[70] Fragmentation of corporate strategies and planning caused by the instabilities and short-run nature of national economic policies (which has already been mentioned in this respect (Chapter 3, Section 7 and Chapter 5, Section5)).

Experience suggests that among the problems of state monopoly and control one could include inhibitions of consumer choice; possible loss of key allocative indicators; neglect of the politically weak; misuse and abuse of monopoly power; relative insensitivity to demand influences and cross-subsidisation. The human and societal problems of State control and regulation could include repression of entrepreneurial talent; subjugation of individual protest: relative insensitivities of bureaucratic structures; autocratic decision making processes and the atrophy of motivation in managers and managed.[71]

Systems of relatively or completely unregulated marker forces are not necessarily free from many of these problems, particularly where large scale organisation is concerned. Consumer exploitation, resource deprivation, inequitable pricing policies and uninhibited spoliation of the environment have been problems attributed to injudicious exercise of the profit motive.

From the manager's viewpoint, the goal is 'efficient' allocation and deployment of resources and the flexibility of application of this dictum lies in the interpretation of 'efficient'. The creation of surplus value or profit is a sine qua non in any system of growth and necessary even to maintain equilibrium in a stable system because of the inevitability of losses through wastage and usage.

But the measurement of social benefits and human satisfactions has not yet been reduced to the precisions of accounting procedures and the relationships of revenue and expenditure, surpluses and shortages, profits and losses taken in isolation from the qualitative factors could be but poor indicators of 'efficient' management.

12. Identification of Principal Instruments of State Control

The purpose of this part of the analysis was to identify the main instruments of public control and their significance to management in manufacturing industry in terms of the legislative and associated frameworks facilitating positive interventionist policies.

Because of the modification of the compulsory provisions relating to planning agreements; the features most feared by opponents of these instruments of public control are less likely to develop in the near future. The position could change, however, in the event of a stronger Parliamentary majority facilitating the re-imposition of compulsion by a future Labour administration. Consequently, it is necessary to include a study of planning agreements since this aspect may well be of considerable importance to management in private sector manufacturing industry.

The studies at this stage indicate that the factors relevant for analysis within the terms and scope of this work are as follows:-

(a) The objectives, purposes, powers, structure and functions of the National Enterprise Board.

(b) The relevance, scope and purpose of Planning Agreements.

(c) Industrial Democracy, with particular reference to management and managerial processes in the private sector.

(d) Associated and contiguous factors of contemporary significance in the study of public control in the private sector, related to industrial management.

Of these features, a most important one for management is undoubtedly the National Enterprise Board. Although the relationships between the N.E.B. and its operating subsidiaries will be demonstrably different from those between the government and the nationalised industries and public corporations, the problems of corporate and operational dichotomy, identified in Chapter 3, Sections 4 and 5, could emerge to vitiate efficient management in this public/private sector milieu.

A study of the factors nominated above will be carried out in Chapter 7 and the first part of the work of this thesis will then have been completed in terms of objective (a), nominated in Chapter 1, Section 1).

CHAPTER 7.

PUBLIC CONTROL IN THE PRIVATE SECTOR

1. Instruments of State Control

The aims, scope and boundaries of the study of State intervention were delineated in Chapter 1 and the first part of this thesis has been constructed to provide a common basis for the two objectives nominated in Chapter 1, Section 1. Chapters 4, 5 and 6 have been concerned with the first of these objectives, namely, the examination of contemporary developments of public policy and novel instruments affecting or likely to affect management in manufacturing industry.

As a result of these studies, four relevant areas were defined (Chapter 6, Section 12) for further analytical study in this chapter. These were Planning Agreements, Industrial Democracy, the National Enterprise Board and general associated factors.

It is intended now to deal with these aspects in the order mentioned. Due to the removal of the original intention to make planning agreements compulsory and the affirmation that planning agreements would be wholly voluntary,[1] the importance of this instrument, particularly for smaller firms in the private sector manufacturing industry, is likely to be less evident. Consequently, analytical study here will not be given undue prominence.

Industrial democracy, particularly in the explicit form exemplified in the Bullock Report,[2] has not been given the ratification of legislation at this time and the potential scope of analysis and relevant discussion (avoiding conjectural excursions) is thereby reduced accordingly.

However, the National Enterprise Board's role as an innovative holding and managing agency in the public sector is likely to survive political changes in view of its contemporary entrenchment and commitment in the industrial arena (notwithstanding possible future curtailment of its powers of acquisition of private sector corporate assets). For this reason, it is proposed to study the NEB in some depth in this chapter with particular reference to the managerial connotations and public control relationships and problems detailed in Chapter 3, Sections 3,4,5 and 6.

It is intended to conclude this first part of the thesis by a brief survey of relevant aspects, specifically in relation to management of undertakings in the private sector, and to derive conclusions from the preceding and present analyses relating to objective (a), as nominated in Chapter 1, Section 1.

2. Planning Agreements: Managerial Connotations

The intention of the Government (Chapter 5, Section 2) was that planning agreements were, initially, to be with major firms in key industrial sectors and the scope and machinery of planning agreements were established in Chapter 5, Section 2 and Chapter 6, Section 7. Reactions to this novel instrument of public control by informed authorities, bodies and individuals were discussed in Chapter 5, Section 4 and Section 5, and the managerial significance of this innovation formed the body of analysis in Chapter 5, Section 6. These studies indicated that many practising managers in the private sector were not convinced about the efficacy of planning agreements.

The essential philosophy of planning agreements, as exposited by the Government,[3] may be summarised as follows:-

(i) An instrument to achieve a partnership of Government, a profitable private sector, management and workers in industry.

(ii) The sharing of corporate planning, data and setting of objectives at the level of the firm to produce mutual benefits in the national economic interest.

(iii) To produce a participative forum for workers in industry.

(iv) To facilitate the development of efficient public policy relating to industry and central economic policy.

Viewed in the light of politically normative aims, these objectives represent an ideal concertation of public and private sector participants in the national interest. Examined from the pragmatic standpoints of management and managers in private sector firms, with the evidence (Chapter 3, Sections 4, 5 and 6) of long-standing problems between State and industry, the resistance to such extensions of government and unions' influence (Chapter 5, Sections 4, 5 and 6) is explicable and representative of harsher reality.

The differing sectional interests of government, business, management and workers may be reconcilable within a matrix of sanctions arbitrarily imposed by the State but it is hardly credible that a voluntary system of consultation in the nature of planning agreements (i) could produce the desired benefits of consensus and harmonisation and the voluntary alignment of vested interests, so basically dissimilar in many respects.

With regard to (ii), it is clearly possible that the strategies of the State and of major supply organisations in a monopsonistic or oligopsonistic relationship with central government could be compatible - even inseparable. In such cases, the mutual development of corporate strategy between government and private sector board could facilitate decision-making on many issues.

For example, on profitable investment, the creation and location of productive capacity, optimal manning levels, long-run efficiency of a given product mix and the specific components of corporate planning relating to the particular undertaking. Directors of such companies could relate their corporate management activities as wholly connected with, and relevant to, the efficient survival of the firm, and the parallelism of public and private interests could facilitate such a partnership.

But many boards of directors do not have a basis for strategic relationships of this kind with the State. Examples are manufacturing undertakings with multiple products, diverse markets, producer and capital goods outputs principally for the private sector, goods for private consumption, goods for export. What would be their incentive and quid pro quo for relinquishing directorial control of the corporate management of their firms, even partially, on a voluntary basis?

Publication of the Bullock Report (2) has advanced the issue of industrial democracy in terms of worker-directors, and this is discussed in Section 3. The aim of planning agreements to produce a participative forum for workers in industry (iii) is evidently based on trade union involvement and is linked with the compulsory disclosure of corporate data analysed in Chapter 5, Sections 2 and 5 and in Chapter 6, Section 8.

It was shown (Chapter 5, Section 5 and Chapter 6, Section 7 and Section 8) that the original intention to make both planning agreements and information disclosures compulsory did not materialise due to resistance during the progress of the Industry Bill. Of the two linked instruments, the former became voluntary whilst the latter may be the subject of compulsion under the provisions of the Industry Act, 1975.

From managements' viewpoint, compulsory provision of confidential corporate information (detailed in Chapter 6, Section 8), outside the framework of voluntary planning agreements in which trade unions are participants, can hardly be described as a'participative forum'.

The inducement to enter planning agreements has been shown (Chapter 6, Section 7) generally to comprise guarantees relating to the stability of grants or financial assistance provided by the government under the provisions of the Industry Act, 1972, (Sections 7 and 8) and connected legislation. Notwithstanding this and other possible benefits discussed above in this section, and the possibility that planning agreements could be conducted so as to produce detente between the public and private sectors managerial echelons, it seems unlikely that directorial corporate decision-makers will be prepared to forgo, if not relinquish, a considerable measure of their status satisfactions on a voluntary basis.

Directorial powers derived from the exercise of choice in such matters as the following (the subjects of planning agreements[4]) are, clearly, strong inducements for private sector management to retain its existing authority and accountability.

(a) The setting of corporate objectives.

(b) Development of corporate strategy and policies.

(c) Control of investment and assessment of risk.

(d) Freedom to determine optimum product mix.

(e) Marketing strategies and tactics.

(f) Capital and labour intensity ratios.

(g) Control (albeit diminished) of pricing policies.

(h) Measure of acceptance of social and non-monetary accountabilities.

(i) Management of human and industrial relationships.

(j) Control of output and capacity utilisations.

(k) Research and development budgets.

Add to these the personal aggrandizements of directorial roles and it seems not unreasonable to put forward the thesis that voluntary planning agreements as an instrument of public control, in the form envisaged by the Government, will be limited in scope, support and achievement.

Finally, with regard to the fourth main aim of planning agreements - to facilitate the development of efficient public policy relating to industry and central economic policy - this appears to be unexceptionable in the light of the relative failures of the policies of exhortation at industry level that preceded the positive interventionist policies of the 1960's.[5]

It is likely that greater understanding of the effects on industrial management of differing public policies could accrue, over the longer term, at the interfaces between politicians, civil servants, managers and organised labour representatives in an environment of collective participation to secure the objects of such collaboration in the national interest. Such an outcome can only be speculative at present, but the achievement of such a worthy objective could result in a significant amelioration of the problems discussed and detailed in Chapter 3, Sections 4, 5 and 6, and a consequent improvement of the allocation and deployment of economic resources compared with present standards.[10]

3. Industrial Democracy and Management

The contemporary development of industrial democracy, of direct relevance to management in private sector manufacturing industry, may be categorised in the following forms.

1. Directorial echelons:- Effects on strategic decision-making related to corporate objectives, strategy and planning and to general corporate management.

2. Directorial/executive echelons:- Effects on strategic and tactical decision-making related to all facets of managerial accountabilities, authority and responsibilities.

The first of these (1) may be further sub-divided in the following terms:-

(a) External participative structures involving modification of and influences on board decision-making.

(b) Internal participative structures affecting the climate and objectives of directorial corporate decision-making.

The second category (2) may also be sub-divided in the following terms:-

(a) External participative structures involving the injection of non-corporate elements into managerial decision-making.

(b) Internal participative structure affecting all levels of managerial decision-making and involving the injection of multi-lateral influences.

In the case of category 1(a), there is a long history of external agencies having modifying influences on corporate managers' decision-making in the private manufacturing sector, among others.[6]

In addition to government, both central and local, these include customers and suppliers; competitors; operational management and worker's representative bodies; cultural, ethnic, environmental conservationist and political pressure groups; funding agencies (banks, finance institutions, shareholders); industrial and trade associations; and, not least, proprietorial interests.

These long-standing concomitants of board decision making have the ethos of largely voluntary acceptance, apart from statutory and contractual obligations, with degrees of compulsive influence associated with the amounts of pressure capable of being exerted by the external agencies and of being resisted by the directors, if they so wish.

The planning agreement structures, discussed in section 2 above, albeit voluntary, are accompanied by compulsory powers of information disclosure and involve active intervention in the directorial decision-making processes at the level of the board room.

Such a development is clearly an innovative instrument of major importance to top-level managers; particularly so in view of the often adversarial relationships between directorial management and the trades unions in the private sector. If the original intention to make planning agreements compulsory eventually reaches fruition, this instrument of the policy of industrial democracy could result in significant changes in the existing structures of directorial power.

There are also existing internal participative structures affecting directorial decision-making categorised in 1(b) above. These are, of course, the individual, group and corporate relationships within the organisation comprising both workers' and operational managers' interfaces with the board of directors. The structures are both direct and indirect in the senses that executive involvement in data processing and programming for eventual board level decision constitutes a modifying influence based on personal involvement; the operational executive is also often a director and thus intimately concerned with corporate decision-making in a collective capacity at board level.

The indirect contribution of operational managers, whether staff or line, to board level decision-making arises from knowledge or experience exercised in the processing of technological or functionally-orientated data for the purpose of formulating decision alternatives presentable to higher echelons of decision makers. Successful track records in these formative activities at increasingly senior levels of management lead, not infrequently, to directorial election to the board in many progressive companies.

Workers' direct participative structures affecting the climate and objectives of board level decision making are, of course, individual, group and collective agencies acting through line or staff communication channels, both formal and informal. Their indirect contributions arise from professional attitude surveys, representations by intermediaries, management measurements (absenteeism, labour turnover) and application of criteria of performance (efficiencies of usage, output, control, etc.), reactions to innovative policies introductions and, of recent importance, their reaction to takeover or merger situations.

Most of these influences and constraints on management in the private manufacturing sector are traditional and of relatively long standing. Many executive directors have reached the board room from the shop floor. It could be argued that in so doing they have undergone a gradual metamorphosis so that their aspirations and allegiances have become antipathetic to the interests of the rank and file workers. But the fact remains that these individuals represent a repository of invaluable knowledge, training and experience of the organisation within the board room.

It is evident that the structures of board room power, categorised in 1(a) and 1(b) above and examined in the light of these pragmatic considerations, are not immune from tempering external and internal influences that tend to exert, collectively, a democratising pressure on directorial autocracy.

With the growing acceptance of the need for and value of worker participation in the decision machinery and spheres that affect them so intimately in many important respects, and the developing sophistication of collective consultative and negotiating structures representing the interests of the workers, it could be argued that evolution of industrial democracy was assured.

Categories 2(a) and 2(b) defined above, the general effects on industrial management, at all levels, of external and internal participative structures involving the injection of non-corporate elements and multi-lateral influences may now be examined.
It is necessary to define the intended meaning of 'non-corporate elements' and 'multi-lateral influences' in a corporate management context.

First, the former term relates to political, social, ideological and other elements extraneous to the normal management corpus of decision-making involving the economically viable allocation and deployment of resources in manufacturing industry. Secondly, the latter term relates to the numerous and largely indefinable factors affecting the outcome of managerial decision making carried out within amorphous organisational boundaries and within the purview of influences arising from extra-economic motivations of participants. More simply, subjective and qualitative aspects unrelated to real corporate limitations and espoused by non-managerial quasi-decisionmakers.

In these respects, a trade union viewpoint is not inappropriate:-

> 'You need to understand that the argument has really not been about industrial democracy or about the participation of workers, the argument has been about who holds the power in industry ....'[7]

The restructuring of managerial decision making processes must be an inexorable concomitant of 'industrial democracy' couched in these terms.

A strong indication of the contemporary development of public policy is given by the terms of reference of the Bullock Committee of Inquiry on Industrial Democracy set up by the present Labour government.[8]

> 'Accepting the need for a radical extension of industrial democracy in the control of companies by means of representation on boards of directors, and accepting the essential role of trade union organisations in this process, to consider how such an extension can best be achieved, taking into account in particular the proposals of the Trades Union Congress report on industrial democracy ......'

The partisan remit is evident; and the composition of the Committee (three trades unionists, three academics, three industrialists, a legal practitioner and a holder of public office) coupled with the limited time of twelve months given the body to report strongly suggests that the setting up of such a committee was the policy aspect of significance.

Not surprisingly, the outcome of the exercise was inconclusive in that a majority report, a minority report and a note of dissent were issued. The majority report advocated a reconstituted unitary board structure, comprising equal directorial representation of shareholders and (union) workers with a third, numerically smaller element elected by a majority of the two major sectors: thus giving rise to the 2X + Y formula.[9]

Legislation has not yet been programmed to implement the recommendations of the Bullock Report so that further discussion here would be largely conjectural and, thus, inadmissible. However, it is clear that a board of directors constituted on such a basis could provide the potential for conflict and the injection of both non-corporate elements and non-managerial factors into board decision-making.

The equal '2X' components would, of necessity, be basically adversarial in the sense that a gain to one side would be a loss to the other unless the Utopian situation of perpetual growth could be achieved. Moreover, it is probable that the election of the 'Y' component could result in a neutralist sector of the board, selected so as to be of no potential benefit or harm to either of the 'X' sectors, thus possibly introducing extraneous or adventitious factors into corporate decision-making either inadvertently or by design to secure a majority consensus.

It seems not unreasonable to conclude that a structure of 'industrial democracy' enforced throughout management strata on such bases by precipitate legislation could result in inexperienced, untrained and managerially-incompetent participants becoming involved in decision making processes and activities for which they are entirely unfitted.

The minority report by the three industrialists advocated an evolutionary approach during which tyro decision-makers could gain the necessary knowledge at successively senior levels to achieve the necessary competence to act in truly participative capacities. Doubtless, industrial managers at all levels would subscribe to this recommendation in view of the inevitability of future development of the concepts of participation and 'industrial democracy'.

It is evident that structures facilitating greater participation in management decision making by non-managerial employees will evolve to meet this advocated need. The choice between voluntary systems developed on a consensual basis or government dicta could soon face management in private sector manufacturing industry. Whatever the eventual outcome may be, it is clear that fundamental managerial changes must ensue.

4. The Industrial Reorganisation Corporation and the National Enterprise Board - Comparisons.

The Industrial Reorganisation Corporation (IRC) was short-lived (Chapter 4, Section 2 and Section 3) and the National Enterprise Board (NEB) has not yet had sufficient time to establish an operational record to support adequate analyses and the derivation of realistic conclusions. Since the early demise of the former body, major political and economic environmental changes have wrought fundamental restructurings in the corporate private sector and thus limited the opportunity for relevant analyses to be carried out, within the nominated scope and objectives of this work, in respect of the IRC.

A relevant analysis of the IRC in relation to the Industry Act, 1972 was carried out earlier in this thesis (Chapter 4, Section 3 and Section 4) and it is intended now to complete the comparative element of this study by a similar comparison of the IRC in relation to the NEB.

4.1 Policies and Principles: IRC - NEB

The White Papers preceding the legislation giving substance to the IRC and the NEB[11] indicate the basic similarities and dissimilarities of the two bodies, so far as initiating public policies were concerned.

(a) Both the IRC and the NEB were to provide an active agency of intervention for government at the levels of both industry and company.

(b) Both bodies were to perform designated roles of restructuring in the private sector.

(c) The IRC was not to act as a general holding company whereas the NEB was to undertake this function.

(d) The IRC was to dispose of its investments as early as possible to facilitate the turnover of its capital and thus its capacity to promote its objects: the NEB was to hold the interests it acquired indefinitely.

(e) The IRC was not an agency to increase public acquisitions in the private sector; the NEB had a specific role to extend public ownership into profitable manufacturing industry by the acquisition of individual firms.

(f) The IRC was required, in terms of initiating public policy, to give priority to schemes of restructuring or re-organisation of industry aimed to secure increased exports/reduced imports; to comply with central government policies of regional economic development; not to support ventures which had no prospect of achieving viability.

The NEB was to enlarge the activities of its predecessor by acting as a new source of investment capital for industry; by adopting the role of a managing agency for existing Government shareholdings in industry; by providing short-term financial or managerial aid to sound companies. It was also required to act as an employment-creating instrument in areas of high unemployment, to be a general advisor to the private and public sectors on financial and managerial issues and, a major role, to promote industrial democracy. Unlike the IRC, the NEB was to have a social role in supporting ailing companies, on a separately accountable basis.

These comparative studies indicate that, from the public standpoint, the NEB was envisaged to be a larger and more versatile version of its predecessor, the IRC, and its roles were to be much more ambitious.

4.2 Practice: IRC - NEB

The legislation establishing the IRC and the NEB was the Industrial Reorganisation Corporation Act, 1966 and the Industry Act, 1975, respectively. A study of the major aspects of importance in the former enactment, with reference to the IRC, was carried out in Chapter 4, Sections 2, 3 and 4 and suitably cross-referenced (Chapter 4, ref. 9 and 10). A detailed investigation of the provisions of the latter Act, particularly in respect of the NEB, was completed in Chapter 6, Sections 2, 3, 4, 5 and 12, and these were prefaced by related studies in Chapter 5, Sections, 3, 4, 5 and 6. Comparative studies of these sources indicate that the major differences between, and similarities of, the IRC and the NEB are as follows:-

(a) The structures of the IRC and NEB were similar except that that of the latter could be larger (eight to sixteen members, apart from the chairman, against seven to fourteen members).

(b) Purposes and functions of the two bodies, as provided for in the Acts, differed as indicated generally in the preceding sub-section (4.1).

(c) Both the IRC and the NEB were given virtual carte blanche to carry out their functions within the bounds of their specified objectives. The Secretary of State had mandatory powers of direction in both structures; in general terms in the case of the IRC, and for the specific purposes of directing 'financial assistance'; of making decisions in qualifying acquisition intentions (dealt with in detail under Chapter 7, Section 5, as follows) and in nominating appraisal of investment criteria, in the case of the NEB.

(d) The aggregate financial limit on the IRC was £150 million compared with £700 million (ultimate limit of £1,000 million), not including Sections 7 or 8 assistance under the 1972 Industry Act, for the NEB.

(e) Both the IRC and the NEB were executive bodies.

(f) Both Corporations were enabled to act in competition with normal financial market forces.

(g) Whilst the IRC had no limitations on its degree of participation in acquisitions, there are constraints on the NEB (Chapter 6, Section 5 and Chapter 7, Section 5) in this respect.

4.3 Operations: Industrial Reorganisation Corporation.

The practical difficulties outlined at the commencement of this Section preclude realistic comparisons of the operational aspects of the IRC and the NEB; and the vastly different corporate environments of the late 1960s and the latter half of the present decade, coupled with the significantly different terms of reference of the two bodies (sub-section 4.1, above), render sterile analytical approaches of this kind. However, it is feasible to examine, firstly, the closing stages of the work of the IRC and, secondly, the operational framework and initial activities of the NEB (Chapter 7, Section 5) in order to comply with the requirements of continuity deemed necessary in this thesis.

An outline of the projects and work of the IRC was given in Chapter 4, Section 2 and Section 3 and a detailed analysis of the Corporation's activities was undertaken by Young and Lowe.[12] It is seen that a relatively passive role involving activities as a 'catalyst', under Ronald Grierson, the first Managing Director, gave way to a progressively more positive interventionist role[13] under Lord Kearton, who took over as temporary Managing Director for four months after Grierson resigned in October, 1967, and Charles Villiers, who retained the office of Managing Director until the dissolution of the IRC on 31st May, 1971.

In addition to the industrial restructuring activities that comprised its major role, the IRC was involved in peripheral matters such as study of disclosure of company information, of the effects of taxation on investment flows and of promoting efficiency through reform of company law.[14]

Other activities included settling commercial disputes; fostering the promotion of export standardisation of products, i.e. pumps; encouraging product standardisation (machine tools); and attempting to influence bankers and institutional investors to become more actively involved with management of the companies in their investment portfolios.[15]

As stated earlier (Chapter 4, Section 2), the IRC was involved substantially in about ninety projects.[16] Of the forty main projects,[17] analysis indicates that the Corporation was concerned with thirteen mergers, about half of which involved the provision of funds; six private sector takeover situations and one in which the IRC was the acquirer; the formation of three groups and two companies; the subscription of funds in the form of one equity holding, one Preference holding and eleven loans; and the provision of 'rescue' funding in two cases.

On the 30th April, 1971, a month before its dissolution, the IRC had investment commitments amounting to £12,581,000 comprising twenty-eight investments in the form of equity and Preference holdings, straight and convertible unsecured loans.[18]

Of the £150 million funding, authorised in the form of £100 million from the National Loans Fund and £50 million of Public Dividend Capital, £64.4 million of the former and £43 million of the latter had been drawn by the 30th April, 1971.[19]

The redemption dates for the loans made to the IRC varied from the 14th November, 1971 to the 16th June, 1979, and the interest rates ranged from 7½% to $9^{3}/4\%$.[20] The IRC had a surplus, at the 30th April, 1971, of £1,319,000 and this had been applied (with tax relief thereon) in writing down two unquoted investments comprising unquoted equity in British Nuclear Design and Construction Ltd.(£260,000) and £1,936,000 of a £10 million unsecured convertible loan made to Rolls Royce Ltd.

There were loans outstanding amounting to £73,938,000 and it was considered by the Members of the IRC that these would be 'fully realisable on maturity'.[21]

The specific relevance of the IRC's activities to management appears to have been mainly in the field of strategic corporate affairs involving directorial echelons. It did perform an active role in evaluating managerial competence and was involved in the election of directors.[22]

Its Chairman, Sir Joseph Lockwood and the ten members of the Board were actively involved'in some depth' with more than twenty of its investments during the IRC's last year of operation, despite a rundown of its executive in anticipation of termination.[23] However, because of its remit not to retain investments (Section 4.1(d) above) and the velocity of turnover of its projects, it is unlikely that direct involvement with operational and functional management could have been sustained. Unlike the NEB, the IRC was not created to perform a managerially significant role in the operational sphere of corporate affairs. Having studied the IRC's role as an active interventionist government agency in terms of its operations and powers, it is necessary to complement this by a similar analysis of the NEB's role. Because of the limited period during which the NEB has been operational it is evident that its significance for management in manufacturing industry, within the terms of objective (a) Chapter 1, Section 1, has yet to be developed. However, the following Section is devoted to (a) a study of the National Enterprise Board's powers and operations in terms of its remit from and relationships with the government and (b) its field activities so far as data are available.

In view of its contemporary relevance to management in private sector manufacturing industry and to the first objective (Chapter 1, Section 1) of this thesis the analysis must be more detailed than for that of its predecessor, the IRC. The significance of the latter body, from the standpoint of the present work, is that it was an important innovation in public policy affecting private sector industry and that it constitutes an historical signpost indicating the routes likely to be travelled by its successor, the National Enterprise Board (subject to political philosophies and the ideologies of its Members).

5. Theory, Practice and Operations: The National Enterprise Board.

In terms of its importance to management in private sector manufacturing industry, the role of the NEB may be adduced from the two Industry Acts, 1972 and 1975, the NEB Guidelines[24] and the NEB's initial annual report,[25] together with associated data studied in this thesis and available from published sources.

In view of the NEB's function as a holding agency for the publicly owned companies operating in the private sector and of its remit to acquire profitable enterprises in the manufacturing industries, in particular, this body comprises a government instrument of importance-depending on its controlling Administration. Its present environment is that strongly favouring positive interventionist policies,under a Labour Government, tempered by the marginal position of its sponsors' Parliamentary 'majority' (minority), in concert with the Liberals.

The political studies carried out earlier in this thesis (Chapter 3, Sections 1, 2 and 3) indicate that it is not outrageously conjectural to assume that the NEB's role could be drastically modified under a Conservative government but, even if it were completely emasculated as a result of a change of administration, the significance of this novel instrument of policy is likely to prevail over the longer term. Consequently the analyses carried out in the following sub-sections, together with contiguous studies in this thesis, should form adequate bases for an attempt to achieve the first objective of the work.

5.1 Theory and Practice: NEB.

The NEB's objectives and strategies are to be based on the purposes and functions set out, initially, in the 1975 Industry Act.[26] Specifically, in accomplishing its aims, the Board's activities will be subject to the constraints of legislative and voluntary controls exercised also in the case of institutions and companies in private ownership.[27] It will be subject to, for example, the Fair Trading Act, 1973 (Chapter 5, Sections 5, 6, 7 and 8), the City Code[28] and Stock Exchange requirements[29] when using its powers of acquisition (the right to acquire shares, as have incorporated businesses under the Companies Act, 1948).[30]

Acquisition of equity in a private sector listed company, with or without the consent of its directors, is subject to the Secretary of State's power of direction[31] if,

(a) the acquisition would entitle the NEB to exercise more than 10% of voting power,

(b) the acquisition would raise new or significant policy issues,

(c) the cost of acquisition exceeds £10 million,

(d) the acquisition would give the NEB 30 per cent or more of the voting rights.

Subsidiary companies of the NEB have a statutory general authority to acquire more than 30 per cent of share capital in a company provided the directors are not opposed and the cost of the total holding does not exceed £0.5 million.[32]

The freedom of the NEB to enter financial projects within a commitment limit of £25 million (subject to the restrictions listed above) implies considerable potential for control in the private sector, particularly when the industry comprises fragmented structures of numerous low-capital value enterprises. Restrictions on the disposal of voting shares, involving authority from the Secretary of State, does not apply to holdings of less than £0.5 million.[33] It follows that the NEB's subsidiaries have considerable autonomy in strategic policies involving relatively small businesses in the private sector.

The NEB and its subsidiaries have autonomy in the matter of pricing policies[34] and the power to acquire companies in profitable manufacturing industry is subject only to the restrictions noted above, and to the required need to show an adequate return on investment within a reasonable period.[35]

A high retention policy[36] could give the NEB sector an advantage over its private sector competitors since the compounded effect of such funding would increase the rate of investment of internally generated funds without the penalty of possible takeover for cheap assets that a private company could face if it adopted an excessively parsimonious approach to its dividend distribution policy.

Among the NEB's wider responsibilities are:-[37]

(a) a possible participative role in the conduct of planning agreements,

(b) to reduce unemployment,

(c) to consult and collaborate with the Scottish, Welsh and Northern Ireland Development Agencies,

(d) to promote Industrial Democracy,

(e) to consider consumers' interests,

(f) not to influence or have responsibility for, editorial functions in the public communications media, such as the press, other publications and broadcasting.

The above components of the NEB machinery, together with those discussed in Chapter 6 and Chapter 7, Section 4, subsections 4.1 and 4.2, comprise the theoretical bases of its operational capacity. It is clear that the NEB has a measure of autonomy in many important respects.

From the viewpoint of management in the private sector manufacturing industry, the relationships to be practised between the government and the NEB are also of crucial importance in the light of the managerial problems at the interfaces between politicians, civil servants, managers and workers identified and discussed in Chapter 3, Sections 4, 5 and 6.

Consequently, to conclude this sub-section, it is necessary to examine:-

(a) the relationships between the government and the NEB, and

(b) the probable scope of the NEB in practice, as elicited from the timing and availability of its public funding.

First, the interface between the NEB and the Government is governed by the provisions of the 1975 Industry Act discussed in detail in Chapter 6. These general provisions have been augmented by specific machinery detailed to cover the manner in which the NEB's accountability for its functions will be exercised,[38] and a summary follows:-

(i) The NEB is required to prepare and submit to the Secretary of State a Corporate Plan, annually, containing a projection of long term strategy. Contents shall include,

(a) financial targets,

(b) investment plans,

(c) employment matters,

(d) efficiency criteria,

(e) export considerations,

and the NEB's performance is to be assessed in the light of its achievements of set objectives.

(ii) Planning information shall include specific investment and financing data relating to existing NEB holdings; acquisitions, joint and new ventures; assistance operations. These data will provide bases for tripartite discussions, with the Department of Industry, the Treasury and the NEB as participants, with the objective of arranging funding of the latter's approved activities.

(iii) Because of the diversity and variability of the NEB's programme of activities and the need for flexibility throughout the period of the Planning Cycle, special arrangements for consultation between Ministers and the NEB will be made to facilitate major decision-making, as appropriate.

(iv) Major NEB companies are intended to operate within the scope of planning agreements as negotiated in a reference framework agreed between them and the NEB.

(v) The measures of control to be applied to very large companies are quoted verbatim.[39]

'The Government will take a close interest in the performance, plans and prospects of the very large companies whose shares are vested in the NEB, such as British Leyland Ltd. or Rolls Royce (1971) Ltd.(sic). This reflects the undertakings given to the House of Commons by the then Prime Minister on 24th April, 1975 that British Leyland "will be required to put forward annual business plans before further funds are provided covering improvements in industrial relations and productivity and putting forward precise investment

and operating programmes for specific Government approval within the new system of planning agreements...
... The aim will be to satisfy the criteria for the provision of public funds on such a vast scale while at the same time allowing the company to operate on an effective commercial basis without day-to-day Government intervention'.

Examination of the details of this machinery indicates that the interface between directorial management at the level of the smaller NEB companies and the Government will be 'buffered' by the Members of the NEB as the holding agency. Whether or not an analogy can be drawn between the board of a private sector company and its holding company proprietor(s) or shareholders, as the case may be, depends largely on the constitution of the NEB in terms of its individual Members and, particularly, of the philosophies they espouse. Since an element of speculation must enter such a treatise no excursion can be made in that direction at this point.

However, it is evident that, because of the interposition of the NEB between directorial management and central government and the declared autonomy in corporate management functions, a significantly different ambience could exist in smaller companies so far as managerial echelons are concerned, compared with larger companies. The non-corporate constraints on directorial decision-making will depend on the complexion and make-up of the NEB, primarily, and on the degree of intervention at the level of the company desired by the State and facilitated by the NEB, secondarily.

The situation is different in the case of the very large companies in the public/private sector. There is to be a direct interface between directorial management and government, civil servants and, through planning agreements, the trades unions in matters of corporate management at the strategic and functional levels. This managerial environment may be compared directly with that of the nationalised industries and public corporations, discussed in Chapter 3, Sections, 3,4,5 and 6, with the inference that similar problems could result.

Thus, it is possible that management in the erst-while private companies acquired by the State could find itself operating in two very different milieux. The operational significance of the distinctions would clearly depend on policies of both Government and the NEB. Experience of the IRC (Chapter 4, Section 2, and Section 3; Chapter 7, Section 4, sub-section 4.2) in practice indicated that the collective philosophy of that body was strongly attuned to the individual outlooks of its protagonists, notably those of its Chairmen and Managing Directors.

Since the NEB has a not dissimilar format it is not unreasonable to assume that in the matter of operational philosophy, it could follow the pattern of its predecessor. Consequently, changes in policy could follow both government and NEB restructurings but the pursuit of such eventualities, conjectural as they are, lie outside the scope of this thesis.

To conclude this sub-section, it is necessary to examine the second aspect (b) nominated above, that is, the funding of the NEB. An indication of the relative magnitude of the NEB's role in the public control of private sector companies is contained in the Government's expenditure projections[40] and in comparable spending plans.

The amounts allocated to the NEB in money terms are £225 million for the years 1976-77, 1977-78, 1978-79 and 1979-80, respectively, giving £950 million, including the £50 million allocated in 1975-76, for the five year period. These provisions compare with projections for selective assistance to industry and individual companies (Industry Act, 1972, Section 7 and 8 provisions) amounting to £132.9 million in 1976-77, £120.8 million in 1977-78, £93 million in 1978-79 and £52 million in 1979-80 (totalling £398.7 million), at 1975 Survey prices.

The Expenditure White Paper points out[41] that the NEB's allocation is subject to review and that a further source of funding will be available to NEB companies under the 1972 Industry Act. An example of the latter is the £200 million support for British Leyland[42] over the projected period, giving a commitment of £0.747 billion when the £247 million equity purchase and the £300 million capital injection for British Leyland are included.

These figures suggest that the public acquisition of British Leyland has materially affected the financial capacity of the State to extend its programme of public control in the private sector in the relatively short term. On the other hand, the significant economic influence of this group, in terms not only of its output but also of its purchasing power and position as a monopsonistic or oligopsonistic customer of thousands of primary, secondary and tertiary suppliers, has now accrued to the public sector in practical terms and must be considered crucially important to the managements of the many enterprises so affected.

To put these financial aspects into perspective vis-à-vis industrial financial projections and expenditures, Imperial Chemical Industries was to spend £550 million on new fixed assets in 1977[43] and net domestic capital issues on the U.K. market for the total manufacturing sector amounted to £686.3 million[44] in 1975. The fixed capital expenditure of manufacturing industries was £1,737 million in 1975 and £1,221 million for the first three quarters of 1976, at 1970 constant prices;[45] the sector's gross fixed capital formation was £3,941 million in 1976 at current prices.[46]

The relatively open-ended funding availability to the NEB and its subsidiaries under Sections 7 and 8 of the 1972 Industry Act precludes direct quantitative comparisons but it may be seen that the entire net domestic capital issues on the U.K. market for the total manufacturing sector in 1975 was only 92% of the commitment of public funds on British Leyland alone. The NEB's firm funding up to 1980, ignoring 1972 Industry Act provisions, represents an annual rate of 43% of ICI's major fixed asset expenditure in 1977; of 14% of manufacturing industry's fixed capital expenditure in 1975, and the global amount of £950 million represents 24% of that sector's gross fixed capital formation in 1976.

These comparisons indicate that the NEB has sufficient financial strength significantly to affect ownership and control in the manufacturing industries of the private sector and, concomitantly, the management echelons within these companies.

It appears (Chapter 7, Section 5 and sub-section 5.1) that, from managements' viewpoint, the structures, framework and modus operandi of the NEB could result in two distinctive corporate ethos relating to very large companies on one hand and smaller companies on the other.

The degree of autonomy accorded to the directorial and executive managers could well vary from almost completely discretionary roles in the smaller companies, with virtually absolute accountability for the corporate management of the enterprise, to largely prescriptive relationships, with the emphasis on bureacratic, mechanistic systems of decision making in the very large companies - having the effects discussed in Chapter 3, Sections 4 and 5, i.e. serious managerial problems of accountability, authority and responsibility, inter alia.

Having completed the studies of theory and practice related to the National Enterprise Board's role as envisaged by the Government and within the context of the studies in this thesis, it is now necessary to complete the NEB/IRC analysis by examining the contemporary operations of the NEB as far as the public record allows in this early stage of development of the Board.

5.2 Operations: The National Enterprise Board.

With one exception, the Members of the National Enterprise Board were appointed in November, 1975 and their first annual report[47] was issued in May, 1977, for the period 20th November, 1975 to 31st December, 1976. The Board comprised the Chairman, Lord Ryder, the Deputy Chairman, Leslie Murphy (later Chairman in succession to Lord Ryder) as full-time Members and eight part-time Members.

The immediate backgrounds or occupations of the Board members consisted of five industrialists, three trades unionists, one merchant banker and one economic/industrial consultant (with commercial directorships). By April of 1977 the Board had appointed some fifty staff located at the London headquarters and the two regional offices in Liverpool and Newcastle.

Lord Ryder's introductory statement in the Report stressed the preparatory nature and essential groundwork of much of the NEB's early activities and it is evident that the significance of the Board's role as an agent of change in the philosophies, principles and practice of industrial management will emerge in the longer rather than the shorter term of operation.

In referring to the operational criteria that had shaped its early work, the NEB cited the influences of the Secretary of State's policy guidance and the activities of the thirty-nine Industrial Sector Working Parties set up by the National Economic Development Council.[48] Although computer products are mentioned specifically as one field of involvement, the commercial need for confidentiality prevented the NEB from disclosing other sectors with which it had been concerned.[49] So far as actual operations were publishable, the NEB had substantial interests in thirteen companies (excluding loans to machine tool companies) and these represented assets employed amounting to £959 million producing £51 million group profit at the 31st December, 1976. The following Table (No. 7.1) shows the companies, their status, the products, percentage of shares (equity) held, the total NEB investment in each company and its relative proportion. An indication of the scope of the NEB's activities and commitments subsequent to the 31st December, 1976 is included in Table No. 7.2.

	Investment	Products/Industry	Percentage of Shares (a) (Equity) held by NEB.	Total NEB Investment £ million	Proportion of Total Investment (d) (Percentage)	Turnover £ million
1.	Subsidiary Companies					
	British Leyland Ltd.	Automotive, etc.	95.1	256.49	43.25	2,892 (b)
	Data Recording Inst.Co.Ltd.	Computer Peripherals	53.9 (21.7.76)	2.41	0.41 (a)	8.50
	Ferranti Ltd.	Electro-mech.Engs.	(62.5)	15.00	2.53	108.5
	Herbert Ltd.	Machine Tools	100.0	29.33	4.95	49.4
	Rolls Royce Ltd.	Aero Engines	100.0	250.26	42.20	620.2
				553.49	93.34	3,678.6
2.	Associated Companies					
	Agemaspark Ltd.	Spark Erosion Mcs.	30.0	0.41	0.07	1.71
	The Cambridge Inst.Co.Ltd.	Medico-scientific Inst.	100.0 Preference 46.3 Voting 100.0 Non-voting	6.02	1.02	15.4 (b)
	I.C.L. Ltd.	Computers	24.4	12.08	2.04	288.3
	Reed & Smith Holdings Ltd.	Paper-Printing etc.	29.8	0.79	0.13	31.41
	Sinclair Radionics Ltd.	Electronic equipment	42.9(12.11.76)	0.65	0.11	5.62
	Twinlock Ltd.	Filing/Office equipment	100.0 Preference 33.3(20.9.76)	1.00	0.17	19.72
				20.95	3.54	362.16
3.	Other Investments					
	Brown Boveri Kent Ltd.	Industrial Instruments	17.6	1.88	0.32	-
	Dunford & Elliott Ltd.(c)	Steel	2.6	0.12	0.02	-
	Machine Tool Co.Loans	Machine Tools	-	0.42	0.07	-
	Subsidiaries' Holdings	-	-	15.96	2.69	-
	Group Share of Profits	-	-	0.20	0.03	-
				18.58	3.13	
		TOTAL NEB INVESTMENT AT 31.12.76:		593.02	100.01	

Notes:
(a) Ordinary Shares unless otherwise stated
(b) 15 months period.
(c) Sold in March, 1977
(d) At 31st December, 1976. Refer to Table No. 7.2 for later data.
(e) See also Table No. 7.2

Sources:NEB Annual Report and Accounts, 1976 and the Financial Times.

Table No. 7.1 shows the operational scope and commitments of the NEB in terms of the relevant companies and their relative significance, up to 31st December, 1976. Of the companies listed in the table, the Government's existing investments in the following were transferred to the NEB:-

British Leyland Ltd.

Brown Boveri Kent Ltd.

The Cambridge Instrument Co. Ltd.

Dunford & Elliott Ltd.

Ferranti Ltd.

Herbert Ltd.

I.C.L. Ltd.

Rolls Royce Ltd.,

and thus represent the nucleus of the management agency role initially envisaged for this body by its sponsors. The remaining six investments comprise an indication of the NEB's acquisitive policy from the standpoints of choice, type of company, holding sought and reason for investment; and these were:-

Data Recording Instruments Ltd.

Agemaspark Ltd.

Twinlock Ltd.

Reed & Smith Holdings Ltd.

Sinclair Radionics.

The eight transferred investments represented a current percentage of 94.29% at 31st December, 1976, and the relatively minor part (5.71%) of the NEB's total investment at that date involving the latter five companies indicates that the Board's role in furthering public policies of acquisition and control was still at a relatively embryonic stage.

Undoubtedly, the cuckoo's egg is British Leyland Ltd. since this Group's turnover (on a 12 months' prorated basis) represents over half that attributable to the entire NEB sector. The combined 85.45% of the NEB's investment comprising British Leyland Ltd. (43.25%) and Rolls Royce Ltd. (42.20%) clearly shows the importance of these two undertakings in the Board's overall commitment.

The smallness of the five new investments may be adduced from the percentage of the shares held by NEB and the investment cost of the holdings. These investments were made to facilitate expansion and modernisation, in general, and more specifically to improve export potential, to develop new products, to acquire more competitive fixed assets and to help consolidate and develop technological products.

In addition to the activities enumerated in Table No. 7.1 and above (to the 31st December, 1976) the NEB had been involved in the promotion of export markets and marketing, notably by associating itself with the risk capital of export contracts by way of joint ventures and with the provision of finance for machine tool stock building.[50] A further activity was the building up of regional organisation to facilitate the task of job creation in areas of high unemployment.[51]

Table No. 7.2 shows later activities of the NEB subsequent to the 31st December, 1976, and is of particular interest since it indicates the development of its policies of acquisition in the private sector. Despite the variety and number of the companies involved during this period, the scale of commitment in financial terms was relatively small. Of the thirteen new investments, five had the status of subsidiary companies and eight were associated companies, representing

NATIONAL ENTERPRISE BOARD INVESTMENTS (B)

Investments	Products/Industry	Percentage of Shares Held by NEB. Date (.........) (a)	Total NEB Investment £ million	Percentage of Total Investment Announced (b) (£600.94 million)
			b/f 593.02 (c) (Table No.7.1)	98.68
1. Subsidiary Companies				
Data Recording Instruments	Computer Peripherals	53.9 (31.12.76)	1.0 + (d)	0.17 (i)
Insac Data Systems Ltd.	Computer Prods/Services	100.0 (April 77)	N.A.	-
United Medical Co.Int. Ltd.	Medical supplies Exporting	55.0 (April 77)	N.A.	-
Keland Electrics Ltd.	Electro-mech. Products	100.0 (April 77)	N.A.	-
Mollart Engineering Co.Ltd.	Precision Engineers	71.0 (April 77)	0.58 (e)	0.10
Thwaites & Reed Ltd.	Clockmakers	90.0 (April 77)	0.24	0.04
2. Associated Companies				
Dunford & Elliott Ltd.	Steel	- (Feb. 77)	0.071	0.01
Dunford & Elliott Ltd.	Disposal of NEB interests in March 1977		less(0.354)	Less(0.06)
Computer Analysts & Programmers(Holdings) Ltd.	Computer Services	29.9 (April 77)	N.A.	-
R.R.Chapman(Sub Sea Surveys)Ltd.	Maritime Services	47.2 (April 77)	N.A.	-
Francis Shaw & Co. Ltd.	Plastics/Rubber Products	N.A. (April 77)	1.75 (f)	0.29
White Child & Beney Ltd.	Plastic Containers, etc.	N.A. (April 77)	c 1.00	c 0.17
British Tanners Prod. Ltd.	Leather/Animal Products	50.0 (9.3.77)	3.00	0.50
Packaging Methods Ltd.	Packing materials mach'y	34.0 (April 77)	0.046	0.01
Pitcraft Ltd.	Mining equipment	20.4 (July 77)	0.487	0.08
Hemmings Plastics Ltd.	Plastic closures(containers)	(49.0) (g) 29.8 (h) (Sept. 77)	0.10	0.02
		TOTAL INVESTMENT:	£600.94 million	100.00

Notes:
(a) Dates of announcement.
(b) N.A. indicates not announced at date shown.
(c) To the 31.12.76
(d) Includes future commitment by NEB.
(e) Includes £200,000 loan commitment.
(f) Includes £1.0 million loan commitment.
(g) On conversion of loan stock.
(h) Partly convertible Preference Shares.
(i) See Table No. 7.1.

Sources: NEB Annual Report 1976; Financial Times.

eleven distinctive product/service categories.

Two of the subsidiaries, INSAC Data Systems Ltd. and United Medical Co. International Ltd. were new enterprises and a third, Keland Electrics Ltd., had been newly formed from a company in receivership. Of the associated enterprises, one was a new company (R.R. Chapman) and one (British Tanners) was formed from part of the Barrow Hepburn Group.

Compared with the global investment of the NEB (£600.94 million) for which details were available, the investment of the Board in these companies represents a relatively low profile approach.* The sizable commitment represented by the British Leyland and Rolls Royce Holdings has clearly inhibited the funding of a more ambitious programme at this stage of the NEB's operations since the scale of future calls on available finance, particularly by British Leyland, may be considerable.

However, sufficient evidence is available to suggest that the dichotomy of management control and relationships discussed in Chapter 7, sub-section 5.1 above could be a feature of the NEB's operations now and in the future. The corpus of very large companies specified as being subject to tripartite strategic control by government, management and unions is now under the banner of the NEB and the initial fragmentation, represented by the wide spread of small subsidiary companiės in different industries, suggests a conglomerate structure in which the NEB will be analogous to a private sector holding company.

*Post-completion of this research, the NEB became involved in a controversial use of public funds; as had its predecessor, the IRC. 'NEB's controversial new venture with Fairey' refers: Financial Times, 7th December, 1977.

Because of the inherent variety normally to be found in multi-product/ service conglomerates so far as management expertise, inter alia, is concerned, it is likely that a high degree of autonomy in both the strategic and operational spheres will need to be accorded to senior managers in these companies, if the relationships between accountability, authority and responsibility are to be maintained intact.

The nature of the managerial philosophies to be developed between the NEB and its companies cannot be ascertained merely from a study of unilateral indicators since qualitative relationships depending on personalities on both sides will clearly have formative effects. However, study of the NEB's Report does provide indications of the ethos likely to prevail within the sector.

Lord Ryder's Introduction,[52] emphasises the dual role of the NEB to ensure that its companies are properly managed and that there should be an adequate return on public funding. The latter object is qualified by the proviso "... where we are in a position to influence the companies concerned ..."

Whilst the Report reiterates the relationships between the Government and the NEB, established in legislation and in the framework of policy discussed above (Section 4 and sub-section 5.1), in some detail, the relationships between the NEB and management in its sector companies cannot be generalised because of the varying commitments in terms of degree of control and influence.

Notwithstanding this obvious difficulty, a clear statement of policy has been made[53] and, in view of its importance to the first objective of this thesis, it is quoted verbatim:-

> "In those cases where the NEB is the sole or major shareholder, or for any other reason is in a position to influence a company's performance, the aim has been to set up a relationship with the companies based on the philosophy that the NEB has no intention of usurping the responsibilities of company boards nor of intervening in matters of day to day management, whilst recognising that companies have certain obligations toward the NEB as a controlling or substantial shareholder or provider of loan finance. This involves in most cases agreeing on arrangements for the provision of annual and long range plans for approval by the NEB and for the submission (in the case of subsidiaries) of major capital investment proposals, acquisitions and disposals for approval. In addition, informal contacts at board and senior management level have enabled the NEB to familiarise itself with the particular characteristics and problems of each company".

This information confirms that a large degree of autonomy resides at board level in NEB companies and the ethos appears to be of managerially-aware support and inter-communication. The management of corporate strategies seems to have been differentiated from operational and functional management, unlike the situation between government and nationalised industries and public corporations discussed in Chapter 3, Sections 4, 5 and 6.

Data relating to public control in the private sector in general and to the nominated instruments of policy (Chapter 7, Section 1), in particular having now been examined, with specific reference to the first objective (a) detailed in Chapter 1, Section 1, it is intended to conclude this part of the thesis by a discussion of managerially significant information arising from the analysis carried out in Chapter 3, Sections 4, 5 and 6. This will be followed by a summarisation of the formative study material conclusions developed in earlier chapters and this chapter and final conclusions, as appropriate, relating to objective (a).

6. Public Management and Private Enterprise

The milieu of management in industry within the public sector is explored territory and examination of the evidence adduced in Chapter 3, Sections 3, 4 and 5 indicated some serious problems at the interfaces between politicians, civil servants, board members and executive management. Many of these problems were of long-standing duration despite periodic attempts to overcome or ameliorate them.

For the purpose of maintaining continuity it is useful here to summarise features of management in the public sector that were thought to be capable of being stated"...without risk of contradiction".[54]

> "- there is a lack of trust and mutual understanding between those who run the nationalised industries and those in government (politicians and civil servants) who are concerned with their affairs;
>
> - there is confusion about the respective roles of the boards of nationalised industries, Ministers and Parliament, with the result that accountability is seriously blurred;
>
> - there is no systematic framework for reaching agreement on long term objectives and strategy and no assurance of continuity when decisions are reached;
>
> - there is no effective system for measuring the performance of nationalised industries and assessing managerial competence."

The McIntosh team of the National Economic Development Office that carried out the study of U.K. nationalised industries, which resulted in the above findings, considered, inter alia, the merits and demerits of the two main alternative approaches. Namely, the 'arm's-length' relationship between government and industry and the 'concerted' involvement with maximum participation.[55]

Their recommendations were intended to combine the strengths of these differing philosophies and proposed institutional innovations involving the formation of a permanent Policy Council for each nationalised industry and a Corporation Board to act as the executive authority in each case.[56]

The Policy Council would comprise an independent President, a Chairman and should include representatives of government, trade unions (representing employees) and executive management . Government representatives would normally be senior civil servants in the sponsor departments or Treasury.

Executive functions would be the role of the Corporation Board. Its chairmanship would be separate from that of the Policy Council and the holder of that office would represent the Corporation at Council level, together with Board Members nominated by the Board. All Board members would be employees of the corporation.

Role differentiation between the two bodies comprised the separation of strategic corporate management, which would be exercised by the Policy Council, and operational management, which would be the function of the Corporation Board within the terms of reference agreed by the Policy Council.

The specific functions of the Policy Council would be:-

(a) to agree corporate aims and objectives,

(b) to agree strategic policies associated with them,

(c) to establish performance criteria,

(d) to endorse corporate plans, including annual budgets and related pricing and cost assumptions,

(e) to monitor performance.

Executive management at Board level would be carried out within a framework of policies, plans and performance criteria agreed jointly with the Policy Council. The Corporation Board's quasi-directorial functions would be the initiation of corporate aims, strategic policy options and proposals, the carrying out of detailed planning and to be responsible for implementation of policies and plans that had been agreed by the Policy Council.

Following publication of these proposals, the Select Committee on Nationalised Industries sought the views of all the public industries with which they were concerned and the results are of specific relevance to the studies of public control in this thesis.[57] Of the twenty-five public bodies responding to the request, twenty-two were against the Policy Council structure recommended by the NEDO Report. The objections varied in intensity but a common theme appeared to be rejection of the concept of truncation of corporate management at the strategic level.

A number of commentators did not agree that the arm's-length relationship advocated in the 1967 White Paper[58] had been a failure and advocated its continuance. A number of the respondents did not comment in detail on the NEDO Report since its findings and recommendations had been based on a study of nine of the largest industries but, of those hodies that did, a majority were able to associate themselves with the problems enumerated as a result of the NEDO investigation (detailed in Chapter 3, Section 4).

A recurring theme in rejection of the advocated Policy Council structure was the imperative need for continuity of the management structure and avoidance of involvement of politicians and civil servants in matters more properly the prerogative of managerial echelons at corporate and operational levels. It was widely confirmed that ill-considered and inappropriate interventions had been the cause of many problems (discussed in Chapter 3, Sections 4 and 5) and had led to serious undermining of confidence and failures in performance.[59]

The generally acrimonious tone of the responses indicated both the depth of feeling of professional managers in the public sector and the severity of the problems at the government/industry interface. Doubtless, equal opportunity for the public airing of the politicians' and civil servants' viewpoints would reveal that they also have problems in carrying out their respective roles.

Relating the track record of public control to the emergent NEB sector, it has been shown (Chapter 7, Sections 4 and 5) that of the two managerial environments that appear to be developing in this case, that of the very large companies could approximate to existing State/corporate relationships in the public sector.

The close correspondence between the matters to be dealt with through the machinery of planning agreements and directorial responsibilities in private sector management have been indicated previously (Chapter 3, Section 5 and Chapter 7, Section 2), and the proposed functions of the NEDO Policy Councils also reflect corporate managerial responsibilities at directorial level. The inference is that existing corporate management problems in the public industrial sector could also develop in the cases of the major NEB sector companies, such as British Leyland Ltd. and Rolls Royce Ltd.

Directorial competence to manage corporate affairs in private sector manufacturing industry, as discussed in Chapter 3, Section 5, is a product of many years', often a lifetime's, experience of the company's, or similar undertakings', activities, functions, organisation and environment. Alternatively, in the case of non-executive directors, the qualifications to be involved in corporate management at board level are often professionally acquired through education and training and/or substantive experience in the fields deemed to be appropriate for directorial contribution to the collective decision-making processes.

Recognition of these factors is evident in the NEB declaration of policy (Chapter 7, sub-section 5.2, ref. 53) relating to its philosophy of management and control of its subsidiary companies. Fundamentally, the ethos appears to be analogous to that of a private sector holding company with conglomerate subsidiaries where corporate autonomy at the level of the company is maintained within a boundary of financial control. In such an organisational structure, directorial decision making at board level, with the formative participative roles of senior executives to be found in progressive companies, is intimately concerned with corporate matters of strategy, tactics, function and operation.

The ultimate criterion of performance is the creation of profits or 'surplus value' consistent with the 'efficient' survival of the undertaking in the short and long term. Distribution of the surplus is a matter of group strategy, with the corporate constituents of the group participating in the formation, ratification and support of the strategy. Corporate strategic accountability, responsibility and authority are maintained intact and the levels of operational performance are products of the control of corporate managers and their managerial echelons at all levels.

In the case of the NEB, an agency of central government, the holding company concept would be modified by the provision of a juridical function to ensure that financial probity and operational integrity be maintained (since public funding is involved) and by consultative and advisory machinery to facilitate the adoption of agreed public policies relating to the roles of all participants and the benign social structuring of the working environment.

The philosophy would be to let the managers manage, and the exercise of decision making powers at all levels would be subject principally to the competence of the participants, whatever their antecedents.

Financial surpluses not allocated to re-investment would accrue to the Treasury, thence to be disbursed according to the demands of contemporary public policies - possibly including the underwriting of social accountabilities to be undertaken by public sector industry as extra-corporate duties in the public interest.

Involvement of politicians and civil servants in corporate managerial decision making should be subject, as with all management participants, to their proven competence in such capacities, and this should apply no less strictly to trades unionists, either officials or worker representatives. This is not to suggest that politicians, civil servants or trades unionists should be disqualified from exercising managerial decision making functions in public or private sector companies merely on account of their principal or professed callings.

Since the allocation and deployment of public resources in a demonstrably efficient manner is a matter of obvious public interest, it is equally clear that the decision makers' competence to act, in the management of corporate entities in the public sector, is correspondingly a matter of public interest and concern.

The conclusion is that participation in public sector managerial decision making activities should be preceded by sufficient education, training and/or experience, as appropriate, to ensure competence in the role at whatever level of function.

7. Summary: Public Control in the Private Sector

The opening chapter was concerned with establishing the aims objectives, scope and range of investigation of this thesis, and the first objective (a) was nominated to be the study of public ownership and control with particular reference to management in manufacturing industry in the private sector. Chapter 2 contained a formative study of economic aspects relating to State interventionist roles and it was seen (Section 9) that the comtemporary economic climate was favourable in these respects and that good and sufficient economic reasons existed to justify such activities on the part of central government.

A complementary study of political aspects was carried out in Chapter 3 to give further formative support to the thesis and it was shown (Section 6) that the two major political parties in the U.K. subscribed to a mixed enterprise economy concept, the major differences between the respective standpoints of the Conservative and Labour parties comprising the degree of government intervention in private sector industry, the machinery of public control and the question of corporate ownership. The studies indicated that sufficient political (and economic) reasons for State intervention existed and that positive interventionist policies in industry had given rise to problems in the fields of public sector management. It was concluded that satisfactory methods and machinery of public intervention remained to be developed.

Chapters 4, 5 and 6 contained the substantive studies of contemporary policies, instruments, legislation, agencies and associated data relating specifically to objective (a), public control and its relevance to management in private sector manufacturing industry. Chapter 4 was devoted to studies of the development of novel agencies and machinery of State intervention, in particular, the IRC, the changing philosophies reflected in its dissolution and the enactment of the 1972 Industry Act. It was shown (Section 9) that these developments and the related public policies had particular significance for management in the private sector, and the following chapter (5) dealt with the crucial struggle that preceded the enactment of the 1975 Industry Act.

Arising from this study, examination of the data indicated the importance of new instruments of public intervention. Namely, the National Enterprise Board, planning agreements, compulsory corporate information disclosure, the concept of Industrial Democracy as an instrument of potential significance to private sector directorial and executive echelons and, not least, the powers available under the Fair Trading legislation relating to mergers and takeovers.

In view of the importance of the 1975 Industry Act to the work of this thesis, Chapter 6 was concerned with a detailed study of the legislation and the substantive form of the instruments of intervention it established. The purpose of the chapter was primarily analytical and secondarily to identify the relevant areas of discussion to be dealt with in this concluding chapter of the nominated objective study.

Planning Agreements, Industrial Democracy, the National Enterprise Board (in particular) and associated factors within the scope of this thesis have been examined in the preceding sections and sub-sections and it now remains to draw together the related conclusions in the final section of Chapter 7, before passing on to the second main objective (b),as nominated in Chapter 1, Section 1.

8. Conclusions: Public Control and Corporate Management

In the interest of continuity, the several aspects considered to be of primary importance to the achievement of the first objective (a) of this thesis have been discussed and conclusions drawn, where appropriate, in the preceding and present chapters. The integrated presentation of final conclusions on public control, interventionist policies and their relationships to industrial management in private sector companies can now be attempted. Because of the macro and micro natures of the studies and their implications for management, it is intended to summarise these conclusions under two headings, (a) general and (b) specific, so as to reflect the differing levels of approach.

Quantitative and qualitative components of the thesis have been referenced throughout the work under the appropriate chapter headings and it has been an aim to maintain a balanced presentation, particularly where controversy was a feature. Nearly forty years' personal contact with, practise in and education of industrial management has provided a modicum of help in this respect.

The areas of study leading to, or in connexion with, particular conclusions are indicated by the chapter references in brackets. Because of the nature of the studies and the relative complexity of their inter-relationships, it was not practicable to nominate specific Sections although such cross-referencing has been practised throughout the work, where appropriate and necessary.

8.1 General Conclusions

1. The economic and political climates in the U.K. appear to be generally favourable to public policies featuring positive State intervention and extensions of public control in private sector manufacturing industries. (Chapters 2, 3 and 4).

2. Controversy centred on the State's policies of positive interventionism at the level of the company appears to be rooted in the extent, machinery and methods of application rather than the fact of central government direction. (Chapters 2 to 7 inclusive).

3. Notwithstanding thirty years' experience of central government association with and control of major industries in the public sector, satisfactory relationships between political and administrative government and industrial management remain to be developed and established. The existing methods and machinery of State intervention have not been conducive to the efficient management of resources in industry.
(Chapters 3, 6 and 7).

4. The institution and implementation of new instruments of state intervention in industry at the level of the firm could bring about fundamental and possibly adverse changes in the loci and structures of managerial power in manufacturing industries.
(Chapters 3, 5 and 7)

5. Transfer of power from management to trades unions is among the motives for seeking extensions of public ownership and control of private sector industrial corporate assets.
(Chapters 3, 5 and 7).

6. A major cause of failure to integrate the philosophies, objectives, operations and activities of politicians, civil servants, industrial managers and trades unionists in public sector industry appears to be inadequate recognition of the following factors:-

   (a) managerial competence is a product of, inter alia, personal attributes, education, training and experience gained and developed in the fields, operations and practice of management,

   (b) competent management decision making is based on managerial knowledge and ability in addition to the availability and sufficiency of data,

(c) truncation of corporate from operational and functional levels of industrial management is inimical to managerial coordination and is productive of inefficiency, demotivation and poor performance.

(Chapters 3 and 7).

8.2 Specific Conclusions.

1. In the interests of efficient corporate, functional and operational management of companies in the public and private sectors, State interventionist policies and instruments should operate so as to preserve the coherence of the corporate entity and eschew interference in matters more logically the province of competent professional managers.

(Chapters 3, 5 and 7).

2. The collective right of political, civil service and union bodies to participate in industrial corporate management decision making should be subject to the proven ability of their representatives to act at the particular level involved.

(Chapter 7).

3. Methods of public control of industry should not entail precipitate dissolution or fragmentation of efficient corporate or operational management teams.

(Chapters 4, 5, 6 and 7).

4. Democratisation of industrial management power should be accomplished by participatory evolutionary means and not by compulsory revolutionary processes. (Chapters 3 and 7).

5. The concept of voluntary participation in planning agreements between the State and private sector industrial firms appears likely to result in lack of success of this instrument of public policy, except in cases where special inducements are present. (Chapters 3 and 7).

6. Quadripartite planning discussions of an advisory and consultative nature at the level of the company could provide a learning medium to improve relationships and understanding at the interfaces of government, public administrators, industrial management and trades unions. (Chapter 7).

7. The concepts of managerial accountability, authority and responsibility should be considered collectively in any attempt to improve industrial corporate performance by restructuring systems of power as a concomitant of industrial democratisation. (Chapters 3 and 7).

8. The National Enterprise Board could be a catalyst in the evolution of tenable public/private sector managerial relationships over the longer term, with commensurate benefits to the community, provided its entrepreneurial role is not subjugated by excessive bureacratic control and/or arbitrary government

interventions in the furtherance of

short term political aims and expediency.

(Chapter 7).

This section concludes the first part of the thesis as nominated in objective (a) of Chapter 1, Section 1, and it is intended now to continue with the second objective (b) detailed in the same place. For convenience, it is restated below:-

Objective (b)

An investigation of corporate asset valuation methodology in the private and public sectors, relating to expropriation of private corporate assets by the State.

The compulsory expropriation of private sector corporate assets by the State involves transfer considerations assessed by valuation methods which may, or may not, produce equitable results. Chapter 8 comprises studies of valuation methodology practised in private sector transfers of corporate assets as a foundation for relevant comparative analyses of the methods used in the public sector.

CHAPTER 8

PUBLIC OWNERSHIP: A SURVEY OF VALUATION OF CORPORATE ASSETS IN THE PRIVATE SECTOR.

1. State Ownership: General Introduction

The transfer of corporate assets from the private sector to the public sector entails not only changes in the loci of economic power but also changes in societal structures. Many of these differences are obvious, such as the accountability, motivations and loyalties of management and workers, but other possible repercussions may be less evident.

Accretions of wealth available to the entrepreneur have been an important factor in rising standards of living in capitalist societies. But the redistributions of such accretions in the form of compensatory transfers over the long term and pre-emption of wealth-producing assets by the State could, conceivably, lead to a gradual erosion of national output capacity unless rewards for risk-taking (returns on investment) were still available in a society dominated by central government.

In considering potential post-distribution sequels; of the compensatory considerations for the forced transfer of private sector assets, a large proportion would possibly be allocated to non-wealth-producing consumption rather than investment, particularly in a system made punitive to the latter by fiscal and political pressures. More so if investment apportunities were blighted (made unrewarding) by an ethos hostile to adequate rewards for risk-taking. The entrepreneurial activities, by which the factors of production are made to produce a surplus by productive deployment, would have less scope for application and the entrepreneur would have the choice of 'exporting' his capital (if this were feasible) or of sublimating his creative urges in alternative outlets to those associated with the creation of wealth in a 'free'society.

A counter argument may be postulated, that the releasing of resources newly available to investors would accelerate entrepreneurial activity by providing fresh opportunities for the undertaking of new ventures. This consideration leads to the question of what is an equitable return for private sector assets taken into public ownership?

2. Valuation of Corporate Assets in the Private Sector

The valuation of corporate assets is a highly complex undertaking and it is not an objective of this work technically to analyse the methods developed by professionals in this field. However, in order to compare private and public sector methods of valuation, studies of the factors leading to explicit valuations of corporate assets need to be undertaken. Compensation for assets taken into the public sector may be derisory in which case 'confiscation' would be the appropriate term, or, at the other extreme, overly munificent and so wasteful of public resources.

It is axiomatic that the vendors of corporate assets will derive valuations, directly or through agents, which will maximise the benefits accruing from relinquishment of ownership, whilst the purchaser will seek to minimise the costs of acquisition. In this sense, neither vendor nor purchaser are likely to employ impartial and disinterested methods of valuation which are mutually acceptable.

The views taken will, or should, depend on the performance or potential performance of the assets, inter alia. The purchaser may prefer a strong historic record of profitability and capital appreciation to a future of risk and uncertainty as a basis of assessment whilst, conversely, the vendor may emphasise the attractions of potential future earnings and growth as a counter to past instability of returns and a questionable track record. The prospective purchaser will, of course, be prepared to exploit any shortcomings of the assets, in terms of factual historic and predictive data, which may be adduced to support a cost-minimisation approach to valuation.

In the last analysis, both vendor and prospective purchaser are free to come to terms or to withdraw in an arm's-length negotiation of a normal commercial nature, but the owner of corporate assets subject to compulsory acquisition by the State is in a very vulnerable position. For this reason, equity suggests that compensation for corporate assets vested in central government should be demonstrably fair, although the vendor need not be protected against the normal hazards of such a transaction in the commercial arena.

A consideration which is not likely to be given weight in assessing compensatory terms is the nature of the relationship between the vendor and the assets. Businesses developed as the fruit of generations of family effort and personal commitment will hardly be differentiated from the professionally managed undertakings whose owners are members largely through the medium of shareholdings purchased in the secondary market.

3. Objectives of Corporate Transfers of Ownership

Clearly, corporate assets assume valuations which are normally dependent upon the end product of a transfer of ownership. The price related to an undertaking which is to continue as a going concern may be entirely different from its value in other respects, such as potential synergy in product, market or assets rationalisation; land usage for development; integrational restructuring or even asset-stripping operations.

Hence, the opportunity-cost to the vendor of corporate assets to the State may well be significantly out of alignment with received compensatory transfers.

4. Basic Criteria and Considerations - Valuations

Fundamentally, the valuation exercise relating to transfers of corporate assets is concerned with a purchase consideration for a stream of future returns in the form of revenue flows and/or capital growth.

In a stable environment, the factors giving rise to positive cash flows may be predictable and subject to low risk probabilities; whilst the converse is the case where the environment is dynamic and unstable and uncertainty precludes allocation of reasonable probability assignments to variables material to the assessment of returns and their capitalised values. Quantitative methods have been developed and thoroughly researched[1] but the precision of numbers becomes spurious if the underlying assumptions prove subsequently to have been false or unacceptably inaccurate.

5. Corporate Asset Valuations - Methodologies and Mysteries

The methods of corporate valuation are, in general, well-known and the different techniques have engaged the attentions of many researchers. To facilitate the continuity of the present work, a description of more or less conventional methods has been appended (Appendix A) together with comments on their features and attributes, where appropriate.

It will be noticed that the methods used widely in the private sector relate to assessments of net surpluses, post or pre-tax, net asset values and combinations of these factors. Capitalisation criteria relate mainly to cost of capital or going market rates. The appendix also contains lesser known and more recent developments in the field of investment and valuation.

Notwithstanding the scientific bases and quantitative approaches of some of the methods, the claim that:-

> "Share valuations is an art rather than a science",

made by the late T.A. Hamilton Baynes[2] in his standard work on valuation, seems to be borne out by the researches of the present writer.[3]

An example of the qualitative nature of corporate valuation is contained in Baynes' work.[4] He states:-

> "This concept of the market is of the greatest importance in valuing unquoted shares, either for purposes of an actual transaction or ... even though no sale of those shares may be in prospect at all. In these cases ... a hypothetical purchaser in an open market has to be imagined. Any idea that the value of a share can be settled by a formula without disagreement among experts must be dispelled

by reading the judgment in the Holt case (Holt v. Inland Revenue Commissioners, 1953), in which four chartered accountants went into the witness box giving valuations varying between 150p and 86p. The difficulties of share valuation could not be better demonstrated".

Baynes quotes many such examples of variation in share valuations in both private companies (with which his work is primarily concerned) and public companies. In discussing the Holt case, he draws attention to the different valuations or approaches of the participants.[5] A chartered accountant witness for the petitioners suggested a valuation of 86p per share; a chairman of another company suggested 61p ex dividend; a merchant banker suggested 75p and a stockbroker arrived at a price of 80p cum dividend. A chartered accountant, witness for the Crown, advanced an initial valuation of 170p, amended later to 125p whilst another chartered accountant for the Crown proposed 141½p; a further chartered accountant gave a valuation of 150p. A stockbroker for the Crown quoted a figure of between 140p and 145p, initially, and later reduced his estimate to 125p.

The case was decided on a valuation by Judge Danckwerts of 95p a share. As a point of interest, the merchant banker expressed the view[6] that asset cover was of academic interest in valuing ordinary shares and that the value of assets was what they would earn rather than their balance sheet valuation. The difficulties inherent in share valuation are well recognised and commented upon by Samuels and Wilkes.[7] They write:-

"Is it possible to calculate what a share is worth? There are numerous differences of opinion, but they can all be characterised within two limiting cases.

At one extreme is the belief that price is determined by a rational process: that there is some true value for a company share, and that this is based on the economic value of a company. The price of the share depends on the value of the company, which in the case of a going concern is based on the prospective earnings of the company. The earnings of a company, after prior claims have been met, belong to the shareholders; the number of shareholders is known, so the value per share can be determined. The other extreme is the view that it makes no sense to talk about a 'true value' for a company share; that there is no such thing as an inherent value. Share prices are what they are, only because of what purchasers and sellers expect them to be. The prices are determined by anticipatory and speculative factors; and the expected earnings of a company are only one among a number of factors which influence investors. Price is the outcome of demand and supply pressure and demand is in turn affected by hunches and speculation".

A protagonist of the former view is Joel Stern who is on record[8] as stating:-

"The key to successful capital investment and acquisition analysis is to focus on the determinants of the market value that are employed by sophisticated investors. The pricing mechanism is to calculate the discounted value of the expected future Free Cash Flow. The resulting EPS is unimportant".

(The Free Cash Flow (FCF) method is outlined in Appendix A).

The converse is succinctly expressed by Fisher:-[9]

"In a perfect market with perfect certainty, the value of a security would be the sum of discounted future returns. But in reality the capital market is imperfect and uncertainty prevails. Each of these factors will influence price".

And in another context:-[10]

> "The representative and rational entrepreneur reaching decisions in a certain world is simply too fictitious a character to command all of the analysts' attention. Chance, irrationality and personal peccadilloes are omnipresent ingredients that affect and effect individual decisions".

6. Problems of Valuations - Inherent Variabilities

Many researchers have thrown light on the various criteria used in attempts to predict or determine share values.[11] (The behaviour of the stock market in 1973-74-75 demonstrates the inadequacy of historic series evaluation as a guide to future share valuation). Conflicting results of work to adduce the relevance of factors such as dividend distributions, retained earnings and capital gains are notable examples. Also included are the influence of directorial policies, the relationship of company size to dividend distribution policies and behavioural (motivational) aspects; all of which have been found to be material but not quantifiable in terms of mathematical formulations.

A difficulty in relating past changes in any independent variable to a dependent one in the future is the problem of distinguishing between cause and effect. For example, encouraging signs of growth in a company may strengthen its 'paper' so as to afford it access to accelerated increments of capital, thus providing a self-fulfilling outcome if the invested capital secures better returns as a consequence of economies of scale. In the same way, a market consensus of a particular company's enhanced rate of growth may, through demand and supply, force up the market value of its shares.

The consensus might have arisen as a result of information based as a single analyst's research which may or may not be justified by events.

The well-known effect of trading in a thin market ('Poseidon' was a classic example) where the exuberance and over-optimism of investors may cause the share's value to lose touch with intrinsic reality, is another factor to be considered.

7. Stock Market Criteria Fallibilities.

Numerous research studies have shown that stock-market prices exhibit the characteristics of a random walk,[12] thus casting doubt not only on the use of past prices and earnings as forecasting bases of future prices and earnings but also, it should be noticed, on the concept of the 'sophisticated investor' predominant in the market in terms of accurately determining 'true' values of investments and thus, collectively, shaping the market in total.

But the activities of major investors, such as the institutions, when aligned in concert as the result of processing identical information by similar methods or by a 'follow-the-leader' philosophy, would appear to produce a self-fulfilling relationship between expectation and realisation. Since jobbers collectively mark prices up or down in accordance with market 'sentiment' (often irrespective of supply/demand indicators, e.g. in anticipatory response to assumed future market trends or to stimulate or restrain business according to the portents)and since stockbrokers' business is often geared to and triggered by marginal price changes (e.g.

'stop-loss' orders on behalf of clients in falling markets and 'buy' signals in rising markets) the hypothesis that the 'market' is not necessarily the result of precise, quantitative calculation by a majority of 'sophisticated investors' seems not to be unreasonable.

The incidence of 'hammerings' also suggests that the professionals are not always able to avail themselves of the security of invulnerable investment positions as the result of merely being in the ranks of 'sophisticated investors' or of having access to the information flows deemed to exist at the professional levels.

Merrett and Sykes, in their research[13] on the returns on investment over the period 1919-66, draw attention to the differences between equity and fixed interest returns and the marked fluctuations in returns in both monetary and real terms: other researches have also indicated that the earnings of companies exhibited the randomness exemplified by the random walk characteristics and, therefore, suggested that future performance cannot be predicated from such data.[14]

The volatility of share prices and their randomness have also been illustrated by researchers[15] using both British and U.S. data. Work on the behaviour of share prices has differentiated between 'informed' and 'uninformed' investors[16] with the suggestion that the former, possibly as a result of inside information, influence the direction of share prices initially whilst the latter tend to produce movements unrelated to realistic performance forecasts, hence, to resultant randomness characteristics in stockmarket patterns.

Other bases of predicting share price levels, such as market turning point determinations, changes in aggregate profitability, attitudinal changes to risk evaluation, the differences between interest rates and equity returns (yield gap) and the influence of chartists have been researched,[17] but none has been found to be reliable. The reward for finding the Philosopher's Stone in this area of research is obvious and attractive but whether or not such details would ever be published is a question not difficult to answer.

8. Cost of Capital Aspects in Valuation

In corporate asset valuation, it appears, then, that the precise determination of the value of future returns is a considerable problem. The other side of the equation, the cost of capital, also appears not to be completely determinate. Modigliani's and Miller's basic (tax-ignored) theory[18] that the cost of capital is not dependent on the capital structure has received much attention, whilst conflicting views on the feasibility of determining the cost of capital on realistic bases have also arisen.[19]

Compromises based on the concept of a weighted average cost of capital[20] appear to require assumptions which may or may not result in realistic measures of capital costs. Thus, considering the difficulties of establishing universally acceptable and practical methods of measuring both returns on and costs of capital the problems associated with corporate valuation are manifest.

It has been shown that the processing of basic data on accepted discounting principles is well established,[21] the deficiencies of input data are, it seems, sufficient to suggest that Bayne's assertion (2) is well-founded.

9. The Reality of Profits and Profitability in Valuation

Profitability, another important component of corporate valuation, is also subject to a number of conceptual interpretations and establishment of the present reality of 'profits' has exercised the talents of many researchers. Work on the profitability of British manufacturing industry by Panić and Close[22] showed that the pre-tax rate of return on net assets (historic cost) during the period 1952-1969 fell markedly (about 23% on the 1952 base) whilst average rates of return fell by 30% (pre-tax) and 25% (post-tax) over this period. They attributed this (Conclusions) to decline in the rate of profit due to, inter alia, the growth of productive capacity, and thus of competition, domestically and internationally.

Among their findings were the facts that declining profitability appeared not to have had adverse effects on investment in manufacturing and that shortfalls in internally resourced funding had been offset by external finance. These latter conclusions appear to suggest that the investors providing the investment funds (external) were either not deterred by potentially lower returns on investment or, possibly, not aware of the real deterioration as it was occurring.

In a later study, which included comparisons of the works of Panić and Close,[22] Glyn and Sutcliffe[23] and others, Burgess and Webb also dealt with British industry profits over the last twenty years.[24] The study also concludes that rates of return (pre-tax) fell markedly during the period over the entire company sector (and less markedly post-tax) on different bases of calculations.

An article by A.J. Merrett on profitability trends[25] compares profits of industrial and commercial companies by the criterion of Valuation Profits (see Appendix A) on both historic cost and replacement cost of assets bases. The study concludes that, inter alia, on the Sandilands basis of current cost replacement, industry was reduced to a loss in 1974 and that the value of cumulative retentions in real terms over the preceding decade was negligible. This latter conclusion suggests that profit distributions were partly financed in real terms by a virtual erosion of capital, thus producing a smaller plinth for eventual economic recovery. A research study on trends in company profitability by J.S. Flemming with L.D.D. Price and D.H.A. Ingram[26] included consideration of the effects of taxation and inflation. Flemming noted that the extent of decline in company profitability had varied with the different methods used.

Taking the period from 1960-1974, it was found that pre-tax rates of return had declined from 19.00% to 16.8% on an historic cost (conventional accounting) basis; from 14.7% to 10.8% on a revised basis using a revaluation of capital stock at replacement cost; from 13.7% to 9.3% when further revaluing by calculating capital depreciation at replacement cost rates; and from 13.4% to 4.0% with stock appreciation included. The latter figures give an indication of the rate of decline over the period in real terms (having regard to alternative methods of, e.g., asset valuation possibly giving rise to dispute as to best measures of 'real' rates of return).

10. Taxation Effects on Rates of Return

The inclusion of the effects of taxation in the results, on both'backward-looking'bases (the effects of pre-dated tax liabilities) and 'forward-looking' bases (the effects of post-dated tax adjustment) indicated similarly significant deteriorations in real rates of return.

Post-tax real rates of return over the period 1960-74 were reduced ('backward-looking') from 8.3% to 0.2% (3.5% taking account of tax relief on stock appreciation) and ('forward-looking') from 9.7% in 1960 to 0.3% (4.1% with stocks tax relief) in 1974.

11. Interest Rates and Equity Cost Considerations.

Flemming's and his colleagues'work on profitability trends was later complemented by research on the cost of capital, finance and investment.[27] It was suggested that interest rates and the cost of equity were not good measures of the cost of capital in inflationary periods and that reduced profitability had reduced the internal finance available to companies and was tending to prevent companies' exploitation of investment incentive tax reliefs.

To avoid the distortions of valuation of the cost of capital caused by combining separately derived results for the cost of equity and interest-bearing capital, the measure used to determine the cost of capital was a combined valuation of the two capital elements on a market basis. Thus, the overall cost of capital was taken to be the rate at which the capital market discounts the company's future earnings, the discounted value representing the market value of its equity, preference shares and borrowings in the forms of long, medium and short-term debt. In discussing this form of valuation, it is pointed out by the authors that expectations of future earnings are unobservable and that a further limitation of the method comprises consideration of only the existing volume of capital.

Using aggregate figures and correcting for earnings on domestic physical capital in order to compare costs of capital with derived rates of return (26) it was found that the post-tax real cost of capital between 1960-1975 had fluctuated between 8.8% in 1960, 3.8% in 1969 and 1971 and 5.9% (provisional estimate) in 1975, the latter figure having been adjusted to allow for tax relief on stock appreciation.

It is of interest to note that in 1974 the 'real' cost of capital on the above basis was actually 11.5% due to greatly reduced market capitalisation affecting the denominator of the ratio. But if tax relief on stock appreciation had not been available the adjusted cost of capital for 1974 would have been a miniscule 0.9% owing to stock appreciation having reduced the value of real earnings to a negligible figure (£149 million)[27], thus reducing the numerator of the ratio (earnings/market capitalisation). However, it is pointed out by the researchers that the estimates are no more than broad approximations, although they are preferred to nominal or real interest rates or equity yields more commonly used in such calculations, and caveats are given about the 1974 data in view of special circumstances in that year.

12. Relative Profitability Trend

In combining the results of research on the real cost of capital and rate of return, it is seen that both measures show a downward trend in the 1960s but, in the present decade, the cost of capital has tended to rise whilst the rate of return has continued at a lower level. The conclusion is that relative profitability (rate of return/cost of capital) has declined.

13. Profitability as a Valuation Determinant

The question of company profitability exercised the CBI in representations made to the Chancellor of the Exchequer.[29] Among the points made were the following. Reduction in the share of gross trading profits in total domestic income from an average of 15% between 1950-59 to only 5.5% in the first half of 1974 (both net of stock appreciation). A reduction of Gross Trading Profits less stock appreciation and capital consumption from £1,898 million in the first half of 1973 to £230 million in the first half of 1974, a reduction of about 88%. A change in net liquidity of industrial and commercial companies from - £1,993 million at the end of 1972 to - £6,900 million (approximately) by mid-1974. Declining rates of return (gross trading profits, less stock appreciation, as a percentage of company sector net capital stock at current replacement cost) from about 20% in 1955 to around 9% in 1973. A declining trend in the net acquisition of financial assets from +0.63% in 1952 to about zero in 1962 and around -1.0% in 1973.

These trends broadly mirror the picture outlined by various researchers in the company sector and indicate that the value of companies, on these bases, had been falling for a considerable period.

The question of profitability as a determinant of company valuation should not be left without comment on some other factors which affect the volume of profits or the interpretations of profitability. Whilst output from fixed capital may be determined to high levels of precision in intensively mechanised or automated systems, the converse is the case where labour-intensity is a feature and industrial action may decimate output and, hence,profits.

Another factor affecting valuation is the interpretation of company accounts and the varied output from the Accounting Standards Steering Committee in recent years is sufficient comment on that difficulty. The effects of price and wage controls have been illustrated[30] insofar as investment and profits of different companies have been adversely affected by these factors.

Constraint on one form of return on investment, if not accompanied by restraints on all (e.g. gold, gilts, commodities, property, foreign exchange transactions, etc.), is not conducive to retention of market relationships between the costs of and the rewards for investment in the company sector.

14. General Influences on Corporate Valuation

Other factors which may be relevant in their effects on corporate valuation include the following. Alternative investment berths for individual and aggregate funds; interest rates; the establishment of accountancy conventions which adequately recognise distinctions between financial, trading, extractive, manufacturing, construction and service companies. Additionally, the valuation treatment of intangibles; sterling international values; international commodity prices; U.K. inflation and relative inflation. Also, public policy decisions on tax deferrals; underwriting costs; industrial democracy; multi-national group operations; public policies relating to the operations and profitability of the private sector; and, not least, behavioural aspects such as willingness to undertake capital risk ventures.

In a work of this kind, it is evidently impossible to explore all these avenues, particularly in view of the objectives nominated in chapter one, but the effects of many of these factors are self-evident and, since the declared aim of this chapter has already been achieved (when taken in conjunction with Appendix A), it is not proposed to extend the investigation and discussion on these bases at present.

15. Inflation: Sandilands and Accountancy Conventions

A factor which has become increasingly important since 1973 is inflation. The works adduced above in the fields of company profitability, returns an investment and cost of capital have indicated the serious effects of accelerating inflation at high rates on the performance of companies, and it has been shown that increasing difficulties of corporate valuation, using conventional methods, have ensued. The Sandilands Report[31] contained among its terms of reference the injunction that account should be taken of, inter alia, effects upon investment and effects on efficient allocation of resources through the capital market. The recommendation of a system of Current Cost Accounting was not received with universal approval.[32] The main features were stated to be a basis of monetary measurement; balance sheet assets and liabilities to be shown at a valuation, and 'Operating Profit' to be struck after charging the consumption of assets at a 'value to the business; thus excluding holding gains from profit and showing them separately.

Notwithstanding criticisms of its recommendations,[33] the Sandilands Report codified much useful information about corporate accounting practices. Among the data was a summary of methods of valuation[34] of non-monetary assets gathered in evidence; since valuation is germane to this chapter the measures are summarised below:-

1. Current replacement cost (the price now to replace an asset of the same type purchased previously).
2. Written down replacement cost (as above but with depreciation taken into account).
3. Current open market sales value of the asset.
4. Forced sale value (buyer's market conditions).
5. Net realisable value (less costs of sale of asset).
6. Net present value of all expected future earnings (discounted present value or 'economic value').
7. Existing use value (value to owner for existing purpose).
8. Alternative use value (prospective alternative use value).
9. Going concern value (assumption of unchanged and continuing use of asset as at present).

In summary, the above classifications fall into three categories:-

(a) Current Purchase Price

(b) Net Realisable Value

(c) Economic Value.

Whilst the difficulty of the valuation of intangibles is mentioned, no particular measure is suggested.[35] The report also comments on the distinction between stock market capitalisation value and the company's net worth (net asset value).[36]

A comment on the relevance of inflation in general so far as the company sector was concerned (and in particular on the Sandilands Report) was given by the National Economic Development Office in the introduction to one of its publications.[37] It stated:-

"The effect of inflation adjustments is even more marked (than the declining return on assets)on companies' net real retentions. Had companies taken into account the changing values of stocks and of depreciation on fixed assets, they would have incurred negative retentions in five of the last six years."

(December, 1975).

The above statement may be compared with another:-[38]

"The Government propose to extend for a further year from 1st August, 1976 the powers to control prices through the Price Code. There will continue to be both cost control and profit control under the Price Code and the Price Commission will continue to enforce it."

So do politics and economics make strange bedfellows.

Clearly, the bases of accountancy and the accounting conventions ultimately adopted to deal with high rates of inflation and high rates of accelerating or decelerating inflation will affect the bases of valuation of corporate assets. Doubtless, professional approaches to valuation practices in such conditions will be adapted to cope with these, possibly transient, changing environments and to establish mutually acceptable interpretations of asset and economic worth.

16. Corporate Valuation and Fiscal Aspects

Another important factor having a direct bearing on the valuation of corporate assets is that of taxation. Corporate taxation is, of course, a specialist subject and detailed investigation of its effects on the asset and economic worth of companies would require a correspondingly adequate commitment of time and research availability. For these reasons it is not possible to do more than a brief survey of current effects or possible effects of taxation, as follows.

One obvious factor is the differing treatment of capital gains on gilts and equity: the ultimate redemption or transfer worth of certain classes of the former in comparison with equity is enhanced by relief from Capital Gains Tax (under appropriate conditions) thus affecting valuation comparisons. The recent doubling of stamp duty on share transfers; the two per cent stamp duty levied on company convertible issues; the abandonment of the original intention of the introduction of Corporation Tax (that dividends and retentions would be taxed at the same rate); the uncertainty of tax liabilities due to fluctuating tax reliefs for investment and stock appreciation, all affect corporate valuation.

Other aspects include the ultimate fiscal treatment of corporate tax deferrals; the tax-significant relationships between depreciation allowances and future cash flows and between tax liability and debt interest allowances; and, less obviously, the tax treatment of interest rate payment escalations resulting from sterling depreciation in relation to foreign currency borrowings. All of these tax-related factors have greater or lesser effects on the real rates of return on corporate assets and thus on the economic worth of the latter.

Additional factors of taxation or fiscal policies affecting corporate worth are the investigatory powers over multi-national pricing policies conferred under the 1975 Finance Act; the adverse effect of indefinite tax deferrals on borrowing potentiality; the structures of Capital Transfer Tax (the proposal in the 1976 Budget to value business interests including controlling holdings of unquoted shares and securities at 70 per cent of their open market values[39] is an example); and the final form of the accounting conventions dealing with the treatment of tax deferrals in company accounts and inflation.

17. Stock Market Volatility and Capitalisation Changes

Earlier in this chapter reference was made to the volatile behaviour of the stock market and the consequent fragility of historical series evaluation as a determinate guide to share valuation. The following table (No. 8.1) showing variations in the Financial Times - Actuaries Share Indices indicates the swings in market capitalisation values over a comparatively short period[40] and reflects the influences of exogenous factors on estimates of corporate worth at any given time.

The work by Professor Davis and his colleague, K.A. Yeomans, (Chapter 10, ref. 1, Section 12), provides definitive analytical studies of stock market volatility and the effects of differing market climates on investment criteria.

TABLE NO. 8.1

F.T. - ACTUARIES SHARE INDICES: VARIATIONS IN SHARE VALUES

Equity Class	Index at Dates		Highs and Lows				
	3.2.75	8.3.76	1974-75 High	1974-75 Low*	1975-76 High	1975-76 Low	1972 High*
(A) Industrial Group (476 Stocks)	96.11	161.19	140.63 (2.1.74)	59.01 (13.12.74)	164.06 (30.1.76)	59.19 (6.1.75)	220.17 (1.5.72)
(B) Financial Group (100 Stocks)	94.52	140.25	156.38 (2.1.74)	55.88 (13.12.74)	153.46 (30.1.76)	56.50 (6.1.75)	241.41 (11.4.72)
(C) All Share (650 Stocks)	101.94	167.04	150.52 (2.1.74)	61.92 (13.12.74)	172.64 (30.1.76)	62.16 (6.1.75)	228.18 (1.5.72)

* Representing range extremes at date of compilation (9.3.76)

NB Series commenced in 1962.
Refer to Table No. 9.1 for illustration of inflationary effects.

Source (40): Financial Times

Taking the indices of all-time 'lows' as bases and comparing them with all-time 'highs' for the three groups A, B and C (Table No. 8.1) it is seen that the total variations were 161.16, 185.53 and 166.26 respectively; percentage variations from the bases of 273% 332% and 269% (rounded). If similar calculations are done for the indices of 1975/1976 ('highs' and 'lows'), it is seen that the total variations were 104.87, 96.96 and 110.48 respectively; percentage variations ('lows' as bases) of 177%, 172% and 178%.

From these results, the maximum range of variation in the indices took place between (A) 1.5.72 and 13.12.74, a period of about 31 months; (B) 11.4.72 and 13.12.74, a period of about 32 months; (C) 1.5.72 and 13.12.74, a period of about 31 months; thus, just over 2½ years for full transition from the highest to the lowest stock market values. Yet, in just over 12 months, the 1975/76 variations at date of compilation were (A) 65%, (B) 52% and (C) 66% of the total range. It is doubtful that there exists a rational, statistically-supportable explanation for these massive swings in share values over so short a period. Clearly, the extreme movements in market capitalisation were the result of complex environmental causes, including financial, political, economic and general investment factors.

The quantitative image of a stable, statistically predictable market determined by the operations of 'sophisticated investors' seems hardly credible, at least during the period in which these violent transformations took place.

18. Value of Control as an Adjunct of Ownership.

A factor which has been mentioned previously in stock market valuations discussion is the difference between normal share values on a consensual basis as the result of normal market transactions in the secondary market and the different valuation when control is to be transferred as the result of a bid for the company. Comprehensive analyses of takeovers of quoted companies have been carried out and rigorous statistical analyses in the form of a monograph has been published by the Department of Applied Economics at Cambridge[41] (W.B. Reddaway has published a more qualitative treatment of the analysis[42]). The specific aspects of the values of control are discussed more fully in Chapter 10, Sections 6, 7 and 8.

19. <u>Relationships of Bid Premia in Corporate Takeovers</u>

For this purpose, as a practical test, the writer investigated the details of takeover bids for 100 quoted companies over the period March to August, 1976[43]. The companies included all categories of industrial, commercial and financial companies: agreed mergers were not included.

Obvious limitations are the possibility of the period selected not being sufficiently representative of the market overall, lack of competitive bidding in many instances, a biased sample of companies in terms of proportions in the sample to the population, inter alia.

The results are given in the following tables, figures and discussions. Weighting in terms of bid values was not applied to the data in Table No. 8.2 since the initial objective was to test the relationship, discussed in the previous paragraph, on an aggregate basis.

TABLE NO. 8.2

MARKET CAPITALISATION OF COMPANY EQUITY IN TAKEOVERS

Number of companies: 100. Survey period: March-August 1976. Status of companies: Stock Market listed and quoted. Description of companies: Industrial, Commercial, Financial, etc.; non-exclusive as to type.

AGGREGATE VALUES PER SHARE
(Market Capitalisation)

(a)	(b)	(c)	(d) $\left(\frac{b-a}{a} \times 100\right)$	(e)	(f)
Pre-Bid	Bid Value	Difference (b-a)	Aggregate Percentage Change	Total Value of Bids (Market Capitalisation)	Mean Bid Value (e/100)
£74.38	£87.07	£12.69	+ 17.06% (Aggregate Bid Premium)	£500.43 million (Rounded)	£5 million

(g) Range of Bid Values (Per share)		(h) Range of Total Bid Values (Market Capitalisation)		(j) Range of Bid Premia	
Highest	Lowest	Highest	Lowest	Highest	Lowest**
£6.00	2p*	£60.6 million	£0.05 million	127% (0.2m.value)	-21.3% (£4.8m. value)

* Price on suspension = 12p. ** (a) 'Minorities' Bid. (b) Not including 'suspensions'.

Notes (1) Of the 100 takeover bids only 12 bids were of less value than the last pre-bid quoted price. Three of these were post-suspension of quotation bids; four were cash bids; five were, presumably, 'leaked' and so were anticipated by the market.

(2) With four exceptions, all the above were non-competitive bids, ie single bidders. The highest bid was included in the cases of the four competitive bids.

(3) Clearly, the significance of the results above relates only to the particular corporate investment climate in which the investigation was undertaken.

(Source: Financial Times Company Statistics)

20. Analytical Problems of Qualitative Market Factors.

The data summarised in Table No. 8.2 comprise both observations and derived statistics: the headings are self-explanatory but, before entering a detailed investigation, certain points should be made.

First, the percentage difference of +17.06% between the pre-bid values and the bid values, whilst giving an overall indication of the amount of aggregate premium, is of comparative value rather than a measure of significance due to the inherent variability of the underlying components.

Clearly, the pre-bid values would be more or less affected by any inside dealings consequent upon pre-knowledge prior to general dissemination of information to the market generally. Conceivably, this could result in, on one hand, negligible or zero share price movements prior to the bid and, on the other, such significant advances as to create a general market price change towards, or even beyond, the actual bid as a final result of initial 'nosy' buying.

As is well-known, stock market rumours are common and often give rise to exaggerated (in the outcome) movements in share prices; prime examples are bear raids, which are not uncommon during times of market sensitivity, and bull operations which cause target shares to lose touch with their intrinsic values often for brief, transient periods during trading sessions.

The other main component, bid values, are often fragile and may undergo violent changes as a result of competitive bidding in takeover battles. Shute reports one such situation[45] where the escalation, taking the initial share price as base (100), was 28%, 57%, 80%, 106%. Thus, the ultimate bid valued the group (Cambridge Instrument Co. Ltd.) at more than twice its prebid market capitalisation.

Bid values and bid premia will also, obviously, be affected by such factors as limited marketability of target shares, size of bid, structure of holdings, uncertain asset values and/or economic worth, quotation suspensions, stock market levels and volatility, general economic and monetary trends, inter-company and inter-group corporate strategies, supplier and customer dependencies, personal relationships, and many others. The rounded value of bids (£500.43 million), although having a mean of £5.00 million, is seen to have had a range of values from £60.6 million down to £50,000 and the total range of bid premia was 150%. Of the twelve bids which had negative premia (bid value less than last-quoted market value), three had a total market value of £160.6 million and the remaining nine an aggregate value of £12.35 million, a proportion of 92.9% and 7.1% respectively in this class. The latter number of bids included post-suspension and rationalisation bids where control was not a contested issue and, hence, may be considered less significant for the purpose of this work.

However, the three bids amounting to £160.6 million represented 31% of the total market value of all the 100 bids and, in this sense, were significant. But since the market had clearly discounted the bids, or the possibility of a competitive bid situation developing later, the value of the sample in determining a consensual bid premium for control was correspondingly diminished.

Of the 100 bids, only three had a bid premium of over 100% (as in Table No. 8.2(d)) the bid premium percentage is defined as:-

$$\frac{\text{Bid Value - Pre-bid Market Value}}{\text{Pre-bid Market Value}} \text{ x 100)}$$

These three bids had a total value of only £3.8 million, representing 0.75% of the aggregate value. Their actual bid premia and values were, respectively, 106%(£1.7 million), 106%(£1.9million) and 127%(£0.2 million), the latter being the highest bid premium in the sample of 100.

21. Takeover Bid Premia Relationships to Bid Values

Although the aggregate results have points of interest and relevance in terms of bid premia variations, no significant conclusion may be drawn from the 17.06% aggregate premium percentage. It was evident that a detailed analysis of the data was necessary in order to establish whether or not market bidding operations indicated consensus so far as bid premia were concerned. Since the spectrum of bid values varied from £60.6 million down to £50,000 and inspection of the range revealed a lack of homogeneity of the values within the range, the monetary bid values did not present a reasonable basis for analysis.

However, since the objective here is concerned with comparative values of bid premia, the decision criteria of bids could be affected by global values in monetary terms although much more extensive investigation on larger samples would be necessary to establish such a relationship, if any. A limited test was carried out using the ten highest value bids, excluding negative bid premia for reasons already stated, and the ten lowest value bids in which control of the company was a factor (post-suspension and rationalisation bids were not considered for similar reasons to those already mentioned, i.e. since control of the company was not a factor, the bid premium, if any, could not be related to this aspect). Bid (market) values were compared with the indicated bid premium and the basic results are given in Table No. 8.3.

TABLE NO. 8.3

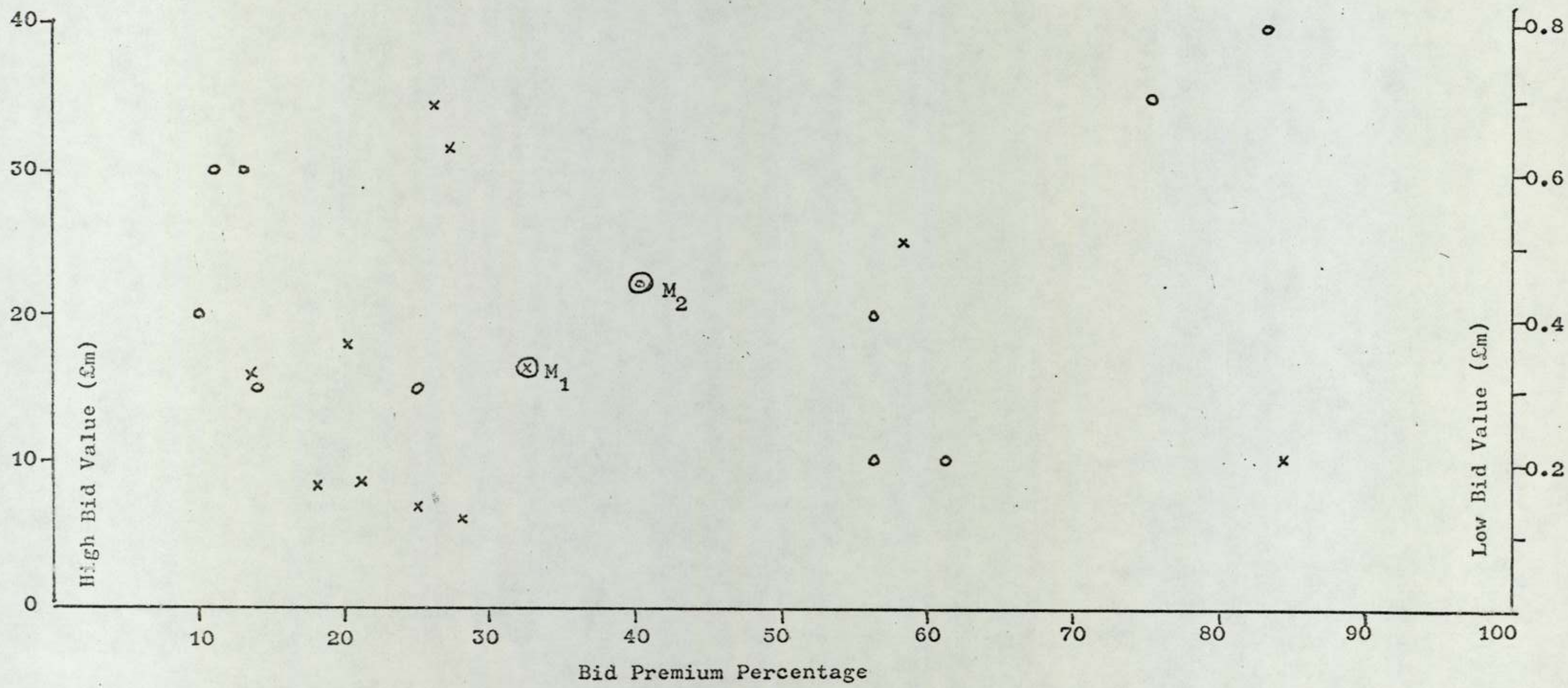
RELATIVE BID VALUES AND BID PREMIA

	(a)	(b)		(c)	(d)
Entry No.	Higher Bid Value (£m)	Bid Premium Percentage	Entry No.	Lower Bid Value (£m)	Bid Premium Percentage
1	34.2	26	11	0.8	83
2	31.4	27	12	0.7	75
3	25.0	58	13	0.6	13
4	18.0	20	14	0.6	11
5	13.6	16	15	0.4	56
6	10.1	84	16	0.4	10
7	8.5	21	17	0.3	25
8	8.1	18	18	0.3	14
9	6.9	25	19	0.2	61
10	6.0	28	20	0.2	56

Totals: £161.8 million	323	Totals: £4.5 million	404
Means: £16.2 million	32.3%	Means: £0.45 million	40.4%
Mean Deviation: =	15.48%	Mean Deviation: =	25.8%
Standard Deviation: =	21.66%	Standard Deviation: =	28.67%

Figure 8.1 SCATTER DIAGRAM OF BID VALUES v. BID PREMIA

(Table No. 8.3)



x = High Bid Values/Bid Premia
o = Low Bid Values/Bid Premia

$\otimes_{M_1}$ = Mean of High Bid Values/Bid Premia
$\odot_{M_2}$ = Mean of Low Bid Values/Bid Premia

With the qualification that the characteristics of the extremes of a distribution may not be taken to be indicative of the behaviour of the distribution as a whole, the results of the test may be seen in Table No. 8.3 and in Fig. 8.1.

Inspection of the high bid values side of the table (8.3) reveals no obvious relationship between the magnitude of the bid value and the derived bid premium percentage although it is evident that, except for entries (3) and (6), there is a relatively close grouping in the 20-30% premium bracket. On the other hand, the entries (11) to (20) the low bid values, show a higher degree of heterogeneity, with the bid premiums fairly evenly scattered in two ranges (83-56% and 10-14%) with a single value between them.

The means of the respective groups show a difference of about 8% for the bid premia, with the higher average relating to the lower value bids. A hypothesis may be proposed that when bid total values are higher, the bid premium tends to be lower; which is, perhaps, consistent with the precepts of business practice of conservation of capital. A more rigorous analysis with more extensive sampling would be required adequately to test this hypothesis - which may be explained by partial bid anticipation increasing the pre-bid capitalisation in cases of higher bid aggregate values.

To ascertain if a discernible distribution existed, a scatter diagram was constructed from the data in Table No. 8.3 (Fig. 8.1). The diagram indicates, as do the figures, that there are no clear relationships either between the two groups of bid values or within the respective groups. Visually, the moments of the lower bid values about the mean appear to have a general balance.

22. Relative Premia Homogeneity in Higher Value Bids

The plots for the high bid values, however, show a tendency to group about the 15%-30% range, with the two high values (3 and 6 in Table 8.3) pulling the group mean upward toward the low bid value mean. Excluding these two values reduces the average bid premium of the high value bid group from 32.3% to 22.6% and the deviations of the sample values about this lower mean are quite small. Also, this latter adjustment increases the difference between the means considerably indicating that further research into this relationship may prove fruitful.

23. Bid Premia - Bid Value Correlation

Comparison of the mean deviations (15.48% for the high bid values, 25.8% for the low) confirms the relative dispersions about the means, as do the standard deviations. A correlation test on an extended sample of 100 positive bid premia cases produced a value (r) of -0.03934 for the relationship between bid values and bid premia. This indicates no evidence of linear correlation at any level of significance. The survey period was March - October, 1976.

24. Bid Premia Distributions

Adverting to the question of bid premium variability and relationships, as outlined by the data in Table No. 8.2, a more detailed analysis of bid premia was carried out and the results were as follows. Table No. 8.4 shows the distribution of the data of Table No. 8.2, specifically in terms of bid premia. Although the negative bid premia were less significant for the purposes of the analysis, these have been included in Table No. 8.4: as a comparison, the data have been re-classified in Table No. 8.5 to omit the negative values.

TABLE NO. 8.4

DISTRIBUTION OF PREMIA IN TAKEOVER BIDS

(a) Premia Percentage Class (Bid Value-Pre bid Value x 100) / Prebid Value	(b) Observed Frequency	(c) Cumulative Frequency & % Cum. Frequency.
Less than 0	12	12
0 - 10%	15	27
+10 - 20	16	43
+20 - 30	16	59
+30 - 40	6	65
+40 - 50	8	73
+50 - 60	8	81
+60 - 70	8	89
+70 - 80	2	91
+80 - 90	5	96
+90 - 100	1	97
+100	3	100
TOTAL	100	

TABLE NO. 8.5

DISTRIBUTION OF POSITIVE BID PREMIA IN TAKEOVER BIDS

Premia Percentage			Cumulative	Percentage	Relative
Class	Mark	Frequency	Frequency	Cum.Frequency	Frequency %
0 -10%	5%	15	15	17.0	17.0
+10 -20	15	16	31	35.2	18.2
+20 -30	25	16	47	53.4	18.2
+30 -40	35	6	53	60.2	6.8
+40 -50	45	8	61	69.3	9.1
+50 -60	55	8	69	78.4	9.1
+60 -70	65	8	77	87.5	9.1
+70 -80	75	2	79	89.7	2.3
+80 -90	85	5	84	95.4	5.7
+90 -100	95	1	85	96.6	1.1
+100-110	105	3	88	100.0	3.4
	TOTAL	88			

Weighted Mean = 36.7%   Mean Absolute Deviation = 23.19%

Standard Deviation = 27.43%

In Table No. 8.5, the small error in assuming a class mark of 105 is not material in view of the weighted distribution of the three bids in this class. Inspection of the frequency distribution and relative frequencies indicated a positive-skewed distribution and this is confirmed by the histogram in Fig. 8.2. There is a well-defined grouping of bid premia values in the 5%, 15% and 25% classes; with a pronounced skew toward the higher values.

It is likely that a larger sample may have produced greater continuity of the distribution since the breaks in contour at the 35%, 75% and 95% values appear to offer no rational explanation other than the relative smallness of the sample. Alternatively, of course, the 45%, 55%, 65% and 85% values may have offered a smoother distribution with a larger sample since the 105% class is representative of the 100% plus samples.

25. Summary of Statistical Results of Bid Premia Analyses

Fig. 8.3 is the ogive for the entire sample and licence has been taken to include the negative bid premia. However, for the purpose of this analysis the ogive constructed from Table No. 8.5 (omitting negative bid premia) and shown in Fig. 8.4 is the more germane of the two. Comparison of the two ogives and the quantiles indicated in the figures show a difference ranging from about 7.5% at the lower values to about 5.4% at the P_{90} level.

Figure 8.2 HISTOGRAM OF BID PREMIA FREQUENCY

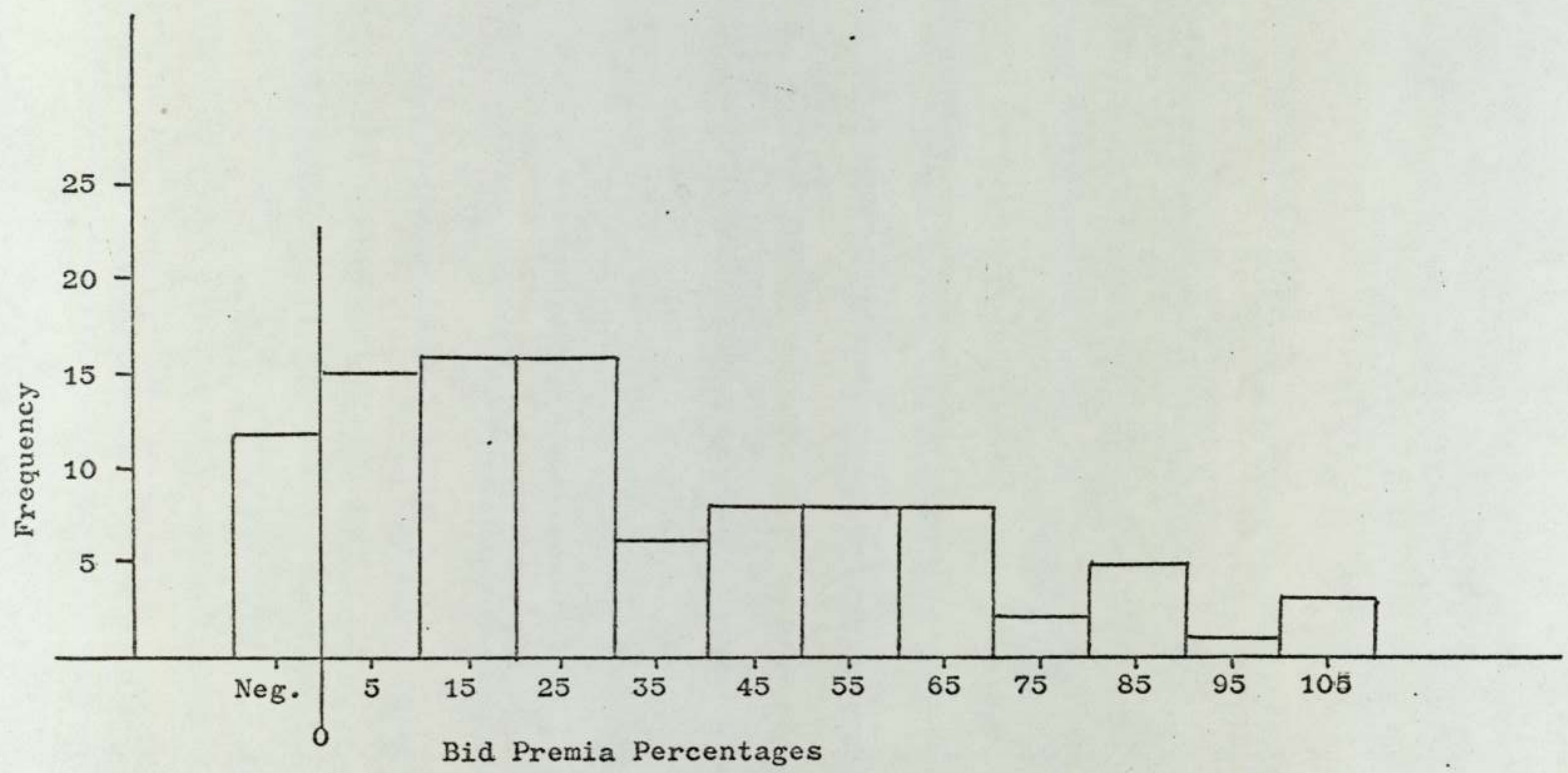


Figure 8.3 BID PREMIA OGIVE (A)

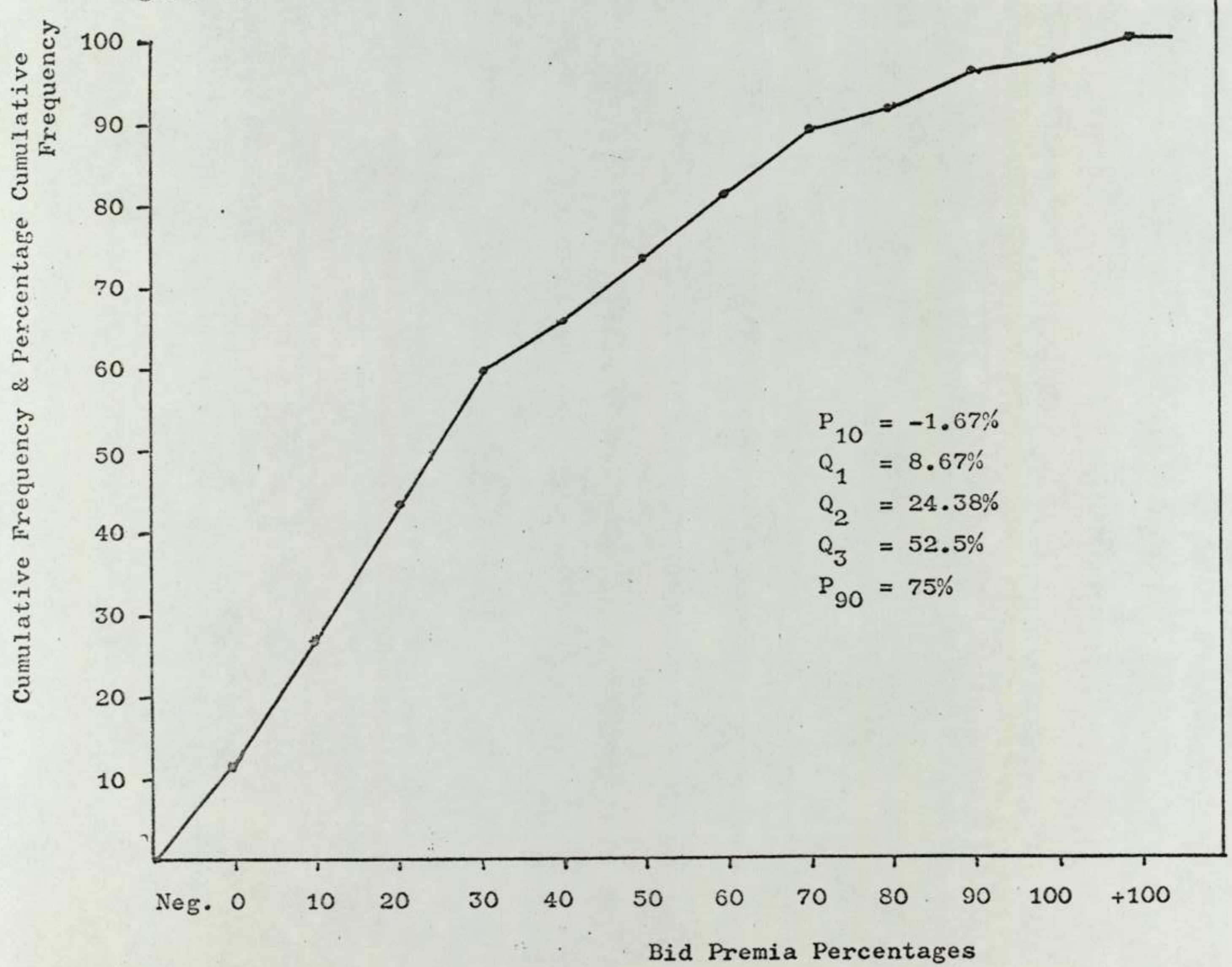
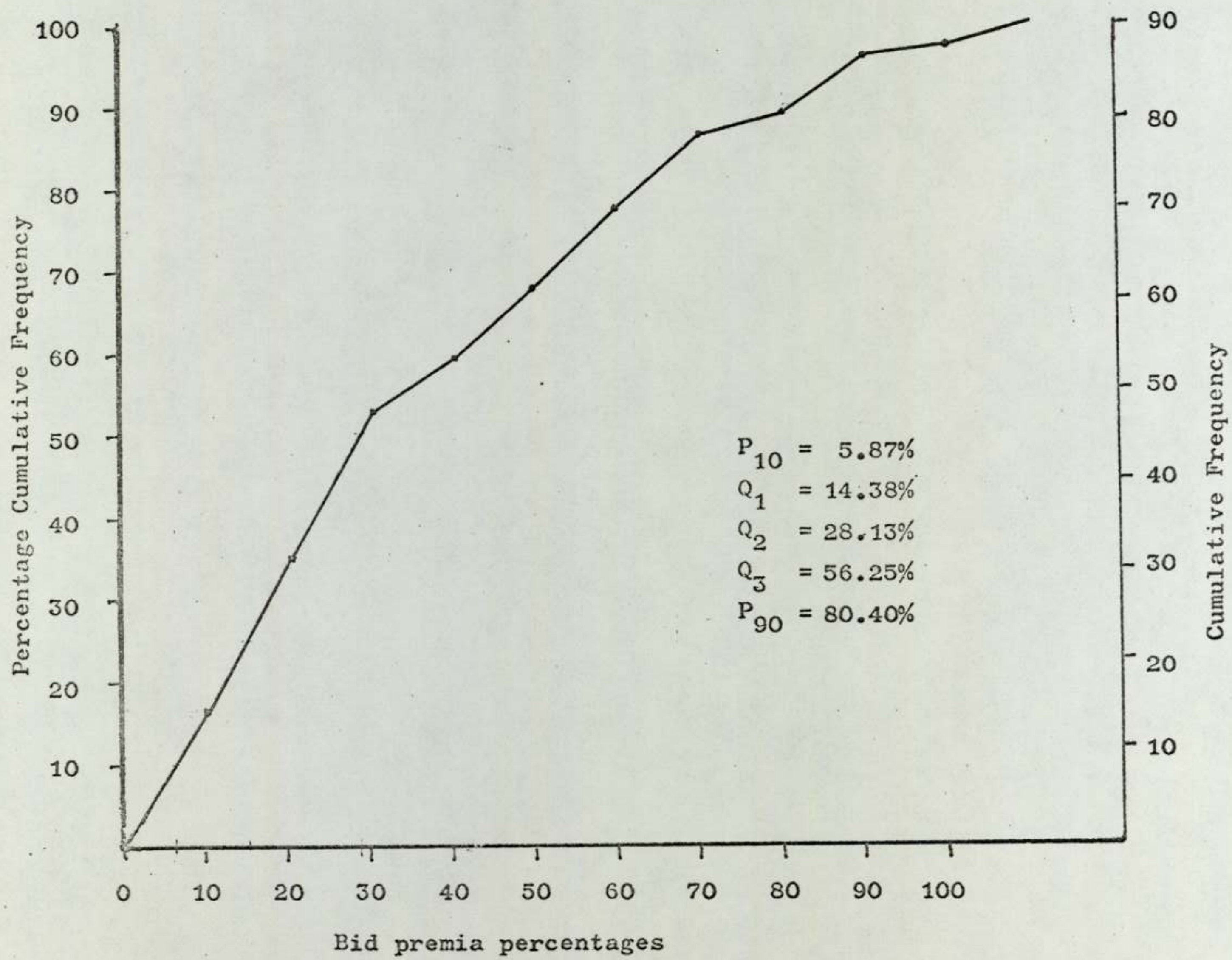


Figure 8.4 BID PREMIA OGIVE (B)



The median for the Fig. 8.4 ogive is 28.13% compared with the weighted mean (Table No. 8.5) of 36.7% and of 35.32% as the result of $\frac{1}{2}(Q_1 + Q_3)$; the modal values (Fig. 8.2) are 15% and 25%.

In comparing these measures of central tendency with the aggregate bid premium of 17.06% (Table No. 8.2) it is evident that the weighting effect of the negative bid premia in the aggregate data is marked and productive of potentially invalid conclusions.

So far as dispersion is concerned, the semi-interquartile range (Fig. 8.4), $\frac{1}{2}(Q_3-Q_1)$, is seen to be 20.94%; the 10-90 percentile range, $P_{90} - P_{10}$, (Fig. 8.4) is 74.53%; the mean absolute deviation (Table No. 8.5) is 23.19% and the standard deviation is 27.48%.

50% of the bid cases lie between Q_1 and Q_3, that is, between the range 14.38% to 56.25%, whilst 80% lie between the range of 5.87% to 80.40%.

The relative dispersion of the distribution is indicated by the coefficient of variation (standard deviation/mean) and, in this case, is 27.48/36.7 = 0.7487 or 74.9%. Generally, the overall distribution exhibits Poisson/negative exponential characteristics.

26. Summary of Conclusions on Bid Premia Analyses

Consideration of these results indicates that specific conclusions based on a 'norm' of bid premium are not feasible. Consensus appears more strongly in the lower ranges of bid premium but the evidence is not sufficiently conclusive to support a thesis that corporate asset valuation involving change of control has a particular premium value in stock market capitalisation terms. Rather, the evidence above tends to suggest that change of control valuation is subject to market negotiation according to the many criteria of judgement governing company takeovers already discussed previously in this chapter.

A more comprehensive research programme might enable the valuation of the utility of control to be established in particular, limited circumstances, but the present work suggests that the dispersion of the distribution is indicative of a multi-faceted market relationship between vendor and purchaser in which the transfer of control is but one (more or less significant)factor.

27. Professional Practice in Corporate Asset Valuations

This chapter has surveyed some of the many aspects of valuation of corporate assets in the private sector. Clearly, the subject is complex and inherently qualitative since it is concerned with human judgement and the inter-actions of professionals, an environment of instability and rapid change and a consequent lack of precedential guidelines.

To throw further light on the subject, an attempt was made to elicit the views of professionals in this field, notably of issuing houses and merchant banks, for whom the transfer of corporate assets in practice demands adaptations and philosophies related to a dynamic environment.

28. Research Methods Constraints - Professional Valuations

Since the views of professionals have been illustrated in works referred to previously, e.g. the wide-ranging research of the late T.A. Hamilton Baynes (2) and others[46], it was neither appropriate nor possible to have attempted other than a brief survey within the scope, objectives and limitations of the present work. It was decided that a formal, structured approach, such as a questionnaire, was quite inappropriate for obvious reasons which included confidentiality, 'in-house'traditions, the potential diversity of professional approaches and, not least, the relative insensitivity of this method as a research tool in such a highly qualitative field. Additionally, a structured approach would have elicited a structured response which, in the writer's opinion, might have distorted - even disguised - the differing philosophies subscribed to by the respondents. Consequently, the method adopted was to select a number of leading issuing houses/merchant banks and to seek their professional views on the subject of valuation of corporate assets in the private company sector.

As every researcher knows, the return on such investments is seldom more than about from 6% to 15% and the nature of the present research tended to suggest a possible zero return. In fact, the respondents, in general, were most helpful not only in freely giving their valuable time but also in permitting their views to be quoted by the writer. The information not limited by the requirements of confidentiality is discussed below and the writer reiterates his gratitude for the kind co-operation of the respondents.

29. Corporate Asset Valuation: Survey of Methodologies in Practice

Gerald James, a (then) director of Henry Ansbacher & Co. Ltd. (Fraser Ansbacher Ltd.) was of the opinion that, "The only true basis for a valuation is the value that exists between a willing buyer and a willing seller".

In a later conversation he expressed a view that State valuations of corporate assets were often arbitrary and based more on political criteria than on economic worth. He instanced the fallacies of 'profit' figures quoted in the public sector which had been derived by basing them on false capital structures which ignored the facts of huge capital write-offs, a ploy unheard of in the private sector: these practices constituted virtual prostitution of professionalism in terms of accountancy principles and practices.

He summed up the position by claiming that if there were no proper market there could be no proper valuation.[47]

Mr. T.P. Thornton, of Hill Samuel & Co. Ltd., commented in an initial letter that it was difficult to offer assistance because of the constraints of confidentiality: "Each valuation of course has its own reasons and each of those would be very peculiar to a client's circumstances". However, in a later conversation, he was able to amplify this statement. He said that Hill Samuel did not use conventionalised quantitative methods to arrive at prices for companies and that no computer programme was suitable or available. Calculators and slide rules were used merely as tools but the actual valuation was a matter of highly qualitative professional judgement in which knowledge of the particular circumstances of clients and the business formed an important part.[48]

Adam Broadbent, a director of J. Henry Schroder Wagg & Co. Ltd. expressed the (personal) view that, whilst quantification in valuation may be exact, qualitative factors, intuition, experience and judgement often enabled professionals to reach a sound valuation of corporate assets without recourse to mathematical formulation.

Less formally, he mentioned his own observation of professionals "sucking their thumb" and coming up with valuations comparable with those reached by sophisticated techniques.

In his view, the final valuation figure may be a result of combinations of influences, including "what the market will bear", knowledge of vendors and potential purchasers and the general circumstances of the prospective deal.

He doubted that there was a "philosophy of corporate asset valuation" to espouse and thought that views as to value differed from person to person and that this was what made the market place.[49]

Mr. Mackworth-Young, Deputy Chairman of Morgan Grenfell & Co. Ltd. underlined the difficulty of offering constructive help in this area of research when he wrote that, "... we are in a confidential relationship with one client or another and it is therefore impossible to discuss these subjects with a third party at any time".[50]

G.C. Seligman, Deputy Chairman and Chief Executive of S.G. Warburg and Co. Ltd., thought that a comparison of State and private sector valuations of corporate assets could be made only in a very generalised way and he doubted the feasibility of such a comparison.

His view on private sector valuation (on which he had had considerable experience) was that it was so much a matter of the facts of the particular case that "... virtually the only factor common to all is a judgement of what the market will bear, which is then tested against the market itself".[51]

John Vaughan, Chairman* of the Charterhouse Group Ltd., (who had been most generous with personal help in the past), whilst not able to offer specific assistance with the research on corporate asset valuation in the private sector, did comment on the consideration paid by the National

* (now President)

Enterprise Board for its holding of Brown Boveri Kent shares. He thought that 25p per share (par value), "... seems to me a perfectly fair basis as it was approximately equivalent to the market quotation for the BBK shares at the time of transfer".[52] The holding, although substantial (4,261,757 Ordinary voting shares), did not entail a change of control in terms of ownership.

John Harrison* a director of Chesham Amalgamations & Investments Ltd., summarised the activities involved in corporate valuation as, "... the acquirer is using an investment yardstick based on the anticipated profit modified by the assets involved and also by the general competitive situation".

In a later discussion, he amplified this information by detailing more specifically the general modus operandi. An edited version of the company accounts and forecast submitted by the vendor management is prepared. If the result is considered realistic, i.e. it makes commercial sense, or alternative explanations are acceptable, then a "likely outcome" is constructed. A figure is based on this depending on the degrees of risk and the pretax return sought in particular cases. For example, if pretax profits were, say, £100,000 then a price of £300,000 to £400,000 may be assessed, depending on circumstances, associated with a return of $33^1/3$% or 25%.

Asset values would be considered in support of a profitability assessment and any necessary modifications made accordingly.

* Mr. Harrison was most helpful in his approach to the research area. He commented that whilst his organisation was primarily concerned with private company transactions, the question of valuation reflected what was happening on the Stock Exchange at any given time.

Goodwill is normally viewed very conservatively - a poor view of such assets often being taken. Valuations of stock and real estate are examined critically with reference both to amounts and age of valuations. Vendor/purchaser relationships are important and undertakings given regarding intentions about staff retentions are sometimes given weight.

Mr. Harrison has found that refusal to proceed with a corporate sale may be due to quite subjective matters such as personal likes and dislikes. Market (and personal) sentiment ranked as highly important, as did correctly-based personal relationships and loyalties to long-standing friendships. His experience had shown that many subjective factors were involved and that, above all, there was no 'one method' - quantitative or otherwise.[53]

30. Conclusions on Professional Practice Survey.

From the above responses, it seems evident that valuations of corporate assets in the private sector are based, practically, on both quantitative and qualitative methods in which professional judgement plays a leading part. Clearly, the observed reluctance to nominate 'one method' indicates that theoretical attempts to postulate a universally-applicable modus operandi would be unrealistic if not chimerical.

Since the private sector is not able to subscribe to a prescriptive methodology of valuation applicable to all cases in all circumstances, it seems appropriate to examine the methodology used by the State, in valuing the corporate assets to be taken into public ownership from the private sector, to ascertain whether or not a specific method is preferred and, if so, the particular merits/demerits of such a method.

31. <u>General Conclusions on Private Sector Valuation.</u>

The studies in this chapter indicate the complexity of the subject of corporate asset valuation for the purpose of transfer of ownership: methodology surveyed in Appendix 'A' indicates the breadth of the field and the inherent variability of feasible approaches to the task.

An obvious conclusion is that, irrespective of the methods used to derive assessments of value, a primary sine qua non is the existence of willing vendors and purchasers free to deal within the normal inhibitions of the commercial environment. This freedom includes the ability to withdraw from dealing if either party deems it appropriate so to do, subject to legal relationships freely undertaken.

The very tenor of such a market, including the caveats for both vendor and purchaser in terms of normal commercial risks, is one of voluntary subscription and engagement.

The evidence adduced from the above studies (Chapter 8) indicates strongly the process of bargaining between willing vendor and willing purchaser in a market environment supportive of a consensual compromise to mark the mutual satisfactions aimed at in any transfer of assets for a consideration.

Stock exchange bargains are struck in an atmosphere redolent of this ambience of voluntary exchange. Even the circumstances producing forced sales do not, in a free market, compel buyers to deal save within freely entered contractual obligations. It has been shown (Sections 19-26) that transfers of corporate assets involving control of the undertaking, voluntarily exchanged, is invariably accompanied by a premium in recognition of the value of 'control'-a property in itself.

Compulsory acquisition of corporate assets by the State is essentially different from the market processes exemplified above. Chapter 9 is devoted to an investigation and analysis of this milieu in order to provide complementary material to the work in this chapter and to form the bases of conclusions relating to the second objective (b), as nominated in Chapter 1, Section 1 of this thesis; that of public ownership in the private sector and the compulsory transfer of assets.

CHAPTER 9

PUBLIC OWNERSHIP: VALUATION OF CORPORATE ASSETS IN THE PUBLIC SECTOR

1. Research Constraints in the Public Sector

It has been indicated that direct research into the criteria and methodology of corporate asset valuation, currently applied in practice in the private sector, presents difficulties associated with the nature of the operations, the client relationships and the restrictions of confidentiality.

Pursuance of the research in the public sector proved no less difficult, as soon became evident from the response to approaches made to the Treasury, the Department of Industry and the Central Statistical Office.[1] The problems were summed in a succinct statement from the Department of Industry:[2]

> "The bulk of the information you are seeking on the valuation criteria used by central government in the acquisition of corporate assets is classified; for this reason you will appreciate that we are not permitted to pass it on".

Clearly, the strictures imposed by the Official Secrets Act and the inevitability of political sensitivity precluded open examination of contemporary State criteria in this field. It could be argued that this was an area, par excellence, for full disclosure to enable Government's motives and reasonings to be subjected to the fullest scrutiny, since the compulsory transfer of private property to central government and the sanctity of ownership in a true democracy are matters of importance and public interest.

Consequently, it has been necessary to rely partly on the public record for relevant information and although an historical approach was eschewed at the outset, it is necessary here to establish some groundwork of the philosophies and ideological influences which accompanied the major postwar acquisitions and nationalisations by the State, before developing a study of evidence of contemporary thinking in this field. Fortunately, a monumental record of the nationalisation of British Industry between 1945 and 1951 has been published and the author, Sir Norman Chester, had been given full access to official documents.[3] The work has been accorded the status of an official history and it deals authoritatively with the circumstances of, inter alia, the transfer of corporate assets, the form and bases of compensatory settlements and associated matters.

2. Bases and Forms of Compensatory Transfers

Early resolution of the question as to whether or not compensation should be paid for expropriated private sector corporate assets[4] resulted in the basic remainders of

(a) what should be the basis of compensation, and

(b) in what form should compensatory transfers be made?

Early discussions within the Labour Party and the Trades Union Congress[5] produced four possible bases of compensation:-

1. Market value of stocks and shares
2 Total capital expenditure net of depreciation
3. Net maintainable revenue (capitalised)
4. Actual valuation of physical assets.

The first method was seen as having the advantage of simplicity, but objections to its use included problems associated with unquoted companies and lack of homogeneity of assets to be acquired, municipal undertakings, the fact (discussed in Chapter 8) of supply and demand characteristics of Stock Exchange prices, which are not necessarily related to true corporate worth, possible market manipulation and the influence of politico-economic factors on stock market prices.

Valuations based on the second method had the obvious shortcomings that past capital consumption was not necessarily a satisfactory basis of estimation of present worth and that depreciation methods and policies could produce unrealistic present capital values, inter alia.

Net maintainable revenue, by which the assets are valued in terms of their earning powers, although widely used as a measure of corporate worth, suffers from disadvantages already discussed in Chapter 8. That is, problems of accurate assignment of probabilities to possible earnings outcomes, difficulty of assessments of the longevity of particular revenue levels, vulnerability of super-profits, the existence and effects of explicit or implicit subsidisation, the treatment of externalities, the effect of entrepreneurial and managerial talents, substitution and consumption alternatives and so on.

The fourth method was seen to have difficulties associated with expenses of valuation, costs of deriving mutually acceptable assessments, possibly lengthy delays in terms of arbitration and, of course, the actual bases of valuation to be adopted.

3. Capitalisation of Past Earning Capacity

The establishment of the Labour Party's principle that fair compensation should be paid for expropriated assets[6] was followed by a refinement of the discussion on the possible bases of compensation. An Official Committee established to consider and report on the issues suggested four possible bases of compensation[7]. The Report, issued in February, 1946, discussed four possible methods, three of which corresponded with the bases (1), (2) and (3) outlined above: the remaining one (4) was not included. An extension of the range of proposed alternatives was contained in the committee's proposal to use

> "Past earning capacity capitalised at so many years' purchase "

as a possible approach. It was suggested that this method recognised the importance of earning capacity of a business and was the basis of Stock Exchange quotations.

The proposal was to take the average earnings of an undertaking over a selected period, to apply any necessary corrective factors to recognise inherent circumstances which would have altered the earnings levels and to multiply the derived figure to produce a capitalised value based on so many years' purchase of earnings. The multiplier would depend on the variables and particular circumstances associated with the undertaking and/or the industry.

It was recognised by the committee that this method suffered from disadvantages, inter alia, that past performance was not necessarily a good indicator of future profitability*. In practice, it was suggested that a compromise between principle and expediency might

* I.M.D. Little & A.C. Rayner refer to these aspects in Higgledy Piggledy Growth, Blackwell 1962 and 1966.

be appropriate depending upon the factors to be considered in each particular case.

4. Funding and Forms of Compensatory Settlements

Early discussion on the form of compensatory transfers[8] led to considerations of continuing liability of public undertakings to fund the compensatory settlements of former private owners and shareholders (i.e. in the form of fixed interest stock issues 'tied' to the public undertaking's earning capacity as against compensation in the form of Treasury-guaranteed stock). The relevant advantages and disadvantages of cash settlements were considered (inter alia, the extinguishing of all liabilities to former owners, the flexibility and acceptability of cash in terms of re-investment choice as against the problems of funding cash settlements and the resultant onerous loan charges against the new public undertakings).

Discussions included aspects such as the incompatibility of a continued interest in the earnings of public acquisitions without any power of control should fixed interest stock be issued (by the public undertaking or by the Government) by way of compensatory settlement and methods of financing public undertakings - by the State or self-credit arrangements.

These arguments resolved into a tripartite philosophy of compensatory settlements. The former owners of corporate assets could be compensated by the State in one or more of the following forms (the question of equity having been ruled out on ideological and political grounds and the cash settlements having been rejected on the grounds of impracticability and difficulties of funding on account of the scale of the operations)[9]:-

(a) The issue of fixed interest bearing Stock based on the credit of the public undertaking, i.e. a 'tied' or named Stock.

(b) Stock as in (a) but with a Treasury guarantee.

(c) Issue of a Government Stock.

Of these three forms the first was not favoured since the absence of a guarantee implied not only a risk element, which was incompatible with a complete absence of control on the part of the previous owners, but also that the existence of a group with vested interests would be inconsistent with the principles and practice of centralised control by the State.

In general, the basis of compensation most favoured was that of net maintainable revenue, suitably capitalised, and the preferred forms of settlement were the methods (b) and (c) outlined above.[10]

5. Compensation in Practice

In practice, the Bank of England was acquired (on a maintenance of revenue to shareholders basis) for £58,212,000 of 3% Government Stock. The global value of the coal industry, assessed at £164,660,00 by the (undisclosed) application of the capitalised revenue method, was disbursed mainly by the issue of Government fixed interest Stock with some £66 million cash being paid for associated acquisitions and charges.

The balance of Cable and Wireless Ltd. not held by the Government (assessed by a Valuation Tribunal on the capitalised revenue basis - the application details of which were not disclosed) amounting to a declared value of £32,195,000, was compensated by issues of 3% Savings Bonds, 1960-70 and 1965-75.[11]

6. Stock Market Capitalisations and Arbitrary Datum Period

The heterogeneous nature of the corporate assets in the transport, electricity and gas industries caused major problems in terms of both the bases and the forms of compensatory settlements. In the case of the railways, the bases were to be the stock market values of quoted and dealt-in stocks and agreement/arbitration values for other stocks not so quoted or with only nominal market prices due to lack of recent dealings.

Use of stock market prices gave rise to strong criticism and differences of opinion regarding the choice of a datum period equitable to the shareholders and the State.[12] Use of the net maintainable revenue basis was considered impracticable in the transport industries. In the event, figures of £927.3 million, £128.1 million and £11.4 million were assessed for the Railways, the London Passenger Transport and the Canals and Inland Waterways, respectively. The form of compensation was by way of Treasury guaranteed 3% British Transport Stock.[13]

7. Public Sector Use of Negotiated Valuations and Arbitration

Difficulties of valuation bases in the electricity industry were finally resolved by a combination of stock market capitalisation values and negotiated valuations in the cases of non-quoted undertakings, in which the Ministry of Fuel and Power, the Treasury, the Estate Duty Office and a leading firm of stockbrokers had been involved. The ratio of quoted to unquoted securities was roughly of the order of 1:2 and none of the major negotiated valuations were disputed to the point of access to the arbitration procedures under the legislation.

In the outcome, compensation was made in the form of British Electricity fixed interest guaranteed Stock to the overall amount of £341.9 million; the Stock was of 3% and 5% with maturity dates ranging from 1948-53 to 1968-73, the principal Stock being the latter (issued at 3%). Further liabilities of and payments to the then electricity undertakings amounting to £200.1million brought the total to about £542 millions.[14] The relevant stock market period for both the transport and electricity industries pricing bases was October, 1947.

The gas industry also presented problems of compensation in terms of valuation of assets. Of about 1,950 securities, representing a compensatory value of an estimated £182 millions, only 50 were fully quoted on the stock exchange, leaving about 1,900 securities worth about £132 million to be valued on a negotiated basis: these latter securities involved about 640 companies.

The terms of compensation, settled by reference to stock exchange quotations and/or negotiations with Stockholders' representatives, resulted in the issue of 3% British Gas Guaranteed Stock 1990-95 to the amount of £189,075,805. A further £31 million in severance and net debt liabilities brought the total considerations to about £220 million.[15]

8. Problems of Allocation and the Net Maintainable Revenue Method

The allocation and distribution of compensatory transfers for expropriated assets gave rise to problems in the management of the early nationalisation measures. The net maintainable revenue basis, which received early approval, proved not to be universally applicable in practice.

Where an industry comprised a large number of disparate undertakings with widely differing profitability characteristics, the application of the method was attended by serious practical difficulties not only in terms of equitable valuation criteria acceptable to vendor and purchaser but also in the allocation of compensatory settlements to individual shareholders or proprietors.

Whilst the assessment of a global sum might be practicable (for both a single undertaking and an industry), its division was found in practice to present difficulties which could be resolved only be resorting to many valuations on a 'micro' basis - with the attendant inefficiencies and expense of such an approach.[16]

Choice of the stock market share price as a valuation method was a measure of expediency rather than of justification. Its ease of application solved problems of valuation and compensatory distribution and its relative political defensibility commended it to the proponents of 'socialisation'. Arguments against the stock market basis included those developed in Chapter 8, notably the difference between prices when control was or was not involved, the effect of major and minor stock transactions on demand/supply equilibrium, the effect of the threat of nationalisation on share prices and the compulsory nature of the transfer of ownership.[17]

9. Fixed Interest Securities as Compensatory Settlement

The form of compensatory transfers for expropriated assets, mainly in the form of fixed interest securities, also gave rise to dissension. Low rates of interest meant that former owners' income suffered substantial falls in many cases, notwithstanding the enhanced security of income, and holders of British Transport Stock seeking to dispose of their holdings were also faced with immediate capital losses. Thus, the argument that former shareholders could sell their Government-guaranteed Stock to re-invest in high-yielding risk capital, if they so wished, was chimerical in some cases.[18]

Of the total compensation of about £2,639 million paid for the nationalised industries, roughly £2,300 million was in the form of fixed interest securities of various maturities.[19]

10. Rolls Royce Ltd. as a Public Policy Indicator

A more recent indication of public policies relating to the transfer of private sector corporate assets to State ownership was given in the reports and discussions concerning the Government's acquisition of assets important to national defence (aero-engine production, etc.), following the collapse of Rolls Royce Ltd. in February, 1971. The general circumstances of the transfer were dealt with in a report issued by the Comptroller and Auditor General.[20]

The assets in question were transferred to a new State-owned company, Rolls Royce (1971) Ltd. in May, 1971. Bases of price determination were set out in 'Heads of Agreement' in March, 1971, and a settlement was reached in global terms in June, 1973. The price to be paid to the Receiver for the transferred assets was defined to be a fair price such that the assets (with the obligations properly attributed to them) might reasonably be expected to fetch if sold on the 31st March, 1971, by the Receiver in the open market to a willing buyer or buyers. In the event that the parties were unable to agree on a price, the matter would be decided by an expert appointed jointly by them and his decision was to be accepted as final and binding.[21]

It had also been provided that assets relating exclusively to the RB 211 aero-engine would be transferred to Rolls Royce (1971) Ltd. for the nominal sum of £1 if a new agreement for the supply of the RB 211 to Lockheed had the effect of mitigating any damages payable by the collapsed company in respect of breach of their contracts with Lockheed. If such a transfer of the particular assets were made, the negotiated price for the remainder of the assets would be fixed on the basis that neither a profit nor a loss would be made in carrying out the RB 211 project.

Evidently, the market value of the RB 211 assets depended heavily on whether or not contracts could be secured to make use of their productive value as a going concern with Rolls Royce (1971) Ltd., and this was uncertain at the time the Heads of Agreement were agreed.

The book value of the RB 211 assets had been estimated at £30 - £40 million. Additional factors were that deposits totalling 21 million dollars had been made for RB 211 engines and that potential damages for breaches of contract, amounting to "hundreds of millions of pounds", in respect of RB 211 contracts[22] were involved (as a going concern).

In the outcome, a new RB 211 contract was arranged and came into force in September, 1971; the RB 211 assets were duly transferred for £1; damages under the previous contract were mitigated and the remainder of the assets to be transferred were the subject of price negotiations under the Heads of Agreement. The 21 million dollars deposits were also handed over to Rolls Royce (1971) Ltd. since the new contract had removed the Rolls Royce Ltd. liabilities under the old contract.[23]

11. <u>Net Maintainable Profits and Price/Earnings Ratios Bases</u>

A further indication of the imprecisions and qualitative elements of corporate asset valuation was given in the widely divergent figures put forward for the remaining assets to be taken into public ownership. The Government's offer was £33.5 million, whilst the Receiver, emboldened doubtless by his previous success, put forward a price of £162 million.

These figures were derived by evaluating the assets on the bases of forecasts of maintainable profits, adjusted for tax and interest, multiplied by a price/earnings ratio.[24] In a later investigation of this transaction, a Committee of Public Accounts established that major disagreements had arisen in both of the valuation factors (maintainable profits, net, and the price/earnings ratios). Unfortunately, although the actual figures were given in evidence, they were not published.[25]

Unsurprisingly, resort was made to expert assistance (Sir Edmund Parker), in which a High Court Judge assisted with rulings on various points of law and definitive interpretations, and a global settlement of £87.5 million was agreed. This figure covered not only the price for the assets and undertaking acquired by Rolls Royce (1971) Ltd., but also other outstanding issues between the Receiver and the new company and the Receiver and the Government.

Clearly, qualitative factors entered the negotiations since, although the initial offer of £33.5 million had been endorsed by the Government and had been exceeded in the outcome by 161%, the (then) Department of Trade and Industry considered that the public interest had been served in that lengthy negotiations had been avoided and the management of the new company had been enabled to concentrate on the management of the business.[26]

The lack of 'micro' analysis was also in evidence since no apportionments of the global sum had been made in respect of the various elements of the assets, such as land, buildings, plant, contractual liabilities and settlements, etc.[27]

12. Valuation Discrepancies in the Rolls Royce Settlement

In the subsequent investigation, referred to above (25), the Committee of Public Accounts drew attention to the fact that the Receiver's price of £162 million was 85.1% up on the settlement figure of £87.5 million (actual percentages were not quoted) but that the settlement exceeded by 161% the Rolls Royce (1971) Ltd./ Government's opening offer. Evidence failed to disclose the exact bases on which the offer of £33.5 million had been established.[28]

Attention was also focused on the fact that the Receiver had been able to satisfy the creditors of Rolls Royce Ltd. in full (agreed claims) and to produce a surplus of £26.9 million for the stockholders, (equivalent to 40.9p per £ of stock held)[29]. This latter payment compared with closing Rolls Royce Ltd. stock market prices of 46.25p (9s.3d) on the 2nd February, 1971 and 38.75p (7s.9d) on the 3rd February, 1971, immediately prior to the collapse. However, it was pointed out subsequently by the Treasury that, to achieve these levels of payment, the liquidators had to realise in excess of £250 million, of which £87.5 million came from the settlement discussed above.[30]

A more recent report[31] disclosed that the expected surplus arising from the liquidation of Rolls Royce Ltd., was £40.1 million, equivalent to 60.9p. per share for the stockholders. £174.3 million had been paid out to creditors and stockholders, with an expected balance of 5.9p (60.9p - 55p already paid out to shareholders) per share in hand to cover matters still pending - a total amount of about £3.88 million. The market capitalisation value of Rolls Royce Ltd. after the collapse was the nominal figure of about £700,000, around 1p per share.

The Rolls Royce affair was complex owing to the magnitude of the undertaking, the then Government's role in the events leading to its collapse, connotations of national security, the product mix of the company and the nature of its contractual relationships both in the U.K. and abroad.

The not unhappy outcome for its former shareholders and creditors may be attributed to the acumen of the Receiver, the vulnerability of the State as a purchaser and the ideologies of the Conservative administration toward public ownership and the sanctity of private ownership. The mitigation of the potentially crippling damages and, not least, the relative dependency of Rolls Royce's major aircraft engine customers may also have been relevant.

13. Evidence of Qualitative Factors in Corporate Asset Valuation

The published information reveals the highly qualitative nature of both private and public valuations of corporate assets, and the wide divergences in terms of 'net maintainable profits' and the appropriate price/earnings multipliers also suggest the lack of determinate prescriptive formulae acceptable, in such circumstances, to both vendor and purchaser.

In retrospect, it seems surprising that the 'Heads of Agreement', relating to the transfer of major resources and contractually binding on such informed parties, should stipulate that "the price to be paid.....shall be a fair price"[32] without a determinate expression of how such a price was to be derived.

14. Contemporary Valuation Methodology in the Public Sector

A contemporary indication of the (Labour) Government's approach to the bases and forms of compensatory transfers for private sector corporate assets to be taken into public ownership is given in the Aircraft and Shipbuilding Industries Act, 1977.[33]

Schedules 1 and 2 of the Act list four aerospace companies, nineteen shipbuilding companies, five companies manufacturing slow speed diesel marine engines and three shipwork training companies; these companies having met the qualifying conditions specified in the Act.[34]

The fact that the list comprises a heterogeneous collection of corporate assets, both quoted and unquoted on the stock market, means that the processes of valuation and compensation are inherently complex notwithstanding that political expediency may result in the application of over-simplified criteria to achieve the State's objects within the available time scale.

The form of compensation is specified to be interest-bearing Government stock, the principal and interest of which are to be charged against the National Loans Fund with recourse to the Consolidated Fund.[35] The amount of compensation stock payable would be subject to adjustments in respect of financial assistance from the government and special payments from or charges against the company within stipulated periods.[36] In determining the actual value of issued compensatory Stock, regard would be had to the market values of other government securities on or about the issue date.[37]

The bases of compensation are dependent upon whether the company's securities are quoted on the Stock Exchange or are unquoted.[38] In the former case, securities quoted in the Stock Exchange Daily Official List, the base value is to be taken to be the mean value of the quotations taken on specified days over the period beginning on the 1st September, 1973 and ending on the 28th February, 1974; the relevant days are defined as every Wednesday in the six months' period with the exception of the 26th December, 1973 but including Thursday, the 27th December, 1973. The mean of the quotations would be calculated on the average of the two figures quoted in the Daily List.[39]

Unquoted securities are to be valued by agreement between the Secretary of State and the Stockholder's Representative or, in default of such agreement, the value determined by arbitration on the assumption that the securities had been quoted on the same basis and over the same period in the Daily List as the quoted securities.[40]

The arbitration tribunal would comprise a barrister or solicitor of not less than seven years' standing and two other members, appointed by the Secretary of State, with experience in business and finance respectively; the legally qualified member would act as president and would be appointed by the Lord Chancellor.[41] The Act does not specify the bases on which such notional values are to be assessed.

15. Stock Market Capitalisation Values and Volatility

Apart from the well-rehearsed discussions about the suitability of stock market quotations for corporate valuations, the choice of a suitable datum period may also be subject to differences of opinion. The use of a datum such as that proposed above will give results which depend not only on the relative stock market sentiment, volatility and climate during the period from September, 1973 to February, 1974 but also on the differing fortunes of the undertakings featured in the State's takeover list.

Table No. 9.1 shows comparative data relating to measures of market capitalisation and dividend yield of shares. The aspects of market volatility are discussed more fully in Chapter 10, Sections 11 and 12, in particular, the work of Professor E.W.Davis and K.A. Yeomans.

A number of stock market indicators might have been selected for the purposes of the illustration offered in Table No. 9.1 : the two factors, the FT Industrial Ordinary Share Index and the Ordinary Dividend Yield, were chosen to indicate relative market stances on both capitalisation and income bases. It was decided not to use earnings yield indicators in view of the distorting effects of accelerating inflation rates during the period and because of the emerging tendency for high retention policies to be adopted by many Boards.

16. Limitations of Arbitrary Market Datum Period

Clearly, the 'macro' indicators used in the table are of limited use so far as the analysis of effects at the company level are concerned, but the data do present some relevant comparative

TABLE No. 9.1

STATE TAKEOVER DATUM PERIOD(a) 1973-74: STOCK MARKET CAPITALISATION AND YIELD INDICATORS

INDICATORS	RELATIVE AND ADJUSTED (b) INDICES AND YIELDS								
	WEDNESDAYS (DATUM PERIOD)				HIGHS AND LOWS				
					1976		RANGE EXTREMES (c)		
	5.9.73	28.11.73	5.12.73	27.2.74	4.5.76	27.10.76	19.5.72	6.1.75	26.6.40
FINANCIAL TIMES INDUSTRIAL ORDINARY INDEX	404.8 (305.7)	379.1 (282.0)	340.2 (249.4)	332.9 (237.1)	420.8 (199.4)	265.3 (120.7)	543.6 (466.6)	146.0 (107.4)	49.4
					YIELDS AT DATES				
					2.4.75	23.12.75	23.12.76		
FINANCIAL TIMES ORDINARY DIVIDEND YIELD (%)	4.65 (3.51)	5.00 (3.72)	5.49 (4.02)	5.55 (3.95)	6.98 (3.92)	5.74 (2.87)	6.41 (2.88)		

NOTES:-

(a) 'DATUM PERIOD' refers to stock market datum nominated for valuation purposes of quoted aircraft and shipbuilding etc., companies listed in the Aircraft and Shipbuilding Industries Act (1977)

(b) (---) indicate adjusted values to pro rata Retail Price Index levels: 1970 base period

(c) Since compilation of the series and at date of preparation of table (28.12.76)

SOURCES: Financial Times Statistics
Bank of England Quarterly Bulletin, Dec. 1976
Central Statistics Office Publication (RPI)

information. The datum dates in the first section of the table were the first Wednesday, the two mid-period Wednesdays and the final Wednesday of the datum period selected by the Government for valuation purposes.

Examination of the Industrial Ordinary Index indicates that a fall of about 18% occurred, using the first value as a base, over the period; the two mid-date values suggest that the fall was relatively continuous. This is borne out by the well-known characteristics of the stock market's descent during the autumn of 1973, continuing throughout 1974 and culminating in an accelerating decline and fall through the FT Industrial Ordinary Index 150 level in December 1974. The behaviour of the ordinary dividend yield was, of course, inversely related to the capitalisation values over the period.

Relating the approximate position of the datum period to the 'high' reached in May, 1972, by taking the average of the nominal figures in the table (404.8, 379.1, 340.2 and 332.9), which gives 364.25, it may be seen that the period gives a value of about 67% or two thirds, of the previous high point (Index 543.6).

A similar exercise for the relationship to the low point reached in January, 1975 (146.6) gives a corresponding value of about 248% above the contemporary low; or, alternatively, the low is seen to be about 40% of the datum period mean. Taking the nominal mid-point of the high (543.6) and the 1975 low (146.0) as 345.1, the datum period mean (364.25) is seen to be about 5.6% in excess of the range mean; a reasonably close approximation ignoring, of course, the significance of weighting of range values.

The upper and lower values of the Index range would, if suitably weighted by the corresponding time values (in terms of the duration of the periods over which they were maintained), doubtless give a materially different weighted mean - as indicated by the graph of the FT Industrial Ordinary Index over the period.[42]

17. Effects of Correction for Inflation on Stock Market Indices

Since inflation has materially affected the significance of indices such as the FT Industrial Ordinary Index, the relevant values in Table No.9.1 were adjusted by applying Retail Price Index (RPI) correction factors and the revised indices are shown in brackets below the corresponding base figures. 1970 was selected as the base (100) RPI. The annual average of the monthly indices was located at the year mid-points and the adjusted index values were derived pro rata to the adjacent years' RPI indices.

Using the adjusted figures, the adjusted average of the datum period (305.7, 282.0, 249.4 and 237.1) was found to be 268.55 compared with the unadjusted average of 364.25. Taking the nominal mid-point of the adjusted range (466.6 to 107.4) to be 179.6, it is seen that the adjusted datum period mean (268.55) differs widely from the adjusted range mean (179.6). Whereas the unadjusted datum period mean was found to be 5.6% in excess of the unadjusted range mean, the corresponding excess for the adjusted values is 49.5%.

This is accounted for, of course, by the greatly increased rate of acceleration of inflation during the later stages of the period 1970-1976, particularly during 1974-75, and the failure of stock market prices to maintain corporate value relativities in the aggregate. Inspection of the values in the table (No.9.1) also indicates a fall of over one-third in 'real' terms between the index 5.9.73 (404.8, adjusted to 305.7) and at 4.5.76 (420.8, adjusted to 199.4).

It follows that compensation to shareholders, who held stock during and since the datum period selected by the government, will be effectively in debased currency in the sense that general market adjustments in recognition of real (monetary-adjusted) values of equity during the time elapsed since then will not be fully recognised. If voluntary transactions were involved, the vendors could withdraw in view of onerous terms, but the compulsory nature of public acquisition could be considered to introduce a punitive element due to these elements of change in compensatory values.

Inspection of the Ordinary Dividend Yield percentages, both adjusted and unadjusted, in Table No.9.1, confirms the characteristics outlined above. A yield of 4.65% (3.51% at constant 1970 prices) on 15.9.73, the start of the datum period, compares with a nominal yield of 6.41% (2.88% at constant 1970 prices) on the 23.12.76, the date of compilation of the data in the table.

18. Commonality of Private and Public Sector Problems of Valuation - Some Conclusions

Because of the complexity of the factors involved in the discussion of methodology of corporate asset valuation for the purpose of public acquisition, the main conclusions are reserved, together with analyses of complementary aspects, for the 10th and 11th chapters of this thesis.

However, comparison of the discussion and studies in this and the preceding chapter (Ch. 8) indicates that the problems of valuation of corporate assets to elicit equitable compensatory terms for transfer from vendor to purchaser, and in particular for compulsory acquisition, are largely common. The approaches in the private and public sectors have been shown to be comparable (Chapter 8, Sections 2 et seq, and Chapter 9, Sections 3,6,7,11,13,14) and the methodologies not dissimilar. The constraints of the Official Secrets Act (Ch. 9, Section 1) have limited the opportunities to analyse the valuation methods used in the public sector in the same detail as those for the private sector (Chapter 8 and Appendix A). Even in the case of the Rolls Royce transactions, a matter of considerable public interest, the crucial details of valuation were withheld (Chapter 9, Section 11 and ref. 25).

Contemporary reliance on stock market criteria by the State has the undoubted advantage of its being a defensible measure politically and, arguably, economically. It means that discrepancies between compensatory values and net worth or economic worth (earning capacity), which exist in any case of market capitalisation to a greater or lesser extent, can be attributed to a consensual market view or sentiment relating to the particular corporate assets at a point in time.

Due to the crucial fact of State compulsion it would be of little value to make comparisons in an attempt to exemplify the equitableness or otherwise of compensatory settlements based on market capitalisations arrived at by purely voluntary processes. Notwithstanding this fact, there are other aspects of relevance to a study of compulsory public acquisition and the closing chapters (Ch.10 & 11) have been devoted to an analytical amplification and the formulation of conclusions germane to objective (b)(Chapter 1, Section 1), thus bringing the second part of this thesis to an end.

CHAPTER 10

PUBLIC OWNERSHIP: COMPENSATION FOR COMPULSORY ACQUISITION - CONCLUSIONS

1. The Macro and Micro Valuation Relationships

Compulsory acquisition of private sector corporate assets by the State should have the corollary that, since the element of choice whether or not to relinquish ownership is removed by statute, the compensatory terms and bases must be manifestly fair and equitable.

The investigations and analyses carried out in the two previous chapters indicate that such a prescription may be theoretically unimpeachable but difficult to observe in practice. It has been established that problems of valuation exist at both macro levels, in the sense of public acquisition of entire industries comprising diverse and financially and structurally differentiated corporate units, and micro levels, in terms of takeovers of single undertakings.

The expediency of establishing global values at the macro levels has been shown to be attended by practical difficulties when micro apportionments and, hence, compensatory allocations have to be determined. On the other hand, the multiplicity of methods and the differing results of professional valuation appraisals even at the level of the company appear to offer no ready solution of the problem.

2. Fundamental Imprecisions in Compensatory Appraisal

The nature of corporate assets and liabilities is inherently indeterminate in many instances and the apparent logic of building up an accurate aggregate valuation from 'precise' partial assessments is, in practice, chimerical. Typical wordings of auditors' reports[1] are often replete with inferred qualifications such as :-

"In our opinion....accounts prepared on (this or that) basis.... including adjustments for the revaluation of certain assets....based on the reports of auditors of other firms....so far as concerns members of the holding company....etc." Declared profits may be more or less meaningful depending on the basis of determination and the interpretation of the consumption of working and fixed capital.

Earnings and dividend yields depend on the veracity of the measures of the constituents that comprise the numerators and denominators. Variations in fiscal and monetary policies may undermine or reinforce - even destroy - the most carefully prepared corporate projections, policies or strategies.

Output volume measurements in labour-intensive situations may be subject to widely erratic variations; as may be the ultimate returns on investment in capital-intensive commitments, particularly in situations of premature obsolescence of fixed assets due to conditions of rapid technological change.

These are only a few examples of the many contemporary factors militating against determinate approaches to precise corporate asset valuations and thence to the desirable consensus of adequate compensation for compulsorily-acquired private sector assets.

The constituents of the balance sheet and the profit and loss account often provide only meagre foundations for evaluatory appraisals. Transfer pricing complexities may conceal the true worth of group operational units or profit centres (even from directors).

Goodwill is an acknowledged focus of disagreement among experts. The estimation of value of stocks and work-in-progress is not necessarily amenable to precise formulation and accurate quantification. Associated companies' results may be relatively indeterminate if differing accounting conventions are used. Depreciation policies, methods and allowances may give rise to over-valued or under-valued capital worth. Maturities of debt may affect the corporate valuation differently depending on time projections, the movement of monetary rates and the rates of increase or decrease of inflation. Current and deferred taxation provisions may be vulnerable due to unforeseen illiquidity or unbudgeted fiscal changes at home or overseas.

Pension fund charges may involve heavy cash flow depletions if investment revenue shrinks. Income from long term leasing contracts may not reflect current charge and/or expense levels. Interest rate escalations may cause capital investment in fixed assets to appear ill-advised in retrospect. The materialisation of high termination charges may, ironically, lead to the point where one cannot afford to become insolvent and thus cut out loss-making activities.

Expropriation of overseas assets (nationalisation with delayed or no compensation) may, without warning, so restructure a viable group as to lead to its eventual disintegration. Capital project commitments may prove to be onerous should unforeseen eventualities arise (e.g. the insolvency of a supplying company). Contingent liabilities and guarantees have been known to bring down companies.

3. The Influence of Non-Quantitative Factors and Ideology

Having regard to the above factors, inter alia, it is not surprising that the question of compensation, based on corporate asset valuation, has given rise to controversy. Clearly, the stochastic factors dealt with in Chapters 8 and 9 and above preclude the advancement of a simplistic thesis that shareholders and proprietors should be compensated on the basis of a particular method of corporate valuation. The normal manufacturing, distribution, marketing and trading risks faced daily by management in the private sector also constitute a not inconsiderable element of uncertainty to be added to the problem.

The basically different, though complementary, bases of corporate valuation, 'economic' worth and assessment of net (asset) values, as discussed in the previous two chapters (Ch. 8 and 9) and in Appendix A, have been shown to be methods used, singly or together, by professionals in corporate asset valuation and by investment analysts.

It has also been seen (Ch. 8) that consensus valuations derived as the results of disparate assessments by vendor and purchaser or their agents, have constituted acceptable bases for compromises. Evidently, such results are redolent of the 'market-place' ethos in which private sector transfers of ownership of corporate assets have traditionally taken place.

This milieu, commercial and pragmatic, is far removed from the arena in which public sector compulsory acquisitions take place; where commercial practices are made subservient to political and ideological influences and considerations and where the private ownership of 'the means of production' may be considered to be a stigma irrespective of how such ownership has been gained.

4. The Stock Market Consensus

Contemporary reliance on stock market mechanisms, by the Labour Government, for its vade-mecum of corporate valuations may be thought to be a reasonable compromise between political expediency and the necessity of establishing a defendable basis of compensation. Whether or not the stock market's secondary function provides a universally acceptable and equitable basis of corporate asset valuation for compensatory purposes is clearly dependent on a large number of factors, some of which have been discussed previously (Ch. 8, Sect. 6-26 inc.)

5. Importance of Stock Market Volatility Concepts

Arbitrary choice of a particular datum period may be shown to be reasonable as a price-determining basis in a relatively stable market and monetary environment but, as has been shown in Chapters 8 and 9 and by other research, the effects of inflation and stock-market volatility[2], induced by world-scale influenc es in addition to U.K. factors, introduce serious distortions which should be corrected, or at least recognised, in subsequent determination of compensatory terms for public sector acquisitions; particularly if the selected datum period is remote in time from the settlement date.

The argument that shareholders have the opportunity to liquidate their holdings by means of the normal stock market secondary functions as soon as government plans for private sector acquisitions are made known does not recognise the contrary indications introduced by the following factors, inter alia. A constantly falling market (not entirely divorced from political causes). The existence of depressed capitalisation values due to public policy restrictions on dividend distributions. Price sensitivity of securities to market transactions depending on the volume of business and the standing of the holdings. And, not least, the relatively vulnerable position of the private investor with a small shareholding vis-à-vis the powerful institutional investor (in terms of both bargaining power and ability speedily to take advantage of trading period opportunities of investment/divestment on favourable terms).

6. <u>The 'Property Right' Value of Control</u>

Another factor which is not recognised in the stock market method of corporate asset valuation for public acquisition is the price-significant difference between major shareholdings having control connotations and minor holdings important only in the aggregate in this respect. The statistical analysis carried out in Chapter 8 and observation of the stock market indicate that, in general, change of control commands a premium on the consideration related to change of ownership without the concomitant of control.

In cases where control of a private sector undertaking is located in a specific major shareholding, such that the balance of shares, even in the aggregate, does not constitute control, the thesis may be advanced that a dual level of compensation might be justified: the lower level being based on normal Stock Exchange Daily List data relating to arm's-length transactions (non-control business) and the higher level containing a premium to recompense for the transfer of control as well as ownership, inherent in the major holding.

The theoretical justification for such arrangements would be difficult to sustain in practice since although ownership and control may not be synonymous in particular holdings, aggregations of different shareholdings may, and in many cases would, produce the congruence of ownership and control depending upon the selected re-arrangement patterns. Also, it may be claimed that, for the purpose of compulsory transfer of corporate assets to the State, control and ownership are inseparably linked however small the proportion of the equity. Additionally, private sector takeover premia do not depend on size of holdings - shareholders benefit equally, in general.

7. Compensation for Loss of Control

Since it would be impractical to offer differing compensatory terms on the basis of proportion of holdings differentiations, the State should not be seen to profit inequitably at the expense of former private holders as it would if the compensation were based on the normal transactions (non-control significant) of the stock market.

If the transfer terms are to be based on the stock market for valuation purposes then the normal practice of a premium for synonymous transfers of ownership and control should be observed.

Takeovers in the private sector are regulated so that shareholders relinquishing their securities receive the benefit of premiums on the normal market prices: it seems not unreasonable that the State should be expected to follow suit if it chooses to use market mechanisms to expedite its programme of public sector acquisitions.

8. Valuation of Control of Corporate Assets

Establishing property rights in 'control' of corporate assets for the purpose of compensation leads to the question of valuation of 'control'. Clearly, the value of control at a point in time depends on the projection of an assessed flow of future returns or benefits resulting from the transfer of ownership and the exercise of control functions in the future. The determination of returns is subject to similar problems and qualifications as those seen to attend the valuation of the underlying assets giving rise to them, whilst estimates of benefits give rise to problems of social cost-benefit analyses, inter alia, for transfers to the public sector.

A possible solution would be to use a 'macro' device based on a quantitative analysis of a number of selected private sector takeovers in which 'control' may be shown to have been a primary factor (as is overtly the case in Labour Governments' public policies). The resultant premium, suitably adjusted for sectoral market differences and inherent circumstantial variations could then be related to a base valuation to give a composite figure for compensatory purposes.

Such a practice would at least partially compensate for the forced relinquishment of assets, which is only experienced in the private sector (cum any 'premium') under the provisions of the 1948 Companies Act (where an acquirer may compulsorily obtain ownership of the remaining 10% of holdings once 90% have been secured)[3]. The results of the investigation carried out in Chapter 8 suggest that such premia may fall within the range from 15% to 45%.

However, the precedent of basic stock market capitalisation values, sans premium elements, having been established and accepted by shareholders and their representatives in the past, it is virtually certain that the benefits of transfers of control as well as ownership will continue to accrue to the State without such recompense in the future.

9. Inflation: Accounting Factors in Corporate Valuations

The factor of accelerating rates of inflation has received attention previously in this work (Chapter 9, S.15,16,17). It has been shown not only to be highly relevant in terms of the actual compensatory media and thus of 'real' value received by private sector owners but also material in the valuation of physical and net financial corporate assets and of their 'economic' worth in terms of earning power.

Exposure Draft 18*, issued by the Morpeth Inflation Accounting Steering Group[4] and based on the Sandilands Report, comprised a stage in the development of an acceptable system of current cost accounting intended to cope with the difficulties of corporate valuation caused by changing rates of inflation.

Examination of the advocated basic principles indicated that non-monetary assets were to be shown in the balance sheet at their value to the business at the B.S. date, such value being replacement cost but, exceptionally, the higher of net realisable value and economic value (defined as present discounted value) if both valuations were lower than replacement cost. That revenue was to be charged with the cost of stocks consumed, valued at replacement cost at date of sale. That revaluation surpluses, arising mainly from the difference between the replacement and historical costs of stocks consumed and from the revaluation of fixed assets, were to be credited initially to the Appropriation Account.

* Exposure Draft 18 was not adopted as an accounting standard; but its provisions are of value in this thesis further to illustrate the problems of corporate valuation.

The treatment proposed for physical balance sheet assets and liabilities included:

(a) professional valuation of land and buildings at open market value (alternatively, buildings at depreciated replacement costs) not less than quinquennially,

(b) replacement cost valuation of plant and machinery optionally based on (trade discounted) suppliers' prices, company expert opinion, appropriate company indices, authorised external indices related to asset classification, or the latter classified on an industry basis,

(c) valuation of stocks and work-in-progress at their value to the business in accordance with the basic principles outlined in the preceding paragraph, Specifically, at the lower of current replacement cost and net realisable value based on current consumption costs, current purchase prices less trade discounts or company or authorised external indices suitably differentiated to reflect identifiable elements of applicability.

The CCA adjustments for stocks and fixed assets were relatively uncontroversial but the proposed treatment of financial assets and liabilities did not meet with universal acceptance. Monetary items such as debtors, creditors, etc. were to be shown in the balance sheet at their face values and the Profit and Loss Account would not carry adjustments in respect of them. But net gains or losses on carrying monetary assets, analysed into their principal components, it was proposed, were to be shown in the notes to the accounts.

Investments were normally to be valued at the quoted mid-market price or, if unquoted, on the basis of the current cost accounting (CCA) assets of the company invested in the investment or the stream of income therefrom.

Where appropriate, full provision was to be made for deferred taxation, otherwise it was to be shown in notes to the accounts: no provision was to be made if it could be shown that an actual liability would not accrue in the foreseeable future. Accounts of subsidiaries and associate companies were to be prepared on a CCA basis or adjusted thereto by the holding company before consolidation. It was proposed that overseas assets and operations were to be formulated in CCA terms on the basis of the ruling currency, then converted to sterling at the closing exchange rates.

Goodwill and other intangible assets had been covered only in a non-definitive manner and it was recognised in the Draft that the accounting treatment of such assets was a continuing subject of debate. The practice of writing off goodwill, progressively, against future profits could be obviated, where possible, it was suggested, by eliminating it against a revaluation reserve arising from revaluation surpluses on fixed assets, thus disposing of the need to apply complex CCA adjustments.

10. Current Cost Accounting and the Shareholders' Interests

The five major advantages claimed by the Morpeth Group for the proposed CCA methods, in comparison with the traditional historic cost system, comprised improvements relating to the treatment of depreciation, cost of sales, appropriation, balance sheet values and corporate performance.

It was thought that depreciation based on 'value to the business' of the assets concerned would give a more realistic measure of capital consumption, whilst the cost of sales adjustment on the bases of replacement, rather than historical, cost of goods should more accurately reflect the actual position.

The proposed Appropriation Account should, it was claimed, facilitate the collective consideration of the current cost profit, the revaluation surpluses, retentions and dividends. Balance sheet values should, it was thought, reflect current rather than historic costs, in general. Corporate performance in terms of the equity interest - the change in the amount attributable to ordinary shareholders - were to be indicated by comparison with inflation rates and the holding gains or losses arising from monetary items were to be clearly shown.

Current Cost Accounting treatment of costs and values was complemented by proposals relating to the changes in monetary values. It had been proposed that the general index of retail prices (RPI) be used to prepare a statement in the notes to the accounts showing the effect of inflation on the shareholders' net equity interest. The RPI would have been used to produce comparable values in real terms to indicate a gain or loss in the purchasing power of the shareholder's net equity interest over the year.

Clearly, the adoption of accepted inflation accounting methods should help to correct some of the weaknesses inherent in the historic cost conventions during periods of rapidly accelerating or decelerating rates of inflation. Nevertheless, since the proposed methods dealt differently with the differing assets of companies and not fundamentally with the monetary medium of exchange, store and measure of value, it was evident that problems of corporate valuation would remain.

11. Variability of Bases for Consensus

Reference to stock market valuation criteria does have the benefit of consensus in the sense of readily accessible market indicators which represent agglomerations of opinion, expectations and other formative influences. Practice in developing the use of accounting conventions which are designed to cope with volatile, as distinct from stable, corporate asset valuations will doubtless refine the measures of resource management as time goes on.

Complexities introduced by attempts to fit a specific set of accounting conventions to a multitude of differing industrial, commercial and financial trading and resource allocative activities should eventually result in the emergence of pragmatic solutions which may ameliloriate some of the more obvious difficulties of corporate asset valuations for purposes of transfer between vendor and purchaser.

12. Stock Market Volatility and Fundamental Structural Changes

Professor Davis and K.A.Yeomans (2) have shown the importance of considering Stock Market Volatility States in any attempt to quantify corporate asset valuations on stock market bases. They differentiate four such states: (a) Level 1 = stable or rising and stable, (b) Level 2 = rising but uncertain, (c) Level 3 = falling and uncertain, (d) Level 4 = falling and very uncertain. Conditions of stock market uncertainty were found to increase errors in new issue pricing and significantly to alter the relationships observed under stable market conditions.[5]

It may be assumed that the selection of a datum period of stock market transactions as a parameter or yardstick of corporate asset valuations for the purpose of determining compensatory terms in compulsory public sector acquisitions should be subject to recognition of such factors as market volatility.

12. Unfortunately for the precision of assessment of such valuations based, as they are, on periods remote from the time of compensatory settlements, there are additional factors which may have the effect of introducing not only extensions of volatility amplitudes but also permanent structural changes that may render historic share valuations less susceptible to accurate retrospective assessment.

13. Evolutionary Stock Market Changes Affecting Datum Period Validity

The well established stock market evolutionary developments such as the following could have produced permanent structural changes. The rationalisation of the jobbing system[6] (resulting in much more restricted market machinery and the widening of jobbers' turns). Amalgamation of stock brokerage firms. The emergence of institutional equity ownership as opposed to the shrinking proportion of equity owned by the personal sector.[7] Increased ratios of dealing, commission and transfer costs in small-scale transfers of equity. The inhibitive effects of the Capital Gains Tax coupled with the lack of fiscal indexation (which results in the taxing of nominal gains that are, in real terms, actual losses). These factors, inter alia, are features that may be adduced to support the hypothesis that compulsory corporate valuations based on historic stock market criteria may be, at best, suspect and, at worst, inappropriate and inequitable from both the vendor's and the purchaser's viewpoint.

14. Effects of Jobbing Oligopoly/Monopoly

Amplifying discussion of the above factors, it is clear that excessive reductions in jobbing facilities may lead to monopolistic or oligopolistic trading in the securities affected with the concomitant risk or actuality of onerous terms to the parties to stock market transactions.

The unusually wide margin in the jobber's turn between bid and offer, normally associated with high degrees of uncertainty and 'holding' risks in particular securities, could well become the norm in restricted trading opportunity situations produced by the dearth of jobbers and the virtual elimination of competition.*

15. The Effects and Influence of Security Trading Factors

A significant reduction in the volume of stock market transactions, caused by such factors as those mentioned above in addition to more general influences, has led to a marked reduction of the numbers of stock brokerage firms and to amalgamations of smaller units. This has the effect of limiting opportunities for the small investor in the personal sector not only in terms of finding brokers willing to undertake (what may well be unprofitable) small transactions but also of increasing the fixed cost element of trading of larger brokerages, which then resort to economies of scale such as preference for larger unit transactions and the discouragement of 'fragmented' business.

Over the longer term these developments may well lead to greater amplitude of swings in the stock market capitalisation values owing

* 'Spotlight on Merger Plan': Financial Times, 15.10.77 refers to this aspect.

to the disappearance of the inertial, dampening effect of the holdings of many small investors which have, traditionally, tended to stabilise market oscillations.

16. Investing Institutions, Personal Investors and Market Changes

The phenomenon of the growing proportion of U.K. equity held by the institutions and the decline of the personal sector is now well established (7). It has been shown that the proportion of U.K. quoted equity held by the investment institutions (pension funds, insurance, investment and unit trusts, etc.) rose from 18% in 1957 to over 40% in 1973, and it is possible that the holdings may be about two thirds by 1984.[8]

Apart from the growing dichotomy of ownership and control inherent in this development, it is likely that parallel investment policies, initiated as the sequel of 'sophisticated' prognostications by investment analysts processing identical data and using comparable formulations, may produce market oscillations of an amplitude in excess of those experienced at present under normal trading conditions.

An alternative hypothesis might be that the use of scale economies available in inter-institutional securities trading may so emasculate the stock market's secondary functions that it becomes, eventually, merely an agency for the exchange of gilts, fixed interest and relatively minor equity securities. In either case, the massive and volatile swings or the virtual extinction of the secondary equity market, the continuance of the stock market as a reliable barometer of corporate worth would be less probable in the longer term.

17. Cost-Benefits of Small Volume Trading in Securities

Another factor that has undoubtedly helped to progress the withdrawal of the small personal investor from the stock market or to render small security holdings less liable to be traded is the increase in dealing, commission and transfer costs with specific relationship to small value transactions.

Although the ratio of dealing cost to intrinsic value might not have changed significantly in real (corrected for inflation) terms, the historically depressed security values, discounted as they have been for a multitude of oppressive causes, create an imbalance between the cost of trading and the received benefits of transfers. Consequently, as is indicated by the well-documented fall in stock market equity turnover,[9] the shrinking volume of small shareholdings tend to be traded less and develop, in the aggregate, an unrepresentative inertia that helps to reduce a balanced market consensus based on current trading conditions.

18. Unindexed Capital Gains Tax as a Market Depressant

The Scylla and Charybdis of Capital Gains Tax and the lack of fiscal indexation have furthered the structural changes in the stock market in that shareholders are unwilling, not unnaturally, to be taxed on nominal gains which are, in real terms, actual losses. Inflation has produced unrealities in both the standing and the conventional measures of stock market performance.

The large discrepancies between indicated and true relative values have been shown in the analytical studies carried out in Chapters 8 and 9. Even the most naive holder of equity will be aware of these adverse factors and, consequently, may tend to adopt a risk-averse stance which could entail not only a reluctance to trade his existing holdings but also a disinclination further to invest in risk capital in view of the currently punitive ethos to such 'immoral' activities.

This philosophy, widely subscribed to as it may be, could exert a further depressive effect on the secondary equity securities market and lead inexorably to an undervaluation of assets through diminished demand.

19. Effects of Change on Market 'Benchmark' Valuations

These structural changes, inter alia, clearly indicate that the stock market is undergoing major evolutionary transformations and suggest that the market forces which produced a particular set of corporate asset valuations in the (even recent) past may not be relevant today and may be of only historic interest tomorrow.

The concept of a continuing machinery of stock market transfers determining a constant and precisely repetitive series of accurate corporate asset values may not be tenable in the current dynamic phase of metamorphosis.

20. Industrial Democracy: Effects on Investment

A further factor that may result in permanent structural changes in the investment ambience, the philosophy of risk capital subscribers and the secondary function of the stock market so far as equity trading is concerned is the increasing dominance of so-called Industrial Democracy.

The Bullock Report[10] and the development of the concept of worker-directors was discussed earlier, with particular reference to effects on control of private sector corporate assets (Chapter 7, S.3). It is clear that such fundamental changes, if implemented on the basis of the Bullock 2X + Y formula, could introduce novel risk factors in terms of possible losses in corporate management expertise and professionalism at directorial level; facilitate the insertion of ideological influences into commercial and business practice and relationships and lead to a further widening of the dichotomy of ownership and control. The latter resulting from a further diminution of shareholders' influence and a corresponding accretion of power to organised employees.

Taken together with the anti-private-ownership factors already discussed, and the policy intentions of the trade unions to seek 50% representation in the administration of corporate pension funds coupled with the increasing interest in nationalisation or enhanced State control of private sector financial institutions, it is possible that the eventual result in the longer term may be the virtual disappearance of private risk capital and its replacement by 'directed' funds in the capital structures of major private sector groups and companies.

Thus the dichotomy between ownership and control would be increased due to the relative anonymity of aggregate funds, and emasculation of the private industrial corporate sector as a significant countervailing market force to the State-regulated economy could ensue in the long term.

21. Fixed Interest Compensatory Stock: Conversion Aspects

Turning from the bases of compensation to the forms in which compensatory transfers may be made, the investigation and analysis in Chapter 9 indicated the following factors. That compensation in the form of cash was ruled out on grounds of impracticability of funding such payments on the scale required and associated problems. That the issue of equity was, inter alia, incompatible with concepts of centralised State control. That the third possibility, the issue of Government Stock, was the preferred and customary method.

The latter course has been chosen in the case of the public acquisition of aircraft and shipbuilding industries companies, as discussed in Chapter 9. This form of compensation, interest-bearing Government Stock guaranteed by the State, does have the clear anomaly that risk capital is being replaced, without an option, by securities of an entirely different character.

Relative security of income (albeit of a lower order if precedence is followed) is an advantage which must be set against the certain disadvantage of loss of the opportunity for capital growth concomitantly with increased income. Conversely, the capital is not likely to disappear in the short term as may happen in the case of risk capital.

The argument has been advanced (and discussed in Chapter 9) that compensatory stock may be sold in the market and the realised funds may then be re-invested in securities of the recipient's choice. This is clearly fallacious as a possible stratagem in the short run although it may be tenable in the longer term. The effects of a large volume of gilts seeking liquidation could so depress the market as to produce lower capital values and consequent potential losses for the vendors. Evidently, immediate conversion is available only to a relatively small proportion of the holders of compensatory stock, at any one time.

22. <u>An Alternative Compensatory Measure</u>

A novel alternative to bridge the gap between the virtues of risk capital investment and fixed-interest bearing government stock would be the issue of floating rate securities of which the nominal principal would be guaranteed by the State, as at present, but the rate of return would be indexed not to the general market rates but to the returns of the erstwhile private sector undertaking now in the public sector. This would produce a security of guaranteed minimum capital value in the event that the undertaking to which it was 'tied' did poorly (as a possible sequel to public ownership) whilst a growth in capital value would accrue from an enhanced earning capacity of the undertaking on an unchanged capital base. Injections of capital post acquisition would, of course, be reflected in rate adjustments to the security.

Such an arrangement may be a feasible and preferable alternative to shareholders in undertakings to be taken into public ownership but, in view of the track record of nationalised industries (discussed in Chapter 2), it is hardly likely to become a viable and acceptable proposition. Moreover, although ideologues appear to ignore the possibility of risk capital vanishing when condemning capitalistic returns, they would undoubtedly regard the set-off of a capital guarantee against the real possibility of a virtual cessation of income to be incompatible with social justice.

An additional contrary indication to the issues of such a compensatory stock would be the problem of lack of management control or influence on the part of the stockholders.

23. Some Conclusions on Compulsory State Takeovers

Considering the analyses and discussion in this chapter and in Chapters 8 and 9 relating to the question of public ownership, with particular reference to the valuation of private sector corporate assets and the forms of compensatory transfers, the hypotheses that there is one best method of valuation and of compensation appear to be invalid. Clearly, the method of valuation chosen by central government will have the merits of expediency, political defensibility, a consensus of ideological acceptability and the respectability accorded by custom, usage and tradition.

Contemporary practice indicates that Stock Exchange criteria in terms of market transactions satisfy these requirements. The concept of values freely negotiated resulting in bargains being struck between vendor and purchaser having, theoretically, perfect knowledge of the market and of the security is redolent of the free play of enterprise and market forces held sacrosanct by the capitalist system.

Unfortunately, the reality of this idyllic picture is rendered illusory by the brutal fact of State compulsion. Statutory power deprives the owner of corporate assets not only of choice of alternatives in terms of compensatory transfers but also of equitable treatment as a vendor. Not only is he penalised by exclusion from the decision making processes which create the conditions for acquisition of his holdings, he is also compelled to accept arbitrary bases of valuation and compensation selected and enforced on a unilateral basis by the State.

Valuations of shareholdings based on stock market bargains transacted on a normal arm's-length basis without, concomitantly, the consideration of control of the undertaking passing with ownership of the shares fail to recognise the intrinsic value of control and ownership as a unified concept. This leads to the conclusion that an element of confiscation has attended the State's public ownership programme in the past at the expense of the erstwhile private owners.

24. <u>Theses on Valuation and Compulsory Transfer of Corporate Assets</u>

A thesis advanced by the writer is that future takeovers by the State, on a compulsory basis, should recognise that ownership and control is a more valuable property than mere ownership and that compensatory terms should recognise this fact of economic life by the inclusion of a premium element over the basic valuation adduced from normal stock market trading criteria, where appropriate.

Arbitrary unilateral fixing of a particular datum period of stock market activity should be discontinued since such statutory inflexibility inhibits equitable treatment of shareholders and proprietors. Clearly, the fortunes of private sector undertakings do not necessarily fluctuate on an aggregate cyclic basis and a time of poor trading results for one set of companies, or company, is not automatically shared by others - and the converse applies when earnings are high.

The thesis is that stock market datum periods should be chosen, in concert with the private owners or their representatives, to reflect an equitable consensus of vendor and purchaser for particular undertakings in the light of their individual earnings and market records.

Also, in view of the effects of changing rates of inflation on the real values of compensatory transfers, corrective factors should be applied to obviate anomalies caused by the effect of legislative delays over which the vendors of private assets have little or no control.

Finally, it is proposed that the property value of control in addition to ownership should be recognised in all arbitration machinery and procedures concerned with the valuation of private sector corporate assets for the purpose of compulsory acquisition by the State, where stock market quotations are not available or applicable.

25. Public Ownership : A Paradigm and An Analysis

In the second part of this work it had not been the intention to attempt to demonstrate the superiority of a particular method of corporate valuation since the ambience of voluntary negotiation in the commercial arena is, demonstrably, not comparable to or compatible with compulsory acquisition by the State. The views of professionals (Chapter 8, Sections 29 and 30) and the research studies in this thesis clearly indicate the reciprocal nature of bargaining between willing vendors and purchasers in the private sector. It is axiomatic that the empiricism involved in such transactions is experiential rather than experimental.

Nevertheless, it is considered necessary in a work of this kind to demonstrate, if feasible, the application of methodologies and theories which have been discussed, albeit on a philosophical rather than a scientific plane - an approach made obligatory by the nature of the studies. Consequently, it now remains to carry out such a task with particular reference to the objectives and

and conclusions of the second part of this thesis.

Since the aims of this research (delineated in Chapter 1, Sections 1, 2 and 3) have been, inter alia, the study of contemporary influences on and the matrix of directorial decision-making in the field of business policy, it is important that the model selected for the final analytical task should be in a time phase relationship with the preceding researches.

The passing of the Aircraft and Shipbuilding Industries Act, 1977, has ushered in a new series of compulsory corporate acquisitions by the public sector. One such company is Robb Caledon Shipbuilders Ltd. This undertaking has become vested in British Shipbuilders under the provisions of the Act and the compensatory terms of settlement have been completed.

As a prospective model for analysis the company meets the two indispensable conditions of timeliness and completeness of essential data and it is nominated as the vehicle for the empirical research to be the subject of Chapter 11.

CHAPTER II

PUBLIC OWNERSHIP : CORPORATE ANALYSIS OF AN ACQUISITION

1. Introduction

The preceding studies in Chapters 8, 9 and 10 and in Appendix 'A' have been concerned with Objective (b) as nominated in Chapter 1, Section 1 : that is, an examination of the methodologies of private and public sector valuation of corporate assets with reference to expropriation by the State.

These researches have indicated that vendors and purchasers of manufacturing companies base their assessments of the value of corporate assets on detailed studies of salient features, inter alia, many of which may be quantified in relative or absolute terms. Additionally, it has been shown (Chapter 8, Sections 29, 30 and 31 : Chapter 9, Section 13 : Chapter 10, Sections 2, 3, 9, 11, 12, 13, 20, 23 and 24) that the more quantitative factors are customarily and necessarily considered in the context of qualitative aspects; which are subjected to scrutiny based on professional expertise, judgement and experience.

In private sector transactions of this kind, it is evident that the prospective vendor will have every incentive to facilitate the enquiries of a bona fide purchaser. It is also obvious that the prospective purchaser would regard any reticence on the part of the vendor. to reveal the fullest information as a caveat of greater or lesser importance depending on the circumstances.

On the other hand, the prospective purchaser, having garnered such information as was necessary to enable a valuation to be derived according to his own criteria of judgement, would be unwilling to divulge the data - particularly in a competitive transaction - since it would represent a considerable vesting of his time and resources in arriving at a bid value.

In any transfer of ownership of a company by way of sale, the vendor's offer and the purchaser's bid will be based on their respective interpretations of best possible information examined in the context of prevailing market conditions. Contemporaneous factors will be given due weight and the timeliness of data will be a sine qua non of any such transaction.

Thus it may be seen that a retrospective analysis of a sale of corporate assets or of a transaction involving acquisition by the State will, inevitably, suffer two grave disadvantages.

The first of these is the problem of recreating the market environment in which the negotiations (or nationalisation) took place. Certain quantitative indicators may be adduced to facilitate comparative conclusions but the subjective factors in dynamic market conditions are not so amenable to the experimental processes. Empiricism in the field of business policy is necessarily based on experience and judgement rather than on the mechanics of academic experiment, in which the precision of numbers may be held sacrosanct.

A second major problem is one that has been referred to in Chapter 8, Sections 28 and 29, in Chapter 9, Sections 1, 11 and 12 and above - the ubiquitousness of professional confidentiality and the non-availability of data to third parties, whether competitors or academic researchers.

As an indication of the constraints which have attended the marshalling of data in the case of the present analysis of Robb Caledon Shipbuilders Ltd. it is appropriate to mention the difficulties experienced in this connection.

The first approach to the company in August, 1977, was entirely non-productive. Constraints of confidentiality imposed by professional relationships prevented the Stockholders' Representative from directly participating in the research when renewed attempts to establish liaison were made in October 1978. Similar constraints hampered other sources and although certain unpublished information and authoritative views were obtained, clearance for use in the thesis was given only on the strict understanding that confidentiality would not be violated.

The following analysis indicates that a measure of success in garnering relevant information was finally achieved but it will be evident from the foregoing comments that the usual third party limitations in such investigations apply in the present case.

2. The Model : Robb Caledon Shipbuilders Ltd.

Before commencing the quantitative analysis of the Group it is necessary to establish a corpus of general information to assist perspective in viewing the derived data and, in particular, the final outcome of its acquisition by the public sector.

Robb Caledon Shipbuilders Ltd. is a Group specialising in shipbuilding, ship repairing, the construction of deck modules for the offshore oil industry and associated heavy marine engineering. It was registered as a private limited company in 1918 and became a public company in 1955.

The Group comprised five subsidiaries, as follow :-

1. The Caledon Shipbuilding and Engineering Co. Ltd. (100%) - the principal operational company.
2. Burntisland Engineers and Fabricators Ltd. (52% owned but increased to 75% subsequent to nationalisation). (B.E.F. Ltd.)
3. Menzies & Company Ltd. (100%) - inactive.
4. Henry Robb (L.P.G.) Ltd. (100%).
5. Robb Caledon Shipbuilders (Training) Ltd. (100%) (the latter small company is precluded from paying dividends by its Articles and is not consolidated).

The Group also had a 50% interest in the equity capital of Ocean Inchcape (Caledon) Ltd. This was not a material investment; the details of which are £500 Shares at cost, £8,000 loan and a total profit of £600 up to the end of the 1976 financial year.

Robb Caledon's principal operations (shipbuilding and ship repairing) are carried out on two sites: Dundee and Leith, Scotland, respectively. The output is in the classification of smaller cargo and special purpose vessels; such as tugs, ferries, cable repair ships, floating cranes, miscellaneous carriers, survey vessels and the like. Since 1971 the shipping gross tonnages completed by the two yards have been 37,888 (Dundee) and 16,955 (Leith), a ratio of 2.24 : 1. The largest vessels listed were a cargo liner of 9,000 gross tons (Dundee) and a bulk carrier of 8,700 gross tons (Leith).

It is evident from the foregoing that the company is not comparable to large shipbuilders although a large proportion of its output is in shipping tonnages. Quantitative details are given in the following analysis but, as a further indication of structure, the turnover in shipbuilding and ship repairing in the last four years and three months of its operation as a private sector company was £44,849,074 as against £10,238,703 for deck modules and other marine engineering. The total of £55,087,777 turnover was, therefore, in the ratio of 4.38 : 1 in favour of shipbuilding and ship repairing compared with ancillary operations.[1]

Burntisland Engineers and Fabricators Ltd. (B.E.F. Ltd.) is the subsidiary responsible for the deck modules and associated work for the offshore oil industry, principally for exploration and development of North Sea Oil resources. Henry Robb (L.P.G.) Ltd. is a small subsidiary concerned with supply and distribution of vessels used in the storage and transport of liquified petroleum gas. Menzies & Company Ltd. contributed ship repairing and some general engineering output but had not been operated as a separate entity since 1971.

The transition from a private limited company to public status was achieved through a placing of ordinary shares in October 1955, comprising 613,600 shares (10/- par) which were priced at 14/3¾d (71.6 new pence) in November of that year. Caledon Shipbuilding and Engineering Co.Ltd. was acquired in September 1968, in respect of which a further 760,000 ordinary shares (10/- par) were issued, making a total issued capital of 1,373,600 ordinary shares (50p). This capital structure continued until 1976 when two issues of 125,000 10% Cumulative Redeemable Preference Shares (£1) were made. A further tranche of 125,000 shares of this description were issued in March 1977, making a total of £375,000 in preference capital and £686,800 in ordinary shares. An analysis of capital is incorporated in the general analysis of the Group which follows in Section 4 et seq.

Turnover generated in overseas markets, such as South America, Norway and South Africa, had increased in recent years; the proportions of the total for the last three years and three months of its operations as a private sector group being 11% (1975), 51% (1976) and 39% (fifteen months to June, 1977).

The operational results and details of Robb Caledon Shipbuilders Ltd. for the last eleven years and three months of its tenure as a constituent of the private sector are analysed later in this chapter and further aspects will be discussed under the appropriate headings.

3. The Analysis : Preliminary Considerations

It has been established that many subjective elements enter the valuation processes of assessment of worth in the transfer of ownership of corporate assets. For this reason it would have been inappropriate to have embarked on such an analysis in this thesis without considering the environmental, business, market, operational and other constraints and influences which, collectively, have a crucial effect on the value of such a business as Robb Caledon Shipbuilders Ltd. (R.C.S.Ltd.)

Many of these factors cannot be quantified because their nature and effects are qualitative. The precision of numbers, untempered by rational appraisal and qualified judgement, may represent but cannot reflect entirely the pragmatic realities of the industrial and commercial market-places in such an investigation.

In the case of the present model for analysis an important modifying factor is the nature of its output. Shipping cycles are as notorious as the pig cycle and although R.C.S. Ltd. has the benefits of flexibility, endowed by its capacity to supply a wide range of marine products, it cannot be wholly immune from the effects of world-scale depressions in the shipping industry.[2]

Study of R.C.S. Ltd. has revealed a number of problems and difficulties which have attended its operations in recent years. Some of these are of a general nature common to many businesses but others are specific to the marine engineering world in general and to Robb Caledon Shipbuilders Ltd. in particular.

The following analysis provides a convenient vehicle to discuss these aspects systematically but, to reinforce structural perspective, it is appropriate here to indicate the more salient features of the environment in which directorial decision making has been carried out. These factors are not in any order of importance but are cited generally in chronological order ; thus avoiding the tedium of unnecessary repetition (since certain features appeared to be recurring over the period to which this study relates). (Ref.1).

1. Auditors' qualification of report relating to the appropriateness of the Directors estimate of future losses (1971 Report).

2. Effects of inflation on fixed cost contracts. (1970).

3. Unforeseen magnitude of trading losses by subsidiaries.

4. Delays in completion of contracts owing to :

   i. failure to obtain a satisfactory rate of output,

   ii. serious delays in the supply of and failures in equipment supplied by subcontractors,

   iii. increased penalties and costs incurred through (ii) without adequate recourse to the subcontractors.

5. Unforeseen increases in variable and fixed costs when estimating for contracts.

6. Dislocation of output due to re-development of Leith shipyard; unofficial strikes, "go-slows" and overtime bans at both Dundee and Leith shipyards. Pay differentials problems.

7. Reduction in volume of orders placed with British yards. General scarcity of orders.

8. Discontinuance of structural steel work subsidiary due to continuing losses.

9. Increases in rates of interest on shipbuilding loans coupled with substantial declines in shipping freight rates (leading to the inhibition of new shipbuilding projects).

10. Fluctuations in and uncertainty of currency exchange rates.

11. Vacillations of U.K. Government shipping/shipbuilding industries support policies compared with overseas governments.

12. World-scale depressions in the marine industries.

13. Considerable delays in the provision of parts, specialist drawings and technical information by main sub-contractors resulting in schedule delays of up to twelve months.

14. Refusal of prime customer to enter into re-negotiations of contract with a view to securing a price increase (1975).

15. Severe depression in the shipbuilding market (1975 onwards).

16. Qualified Auditors' Report (1975) in respect of provisions for losses on contracts as estimated by the directors.

17. Negligible provisions for redress against sub-contractors for incurrence of major cost increases caused by their failure to fulfil contractual commitments.

18. Additional severe burdens of servicing emergency loan (£2,500,000) and Preference capital (1976).

19. Delays occasioned by design changes leading to uneconomic deployment of the labour force.

20. Uncertainty caused by the prospect of nationalisation and the erratic progress of the Aircraft and Shipbuilding Industries Bill (1975).

21. Hindrances to the implementation of plans for the substantial modernisation of the shipyards at Dundee and Leith (caused by a major business setback and the prospect of nationalisation) (1975).

22. Qualified Auditors' Report (1976) on bases of assumptions (on a going-concern basis) of (a) the obtaining of further orders, (b) the continuing use of the assets of the Group, and (c) the directors' estimated provisions for losses on contracts.

23. Competition for ship repairing business by newcomers to the market (1976).

24. Reduction in volume of business for the offshore oil industry leading to redundancies at B.E.F. Ltd. (1976).

25. Severe shortage of orders and very small margins (1976).

26. Difficulty of quoting for delivery of ships two to three years ahead on a basis of unstable cost structures and varying rates of inflation (1976).

27. Reduction in the regional employment premiums receivable and an additional 2% on national insurance contributions - thus increasing prime costs by £200,000 per annum without recourse to tax reliefs (operating losses) (1976).

28. Qualified Auditors' Report (November, 1977). The final report on the period prior to the vesting of R.C.S. Ltd. in British Shipbuilders was heavily qualified. The auditors noted that the accounts had been drawn up under the historical cost convention and the assumption was made that there would be no significant change of use of the assest under British Shipbuilders. They were unable to form an opinion on the following matters.

    (a) The outcome of a contract dispute involving £277,000 under group debtors, which was substantially disputed by the customer. That the making of a provision of £45,000 was sufficient to offset counter-claims, involving £459,000, by the customer.

(b) That the provision of £576,000 in anticipation of total losses to completion of existing contracts would be more or less than required.

The formative effects on decision making at board level of the above problems and influences will be clearly appreciated by directors and senior managers in private sector industry and commerce. Elegant academic experiments within such a matrix of subjective factors are impracticable since empirical bases of a supportable quantitative nature are largely absent. It is evident that the milieu of business policy in the case of Robb Caledon Shipbuilders Ltd. is more than usually amorphous and fraught with unpredictable events of a local, industrial, national and international significance and import.

Nevertheless, sufficient evidential data exists to support an analysis of the group in terms of its intrinsic worth based on studies of its assets, its operations and its earning powers. Interpretation, judgement and subjective estimation cannot be excluded in carrying out such a task within the constraints outlined above.

A preliminary study of the parameters of the present corporate analysis was carried out to determine, firstly, the period over which data should be considered. Because of the relatively rapid decay in usefulness of stale information about a company's performance, it is not unusual for such analyses to be limited to a period of the past five years' results.

The widely oscillating nature of the R.C.S.Ltd's. performance and the general instability of its operational fields (as illustrated above) convinced the writer that a period of not less than ten years should be selected. In the event, it was decided to deal with a ten year period on a stable analytical basis, so as to preserve as much comparability as possible, and to deal with a further fifteen month final period (before nationalisation) separately, but retaining comparability as far as possible.

R.C.S. Ltd. was vested in British Shipbuilders on the 1st July, 1977; its final (unpublished) report relating to the previous fifteen month period to the 30th June, 1977. This final period was carried out in the penumbra of virtually certain nationalisation and may therefore be considered to be atypical compared with 'going concern' operation in the previous ten years in the private sector.

The following analysis comprises studies of income, capital, operations, assets, earnings, dividends, yields, cash flow, etc. Relevant comparisions are made using appropriate data to facilitate consideration of the terms of compensatory settlement with respect to derived assessments of corporate value on various bases, as indicated.

The analysis is designed to adduce probable assessments of value of R.C.S.Ltd. in support of the studies of methodology of corporate valuation carried out in this thesis. Since it is customary for such companies to receive prepayments for contracts on account, necessitating temporary investment of funds which would otherwise be absorbed over the longer term in working or fixed capital assets, no distinction is made between returns on such investment and returns on capital employed.

Treatment of government grants has been based on 'going concern' assumptions except for the final analytical phase culminating in acquisition by the public sector. Other discretionary treatments or options are specified or noted in the detailed analysis which follows.

TABLE No. 11:1

INCOME ANALYSIS
ROBB CALEDON SHIPBUILDERS LTD.

£000 (d)	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
1. Turnover	2,672	2,407	4,108	5,889	6,949	8,158	7,443	8,404	10,511	16,719
2. Net Capital Employed (a)	898	935	1,348	1,529	1,251	1,250	1,666	2,541	2,312	2,960
3. Net Profit (pre-tax & Int.)	50	104	-237(b)	-611	-480	188	934	213	-1,528	466
4. Net Profit (Pre-tax)	49	103	-238	-617	-504	150	900	181	-1,567	230
5. Net Profit (Post-tax)	42	94	-238	-617	-504	150	752	89	-1,510	26
6. Dividends (Cost)	31	31	-	-	-	-	48	48	-	-
7. Depreciation	28	26	76	93	120	98	90	131	182	195
8. Retained Profits	11	63	M238(c)	M617	M504	150	703	40	M1,510	26

Notes: (a) Average at mid-year
(b) Minus sign = Loss
(c) M = Minus
(d) Figures are rounded

Sources: Company Accounts
Extel Company Statistics

4. Income : Robb Caledon Shipbuilders Ltd.

Table 11.1 and Figures 11.1, 11.2, 11.3 and 11.4 illustrate the income position of R.C.S. Ltd., in the financial years 1967-1976 inclusive. The twin pillars of profitability, margins and turnover rate, are examined and initial analysis of disposable surpluses is carried out.

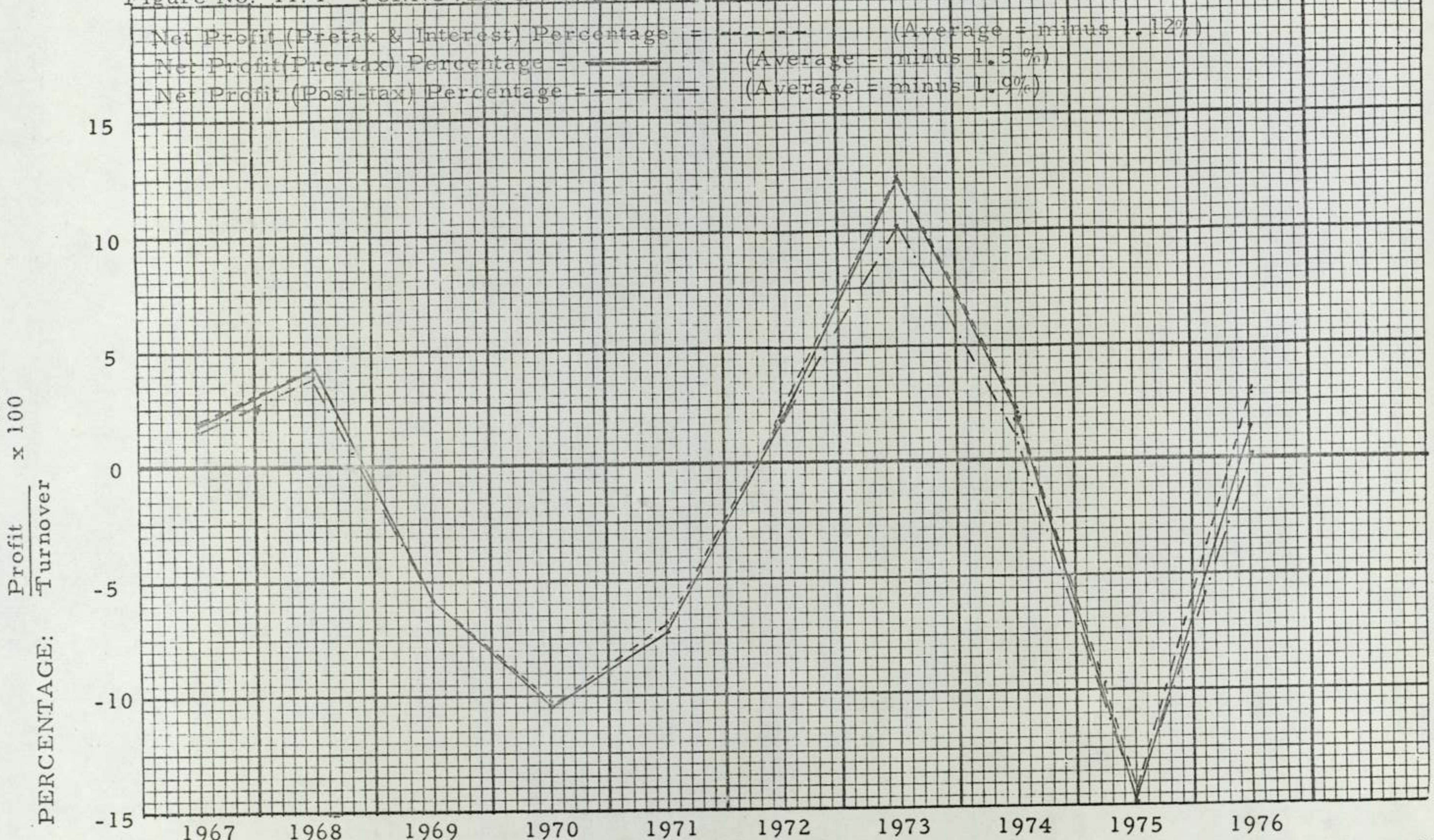
Where a company has a stable or smoothly progressive/regressive net capital employed position over a period, the choice of taking the figures at the beginning or end of the respective financial years is a discretionary matter so far as ascertaining the turnover rate is concerned. Inspection of the R.C.S. Ltd. figures revealed material fluctuations on a year to year basis partly due to the system of prepayments already noted and also to the type of contractual business related to high value investment products.

To secure a more equitable reflection of the group's turnover rate performance it was decided to adjust the net capital employed by taking the average at mid-year, thus indicating more rationally the real rate of turnover on a going concern basis.

Net profits are stated before tax and interest, before tax and after tax, respectively, to facilitate analysis in this and following sections. The dividend record (at cost) is shown in the Table (11.1) as are the amounts retained and provisions for depreciation.

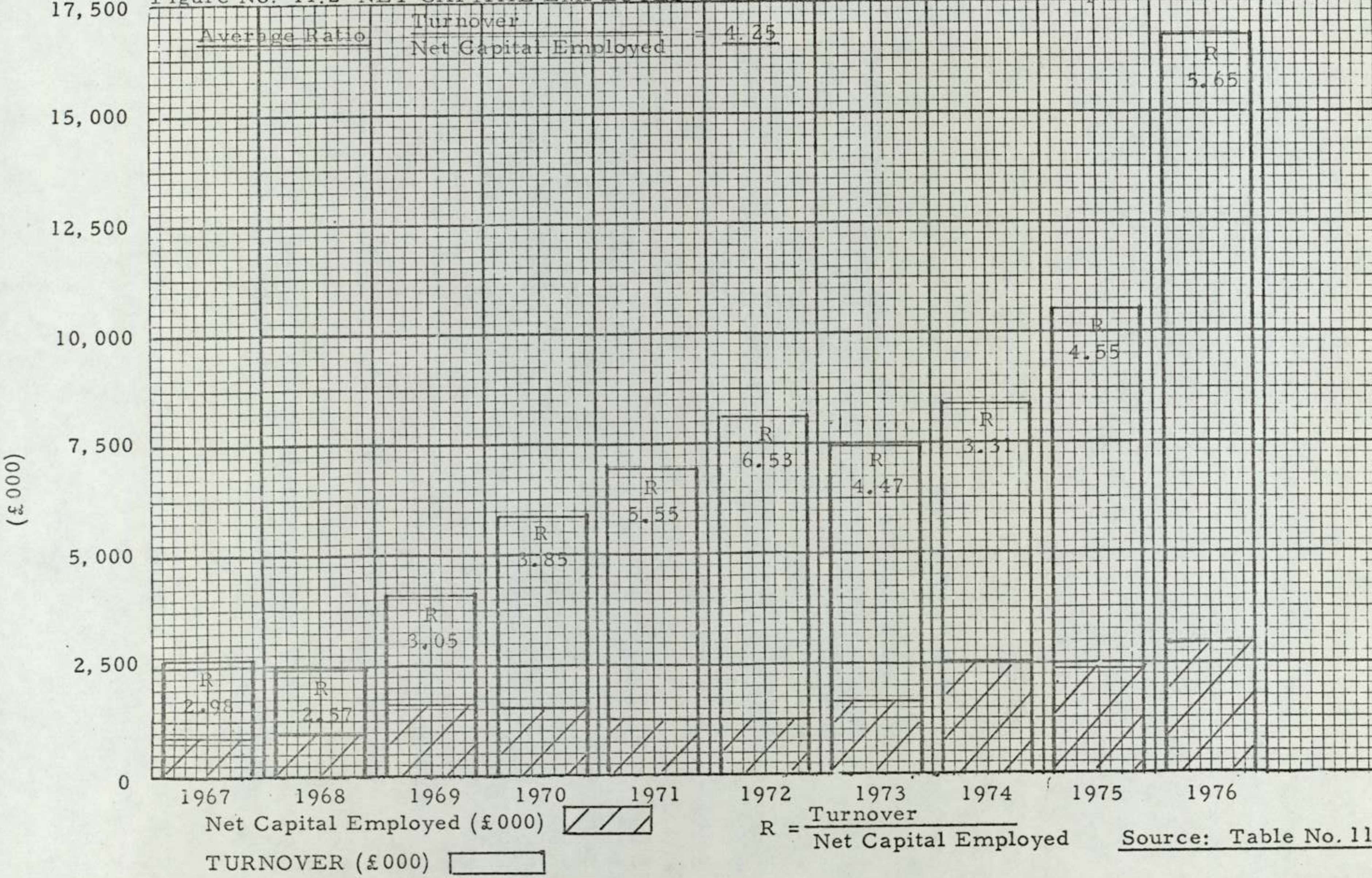
Preliminary inspection of the figures for turnover indicates growth over the ten year period, but their significance in real terms is examined more closely later.

Figure No. 11.1 TURNOVER & PROFIT: ROBB CALEDON SHIPBUILDERS LTD: 1967-1976



Source: Table No 11;1

Figure No. 11:2 NET CAPITAL EMPLOYED & TURNOVER: Robb Caledon Shipbuilders Ltd. 1967-76



Source: Table No. 11:1

4.1 Turnover and Profit

Figure No. 11.1 illustrates the R.C.S. Ltd. performance in terms of margins over the ten year period. The most obvious characteristic is the complete lack of stability. Profit margins are seen to fluctuate between a maximum of about 12% and a loss situation of about minus 15% in magnitude, with means varying from minus 1.12% to minus 1.9% depending on the selected basis.

Allowable tax losses have reduced the differences between pre-tax and post-tax results except in the period of maximum profitability (1973). The influence of interest payments is seen to be very small (reflecting the low gearing) until the final financial year of the graph (1976).

It is evident that a prospective purchaser would have very great difficulty in attempting to project future profits on such a basis. The reasons for the gross variations in performance have already been indicated (Section 3). The fact that all the means are in the minus zone can only indicate that the prognosis for aggregate positive profits in the future is very poor, particularly when viewed in the context of this Group's chronic problem areas (Section 3).

4.2 Net Capital Employed and Turnover.

The second pillar of profitability, turnover rate, is illustrated in Figure No. 11.2. In general, the turnover rate appears to have improved, with some setbacks, over the ten year period. However, it is necessary to consider the constituents in order to arrive at rational conclusions.

Growth of turnover is seen to occur in two distinct phases, reaching peaks in 1972 and 1976 respectively. The turnover rate is, however, seen to exhibit bi-modal characteristics under the influence of the net capital employed constituent.

Comparison of the growth of turnover with the deflators used in Figures 11.11 and 11.12 (Gross Domestic Product at factor cost, seasonally adjusted, at constant 1967 prices and the General Price Index on a 1967 base) suggests that a growth in real terms on the 1967 base did occur, the figure in 1976 being about twice the amount expected on a constant price basis.

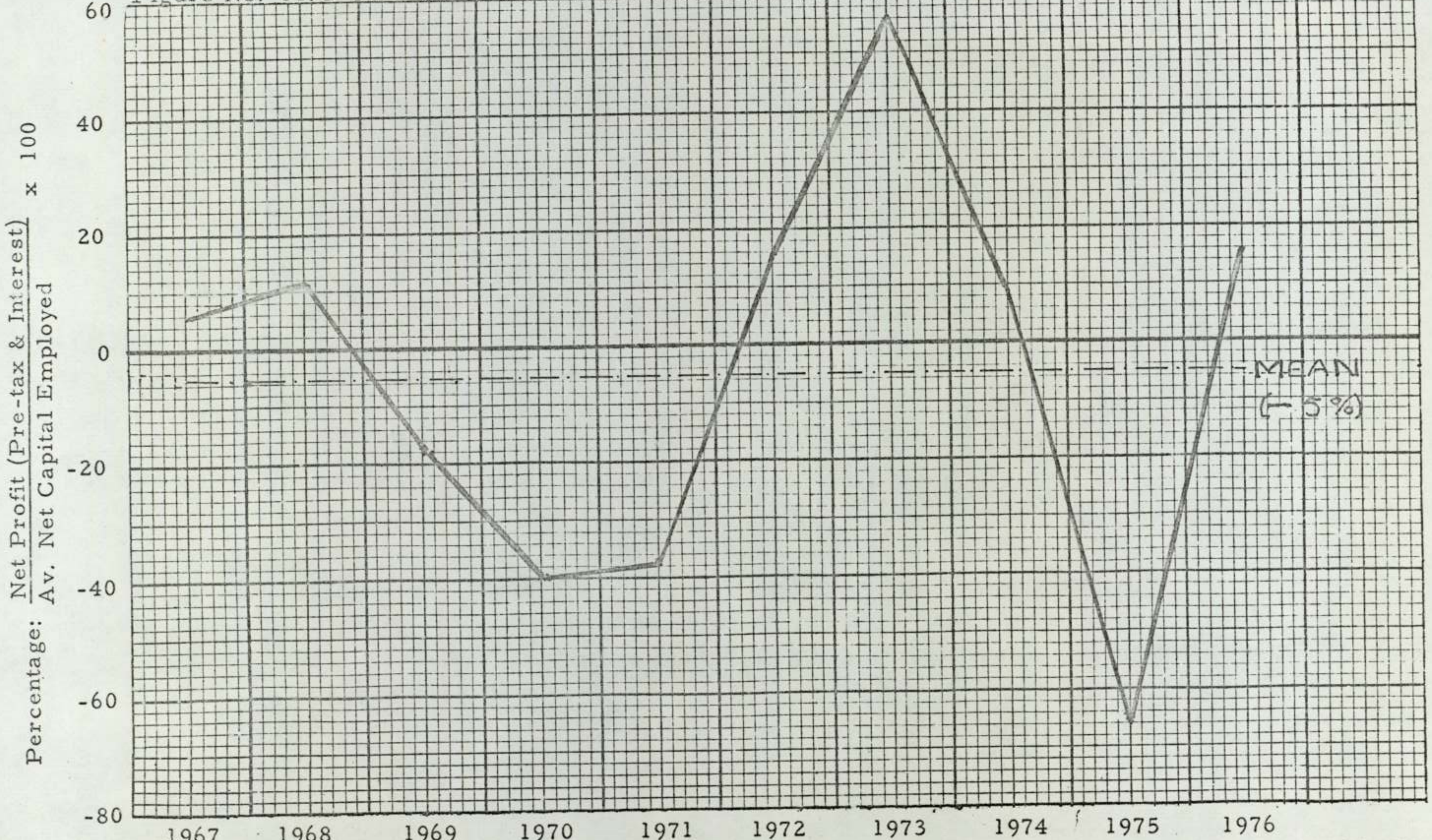
Appraisal of the net capital employed constituent indicates that the growth over the period, on a 1967 base, was generally in line with the rate expected in comparison with the above parameters (G.D.P. and R.P.I.). However, since the accounts were prepared throughout on the historic cost convention it is clear that expansion occurred in both of the constituents, albeit at differing rates.

The improvements in productivity of the assets were not due solely to book-keeping distortions and it may be seen that the deviations about the mean ratio (4.25) were much less pronounced than in the case of the margins on sales.

Variations in net capital employed are relatively pronounced, the ratio of fixed assets to current assets ranging from 0.17 to 0.43 and the ratio of fixed assets to net capital employed ranging from 0.23 to 1.22 over the ten year period. The latter figure relating, of course, to the catastrophic result in 1975. (Data in Table 11.2).

It may be inferred that margins rather than activity were the root cause of poor overall profitability, although the pattern of variation in turnover rates suggests that asset productivity was a contributing

Figure No. 11.3 NET CAPITAL EMPLOYED & PROFIT: Robb Caledon Shipbuilders Ltd. 1967 - 1976



Source: Table No. 11.1

factor - and this is confirmed in the Activity analyses later in this chapter. In considering the volatility of margins and turnover rates, it must be pointed out that the relatively long production gestation periods of high value investment goods tend to produce greater amplitudes of fluctuation than continuous output of lesser value products, even allowing for the practice of prepayments in the shipbuilding industry.

4.3 Net Capital Employed & Profit

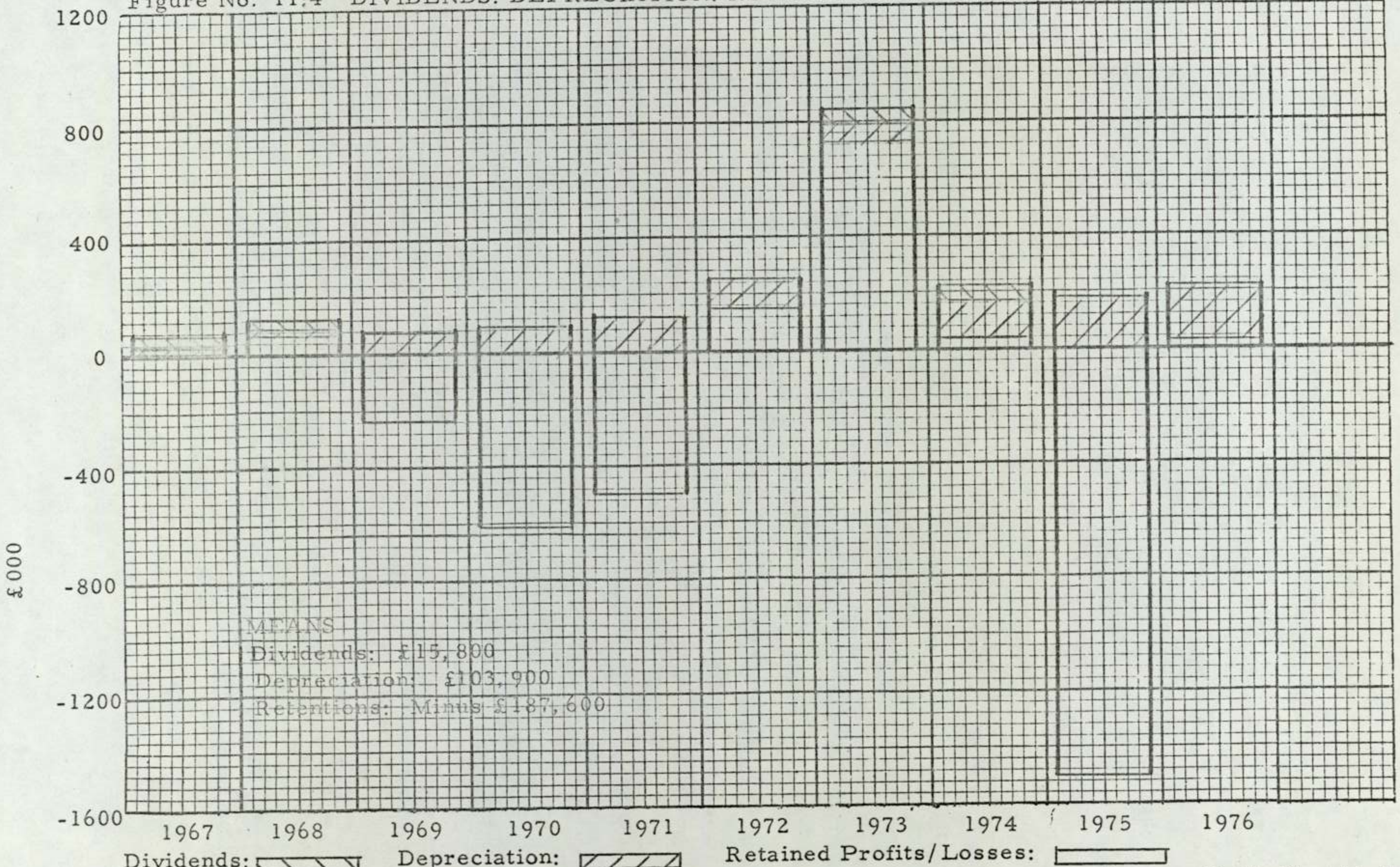
Figure No. 11.3 shows the return on net capital employed and is, of course, the resultant of the previous two constituents considered under sub-sections 4.1 and 4.2, margins and rates of turnover.

The parlous trading position of R.C.S.Ltd. is indicated very clearly in this graph. Widely erratic results ranging from a positive return of 56% at maximum to a minimum of minus 66% give a mean over the ten year period of minus 5% return. If interest is excluded the maximum is 54% and the minimum is minus 68%, indicating that equity has borne the brunt of this lamentable performance.

It will be noticed that the form of the cycles show only about 2-3 years between apogee and nadir and, thus, are not comparable with the longer shipbuilding industry cycles. This point is established in Figure No. 11.13 and the associated comparative yields analysis.

From a prospective purchaser's viewpoint, these results could hardly engender confidence in the Group's viability and, in the absence of other attractions, it might be difficult to find a purchaser describable by the usual terms 'willing' and 'voluntary' in the private sector.

Figure No. 11:4 DIVIDENDS: DEPRECIATION: RETAINED PROFIT: Robb Caledon Shipbuilders Ltd.



Source: Table No. 11.1

The government's datum for compensation terms calculation was over the six months from September, 1973 to February, 1974, as detailed in Chapter 9, Section 14. As may be seen in Figure 11.3, the unilateral choice of this period was not unfortunate for the shareholders of R.C.S.Ltd.. It is certain that a private sector purchaser would not have been prepared to negotiate on such a favourable basis in the light of the Group's track record over the previous five years since 1967.

It is also noticeable from Figure 11.3 that the rate of change from profitable operation to loss making status had increased in 1974/5 compared with earlier periods.

4.4 Distributions and Retentions

Table No. 11.1 and Figure No. 11.4 illustrate salient features relating to R.C.S.Ltd.'s disposable surpluses and losses over the ten year period. To facilitate comparison, the means are given for the three elements in the figure;namely dividends, depreciation and retained profits/losses.

From a prospective purchaser's viewpoint, the analysis is far from encouraging. Dividend payments have been made in only four years out of ten, the payments representing 10% in 1967 and 1968; 10% and 10.5% respectively (the latter rates under the inputation system), in 1973 and 1974. The mean dividend cost is seen to amount to £15,800 and the cover is as follows (a detailed analysis of yields is shown in Table No.11.4 and Figures 11.11 and 11.13):-

Table No. 11.1(a)

DIVIDEND COVER (ex Table No. 11.4)

1967	1968	1973	1974
1.36	3.06	10.96	1.56
PRIORITY PERCENTAGES	-	ORDINARY SHARES	
74	33	9	64

Of the years in which shareholders received dividends only 1968 and, particularly, 1973 may be considered to have had adequate or more than adequate cover.

Depreciation provisions over the entire period amounted to £1,039,000 giving a mean of £103,900 per annum. This compares with an overall increase in valuation of net fixed assets of £1,788,000(Table No. 11.2). The comparable figures for the period since and including 1969 (thus omitting the acquisition of Caledon Shipbuilding and Engineering Ltd. in 1968) were total provisions for depreciation £985,000, the increase in valuation of net fixed assets was £1,473,000 and capital contractual commitments (since 1969) were £540,000 in total (Capital aspects are analysed in detail in Section 5, following)

Probably the most disturbing feature of Figure No. 11.4 from the standpoint of a prospective purchaser or professional valuer of Robb Caledon Shipbuilders Ltd. is the record of retained profits and losses. The mean amount of minus £187,600 over the period indicates a serious erosion of the capital base - a fact which is established in the following analysis.

It is evident that, even before the catastrophic outcome of operations in 1975, the accumulated retentions since 1967 and up to 1974 had been more than wiped out by losses in 1969, 1970 and 1971. In fact, the deficit on the running total for the stated period was (minus)

£392,000, giving a cumulative deficit of £1,902,000 by the end of the 1975 financial year. The Group was evidently in no condition to absorb further adverse trading results but, as will be shown in the analysis of its final operational phase prior to acquisition by the public sector, further disasters were to follow.

The capital analysis which follows in Section 5 illustrates clearly the parlous position of R.C.S.Ltd., particularly in respect of the effects of the disastrous loss in the 1975 financial year on the Group's capital base.

TABLE No. 11:2

CAPITAL ANALYSIS
ROBB CALEDON SHIPBUILDERS LTD.

£000 (a)	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
CAPITAL EMPLOYED										
1. Net Capital Employed (b)	903	967	1,728	1,329	1,174	1,326	2,006	3,076	1,548	4,374
2. Net Reserves (f)	596	660	1,041	436	57	208	913	1,204	M258(d)	M132
3. Ordinary Shares	307	307	687	687	687	687	687	687	687	687
4. Other Sources (c)	-	-	-	206	430	431	406	1,184	1,119	3,818(e)
EMPLOYMENT OF CAPITAL										
5. Net Fixed Assets	238	222	553	899	884	801	737	1,651	1,891	2,026
6. Current Assets	996	1,299	3,059	3,183	2,100	2,838	3,145	7,076	4,842	5,962
7. Current Liabilities	332	554	1,884	2,753	1,814	2,337	1,876	5,647	5,179	3,614
8. Trade Investments	1	-	-	-	4	24	1	M4	M6	M1

Notes:
(a) Rounded figures
(b) Years ended 31st March
(c) Loans, Def'd Tax, Minorities Preference (1976 = £125,000)
(d) M = Minus
(e) Includes Subordinated loan of £2,500,000 in 1976.
(f) Inclusive of Government Grants.

Sources: Company Accounts
Extel Company Statistics

5. Capital : Robb Caledon Shipbuilders Ltd.

Salient features of capital employed and employment of capital are exhibited in Table No. 11.2 and Figures No. 11.5 and 11.6. The ten year record is dismal and would be interpreted far from favourably by a prospective purchaser, particularly if the 'book worth' were a criterion of judgement.

A cursory inspection of the figures presented in Table No. 11.2 indicates that the prognosis for capital health - even survival - of R.C.S.Ltd. is gloomy when taken in context with factors discussed in Section 3. In particular, obsolete plant, a dearth of orders, long term market depression and severe drains on cash flow occasioned by the need to service an inordinately high proportion of loans and fixed interest capital.

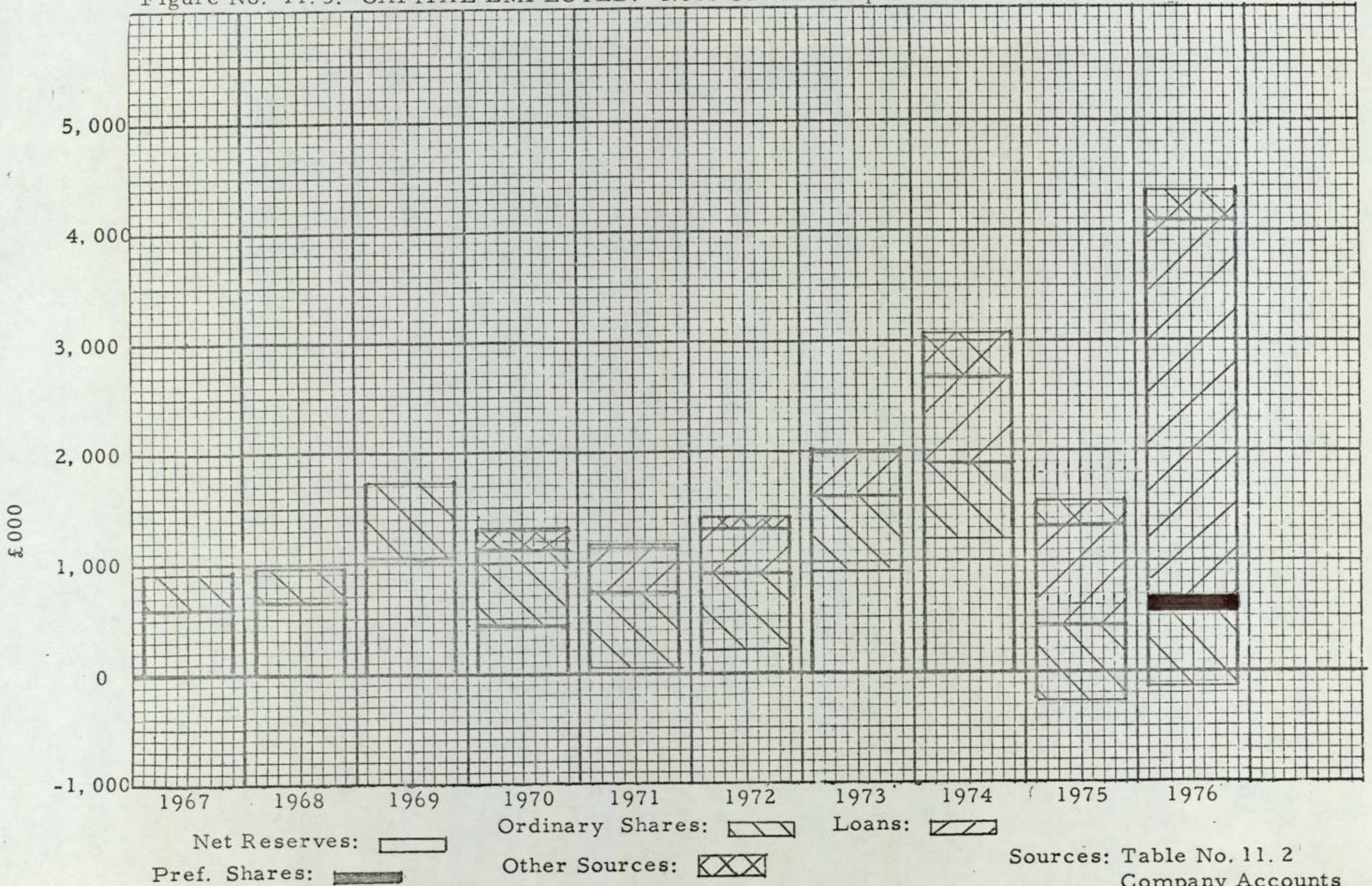
5.1 Capital Employed.

Detailed analysis of the Group's capital position over the ten year period is facilitated by the statistical presentations in Figures 11.5 and 11.6. Figure 11.5 illustrates the capital employed relationships and changes up to the end of the 1976 financial year.

The most obvious factor is the near-erosion of the capital base in 1971 and the actual erosion of the capital base in 1975 and 1976. It will be recalled that the analysis was prepared on a 'going concern' basis, and that government grants entitlement was included, thus giving the most favourable interpretation to the capital position.

Figure 11.5 indicates that net reserves (including credit and deficit balances on profit and loss account) fluctuated markedly

Figure No. 11.5: CAPITAL EMPLOYED. Robb Caledon Shipbuilders Ltd. 1967-1976



Sources: Table No. 11.2
Company Accounts

in two cycles over the period, reaching a minimum in 1971 and an absolute minimum in 1975; actual erosion of the capital base occurring as a result in both 1975 and 1976.

Equity capital and reserves comprised the principal bases between 1967 and 1973, inclusive, although the growing proportion of loans from 1970 onwards was a major contribution to capital. The histogram indicates that secured loans were used continuously over the period 1970 to 1975, culminating in a massive increment of loan capital in the latter year. Actual loans outstanding at the end of the financial year 1971 were as follow :- (R.C.S.Ltd.)

£		SECURED LOANS : 1971
150,000	@	$8^7/8$% per annum
210,000	@	$8^1/2$% " "
40,000	@	$8^5/8$% " "
400,000		

These loans were repayable by sixteen half-yearly instalments commencing 1st January, 1973 (or earlier at the borrowers' option) and were secured by floating charges over the whole properties and undertakings of the Group.

This position may be compared with the loan capital position at the end of the analysis period illustrated in Figure 11.5 (1976).

£		SECURED LOANS : 1976	
84,000	@	$8^7/8$% per annum	) repayable by nine equal half-yearly instalments
28,000	@	$8^5/8$% " "	)
113,000	@	$8^1/2$% " "	)
450,000	@	$7^1/2$% " "	: repayable by eight equal half-yearly instalments commencing 30.6.76
675,000			

All were secured by overall floating charges.

SUBORDINATED LOAN : 1976

(Received on 2nd September, 1975)

£		
2,500,000	:	Interest at $1\frac{1}{2}\%$ above the rate at which sterling deposits of £2,500,000 were offered for a six month period to Lazard Bros. & Co. Ltd. on the first business day of each half-year, up to the 2nd September, 1977: payable half-yearly in arrears. Subsequently, at $2\frac{1}{2}\%$ above the yield to redemption, at 2nd September, 1977, on $8\frac{1}{2}\%$ Treasury Loan, 1987/90.

The principal was repayable on 2nd September, 1977 but, provided no event of default had occurred, R.C.S.Ltd. could elect to extend the term of the loan, or a proportion thereof, for a further thirteen years. In fact, the loan was duly repaid on the first due date (after the company became vested in British Shipbuilders).

Interest on the subordinated loan for the initial period was about 14.1%. Had the loan been continued after the 2nd September, 1977, the interest rate would have been 14.08% on the stated basis (11.58% + 2.5%).

The circumstances in which this loan was obtained have been briefly referred to (Section 3) but, in view of its material nature so far as the capital structure of R.C.S.Ltd. was concerned, a more detailed explanation is given below.

Comparing the relative loan capital positions in 1971 and 1976 (above) it may be seen that the amounts were £400,000 and £3,175,000 respectively. Before entering on a further analysis of loan capital it would be appropriate at this point to discuss the £2,500,000 loan from Lazards and the factors associated with this injection of capital. Cursory examination of the capital employed relationships exhibited in Fig. No. 11.5 suggests that the acquisition of loan capital of such magnitude following the 1975 disaster was little short of a miracle. The facts are as follow :

Very substantial losses on contracts for the construction of two cable repair ships, the C.S. Monarch and the C.S. Iris, for the Post Office, were sustained in the financial year ending 31st March, 1975. These losses were attributed[3] to causes detailed in Section 3, i.e. delays incurred in provision of services and supplies by main sub-contractors, late receipt of specialist drawings and information for construction and delays in delivery of major items of supply of up to twelve months.

The contracts were on a fixed price basis without provision, in terms of legal rights, to secure increases in the price of the ships. In the event, the Post Office refused to enter re-negotiation of the contracts. However, a package deal was arranged in which Lazard Bros. & Co. Ltd. provided capital facilities in the form of a £2,500,000 subordinated loan, on the terms detailed above, and an agreement to subscribe in cash at par for 500,000 (£1) 10% Cumulative Redeemable Preference Shares in tranches of 125,000 to coincide with the last dates of the four periods of initial interest payments. The latter provision doubtless to avoid default by R.C.S. Ltd. on interest payments on the subordinated loan.

Drawings on the Preference Share facility comprised subscriptions of £125,000 on 2nd March and 2nd September, 1976, and a final drawing on 2nd March, 1977; making a total issued Preference Capital of £375,000 by that date. Under the agreement, the balance of 125,000 Preference shares could not be issued other than to the Subscriber (Lazards). The shares were redeemable on the 30th September, 1990 or earlier if control of the company changed or if its assets became vested in the Crown.

The issue of the subordinated loan imposed conditions on R.C.S. Ltd. relating to the transfer and charging of company assets, limits on overall borrowing, restrictions on capital expenditure and distributions to shareholders (in relation to the deduction of revenue losses incurred after 31st March, 1975). A prospective purchaser of the company would doubtless view these developments with trepidation and would wish to make full allowances, in any assessment of value, in recognition of the onerous burdens on R.C.S. Ltd. in the future.

The company was indeed fortunate to have been rescued by this relatively massive injection of capital in view of its overall structural position. Fortunately, the existence of locked up investment in the shape of the partially completed vessels for the Post Office and the influence of a major customer's interest in securing completion and performance of the specific contracts coincided to bring about this outcome. Both ships were delivered and the company lived on to achieve its nationalisation metamorphosis on the 1st July, 1977.

Adverting to Figure 11.5, the relationships between loan capital and equity are clearly illustrated. However, in view of the nature of the changes between 1970 and 1976, the relative positions are amplified by the following analysis based on the ratio:-

$$\frac{\text{Total Loans + Preference Capital}}{\text{Equity + Net Reserves}}$$

Table 11.2(a) EQUITY AND FIXED INTEREST CAPITAL

1970	1971	1972	1973	1974	1975	1976
0.18	0.54	0.45	0.23	0.41	2.11	6.43

The above ratios are calculated to illustrate the effect of overwhelming injections of loan capital (including bank overdrafts) in the last two years of the series. Discussion of gearing in the light of such relationships is merely academic and it is obvious that the company would have foundered were it not for the circumstances detailed above.

Further light on the adverse capital position is given by the relationship of interest charges to unassigned net cash flow over the period 1970 to 1976. Since the influence of tax payments (due to deferred tax and tax losses - £3,438,000 by the end of the 1976 financial year) was minimal, the position shown for net cash flow per share is relatively unbiased.

TABLE No. 11.2(b)

INTEREST CHARGES AND NET CASH FLOW PER SHARE (ORDINARY)

	1970	1971	1972	1973	1974	1975	1976
(a) Interest Charge (p)	0.46	1.76	2.78	2.54	2.37	2.84	17.18
(b) Net Cash Flow (p) *	(c)	(c)	18.05	57.7	12.45	(c)	16.09
Ratio (a)/(b)	-	-	0.15	0.04	0.19	-	1.07

* Data ex Table No.11.4
(c) Negative. (p) New pence (Figures are rounded)

The data in Table No. 11.2(b) above indicate that R.C.S. Ltd. had negative net cash flows per ordinary share in 1970, 1971 and 1975 against interest charges in pence per ordinary share of 0.46, 1.76 and 2.84, respectively. For the final fifteen months of operation in the private sector, ending on the 30th June, 1977, the interest charge on loans per ordinary share amounted to 35.8 pence, with a loss per share amounting to 49.6 pence. Scrutiny of the ratio figures in Table No. 11.2(b) reveals that, apart from the years in which negative cash flow occurred, the most favourable proportion of charges to unassigned cash flow was 4% (1973) and the most adverse was 107% (1976).

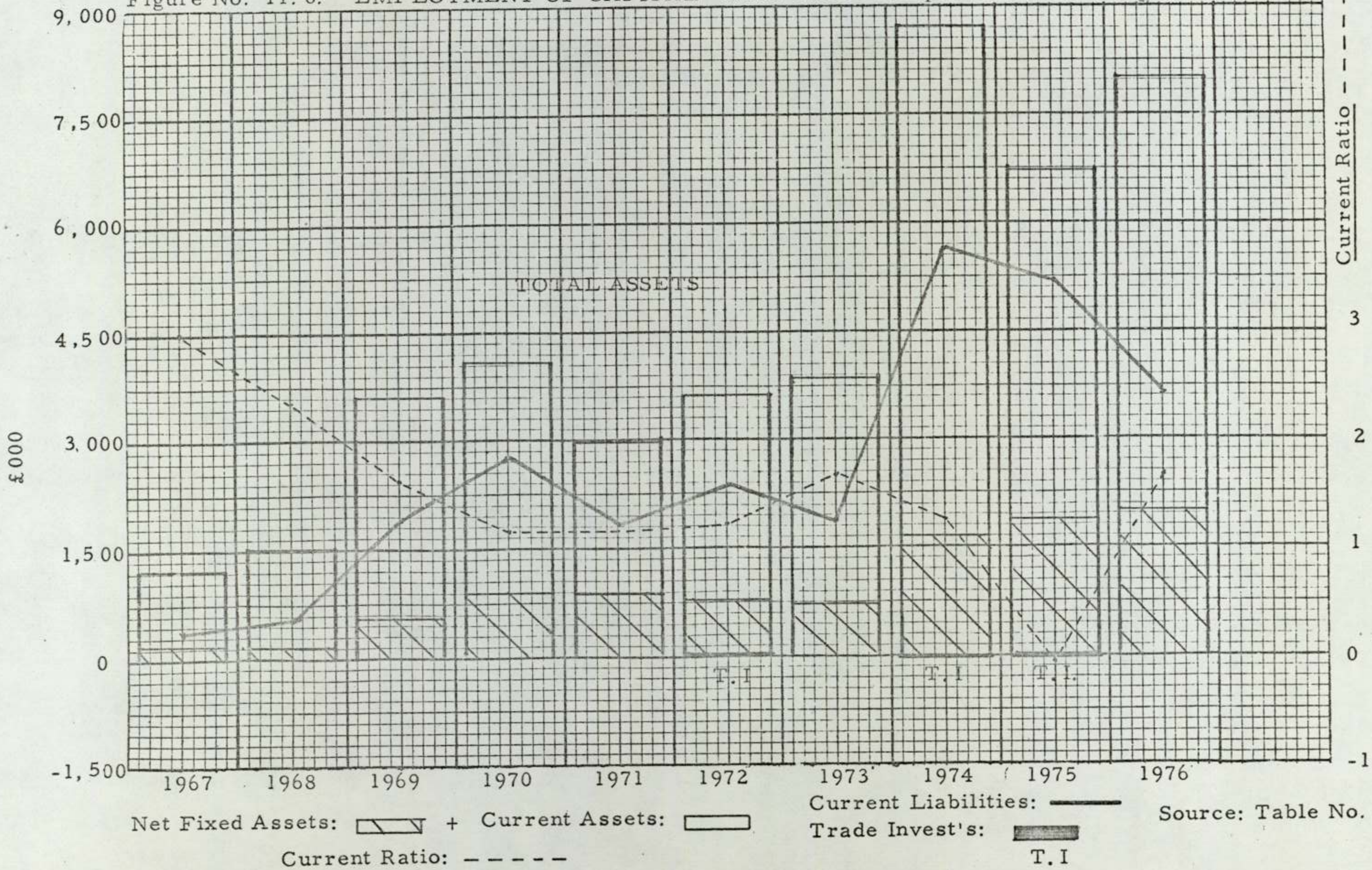
The remaining factors for discussion in Figure 11.5 are the proportion of capital employed from'other sources' apart from loans and net reserves. Deferred tax and a minority interest arising from B.E.F.Ltd. comprised part of the balance, the former rising from £6,000 in 1970 to £231,000 in 1976. Finally, the first tranche of Preference capital (£125,000) is shown as having been subscribed for by the end of the 1976 financial year.

As detailed above, a total of £500,000 in 10% Cumulative Preference Capital was available for issue, together with an enhanced borrowing capability, under the agreement with Lazards. The total of 375,000 Preference Shares outstanding at the time of nationalisation was due for redemption under the terms of the agreement. This could not be accomplished due to the position of the reserves (Table No.11.5 and Figure No. 11.14 refer to this aspect, inter alia), and the Preference Shares were acquired by British Shipbuilders and, finally, by the Post Office.

It has been shown that the usual basis for appraisal of economic worth (earning power of assets), exhibited and discussed in Section 4, offers meagre support for projections such as a prospective purchaser would wish to establish. The other chief basis of corporate valuation, net asset value, is also seen to be far from satisfactory on the evidence of the above analysis.

Sub-section 5.2, following, comprises an analysis of the employment of capital and this leads on to an activity analysis in Section 6.

Figure No. 11. 6. EMPLOYMENT OF CAPITAL Robb Caledon Shipbuilders Ltd. 1967-1976



Source: Table No. 11. 2

5.2 Employment of Capital

A prospective purchaser, having analysed capital employed, would also be interested in the actual deployment of funds in the business. Table No. 11.2 and Figure No. 11.6 exhibit the relevant data and relationships between the various assets and liabilities. Table No. 11.2 shows the ten year position and the values relating to net fixed assets, current assets, current liabilities and trade investments. Figure No. 11.6 amplifies the data in the table by illustrating their relationships and showing the current ratio over the period.

Reference has been made to the imprecisions of corporate valuations and the reasons for these in Chapters 8, 9 and 10. One of the areas of particular difficulty lies in the valuation of fixed assets, an important underlying basis of net asset value. So much depends not only on the nature of the assets themselves but also on the present and future use to which they are put, thus linking intrinsic and economic worth. Directors often resort to professional valuations for obvious reasons and the results may or may not be incorporated in the balance sheet. With the effluxion of time and variable rates of inflation the real value of fixed assets, from a prospective purchaser's standpoint, might be very difficult to establish.

A third party, not being privy to sources of information available to vendors and purchasers of corporate assets, must needs rely on published data of a primary nature backed by such industrial or commercial experience as is germane to the nature of the business.

In the present case, the net fixed assets were referred to and discussed briefly in the income analysis (Section 4). Table No.

11.2 and Figure No. 11.6 indicate the pattern of change of net fixed assets over the ten year period.

A period of relatively rapid growth in 1969 was followed by a period of gradual growth and subsequent decline between 1969 and 1973. Another rapid expansion of net fixed assets occurred in 1974, followed by a relatively slowgrowth in the two years 1975 and 1976. The overall increase in valuation of net fixed assets between 1967 and 1976 exceeds that expected by applying the deflators used in Figures 11.11 and 11.12 (G.D.P. and general R.P.I.) by a factor of 2.84, which suggests that real growth did occur over the ten year period; but this is qualified by later discussion.

To put these results in perspective, it is necessary to consider the nature of the fixed assets and valuation aspects. A prospective purchaser might be disappointed to note that there was no land of material value and that the assets largely comprised components of relatively inflexible operational usage. Net book values at 26th March, 1976 were as follow :-

BUILDINGS (Short Leasehold) £000	HOUSE PROPERTY (Freehold) £000	MACHINERY PLANT & VEHICLES £000	TOTAL £000
1,383	30	613	2,026

Valuations, derived in 1973, of £30,000 (Buildings) and £120,000 (Machinery, Plant and Vehicles) were incorporated in the above amounts. The fixed assets (other than House Property) were valued at £2,809,000 on the 31st December, 1974, by a professional firm of chartered surveyors. This latter valuation was principally on the basis of existing use, assuming an adequate level of profitability in support and on the understanding that leases of the shipyards at Dundee and

Leith would be continued as required on fair terms. At least one proviso (profitability) was not met. This (1974) valuation was not incorporated in the accounts.

The 1974 valuation of £2,809,000 compares with a total net book value of £1,651,000 at the 31st March, 1974, in the annual report; a favourable difference of 41% on the basis of the former amount or of 70% on the basis of the £1,651,000 book value. (Depreciation rates are calculated to write off assets over their estimated lives).

An earlier professional valuation (by the same company of chartered surveyors) at the 30th September, 1967, on a going concern basis placed the value at £1,297,310 compared with a book value of £609,714. This valuation was carried out for the purposes of the merger with the Caledon Shipbuilding and Engineering Co. Ltd. and included the fixed assets (excluding house property) of both companies. The valuation was not incorporated in the accounts.

Had the profitability criterion been met, it is reasonable to assume that a measure of hidden reserves existed in the valuation of fixed assets. If the professional valuation of 1967 is taken as a realistic base and the amount of £2,026,000 in 1976 is adjusted upwards by the same factor as the 1967 book valuation had to the professional valuation (2.13 times), giving a revised figure of £4,310,791, a rough comparison may be made. The relationship between the professional valuation of 1967 and the adjusted total of £4,310,791 for 1976 shows a reasonably close approximation to that expected for zero growth at 1967 constant prices: that is, a figure of about £3,900,000 (omitting house property values). Alternatively, an adjustment of plus 70% on the 1976 value of £2,026,000 gives £3,444,200.

These results cannot, of course, be relied on to reflect a 'real' value of the net fixed assets since many subjective factors will affect a final professional valuation. It could be argued that the value of the short leases is virtually zero in the light of long-term world over-capacity in shipbuilding,[4] obsolete plant and equipment (ref. Section 3), chronic under-utilisation of assets, marginal or negative profitability and poor labour relations. If this were tenable, then the value of the plant, machinery and vehicles might not be more than residual or scrap value. This would leave the only valuable marketable assets, (house property) at a possible heavy discount in view of local demographic changes consequent on cessation of the business.

Indeed, a prospective purchaser may well conclude that the only rational course, in the light of all these considerations and those detailed in Section 3, would be for British Shipbuilders to close down the business at the earliest opportunity. The important conclusion in respect to the question of the 'real' value of R.C.S.Ltd.'s fixed assets is that hidden reserves of about 70-80% could only be assumed to be present if the assets were to be used profitably and securely in the longer term. A prospective purchaser would be brave indeed if he were prepared to subscribe to such an assumption.

Considering now the current assets, Table No. 11.2 and Figure NO.11.6 indicate the degree of variability over the ten year period. The practice of pre-payments on account and the temporary investment of such liquid funds by way of short loans has been referred to previously. Evidently, the influx and effluxion of such funds, not necessarily in synchronisation with the value of work-in-progress or proportion of contracts completed, tend to obscure the usual relatively stable relationships between current assets and current liabilities.

However, the existence of fairly major variances in the absolute levels of current assets is seen to be superimposed on an aggregate increase over the entire ten year period. The two periods of rapid expansion are seen to have occurred in the years following profitability maxima, 1968 and 1973. In view of appreciation of stocks and the underlying variability of the yearly figures, it is not feasible to attempt a precise appraisal of current assets other than in relation to the other main component of activity, current liabilities.

Whereas the ratio of current assets between the base year of 1967 and the period of maximum activity in 1974 is seen to result in a factor of 7.1, a similar calculation for current liabilities gives a factor of 17 times. Examination of Figure 11.6 shows that current liabilities followed broadly the pattern exhibited by current assets, with a limited relative gain of the latter in 1973.

The current ratio : $\frac{\text{Current Assets}}{\text{Current Liabilities}}$ shows the relationship between the two components over the ten year period. A prospective purchaser would not find much encouragement in the result of this comparison. A steadily worsening ratio over the years 1967 to 1970 (albeit reflecting a better use of current assets) is followed by a period of relative stability until 1972, a slight improvement in 1973 followed by a decline in 1974 and a catastrophic fall in 1975. This was followed by a rapid improvement in 1976 brought about by a reduction in current liabilities and an increase in the value of current assets.

In the light of results already observed in this analysis, the reason for the abysmal current ratio in 1975 was the failure to release revenue flows to offset the incurrence of liabilities tied up in delayed construction and uncompleted contracts. The presence of trade investments may be regarded virtually as a minor balancing item in view of their relatively small values. Further aspects of activity are considered in the following analysis of operational data (Section 6).

TABLE No. 11:3

OPERATING DATA
ROBB CALEDON SHIPBUILDERS LTD.

£000 (a)	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
1. Turnover	2,672	2,407	4,108	5,889	6,949	8,158	7,443	8,404	10,511	16,719
2. Stocks & W.I.P.	453	425	761	66.3	771	656	707	611	1,048	1,775
3. Percentage $\frac{(2)}{(1)}$ (a)	17	17.7	18.5	11.3	11.1	8.0	9.5	7.3	10.0	10.6
4. Debtors	240	288	457	462	600	562	809	1,072	2,063	2,958
5. Creditors	301	292	502	1,012	1,101	1,133	846	1,315	2,212	2,267
6. $\frac{(5)}{(4)}$ Ratio (a)	1.25	1.01	1.1	2.19	1.84	2.02	1.05	1.23	1.07	0.77
7. Quick Assets	305	601	1,859	2,074	754	1,662	1,661	5,393	1,731	1,829
8. Quick Liabilities	31	31	-	-	-	-	196	130	-	-

Notes (a) Rounded figures

Sources: Company Accounts

6. Activity : Robb Caledon Shipbuilders Ltd.

Although the main determinants of corporate value for the purpose of transfer of ownership comprise net asset value (intrinsic worth) and earning power value (economic worth), and these parameters are usually assessed by calculation of book worth and relevant comparisons of earnings and dividend yields, the questions of profitability, liquidity etc., require that activity of the business be analysed.

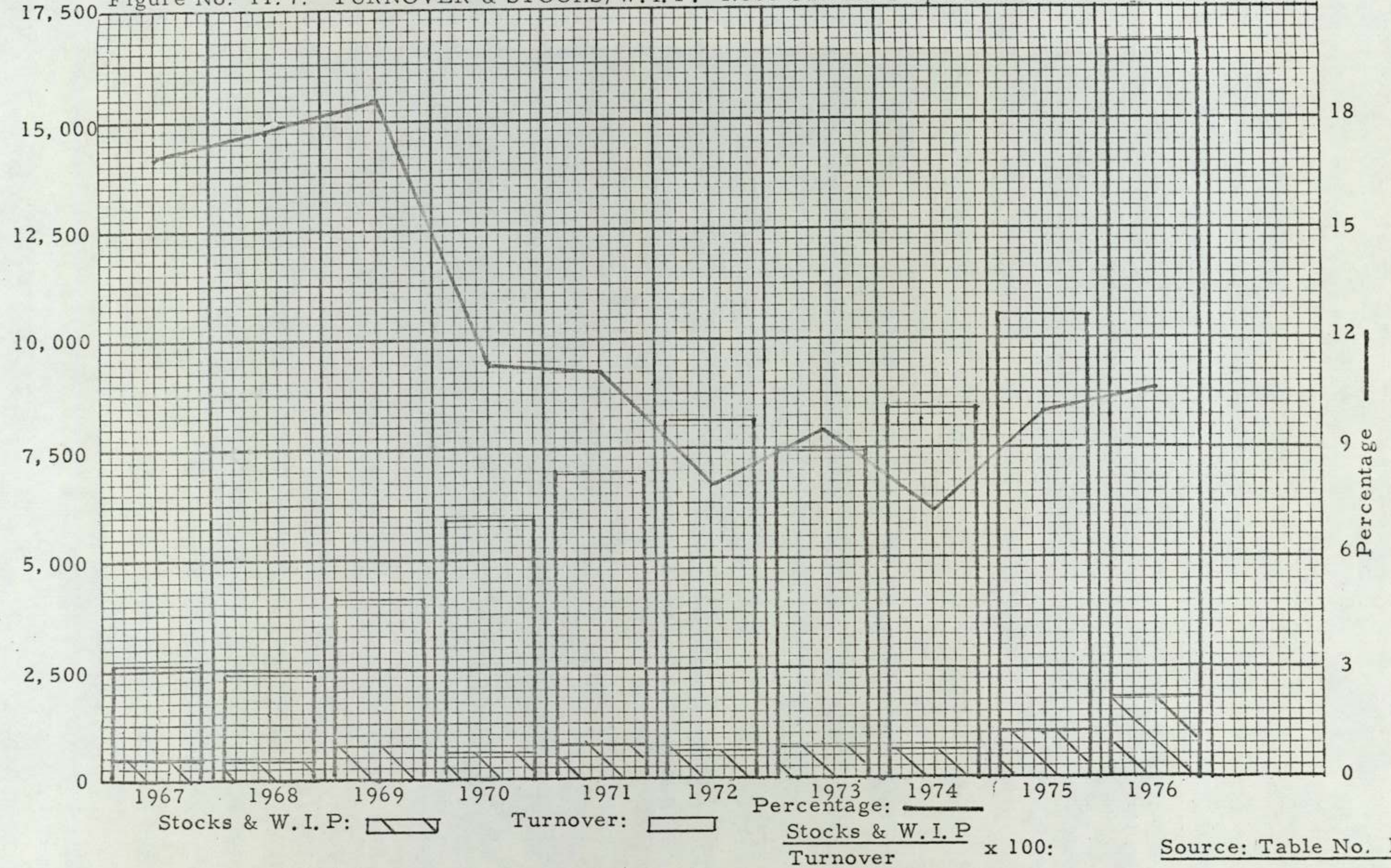
Table No. 11.3 and Figures No. 11.7, 11.8 and 11.9 exhibit the data relating to activity at the level appropriate for the objects of the present analysis. The factors include turnover, stocks and work-in-progress (W.I.P.), debtors, creditors, quick assets and quick liabilities; the latter two aspects in relation to short term liquidity at an operational level.

6.1 Turnover - Stocks - Work in Progress

Turnover has been discussed in relation to the income analysis in Section 4 but it is necessary to consider it again in operational terms rather than in financial terms, particularly in relation to stocks and W.I.P. A corporate valuer necessarily enters a specialist area requiring professional knowledge of the specific business activity when stocks and W.I.P. are to be valued.

Balance sheet valuation of stocks and W.I.P. is another area, similar to that of fixed assets, where directorial subjective/ objective appraisal results in an aggregate result depending, inter alia, on whether or not the business is likely to continue as a going concern. Managers in industry are familiar with the problems of arriving at an equitable valuation of stocks and W.I.P., particularly in a business such as that of R.C.S. Ltd.

Figure No. 11.7. TURNOVER & STOCKS/W.I.P. Robb Caledon Shipbuilders Ltd. 1967-1976



Source: Table No. 11.3

The output of investment goods requires that a relatively long term servicing commitment be accepted in the interests of customer goodwill. It follows that, because of the lengthy gestation period of capital products of a high intrinsic value, the stocks relating to such products as shipbuilding and shiprepairing/heavy marine engineering will turn over relatively slowly compared with e.g. retail or high volume mass production companies. Also, because of the industrial economics of high variety, low volume production, replacement parts and orders for them will often be back-logged until the organisation can cope with them on a rational basis.

Thus it will be apparent that balance sheet valuations of stocks and W.I.P. in manufacturing companies generally and types of business such as the present model, in particular, will need to be approached with caution. More so if the reason for valuation is prospective change of ownership and control.

Figure 11.7 illustrates the relationship between turnover and stocks/ W.I.P. over the ten year period. Because of the nature of the business the volatile constituent will be W.I.P. and, assuming efficient management, the stocks inventories will be relatively stable. As an example of this aspect the relevant constituents for 1974-77 are given below.

(£000)	1974	1975	1976	1977 (15 months)
(a) STOCKS	411	510	617	574
(b) W.I.P.*	200	538	1,158	1,876
(c) TOTAL	611	1,048	1,775	2,450
(d) Ratio $\frac{(b)}{(a)}$	0.49	1.05	1.88	3.27

* After provisions for losses and instalments to account.

It will be noted that whilst the range of variation on the minimum stocks figure is only 50%, the comparable figure for W.I.P. variation is 838%. The nine-fold increase in W.I.P. over the four year period compared with the relatively stable stocks position could be accounted for by a number of factors. These include relative volume changes, changes in valuation policies, re-allocation of oncosts in respect of prime costs, expansion in trading/operational volume, writing down of stock categories and W.I.P., inflationary factors operating on prime costs of manufacturing, delays in completions due to the multiplicity of reasons listed in Section 3 and so forth.

Provisions for losses to completion on existing contracts have been referred to in Section 3 et seq. A breakdown of these net provisions indicates the major influence of this particular factor in the ultimate valuation of W.I.P.

1974	1975	1976	1977 (15 months)
£385,500	£3,503,000	£1,713,000	£576,000

Evaluating the relationships exhibited in Table No. 11.3 and Figure No. 11.7 in the light of the above qualifications and unknown factors can only be on a very general basis and conclusions cannot be other than putative.

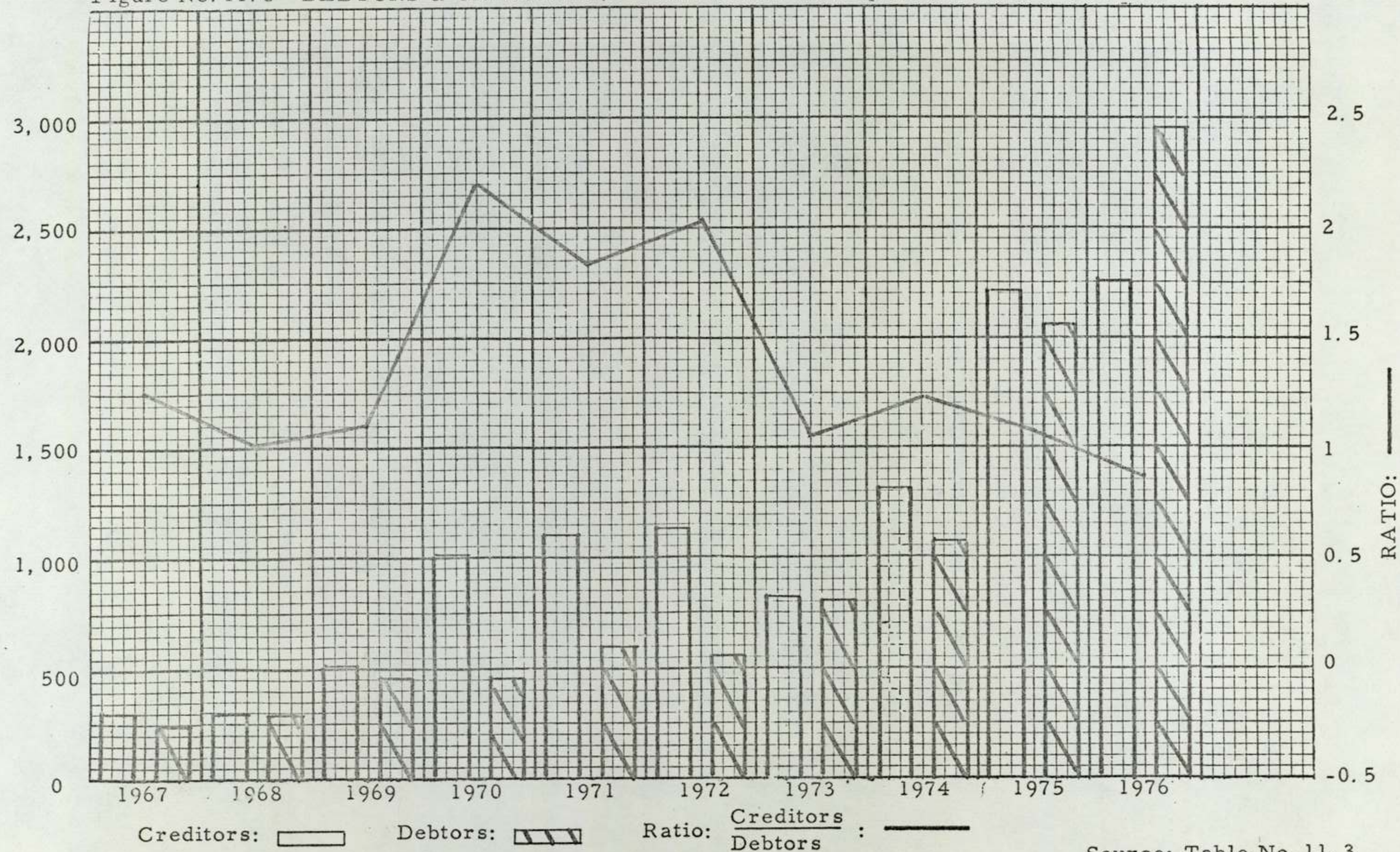
The general picture of turnover, illustrated in Figure No. 11.7 has been analysed in Section 4 in relation to the income aspect. It was established that growth had occurred over the ten year period, allowing for adjustment by the deflators (G.D.P. and the general R.P.I.) and subject to the stated qualifications.

It is unnecessary further to elaborate on the stocks/W.I.P. factor other than to comment on what appears to be a remarkable degree of stability or stagnancy considering the growth in turnover and the influences of factors discussed above.

Perhaps the most striking feature is the behaviour of the percentage of stocks and W.I.P. to turnover over the ten year period. This varies from a maximum of 18.5% in 1969 to a minimum of 7.3% in 1974. Viewed inversely as an indication of the rate of stocks/W.I.P. turnover, this gives ratios of 5.4 and 13.8 respectively, a relative increase in velocity of 2.6 times. Because of the distortions of the related measurements, it is clearly inappropriate to draw the conclusion that management efficiency has been entirely responsible for such an improvement between 1969 and 1974. As a comparison, the percentage of stocks/W.I.P. to turnover for the fifteen month period of operation ending 30th June, 1977 was 12.6%, giving a velocity ratio of 7.9 for the rate of turnover of stocks/W.I.P.

Before leaving this part of the investigation, it would be appropriate to detail the basis of accounting used by R.C.S.Ltd. in regard to work in progress and stocks valuation. W.I.P. comprised direct costs and overheads based on a normal level of activity less provisions for estimated total losses to completion. No credit was taken for shipbuilding construction grants in arriving at provisions for losses. Stocks were valued at the lower of cost and net realisable value.

Figure No. 11.8 DEBTORS & CREDITORS. Robb Caledon Shipbuilders Ltd. 1967-1976



Source: Table No. 11.3

6.2 Debtors and Creditors

Table No. 11.3 and Figure No. 11.8 exhibit the data relating to debtors and creditors. Comparison of the relationships between debtors and turnover in 1967 and 1976 indicates that the percentages of debtors to turnover were 9% and 17.7%, giving a recovery rate of 11 times and 5.7, respectively. These figures suggest a worsening of, inter alia, credit control over the ten year period since the average periods for outstanding debts rose from about 4/5 weeks in 1967 to about 9 weeks in 1976.

As with other aspects, however, caution has to be exercised in interpreting the above results since it has been shown that the balance of output in terms of the nature of throughput was changed in 1968 by the acquisition of Caledon Engineering and Shipbuilders Ltd.

A similar comparison of the relationship of creditors to turnover for the same years indicates percentages of creditors to turnover of 11.3% (1967) and 13.6%, respectively. These results indicate an average period for credit taken of 5.9 weeks and 7 weeks for 1967 and 1976, respectively. It may be inferred that R.C.S.Ltd. was generally successful in improving its capital availability by extending its credit taken to credit given balance on this basis of comparison.

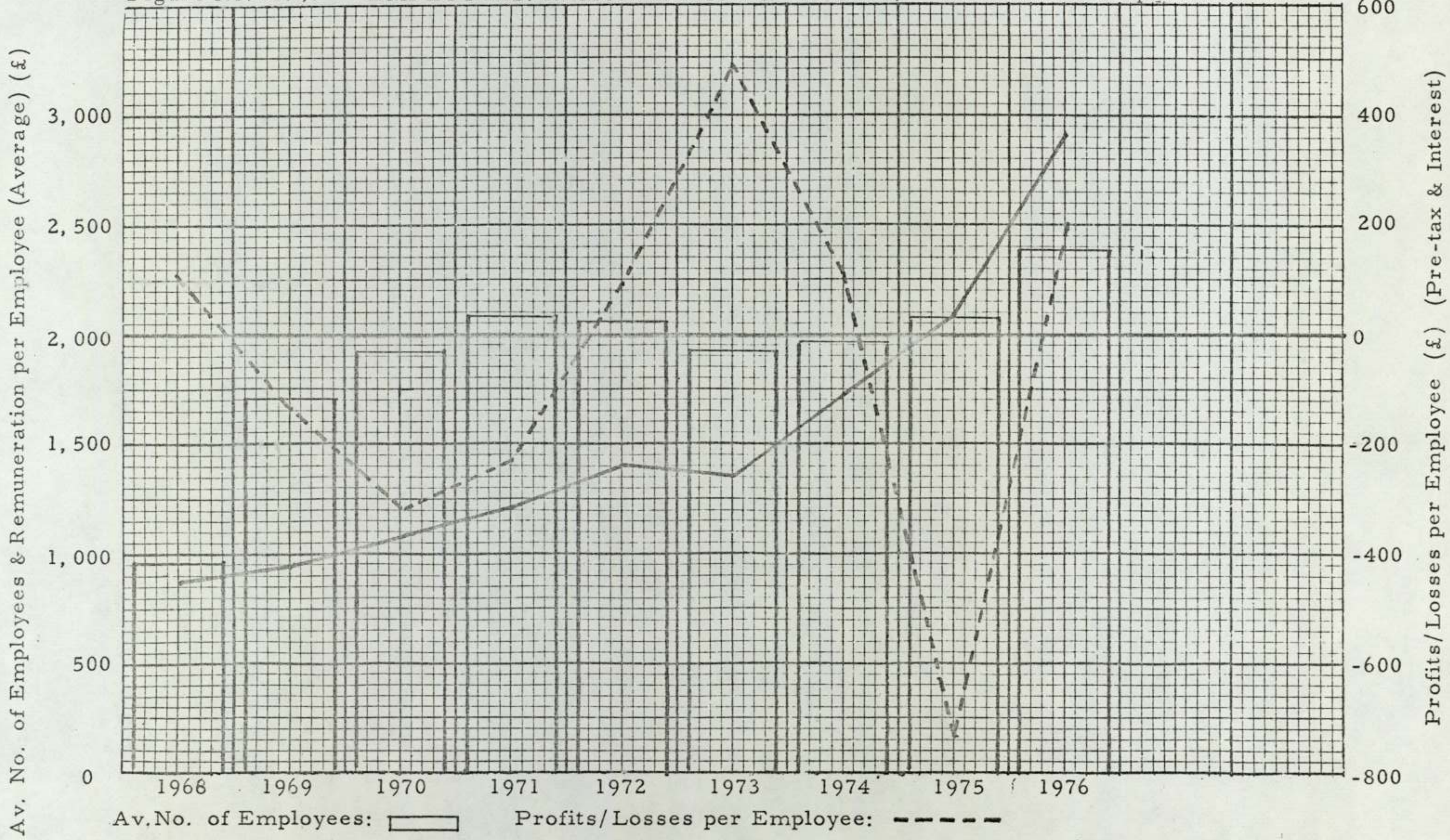
However, a more fruitful indication of debtor/creditor control and relationships may be derived from Figure No. 11.8. The growth in absolute values of creditors is seen generally to follow that of turnover with the exception of 1976. In contrast, the pattern of debtors over the ten year period is seen to differ from that of both turnover and creditors in that a relatively stable but oscillating state between 1967 and 1972 was followed by an exponential growth in debtors totals in the latter five years of the term.

The behaviour of the debtors component strongly suggests, inter alia, the influence of fixed cost contracts unduly limiting the value of output in relation to input costs (creditors' histogram) until 1973, when more realistic pricing policies were adopted. This interpretation is supported by the analysis of margins, etc. (Figures 11.1 and 11.3) and the incidence of provisions for losses. A less sanguine reason for the rapid increase in debtors might have been neglect of prudent credit control management of the accounts or, alternatively, debtors' deliberate credit maximisation policies.

Figure 11.8 indicates the overall relation of creditors to debtors over the period 1967 to 1976 by the graph of the ratio. This curve clearly shows the adverse relationships (from the standpoint of solvency) in 1970, 1971 and 1972; although this was the period of most favourable credit taken/credit given balance in terms of working capital.

Interpretation of the excess of debtors over creditors in 1976 is obfuscated by the disclosure of a contract dispute amounting to £322,000 in total (with counter-claims of £459,000) in the following year. As an indication of the relative frailty of the amounts shown for creditors and debtors in the 1976 financial year, giving a ratio of 0.77, the corresponding figures (unadjusted) for 1977 (fifteen months) were (creditors) £2,282,000 and (debtors) £1,439,000 giving a ratio (creditors/debtors) of 1.59. The debtors figure included the disputed amount referred to above. Later analysis of the period March, 1976 to June, 1977, indicates further the significance of the latter ratio in terms of solvency.

Figure No. 11. 9.   EMPLOYEES: REMUNERATION & PROFITS.   Robb Caledon Shipbuilders Ltd.



Sources: Table No. 11. 1.
Company Accounts

Operational liquidity had not been a problem for R.C.S.Ltd. during the ten year period under analysis, as shown by Table No. 11.3. The reasons have been referred to in Sections 3, 5 and above. Prepayments on account of part-completion of contracts, giving a regular supply of liquid funds, coupled with minimal liability for tax payments, meagre dividend distributions, low capital expenditure contractual commitments had combined to secure a relatively sound liquid position, operationally. The availability of government grants, regional employment premiums and shipbuilders' reliefs had also contributed to liquidity, as had income from loans and deposits. As an example of the magnitude of these cash flows, the total amount received in shipbuilding construction grants between 1972 and 1977 was £1,050,572.

6.3 Remuneration and Profits per Employee

Figure No. 11.9 continues the activity analysis by exhibiting the data and relationships of the average number of employees, remuneration and profit per employee. The sharp increase in numbers of emplcyees in 1969 following the merger with Caledon Shipbuilding and Engineering Ltd. is seen to have been followed by a remarkably stable record in the years 1969 to 1975: the average numbers employed varying only marginally around the 2,000 mark.

This stability of numbers employed could be interpreted in various ways. It could reflect the traditional methodologies of ship-building and engineering stabilised, in terms of labour/capital intensity, by demarcation and restrictive practices, lack of investment to improve the productivity of labour and general saturation of innovation in these basic industries. Since R.C.S. Ltd. were in receipt of regional employment premiums, it is possible that government support policies might have contributed to the stability of the labour force. Lack of alternative employment opportunities and the relative rigidity of labour skills, location and demographic factors might also have been underlying causes.

Unit labour costs have not changed greatly in real terms, since the graph of remuneration per employee follows quite closely the rise of the G.D.P. and general R.P.I. over this period (Figures 11.11 and 11.12) and the volume of turnover was seen to have been relatively stable in this respect (Sections 4 and 5). This reflects the influence of government income policies and the realities of employment in depressed industries.

The most significant curve in Figure 11.9 is that of profit/losses per employee. R.C.S.Ltd. is seen to have been securing a profitable return per employee only in five of the nine years compared in the graph. In three of these years, 1968, 1972 and 1974, the profits per employee were only about £100 (pre-tax and interest). The graph peaks at a profit per employee of about £480 in 1973, the outstanding year, and reaches its nadir at a loss of about £740 per employee in 1975.

These results compare with the corporate income analysis in Section 4, where it was noted that margins rather than volume of output were the principal problem areas; thus reflecting competitive pressures, inappropriate pricing policies and the multifarious contributory causes detailed in Section 3.

Doubtless, a prospective purchaser would find these results very discouraging so far as future prospects were concerned. It is clear that R.C.S.Ltd. had severe problems of a fundamental nature. The quantitative analysis thus far has revealed a number of serious weaknesses in the income, capital structure and activity areas.

Apart from the business environmental aspects studied in Section 3, the foregoing analysis has been directed at the corporate entity of Robb Caledon Shipbuilders Ltd. It now remains to consider the context in which R.C.S.Ltd. was operating in order to adduce comparisons which may be developed to facilitate conclusions relating to the nationalisation of the company and the compensatory terms derived and declared in settlement by the government.

TABLE No. 11.4

EQUITY ANALYSIS : ASSETS - EARNINGS - DIVIDENDS - YIELDS
ROBB CALEDON SHIPBUILDERS LTD.

	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
1. Ordinary Shares Issued (50p) (00)	6 136	6 136	13 736	13 736	13 736	13 736	13 736	13 736	13 736	13 736
2. Equity Net Assets (£000)	903	967	1,728	1,123	744	895	1,600	1,891	429	555
3. Equity Earnings (£000)	42	94	L238(a)	L617	L504	150	752	113(h)	L1,506(h)	54(h)
4. Earnings per Share (e)(f)*	6.8	15.3	M17.3	M44.9	M36.7	10.9	54.8	8.2	M109.6	3.9
5. Dividends Paid (d)*	5	5	-	-	-	-	5	5.25	-	-
6. Net Asset Value per Share (2/1)*	147.2	157.6	125.8	81.8	54.2	65.2	116.5	137.7	31.2	40.4
7. Share Price (mean)(b)*	50	91	61	50	24	61	94	69	53	43
8. Share Price (c)*	51	58	44	25	25	75	110	60	25	65
9. Earnings Yield % on (8) basis. (d)	13.4	26.4	-	-	-	14.6	54.5	26.34	-	9.3
10. Dividend Yield % on (8) basis. (d)	9.8	8.6	-	-	-	-	4.6	8.75	-	-
11. Net Cash Flow per Share (e) * (g)	6.36	14.50	M11.8	M38.15	M27.96	18.05	57.7	12.45	M96.68	16.09

Notes: (a) L = Loss
(b) Unweighted
(c) At date of issue of Annual Report.
(d) Gross. Based on Imputation System from 1973.
(e) M = Minus.
(f) Net of Tax.
(g) Retentions plus Depreciation.
(h) Include tax adjustments.
* New pence (with conversions). Figures are rounded.

Sources: Tables No. 11:1 & 11.2
Company Accounts
Extel Statistics

7. Equity Analysis : Assets - Earnings - Cash Flow - Dividends

In order to develop a structure to facilitate external comparisons with R.C.S.Ltd. as a going concern and as a prospective corporate acquisition, it is necessary to analyse the returns, flows and capital values attributable to the ordinary shareholders.

Table No. 11.4 and Figures No. 11.10, 11.11, 11.12 and 11.13 exhibit the data appropriate for this purpose. Table No. 11.4 contains information relating to equity net assets, earnings, prices, yields and net cash flows, and these aspects are studied in relation to external comparators in the following four figures.

To ensure comparability, the period of analysis is retained for the reasons stated previously (Section 3). Since the final fifteen months of operation were carried out in the penumbra of certain nationalisation, the stock market response to the company was coloured more by the expected compensatory terms than its value as an ongoing investment, as will be demonstrated later in the analysis.

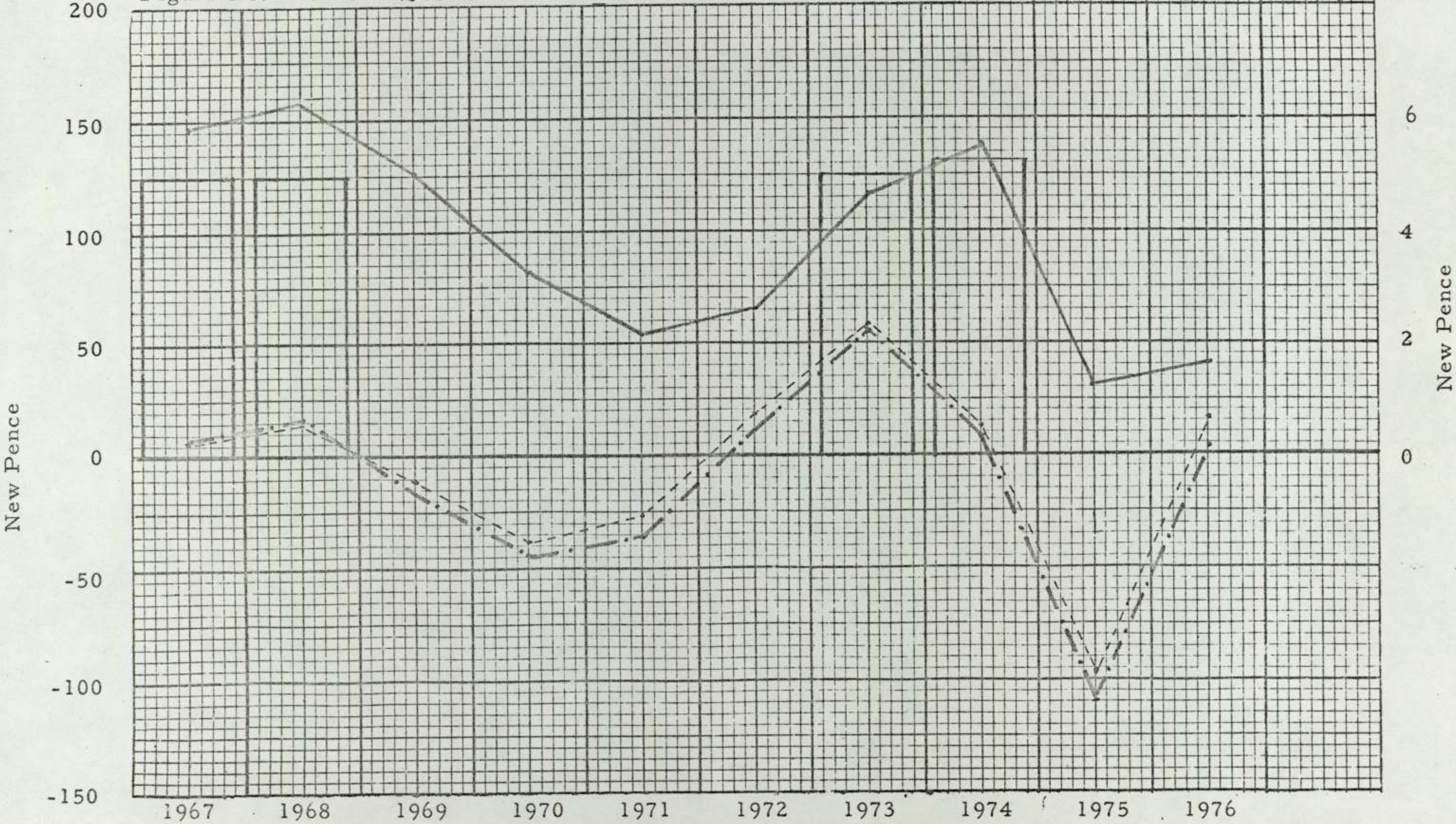
The salient features of R.C.S. Ltd. as an investment vehicle for risk capital may be seen in Table No. 11.4. To facilitate closer analysis of the different fortunes of the group over the ten year period 1967 to 1976, the data are exhibited in the following figures Nos. 11.10 to 11.13 inclusive.

7.1 Net Assets - Earnings - Cash Flow - Dividends

Figure No. 11.10 illustrates the relationships between the above factors and, since the comparison is internal, the data are plotted on linear scales.

A prospective purchaser would not be inspired by the general

Figure No. 11. 10. EQUITY ASSETS - EARNINGS - CASH FLOW - DIVIDENDS. Robb Caledon Shipbuilders Ltd.



Earnings per Share: — · — Net Asset Value per Share: —— Net Cash Flow per Share: - - - - - (LH Scale)

Gross Dividends Paid: ▭ (Right-hand Scale)

Source: Table No. 11. 4.

picture shown in Figure 11.10, and a prospective vendor would have considerable difficulty in presenting the company in a favourable light on the bases of such an execrable record of performance.

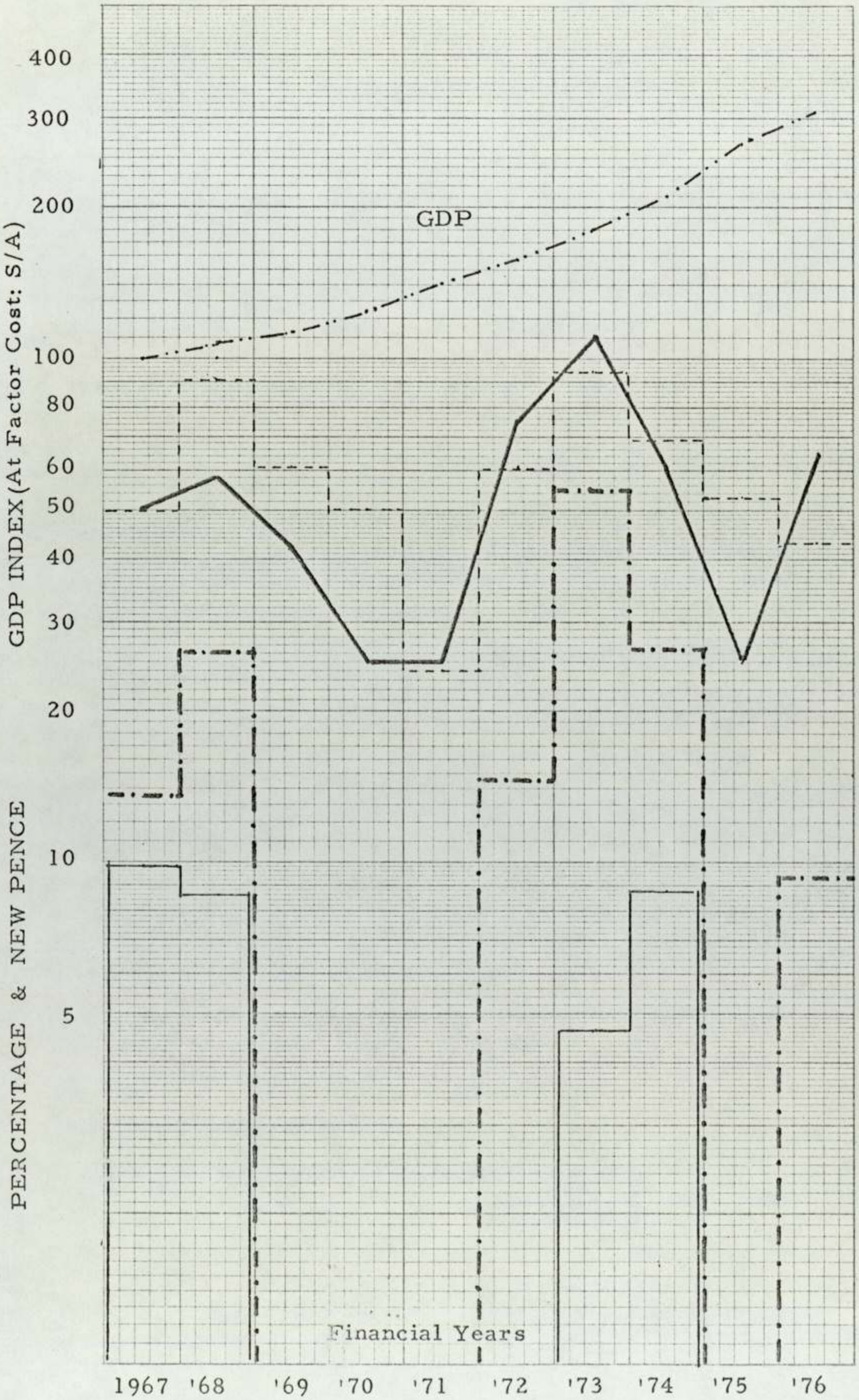
Earnings per share are seen to have been positive in only six of the ten years and only marginally so in the last year. Net cash flow per share is seen to follow the E.P.S. very closely, reflecting the adverse trading record amply illustrated in the income analysis (Section 4).

The general trend of the graph of net asset value per share is inexorably downwards notwithstanding the excellent results in 1973 and 1974. The net asset value peak of 157.6 pence per ordinary share in 1968 is seen to have fallen to its nadir in 1975 at 31.2 pence, thus reflecting the cumulative effects of successive losses as well as the disastrous trading outcome of 1975. As will be shown by the later analysis of the final operational stage of R.C.S.Ltd., the final outcome was as suggested by the trend, notwithstanding the marginal improvement in 1976. In the final outcome, the recovery to 116.5p (1973) and 137.7p (1974) will be shown to have been extremely fortunate for the shareholders.

Distribution policy, based on meagre aggregate income, is illustrated by the payment record to ordinary shareholders: the position illustrated in Figure 11.10 needs no further comment in view of the earlier analyses.

Figure No. 11. 11

EARNINGS & DIVIDEND YIELDS. Robb Caledon Shipbuilders Ltd.



Earnings Yield: —·—· Percentage
Dividend Yield: —— Percentage
Datum Share Price(np): ▬▬
Mean Share Price(np): - - - -
GDP(1967 base): —··—··— (Factor cost;S/A)

Sources: Table No. 11. 4
Economic Trends, 1977

7.2 Earnings and Dividends Yields

In order to facilitate comparison with external reference standards and relative rates of change, Figure No. 11.11 has been plotted on a logarithmic scale.

Earnings and dividend yields have been based on the datum share price as indicated in Table No. 11.4, and the datum share price is compared with the mean share price over the ten year period. Inspection of the relationships shown between the two (Figure 11.11) indicates that the datum basis was not over-optimistic: it virtually equates with the mean in three years, understates the mean in four years and overstates the mean in three years. As noted in Table 11.4, the mean is unweighted.

The graph of the datum (and mean) share price typifies the operating results of R.C.S.Ltd., as indicated in the foregoing analysis, illustrating the relative improvements and declines in the company's fortunes. To afford a broad indication of external trends over the ten year period, the Gross Domestic Product at constant factor cost, seasonally adjusted, is shown on a 1967 base. It may be seen that the increase on this basis was of the order of about 200% or a three-fold expansion.

Cursory inspection of the graph (figure 11.11) indicates that the share price indicators and both the earnings and dividend yields have failed to maintain expected growth in terms of the G.D.P. parameter. However, this comparison is limited since it does not compare R.C.S. Ltd. with other similar business in these respects. Such a comparison is made later in Figure No. 11.13.

Figure No. 11.11 illustrates the behaviour of the R.C.S.Ltd. earnings and dividend yields over the ten year period. Since earnings were negative in the years 1969, 1970, 1971 and 1975 and dividends were paid only in the four years shown in Table No. 11.4 and Figure 11.11, the data relate only to the appropriate financial years.

Earnings yields are seen to have fluctuated between a minimum of 9.3% in 1976 and a maximum of 54.5% in 1973. The relationship between the earnings yields and the dividends yields reflects both the relative discrepancies in absolute earnings and the effects of stock market opinion about the company and its prospects at different times over the period studied. Indicators of both kinds of yield illustrate the stock market's synchronous response to corporate performance and confirm the results adduced in the internal analysis of R.C.S. Ltd.

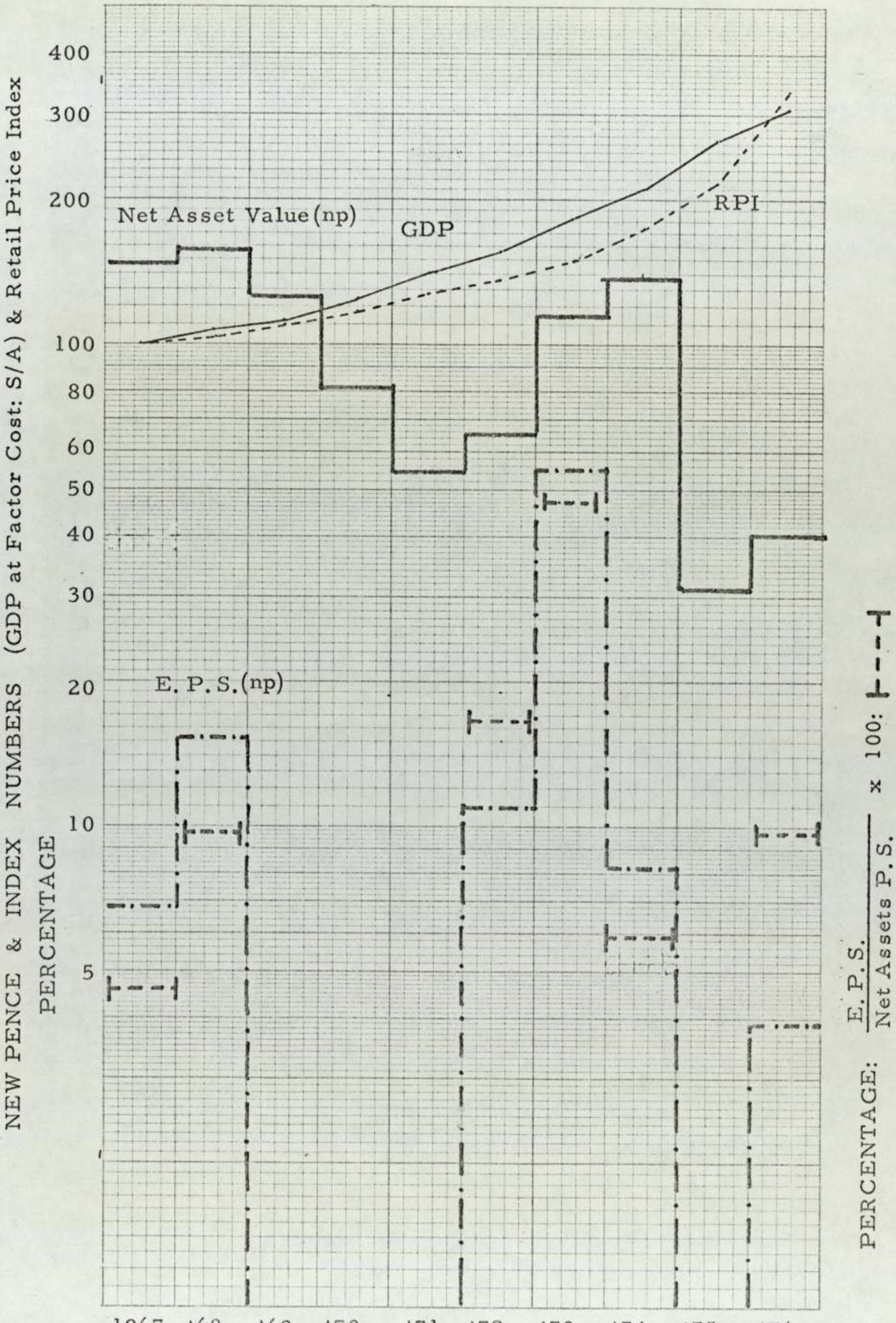
Dividend yields, when applicable, are seen to have varied between a maximum of 9.8% in 1967 and a minimum of 4.6% in 1973. In view of the fragmentary nature of the company's return to shareholders and its abysmal record of earnings, the data provide an insubstantial basis for meaningful projections, in terms of future corporate worth, from the viewpoint of a prospective purchaser.

7.3 Net Asset Value & Earnings per Ordinary Share

Figure No. 11.12 continues the illustration of data contained in Table No. 11.4, namely, that of net asset value per share and earnings per share in comparison with each other and with the deflators of G.D.P. and the general Retail Price Index (R.P.I.), both at constant 1967 prices. An extension of analytical data comprises an indication of the relative qualities of asset values

Figure No. 11.12

NET ASSET VALUE & EARNINGS PER SHARE. Robb Caledon



Net Asset Value per Share: ——— Net Earnings per Share: —·—·
GDP Index: ——— RPI (1967 Base): - - - - -
(1967 Base)

Sources: Table No. 11.4.
Economic Trends, 1977
CSO Statistics

and their earning powers by the relationship

$$\frac{\text{E.P.S.}}{\text{Net Assets per share}} \times 100$$ shown in Figure No. 11.12.

The data are exhibited on a log scale again to facilitate comparison. Net asset value per share is seen steadily to depreciate over the period with the exception of the favourable years 1973 and 1974. It is noticeable that the N.A.V. trend is, in general, counter-cyclical to that of the deflators.

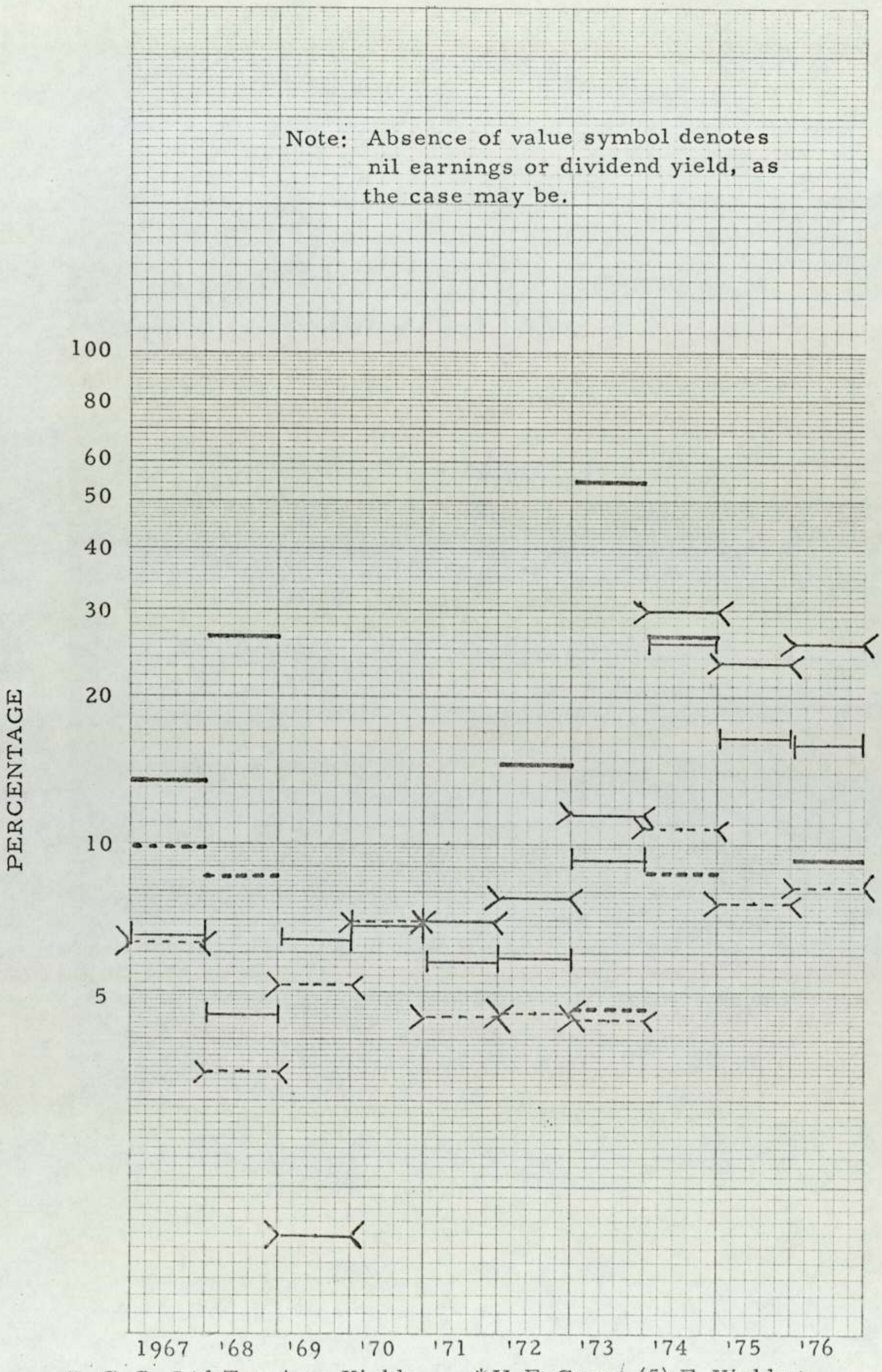
Internal reasons for the decline have been illustrated in the foregoing analysis and are amply substantiated by the behaviour of the E.P.S. (earnings per share) histogram in Figure 11.12. It is clear that the net asset value per share has been steadily eroded, despite the boost given by the favourable trading in 1973, and the incubus of poor profitability had resulted in a value less than the E.P.S. in 1973 in the final two years of this data.

Examination of the quality of earnings from assets indicators in the years of positive earnings shows that a maximum of about 47% in 1973 compares with just over 5.9% in 1974, thus emphasising the volatility of the company's record in these respects. Absolute extremes of the range are seen to be 4.6% in 1967 and the 47% recorded in 1973. An interesting comparison may be made between the years 1968 and 1976, when the percentage of E.P.S. is seen to be similar at about 9.7% despite the large disparity in net asset values per share.

Figure No. 11.12 confirms the earlier findings and relates the decline to external comparators which indicate that the generally gloomy prognosis suggested by the company's track record is indeed justifiable.

Figure No. 11.13

COMPARATIVE YIELDS. Robb Caledon Shipbuilders Ltd.



R. C. S. Ltd Earnings Yield: ——— * H. E. Group (5) E. Yields: >——<

R. C. S. Ltd Dividend Yield: - - - - * H. E. Group(5) D. Yields: >- - - -<

* '500' Group (59) E. Yields: |——|

Sources: Table 11.4
Extel Statistics. Fin. Times.

7.4 Comparative Yields

Two series of external yields are exhibited in Figure No. 11.13 to facilitate comparison of R.C.S.Ltd.'s earnings and dividend yields. A logarithmic scale is used again to enable direct appraisal of the differing components to be made more readily.

Both of the series are derived from the F.T. - Actuaries Share Indices. They comprise dividend and earnings yields of

(a) Engineering Contractors (Group 5) Section, which contains thirteen marine and heavy engineering companies with a comparable output to that of Robb Caledon Shipbuilders Ltd. and,

(b) Group 59 (earnings yields), which comprises 500 industrial companies, including a broader mix of trading activities.

Because of the relative complexity of the contents of Figure 11.13, it is advisable to cover the analysis on a year by year basis. Inspection of R.C.S.Ltd's earnings yield indicates a more favourable situation in 1967 and 1968 than for Group 5, whose aggregate results produced a nil return; and the earnings yield (1967) compares favourably with the '500' Group at 13.4% to 6.5%. The dividend yield (DY) for R.C.S. Ltd. in 1967 was 9.8% compared with 6.3% for Group 5, and 8.6% compared with Group 5's 3.45% in 1968. R.C.S. Ltd.'s earnings yield (EY) was almost three times that of the '500' Group in 1968, whilst its dividend yield (DY) was more than twice that of Group 5.

A less favourable picture emerges in the following three years, 1969 to 1971, when the EY and DY of R.C.S.Ltd. were nil against the following results for Group 5:

YIELD	1969	1970	1971
Earnings	1.58%	-	6.97%
Dividend	5.17%	6.97%	4.41%
'500' Group Earnings	6.37%	6.79%	5.77%

In 1972, R.C.S.Ltd. did not declare a dividend although the earnings yield was 14.6%. This compares with an EY of 7.79% for Group 5 and of 5.86% for the '500' Group. Group 5's DY was 4.52% in that year.

1973 was R.C.S.Ltd.'s most favourable year for earnings yield, as clearly indicated in Figure 11.13. It is seen to be more than four times the reference EY's of both the Group 5 and the '500' Group; albeit that the DY of R.C.S.Ltd. was only about the same as the former Group. In 1974, the DY of R.C.S. Ltd. is seen to be about a couple of points below that of Group 5 and its EY, at 26.3% is somewhat below Group 5 (29.96%) and about the same as the '500' Group.

As indicated previously, 1975 was a disastrous year for R.C.S. Ltd. and nil EY and DY were returned. The final year compared (1976), shows that the model company's DY was nil and the EY was 9.3%. This compared with a DY of 8.17% and an EY of 25.75% for Group 5 and an EY of 16.05% for the '500' Group.

These investigations clearly indicate that in the years of positive earnings, the EY of R.C.S. Ltd. bore favourable comparison, in general, with those of the peer group (Group 5) and of the '500' Group. The record of the company's DY, such as it is, indicates an above average performance in 1967 and 1968 but a less favourable achievement in the later years when dividends were paid (dividend cover was dealt with in Section 4).

It is plain that the instability of R.C.S.Ltd.'s trading results, its serious losses and inherent unpredictability are such as to render any deterministic valuation speculative on the basis of such evidence as has been adduced in the foregoing analysis (Sections 3 to 7 inclusive).

Before comparing these derived results with the State valuation, it is necessary to deal with the final fifteen months operation of R.C.S.Ltd. as a private sector company. This analysis is carried out in Section 8, following, and the relevant data indicates that the problems of the business were accentuated in the final stage of its operation prior to nationalisation on the 1st July, 1977.

TABLE 11:5. FINAL CORPORATE RESULTS : 15 MONTHS TO 30th JUNE, 1977

ROBB CALEDON SHIPBUILDERS LTD.

1. Turnover : £19,454,000*

2. Loss (pre-tax) : £787,000* (post-tax) : £708,000*

3. Ordinary Shares in Issue (50p) : 1,373,600 (£ 686,800).

4. 10% Cum. Redeemable Preference Shares (£1) : £375,000.

5. Equity Net Assets : Nil.

6. Equity Earnings : LOSS £681,000*.

7. Earnings per Ordinary Share : LOSS 49.6p.

8. Net Asset Value per Share : Nil.

9. Share Prices (to 20th June, 1977) : High:- 96.5p. Low:- 32p.

10. Net Cash Flow per Share : Minus 31.3p.

11. Deficit on Ordinary and Preference Capital: £112,000 *

12. Earnings Yield : Nil.

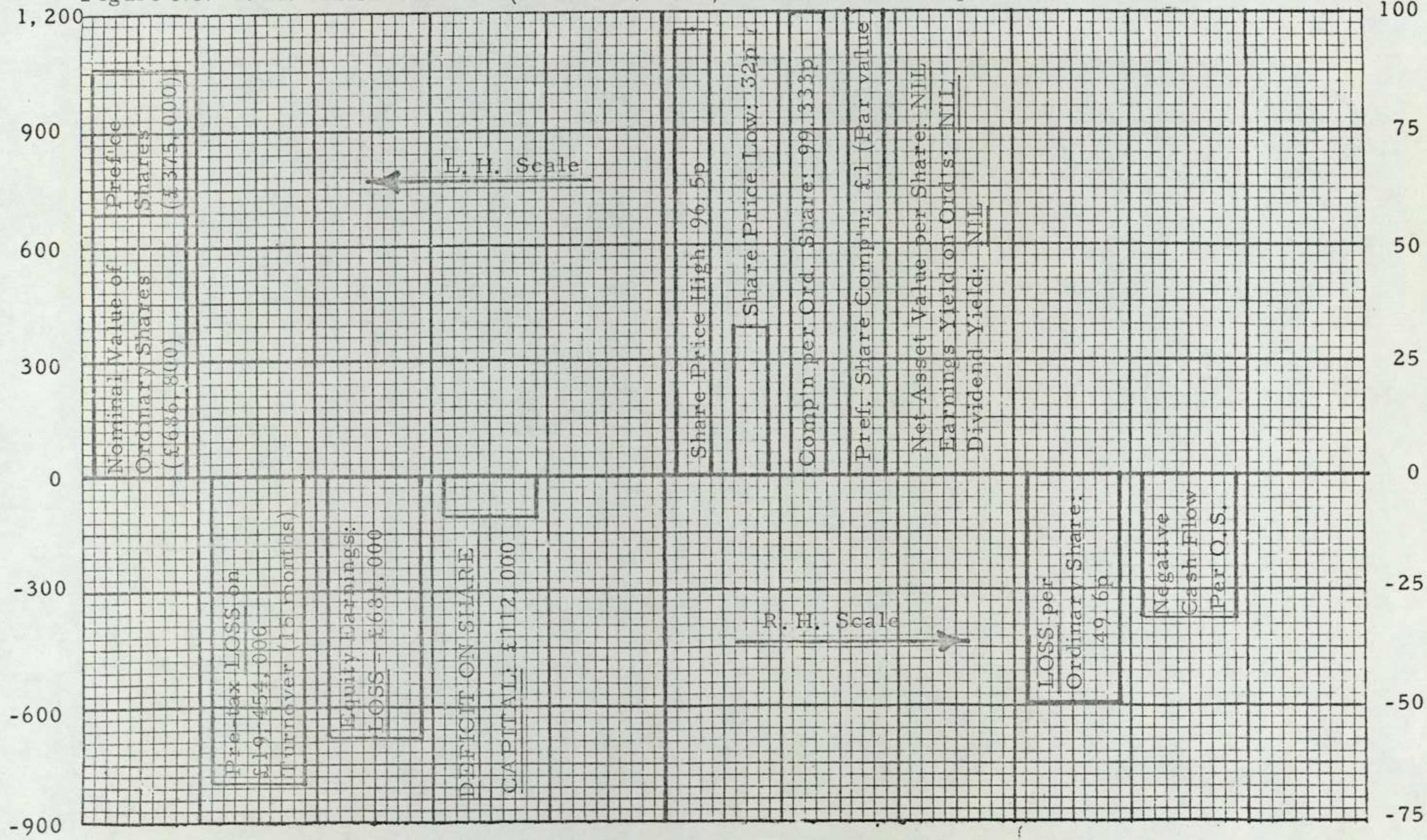
13. Dividend Yield : Nil.

Notes: On the 1st July, 1977, the company became a wholly owned subsidiary of British Shipbuilders under the terms of the Aircraft and Shipbuilding Industries Act, 1977.

* Rounded figures.

Sources: R.C.S. Ltd.
Financial Times.

Figure No. 11.14. EXIT VALUES (30th June, 1977): Robb Caledon Shipbuilders Ltd.



Note: Final results are based on 15 months' operations.

Sources: Table No. 11.5.
R.C.S. Ltd.

8. Analysis of Final Corporate Results : Robb Caledon Shipbuilders Ltd.

The derived data concerning the final fifteen months' operation of R.C.S.Ltd. as a private sector company, prior to its acquisition by the public sector, are exhibited in Table No. 11.5 and illustrated in Figure 11.14.

Since the objects of the analyses have been to derive a valuation of the company and, in so doing, to demonstrate the methodologies of valuation at an 'empirical' level, the data relating to the final period has been designed to concentrate on these aspects.

Table No. 11.5 contains thirteen observed and/or derived results germane to the corporate valuation of R.C.S. Ltd. and it is proposed to discuss these in their appropriate relationships to the foregoing analyses in Sections 3 to 7 inclusive. To facilitate consideration of these results, the government's valuation of the equity of the company is displayed in Figure No. 11.14, together with the data from Table No. 11.5. Further investigation of comparative valuations is carried out in Section 9, following.

The turnover of £19,454,000 for the fifteen months is seen to fall below that of 1976 at an annualised rate (£15,563,000 as against £16,719,000 in 1976), a decrease of about 7%. In view of the nature of the output and lack of information about relative volume/velocity over this period, no useful conclusion can be drawn about this aspect.

Item 2 in Table No. 11.5, shows that a pre-tax loss of £787,000 and a post-tax loss of £708,000 occurred, giving an annualised loss (pre-tax) of £629,600 and (post-tax) £566,400. The seriousness of this result cannot be stressed too highly and, following the operational record up to 1976, is nothing short of disastrous in the absence of special factors. For instance, since it has been shown that the output of R.C.S.Ltd. is principally high value investment products, the date of completion of major contracts, will necessarily affect the single financial year's results if revenue flows are back-logged.

This does not appear to apply in the present case since the consolidated adjusted Work-in-Progress amounts were £1,500,800 (1977 annualised rate) and £1,158,000 (1976), respectively. These figures are accompanied by a reduction from £1,080,000 (1976) to £213,600 (1977 annualised rate) for the current liability of instalments on contracts in excess of W.I.P. Also, since debtors fell to (actual) £1,439,000 - with a disputed amount (see Section 6) - from £2,958,000 in 1976 and creditors and provisions were (actual) similar at £2,282,000 (1977) against £2,267,000 (1976), the conclusion that the loss was substantive appears to be justified.

The crushing burden of interest at an annualised figure of £393,600 (1977), amounting to an interest charge per share of 28.7 pence, is a further indication of the company's desperate position when viewed in the light of a 1977 loss per share amounting to 49.6 pence (actual).

Item 5 in Table No. 11.5 indicates that equity net asset value was nil. In view of the facts adduced above and in the foregoing analyses, this was not an unexpected outcome. The disappearance of the ordinary capital of R.C.S.Ltd. means, of course, that the company was technically (and actually) insolvent when it was acquired by British Shipbuilders.

The significance of item 9 in Table No. 11.5 will be obvious in the light of the ordinary share compensation value, amounting to 99.333 pence per share, displayed in Figure 11.14. As shown in Table No. 11.5, item 9, the stock market price (low) was about 32 pence per ordinary share, no doubt reflecting the market's justifiable rating of the company as a dubious 'going' concern, compared with a 'high' of 96.5 pence; the latter rating reflecting the certainty of compensation less dealing costs.

Item ten in Table No. 11.5, showing the negative cash flow per share at 31.3 pence, is academic in view of the overall results of R.C.S. Ltd.'s final operational period before nationalisation. And the deficit on Ordinary and Preference Share Capital of £112,000 (item 11) concludes the analysis of these salient features in Table 11.5 and Figure No. 11.14. respectively.

Finally, to put the R.C.S.Ltd. analysis into perspective, with particular reference to circumstances attending the final transition from private to public ownership, the following additional points are not irrelevant.

As mentioned earlier, the £2,500,000 subordinated loan from Lazard Bros. & Co. Ltd. was duly repaid on the 2nd September, 1977, subsequent to nationalisation on 1st July, 1977. The associated £375,000 of 10% Cumulative Redeemable Preference Shares subscribed for by Lazards out of the total of 500,000 was due for redemption under the terms of the agreement (assets vested in the Crown) described earlier in this chapter. Since insufficient funds existed to enable this to be done, the Preference shares were acquired by British Shipbuilders and later (perhaps ironically) by the Post Office.

A total of 42,300 Ordinary Shares (50p) comprised the capital interests of the ten directors, with an additional 4,750 shares held as trustee. The majority were of minor amounts other than two holdings of 20,300 and 18,700, respectively. R.C.S.Ltd. was not a close company.

A provision of £576,000 in respect of total losses to completion of existing contracts at the 30th June, 1977 remained of the earlier years' provisions, as discussed in Section 6. Available tax losses for carry forward amounted to £4,335,000 of which £1,524,000 had been created by relief for appreciation in stocks and work in progress.

The loss of 49.6 pence per ordinary share was calculated on the net loss attributed to the Group of £681,000. Net fixed assets were £1,924,000 at book value, plus £17,000 representing the proportion of an associate company (B.E.F. Ltd.). Net current assets (including the disputed amount of £277,000 (net) amounted to £1,736,000. Deferred liabilities of (tax) £152,000; (secured loans) £508,000; (subordinated loan) £2,500,000; (Government grants) £351,000; and a minority interest of £260,000, were the remaining salient balance sheet features. The overall deficit was about £166,000, not including the minority interest.

This latter figure is merely academic since the assets valuations were on a going concern basis. Had the company gone into compulsory liquidation, the value of net fixed assets and net residual assets would doubtless have been negligible in the absence of a willing buyer. A side light on operational liquidity is given by the existence of cash and near cash available amounting to £592,000 at the 30th June, 1977. The loans (secured) position, so far as debt maturity was concerned, was detailed in Section 5.

Contingent liabilities of R.C.S.Ltd. at the 30th June, 1977 comprised undertakings in respect of availability of working capital for the execution of contracts undertaken by a subsidiary; the counter-claim of £459,000 in connection with work included in group debtors in the consolidated accounts, and guaranteed repayment of up to £154,000 out of a loan made to Burntisland Engineers & Fabricators Ltd. (B.E.F.Ltd.)

To end this analytical study of Robb Caledon Shipbuilders Ltd. it is not inappropriate to refer again to the heavily qualified 1976 auditors' report detailed in Section 3, (28) earlier in this chapter.

From a corporate valuation standpoint, the value of Robb Caledon Shipbuilders Ltd.'s assets, whether in terms of book, intrinsic or economic worth, depended heavily on their continued use on a going concern basis. The auditors had repeatedly made this point in issuing their reports. For a company to remain a going concern, it is necessary that a market should exist for its output, that it should be competitive, that there should be a sufficiency of orders and a willingness of potential customers to place orders. Given these requirements and the evidence adduced in the foregoing studies, it is extremely doubtful that R.C.S. Ltd. had any prospect of a future as a going concern.

Its survival is, at present, a matter of record, and entry into the public sector has transformed the indispensable conditions and criteria of performance from the financially-orientated ones of the private sector into the social accountabilities and political sensitivities of central government; albeit that the corporate status of British Shipbuilders as an intermediary may have the effect of increasing the economic desiderata.

The following Section (9) is devoted to study of the valuation criteria relating to R.C.S. Ltd. in terms of the governments' compensation settlement and to conclusions in this respect, with particular reference to the valuation analysis in the foregoing Sections (3 to 8 inclusive).

9. Valuation Comparisons and Conclusions

The State's valuation methodology has been detailed in the Aircraft and Shipbuilding Industries Act, 1977, and was dealt with in this thesis (Chapter 9, S.14 and Ref. Ch.9, (33 to 41, inclusive). For listed companies such as Robb Caledon Shipbuilders Ltd., the relevant basis is the mean value of the quotations, in the Stock Exchange Daily Official List of Officially Quoted Securities, observed on specified days in a period beginning on the 1st September, 1973 and ending on the 28th February, 1974. Relevant days are defined as every Wednesday in the six months' period with the exception of the 26th December, 1973, but including Thursday, 27th December (a Stock Exchange working day), 1973 in its stead. In view of the foregoing analysis of R.C.S. Ltd., these dates will be seen to have had a special significance in the company's valuation.

In accordance with the government's formula, the compensatory terms for settlement in Robb Caledon Shipbuilders Ltd.'s case were formally announced by Mr. Gerald Kaufman, Minister for Industry, on the 24th June, 1977.[5]

Table No. 11.6

COMPENSATION TERMS : ROBB CALEDON SHIPBUILDERS LTD.

(a) Ordinary Shares

Price to be paid per Ordinary Share : 99.333 pence

Total number of Ordinary Shares : 1,373,600

Total compensation value : £1,364,438.

(b) Preference Shares (10% Cum. Redeemable)

Compensation at par value (£1) : £1 per Share

No. of 10% Cumulative Redeemable Shares : 375,000

Total compensation value : £375,000

Table No. 11.7 COMPENSATORY VALUATION AND NET ASSET AND STOCK MARKET VALUATIONS

VALUATION (pence)	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977
1. Net Asset Value per Ordinary Share (Table 11.4)	147.2	157.6	125.8	81.8	54.2	65.2	116.5	137.7	31.2	40.4	Nil
2. Mean Share Price (Table 11.4)	50	91	61	50	24	61	94	69	53	43	64.25
3. Datum Share Price (Table 11.4)	51	58	44	25	25	75	110	60	25	65	-
4. Compensatory valuation (Chapters 9, S.14 and Chapter 11, S.9)							99.333				

(All values in new pence)

Sources : Table 11.4
Chapter 11, S.9

(c) Forms of compensation

$9\frac{3}{4}\%$ Treasury Stock, 1981; issued at a rate of £100 of Treasury Stock per £$98\frac{1}{4}$ compensation value.

Stock issued in settlement to holders of Ordinary and Preference Shares on 1st July, 1977.

NB. The issue at a premium was in observance of the governments' undertaking to issue such compensatory Stock at Market rates at time of issue.

In order to compare these compensatory valuations with those derived in the analysis, it is only necessary to consider the equity since the 10% Cumulative Preference Shares were issued and compensated at par in a relatively short period of time.

An initial comparison may be made by considering (a) net asset value per share and (b) datum and mean share prices over the ten year period in general, and specifically at the time of the application of the averaging formula used by the government. To facilitate such a comparison, the relevant data are displayed in Table No. 11.7.

9.1 Net Asset Valuation : Book Worth

In comparing the book worth of Robb Caledon Shipbuilders Ltd. with the compensation value of 99.333 pence per share in the numerically precise matrix of the tabulated data in Table No. 11.7, it is hardly necessary to repeat the caveats made evident during the foregoing analysis of the company.

The model has shown, par excellence, the importance of adequate interpretation of non-quantitative factors, as stressed emphatically by the professional corporate valuers whose philosophies were discussed in Chapter 8. Comparison of R.C.S. Ltd.'s net asset value per share was shown (Table No. 11.4, Figure No. 11.12) to have declined in real terms and the numerical data in Table No. 11.7 need to be interpretively qualified by the numerous adverse considerations identified in Sections 3 to 8 inclusive.

Considering, first, the net asset values per share of 1973 and 1974, 116.5p. and 137.7p, respectively, a straight average of the two to give a mean located at September, 1973, gives a value of 127 pence, a value about 27% higher than the compensation value. As indicated above, September, 1973 was the commencement of the State datum valuation period.

A similar exercise using 1973 (116.5p), 1974 (137.7p) and 1975 (31.2p) to give a mean located at March, 1974 (the end of the stock market datum valuation period) gives a further value of about 95 pence, lower than the compensation value by about 5%.

If the two means are averaged to give a notional location of valuation at the middle of the datum period selected by the Government, a value of 111 pence is derived, a valuation about 12% higher than the settlement value. A professional corporate valuer would not, of course, be overly concerned with historic net asset values except as an indicator of trends. The question of discounting backwards and forwards to derive a notional net present value would doubtless be rejected in view of the volatility of the underlying components. Fortunately, 'goodwill' is not a factor in the case of R.C.S. Ltd.

As is well known, the net assets of heavy engineering and shipbuilding/shiprepairing companies are normally at a premium (sometimes considerable) above their stock market rating due to the cyclical nature of the businesses and the relatively low and highly volatile earnings/dividend records (see Figure No. 11.13).

In view of the known record of R.C.S.Ltd. in these respects, vide the foregoing analyses, and ignoring the known outcome of operations between 1975 and 1977, the writer's conclusion is that the Government's valuation was higher than that which is merited by the underlying assets. A professional valuer, assessing R.C.S.Ltd. in 1974 as a prospective acquisition would have had the evidence of net asset values of 1970-71-72 to put the 1974 value in perspective: in 1977, he would not have selected 1974 values.

Taking a straight average of the unweighted mean stock market prices of R.C.S.Ltd.'s equity in 1973 and 1974 (94p and 69p) gives a value of 81.5 pence. A similar exercise with the corresponding datum share price (item 3), 110p and 60p. returns a value of 85 pence. In view of the lack of weighting, these values are less relevant. However, they indicate that the market's view of R.C.S.Ltd.'s net asset value was not optimistic or necessarily the most appropriate basis of valuation.

Neglecting all other known adverse factors, it is a fact that the auditors' qualifications of the company's annual reports, such as the provisions for continuing use of the assets on a going concern basis (Section 3), and the relatively meagre total capital expenditure on the assets (Sections 4.4 and 5.2) suggest that a corporate valuation of R.C.S.Ltd. on net asset value or book worth basis is not a prudent method in the circumstances.

Valuation on the basis of the stock market prices is seen to be unsatisfactory in the case of a company such as R.C.S. Ltd., especially in view of the transience and relative volatility of the market's response to what prove in retrospect to have been very short term improvements. Before considering the remaining important arbiter of corporate worth, that of earning power, it seems not unreasonable to conclude, tentatively at this stage, that the shareholders of R.C.S.Ltd. appear to have been fortunate that the valuation datum period was fixed at the period when the company's fortunes were at an apogee rather than a nadir.

This comparative valuation exercise, in the context of the detailed analysis of Robb Caledon Shipbuilders Ltd., amply demonstrates that intrinsic worth of corporate assets cannot be determined solely on the basis of quantification or purely numerical analysis. The empiricism of 'experiment' may be appropriate in terms of the researcher's approach to the treatment of numerically defined factors, but, as indicated in Chapters 8, 9 and 10 and the discussion above, the empiricism of experience is no less important in the rational interpretation of qualitative influences.

In the summary of valuation methods contained in Appendix A, that of net asset value is qualified by caveats relating, in particular, to the economic worth of corporate assets, i.e. their power to earn an adequate return on investment. Profitability is the attribute to be measured and compared in this respect and the following sub-section (9.2) contains the discussions and conclusions relating to this aspect.

9.2 Earnings Basis Valuation : Economic Worth

Figure No. 11.3 shows that the mean return on investment of capital employed in Robb Caledon Shipbuilders Ltd., over the ten year period 1967 to 1976, was negative at about minus 5%. Table No. 11.5 and Figure 11.14 show that the company was worthless at the 30th June, 1977.

In such a context, any discussion of corporate valuation in terms of earning power and returns on investment as measured by yields becomes ludicrously academic. However, the customs and usage of academic empirism require that the integrity of investigation and analysis be made axiomatic by adequate application and the formulation of conclusions.

The foregoing analysis of income (Section 4) and corporate returns (Sections 7 and 8) contains both the structural information and detailed conclusive data to support a thesis that any price paid for this company by any purchaser would be unrealistic if based on a putative earning power related to the present composition, circumstances and uses of its corporate assets.

To facilitate consideration of the chief indicators of economic worth, Table No. 11.8 has been constructed to bring together the salient features of the foregoing analyses. Professional corporate valuers face certain difficulties in appraising earning power of corporate assets due to the fiscal complexities of differing tax rates (i.e. corporation tax at 52% and dividend tax credits and Advance Corporation Tax at 33%, for example).

Also, the current methods of taxation introduce problems of comparing earnings and yields bases owing to the effects of varying distribution of disposable surpluses, and the 'imputation' system. The treatment of earnings and dividends needs to be based on a constant approach to preserve reasonable comparability of yields over the longer term. The data presented in the foregoing analysis were calculated on such a basis and the addition of a straight gross earnings (pre-tax) comparison in Table No. 11.8 has been included to facilitate comparability. Use of the deflators (G.D.P. and R.P.I.) in figures 11.11/12 may be made to put

Table No. 11.8

COMPENSATORY VALUATION AND EARNINGS BASES OF VALUATION

Item	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977
1. Earnings per Share (pre-tax)(a) *	8.0	16.8	M17.3	M44.9	M36.7	10.9	65.5	13.2	M114.1	16.7	M43.8
2. Earnings per Share (post-tax)* (a)(b)	6.8	15.3	M17.3	M44.9	M36.7	10.9	54.8	8.2	M109.6	3.9	M49.6
3. Share Price * (c)	51	58	44	25	25	75	110	60	25	65	64(d)
4. Earnings Yield % (A) (pre-tax basis)	15.7	29.1	-	-	-	14.5	59.5	22.0	-	25.7	-
5. Earnings Yield % (B) (post-tax basis)	13.3	26.4	-	-	-	14.5	49.8	13.7	-	6.0	-
6. Price/Earnings Ratio: (3)/(2)	7.5	3.8	-	-	-	6.9	2.0	7.3	-	16.7	-
7. Dividend Yield %	9.8	8.6	-	-	-	-	4.6	8.75	-	-	-
8. Dividend Cover	1.36	3.06	-	-	-	-	10.96	1.56	-	-	-
9. Net Cash Flow per Share * (a)	6.36	14.50	M11.8	M38.15	M27.96	18.05	57.7	12.45	M96.68	16.09	M31.3

* New Pence.

Notes: (a) M = Minus
(b) Including tax adjustments
(c) ex Table No. 11.4/5 and Figure 11.11
(d) Unweighted Mean

Sources: Tables No. 11.1, 11.1(a), 11.4, 11.5
Company Reports.

inflationary influences into perspective.

Dividend yields and cover are included in Table No. 11.8 for the sake of completeness of information but the data are limited so far as realistic corporate valuation is concerned. However, the record of yields and cover does put other factors into perspective.

Table No. 11.8 brings together the data necessary to appraise the earning power of the corporate assets of R.C.S.Ltd. in the context of the analyses in Sections 3 to 8 inclusive. Item 1 shows the straight pre-tax earnings attributable to the ordinary shareholders over the eleven year period 1967 to 1977. Cursory inspection indicates positive earnings in only six years and losses of varying magnitudes in the remaining five years.

Item 2 comprises the post-tax earnings on a nil distribution basis and the record is seen to follow that of Item 1. The decrease in pre-tax earnings compared with post-tax in 1977 is accounted for by tax credits in that year. Item 3 is the datum share prices used in all of the yields calculations, whilst the earnings yields (A) and (B) are the percentages of earnings to market prices.

The effective exit price/earnings ratio is calculated as shown and the results are exhibited under item 6. This P/E exit ratio is, of course, merely the derived ratio based on R.C.S.Ltd.'s normal operating performances. In practice, the exit P/E ratio would be generated by stock market dealing pressures and, for successful companies, would invariably be higher than the performance level at normal operation, thus reflecting the premium for transfer of control in addition to ownership (as demonstrated in the analysis of corporate takeovers detailed in Chapter 8). Such a premium would depend, for its magnitude, not only on the desirability of the company as a generator of earnings but also on whether or not competitive bidding by prospective purchasers of control developed, and the views taken by takeover bidders as to the prospective end uses to which different classes of assets may be assigned.

Table No. 11.8 also contains the values of net cash flow per share to facilitate comparison of trends and the retentions and provisions for depreciation over this period. The paucity of capital expenditure on fixed assets has received attention in the relevant parts of the general analysis (Sub-section 4.4 and Section 5).

Turning to the notional valuation of R.C.S.Ltd. on an earnings basis, a projection of future pre-tax earnings would normally be made on the basis of historic generation of earnings suitably adjusted for special circumstances and related modifying factors. Since the record in Table No. 11.8 gives a mean of minus 12.57 pence per share, this does not represent a fruitful approach for the present purpose.

Taking a hypothetical case with positive earnings, a future (projected) stream of earnings would be suitably discounted (see Appendix A) to give a net present value. The number of years taken at a given value would depend on the degree of risk present and the desired capitalisation rate would reflect the latter factor.

As a demonstration of a typical earnings basis valuation, the mean of 1973 and 1974 amounting to £540,500 per annum may be taken to represent expected earnings flows over the foreseeable future. A return of 25% (four years capitalisation of earnings) would represent a derived value of £2,162,000 for the company (£540,500/0.25 or £540,500 x 4).

Comparing this with the notional capitalisation rate, the government's settlement with the holders of R.C.S.Ltd.'s equity amounted to a total of £1,364,438 (Table No. 11.6). This gives a capitalisation rate (on the above earnings assumptions) of:-

$$\frac{£540,500}{£1,364,438} = 39.6\% \text{ or } 2.52 \text{ times earnings.}$$

Taking into account only the woeful performance prior to 1973/74, this high capitalisation rate of about 40% would be too low in practice.

Using the mean NET ASSET VALUE PER SHARE of 111 pence, nominally located at the centre of the State's valuation datum period (the figure derived in Sub-section 9.1) a notional asset value of £1,524,696 may be calculated. This, as noted previously, is seen to have exceeded the compensation settlement by about 12%. At a (justified) capitalisation rate of 39.6%, this excess would be recovered in about four months of earnings generation (ignoring tax and distributions).

As stated previously, the earnings yields (A) and (B) in Table No. 11.8 provide an unsuitable and very meagre basis for effective corporate valuation on account of the inherent volatility of the positive percentages and the fragmentary nature of the earnings record. A straight average of the Earnings Yield (A) amounts to 15.1% over the eleven years, treating loss years as zero earnings. Because of the magnitude of the losses, this figure of 15.1% has very little significance. As a capitalisation rate indicator in a context of uniform positive earnings it would suggest that a price related to earnings would be recovered on the basis of reinvestment of earnings in about five years, assuming stability of performance at this level.

The final basis of corporate valuation to be discussed, in the context of the present model, is that of the Price/Earnings Ratio (P/E ratio). As detailed in Appendix A, the P/E ratio is a relatively recent arbiter of value and when initially developed for corporate value assessments it was merely a question of taking the reciprocal of the earnings (post-tax) yield. Use of the P/E ratio has become, however, obfuscated to a certain extent due to the fiscal effects of differing distribution policies.

However, this problem is less onerous if the P/E ratio relates to the corporate results of one company calculated on a uniform basis. The P/E ratios for R.C.S.Ltd. (Table No. 11.8) are seen to present similar difficulties to the earnings, yields and net cash flow bases, in that they are fragmentary, erratic and lack uniformity of relationship or trend.

Scrutiny of the values (Item 6) shows that the P/E ratios have a range of 2.0 to 16.7. The reality of the maximum value of 16.7 is inherent not in the measure of stock market regard for the corporate excellence of R.C.S.Ltd. as an investment (especially after the disastrous results of 1975) but in the declared basis of compensation and the listing of R.C.S.Ltd. in the Aircraft and Shipbuilding Industries Bill (1975). Therefore, this maximum value must be disregarded for the present (academic valuation) purpose.

The remaining five P/E values then have a range from 2.0 to 7.5, the latter figure relating to 1967, and a mean (over the five P/E values) of 5.5 and an overall mean (1967 to 1974) of 3.4.

These results may be interpreted as reflecting stock market assessment of the value of investment in R.C.S.Ltd. as a going concern. Since no bid for control of the company was made during this period, the P/E ratios cannot be regarded as exit values. However, the two values in 1973 and 1974 (entirely unrepresentative as they are) may be compared with the government's compensatory valuation, located at the virtual mean of these periods (since the market prices, as the numerators of the P/E ratios, related to the Septembers of 1973 and 1974).

Taking the mean of these two values of 2.0 and 7.3 gives 4.65. This value equates to a deemed capitalisation rate of 21.5%, which would doubtless be considered too low by a professional corporate valuer viewing the ante 1973/4 company record in retrospect in 1974. The single values equate to deemed capitalisation rates of 50% and 13.7%, respectively, and these compare with the (notional) rate of State valuation of 39.6% derived above.

The relatively pessimistic rate of 2 for the 1973 P/E ratio reflects, of course, both the inordinately high earnings (for R.C.S.Ltd.) and the stock market's poor opinion of them following the previous track record of earnings in 1969, 1970 and 1971. In view of the overall corporate results of R.C.S.Ltd., it is fruitless to speculate on a realistic value for a deemed exit P/E ratio, but the stock market's rating of 2 in 1973 probably represents reality at that point in time.

Tentative conclusions have been expressed at various stages of the analysis of Robb Caledon Shipbuilders Ltd. The above section of the analysis completes the task of demonstrating the practice of corporate valuation within the constraints and limitations detailed previously. It is obvious that such a valuation exercise depends greatly not only on the availability and sufficiency of quantitative data but also on professional interpretation of the many qualitative factors which affect corporate valuation for the purpose of transfer of both ownership and control.

The writer's personal conclusion is that the State paid far too high a price for Robb Caledon Shipbuilders Ltd. and that the taxpayer has suffered and will suffer financial losses as a result of this acquisition by the public sector. This is, of course, to ignore the balance sheet of social accountabilities and the communal benefits accruing from the enhanced security of thousands of families depending on this company for their livelihoods. Unfortunately, the short term sectional benefits may be seen, in retrospect, to have been to the longer term detriment of the community as a whole.

In Section 24, Chapter 10, the following thesis was advanced:-

> "The thesis is that stock market datum periods should be chosen, in concert with the private owners or their representatives, to reflect an equitable consensus of vendor and purchaser for particular undertakings in the light of their individual earnings and market records".

The analysis of the Robb Caledon acquisition has indicated that the Government's choice of datum period was singularly fortunate for the shareholders of R.C.S.Ltd. and very unfortunate for the taxpayer. In effect, the State has paid a premium for the benefit of control, in addition to ownership, although this deemed premium was a fortuitous result of the vagaries of valuation on the basis of arbitrary stock market criteria, as set out in the Aircraft and Shipbuilding Industries Act, 1977.

This brings to an end Part 2 of the thesis dealing with corporate valuation methodologies, with particular reference to public ownership and control. Before bringing the work to a final conclusion it seems appropriate to quote the views, on the acquisition of Robb Caledon Shipbuilders Ltd., of a highly qualified professional with personal knowledge of the transaction and the associated corporate circumstances. In view of the nature of these opinions, it is evident that absolute confidentiality must be maintained.

"It would not be appropriate to speculate on another valuation had the sale been a private one on a voluntary basis. In view of the current dearth of orders which, indeed, was obvious at the time of nationalisation, the valuation could well have been very different from the figure eventually agreed and, again, the basis of valuation would, I might suggest, have been dependent on the economic state of the industry at the time. But all things being equal would likely have been a combined approach on an earnings basis and a net asset value. This, I repeat, at this stage is pure speculation however.

Finally, my own personal observation on the share price averaging method which was used was a particularly fortunate one for Robb Caledon in the circumstances."

10. General Conclusion

This thesis was defined in Chapter 1 to be a study of contemporary influences on and the environment of directorial and senior management decision making in manufacturing industry, with particular emphasis on current structures of public ownership and control and the acquisition of private sector assets.

The gestation period of five years since the inception of this research has meant that novel instruments, policies and agencies of industrial change which were merely embryonic in 1974 have now evolved to become historic facts.

It is evident that factors such as Industrial Democracy, the National Enterprise Board, Corporate Information Disclosures, Planning Agreements and proposed and actual changes in legislation, affecting companies and the senior echelons of management, have wrought major changes in the ethos of private sector business policy.

These catalysts of managerial change are likely to have increasing rather than diminishing effects in the longer term, although any attempt to predict feasible outcomes is rendered speculative by the nature and direction of future political changes.

Business Policy itself is a relatively new field of formal study in terms of academic recognition. Its multi-disciplinary nature introduces research problems of identification, location, professional evaluation and, not least, quantification.

The parameters and variables within which specialist functional managers and professional practitioners operate in industry have been formulated, established and conventionalised. It is the function of Business Policy to achieve similar goals, albeit more qualitative and less well defined, for the corporate management echelons of industry.

APPENDIX A

INVESTMENT AND VALUATION

The following brief, descriptive treatment of investment and valuation methods is intended to complement discussion in the study areas and to provide necessary information about the subject. Detailed analytical and explanatory treatments may be found in the specialist works and text books referred to in the bibliography and elsewhere.

1. PAY-BACK METHOD

In this basic method, the invested capital sum is divided by the incremental net operating profit to determine the time required to recover the outlay: the shortest pay-back period being the criterion. The method was used, traditionally, on an undiscounted basis but net returns and the outlays may be discounted to give present values.

Among the disadvantages of the pay-back method are non-recognition of timing of cash flows, potential returns after the 'cut-off' point and the phasing of investment allowances and grants (if any).

2. RATE OF RETURN

A well-established method in which the annual net earnings increase arising from the investment is calculated and expressed as a percentage of the capital outlay, thus giving the rate of return. Variants involve the use of initial or average capital costs, post or pre-tax earnings and straight-line or diminishing balance depreciation. The method is also known as the Book Rate of Return and the Average Annual Rate of Return.

Obvious disadvantages are failure to take account of timing of returns and outlays, the arbitrariness of depreciation apportionments, the incidence of taxation (accrual or liabilities) and the effects of marginality.

3. DISCOUNTED CASH FLOW (DCF): NET PRESENT VALUE

Some of the disadvantages of the above methods are overcome by taking into account the timing and relative magnitudes of cash flows and outlays. The DCF method achieves this by facilitating the calculation of a Net Present Value (NPV) based on the theory of interest. The flows of net returns are discounted to produce a NPV by applying a suitable discount factor (available from discount tables) related to the required rate of return on invested capital, taking into account the cost of capital.

Among the advantages of this method are the ease of appraisal of projects (a positive NPV increasing in magnitude as profitability increases), recognition of positive and negative cash flows, time values of receipts and outgoings, capital allowances effects and the incidence of taxation. Clearly, the efficacy of the method depends, as in other methods, on the cash flow outcomes expectations not differing markedly from those experienced in practice.

4. INTERNAL RATE OF RETURN (IRR)

IRR is the discount rate that makes NPV zero. This is the yield for the particular project and it should give the required rate of return on invested capital. Thus, a lower discount rate would produce a higher NPV whilst a higher discount rate would produce a lower or negative NPV, indicating an adverse effect on project profitability.

5. NET TERMINAL VALUE

Where cash flows differ in magnitude and rate of accrual in different projects and re-investment opportunities are present during the lives of the investments, it may be advantageous to calculate the Net Terminal Value (NTV) of the projects. The NTV is determined by calculating the difference between the re-invested proceeds of the project and the amount which would have accrued from the original capital if invested elsewhere: i.e. $NTV = NPV\ (1 + i)^n$ where the same rate of interest is used for both NTV and NPV (i = interest rate and n = number of years.)

6. RISK AND UNCERTAINTY

A central problem of investment decision-making is the existence of risk and uncertainty. Traditional methods of dealing with risk have been to require risk premiums in the form of higher rates of return on invested capital. The increase in the discount factor is fixed arbitrarily on the bases of the degree of risk involved and the likely range of variabilities of outcomes.

Necessary attributes are informed judgement, professional expertise, business flair and extensive experience of investment decision-making within the particular field.

Where the probability distribution is derivable and probability factors may be assigned to risk outcomes with reasonable degrees of confidence, a number of statistical and mathematical methods are available to improve the quantification of decision-making in such circumstances.

A simple example is where outcomes are independent, exhaustive and mutually exclusive such that a number of values may be summed to give an overall expected value.

e.g. A project is assessed as having possible outcomes of (a) a £0.5 million surplus with a probability of 0.2 (a 20% chance of success of that order); (b) a £0.25 million surplus with a probability of 0.7 and (c) a deficit of £50,000 with a probability of 0.1. The Expected Value (EV) is, then:-

$$EV = £((0.5 \times 0.2) + (0.25 \times 0.7) + (-0.05 \times 0.1)) \text{ million}$$
$$= £0.27 \text{ million.}$$

Clearly, in practice, the assigned probabilities would be subject to zones of variation depending on the degrees of confidence with which they may be assigned, as would the projected amounts of gain or loss. But given reasonable bases of assessment and sufficient raw data such methods do impose more objective disciplines on the data processors and the decision makers.

Sophisticated methods, such as Sensitivity Analyses, Bayesian Strategies, the von Neumann - Morgenstern calculus and other techniques to be found in the fields of statistics, econometrics and operations research, are of application in investment decision-making under conditions of risk and uncertainty. The statisticians sometimes distinguish between risk and uncertainty by the criterion of assignability of probabilities in risk functions whilst uncertainty provides no bases for such quantification. But attempts at quantification of decision-making under conditions of uncertainty have been developed in such methods as Game Theory (maximin-minimax strategies, etc.).

With the current rapid development of computer potentiality, programming techniques and complex package and 'in-house' programmes, allied with advances in scientific quantification methods, the decision maker's task in investment and valuation should become less onerous and, hopefully, more rewarding. But the need for business experience, flair and professional judgement will always be a primary resource of great importance.

VALUATION

The valuation of corporate assets obviously depends upon a large number of variables and estimation and assessment of value is correspondingly affected by the degrees of subjectivity and objectivity inherent in the methods used by the valuer. The criteria listed below comprise mainly well-known conventional approaches on the bases of asset values, earnings or combinations of these methods. Clearly, treatments of future flows of returns to determine a present value may follow the methods already outlined above.

7. NET ASSET VALUE (NET WORTH)

This is a widely used, conventional and basic method which is subject to wide variations in results depending on the treatment of the various classes of asset. It comprises the valuation of tangible fixed and current assets less the valuation of loan capital, current and deferred liabilities to determine a Net Asset Value. In practice, the value of a company on a going-concern basis (if no winding-up is contemplated) would take account of the assessment values of goodwill and other intangibles. The derived Net Asset Value in isolation from the earning capacity of the assets (or the break-up value in an asset-stripping or development operation) is evidently of limited applicability in practice. Also, the earning power values of going-concern assets may bear little or no relationship to intrinsic sale valuations.

8. MARKET CAPITALISATION VALUE (MCV)

Usually taken as the middle market price of the company's equity on the Stock Exchange: the midway value between bid and offered price in the secondary market for shares. Since secondary market prices are determined as the resultants of bargains during trading, the majority of which are arm's-length transactions not affecting changes of control of companies, market capitalisation values derived therefrom are not necessarily indicative, or a measure, of real intrinsic worth.

The fact that the proportion of a company's equity undergoing change of ownership in this way is usually small also suggests that MCV may be unreliable as a criterion of worth. In the light of recent events (stock market behaviour over the period 1973-74-75) it may be suggested that MCV's are often more a reflection of market sentiment than a reliable estimate of corporate worth. The MCV is, then, the middle market price times the issued number of equity shares; and is applicable only to listed companies which have a current quotation.

9. EARNINGS BASIS

The conventional method in general use to determine corporate worth; either in isolation or in conjunction with other methods (such as Net Asset Value). Capitalisation of potential future earnings before tax (profits criterion) is a traditional method of valuation.

The capitalised value may be stated as a number of years earnings or as a desired rate of return. Evidently, eight years' maintainable pre-tax earnings of £0.25 million (£2 million) is the same as £0.25 million/0.125 (£2 million), at a capitalisation rate of 12½%. However, this method, as other pre-tax measures, ignores the benefits of astute tax management, which may result in lower tax liabilities per unit of profit and, hence, a higher net return on invested capital. Calculations on an earnings basis result in a statement of 'economic worth' of the assets.

10. EXIT PRICE/EARNINGS RATIO (P/E)

This method originated in property markets (freehold value of leased property = x years purchase of annual ground rent). Analogous to the Earnings Basis, the P/E represents the share price divided by post-tax earnings per share; alternatively, market capitalisation divided by earnings (less tax). The P/E ratio is the reciprocal of post-tax earnings yield.

Differentiation between the EXIT P/E and the P/E commonly quoted in the financial press is necessary since the former is a measure of assessed value (change of control) whilst the latter is a product of normal market transactions and, in practice, it may be unreliable owing to time lags, company and trading changes since its earnings component was derived.

11. DIVIDEND BASIS

Similar to the Earnings Basis as a measure of the present value of a stream of future returns. Since control of the source of dividends would obviously carry authority to determine the appropriation policies and distribution of disposable surpluses, the Dividend Yield method would be less relevant than the Earnings Basis. However, Dividend Yield is useful as an attribute of comparability in company appraisal and in terms of investment returns where control of the distribution of disposable surpluses resides elsewhere.

12. SUPER-PROFITS METHOD

A concept of corporate valuation based on the recognition of levels of earnings in excess of the returns normal to the particular assets. The method comprises the capitalisation of the super-profits to give an estimate of value which is usually added to the Earnings Basis derivation and/or compared with or added to the Net Asset Value.

e.g. 'Normal' Profits = £80,000

Super-Profits = £35,000

Net Asset Value = £560,000

Valuation (1):- 3 years', say, capitalisation of Super-Profits ($33^1/3\%$) = £105,000

plus 6 years' capitalisation of 'normal' profits ($16^2/3\%$) = £480,000

then V_1 = £585,000

Alternatively,

Valuation (2):- Net Assets = £560,000

plus, say, 2 years' capitalisation of Super-Profits (50%) = £70,000.

Then V_2 = £630,000.

Compared with the Net Asset Value, both valuations show a premium in recognition of the presence of super-profits.

In practice, taxation aspects would be considered, as would the possibility of super-profits attracting competition eventually, thus forcing a possible reversion to 'normal' earnings. The latter eventuality is recognised above by the high rate of discount (short-term capitalisation) allocated to the super-profit figure. However, the combination of capitalisation of normal and super-profits does lend itself to a 'fine tuning' approach in terms of the break point between the two classes of profit and of the respective rates of return attached to them.

13.* FREE CASH FLOW

A more recent development which entails deriving the difference between Net Operating Profit After Taxes (NOPAT) and new capital investment. Thus Free Cash Flow (FCF) is defined as the operating cash flow that exceeds the company's capital needs.

The method requires determination of six factors:-

(a) NOPAT,

(b) new capital investment opportunities (the increase in capital employed),

(c) the expected rate of return on new capital investment in terms of the added FCF generated thereby,

(d) the cost of capital for business risk, comprising management's lowest acceptable rate of return,

(e) the added value created by interest-bearing debt in the target capital structure,

(f) the estimated period over which (b) will generate (c).

The combination of (d) and (e) enables the weighted average cost of capital to the company to be defined and, hence, the appropriate discount rate for the company's expected future FCF. It will be seen that FCF is equal to NOPAT if incremental capital is not invested, or to be invested in the business. Also, that PRESENT VALUE is equal to the FCF discounted by the present weighted average cost of capital.

* Full details of the method are given in the publication, Measuring Corporate Performance Stern J. The Financial Times (1975)

14. VALUATION PROFITS: EQUIVALENT CASH DISTRIBUTION

The Valuation Profits (VP) or Equivalent Cash Distribution (ECD) method is another more recent approach developed by Professor A.J. Merrett.* The VP comprises consideration of actual dividend payments and the derived values of returns from retentions: the latter taking into account both the value of the retained surpluses and the compounded returns which have arisen from previous retention investments, or which would have accrued to the shareholder if invested in alternative investments at different interest rates. Valuation Profits are equal to the ECD. The ECD is defined as the sum of dividends plus retentions and retention earnings MINUS the proportion of retention earnings accruing from past investment of retained earnings (the deduction thus avoids double-counting previously earned increments).

It will be seen that the effect of the method is to deem the profits to be totally distributed with a proportion (retained earnings) 'borrowed back' from the shareholder at the company's going rate of return. Clearly, if the shareholder were able to invest the retained earnings at a higher rate of return elsewhere than in the company, the VP would be correspondingly discounted since the opportunity-cost of investment would be equal to the difference between the two rates of return.

One of the advantages of the method is that the derived Valuation Profits reflect a company's adjusted rate of return, whether higher or lower than, or equal to, going market rates, and suitably applied discounting should provide an unbiased valuation of the company based on performance. In practice, potential net asset values would doubtless be compared with, or at least considered in relation to, the VP/ECD value.

* A description of the method and a discussion of the associated philosophy is given in Measuring Trends in Profitability Merrett A.J. (1975) Lloyds Bank Review No. 118, October, 1975.

15. AVERAGING

A compromise method which combines a selected number of valuation method results to give a weighted or unweighted Average Valuation. Its merit is that it minimises the inaccuracies of constituent methods if suitable weighting factors are applied. It also provides possible bases for compromise where differing approaches lead to conflicting views on a 'true' valuation.

16. WHAT THE MARKET WILL BEAR (WTMWB)

Professional negotiations involving transfers of corporate assets (or any other commodity) obviously include a maximisation philosophy on the part of the vendor and a cost minimisation approach on the part of the purchaser. The value point at which these conflicting objectives coincide reflects neutral, positive or negative deviance from a 'true' asset transfer value, thus reflecting the WTMWB philosophy in practice.

'What the market will bear' also includes scope for professional negotiating abilities; business 'nose', the esoterics of utility function appraisal; personal preferences; motivational factors such as ambition, the desire for power, status, a certain ambience; acquisitive satisfactions and, not least, the satisfaction of a healthy profit.

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CHAPTER I REFERENCES AND NOTES

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